2020-21 Accounting and Disclosure Considerations

December 18, 2020

Ongoing COVID-Related Considerations

Part 363 Audit and Reporting Requirements

Interim Final Rule

- Approved October 20, 2020, effective immediately
- Provides temporary relief from Part 363 audit and reporting requirements
- FDIC recognized that recent economic conditions have caused insured depository institutions to experience large cash inflows from participation in PPP, MMLF, and PPPLF, as well as from other government stimulus programs
- Without relief, institutions would be required to incur substantial costs on a temporary basis to develop processes and systems to comply with annual independent audit and reporting requirements
- Allows insured depository institutions to determine whether they are subject to the requirements of Part 363 for fiscal years ending in 2021 based on consolidated total assets as of December 31, 2019
- Press release also indicates that FDIC is actively considering similar targeted adjustments to mitigate unintended consequences from pandemic-related stimulus actions

Changes in SEC "SOX" Requirements

Amendments to Accelerated and Large Accelerated Filer Definitions

- Issued March 12, 2020; Effective April 27, 2020
- "More appropriately tailor the types of issuers that are included in the definitions, thereby reducing unnecessary burdens and compliance costs for certain smaller issuers…"
- Amendments:
  - Modify the accelerated filer and large accelerated filer definitions to provide an exemption for issuers that are eligible to be a "smaller reporting company" and have annual revenues of less than $100 million in the most recent fiscal year for which audited financial statements are available
  - Increase the transition threshold for accelerated and large accelerated filers to become a non-accelerated filer from $50 million to $60 million
  - Increase the transition threshold for exiting large accelerated filer status from $500 million to $560 million
  - Add a revenue test to the transition thresholds for exiting both accelerated and larger accelerated filer status
  - Add a checkbox to the cover pages of annual reports on Forms 10-K, 20-F, and 40-F to indicated whether an internal control over financial reporting auditor attestation is included in the filing.

SEC "SOX" Changes

Amendments to Accelerated and Large Accelerated Filer Definitions

- Smaller reporting companies that meet the eligibility requirements for the exemption will not be required to comply with Section 404(b) of the Sarbanes-Oxley Act (SOX), which requires an issuer's independent auditor to attest to, and report on, management's assessment of the effectiveness of their ICFR.
  - Chief executive and chief financial officers will still be required to certify that they are responsible for overseeing the issuer's ICFR and have evaluated and reported on the effectiveness of its disclosure controls and procedures.
  - Independent auditors will continue to be required to consider ICFR in connection with the performance of financial statement audits.

Status	Public float	Annual revenues	Required to obtain auditor attestation over ICFR?
SRC and non-accelerated filer	Less than $75 million	No limit	No
	$75 million to less than $700 million	Less than $100 million	No
SRC and accelerated filer	$75 million to less than $250 million	$100 million or more	Yes
Accelerated filer (not an SRC)	$250 million to less than $700 million	$100 million or more	Yes
Large accelerated filer	$700 million and greater	Not applicable	Yes

SOX/FDICIA Audit Impacts

Bottom Line

- Determine your institution's specific circumstances in SOX/FDICIA requirements
  - Can be complex with calculations and timing of calculations of market capitalization, gross revenue, and total assets
  - Informs your strategy and timeline for compliance
- Additional time for management to:
  - Develop documentation of internal control processes
  - Identify key controls
  - Remediate any control design deficiencies
  - Develop testing plan
- Consideration of internal (internal audit staff) or external (outsource/co-source) resources <u>and</u> expertise

Loan Modifications

3 primary sources of COVID guidance

- Interagency Statement issued March 22, 2020 (updated April 7, 2020)
- CARES Act passed March 27, 2020
- Interagency Statement on "re-modifications" issued August 3, 2020

Loan Modifications

Interagency Statement – "Loan Modifications and Reporting for Financial Institutions with Customers Affected by Coronavirus"

