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Hot topics: Takeaways from the 2020 AICPA National Conference on Banks and Savings Institutions (updated)

Dec. 14, 2020

Contents

Conference overview

UPDATED

The 45th annual American Institute of Certified Public Accountants (AICPA) National Conference on Banks and Savings Institutions was held from Sept. 14 through 16, 2020. For the first time in its history, the conference was held only virtually. In addition, given the rapidly changing accounting and financial reporting environment due to the COVID-19 pandemic, the AICPA offered a one-day “year-end update” on Dec. 1, 2020. Conference topics focused largely on current events that are significantly affecting the banking industry, both from an economic outlook and from an ever-changing accounting landscape. As expected, the current public health emergency caused by the COVID-19 pandemic influenced the remarks of nearly every presenter.

Many banks continue to struggle with the adoption of the current expected credit loss (CECL) standard. Banks’ models have been challenged to incorporate volatile and uncertain economic forecasts during the current COVID-19 pandemic. In many cases, these models were calibrated based on data primarily driven from the Great Recession (e.g., housing price index). The strength of the housing sector thus far in the current recession, combined with the rapid spike in unemployment and the large amount of government stimulus, has resulted in model outputs that might not be representative of management’s expectation of losses over the life of the assets being measured.

Conference panelists also discussed the accounting and reporting implications of the *Coronavirus Aid, Relief, and Economic Security Act* (CARES Act), including Section 4013, which granted a limited exemption from applying troubled debt restructuring (TDR) accounting to COVID-19-related loan modifications, and Section 4014, which granted temporary relief on the CECL standard’s adoption date. Accounting considerations related to the Small Business Administration’s (SBA) Paycheck Protection Program (PPP) and the Federal Reserve’s (Fed’s) Main Street Lending Program (MSLP) were also discussed at length.

Current projects and rules published by the Securities and Exchange Commission (SEC) and the Public Company Accounting Oversight Board (PCAOB) were highlighted by conference panelists. Other topics included the cessation of the London Interbank Offered Rate (LIBOR), comments from the newly elected chair of the Financial Accounting Standards Board (FASB), and considerations related to asset impairment.

The 2021 conference is slated for Sept. 20-22, 2021, online and – we are hopeful – on-site at the Gaylord National Resort and Convention Center in National Harbor, Maryland.

We hope you find this summary useful.

Economic updates

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The September conference offered two distinct sessions featuring Marci Rossell, former CNBC chief economist, and Mark Palim, vice president and deputy chief economist at Fannie Mae. Both Rossell and Palim provided their unique perspective on the current economic landscape and the ripple effects caused by COVID-19, as well as their outlook on what the near future and a recovery might look like. The December session included an update by Jim Glassman, head economist for commercial banking at JPMorgan Chase.

The public health response to the COVID-19 pandemic resulted in an unprecedented global economic shutdown. Stock markets declined worldwide by around 40 percent, and gross domestic product (GDP) declined around the globe by an average of 10 percent. Rossell kicked off the conference noting we have moved from flattening the curve to fighting the virus and stated her belief that “the COVID-19 pandemic will permanently change how Americans will live, work, and play.” In December, Glassman commented that the economic downturn related to COVID-19 is more akin to a natural disaster than it is to a routine business cycle.

Record unemployment levels at the beginning of the crisis caused a significant decline in consumer confidence levels.

However, Rossell stated, “it is not government lockdowns that depressed economic activities; it’s the fear of returning to regular spending activities.” Of note, Sweden and Denmark experienced the same percentage decline in GDP at 9 percent from 2019 despite each country’s governments applying entirely opposite approaches as a response to the pandemic. While long-term pre-COVID-19 household saving rates in the United States have historically averaged 8 percent, they reached a record high level of 18 percent during the pandemic.

