Accounting Topics

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Accounting Topics

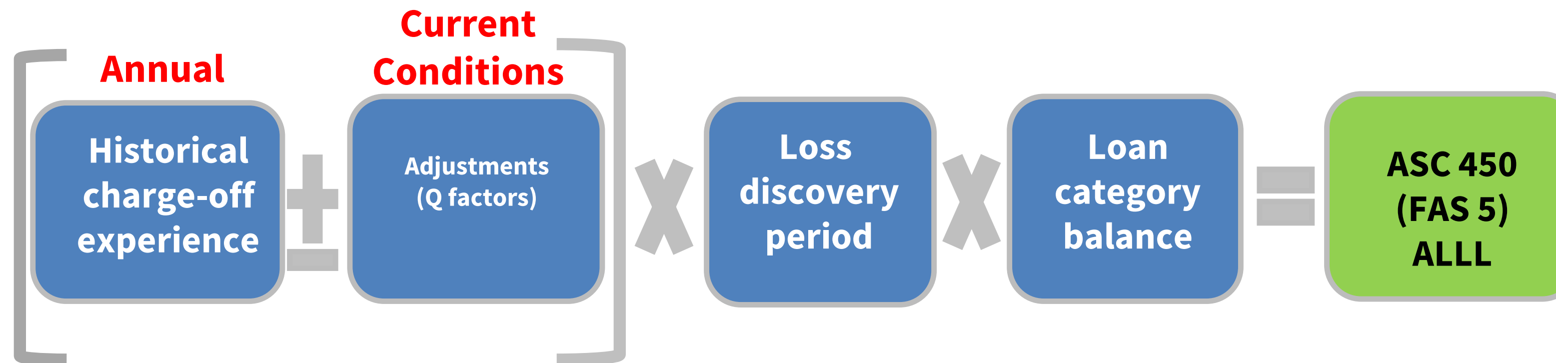
- Asset Impairment Model (CECL) Refresher and Update
- Part 363 Refresher and Update
- Tax Allocation Refresher and Update

CECL Refresher

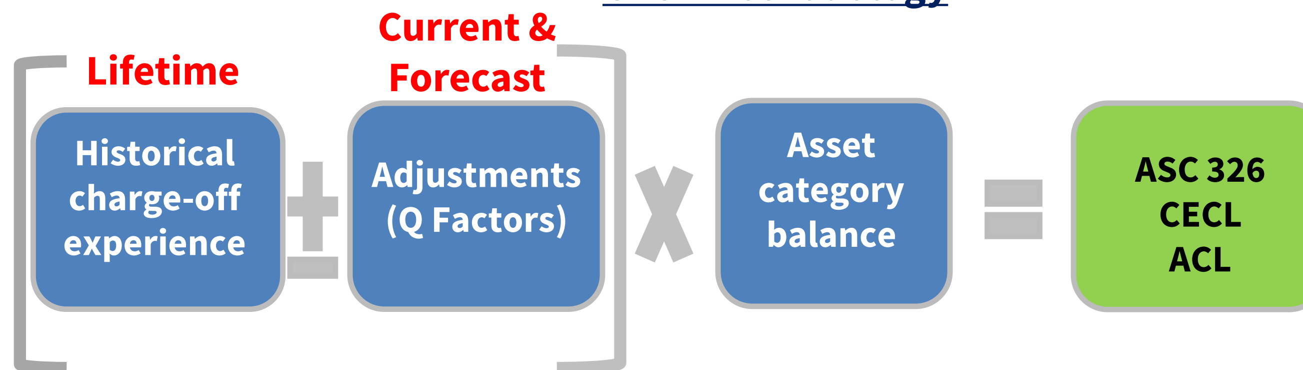
- Overview of the Standard
- Compare to the Incurred Loss Methodology
- Review Effective Dates
- Observations on Implementation
- FASB Updates and Post-Implementation Review Project
- Resources

