



Accounting and Financial Reporting Developments in a Pandemic Environment

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Crowe 2020 Financial Services Conference

SMART DECISIONS. LASTING VALUE.™



Your Presenters

**Rick Childs, CFA, CPA**

Partner
Advisory Services
+1 (317) 706-2654
rick.childs@crowe.com

**Sydney Garmong, CPA, CGMA**

Partner
National Office
+1 (202) 779-9911
sydney.garmong@crowe.com

**Chris Moore, CPA**

Partner
Accounting Advisory
+1 (502) 326-3996
chris.moore@crowe.com

**Matthew Schell, CPA, CFA**

Partner
National Office
+1 (202) 779-9930
matthew.schell@crowe.com

**Mark Shannon, CPA**

Partner
National Office
+1 (202) 779-9921
mark.shannon@crowe.com

Agenda

Accounting and Financial Reporting Developments in a Pandemic Environment

Part 1

- AICPA Conferences
- Impairments – Goodwill and Other Impairment or Valuation Considerations
- Reference Rate Reform and Hedging
- Reminders for Debt or Equity Financings

Part 2

- Loan Modifications
- Paycheck Protection Program (PPP) Developments
- Main Street Lending Developments
- FASB Post Implementation Review – CECL
- Other Accounting Considerations
- Internal Control Considerations
- SEC Considerations, From the PCAOB, and From the CAQ



AICPA Conferences:

- Banks & Savings Institutions
- Credit Unions

AICPA National Conferences

Update
coming
soon!



■ AICPA National Conference on Banks & Savings Institutions

■ Sept. 14-16, 2020

■ Crowe's "Hot topics: Takeaways from the 2020 AICPA National Conference on Banks and Savings Institutions" (23 pages)

■ Dec. 1, 2020

<https://www.crowe.com/insights/asset/t/takeaways-2020-aicpa-national-conference-pdf>

Issued
Oct. 7



■ AICPA National Conference on Credit Unions

■ Oct. 19-21, 2020

■ Crowe's "Hot topics: Takeaways from the 2020 AICPA Credit Unions Conference" (16 pages)

<https://www.crowe.com/insights/asset/t/takeaways-from-the-2020-aicpa-national-conference-on-credit-unions>

Issued
Nov. 13

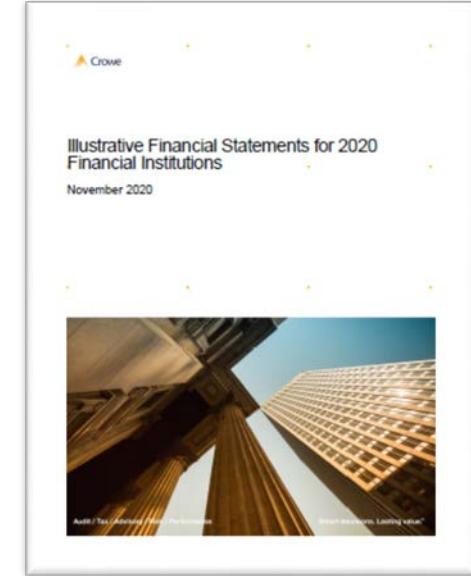


More Resources

- Crowe's "Illustrative financial statements for 2020 financial institutions"

- Issued Nov. 20, 2020
- 144 pages

<https://www.crowe.com/insights/asset/i/illustrative-financial-statements-for-2020>



- Crowe's "Annual Accounting and Financial Reporting Issues for Financial Institutions"

- Slated for Dec. 18, 2020
- Estimated pages - long

Coming
soon!



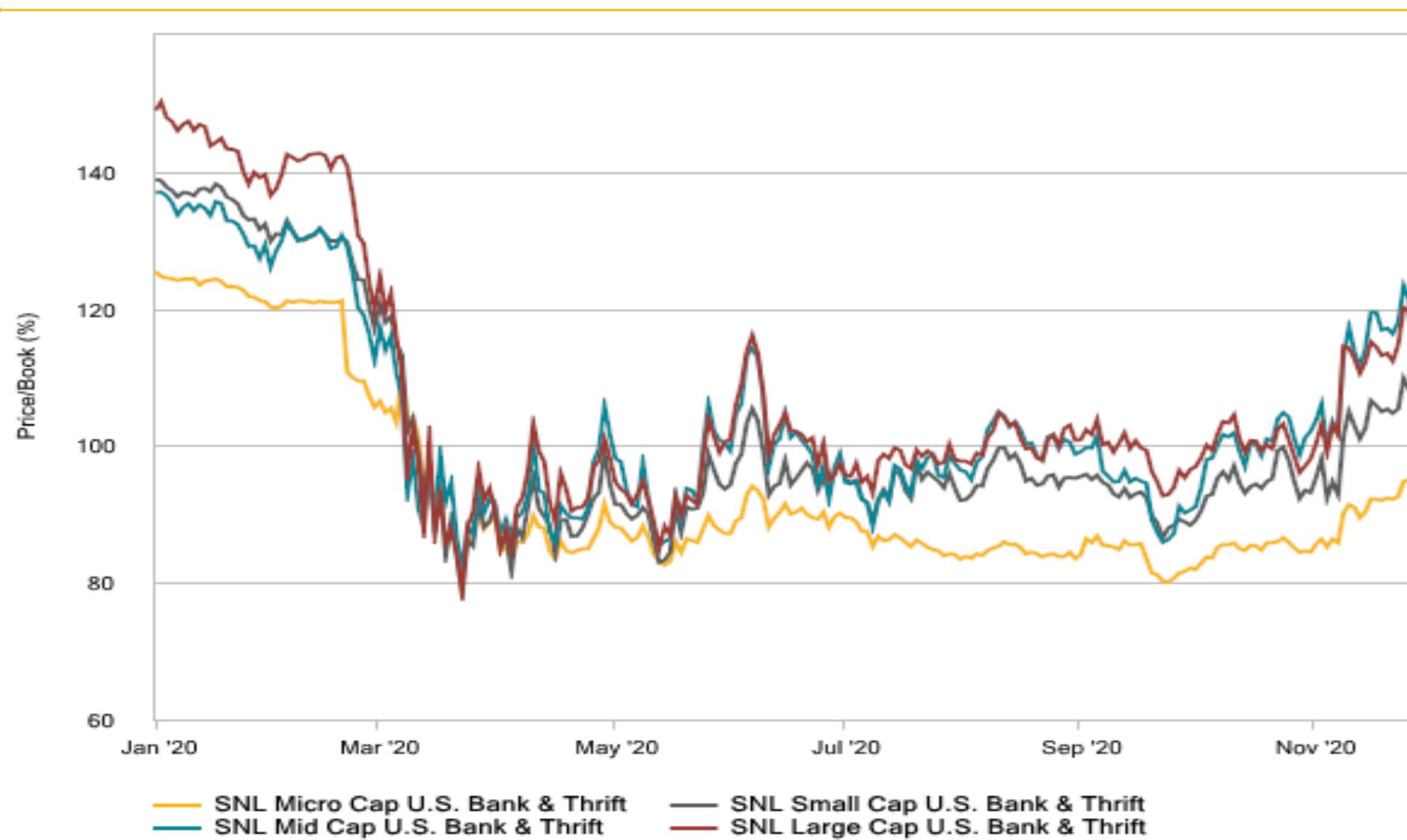
Polling Question

Going into year end financial reporting, our most significant concern is:

- a. Determining the allowance for loan losses
- b. Impairment of goodwill
- c. Other impairments (for example, MSRs, securities)
- d. Accounting for and reporting loan modifications
- e. Other

Goodwill Impairment

Pricing Impact On Goodwill Assessment in 2020



- SNL Large Cap U.S. Bank & Thrift : SNL Large Cap U.S. Bank & Thrift : Includes all publicly traded (NYSE, NYSE American, NASDAQ, OTC) Banks and Thrifts in SNL's coverage universe with greater than \$5B Total Common Market Capitalization as of most recent pricing data.
- SNL Mid Cap U.S. Bank & Thrift : SNL Mid Cap U.S. Bank & Thrift : Includes all publicly traded (NYSE, NYSE American, NASDAQ, OTC) Banks and Thrifts in SNL's coverage universe with \$1B to \$5B Total Common Market Capitalization as of most recent pricing data.
- SNL Small Cap U.S. Bank & Thrift : SNL Small Cap U.S. Bank & Thrift : Includes all publicly traded (NYSE, NYSE American, NASDAQ, OTC) Banks and Thrifts in SNL's coverage universe with \$250M to \$1B Total Common Market Capitalization as of most recent pricing data.
- SNL Micro Cap U.S. Bank & Thrift : SNL Micro Cap U.S. Bank & Thrift : Includes all publicly traded (NYSE, NYSE American, NASDAQ, OTC) Banks and Thrifts in SNL's coverage universe with less than \$250M Total Common Market Capitalization as of most recent pricing data.

Goodwill Impairments in 2020

	Write-Off Amount		Grand
	Partial	Total	Total
2020Q1	6	2	8
2020Q2	4	4	8
2020Q3	7	4	11
Totals	17	10	27

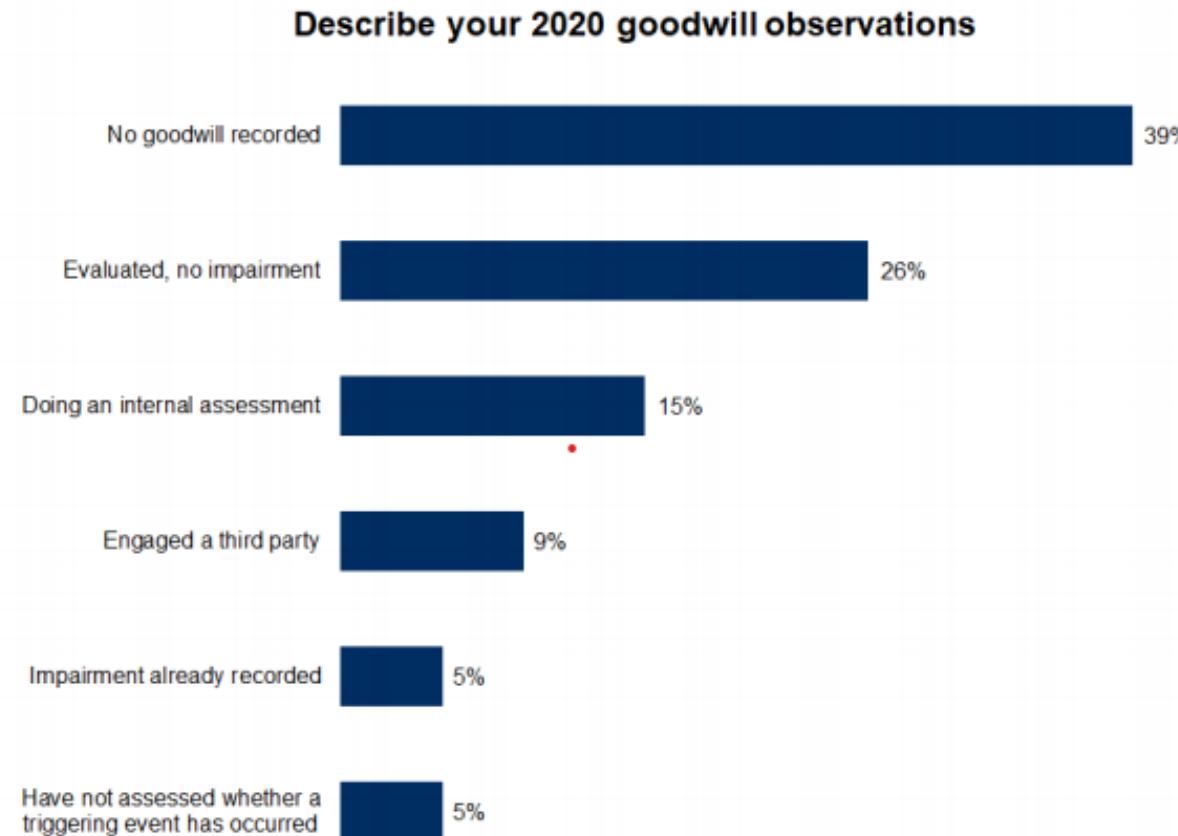
Note: 1 of the 27 took impairment and was also applying the PCC Alternative and amortizing goodwill

Source: S&P Global Market Intelligence

From the 2020 AICPA Banking Conference



A survey of the audience on their goodwill observations provided the following results:



Source: Audience poll results during the conference.

