Accounting & Auditing Update

A Michael Fortman & Nick Keener Production

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CPAs & Advisors

Meet the Presenters

A&A Talking Points

- Loan Modifications in a COVID World
- Goodwill Impairment
- LIBOR Transition
- CECL (It’s Baaaaack)
- Audit Considerations
- FDIC IFR – Temporary Relief from Part 363
- Relevant ASUs

Loan Modifications in a COVID World

Loan Modifications in a COVID World

- Loan modifications are at an all-time high
- Highly encouraged from the regulators (& our conscience)
- But what about the dreaded TDR?

Loan Modifications in a COVID World

- TDR definition – 310-40-15

  Creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not have otherwise considered

- Financial difficulty indicators
  - Payment default or probable debtor will default
  - Projections indicate insufficient cash flows
  - Unable to obtain financing at market rates (for a nontroubled debtor)

Loan Modifications in a COVID World

- First on the scene – The interagents
- Interagency guidance published to **clarify** existing GAAP
- Reminded us
  - ✓ Short-term mods who were current prior to relief are not TDRs
  - ✓ Short-term = six months or less; current = less than 30 days past due
  - ✓ No change to allowance, nonaccrual & charge-off policies

Loan Modifications in a COVID World

- Second on the scene – the federal government: The CARES Act
- **Modifies** GAAP by suspending TDR consideration on modifications during the pandemic
- The fine print
  - ✓ Loan must be less than 30 days past due as of December 31, 2019
  - ✓ Adverse impact must be COVID related
  - ✓ Modification window: March 1, 2020–December 31,2020

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Loan Modifications in a COVID World

- If not a TDR, what is it?
- What about past-due status?
- What's the catch?
- The catch
  - ✓ Accrual versus nonaccrual
  - ✓ Allowing for modified loans

Loan Modifications in a COVID World

- How to pass your December 31, 2020 audit (from an auditor)

  1.) Document, track, document, track

  2.) Clear evaluation & consideration on accrual versus nonaccrual

  3.) Clear linkage between COVID considerations in allowance narrative & additional qualitative loss factors

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Loan Modifications in a COVID World

- What happens after internal modification program expires?
- What happens after December 31, 2020?

Loan Modifications in a COVID World

- Impact on the secondary market
  - ✓ Liquidity crunch on GNMA loans sold
  - ✓ Balance sheet gross-up from GNMA loans sold
  - ✓ Reserve for loan buy-backs – increase significantly?

Polling Question #1

- What is the expected end date of your institution's borrower payment deferral plan?
  1. We have terminated repayment relief – borrowers s/b current
  2. Repayment relief will end on December 31, 2020
  3. Repayment relief will be extended through the pandemic
  4. Not sure
  5. N/A

Goodwill Impairment

Goodwill Impairment

- Difference in measurement timing between issuers & nonissuers
- Qualitative assessment of goodwill (Step 0)
  - ✓ Macroeconomic factors (uh-oh)
  - ✓ Industry & market considerations, specifically multiples (ehhhh)
  - ✓ Overall, individual financial performance (whew)

Goodwill Impairment

- Step 0 failed, now what?
- Consider ASU 2017-04
  - ✓ Simplifies subsequent measurement of goodwill at the reporting unit level
  - ✓ Eliminates Step 3 of the previous goodwill model
- Discuss fair value of your institution with a specialist

Polling Question #2

- Would a Step 0 qualitative assessment of goodwill indicate possible impairment?
  1. Yes
  2. No
  3. We do not have goodwill
  4. I once watched “Good Will Hunting”
  5. Not sure

LIBOR Transition

LIBOR Transition

- Yes – it is still expected to go away in 2021
- Alternative Reference Rate Committee
- **Website** – https://www.newyorkfed.org/arrc/index.html
- **Recommended Best Practices –**
  https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2020/ARRC-Best-Practices.pdf
- **Spread Adjustment Methodology –**

  https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2020/ARRC_Spread_Adjustment_Consultation_Follow_Up.pdf

