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New Disclosure Requirements for Receivables and the Allowance for Credit Losses

In July 2010, the Financial Accounting Standards Board (FASB) issued new guidance requiring significant additional financial statement disclosures relating to the credit quality of financing receivables and the allowance for credit losses. The new guidance was issued in Accounting Standards Update (ASU) 2010-20.

The FASB's intent is to provide additional information to assist financial statement users in assessing an entity's credit risk exposure and in evaluating the adequacy of the related allowance for credit losses. **These requirements are applicable to all entities (not just banks) and are effective for nonpublic entities for periods ending after December 15, 2011 (calendar year 2011)** and generally for periods ending after December 15, 2010 for public entities.

The disclosure requirements are applicable for "financing receivables" which the ASU defines as the contractual right to receive money on demand or on fixed or determinable dates and that is recognized as an asset by an entity. **Financing receivables include loans, trade accounts receivable, notes receivable, credit cards, and receivables relating to leases that are other than operating leases**. Debt securities, unconditional promises to give, transferor's interests in securitization transactions and purchased beneficial interests are excluded from the definition of a financing receivable. It should also be noted that trade receivables which have a contractual maturity of one year or less are exempted from the new disclosure requirements, as are receivables that are carried at fair value, or lower of cost or fair value.

A significant change is the requirement for the disclosures to be made on a disaggregated basis which is comprised of two levels that the ASU terms as the "portfolio segment" and "class of financing receivable." A portfolio segment is defined as the level at which an entity develops and documents a systematic method for determining its allowance for credit losses. Examples of a portfolio segment include; type of receivable, industry sector of the borrower, and risk rating. A class of financing receivable is a further disaggregation of a portfolio segment and should be determined based on:

a. The initial measurement attribute, such as amortized cost.
b. The risk characteristics of the financing receivable.
c. The entity's method for monitoring and assessing credit risk.

The new disclosures will require:

a. A roll forward of the allowance for credit losses **by portfolio segment**, with the ending balance further disaggregated on the basis of the impairment method.
b. The recorded investment in financing receivables **for each portfolio segment** disclosed in the allowance roll forward.
c. Nonaccrual status of receivables by class of financing receivable.
d. Impaired receivables by class of financing receivable.
e. **Credit quality indicators of receivables by class of financing receivables** (credit quality indicators are defined as a statistic about the credit quality of a financing receivable and include consumer credit risk scores; credit rating agency ratings; internal credit risk grades, loan-to-value ratios; collateral, collection experience, other internal metrics).
f. **The aging of receivables by class of financing receivables**.
g. The nature and extent of troubled debt restructurings (TDR's) that occurred by class of financing receivable.
h. The nature and extent of receivables modified as TDR's in the past 12 months that defaulted in the current year by class of financing receivable.
i. Purchases and sales of receivable by portfolio segment.

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The disclosures will be lengthy and may best be explained through example. The ASU contains many example disclosures from which the following excerpts have been taken:

Example Allowance for Credit Losses and Recorded Investment in Financing Receivable Disclosure

	Commercial	Commercial Real Estate	Consumer	Residential	Finance Leases	Unallocated	Total
December 31, 2011							
Allowance for credit losses:							
Beginning balance	$ xx,xxx	$ xx,xxx	$ xx,xxx	$ xx,xxx	$ xx,xxx	$ xx,xxx	$ xx,xxx
Charge-offs	xx,xxx	xx,xxx	xx,xxx	xx,xxx	xx,xxx	xx,xxx	xx,xxx
Recoveries	xx,xxx	xx,xxx	xx,xxx	xx,xxx	xx,xxx	xx,xxx	xx,xxx
Provision	xx,xxx	xx,xxx	xx,xxx	xx,xxx	xx,xxx	xx,xxx	xx,xxx
Ending Balance	$ xx,xxx	$ xx,xxx	$ xx,xxx	$ xx,xxx	$ xx,xxx	$ xx,xxx	$ xx,xxx
Ending balance: individually evaluated for impairment	$ xx,xxx	$ xx,xxx	$ xx,xxx	$ xx,xxx	$ xx,xxx	$ –	$ xx,xxx
Ending balance: collectively evaluated for impairment	$ xx,xxx	$ xx,xxx	$ xx,xxx	$ xx,xxx	$ xx,xxx	$ xx,xxx	$ xx,xxx
Financing receivables:							
Ending Balance	$ xx,xxx	$ xx,xxx	$ xx,xxx	$ xx,xxx	$ xx,xxx	$ –	$ xx,xxx
Ending balance: individually evaluated for impairment	$ xx,xxx	$ xx,xxx	$ xx,xxx	$ xx,xxx	$ xx,xxx	$ –	$ xx,xxx
Ending balance: collectively evaluated for impairment	$ xx,xxx	$ xx,xxx	$ xx,xxx	$ xx,xxx	$ xx,xxx	$ –	$ xx,xxx