Reasons for Goodwill Impairments in 2020

- Primary reason is stock price trading at levels which couldn't reasonably result in non-impairment
- Reporting units more isolated into smaller delineations
- Ongoing poor performance not enhanced with COVID
- Other (???)



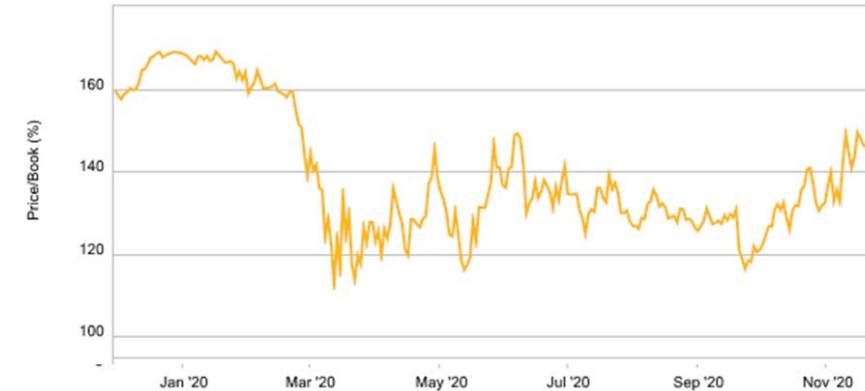
Should You Evaluate Quarterly for Impairments?



- In general, yes, but it's really up to the facts to dictate

- Tale of Two Banks (written by Frank Dickens)

- It was the best of banks



- It was the not-so best of banks (Frank doesn't have his cousin's silver tongue)



Issues in 2020 with Goodwill Testing



- Two of the primary sources of data are not very reliable
 - Control transactions
 - Guideline public company
- Income approach (DCF) has become the predominant source of value estimate
 - Puts the onus on management to provide a reasonable (as reasonable as the times will allow) forecast for the DCF
 - Management should have appropriate internal controls over this estimate, including support for the methodology chosen, assumptions used and the underlying data
- Control premiums from 2019 are not a compelling data source
 - (Note: S&P Global Market Intelligence can be a good source for control premiums)

Simplified test for goodwill impairment

ASU 2017-04, "Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment"

- Eliminates Step Two from the goodwill impairment model
 - No longer required to determine and assign the fair value of a reporting unit to its assets and liabilities
 - Impairment will be measured as the excess of a reporting unit's carrying value over its fair value
 - Impairment is limited to the reporting unit's recorded amount of goodwill
 - Less precise than previous Step Two model
- Model could result in a goodwill impairment that is not attributable to a decline in the fair value of a reporting unit's goodwill
- Applies to all reporting units, including those with zero or negative value
 - Eliminates qualitative assessment for reporting units with zero or negative carrying values
 - Requirement to disclose reporting units with zero or negative carrying values and the amount of goodwill allocated to them

- The Board discussed the feedback received from its July 2019 Invitation to Comment (ITC) - Identifiable Intangible Assets and Subsequent Accounting for Goodwill, supplemental outreach performed by the staff, and the November 2019 public roundtables.

The Board discussed the general direction of the project. Based on that discussion, the staff plans to:

- Explore adding amortization to the goodwill impairment model, including the amortization method and period.
- Explore other changes to the goodwill impairment model.
- Consider the accounting for identifiable intangible assets.
- Address presentation, disclosure, and transition.

- **Wednesday, November 18, 2020 FASB Board Meeting**

Agenda decision—goodwill triggering event evaluation alternative for certain private companies and not-for-profit entities. The Board discussed an issue related to the cost and complexity of private companies performing an interim goodwill triggering event evaluation. The Board decided to: Add a project to its technical agenda to address the cost and complexity associated with interim goodwill impairment testing for private companies and not-for-profit entities.

- Introduce an accounting alternative that would allow entities within the scope of the guidance to perform a goodwill triggering event evaluation on the annual reporting date only.
- Limit the scope of the alternative to entities that meet the definition of *private companies* and *not-for-profit entities* as those terms are defined in the Codification's Master Glossary.
- Limit the scope of the alternative to entities that report GAAP-compliant financial statements on an annual basis only.
- Limit the scope of the alternative to goodwill that is tested for impairment in accordance with Subtopic 350-20, Intangibles—Goodwill and Other—Goodwill.
- As written this agenda items would not apply to banks and credit unions due to call reports



Other Impairment or Valuation Considerations



Impairment Considerations – Mortgage Servicing Rights and Securities

MSR Impairment?

- 30-year fixed mortgage rates December 31, 2018 to November 30, 2020
- 55 bp decline in 2019; 95 bp decline in 2020



MSR Impairment?

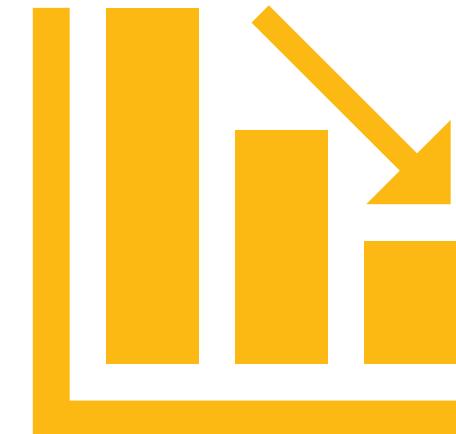
- If not fair value option (FVO), evaluate for impairment by stratum
- Stratify based on predominant risk characteristics

Asset Type	Interest Rate	LTV
Term	Size	
Origination Date	Location	

- Impairment is recognized by stratum, even if total fair value exceeds book
- Allowance (not permanent) vs direct write-down (permanent)

Security Impairment

- **Equities – ASC 321 / ASU 2016-01**
 - Includes mutual funds, regardless of underlying investments
 - Fair value through earnings, with some limited exceptions
- **Debt Securities**
 - Pre CECL (ASC 320)
 - Post CECL (ASC 326)



- Same impairment model applies to both AFS and HTM debt securities
- General allowance is not appropriate
- Is the fair value less than amortized cost?
- Does the investor intend to sell or is it more likely that not that the investor will be required to sell before recovery? If yes, record impairment down to fair value.
- If no, does the investor expect to recover the entire amortized cost?
 - Yes, no OTTI recorded in earnings, but amount of amortized cost > fair value recorded in OCI
 - No, record OTTI (credit loss) in earnings and remaining amount in OCI

- Credit loss

- Factors to consider: 320-10-35-33F & 35G
- Discount cash flows using accounting yield
- Update cash flow analysis quarterly
- Single best estimate of cash flows or probability weighted
- Use same assumptions when determining fair value and credit loss

- Subsequent accounting

- Accrete the difference between new carrying amount and cash flows expected to interest income
- Increases in cash flows are prospective yield adjustments

- Both HTM and AFS
 - Allowance not a direct write-off
 - Immediate recovery for improvements
- HTM
 - Follow the loan model (i.e., Expected Loss)
- AFS (326-30-35)
 - Similar to pre-CECL
 - Length of time in unrealized loss is no longer considered
 - Credit loss cannot exceed the unrealized loss (i.e., fair value floor)
 - Allowed to adjust discount rate to compensate for changes in expected payment timing (326-30-35-7A)

Fair Value Considerations – Derivatives

- Credit risk is a component of fair value; for both assets and liabilities
- Standard derivative valuation models include little to no credit risk (e.g., discounted at OIS or LIBOR)
- Credit risk, and therefore credit valuation adjustment (CVA), exists even without a credit event.
- Risk reductions
 - Centrally cleared, pledging arrangements
 - Cross collateralization (e.g., real estate)
 - Legal right of offset (e.g., deposit accounts)
- CVA exists if credit risk is not reduced to zero

Credit Spreads



■ 5-year Corporates vs US Treasury

	12/31/19	6/30/20	11/16/20
Corporate A	.45%	.66%	.49%
Corporate BBB	.84%	1.18%	.84%
Corporate B	2.46%	5.51%	3.97%

Swaplets

Swaplets



Year	Rcv Fixed	Pay Flt	Net	Disc Rate	PV	Credit Risk
1	90,000	(29,612)	60,388	0.03443	60,368	Borrower
2	90,000	(22,847)	67,153	0.02010	67,126	Borrower
3	90,000	(30,763)	59,237	0.03657	59,171	Borrower
4	90,500	(47,411)	43,089	0.07899	42,951	Borrower
5	89,750	(61,966)	27,784	0.13713	27,591	Borrower
6	89,750	(78,617)	11,133	0.21203	10,990	Borrower
7	90,000	(90,834)	(834)	0.26598	(819)	Bank
8	90,000	(99,813)	(9,813)	0.33261	(9,552)	Bank
9	90,000	(107,558)	(17,558)	0.38467	(16,954)	Bank
10	90,500	(113,752)	(23,252)	0.42677	(22,269)	Bank

NPV 218,604

Net Value

Back-to-Back Swaps

- Two positions, mirrored interest rate risk
 - Dealer: Pay fixed / Receive floating
 - Borrower: Receive fixed / Pay floating
- Credit risk is not mirrored; change in value due to credit is not offset
- Economic hedges, but not hedge accounting
- Both positions carried at FV through earnings; to the extent not offset, recorded in other income
- Change in fair value, including credit risk and credit loss, is recorded in earnings, not the allowance or provision for loan losses



Polling Question

During the fourth quarter, I expect my institution will take charges for (select all that apply):

- a. MSR Impairment
- b. Security Impairment
- c. Losses due to derivative CVAs
- d. Don't know
- e. None of the above



Reference Rate Reform and Hedging

Reference Rate Reform - Background



Background

- LIBOR and other Interbank Offered Rates (IBORs) are an essential part of the financial markets; they serve as a reference rate in a variety of instruments and contracts (over \$200 trillion!)
- Due to concerns about the future reliability of IBORs, central banks and others have recommended replacing IBORs with transaction-based rates (e.g., SOFR); reporting commitments end after 2021
- July 18: SEC Office of Compliance Inspections and Examinations – To begin conducting examinations of preparedness

Derivative Instruments
(e.g., *interest rate swaps, total return swaps*)

Debt instruments
(e.g., *loans, bonds, securitization interests*)

Lease contracts
(e.g., *indexed lease payments*)

Compensation agreements
(e.g., *deferred comp*)

Discount rates used in
various models
(e.g., *impairment*)