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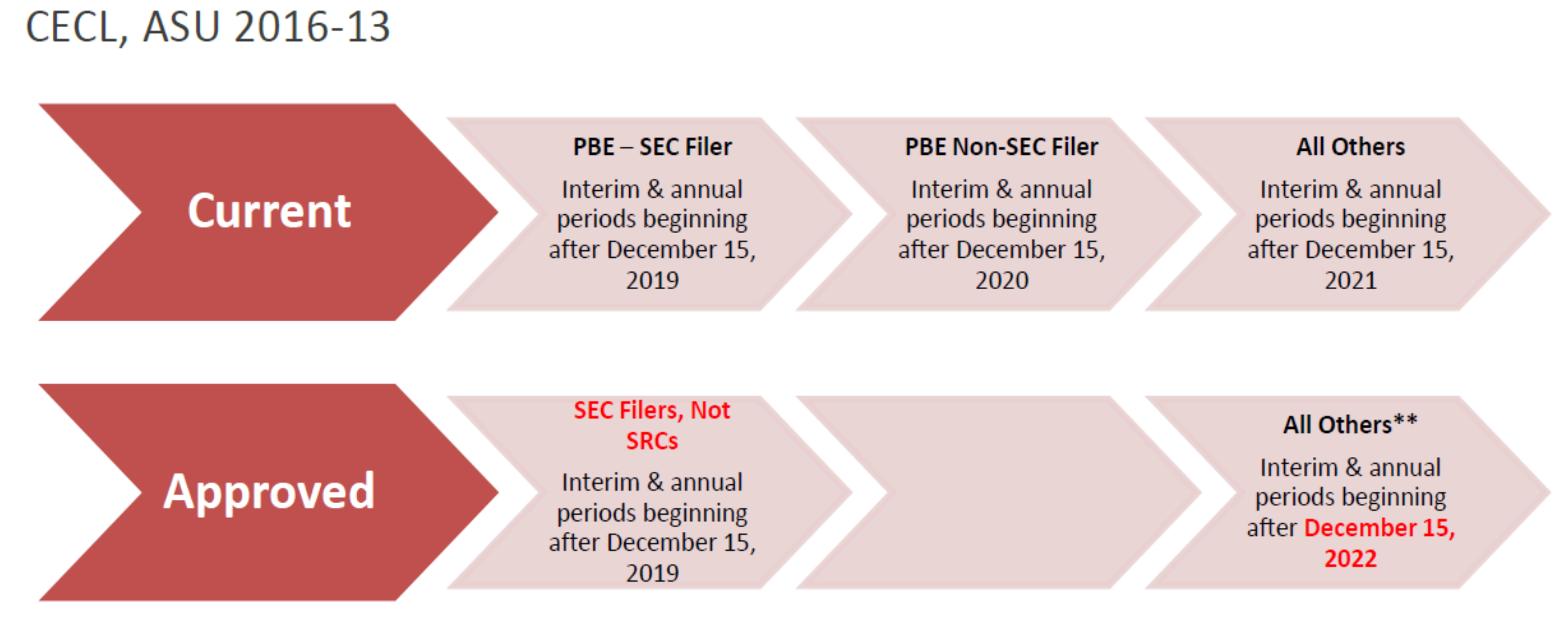
CECL (It's Baaaaack)

Polling Question #3

- Does your institution plan to utilize Section 4014 of the CARES Act, Optional Temporary Relief from CECL?
  1. No, already implemented
  2. No, we are ready to move forward
  3. No, not applicable to us
  4. Yes, we plan to wait until 2023
  5. Not sure

CECL (It's Baaaaack)

- Last-minute CECL delay
  - Section 4014, *Optional Temporary Relief from CECL*



CECL (It's Baaaaack)