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Overall, U.S. GDP has declined by 10 percent compared to 2019; in essence, the country is operating at about 90 percent of 2019 levels, while massive government intervention has kept GDP from declining further. Glassman noted in the December session that the pandemic resulted in a $1 trillion reduction to U.S. GDP. Despite the decrease in GDP, Glassman commented that the current value of the U.S. stock market is approximately one and a half times the current U.S. GDP, the highest ratio on record. Glassman believes that this phenomenon is related not to near-zero interest rates but to significant technological advances and the expansion of international businesses, which allow for growth in U.S. equities to be funded from international business opportunities.

Conference takeaway: Dr. Marci Rossell, former CNBC chief economist, said she believes that the COVID-19 pandemic will permanently change how Americans will live, work, and play.

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Unemployment
History has not offered much insight to thinking about this downturn as past recessions have resulted from economic forces and not public health forces. Generally, peaks in unemployment occur in the later stages of an economic recession. However, the loss of jobs occurred almost simultaneous with the beginning of the current recession. During COVID-19, the unemployment rate peaked in excess of 14 percent at the beginning of the recession and has since declined to 8 percent, which is lower than it was at the worst of the Great Recession. In October 2020 the unemployment rate further declined to under 7 percent.

As seen in the following chart, the leisure and hospitality industries have been the most affected by the pandemic.

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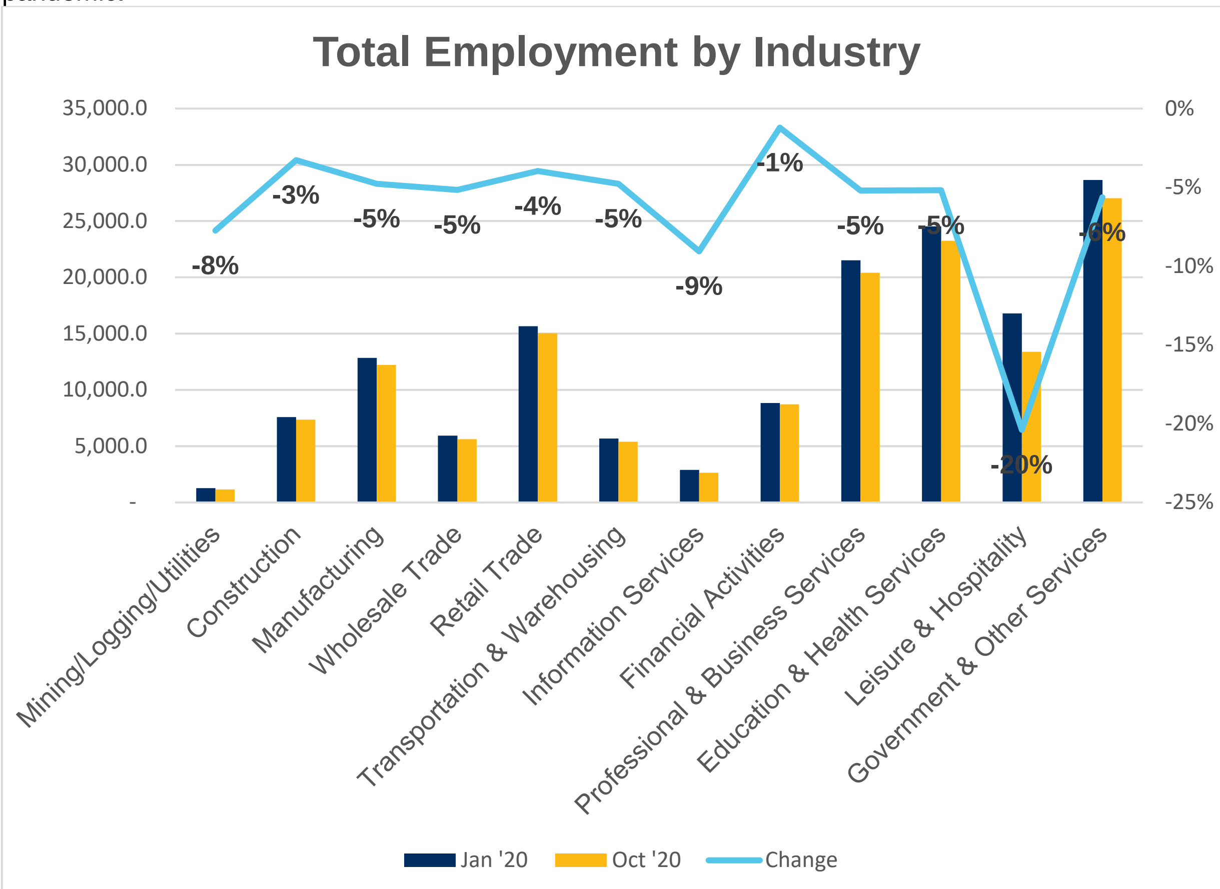