- COVID-related loan modifications are not automatically considered TDRs
  - Modifications that are not TDRs:
    - » Short-term modifications (less than 6 months)
    - » Borrowers current (less than 30 days past due) at inception of modification program
- Past due reporting
  - Not expected to designate loans with COVID-related modifications as past due during modification period
- Non-accrual/charge-offs
  - Short-term arrangements not non-accrual

Loan Modifications

CARES Act (Section 4013 for Financial Institutions)

- 3 criteria (must meet all):
  - Due to COVID-19
  - Occurred between March 1 and December 31, 2020
  - Borrower current on contractual payments as of December 31, 2019
    - » Not required to follow ASC 310-40 for loan modifications
- Do not have to report loans as TDRs in Call Reports or reviewed/audited financial statements
- Do not need to determine impairment associated with certain loan concessions that would otherwise have been required for TDRs
- Required to maintain records of the volume of Section 4013 loans
- Should maintain appropriate allowance for loan/credit losses

Loan Modifications

Interagency Statements – "Joint Statement on Additional Loan Accommodations Related to COVID-19"

- "Follow GAAP"
  - For additional modifications made to borrowers continuing to experience financial hardship at the end of initial accommodation period
  - Maintain appropriate ALLL/ACL
    - » Consider all relevant and available information when assessing the collectability of cash flows, including changes in financial condition, collateral value, and economic conditions
- Past due – determined in accordance with revised contractual terms
- Non-accrual – follow GAAP and regulatory reporting instructions

Loan Modifications

Modifications/Re-modifications

- Order of application…
  - CARES Act Section 4013
  - Interagency Statements
    - » If cumulative modifications remain short-term (< 6 months), and
    - » If borrower is contractually current (< 30 days at modification/re-modification)
      - Lender may presume/continue to presume no financial difficulty and not a TDR
  - All other modifications/re-modifications – evaluate for TDR
  - https://www.occ.gov/news-issuances/bulletins/2020/covid-19-loan-modifications-reference-guide.pdf
- Consider revisiting your documentation/checklists to clearly identify the guidance followed for determining status of modifications (presumption that most modifications fall under CARES Act)

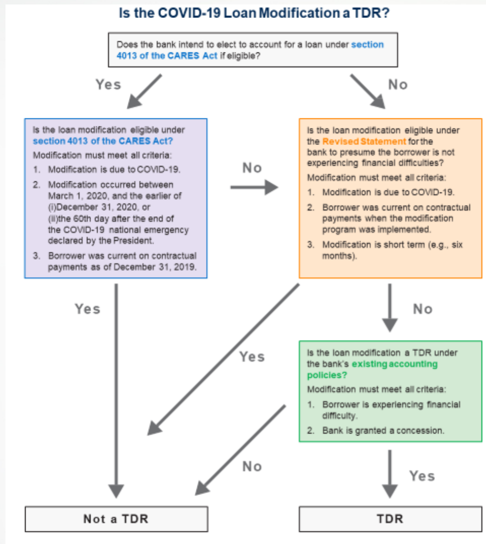
Loan Modifications

OCC Reference Guide

	Section 4013 of the CARES Act	Non-Section 4013 Loan Modifications (Revised Statement)
Evaluation date of whether borrower was current (< 30 days past due)	December 31, 2019	No earlier than when the modification program is implemented
Modifications terms allowed (safety and soundness principles still apply)	Any modification	Short term (e.g., six months)
Time period of when the modification occurs	Between March 1, 2020, and the earlier of (i) December 31, 2020, or (ii) the 60th day after the end of the COVID-19 national emergency declared by the President.	Management should use judgment to determine if the modification is related to COVID-19.
Duration of non-TDR designation	Remaining life of the loan. Subsequent modifications must be evaluated if they are not also eligible under the criteria.	Remaining life of the loan. Subsequent modifications must be re-evaluated.
Why is it not a TDR?	By law, the bank is not required to designate the loan as a TDR.	The bank may presume that the borrower is not experiencing financial difficulty.
If neither section 4013 of the CARES Act nor the Revised Statement criteria are met, the bank should follow its existing accounting policies to determine whether the modification should be accounted for as a TDR.		

