

Accounting & Auditing Update For Financial Institutions



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Accounting and Auditing Update



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Accounting and Auditing Update

- Agenda
 - Accounting Update
 - LIBOR Transition
 - AICPA Auditing Update
 - Questions



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Accounting Update

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Revenue Recognition

ASU 2014-09	Revenue Recognition
Scope	Contracts to sell goods, services, or a nonfinancial asset, excluding certain contracts, such as insurance and leases
Effective	PBE: Beginning after December 15, 2017 Non-PBE: Beginning after December 15, 2018
Highlights	Broad principles-based standard for recognizing revenue from contracts

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Revenue Recognition

- Does not impact:
 - Interest income
 - Premium/discount amortization
 - Mortgage servicing income
 - Loan prepayment, origination, commitment, and late fees
 - Gain on sale of financial instruments
 - BOLI



Revenue Recognition

- Sales of ORE:
 - Removes the specific bright line tests for down payment, ability to repay, etc.
 - Only 2 methods of accounting – sale (like full accrual method) or no sale (like deposit method)
 - Factors like down payment, ability to repay, etc., will continue to be considered
 - Can achieve sale accounting subsequently
 - Will need to adjust gain for off-market terms

Revenue Recognition

- Sales of ORE:
 - Contract must exist:
 - Parties to the contract have approved it and are committed to perform
 - Each party's rights can be identified
 - Payment terms can be identified
 - Must have commercial substance
 - Probable the FI will collect substantially all of the consideration it is entitled to (cannot consider collateral)

Revenue Recognition

- Sales of ORE:
 - What if financial institutions have more questions?
 - A good resource for questions on the sale of ORE is the [OCC Bank Accounting Advisory Series](#) Topic 5A
 - A lot of judgment will be involved, so make sure all of the facts in a scenario are clear
 - Contact your Wipfli relationship executive

Revenue Recognition

- Deposit fees:
 - Contracts are typically day-to-day contracts since customers can cancel the contract (i.e., remove their deposit) at any time without any significant penalty
 - If the contract does not extend beyond the period in which services are performed (wire transfer, ATM usage, overdraft payment, etc.), the revenue is recognized when the fee is charged

Revenue Recognition

- Interchange fees:
 - The biggest question is whether the institution is a principal or an agent; the difference is whether revenue and expense are presented gross or net in the income statement
 - If an agent, recognize net fees



Revenue Recognition

- Trust and wealth management fees:
 - Customers can usually remove their funds at will, so similar to deposit fees, these fees will usually be recognized when earned for the services provided to date
 - Fee earned and recognized at the end of each month/quarter
 - Will need to review contracts more closely when terms do not allow customers to withdraw funds at will



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Revenue Recognition

- Insurance policy commissions:
 - Understand the terms of the commissions:
 - Any refundable portions (variable consideration, constraint)?
 - Any subsequent performance by the institution?
 - When have we completed our performance obligation?
 - Are we a principal or an agent?



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Revenue Recognition

- What should institutions do to prepare?
 - Review various revenue-generating activities (e.g., noninterest income) – identify what is in scope
 - Identify material activities that are in scope
 - Follow the five-step process to determine and document appropriate accounting treatment
 - Look at contracts; don’t just rely on “understanding”
 - Look at public company filings for disclosure samples
 - Implement controls/processes to detect new revenue



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Measurement of Financial Instruments

ASU 2016-01	Recognition and Measurement of Financial Assets and Liabilities
Scope	Entities with financial instruments
Effective	PBE: Beginning after December 15, 2017 Non-PBE: Beginning after December 15, 2018
Highlights	New recognition and measurement model for financial assets and liabilities



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Measurement of Financial Instruments

- **Equity** investments

- Equity method investments – No change
- Readily determinable fair value – Fair value with changes in fair value recognized in net income (FVNI)
- Available net asset value (NAV) measured in accordance with GAAP – May use the NAV as a practical expedient in most cases (unless the asset is expected to be sold for an amount different from the NAV)

Measurement of Financial Instruments

- **Equity** investments

- No readily determinable fair value – FVNI, except entity may choose alternative measurement method:
 - Cost, minus impairment, plus/minus observable price changes in orderly transactions for identical or similar investment of same issuer
 - Excludes FHLB and Fed Reserve stock (cost)
 - Examples of observable price changes...
 - Bankers Bank
 - VISA Class B

