

Community Bank Hot Topics

Tuesday, November 5, 2019

Presented by Wynne E. Baker, CPA, CBA, CFF, CSFA

Agenda

Primary Topics

- CECL
- Small Reporting Companies
- Leases

Additional Topics

- Revenue Recognition
- Critical Audit Matters (CAMs)
- Visa Class B Shares
- Other Accounting Standards Updates



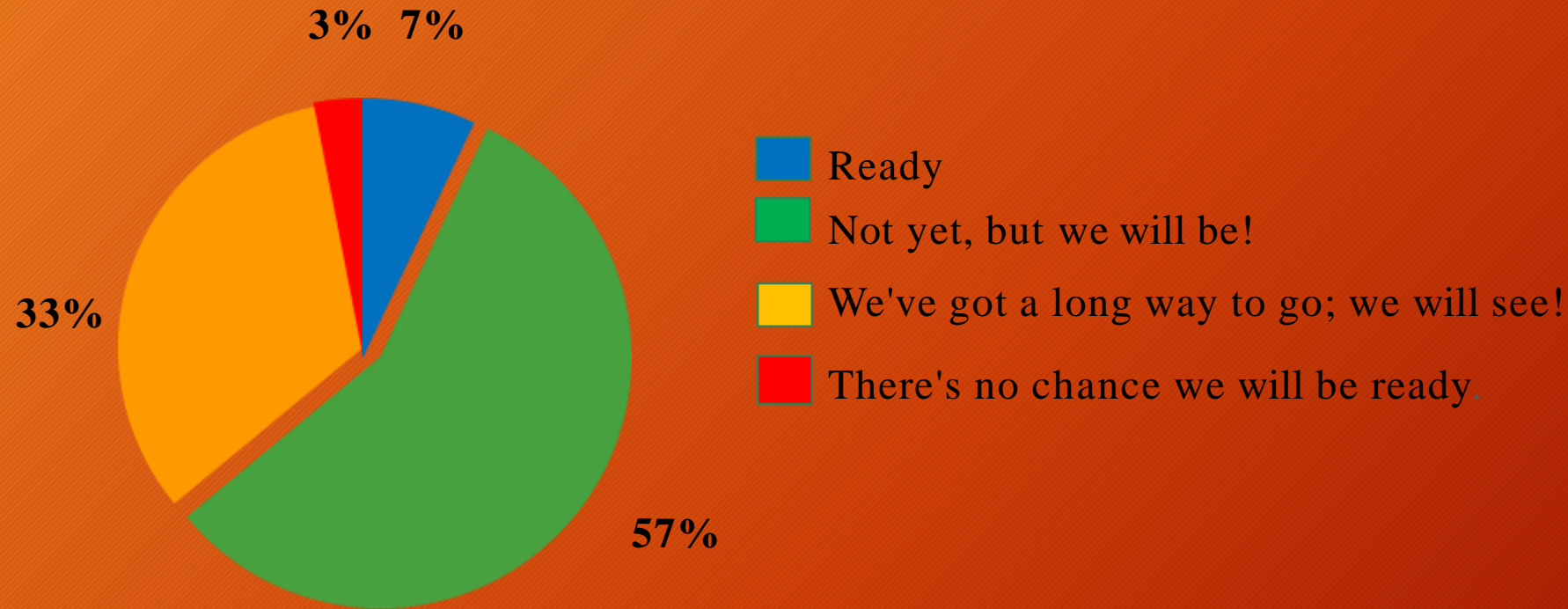
CECL

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CECL – Results from 2018 Polling Question

Which best describes the level of readiness with respect to CECL implementation at your (or your clients') institution?