Agencies Issue Statement on LIBOR Transition



- Interagency Statement from the Federal Reserve Board, Federal Deposit Insurance Corporation and Office of the Comptroller of the Currency
 - Encouraging banks to cease entering into new contracts that use USD LIBOR as a reference rate as soon as practicable and in any event by December 31, 2021, in order to facilitate an orderly—and safe and sound—LIBOR transition.
 - Issued on Nov. 30, 2020

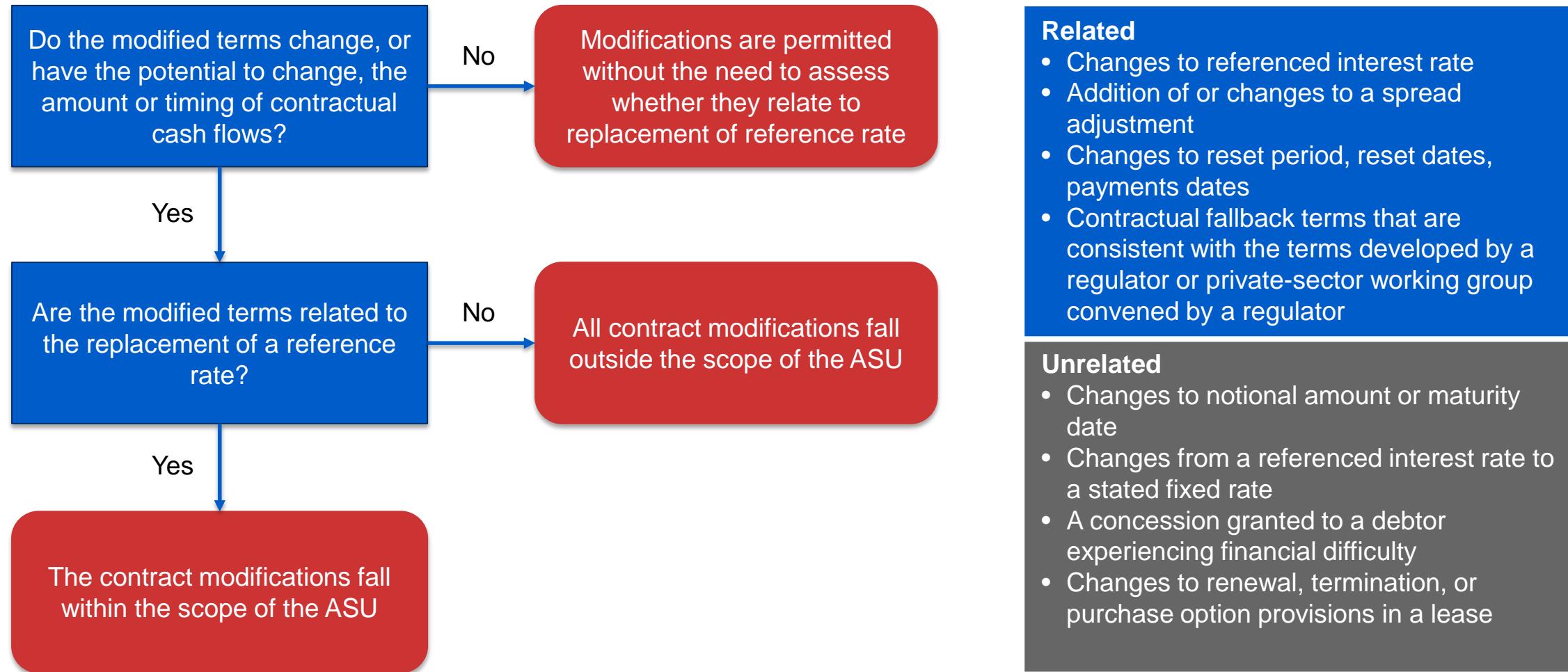
https://www.fdic.gov/news/press-releases/2020/pr20129.html?source=govdelivery&utm_medium=email&utm_source=govdelivery

Codification Topic	<u>Optional</u> Expedient	
Receivables (ASC 310) and Debt (ASC 470)	<ul style="list-style-type: none">➤ Account for the modification as if it was only minor (ASC 310) / not substantial (ASC 470).➤ Prospectively adjust effective interest rate➤ Once modified, prior modifications no longer subject to the 1-year lookback	
Leases (ASC 840 or ASC 842)	<ul style="list-style-type: none">➤ Continuation of the existing contract with no reassessments or remeasurements that otherwise would be required	<p>New expedient available</p> <ul style="list-style-type: none">– One time sale or reclassification of HTM debt securities to AFS or trading classification– Must be tied to LIBOR– Must have been HTM before January 1, 2020– One time, meaning single date
Embedded derivatives (ASC 815)	<ul style="list-style-type: none">➤ No need to reassess whether an embedded derivative should be accounted for as a separate instrument	
Other types of contracts	<ul style="list-style-type: none">➤ Consider modifications of contracts due to reference rate reform to be a continuation of those contracts (i.e., no remeasurement or reassessment).	

Codification Topic	<u>Optional</u> Expedient
Hedge Accounting (ASC 815)	<ul style="list-style-type: none">➤ Allows for changes to critical terms (e.g., hedged item) of hedge relationships without dedesignation➤ Permits rebalancing or adjustments to hedge relationship without dedesignation➤ Continued application of short cut

Codification Topic	<u>Optional</u> Expedient
Cash Flow Hedges	<ul style="list-style-type: none">➤ Allows assertion that the hedged forecast transaction is probable of occurring even though LIBOR to be discontinued➤ Change the designated hedged risk➤ Change method of assessing effectiveness or temporarily suspend effectiveness assessment
Fair Value Hedges	<ul style="list-style-type: none">➤ Change hedged risk to another benchmark (as long as expected to remain highly effective)

ASU 2020-04 / ASC 848 – Eligible Modifications



- **Effective Date & Transition**

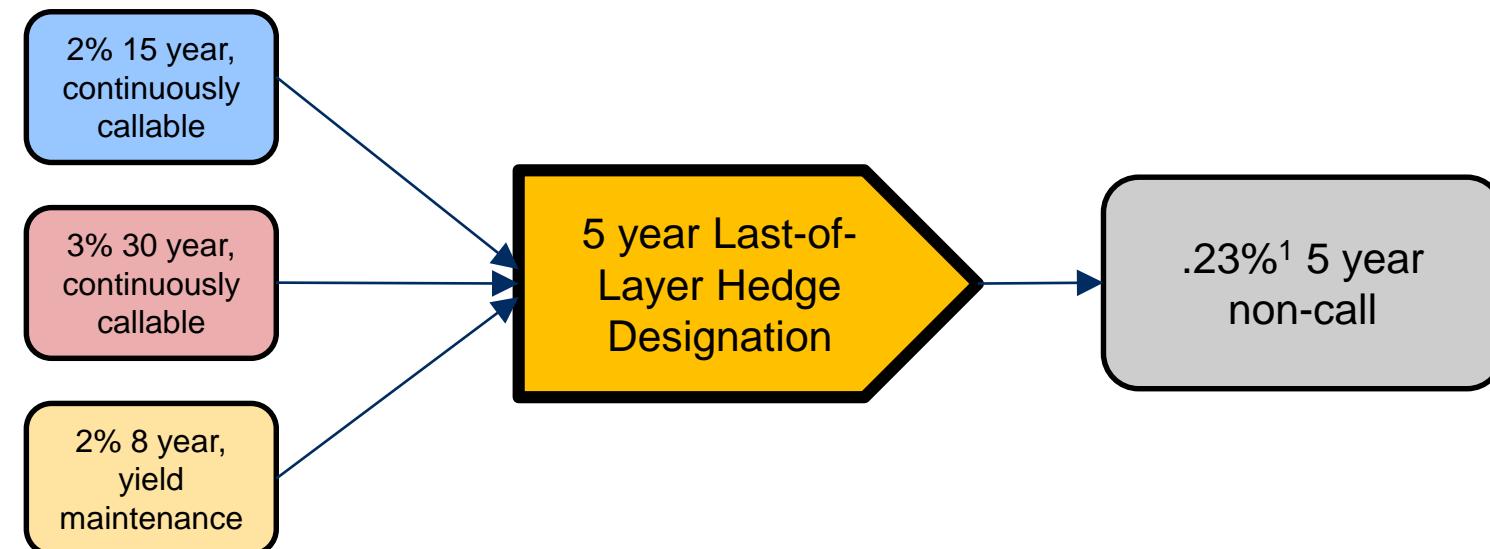
- Effective immediately; Applies to all modifications from January 1, 2020 to December 31, 2022 (hedging items may last longer)
- Applies to all contract modifications within relevant Topic or Industry Subtopic

- **Other**

- One-time election for HTM debt securities must occur before December 31, 2022
- Adoption of ASU 2017-12 prior to or in conjunction with ASC 848 is optional, but recommended
- Cash flow hedge expedites expire when both the hedged instrument and hedging derivative are outside the scope of 848
- Apply relief consistently for eligible contracts, except for accounting hedges
- Hedge-by-hedge basis, multiple reporting periods permitted
 - Designation documentation must be updated

Last-of-Layer Fair Value Hedges

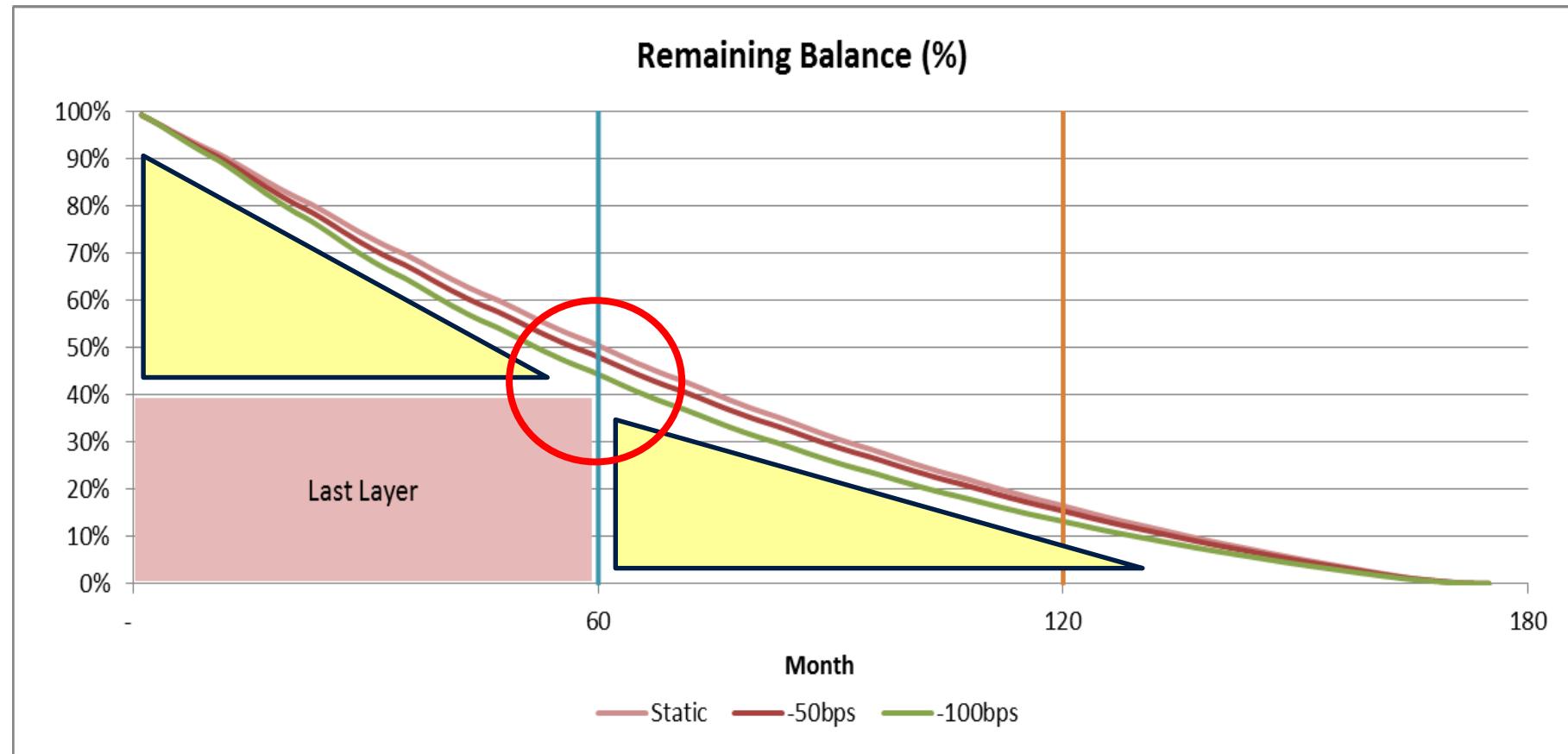
- New approach from ASU 2017-12
- Last of Layer Method – Use partial term and benchmark component of the coupon and create a closed pool of prepayable fixed rate assets (loans, bonds, asset backed securities)
- Rate, term, and prepay features:



¹ Fixed rate equivalent of 5-year benchmark rate (e.g., 1M LIBOR)

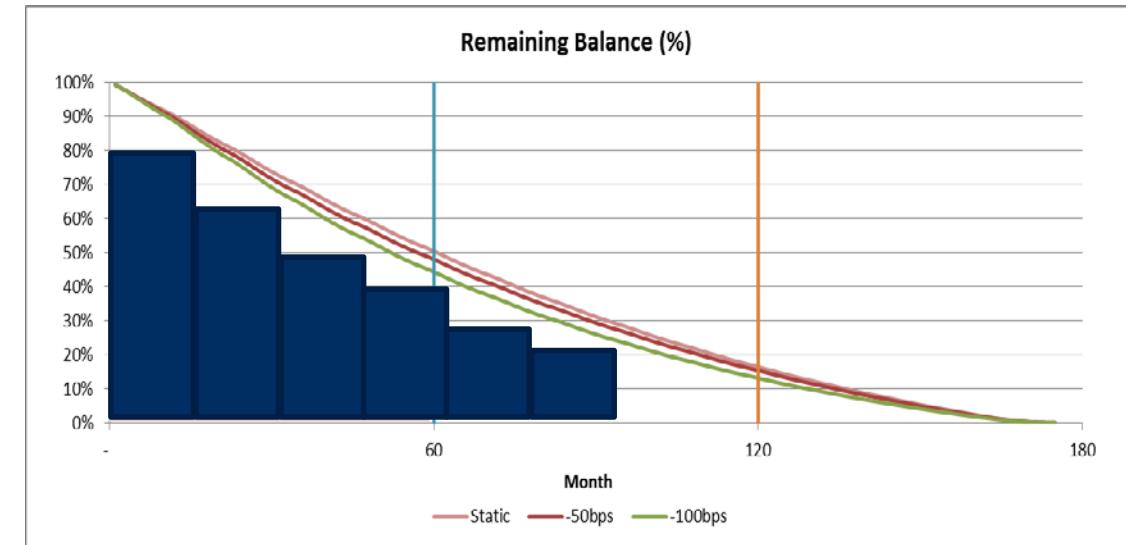
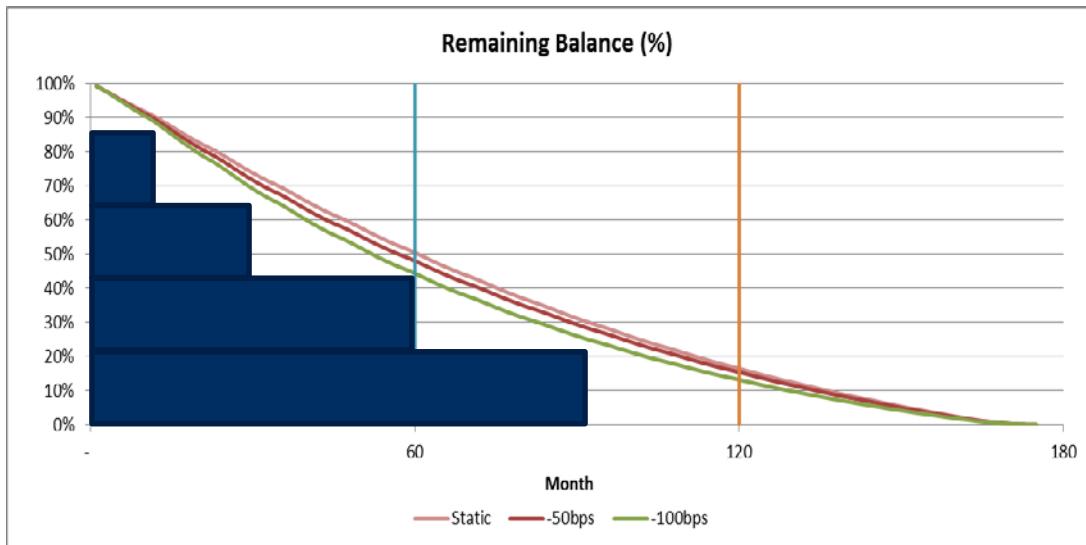
Last-of-Layer Fair Value Hedges (cont.)

- Loan pool vs 5 year last of layer hedge notional



Last-of-Layer – Proposed Changes (cont.)

- In March 2018, the FASB added a Last-of-Layer project to the technical agenda
- More than one possible approach to multiple layers; Vertical or Horizontal stacks
- Alternatively, amortizing swaps will also be allowed



- Actual breach - Permit hedge documentation (inception) to include dedesignation sequencing (specify which layers first); absent documentation breach results in dedesignation of all layers
- Anticipated breach - Partial dedesignation allowed, no sequencing required
- Qualifying assets – All assets in the pool must have contractual maturity after the oldest hedge layer and all prepay feature before the end of the earliest layer
- Exclude non-allocated basis adjustment from CECL
- Present non-allocated basis adjustment as a reconciling item
- Modification of existing hedges would be permitted without dedesignation
- Exposure draft later Q1 2021?

Reminders for Debt or Equity Financings

Debt / Equity Financings

- ASCs 480 → 815 → 470
 - Warrants, convertible/redeemable debt and preferred stock
 - Warrants potentially liabilities/derivatives
 - Conversion/redemption features are derivatives, and potentially require separation and derivative accounting
- Potential beneficial conversion features (BCFs) (sunsetting, ASU 2020-06)
- Financial Institutions Financing Transactions Observations:
 - Typically - Preferred Stock with BCFs, derivative warrants, some convertible debt
 - More recently - Redeemable Preferred Stock (redemption feature not separated, generally)

Questions and answers





Thank you

BREAK



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Loan Modifications

Loan modifications

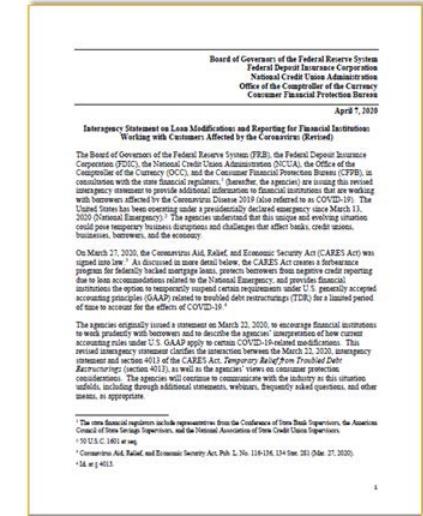
- Modifications
 - Interagency Statement
 - Issued March 22; updated April 7
 - CARES Act
 - Passed March 27
- Re-modifications
 - Interagency Statement
 - Issued Aug. 3



- “Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus”

- Issued March 22; updated April 7
- COVID-19 related loan modifications are not automatically considered TDRs: short term modifications (less than six months) for borrowers current (less than 30 days past due) at inception of modification program are not TDRs

- Past Due Reporting
 - Not expected to designate loans with deferrals granted due to COVID-19 as past due – follow the date stipulated in the legal agreement



	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.

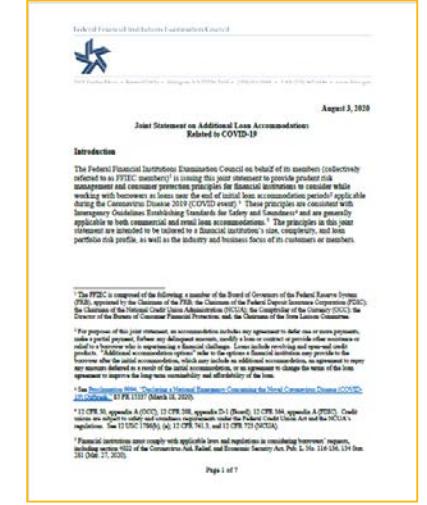
If neither section 4013 of the CARES Act nor the Revised Statement criteria are met, the bank should follow its existing accounting policies to determine whether the modification should be accounted for as a TDR.

<https://occ.gov/news-issuances/bulletins/2020/covid-19-loan-modifications-reference-guide.pdf>

Interagency Statement: Re-modifications



- “Joint Statement on Additional Loan Accommodations Related to COVID-19”
- Issued Aug. 3, 2020
 - Addresses additional modifications made to borrowers who may continue to experience financial hardship at the end of the initial accommodation period.
 - "For example, if the cumulative modifications for a loan are all COVID event related, in total represent short-term modifications (e.g., six months or less combined), and the borrower is contractually current (i.e., less than 30 days past due on all contractual payments) at the time of the subsequent modification, management may continue to presume the borrower is not experiencing financial difficulties at the time of the modification...."
 - Addresses maintenance of appropriate ALLL or ACL, as applicable.



https://www.ffiec.gov/press/PDF/Statement_for_Loans_Nearing_the_End_of_Relief_Period.pdf

Interagency Statement – 3 Paths



CARES – Not a TDR	Interagency – Not a TDR	TDR
<p>Additional loan modification could also be eligible under section 4013.</p> <p>To be eligible, <u>each loan modification</u> must be (1) related to the COVID event; (2) executed on a loan that was not more than 30 days past due as of December 31, 2019; and (3) executed between March 1, 2020, and the earlier of (A) 60 days after the date of termination of the National Emergency or (B) December 31, 2020.</p>	<p>If do not elect to account for under or not eligible for Section 4013</p> <p>For example, if <u>the cumulative mods, in total represent short-term mods (e.g., six months or less combined)</u>, and the borrower is contractually current (i.e., less than 30 days past due on all contractual payments) at the re-mod, lender may continue to presume not experiencing financial difficulty for determining TDR status (i.e., re-modification is not a TDR).</p>	<p>If do not elect to account for under or not eligible for Section 4013 or Interagency</p> <p>Evaluate the subsequent modifications by referring to applicable regulatory reporting instructions and internal accounting policies to determine whether such modifications are accounted for as TDRs under ASC Subtopic 310-40, “Receivables-Troubled Debt Restructurings by Creditors.”</p>

"COVID-19 Supervisory and Regulatory FAQs"

Loan Modification Accounting and Reporting Issues - Updated Dec. 1, 2020

Topic	Question(s)
Nonaccrual Status	<ul style="list-style-type: none">When should a financial institution place a COVID-19 deferred or modified loan on nonaccrual status?
Past Due Status	<ul style="list-style-type: none">In specific cases of payment deferrals, how should financial institutions determine the past-due status of modified loans during and after the deferral period?
Troubled Debt Restructurings (TDRs)	<ul style="list-style-type: none">Does a loan modification need to be "short-term" in duration to be eligible for TDR relief under section 4013 of the CARES Act?
	<ul style="list-style-type: none">Could a financial institution elect not to treat a re-modification, specifically a long-term modification, as a TDR under section 4013 of the CARES Act if the institution previously provided a short-term modification that was not a TDR under the interagency guidance?What is the appropriate accounting treatment for a loan modification that occurs after December 31, 2020? Will examiners approach loan modifications differently after the TDR relief available under section 4013 of the CARES Act expires?