Loan Modifications

OCC Reference Guide



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Payment Deferral Audit Considerations

Bottom Line

- Interplay/authority of CARES Act with regulatory guidance
- Documentation of 2020 modification decisions
- TDR classification is not the only important impact
  - Loan monitoring when some typical reports are not as useful
  - Collectability of problem loans
  - Loan review samples – focused/increased
- Testing of payments and accrued interest on modified loans
- Potential 2021 impacts…
  - Some areas that had been relegated may come back to forefront
    - OREO
    - Loan impairment calculations (collateral-dependent and/or cash flow)
    - Appraisals – accuracy and age
    - TDR identification without CARES Act – additional deferrals/modifications
    - Others

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Paycheck Protection Program

PPP Accounting and Reporting Issues

- AICPA Technical Q&A (Section 2130)
  - https://www.aicpa.org/content/dam/aicpa/interestareas/frc/downloadabledocuments/tqa-sections/tqa-section-2130-42-44.pdf
  - Classification of advances – legally a loan, should account for instrument as a loan
  - Consideration of SBA guarantee – considered embedded and not freestanding, should be considered when estimating credit losses on the loan
  - Accounting for loan origination fee received from SBA – nonrefundable loan origination fee upon funding (offset against loan origination costs) and deferred/amortized over life of loan
    - Loan origination costs should be representative of PPP process and may not be same as standard commercial loan costs

Paycheck Protection Program

Bottom Line

- Consideration in ALLL calculation
- Reasonableness of deferred loan costs

Paycheck Protection Program - Forgiveness

PPP Accounting and Reporting Issues

- AICPA Technical Q&A (Section 2130)
  - Forgiveness
    - Account for the loan as an interest-bearing loan (including amortization of loan origination fees) through receipt of payment from borrower or SBA
      - » Estimating prepayments is problematic/not advisable – no history with this loan type to be probable/reasonably estimable and not homogeneous
    - Payments received from borrower or SBA prior to maturity of the loan are considered prepayments

Paycheck Protection Program - Forgiveness

Bottom Line

- Timing of recognition of deferred fees/costs
- Resources to handle processing

Paycheck Protection Program - Other

Other PPP Accounting and Reporting Issues

- Inflated balance sheets remain – ALM, FDICIA thresholds (relief granted by FDIC)
- Extended covered period (8 to 24 weeks)
- Continuing guidance regarding forgiveness process
- Another round coming???

Impairment - Goodwill

Annual/Interim Impairment Assessment

- Given recent economic downturn due to COVID, expectation of triggering event requiring interim goodwill impairment tests
  - Triggering event: an event occurs or circumstances change that would more likely than not reduce the fair value of the reporting unit below its carrying amount, e.g. macroeconomic conditions, industry or market considerations, overall financial performance, cash flow changes, sustained decrease in share price
  - Prior "cushions" do not negate evaluation of a triggering event
  - Triggering events are required to be evaluated prior to issuance of financial statements
  - Even if market prices/economic indicators improve before year-end, may still have experienced triggering event that should have resulted in interim goodwill impairment assessment

Impairment - Goodwill

Annual/Interim Impairment Assessment

- Considerations in impairment assessment
  - Materiality of potential impairment loss
  - Unusual market conditions may warrant special adjustments/consideration in fair value calculation
    - Adequately support assessments that use fair value of equity that is other than market capitalization (control premium)
    - Adequately support conclusions when stockholders' equity exceeds market capitalization either at annual testing date or continuously for significant period
  - **Consider need for third party valuation specialist to assist with assessment**

Impairment - Goodwill

Bottom Line

- Expectation that triggering event occurred during 2020 – likely required more than standard annual review
- Availability/need for assistance (third party expert valuations)
- Potential for impacts into 2021 for impairment charges – likely continued higher risk in 2021

Other Considerations for 2020-2021

- Take time to critically assess all reporting/disclosure topics
- Impairment of securities
  - Evaluation of stressed industries, municipalities
  - Sale/reclassification of HTM
- Derivatives and hedging
  - Potential impact of deferrals on loan derivative products
- Vendor management
- Various stress tests
- Remote working
- Remote auditing