Source: U.S. Bureau of Labor Statistics.

Fannie Mae’s Palim expressed his expectation for a leveling out of higher unemployment for some time and for jobs to evolve over time, causing a change in the mix of job availability and forcing laborers to adapt and learn new skills or trades. Palim also noted that the special pandemic programs (i.e., government stimulus) are scheduled to terminate at the end of the year.

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Real estate

Despite the pandemic, the housing market remains strong and home sales are increasing. According to Fannie Mae’s October housing forecast, new and existing single-family homes for 2020 are expected to increase by 3.6 percent over 2019 levels, with new single-family home sales driving the increase.[1]

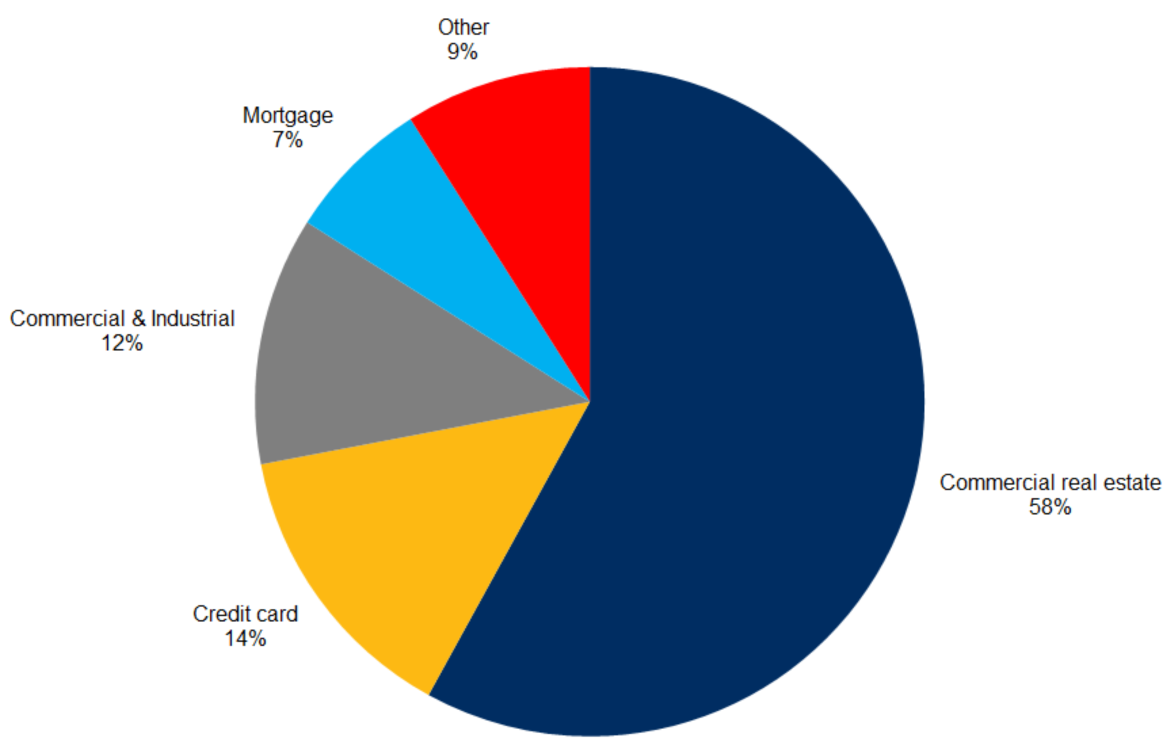
Rossell and Palim both indicated that home prices are expected to stay resilient in the near term. They explained that once Americans learned that COVID-19 was going to be a long-term issue, they made different decisions on how to live, where to live, and how much space they wanted to accommodate a work-from-home environment, causing an acceleration from people who would have been buying in the next few years. Further, the low-rate environment has potentially led future homebuyers to enter the market earlier than they would have absent the COVID-19 crisis.