Additional Guidance from the Fed (cont.)



"COVID-19 Supervisory and Regulatory FAQs"

Loan Modification Accounting and Reporting Issues - Updated Dec. 1, 2020

Topic	Question(s)
Risk Ratings	<ul style="list-style-type: none">• How should the effects of the COVID-19 event, and any related loan modifications, be considered in ongoing risk identification and classification of loans?• In what circumstances would examiners criticize a financial institution's credit risk management and internal risk rating system?
Allowance for Credit Losses	<ul style="list-style-type: none">• For loan modifications that did not result in TDRs, how should the credit loss allowance be determined?• Is there a document available that summarizes the existing guidance for COVID-19 related modified loans?

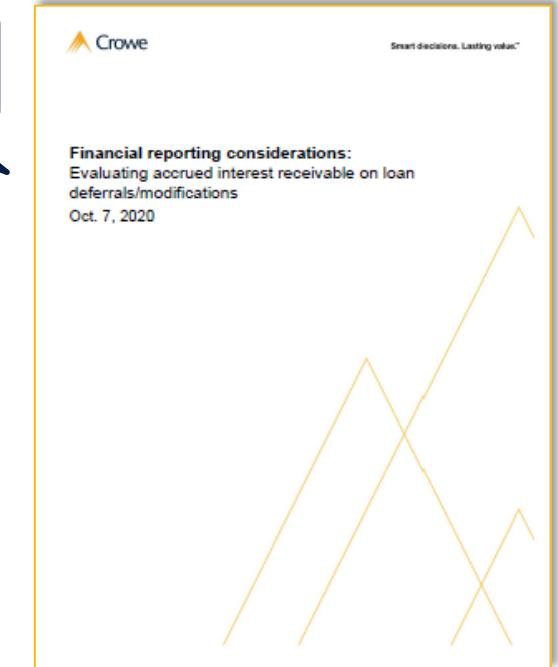
<https://www.federalreserve.gov/covid-19-supervisory-regulatory-faqs.htm>

Nonaccrual and Past Due

- **Interagency Statement**

- Past due
 - Determined in accordance with the revised contractual terms of a loan
- Non-accrual
 - Refer to regulatory reporting instructions and internal accounting policies

Issued
Oct. 7th



- **Crowe's "Evaluating accrued interest receivable on loan deferrals/modifications" (7 pages)**

- Determining past due status
- Accrual versus non-accrual
- Collectibility of accrued interest receivable
- CECL versus incurred
- Disclosures

<https://www.crowe.com/insights/asset/e/evaluating-accrued-interest-receivable-on-loan-deferrals-modifications-pdf>



Paycheck Protection Program (PPP) Developments

PPP Summary



Topic	CARES Act	PPP Flexibility Act (Jun. 5, 2020)
Covered Period	Feb. 15 – June 30, 2020	Feb. 15 – Dec 31, 2020
Covered Expenses	Up to 8 weeks	Up to 24 weeks
Forgivable Expenses	Payroll, employee benefits, mortgage interest, rent, and utilities (max of 25% non-payroll costs)	Increases limitation on non-payroll costs from 25% to 40%
Payback period	Capped at 10 years; Treasury capped at 2 years	Capped at 5 years
Payment deferral	6 months	Until SBA remits to lender any forgiven amounts; Or, for borrowers not applying for forgiveness, until 10 months after conclusion of covered period
Payroll tax deferral	Employer share of certain payroll taxes from Mar. 27 – Dec. 31, 2020 may be deferred, unless employer has a portion of its PPP loan forgiven	Permits payroll tax deferral for employers that are recipients of PPP loan forgiveness

Resources – Reminders and What's New



- Crowe
 - PPP Financial Reporting for Lenders
 - 10 Questions Answered
 - Issued July 8, 2020

<https://www.crowe.com/insights/ppp-financial-reporting-for-lenders-10-questions-answered>

7/8/2020 PPP Financial Reporting for Lenders: 10 Questions Answered | Crowe LLP

PPP Financial Reporting for Lenders

10 Questions Answered

7/9/2020

Introduction

Funding for the Paycheck Protection Program (PPP) ended on June 30, in accordance with the *Coronavirus Aid, Relief, and Economic Security Act* (CARES Act). Late on June 30, the Senate passed [S. 4116](#) by voice vote, to amend the CARES Act to extend the program through Aug. 8. On July 1, the House passed the bill by unanimous consent. On July 4, President Trump signed the bill into law, officially extending the program for another five weeks.

On June 30, the American Institute of CPAs (AICPA) issued three [Technical Questions and Answers \(TQAs\)](#), Section 2130-42-44, to address the following financial reporting questions:

- 42 Classification of Advances Under the Paycheck Protection Program
- 43 Consideration of the SBA Guarantee Under the Paycheck Protection Program
- 44 Accounting for the Loan Origination Fee Received From the SBA

The TQAs were developed by the AICPA's Depository Institutions Expert Panel (DIEP) and cleared by the AICPA's Financial Reporting Executive Committee (FinREC).

PPP loans and the allowance

Q1: Should the lender account for the advance under this program as a loan or as a facilitation of a government grant?

Master Glossary – Loan¹

<https://www.crowe.com/insights/ppp-financial-reporting-for-lenders-10-questions-answered>

5/16

Q&A Section 2130

Paycheck Protection Program (PPP)

The CARES Act, as amended, established the Paycheck Protection Program (PPP). The PPP is a loan designed to provide a direct incentive for small businesses to keep their workers on the payroll. The following questions and answers address certain accounting matters for that program for lenders. Please refer to the [SBA website](#) for detailed information regarding the PPP.

A2 Classification of Advances Under the Paycheck Protection Program

Inquiry: Should the lending institution account for an advance under this program as a loan or as a facilitation of a government grant?

Reply: The instrument is legally a loan with a stated principal, interest, and maturity date. The advance is expected to be reimbursed by the Small Business Administration (SBA) as a guarantee. The institution should account for this instrument as a loan.

A3 Consideration of the SBA Guarantee Under the Paycheck Protection Program

Inquiry: Is the guarantee from the SBA considered "embedded" as opposed to a "freestanding contract" and, thus, can be considered in estimating credit losses on the loan?

Reply: The SBA guarantee exists at the inception of the loan and throughout its life and was not entered into separately and apart from the loan. If the loan is transferred, the guarantee transfers with it. The arrangement does not contemplate the loan existing without the guarantee unless it is ultimately derecognized. The guarantee is not a separate financial instrument and is not a derivative instrument in conjunction with some other transaction and is not legally detachable. As a result, for institutions that have adopted FASB Accounting Standards Update (ASU) No. 2016-13, *Financial Instruments – Credit Losses* (ASC 326-20), *Measurement of Credit Losses on Financial Instruments*, the guarantee would not meet the definition of a freestanding contract as defined by FASB Accounting Standards Codification (ASC) 326-20-20.

FASB ASC 326-20-30-12 requires credit risk revaluations that mitigate credit losses (other than those that are considered freestanding contracts) to be considered in estimating credit losses. The guarantee is considered "embedded" and would, therefore, be considered when estimating credit losses on the loan.

¹ AICPA x CIMA
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For information about the procedure for requesting permission to make copies of any part of this work, please email permissions@aicpa.org with your inquiry. Otherwise, requests should be written and mailed to the Permissions Department, 220 Leigh Farm Road, Durham, NC 27707-4110.

- AICPA
 - Depository Institutions Expert Panel (DIEP)
 - 4 Technical Questions & Answers (TQAs)
 - 3 issued June 30, 2020
 - 1 issued Aug. 28, 2020

<https://www.aicpa.org/interestareas/frc/recently-issuedtechnicalquestionsandanswers.html>

Summary of AICPA PPP TQAs for Lenders



Question (Issue Date)	Question	Answer
2130.42 (June 2020)	<ul style="list-style-type: none">• Is a PPP advance a loan or facilitation of a grant for accounting purposes?	<ul style="list-style-type: none">• The advance should be accounted for as a loan.
2130.43 (June 2020)	<ul style="list-style-type: none">• Should an institution consider the SBA guarantee in estimating credit losses on the loan (that is, is the guarantee embedded)?	<ul style="list-style-type: none">• Yes, consider the guarantee to determine the appropriate expected credit loss.
2130.44 (June 2020)	<ul style="list-style-type: none">• What is the appropriate accounting for the origination fee (including clawback considerations)?	<ul style="list-style-type: none">• Fee should be considered a non-refundable fee, deferred and subject to ASC 310-20; clawback should consider ASC 450.
2130.45 (Aug. 2020)	<ul style="list-style-type: none">• Should a loan determined to meet the criteria for forgiveness be reclassified to “other receivable”?	<ul style="list-style-type: none">• Treat as interest bearing loan through receipt of payment.

- ASC 310-20, “Receivables: Nonrefundable Fees and Other Costs” (FAS 91)
 - When refundable fees become nonrefundable, those fees are in the scope of ASC 310-20.
 - Net with deferred costs
 - Establish a liability for reps and warranties under ASC 450-20, “Loss Contingencies,” for estimated claw-backs (or part of the ACL)
 - Forgiveness and amortization period
 - GAAP requires estimating prepayments at a pool level, based on shared characteristics. Given that the PPP is newly created, lenders might not have a large number of similar loans that share characteristics to estimate the behavior of a pool of loans.
 - GAAP requires estimates of prepayment behavior would consider historical prepayment data including existing and forecasted interest rates, economic conditions, and published mortality and prepayment tables for similar loans which might not be available on PPP loans.

AICPA TQA 2130.44 Accounting for the Loan Origination Fee Received from the SBA

- “SBA will deduct any **EIDL advance** amount you have received from the forgiveness amount remitted to the Lender, as required by section 1110(e)(6) of the CARES Act.”

https://www.sba.gov/sites/default/files/2020-10/PPP%20Forgiveness%20Factsheet-508_r1.pdf

How does deduction of the **EIDL advance** amount impact recognition of PPP fees?

- Deduction of any EIDL advance amounts results in a portion of the PPP loan remaining outstanding with a corresponding impact on fee recognition.
- **EIDL advance** amounts can be up to \$10,000
- EIDL loans differ from **EIDL advances**



Polling Question

What is your institution's current experience related to PPP loan Forgiveness:

- a) We are working with our customers on PPP Forgiveness, our portal is open and we have submitted approved customer applications to the SBA.
- b) We have been communicating with customers about PPP Forgiveness and have processed some forgiveness applications on a pilot basis.
- c) We are waiting for final guidance and have not yet opened our forgiveness portal for our customers.
- d) We did not originate PPP loans, or sold our portfolio, so don't have to worry about PPP forgiveness.