Overview of CECL

Incurred Loss Methodology



CECL Methodology



Incurred Loss vs CECL

Incurred Loss Methodology	CECL Methodology
When are losses recognized?	
When an incurred loss is “probable”	Expected losses estimated at origination and updated each reporting date
How much loss is recognized?	
Recognize amount of loss already incurred	Reduce amortized cost basis to net collection expectation
How is the loss amount determined?	
Past events and current conditions	Also include reasonable and supportable future expectations

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CECL Effective Dates

Entity	Adoption Date	Call Report Date*
SEC filers, excluding entities eligible to be smaller reporting companies (SRCs)	Fiscal years beginning after 12/15/2019, including interim periods within those fiscal years.	3/31/2020
All other entities, including SRCs	Fiscal years beginning after 12/15/2022, including interim periods within those fiscal years.	3/31/2023
Early application	Early application permitted for fiscal years beginning after 12/15/2018, including interim periods within those fiscal years.	Depends
CARES Act deferral	1/1/2022	3/31/2023

*For entities with calendar year fiscal years

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Observations on CECL Implementation

- CECL generally resulted in earlier recognition of losses and higher allowances entering the pandemic compared to incurred allowances in the prior financial crisis
  - Allowance increases
  - Robust regulatory capital levels
- Areas of focus related to CECL include appropriate documentation of:
  - Key assumptions
  - Forecasts
  - Qualitative adjustments
  - Estimation approaches

Advice From Those Who Have Implemented CECL

- Remember off balance-sheet credit exposures and held-to-maturity securities
- Document key decisions
- Look at pools to determine if further segmentation needed
- Qualitative factors are still important
- Consider stressed scenarios
- Review parallel runs and lessons learned
- Gathering and organizing data on prior loan loss history takes time

FASB Updates

Troubled Debt Restructurings

- Adds new disclosures for certain loan modifications
- Eliminates TDR concept for CECL adopters

Purchased-Credit Deteriorated Assets

- Impacts acquisition accounting practices

Non-Public Business Entities

- Implement new TDR standard and CECL implementation date

What to do in 2022 if your bank has not yet adopted CECL

- Continue to plan and prepare for implementation

- Institutions should be preparing now in 2022 with one way of preparing to be conducting CECL parallel runs in 2022.

- Review the regulatory capital transition rules.

Note: There are no plans or conversations underway to further delay or cancel CECL.

CECL Methodologies

- Methodology to Measure Risk
  - No regulatory or GAAP prescribed methodology
  - Consistent with the complexity of the institution
  - Different types of loans may need different methodologies

- Tools to Assist
  - Federal Reserve presentation on SCALE tool
  - Federal Reserve presentation on ELE tool

Debt Securities – Overview

- New credit loss methodologies
  - ASC Topic 326 amends or supersedes sections of ASC Topic 320 (formerly FAS 115) related to credit impairment
  - HTM Debt Securities Accounting (ASC Subtopic 326-20)
    - CECL Methodology
  - AFS Debt Securities Accounting (ASC Subtopic 326-30)
    - AFS Credit Loss Methodology
    - Compare and contrast differences in impairment methodology
    - Fair value floor

- Zero Credit Losses

AFS Debt Securities Credit Loss (Fair Value Floor)

- Must use Discounted Cash Flow Approach
- Credit loss limited by Fair Value Floor
- Subsequent Measurement of Intent to Sell / More-Likely-Than-Not Requirement to Sell Securities that have not yet been Sold
  - New amortized cost basis is previous amortized cost basis less write-off
  - Continue to estimate PV of expected cash flow over life of security
  - Difference between new amortized cost basis and cash flows expected to be collected should be accreted as interest income

AFS Debt Security Fair Value Floor Example

Facts	Example 1	Example 2	Example 3
Amortized Cost	$100	$100	$100
Fair Value	$97	$103	$94
Credit Loss Amount	$2	$5	$9
Allowance Amount	$2	$ -	$6

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CECL Questions?