Measurement of Financial Instruments

- **Equity** investments – Impairment
 - Simplified to require a qualitative assessment
 - If qualitative assessment indicates impairment, recognize at fair value
- Non-PBEs do not have to disclose fair value of financial instruments measured at amortized cost (f/k/a FAS 107 disclosure)
- PBEs do not have to disclose methods and significant assumptions in FAS 107 disclosure



Measurement of Financial Instruments

- Requires PBEs to use exit price notion for FAS 107 disclosure
- Financial liabilities measured at fair value using the fair value option:
 - Change in fair value resulting from change in credit risk recognized in comprehensive income
- Separate presentation of financial instruments on balance sheet or in notes by measurement category and form of asset/liability

Measurement of Financial Instruments

- Entity should evaluate the need for a valuation allowance on a deferred tax asset related to securities available for sale in combination with other deferred tax assets
- ASU 2019-04 – The use of the alternative measurement method is considered a nonrecurring fair value measurement



Measurement of Financial Instruments

- At adoption:
 - Cumulative effect adjustment for the first period presented *as of the beginning of the year*
 - Alternative measurement method related to equity investments with no readily determinable fair value is recognized on a prospective basis



Leases


ASU 2016-02	Leases
Scope	Entities with leases (lessees and lessors)
Effective	<p>PBE: Beginning after December 15, 2018</p> <p>Non-PBE: Beginning after December 15, 2020 (Early adoption is permitted)</p> <p><i>FASB Board approved one year delay in October 2019 for most non-PBEs and the delay is expected to be finalized by end of 2019</i></p>
Highlights	New recognition and measurement model for leases – primary change is that a right-of-use asset and lease obligation will be recognized for operating leases






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Leases

- Lessors
 - Only three lease types
 - Eliminates real estate provisions and leveraged leases
 - Limits what qualifies as an initial direct cost



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Leases

- Lessees

- Still two types of leases – operating and finance
- Expense recognition of leases should be similar
 - Finance – Asset amortization and interest expense
 - Operating – Lease (rent) expense on a straight-line basis
- Most operating leases will be recognized on the balance sheet

Leases

- What else is changing?

- Non-lease components are separated from the lease unless a practical expedient is elected
- Profit recognition for sale-leaseback transactions
- Related-party leases are accounted for based on the contractual obligations of the lease (not the substance)
- New disclosure requirements

Leases

- Adoption

- Retrospective adoption - Existing leases are recognized as of the earliest financial statement period presented
- Modified retrospective adoption – Existing leases are recognized through a cumulative-effect adjustment as of the beginning of the adoption year
- Generally no impact on retained earnings upon adoption (record asset and liability)
- Several practical expedients available



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Leases

- Adoption

- Operating leases – ROU asset and lease liability measured using remaining payments
- Finance (capital) leases – generally no change
- Initial direct costs, prepayments, and lease incentives are reclassified as part of the ROU asset



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Leases

- Adoption
 - Sale leaseback
 - Not reassessed if it already qualified as a sale
 - Reassessed if it did not previously qualify as a sale
 - Transition disclosures
 - Impact on financial statements
 - Use of practical expedient(s)

Leases – Finance Lease Example

CARRYFORWARD FROM 2018

Institution enters into a three-year equipment lease with monthly lease payments of \$2,000. There are no initial direct costs, prepayments, or lease incentives.

	ROU Asset	Amortization	Lease Obligation	Interest	Total Expense
Initial	\$ 61,983		\$ 61,983		
Year 1	41,322	\$20,661	43,342	\$5,359	\$26,020
Year 2	20,661	20,661	22,749	3,407	24,068
Year 3	0	20,661	0	1,251	21,912

Leases – Operating Lease Example

CARRYFORWARD FROM 2018

Institution enters into a three-year equipment lease with monthly lease payments of \$2,000. There are no initial direct costs, prepayments, or lease incentives.