Main Street Lending Developments and ASC 860 Reminders

Main Street Lending Program

- Originate new loans under
 - Main Street New Loan Facility (MSNLF)
 - Main Street Priority Loan Facility (MSPLF)
 - Nonprofit Organization New Loan Facility (NONLF)
- Increase the size of (or "upsize") existing loans under
 - Main Street Expanded Loan Facility (MSELF)
 - Nonprofit Organization Expanded Loan Facility (NOELF)
- Participation
 - Main Street SPV purchases a 95% participation
 - Lenders retain 5%

Program is
scheduled to
end Dec. 31,
2020

<https://www.federalreserve.gov/monetarypolicy/mainstreetlending.htm>

Is the Transfer a Sale?

■ Step One: Is it a “Participating Interest”?

1. Proportionate (pro rata) ownership interest in an entire financial asset
2. All cash flows received (except for servicing or other services), must be divided proportionately based on ownership
3. Each interest holder (including the lead lender) must have the same priority
4. No party has the right to pledge or exchange the entire financial asset unless all agree.

■ Step Two: Is the Transfer a Sale?

1. Assets have been **isolated from the transferor** (i.e., beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership)
2. Transferee has the right to pledge or exchange the assets and no condition both constrains the transferee from taking advantage of its right to pledge or exchange and provides more than a trivial benefit to the transferor
3. Transferor does not maintain effective control over the assets



ABA
consultation
with SEC

- Is a legal opinion required to meet the legal isolation criterion?
- SEC staff did not object to a view that a participating institution has a reasonable basis to conclude that appropriate legal opinion(s) would be given if requested

Other Considerations

- ABA letter limited to legal isolation criteria – it does not address other ASC 860 criteria, which must be considered in the analysis
- Institutions should not analogize to the conclusion in other circumstances

<https://www.aba.com/advocacy/policy-analysis/aba-letter-to-sec-re-assessing-legal-isolation-preclearance>

- Unit of account - whole loan vs participating interest
- Legal isolation
- Potential need for legal opinion(s) if "continuing involvement" exists
 - Continuing involvement includes any involvement with the transferred assets that:
 - permits the transferor (seller) to receive cash flows or other benefits or
 - obligates the transferor (seller) to provide additional cash flows or other assets.
- Transferee (buyer) right to pledge or exchange the financial assets
 - No condition constrains the transferee (buyer) the right to pledge / exchange and provides a more than trivial benefit
- Transferor (seller) does not maintain "effective control" over the assets
 - No agreement:
 - Obligates the transferor (seller) to repurchase
 - Provides the transferor a more-than trivial unilateral repurchase right, or
 - Permits the transferee (buyer) to require the transferor to repurchase at a favorable price that it is probable the transferee will require repurchase.

Applies to all financial asset transfers (e.g., troubled loans, PPP loans, etc.)



FASB Post Implementation Review - CECL

The PIR process is an evaluation of whether a standard is achieving its objective by providing financial statement users with relevant information in ways that justify the cost of providing it.

- Outreach with 117 stakeholders
- Identified four areas for which the Board could consider making certain targeted improvements to address stakeholders' concerns:
 - Issue 1: Accounting for non-PCD Assets
 - Issue 2: Accounting for troubled debt restructurings by creditors
 - Issue 3: Amending the scope of financial assets included in ASU 2016-13
 - Issue 4: Enhancing disclosures for ASU 2016-13.

- General areas of comment
- Preparers:
 - CECL can be costly and complex, in particular for smaller institutions
 - Does not reflect the economics of lending and results in volatile earnings
 - Limitations of quantitative modeling (including due to impact of pandemic) requires qualitative adjustments, which might not match investor expectations
 - Many non-CECL adopters paused adoption activities and do not expect to resume until 2021
- Analysts:
 - Offered mixed feedback on whether CECL was an improvement; some indicated they did not like how model is based on volatile forecasts and suggested an overreliance on third party data used to measure the allowance
 - Some suggested all entities should be subject to the same allowance model
- Academics, Regulators, and FASAC also provided feedback

Issue	Summary of Feedback Received on Specified Issues
Issue 1 – Accounting for non-PCD assets	<ul style="list-style-type: none">Analysts stated the ACL is being double counted in purchase accounting for non-PCD assets and are challenged to understand what purchases qualify for PCD accounting treatment.Some preparers indicated that they find the non-PCD accounting treatment to be unintuitive and complex.
Issue 2 – Accounting for troubled debt restructurings by creditors	<ul style="list-style-type: none">Some preparers indicated more information could be provided on loan modifications, in lieu of the existing TDR designation. Those preparers also noted that TDR designation and disclosure may no longer be meaningful because it overlaps with certain disclosure requirements of Topic 326.
Issue 3 – Scope of financial assets within the scope of ASU 2016-13	<ul style="list-style-type: none">Nonfinancial institutions and FASAC members discussed whether certain or all non-financial institutions should have a scope exception for trade receivables.
Issue 4 – Enhancing disclosures for 2016-13	<ul style="list-style-type: none">Analysts acknowledged CECL provided them with more information than under the incurred loss model but expressed frustration with the current disclosures and noted that they were disappointed with the quality of the information provided because it lacked consistency across different institutions and did not always provide the desired level of detail.Preparers indicated the principles-based measurement model and disclosure requirements make comparability difficult for institutions comparing themselves to peers/competitors.



Other Accounting Considerations

Other Accounting Considerations

Adoption of
CECL

Collectability of
loans or
securities

Sales of HTM
securities

Impairments

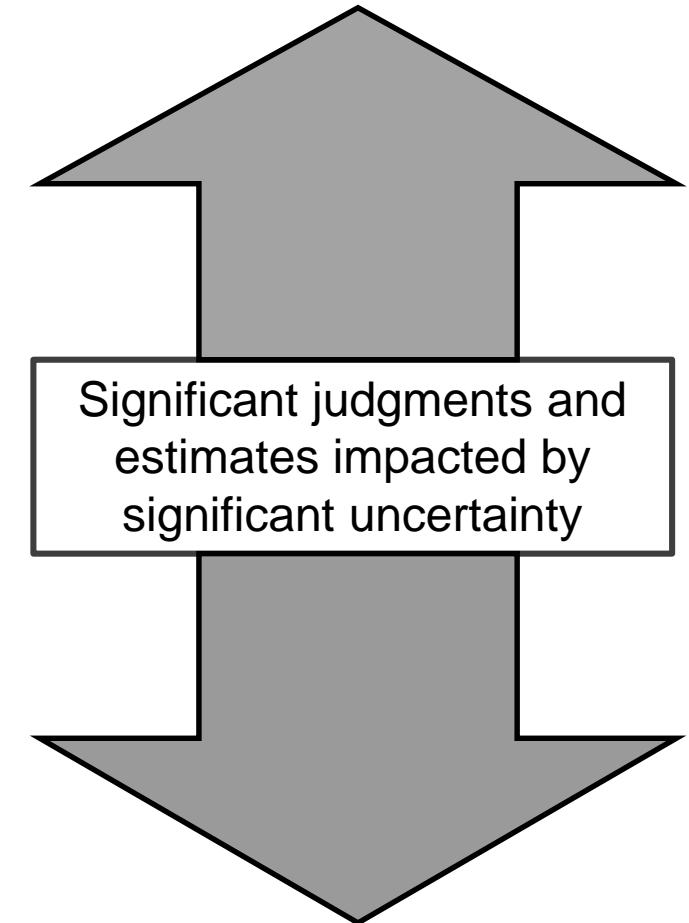
Loan
modifications

Revenue
Recognition

Derivative or
hedging issues

Other

Disclosures



Insights:

<https://www.crowe.com/insights/issues/covid-19-response>

Major standards and clarifications

- Recognition & Measurement, 2019-04 – Clarifications (2020)
- Hedging, 2019-04 – Clarifications (2020)
- Leases, 2019-01 - Clarifications (2020)
- CECL, 2016-13 – CECL (2020) **
 - 2018-19 – Operating leases
 - 2019-04 – Clarifications
 - 2019-05 – Fair value option
 - 2019-10 – Deferral of effective dates
 - 2019-11 – Improvements
 - 2020-02 – SEC SAB 119
 - 2020-03 – Lease term measurement, regaining control
- CECL, Recognition & Measurement and Hedging
 - 2019-04 – Improvements (2020)
- Recognition & Measurement and Hedging (2021)
 - 2020-01 – Equity securities: topics 321 and 323; derivatives

ASUs to adopt or consider early adoption

- 2020-03 – Financial instruments (2020)
- 2020-04 – Reference rate reform (2020)
- 2018-15 – Cloud computing implementation costs (2020)
- 2017-04 – Goodwill impairment testing (2020) **
- 2019-12 – Simplifying income taxes (2021)

ASUs impacting disclosures

- 2018-13 – Fair value disclosures (2020)
- 2018-14 – Pension disclosures (2020)

ASUs to adopt with potentially little impact

- 2018-17 – VIEs under common control (2020)

ASUs for Financial Institutions (Non-PBES)



Major standards and clarifications

- Recognition & Measurement
 - 2019-04 – Clarifications (2020)
- Recognition & Measurement and Hedging (2021)
 - 2020-01 – Equity securities: topics 321 and 323; derivatives
- Hedging, 2017-12 (2021)
 - 2018-2019-04 - Clarifications
- Leases, 2016-02 (2022)
 - 2018-01 - Land Easements
 - 2018-10 – Clarifications
 - 2018-11 – Optional transition method
 - 2018-20 – Narrow scope improvements
 - 2019-01 - Clarifications
 - 2019-10 – Deferral of effective dates
 - 2020-02 – Clarification of PBE definition
 - 2020-05 – Further deferral
- CECL, 2016-13 – CECL & clarifying ASUs (2023)

ASUs to adopt or consider early adoption

- 2020-03 – Financial instruments (2020)
- 2020-04 – Reference rate reform (2020)
- 2018-15 – Cloud computing implementation costs (2021)
- 2019-12 – Simplifying income taxes (2021)
- 2017-04 – Goodwill impairment testing (2023)

ASUs impacting disclosures

- 2018-13 – Fair value disclosures (2020)
- 2018-14 – Pension disclosures (2021)

ASUs to adopt with potentially little impact

- 2018-07 – Non-employee stock compensation (2020)
- 2018-09 – 30 ASC changes (2020)
- 2018-17 – VIEs under common control (2021)

ASUs from Yesteryear: Now Applicable for non-PBES



ASUs Effective for Non-PBE Calendar Year Ends

Non-PBES

Premium Amortization on Purchased Callable Debt (2017-08)

Shortens the amortization period for premiums on purchased callable debt securities to the earliest call date, instead of to the maturity date. Requires the premium to be amortized to the earliest call date; discount continues to be amortized to maturity

12/31/20

Fair Value Measurement Disclosure (2018-13)

Removes, modifies, or adds certain disclosures related to financial instrument transfers and Level 3 instruments, among others.

12/31/20

Codification Improvements (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.

Varies,
with latest
12/31/20

Nonemployee Stock Compensation Simplifications (ASU 2018-07)

Aligns the accounting guidance for nonemployee stock payments with the guidance for employee stock compensation in ASC 718.