- Reasons NOT TO Delay
  - ✓ Costs associated with running incurred & CECL parallel
  - ✓ Retained earnings impact still happens on 1/1/20 (COVID-19 impact can't be included)
  - ✓ Business combination issues
  - ✓ Can't easily go back to incurred
  - ✓ Believe CECL is easier to quantify impacts of COVID-19
- Reasons TO Delay
  - ✓ More comfortable with incurred than CECL due to forecast uncertainty & volatility
  - ✓ Time/resource constraints

CECL (It’s Baaaaack)

- Lessons learned from SEC Issuers at adoption
  - ✓ Most institutions had an overall increase in ACL
  - ✓ Institutions with large amounts of acquired loans were more likely to have large increases (PCI & non-PCI to PCD & non-PCD)
  - ✓ Many comments discussing duration of portfolio as a key impact for increases or decreases
  - ✓ Unfunded commitments ACL increases had a significant impact for many
  - ✓ Adoption did not include COVID-19, so forecasted conditions was not as significant a driver of reserves compared to Q1
  - ✓ Debt securities impact was almost nothing

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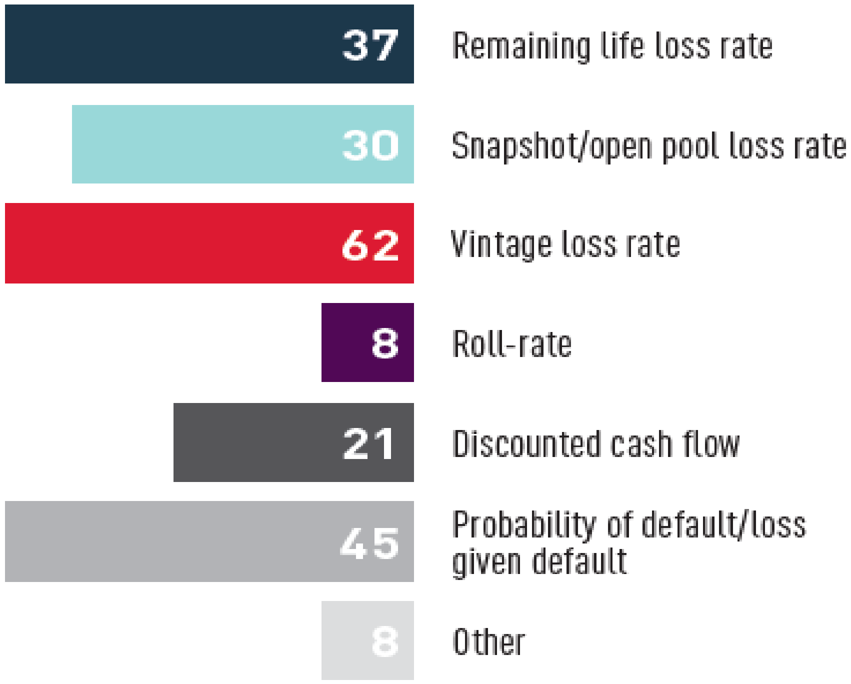
CECL (It's Baaaaack)

- Methodology/model selection lessons learned
  - ✓ Methodology selection is not the same as final model selection
  - ✓ Increased use of predictive statistical models (linear & logistic regression)
  - ✓ Typically not seeing more than two different methodologies used
  - ✓ Significant increase in diversity in estimation methods used compared to incurred loss approaches today (PD/LGD & DCF)



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CECL (It’s Baaaaack)

- Economic variables, forecast, & reversion lessons learned
  - Economic variables being considered varies, however, the following are commonly used
    - ✓ State/national unemployment
    - ✓ State/national GDP
    - ✓ Real estate price indices (example: HPI & CPPI)
    - ✓ Interest rates
  - For regression-based models, typically only using one or two economic variables for forecasting
  - Most common sources for economic data is the St. Louis Fed (FRED) & Moody’s (pay subscription)
  - Forecast period tends to not exceed two years
  - Most common disclosed reversion period & method is one year & straight line