The Landscape: Implementation Observations

- Adoption Status
 - Very largest banks
 - SEC filers, public business entities (PBEs) other than SEC filers
 - Non-PBEs
- SEC SAB 74 disclosures
 - Observations – mostly qualitative, some quantitative

Non-scientific
polling results

We (banks) expect to be able to disclose the likely quantitative impact of adopting CECL:	January 2019	April 2019	July 2019
2018 10-K	17%	9%	8%
1Q19 10-Q	16%	15%	8%
2Q19 10-Q	16%	12%	9%
3Q19 10-Q	19%	24%	29%
2019 10-K	32%	40%	46%

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Landscape for Major Standards

- Proposed ASU to delay effective date of certain standards for certain entities - issued Aug. 15, 2019; comments due Sept. 16, 2019:

Using the most recent SRC determination – i.e., June 30, 2019 for SEC 12/31 year-end

ASU 2016-02 “Leases (Topic 842)”

- **Retains** effective date for **PBEs** (fiscal years beginning after Dec. 15, 2018)
- **Delays** effective date for **non PBEs** to fiscal years beginning after Dec. 15, 2020, and interim periods within fiscal years beginning after Dec. 15, 2021

ASU 2017-12, “Derivatives and Hedging (Topic 815)”

- **Retains** effective date for **PBEs** (fiscal years beginning after Dec. 15, 2018)
- **Defers** effective date for **non PBEs** to fiscal years beginning after Dec. 15, 2020, and interim periods within fiscal years beginning after Dec. 15, 2021

ASU 2016-13, “Financial Instruments – Credit Losses (Topic 326)”

- **Retains** effective date for **SEC filers other than Smaller Reporting Companies (SRCs)** (fiscal years beginning after Dec. 15, 2019)
- **Defers** effective date for **SRCs, other PBEs, non-PBEs** to fiscal years beginning after Dec. 15, 2022, including interim periods within.

CECL: CAQ Resource for Audit Committees

- Center for Audit Quality (CAQ) issued a tool for audit committees, “Preparing for the New Credit Losses Standard”
 - Issued May 7, 2019
 - The tool has four primary sections:
 - “Understanding the Standard” provides an overview of the standard.
 - “Evaluating the Company’s Impact Assessment” offers questions for audit committees to consider when discussing the impact with management and auditors.
 - “Evaluating the Implementation Plan” assists audit committees in understanding and evaluating management’s implementation plan.
 - “Other Important Implementation Considerations” covers matters such as transition methods and new disclosure requirements.

<https://www.thecaq.org/preparing-for-the-new-credit-losses-standard-a-tool-for-audit-committees/>



Would You Like to Learn More?

- CECL Implementation: Wisdom from Community Bankers
- AICPA Credit Losses Task Force Activities
 - AICPA CECL Audit & Accounting Guide
 - Accounting
 - Auditing
 - AICPA Practice Aid “Audit Considerations”
 - Similar to the alternative investments practice aid from 2006
 - Helpful for preparers to understand auditor expectations
 - Table of Contents
 - Management’s Responsibility
 - Audit Committee’s Role in Oversight
 - Internal Control and Governance
 - Audit Objectives
 - Presentation and Disclosure



Smaller Reporting Companies



Smaller Reporting Companies

- What is a Smaller Reporting Company (SRC)?
 - Category of filers established by the SEC for scaled disclosures
 - FASB has proposed deferred effective dates for certain standards for SRCs
 - Two ways to qualify:
 - Public float of less than \$200 million; or
 - Less than \$100 million of revenue and public float less than \$700 million (or no public float)
- Lower thresholds (80%) may apply if entity was previously a SRC, lost SRC status and is attempting to requalify.
- Can be both a SRC and an accelerated filer



Smaller Reporting Companies

- Public float
 - Measured on the last business day of Q2
 - (# of common shares held by non-affiliates) x (market price)
- Revenue
 - Measured as of the most recent fiscal year end
 - Include all gross revenues from traditional banking activities
 - Interest, dividends, fees, mortgage banking, etc.
 - Excludes gain/loss on sale of securities, unless trading



Smaller Reporting Companies

- What happens when entity no longer qualifies?
 - Revenue or public float exceeds limits
- No longer qualify for scaled disclosures, beginning Q1 of year following Q2 measurement date
- As proposed, the effective date for standards would be established at the time the standard is issued and would not be accelerated by the loss of SRC status
- Determination may be complex. Consult with SEC literature and SEC counsel when making determination.