FASB Activity

- Reprioritized agenda in reaction to COVID
- Staff Q&As for COVID-related matters
- Shifted less time-sensitive projects to 2H 2020 and reallocated resources to COVID technical issues (leases, interest income, fair value, hedging, SBA loans)
- Effective date deferral (Topic 842 – Leases)
  - Private companies may elect to adopt new standard for annual reporting periods after December 15, 2021
- CECL Transition Resource Group still active and releasing Staff Q&As

Specific SEC Guidance

- CF Disclosure Guidance Topic 9: Coronavirus (COVID-19)
  - Released March 25, 2020
  - https://www.sec.gov/corpfin/coronavirus-covid-19
  - Disclosure considerations:
    - Assessing and disclosing the impact of COVID-19
    - Management's Discussion and Analysis
    - Risk factors
    - Legal proceedings
    - Disclosure controls and procedures
    - Internal control over financial reporting
    - Non-GAAP financial measures

Specific SEC Guidance

- CF Disclosure Guidance Topic 9A: Coronavirus (COVID-19) Disclosure Considerations Regarding Operations, Liquidity, and Capital Resources
  - Released June 23, 2020
  - https://www.sec.gov/corpfin/covid-19-disclosure-considerations
  - Disclosure considerations:
    - Funding sources
    - Debt covenants
    - Share repurchase programs
    - Dividends
    - Loan modifications and/or concessions
    - Government assistance
    - Going concern

Other SEC COVID Guidance

- Other general SEC comments
  - SEC will not object to well-reasoned judgments (contemporary documentation of rationale)
  - Accounting areas highlighted in light of COVID-19:
    - Fair value and impairment
    - Leases
    - Debt modifications/restructurings
    - Hedging
    - Revenue recognition
    - Income taxes
    - Going concern
    - Subsequent events
    - Adoption of CECL

New Non-COVID SEC Guidance

Human Capital Disclosure Rules

- Part of SEC's Regulation S-K modernization project
- Effective November 9, 2020…so 2020 Form 10-K
- Does <u>not</u> apply to SRCs…continue with prior disclosures about employees
- Intended to provide insight into Human Capital
  - Operating model
  - Talent planning
  - Learning and innovation
  - Employee experience
  - Work environment

New Non-COVID SEC Guidance

Human Capital Disclosure Rules

- Specific disclosures:
  - Number of employees and description of human capital resources (by segment, if material)
  - Human capital measures or objectives that registrant focuses on in managing its business, e.g. development, attraction, safety, engagement, retention
- Expected to be tailored to a registrant's business or industry
- No definition of "human capital" or required measures to disclose
  - May include employees and non-employees (contract workers)
  - Scorecard, board reporting, succession, productivity, recruiting costs, turnover, diversity, HR cost, etc.
- Material – substantial likelihood that a reasonable investor would consider the information important in making an investment or voting decision
- Reliable and consistent – supported by effective controls and procedures…subject to registrant's disclosure controls

Good Resources

COVID-19 Regulator Resource Pages

- Each federal regulator has set up helpful pages with regularly updated information, recent releases and guidance, and FAQs
  - https://www.fdic.gov/coronavirus/index.html
  - https://occ.gov/topics/supervision-and-examination/bank-operations/covid-19-information/covid-19-faqs-for-national-banks-and-fsa.html
  - https://www.federalreserve.gov/covid-19.htm

SBA

- All things PPP related and changing often
  - https://www.sba.gov/page/coronavirus-covid-19-small-business-guidance-loan-resources

Good Resources

AICPA

- Some good insights on remote auditing
  - https://www.aicpa.org/news/aicpa-coronavirus-resource-center.html

OCC Bank Accounting Advisory Series

- Very helpful Q&A format for relevant topics
  - https://www.occ.gov/publications-and-resources/publications/banker-education/files/bank-accounting-advisory-series.html

CDC

- https://www.cdc.gov/coronavirus/2019-ncov/community/organizations/businesses-employers.html

YHB

- https://www.yhbcpa.com/covid-19-resources/