CECL (It's Baaaaack)

- Impact of COVID-19 on CECL
  - ✓ COVID-19 & general economic impacts apply to both CECL & incurred although not to the same level (lifetime versus incurred)
  - ✓ CECL much more sensitive to macroeconomic changes
  - ✓ Lots of uncertainty

CECL (It's Baaaaack)

- Top five lessons learned for 2023 adopters

  1) Use the time you have wisely

  2) Don't confuse movement with progress (make decisions)

  3) Document, document, document

  4) Understand your methodology & models & what drives ACL

  5) Allocate adequate resources & involve appropriate stakeholders

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Audit Considerations

Polling Question #4

- Did your institution move to a remote work environment for a period of time in the current year?
  1. Yes
  2. No
  3. Not sure

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Audit Considerations

- Impact on internal control
  - ✓ Risk assessment in current year versus prior year
  - ✓ Controls related to evaluation under CARES Act & interagency guidance
  - ✓ Inputs into ALLL model
    - How are impaired loans identified?
    - Q-factors
- Impact on financial statement audit
  - ✓ Has the bank documented why or why not a TDR?

Audit Considerations

- Risk assessment
  - ✓ What has changed?
    - ▪ Potential for asset impairments
    - ▪ New lending programs
    - ▪ New liability exposure
    - ▪ Working in a remote environment
  - Changes in significant risk?

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Audit Considerations

- Documentation of key controls
  - ✓ Changes in what are identified as key controls
  - ✓ Changes in the design of internal control
  - ✓ Changes in operating effectiveness
  - ✓ Changes in the IT environment
  - ✓ Changes in inherent risk assessment

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Audit Considerations

- Opinion on ICFR is as of year-end
  - ✓ Adequate period for testing if controls have changed even temporarily
- Different controls during parts of the year
- Reliance on controls to reduce substantive testing
- Documentation in a remote environment – both for financial institutions & for their auditors
  - ✓ Virtual walk-throughs & control testing procedures

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FDIC IFR – Temporary Relief from Part 363

FDIC IFR – Temporary Relief from Part 363

- Temporary Relief from 12 CFR Part 363 Audit & Reporting Requirements
  - ✓ $500MM, $1B, $3B
- Response to COVID-19 & increase in consolidated total assets
  - ✓ PPP, MMLF, PPPLF, other government stimulus efforts
- For FYs ending in 2021 (effective 10/23/20–12/31/21)
- Based on lesser of consolidated total assets as of 12/31/19 or as of beginning of FY 21
- Confirm with regulator/FDIC!
  - ✓ FDIC determines that asset growth was related to a merger or acquisition
- https://www.fdic.gov/news/board/2020/2020-10-20-notice-dis-c-fr.pdf

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Relevant ASUs

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- ASU 2020-05 – *Effective Dates for Certain Entities*
  - ✓ Revenue from Contracts with Customers (Topic 606) & Leases (Topic 842)
  - ✓ FASB Accounting for Lease Concessions Related to COVID-19 FAQ
    - https://www.fasb.org/cs/Satellite?cid=1176174459740&pagename=FASB%2FFASBContent_C%2FGeneralContentDisplay
- ASU 2020-04 – *Reference Rate Reform (Topic 848), Facilitation of the Effects of Reference Rate Reform on Financial Reporting*
  - ✓ HTM securities
  - ✓ Contract modifications
  - ✓ Hedge accounting

Relevant ASUs

- FASB Simplification Initiative
- ASU 2019-12 – *Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes*
- ASU 2017-12 – *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*

Relevant ASUs

- ASU 2017-08 – *Receivables – Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities*
- ASU 2016-01 – *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*
  - ✓ Practical expedient – Investments in investment funds

Questions?

For more information

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Thank You!