Leases



Leases

- Proposed effective dates
 - Existing effective date for standard of fiscal years (including interim periods) beginning after December 15, 2018 is retained for:
 1. PBEs,
 2. Not-for-profit bond obligors, and
 3. Employee benefit plans that file or furnish financial statements with the SEC
 - Impact of two-bucket approach:
 - Effective date is deferred for all other entities by an additional year. Fiscal years beginning after December 15, 2020 and interim periods within fiscal years beginning after December 15, 2021



Leases

- Scope
 - Includes embedded leases – not common in community banking
- Lessee
 - Recognition of right-of-use (ROU) asset and lease liability for almost all lease contracts
 - Practical expedient for short-term leases (<12 month term)
- Lessor
 - No significant impact expected



Leases

- Financial impacts to community banking
 - Balance sheet gross up
 - Capital ratios
- Other impacts
 - Financial and accounting policies and controls
 - Budgeting
 - Contract negotiation
 - Borrower financial statements



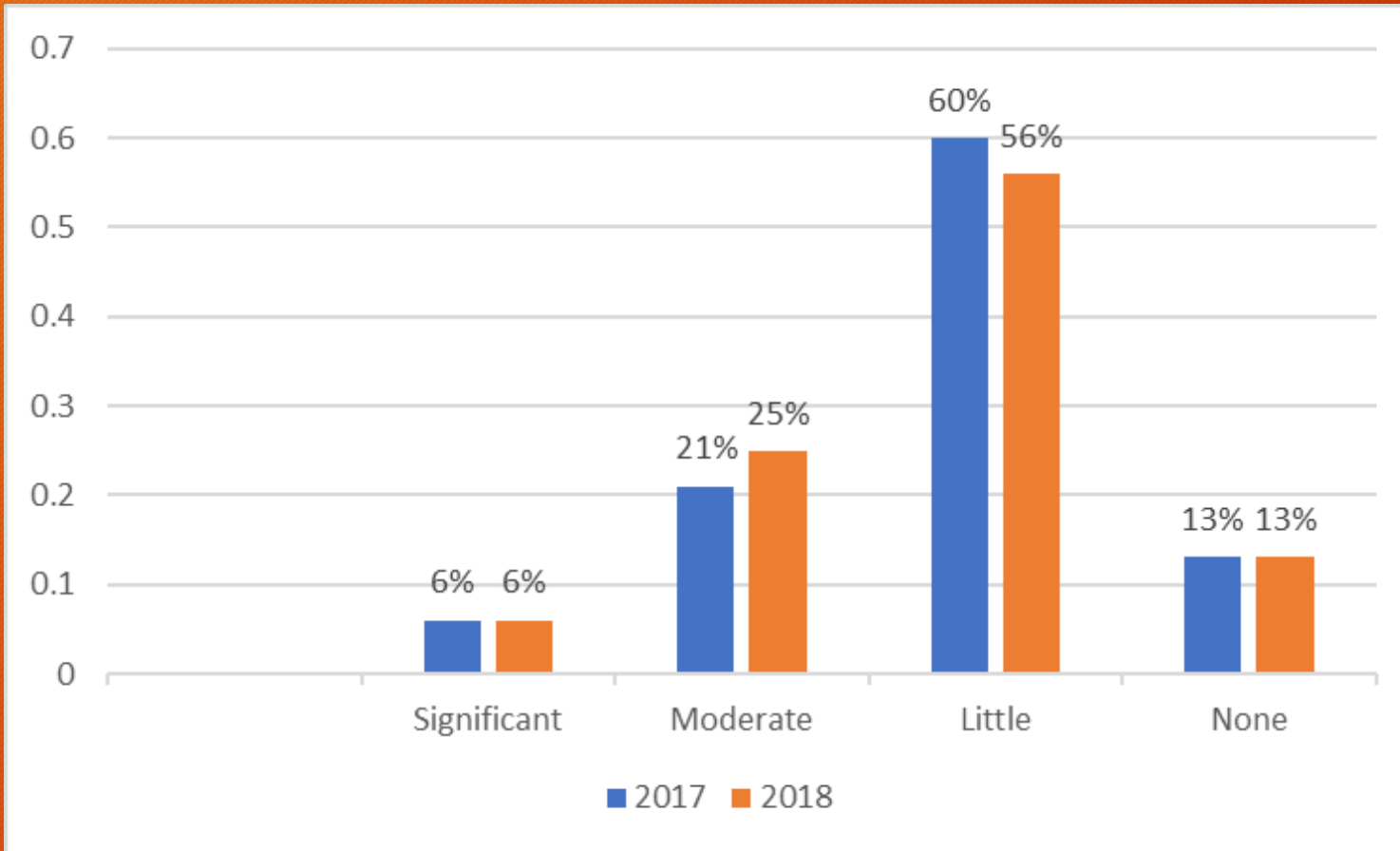
Revenue Recognition

So when should
the revenue
be recorded?



2017/2018 Polling Results

Which best describes the amount of effort expended to implement the new revenue recognition standard at your (or your clients') institution?



Revenue Recognition Implementation

- Already effective for PBEs; For non-PBEs, effective for annual periods beginning after December 15, 2018 (i.e. 2019 for calendar year end companies).

**No Delay
Proposed**

- For non-PBEs, effective for interim periods within annual periods beginning after December 15, 2019 (i.e., 2020 for calendar year end companies).
- Companies who adopt in Q4 2019 will have unique call report issues.
- A significant percentage of most institutions' revenue will typically not fall within the scope of Topic 606.
- Revenue streams that are in scope should be further analyzed to determine whether changes in the revenue recognition process & timing will be required.
- Disclosures:
 - PBEs are required to disclose disaggregation of revenues, contract balances, performance obligations, significant judgments, and practical expedients (if used).