12/31/20

Financial Instruments with Down-Round Features & Scope Exception for Certain Mandatorily Redeemable Financial Instruments (2017-11)

Part I – Simplifies the accounting for certain financial instruments with down-round features by eliminating the requirement to consider the down-round feature in the liability or equity classification determination

Part II – Changes the indefinite deferral available to private companies with mandatorily redeemable financial instruments and certain noncontrolling interests to a scope exception, which does not have an accounting effect.

12/31/20



Internal Control Considerations

- For purposes of Part 363, the Interim Final Rule (IFR) allows IDIs to use lower of consolidated total assets as of:
 - December 31, 2019 or beginning of fiscal year ending in 2021

Example: IDI with fiscal year beginning July 1, 2020, and ending June 30, 2021.

Total Consolidated Assets	Lower Of:	Subject to Part 363?
Dec. 31, 2019 - \$485MM Jul. 1, 2020 - \$550MM	\$485MM	No as consolidated assets less than \$500MM as of the applicable calculation date under the IFR.

<https://www.fdic.gov/news/board/2020/2020-10-20-notice-dis-c-fr.pdf>

*Comments due:
Feb. 1, 2020*

Follow-on Interagency IFR (12/2/2020): <https://www.fdic.gov/news/board/2020/2020-11-17-notational-fr-a.pdf>

SEC Final Rule: Amendments to the Definition of Accelerated Filer and Large Accelerated Filer



Public Float Thresholds and Resulting Filing Status

Public Float	Annual Revenues	Filing Status
Less than \$75 million	N/A	
\$75 million to \$700 million	Less than \$100 million	SRC and non-accelerated filer (ICFR attestation not required)
\$75 million to \$250 million	\$100 million or more	SRC and accelerated filer
\$250 million to \$700 million	\$100 million or more	Accelerated filer (not SRC)
More than \$700 million	N/A	Large Accelerated Filer

Revenues for banks include all gross revenues from traditional banking activities. See Section 5110.2 of the Corp Fin Financial Reporting Manual.

What is not changing:

Filing due dates – based on filing status at the end of the fiscal year

Issuers still must establish, maintain, and provide management's assessment on the effectiveness of ICFR and provide CEO and CFO certifications.

For banks with consolidated assets over \$1 billion and subject to FDICIA, auditors must still attest to ICFR under FDICIA requirements

Transition thresholds:

Final rule adds a revenue test and increases transition thresholds for exiting accelerated and large accelerated filer statuses: (1) from \$50 million to \$60 million for exiting accelerated filer status; and (2) from \$500 million to \$560 million for exiting large accelerated filer status

<https://www.sec.gov/rules/final/2020/34-88365.pdf>

The final rule also includes a new “check-box” on the Form 10-K cover page to indicate whether the 10-K includes an auditor attestation on ICFR.



SEC Considerations

- New Subpart 1400 of Regulation S-K
- Requires annual disclosure (and interim disclosure when there is a material change)
- Generally eliminated disclosures that overlap with GAAP or Commission rules
- New disclosures include, among other requirements:
 - New credit ratio disclosures, including explanation of material changes
 - Uninsured deposits (optional to apply regulatory disclosure requirements when institution makes certain additional disclosures)

Effective Date	Mandatory Compliance	Voluntary early compliance?
Nov. 16, 2020	Fiscal years ending on or after December 31, 2021	Yes – if adopted in full

<https://www.sec.gov/rules/final/2020/33-10835.pdf>



Polling Question

With respect to the SEC's final rule revising Guide 3:

- A. We plan to comply prior to the mandatory compliance date.
- B. We expect to comply at the mandatory effective date.
- C. We are currently analyzing the final rule requirements to determine whether we will comply early.
- D. N/A

SEC Final Rule: MD&A, Selected Financial Data, and Supplementary Financial Information



Objective: Eliminate duplicative disclosure and modernize MD&A for the benefit of investors, while simplifying compliance efforts for preparers. Revises Items 301, 302, and 303 of Regulation S-K.

Effective date: mandatory compliance for first fiscal year ending on or after 210 days after publication in the Federal Register; can elect compliance with individual items prior to mandatory compliance (30 days after publication in Federal Register) if disclosure provided conforms to amended item in its entirety.

MD&A (Item 303)	Selected Financial Data (Item 301)	Supplementary Financial Info. (Item 302)
<ul style="list-style-type: none">Provides objective of MD&ACodifies staff guidance on critical accounting estimatesClarifies requirements to discuss material changesProvides option to compare current quarter to preceding quarterRequires disclosure of prospective information that is “reasonably likely” to have a material impactRevises liquidity and capital resources disclosures (including removing contractual obligations table)	<ul style="list-style-type: none">Removes requirement to present five years of selected financial data	<ul style="list-style-type: none">Removes disclosure requirement unless a registrant reports a material retrospective change to comprehensive income for any of the quarters within the two most recent fiscal years (or subsequent interim period)

SEC Final Rule: Updates to Regulation S-K



Objective: Improve the readability of disclosure documents, as well as discourage repetition and the disclosure of information that is not material.

Effective date: Nov. 9, 2020

Disclosure item	New Rule	Current Rule
Item 101 (Business)	<ul style="list-style-type: none">Principles-based approach that focuses on material business developments;Requires disclosure of human capital resources (if material);	<ul style="list-style-type: none">Five year timeline of business developments (Three years for SRCs)
Item 103 (Legal Proceedings)	<ul style="list-style-type: none">Encourages hyperlinking to footnote disclosure of legal proceedings; \$300,000 environmental proceedings threshold (unless other threshold deemed appropriate within certain limits)	<ul style="list-style-type: none">Material legal proceedings with \$100,000 threshold for environmental proceedings
Item 105 (Risk Factors)	<ul style="list-style-type: none">Material risk factorsRequires summary when risk factor disclosure exceeds 15 pages“General” risk factors must be at end of disclosure	<ul style="list-style-type: none">Significant risk factors

SEC Final Rule: Disclosures about Business Acquisitions and Dispositions



Objective: Provide more meaningful guidance to determine: 1) whether investors need information about acquisitions and dispositions of businesses and 2) the content of required disclosures.

Link to rule text: <https://www.sec.gov/rules/final/2020/33-10786.pdf> and <https://www.sec.gov/rules/final/2020/33-10762a.pdf>

Effective date: Jan. 1, 2021 but voluntary compliance is permitted in advance.

Topic	New Rule	Current Rule
Income test	Requires both a pretax income component and a revenue component to be met to trigger significance, using the lower of the two ratios to determine significance.	Includes a pretax income component only.
Investment test	For acquisitions and dispositions of businesses only, allows comparison of investment in tested business to the issuer's average worldwide market capitalization over a specified period of time, when available.	Compares investment in subsidiary or business to issuer's total assets as of the prior fiscal year-end.

SEC Final Rule: Disclosures about Business Acquisitions and Dispositions



Topic	New Rule	Current Rule
Maximum acquiree annual audited historical periods	Two	Three
Requirements for financial statements of acquired businesses in registration and proxy statements	Financial statements of an acquired business are not required once the acquisition has been consolidated for nine months or a full fiscal year, depending on significance.	Financial statements of an acquired business are required when the financial statements have not been previously filed or are of major significance.
Pro forma information	Revises presentation of pro forma information and allows optional “management’s adjustments” to show estimated and expected acquisition or disposition synergies and dis-synergies.	Expected synergies and dis-synergies typically prohibited.
Significance threshold for dispositions that require pro forma financial information	20 percent	10 percent

SEC Final Rule: Disclosures about Business Acquisitions and Dispositions



Financial Statement Periods Required		
Highest Result of Any of the Three Significance Tests*	Annual financial statements (audited)	Interim financial information (unaudited)
Greater than 20% but not 40%	One year	Most recent interim year-to-date period (prior year comparative is not required)
Greater than 40%	Two years	Most recent interim year-to-date period and comparative prior period

*: Includes income, investment, and asset tests.



From the PCAOB

- Conversations with Audit Committee Chairs (July 31)
 - Summarizes common themes from conversations with audit committee chairs during the first six months of 2020
 - Addresses increased:
 - Risks from remote work
 - Communications with Auditors

 PCAOB
Public Company Accounting Oversight Board

Conversations with Audit Committee Chairs: COVID-19 and the Audit

Overview

As part of the Public Company Accounting Oversight Board's (PCAOB) strategic goal of enhancing transparency and accessibility through proactive stakeholder engagement, the Board has committed to engaging more directly and more often with audit committees. In 2019, we reached out to nearly 400 audit committee chairs of U.S. issuers whose audits we inspected and offered them the opportunity to speak with us. We reported out on those discussions in *Conversations with Audit Committee Chairs: What We Heard & FAQs*.

We have continued this outreach to audit committee chairs during our 2020 inspections. Given the unprecedented challenges for auditors, audit committees, and issuers created by the COVID-19 pandemic, we asked audit committee chairs how they are thinking about the effect of COVID-19 on financial reporting and the audit as they perform their oversight duties.

What we've heard has depended largely on how the pandemic has affected different industries and sectors. While most audit committee chairs said the effect of COVID-19 on the audit had not been significant to date, others shared that the magnitude of the impact of COVID-19 quickly surpassed their expectations. Most audit committee chairs indicated that they are contending with new or increased risks associated with the effects of COVID-19. Audit committee chairs from across industries have identified a wide range of topics that present increased risk—both related to financial reporting and the audit as well as other issues—that they are focusing on at this time. For many, these include cybersecurity, employee safety and mental health, going concern, accounting estimates, impairments, international operations, and accounting implications of the Coronavirus Aid, Relief, and Economic Security (CARES) Act.

This document summarizes certain of the common themes we heard from audit committee chairs related to the effects of COVID-19 and the audit through the first half of the year. We plan to share general takeaways from our audit committee conversations at the end of the year. Please note that the PCAOB does not require or necessarily endorse what we heard from audit committee chairs. We share their perspectives to offer increased transparency into our activities and to further our ongoing efforts to provide audit committees with timely and useful information.

This document represents the views of PCAOB staff and not necessarily those of the Board. It is not a rule, policy, or statement of the Board. The PCAOB does not set standards for, or provide authoritative guidance on, audit committee conduct.

<https://pcaobus.org/Documents/Conversations-with-Audit-Committee-Chairs-Covid.pdf>

- New reports introduce Part I.A and Part 1.B:
- Part I.A: Deficiencies that were of such significance that [the PCAOB] believes the firm, at the time it issued its audit report(s), had not obtained sufficient appropriate audit evidence to support its opinion(s) on the issuer's financial statements and/or ICFR.
- Part I.B: Deficiencies that do not relate directly to the sufficiency or appropriateness of evidence the firm obtained to support its opinion(s) but nevertheless relate to instances of non-compliance with PCAOB standards or rules.
- Part II – Observations Related to Quality Control: Criticisms of, or potential defects in, the firm's system of quality control. Part II deficiencies are not publicly disclosed when the report is first issued.



The image shows the cover of the "Guide to Reading the PCAOB's New Inspection Report". The cover is blue with the PCAOB logo at the top right. The title "Guide to Reading the PCAOB's New Inspection Report" is centered in white text. Below the title is a red horizontal bar.

Contents

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Part II: Observations Related To Quality Control	5
Appendix A: Firm's Response to the Draft Inspection Report	5

Overview

The Public Company Accounting Oversight Board (PCAOB or Board) Inspects registered audit firms to assess each firm's compliance with PCAOB standards and rules as well as other applicable regulatory and professional requirements. Our Inspections are designed to review portions of a firm's issuer audits and evaluate elements of a firm's system of quality control. The PCAOB provides each firm inspected with a report, which summarizes any deficiencies identified during the inspection.