Part 363: Overview

Section 36(a) of the Federal Deposit Insurance Act and the FDIC's Implementation Regulations (Part 363):

- Requires each insured depository institution (IDI or IDIs) with $500 million or more in consolidated total assets to submit a Part 363 Annual Report

- Filing Due Dates for Part 363 Annual Reports:
  - For Public Companies – within 90 days after the end of the IDI's fiscal year end
  - For Non-Public Companies – within 120 days after the end of the IDI's fiscal year end

Part 363: Audit Committee

The audit committee is responsible for the appointment, compensation, and oversight of the independent public accountant.

Audit Committee Composition

- $500 million – $1 billion: comprised of **outside** directors, the majority of whom are **independent** of management
- $1 billion or more: comprised of outside directors who are independent of management
- >$3 billion: shall also include members with banking or financial management expertise, have access to its own outside counsel, and not include any large customers of the institution

Part 363: Indemnification/Limitation of Liability Provisions

- FDIC staff have observed a resurgence in auditors' use of indemnification and liability-limiting clauses in engagement letters that are contrary to the Interagency Advisory and Section 363.5(c) and violate the AICPA Code's "Acts Discreditable Rule"

- The advisory is relevant to all banks regardless of size or nature of the company

- Under the SEC's independence rules, the use of indemnification/limitation of liability clauses in engagement letters for banks subject to Part 363, banks that are public companies, and public bank holding companies may cause the independent public accountant's independence to be impaired

Part 363 Update on Regulatory Relief

- On March 27, 2020, the FDIC issued FIL-30-2020, *Statement on Part 363 Annual Reports in Response to the Coronavirus.* The FIL provides IDIs with an additional 45 days IDI for submitting Part 363 Annual Reports and notifications of late filing.

- On March 15, 2022, the FDIC rescinded FIL-30-2020 with the issuance of FIL-10-2022. The recession is effective for fiscal years beginning after December 31, 2021. The deadline for filing Part 363 Annual Reports for fiscal years beginning after December 31, 2021, reverts to either 90 or 120 days after the end of an IDI's fiscal year, depending on the IDI's status as a public filer.

Part 363 Questions?

Tax Allocation Agreements (Notice of Proposed Rulemaking)

- Institutions must recognize all deferred tax assets (DTAs) and deferred tax liabilities (DTLs).
  - DTAs and DTLs cannot be presented separately from the asset or liability that gave rise to them.
  - An institution is prohibited from de-recognizing any of its DTAs or DTLs, unless the deferred tax items are:
    - Reversed,
    - Settled through payment because the items are absorbed in a current tax period by the consolidated group, or
    - Transferred in connection with the transfer of the associated assets or liabilities.

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Tax Allocation Agreements (Notice of Proposed Rulemaking)

- If an institution's net operating loss (NOL) or tax credit carryforward is used to reduce the consolidated group's current tax liability, the institution must be compensated at the time the NOL or carryforward is used by the group.
- An institution must receive from its holding company no less than the tax refund amount it would have received had it filed tax returns on a separate entity basis.
- An institution may not enter a transaction in which a parent appears to forgive some or all of the institution's DTL, through a capital contribution or otherwise.
- All institutions must have a written tax allocation agreement with its holding company when they file tax returns as part of a consolidated group.
  - Must comply with all aspects of final rule on tax allocation agreements when finalized

Tax Allocation Agreements (Notice of Proposed Rulemaking)

- Intercompany tax allocation agreements must:
  - Be approved by the Board of Directors for both the institution and holding company
  - Expressly state provisions addressing the existence of the agency relationship between the institution and holding company as well as ownership and timing of remittance of tax refunds
  - State that all materials, including returns, relating to consolidated or combined federal, state, or local income tax filings must be made available to an institution or any successor

Questions?