 - Non-PBEs are exempt from the above listed disclosures, but are required to provide alternative disclosures related to disaggregated revenue and contract balances.



Revenue Recognition: What's in Scope

Out of Scope	In Scope
Interest Income	Service Charges on Deposit Accounts
Trading Revenue	Asset Management Fees
Loan Servicing Fees	Gains or Losses on Other Real Estate Owned
Credit Card Fees	Interchange Fees
Guarantee Fees	



Seller Financed OREO



Question 1

Does the bank have a controlling interest in the OREO property AFTER the transaction?
(ASC 610-20-25-2)

Yes

No

Question 2

Does the contract meet all criteria in ASC 606-10-25-1 through 25-8?

No

Slide 22

Question 3

Was effective control transferred to the buyer?
(ASC 606-10-25-30)?

No

Slides 24 & 25

Yes

Yes

NO SALE

Do not recognize gain on sale

SALE

Recognize gain on sale

Revenue Recognition: Contract Criteria

1. Approval and commitment of the parties
 - Executed sales agreement
2. Identification of each party's rights
3. Identification of payment terms
4. Commercial substance
5. Probable that the bank will collect the amount due in exchange for the property sold
 - Intent and ability

Slide 23

Question 2



Intent and Ability

- Amount of cash paid as a down payment
- Existence of recourse provisions
- Credit standing of the buyer
- Age and location of the property
- Cash flow from the property
- Payments by the buyer to third parties
- Other amounts paid to the selling bank, including current or future contingent payments
- Transfer of non-customary consideration (i.e., something other than cash and a note receivable)
- Other types of financing involved with the property or transaction
- Financing terms of the loan (reasonable and customary terms, amortization, any graduated payments, balloon payments)
- Underwriting inconsistent with the bank's underwriting policies for loans not involving OREO sales
- Future subordination of the seller's receivable

**CONTRACT
CRITERIA #5
(SLIDE 22)**

Revenue Recognition: Effective Control Indicators

Question 3

1. Seller has a present right to payment for the property
2. Customer has legal title to the asset
3. Transfer of physical possession
4. Customer has the significant risks and rewards related to the property
5. Customer has accepted the asset