	ROU Asset	Amortization (1)	Lease Obligation	Interest (1)	Lease Expense
Initial	\$ 61,983		\$ 61,983		
Year 1	43,342	\$18,641	43,342	\$5,359	\$24,000
Year 2	22,749	20,593	22,749	3,407	24,000
Year 3	0	22,749	0	1,251	24,000

⁽¹⁾ Interest and amortization numbers are shown for information but are not separately recognized in the income statement – the total is recognized as “lease” expense

Leases

CARRYFORWARD FROM 2018

- Sale-leaseback accounting changes:
 - Determine if a sale occurred using new revenue recognition guidance
 - If sale occurred, recognize gain in accordance with new revenue recognition guidance and account for the leaseback as a lease
 - Finance leaseback precludes a sale
 - Adjustments required for off-market terms

Leases

- What should institutions do to prepare?
 - Take an inventory of leases
 - Determine which adoption method will be used
 - Determine whether practical expedients will be elected
 - Identify the remaining term for leases that will still be outstanding at adoption
 - Consider how the institution will track and generate accounting entries for leases going forward



Leases

- Other items
 - Impact on regulatory capital
 - If you would like some help estimating the impact of the lease standard, Wipfli has a lease analysis tool available
 - Please contact your Wipfli relationship executive



Measurement of Credit Losses


ASU 2016-13	Measurement of Credit Losses on Financial Instruments
Scope	Entities with financial assets
Effective	<p>SEC Filer: Beginning after December 15, 2019</p> <p>SRC, Other PBE, and Non-PBE: Beginning after December 15, 2022</p> <p>(Early adoption is permitted for periods beginning after December 15, 2018)</p> <p><i>FASB Board approved the delayed effective date in October 2019 for small reporting companies and all other non-SEC entities and delay is expected to be finalized by end of 2019</i></p>
Highlights	New impairment model for loans and securities






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Measurement of Credit Losses

- ASU 2019-04
 - Provides a lot of flexibility in how accrued interest is presented and analyzed
 - Institutions should consider recoveries when estimating the allowance for credit losses
- ASU 2019-05
 - May elect the fair value option upon adopting CECL



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Measurement of Credit Losses

- Various resources and recorded webinars at:
www.wipfli.com/FICECL
- For more information or implementation help or to set up a CECL Readiness Snapshot meeting, please contact your Wipfli relationship executive



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Statement of Cash Flows

CARRYFORWARD FROM 2018

ASU 2016-15	Statement of Cash Flows – Classification of Certain Receipts and Payments
Scope	Entities that prepare a cash flow statement
Effective	PBE: Beginning after December 15, 2017 Non-PBE: Beginning after December 15, 2018 (Early adoption is permitted)
Highlights	Updates presentation of certain cash receipts and cash payments in the statement of cash flows



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Statement of Cash Flows

CARRYFORWARD FROM 2018

- Updates statement of cash flow presentation in the following areas:
 - Settlement of zero-coupon and similar debt instruments
 - Proceeds from the settlement of insurance claims
 - Beneficial interests in securitization transactions
 - Separately identifiable cash flows and the application of the predominance principle

Statement of Cash Flows

CARRYFORWARD FROM 2018

- Updates statement of cash flow presentation in the following areas:
 - **Debt prepayment or debt extinguishment costs**
 - Financing activity
 - **Distributions received from equity method investees**
 - Accounting policy election for one of two methods:
 - Cumulative earnings approach
 - Nature of the distribution approach

Statement of Cash Flows

CARRYFORWARD FROM 2018

- Updates statement of cash flow presentation in the following areas:
 - **Contingent consideration payments made after a business combination**
 - Investing activity – Payments made soon after the acquisition date
 - Financing activity – Payments made not soon after the acquisition up to the liability recognized
 - Operating activity – Excess payments made not soon after the acquisition

Statement of Cash Flows

CARRYFORWARD FROM 2018



- Updates statement of cash flow presentation in the following areas:
 - **Proceeds from the settlement of BOLI**
 - Investing activity – Proceeds from settlement of BOLI
 - Operating and/or investing activity – Premiums paid



Goodwill Impairment

CARRYFORWARD FROM 2018

ASU 2017-04	Simplifying the Test for Goodwill Impairment
Scope	Entities with goodwill
Effective	SEC Filer: Beginning after December 15, 2019 Other PBE: Beginning after December 15, 2020 Non-PBE: Beginning after December 15, 2021 (Early adoption is permitted)
Highlights	Eliminated Step 2 from the goodwill impairment test