Example Credit Quality Indicator Disclosure

December 31, 2011

Corporate Credit Exposure
Credit Risk Profile by Creditworthiness Category

Credit Rating *	Commercial	Commercial Real Estate Construction	Commercial Real Estate-Other
AAA – AA	$ xx,xxx	$ xx,xxx	$ xx,xxx
A	xx,xxx	xx,xxx	xx,xxx
BBB-BB	xx,xxx	xx,xxx	xx,xxx
B	xx,xxx	xx,xxx	xx,xxx
CCC-C	xx,xxx	xx,xxx	xx,xxx
D	xx,xxx	xx,xxx	xx,xxx
Total	$ xx,xxx	$ xx,xxx	$ xx,xxx

* Alternatively, loans can be grouped by internal loan grade

Consumer Credit Exposure
Credit Risk Profile by Internally Assigned Grade

	Residential-Prime	Residential-Subprime
Grade:		
Pass	$ xx,xxx	$ xx,xxx
Special mention	xx,xxx	xx,xxx
Substandard	xx,xxx	xx,xxx
Total	$ xx,xxx	$xx,xxx

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Consumer Credit Exposure
Credit Risk Profile Based on Payment Activity

	Consumer-Credit Card	Consumer-Other	Finance Leases	Consumer-Auto
Performing	$ xx,xxx	$ xx,xxx	$ xx,xxx	$ xx,xxx
Nonperforming	xx,xxx	xx,xxx	xx,xxx	xx,xxx
Total	$ xx,xxx	$ xx,xxx	$ xx,xxx	$ xx,xxx

Example Aging Analysis of Past Due Financing Receivables

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Financing Receivables	Recorded Investment >90 Days and Accruing
December 31, 2011							
Commercial	$ xx,xxx	$ xx,xxx	$ xx,xxx	$ xx,xxx	$ xx,xxx	$ xx,xxx	$ xx,xxx
Commercial real estate:							
Commercial real estate construction	xx,xxx	xx,xxx	xx,xxx	xx,xxx	xx,xxx	xx,xxx	xx,xxx
Commercial real estate – other	xx,xxx	xx,xxx	xx,xxx	xx,xxx	xx,xxx	xx,xxx	xx,xxx
Consumer:							
Consumer – credit card	xx,xxx	xx,xxx	xx,xxx	xx,xxx	xx,xxx	xx,xxx	xx,xxx
Consumer – other	xx,xxx	xx,xxx	xx,xxx	xx,xxx	xx,xxx	xx,xxx	xx,xxx
Consumer – auto	xx,xxx	xx,xxx	xx,xxx	xx,xxx	xx,xxx	xx,xxx	xx,xxx
Residential:							
Residential – prime	xx,xxx	xx,xxx	xx,xxx	xx,xxx	xx,xxx	xx,xxx	xx,xxx
Residential – subprime	xx,xxx	xx,xxx	xx,xxx	xx,xxx	xx,xxx	xx,xxx	xx,xxx
Finance Leases	xx,xxx	xx,xxx	xx,xxx	xx,xxx	xx,xxx	xx,xxx	xx,xxx
Total	$ xx,xxx	$ xx,xxx	$ xx,xxx	$ xx,xxx	$ xx,xxx	$ xx,xxx	$ xx,xxx

While the examples in the ASU do not prescribe the required format, they do indicate the significant expansion in disclosure requirements.

In addition to the above quantitative disclosures, **the ASU also requires an entity to disclose the following about their accounting policies and methodology used to estimate the allowance for credit losses by portfolio segment**:

a. A description of the factors that influenced management's judgment, **including historical losses and existing economic conditions**.
b. A discussion of **the risk characteristics relevant to each portfolio segment**.
c. Any changes in policy or methodology from the prior period, the rationale for the change, and **the effect of such change on the current year provision**.
d. Policy for charging off uncollectible financing receivables.

As you may be starting to appreciate, these new disclosures will significantly expand the information contained in financial statements and quite possibly the time required to gather the necessary information, particularly in entities where the information resides in several different information systems. In an effort to minimize the impact to your organization, we encourage you to discuss these new requirements internally and with your regular BNN contact person.

If you have any questions or desire further information, please contact Jeff Skaggs, Audit Senior Manager, Baker Newman & Noyes, LLC at jskaggs@bnncpa.com, or call 800.244.7444.