Effective Control Indicators: OREO Specific

Question 3

- Does the bank/credit union have continuing involvement after the transaction closes?
- Does the bank/credit union have an obligation to repurchase the asset in the future?
- Does the bank/credit union have an obligation to provide support for the property following the sale?
- Did the bank/credit union retain an equity interest in the property after the transaction?
- Control can be transferred, even if legal title isn't





Critical Audit Matters (CAMs) PCAOB Auditor's Reporting Model

CAMs – Critical Audit Matters

- AS 3101 *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*
- Introduces CAM disclosures to the U.S.
- Other enhancements to the auditor reporting model
- Effective Dates
 - Large accelerated filers – Years ending on or after 6/30/19
 - Others – Years ending on or after 12/15/2020
 - Emerging Growth Companies – Not required



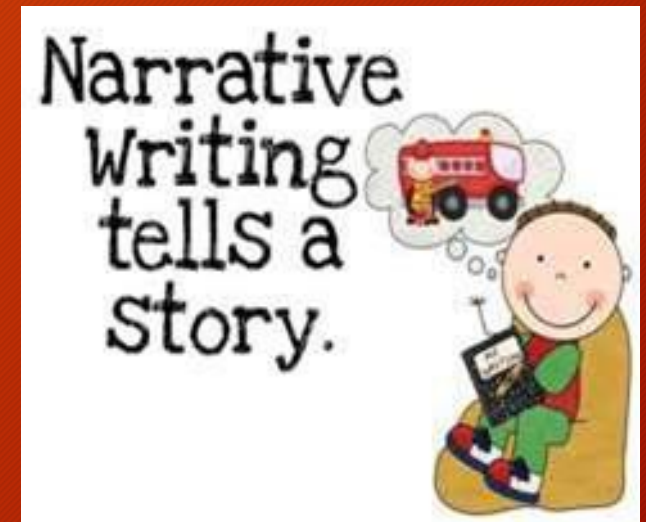
CAMs – Critical Audit Matters

- So, what is a CAM?
 - Matters communicated (or required to be communicated) to the audit committee related to material accounts or disclosures AND involve especially challenging, subjective, or complex auditor judgement
- Possible examples:
 - Allowance for credit losses
 - OTTI
 - Going concern
 - Structured transactions



CAM – Critical Audit Matters

- So, what will CAMs look like?
 - a) Identify the critical audit matter
 - b) Describe the principal considerations that led the auditor to determine that the matter is a critical audit matter
 - c) Describe how the critical audit matter was addressed in the audit
 - d) Refer to the relevant financial statement accounts or disclosures that relate to the critical audit matter



Visa Class B Shares

Visa Class B Shares

- Typical fact pattern in early 2018.
 - Entity A holds **VISA B** shares received initially at zero cost
 - Adopted ASU 2016-01 and elected measurement alternative for equity securities without readily determinable FVs
 - Looks for observable trades, finds none
 - Keeps VISA B shares on books at zero
- Late 2018 and beyond considerations
 - If a sale occurs in orderly transaction and similar security, must mark to fair value observed
 - Looking to another entity who sold their shares and disclosed it will not necessarily indicate that is the fair value that you need to record.
 - Your own transaction might be considered observable and should be evaluated.
 - Visa B settlement announced but certain entities opted out of the settlement.
 - Question is: what does this do to the litigation risk in Visa B shares and does it impact whether your shares are convertible to A shares?



Accounting Standards Updates

ASUs Issued: Impact on Financial Institutions

ASUs to consider

- ASU 2017-04 – Goodwill impairment testing
- ASU 2017-08 – Premium amortization on debt securities
- ASU 2018-02 – Reclassification of tax effects in AOCI
- ASU 2018-09 – 30 ASC changes (Basel disclosure)
- ASU 2018-15 – Cloud computing implementation costs

ASUs impacting or clarifying major standards

- ASU 2018-01 - Land Easements
- ASU 2018-03 – Recognition and measurement
- ASU 2018-04 – Rescission of SAB Topic 5.M
- ASU 2018-10 – Lease clarifications
- ASU 2018-11 – Optional transition method for leases
- ASU 2018-16 – SOFR as a benchmark interest rate
- ASU 2018-19 – Credit losses: Non-PBE transition, leases
- ASU 2018-20 – Narrow scope lease improvements
- ASU 2019-01 - Leases clarifications
- ASU 2019-04 – Various ASC improvements
- ASU 2019-05 – Credit Losses: fair value option