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Goodwill Impairment

CARRYFORWARD FROM 2018

- Goodwill impairment steps:
 - Step “0” – Qualitative assessment
 - Step 1 – Compare carrying basis of reporting unit (including allocated goodwill) to its estimated fair value
 - Step 2 (removed) – Estimate fair values of reporting unit’s assets and liabilities and measure impairment based on implied goodwill
 - Instead, measure goodwill impairment based on difference between carrying basis and estimated FV of reporting unit (Step 1); also consider deferred tax






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Pension/Postretirement Benefit Cost

CARRYFORWARD FROM 2018

ASU 2017-07	Improving the Presentation of Net Periodic Pension/Postretirement Benefit Cost
Scope	All entities
Effective	PBE: Beginning after December 15, 2017 Non-PBE: Beginning after December 15, 2018 (Early adoption is permitted)
Highlights	Service cost component of net periodic benefit cost is separately reported from other components as part of employee compensation costs






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Premium Amortization

CARRYFORWARD FROM 2018

ASU 2017-08	Premium Amortization on Purchased Callable Debt Securities
Scope	All entities
Effective	PBE: Beginning after December 15, 2018 Non-PBE: Beginning after December 15, 2019 (Early adoption is permitted)
Highlights	Premiums on callable debt securities are amortized to the earliest call date





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Derivatives and Hedging
CARRYFORWARD FROM 2018

ASU 2017-12	Targeted Improvements to Accounting for Hedging Activities
Scope	All entities
Effective	PBE: Beginning after December 15, 2018 Non-PBE: Beginning after December 15, 2019 (Early adoption is permitted)
Highlights	Allows for additional risk component hedging; Simplifies and expands the availability of fair value hedging; Simplifies accounting, effectiveness assessments

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Derivatives and Hedging
CARRYFORWARD FROM 2018

- New provisions for fixed rate hedging
 - More options available for fair value hedges to better match the risk being hedged
 - Can use “last of layer” approach for loan pools
- Easier to hedge prime rate instruments
- More practicality to certain effectiveness testing
 - Qualitative assessments
 - Ineffectiveness no longer recognized separately for highly effective hedges

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Derivatives and Hedging CARRYFORWARD FROM 2018

- There is also an opportunity to reclassify “qualifying” securities held to maturity to securities available for sale without tainting the rest of the HTM portfolio upon adoption of this standard



Fair Value Disclosures

ASU 2018-13	Changes to the Disclosure Requirements for Fair Value Measurement
Scope	All entities
Effective	Beginning after December 15, 2019 (including interim periods) (Early adoption is permitted – Can early adopt disclosure removals and modifications and delay adoption of disclosure additions)
Highlights	Changes (generally simplifies) disclosure requirements related to fair value measurements

Fair Value Disclosures

- Disclosures removed:
 - Amount and reason for transfers between Level 1 and Level 2.
 - Policy for timing of transfers between levels.
 - Valuation processes for Level 3 fair value measurements.
 - Nonpublic entities – Changes in unrealized gains and losses for the period included in earnings for recurring Level 3 fair value measurements held at the end of the reporting period.



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Fair Value Disclosures

- Disclosures modified:
 - In lieu of a rollforward for Level 3 fair value measurements, a nonpublic entity is required to disclose transfers into and out of Level 3 and purchases and issues of Level 3 assets and liabilities.
 - When using NAV, an entity is required to disclose the timing of liquidation of an investee's assets and the date when restrictions from redemption might lapse *only if* the investee has communicated the timing to the entity or announced the timing publicly.



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Fair Value Disclosures

- Disclosures modified:
 - Clarifies that the measurement uncertainty disclosure is to communicate information about the uncertainty in measurement as of the reporting date.





Fair Value Disclosures

- Disclosures added (public business entities only):
 - The changes in unrealized gains and losses for the period included in other comprehensive income for recurring Level 3 fair value measurements held at the end of the reporting period.
 - The range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements.

Defined Benefit Plan Disclosures

CARRYFORWARD FROM 2018

ASU 2018-14	Changes to the Disclosure Requirements for Defined Benefit Plans
Scope	Entities that sponsor defined benefit plans
Effective	PBE: Beginning after December 15, 2020 Non-PBE: Beginning after December 15, 2021 (Early adoption is permitted)
Highlights	Changes (generally simplifies) disclosure requirements related to defined benefit plans






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Defined Benefit Plan Disclosures

CARRYFORWARD FROM 2018

- Disclosures removed (not complete list):
 - The amounts in accumulated other comprehensive income expected to be recognized as components of net periodic benefit cost over the next fiscal year.
 - The amount and timing of plan assets expected to be returned to the employer.
 - Related-party disclosures about the amount of future annual benefits covered by insurance and annuity contracts and significant transactions between the employer or related parties and the plan.