Until now, the format of PCAOB inspection reports has remained largely unchanged since the Board's first reports were issued more than fifteen years ago. Through our external engagement activities, we have received feedback that our report could more effectively meet the needs of our stakeholders. To address what we heard, and to advance our strategic objective to provide clearer and more useful information to the public, the Board and staff developed a new Inspection report that:

- Streamlines the content to enhance readability for investors, audit committee members, preparers, audit firms, and the general public;
- Utilizes new charts and graphs to make the information more digestible and accessible;
- Reduces the amount of technical and boilerplate language; and
- Provides access to a new, refined document that describes general, non-firm specific information about what and how we inspect, rather than repeating such information in each report.

In addition to these changes, our reports include some new information, such as a classification system for audits with deficiencies presented in Part I.A. For annually inspected firms, we now also provide PCAOB inspection data for the three most recent inspection years. Furthermore, while we continue to highlight deficiencies we identify in the audit work to support the firm's opinion(s) on an issuer's financial statements and/or ICFR, our new reports include a new section discussing certain other instances of non-compliance with our standards or rules.

This document provides an overview of each section of the report, highlighting the key information we communicate and changes from our previous report format.

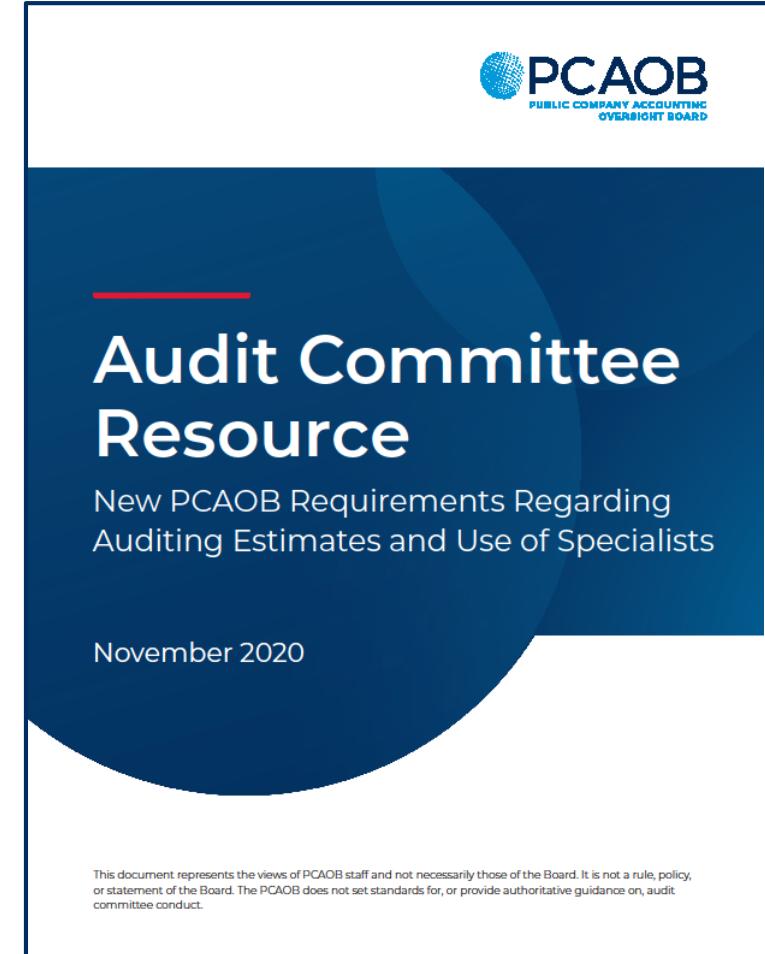
The 2018 inspection reports for the largest six U.S. firms are the first reports to be issued under the new format. 2018 reports for other annually inspected firms will also follow the new format. All triennially inspected firms' 2019 inspection reports will utilize a similar new format, but may not include all of the same data as the annually inspected firms due to the frequency of inspections and the size and nature of the firms. The new report format does not apply to PCAOB inspections of auditors of broker-dealers.

PCAOB Developments – Audit Committee Tool on New Auditing Standards



The PCAOB's new requirements on auditing estimates and using the work of specialists are effective for audits of fiscal years ending on or after Dec. 15, 2020.

- Provides audit committees:
 - Overview of the new requirements
 - Key takeaways from the new requirements
 - Questions to consider asking auditors



The image shows the cover of a document titled "Audit Committee Resource" from the PCAOB. The cover is dark blue with a white circular graphic on the right side. The PCAOB logo is at the top. The title "Audit Committee Resource" is in large white font. Below it, the subtitle "New PCAOB Requirements Regarding Auditing Estimates and Use of Specialists" is in a smaller white font. The date "November 2020" is also visible. At the bottom, a small note states: "This document represents the views of PCAOB staff and not necessarily those of the Board. It is not a rule, policy, or statement of the Board. The PCAOB does not set standards for, or provide authoritative guidance on, audit committee conduct."

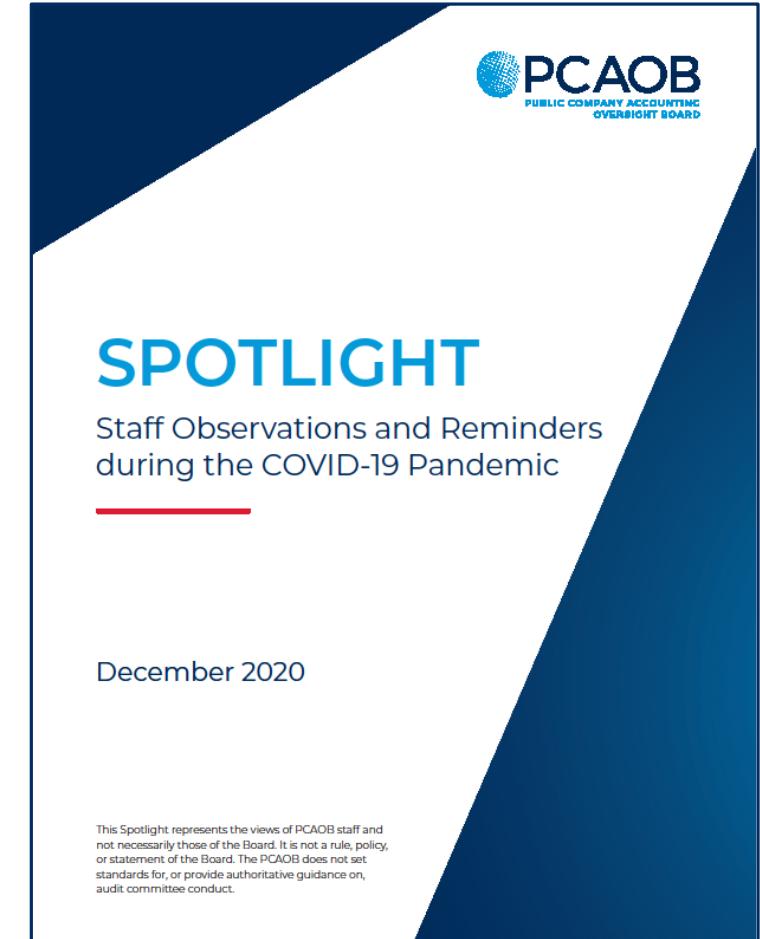
<https://pcaobus.org/Documents/Audit-Committee-Resource-Estimates-Specialists.pdf>

PCAOB Developments – Spotlight: Staff Observations and Reminders during the COVID-19 Pandemic



“This Spotlight highlights select staff observations from recent inspections of reviews of interim financial information and audits. It also shares important reminders for auditors to consider as they plan and conduct audits and reviews of interim financial information in the current environment.”

<https://pcaobus.org/news-events/news-releases/news-release-detail/pcaob-issues-covid-19-spotlight-provides-insights-and-reminders-for-auditors>





From the CAQ

- Provides high level financial reporting considerations of the pandemic:
 - Audit implications
 - Accounting and disclosure implications
 - Audit Committee considerations
- Outlines various additional resources

<https://www.thecaq.org/caq-covid-19-resource/>

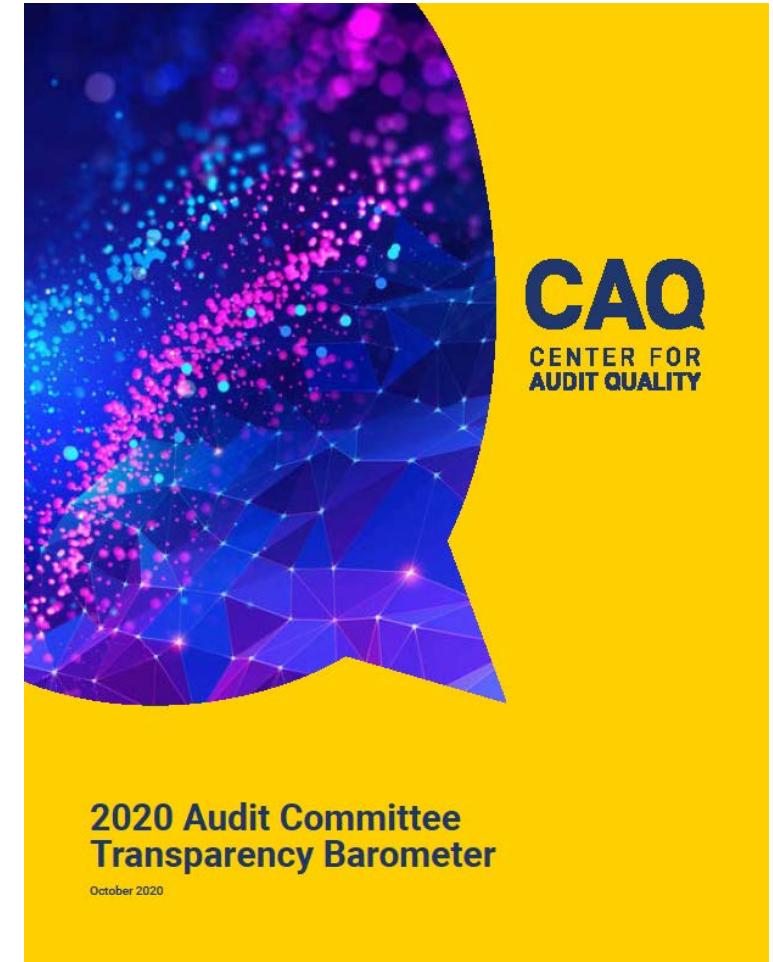


From the CAQ: Audit Committee Transparency



- 2020 Update - summarizes trends in voluntary audit committee disclosures in the S&P 500 including areas of:
 - Positive developments
 - Concerns
 - Opportunities for improvement
- Provides various live examples of effective disclosure (including COVID-19 examples)

<https://publication.thecaq.org/2020-barometer/introduction/>



Questions and Responses



Rick Childs, CFA, CPA

Partner
Advisory Services
+1 (317) 706-2654
rick.childs@crowe.com



Matthew Schell, CPA, CFA

Partner
National Office
+1 (202) 779-9930
matthew.schell@crowe.com



Sydney Garmong, CPA, CGMA

Partner
National Office
+1 (202) 779-9911
sydney.garmong@crowe.com



Chris Moore, CPA

Partner
Accounting Advisory
+1 (502) 326-3996
chris.moore@crowe.com



Mark Shannon, CPA

Partner
National Office
+1 (202) 779-9921
mark.shannon@crowe.com



Thank you