ASUs with potentially little impact

- ASU 2017-11 – Down round features; mandatorily redeemable financial instruments
- ASU 2018-07 – Non-employee stock compensation
- ASU 2018-08 - Contributions received and made
- ASU 2018-17 – VIEs under common control

ASUs impacting disclosures

- ASU 2018-13 – Fair value disclosures
- ASU 2018-14 – Pension disclosures

ASUs of Interest to Financial Institutions

Effective Date
for Calendar
Year Ends

ASUs to consider	PBEs	Non-PBEs
<p>Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income (ASU 2018-02) Allows entity to make an election to reclassify “stranded tax effects” from accumulated other comprehensive income to retained earnings.</p>	1/1/19	1/1/19
<p>Codification Improvements (ASU 2018-09) Contains 30 issues, including EPS, debt, income taxes, fair value measurement, foreign currency and plan accounting. Specific to financial institutions, issue 23, “Disclosure Requirement Update Related to Basel III,” clarifies that an entity must disclose the required and actual amounts of regulatory capital for each measure of regulatory capital for which the entity must comply.</p>	Varies by issue (pages 8-9 in ASU)	Varies by issue (pages 8-9 in ASU)
<p>Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract (ASU 2018-15) Provides additional guidance on accounting for implementation costs for a cloud computing arrangement that is a service contract and aligns the requirements for capitalizing with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal use software license).</p>	3/31/20	12/31/21

ASUs of Interest to Financial Institutions

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ASUs from Yesterday: Effective for Non-PBEs

ASUs Effective for Non-PBE Calendar Year Ends	Non-PBEs
<p>Breakage for Prepaid Cards (ASU 2016-04) Applies to prepaid stored-value products that are redeemable for monetary values of goods or services but also may be redeemable for cash, such as certain prepaid gift cards, prepaid telecommunication cards, and traveler’s checks.</p>	12/31/19
<p>Statement of Cash Flows: Certain Clarifications (ASU 2016-15) Provides guidance on how eight specific cash flows should be classified in the statement of cash flows, including debt prepayment or extinguishment costs, settlement of zero-coupon bonds, contingent consideration payments, insurance settlement proceeds, bank-owned or company-owned life insurance (BOLI or COLI) policy settlements and premiums, equity method investee distributions, beneficial interests in securitization transactions, and predominance principle for receipts and payments.</p>	12/31/19
<p>Income Taxes for Intra-Entity Asset Transfers (ASU 2016-16) Applies to asset transfers between legal entities, including related parties (such as, subsidiaries); transferor recognizes the current and deferred tax effects when the transfers occur.</p>	12/31/19
<p>Statement of Cash Flows: Restricted Cash (ASU 2016-18) Requires that restricted cash and cash equivalents be presented in total cash and cash equivalents in the statement of cash flows, and the nature of restrictions on restricted cash and cash equivalents be disclosed.</p>	12/31/19
<p>Definition of a Business (ASU 2017-01) Applies to the determination of whether an asset or business is acquired (which determines whether goodwill is recognized), as well as asset de-recognition and business deconsolidation transactions.</p>	12/31/19
<p>Presentation of Net Periodic Pension and Postretirement Benefit Costs (ASU 2017-07) Rather than reporting pension expense as a net amount, the service cost component will be presented consistent with similar compensation for the same employees, and the other components will be separately presented in the income statement.</p>	12/31/19

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Wynne is a Director in the Financial Institution Advisory Group of Saltmarsh, Cleaveland & Gund, specializing in advisory services, relationship management, industry training and public speaking. With more than 40 years of experience, Wynne has advised financial institutions through all stages, from consulting on the establishment of new bank charters to buying failed banks from the FDIC. He also has decades of litigation expertise and has served as an expert witness in court cases related to bank failures and frauds across the country.

Thank you