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Defined Benefit Plan Disclosures

CARRYFORWARD FROM 2018

- Disclosures removed (not complete list):
 - Nonpublic entities – The reconciliation of the opening balances to the closing balances of plan assets measured on a recurring basis in Level 3 of the fair value hierarchy. (Nonpublic entities will be required to disclose separately the amounts of transfers into and out of Level 3 and purchases of Level 3 plan assets.)
 - Public entities – The effects of a 1% change in assumed health care cost trend rates for postretirement health care benefits.

Defined Benefit Plan Disclosures



CARRYFORWARD FROM 2018

- Disclosures added:
 - The weighted-average interest crediting rates for cash balance plans and other plans with promised interest crediting rates.
 - An explanation of the reasons for significant gains and losses related to changes in the benefit obligation for the period.

Implementation Costs – Cloud Computing

CARRYFORWARD FROM 2018



ASU 2018-15	Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract
Scope	All entities
Effective	PBE: Beginning after December 15, 2019 Non-PBE: Beginning after December 15, 2020 (Early adoption is permitted)
Highlights	Align the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for internal-use software

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Accounting Update

- Other ASUs:
 - ASU 2016-15: *Statement of Cash Flows – Classification of Certain Receipts and Payments*
 - ASU 2017-01: *Clarifying the Definition of a Business*
 - ASU 2017-04: *Simplifying the Test for Goodwill Impairment*
 - ASU 2017-07: *Improving the Presentation of Net Periodic Pension / Postretirement Benefit Cost*

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Accounting Update

- Other ASUs:

- ASU 2017-08: *Premium Amortization on Purchased Callable Debt Securities*
- ASU 2017-12: *Targeted Improvements to Accounting for Hedging Activities*
- ASU 2018-02: *Reclassification of Certain Tax Effects from AOCI*
- ASU 2018-07: *Improvements to Nonemployee Share-Based Payment Accounting*



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Accounting Update

- Other ASUs:

- ASU 2018-14: *Changes to the Disclosure Requirements for Defined Benefit Plans*
- ASU 2018-15: *Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract*
- ASU 2018-16: *Inclusion of the Secured Overnight Financing Rate (SOFR) Overnight Index Swap (OIS) Rate as a Benchmark Interest Rate for Hedge Accounting Purposes*



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Accounting Update

- A final note – Impact on your borrowers:
 - Revenue recognition
 - Leases
 - Proposed debt classification standard
- Borrower financial statements may see significant changes that could result in covenant violations
 - Consider proactive discussion with borrowers
 - May want to revise certain covenants in advance

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LIBOR Transition

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LIBOR Transition – Background

- LIBOR (London interbank offered rate)
 - Introduced in 1986
 - Panel banks voluntarily report estimated transaction cost for unsecured bank-to-bank borrowings
 - Rates for index related to overnight to one year terms
 - Subjective, not based on actual transactions
- FASB is working on a project to simplify accounting for the eventual transition
 - Example: Debt

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AICPA Auditing Update

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AICPA Auditing Update



SAS 134	Auditor Reporting and Amendments
Scope	All audits
Effective	Years ending on or after December 15, 2020
	Certain changes to the auditor’s report
Highlights	New requirement to communicate key audit matters in the auditor’s report WHEN the auditor is engaged to do so (NOT required to do so)

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AICPA Auditing Update

- Opinion section required to be presented first
- Enhanced auditor reporting related to going concern
- Expanded description of auditor’s responsibilities
- Required to communicate to TCWG significant risks identified by the auditor
- When engaged, include key audit matters (KAMs) in the auditor’s report
- See [At a glance](#) document for a quick summary





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AICPA Auditing Update

SAS 135	Ominibus
Scope	All audits
Effective	Years ending on or after December 15, 2020
Highlights	Aligns GAAS more closely with the PCAOB in areas related to: <ul style="list-style-type: none">• Communication with TCWG• Related parties• Consideration of fraud

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Questions?

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