Although housing demand is high, supply is somewhat constrained by homeowners concerned about having an open house and letting strangers into their homes. Combined with increasing material costs and workforce challenges, the imbalance between supply and demand has caused residential real estate prices to increase.

[1] https://www.fanniemae.com/media/36231/display

Both Rossell and Palim believe that the commercial real estate (CRE) market is more concerning and will likely be the hardest-hit sector as a result of the pandemic. This sentiment was also shared by bankers in attendance. A poll of the audience (see the following chart) on which class of loans was expected to be particularly affected given current economic conditions showed 58 percent of attendees believed CRE loans would be the most affected, followed by credit card loans (14 percent), commercial and industrial loans (12 percent), mortgage loans (7 percent), and other loan types (9 percent). The CRE market will likely need to be reconfigured to meet the demand of the new economy and how people work in the future. Commercial rent contracts will likely need to be renegotiated when lease agreements expire, as businesses adapt to the changing work-from-home landscape.

Which loan class will be the most affected by COVID-19?



Source: Audience poll results during the Sept. conference.

Outlook

Rossell and Palim believe housing will lead the recovery and expect interest rates to remain at historic lows for the foreseeable future. Palin expressed we are in a slow part of the recovery – unemployment is anticipated to remain elevated for some time and eventually drop to 6 percent as jobs continue to evolve through the crisis and workers retrain in new job paths. While uncertainty remains as to the timing and speed of a recovery, both economists believe the worse is probably behind us.

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In the December session, Glassman noted that the availability of a vaccine has been acknowledged by the equity markets and that the second (or third) wave of the COVID-19 outbreak is unlikely to have a significant impact on the U.S. stock market. Glassman further commented that he believes that business will face significant challenges in managing supply chains virtually, especially supply chains with international components. As such, it was Glassman's belief that once the medical event is behind us, business travel will resume in a similar manner as before the COVID-19 pandemic.

Current expected credit loss standard

CECL is finally here. Over the course of the conference, various speakers representing bankers, regulatory agencies, auditing firms, the SEC, and the PCAOB held various discussions on their considerations and observations from the first year of adoption.

Observations and challenges
Bank representatives and auditors reported that based on observations of 100 of the largest CECL adopters, an average increase in the allowance for credit losses (ACL) by 35 percent was reported as a result of adoption; yet they also specified there was a wide range of adoption impacts. Similarly, the Office of the Comptroller of the Currency (OCC) acting Chief Accountant Jeffrey Geer expressed the impact of adopting CECL on OCC-regulated banks was "as expected," with an average increase of 34 percent on the ACL. Geer also noted that there was an outsized impact for banks that carried a high volume of purchased loans. Geer indicated some banks had a decrease in the allowance on day one, and he believes that OCC supervision personnel will work to understand the reasons that entities with similar portfolios had different allowance allocations.

Crowe observation: Although not presented at the conference, the following chart illustrates the day one CECL impact on retained earnings (R/E) at Jan. 1,2020, and four-quarter lookback, for public company banks.

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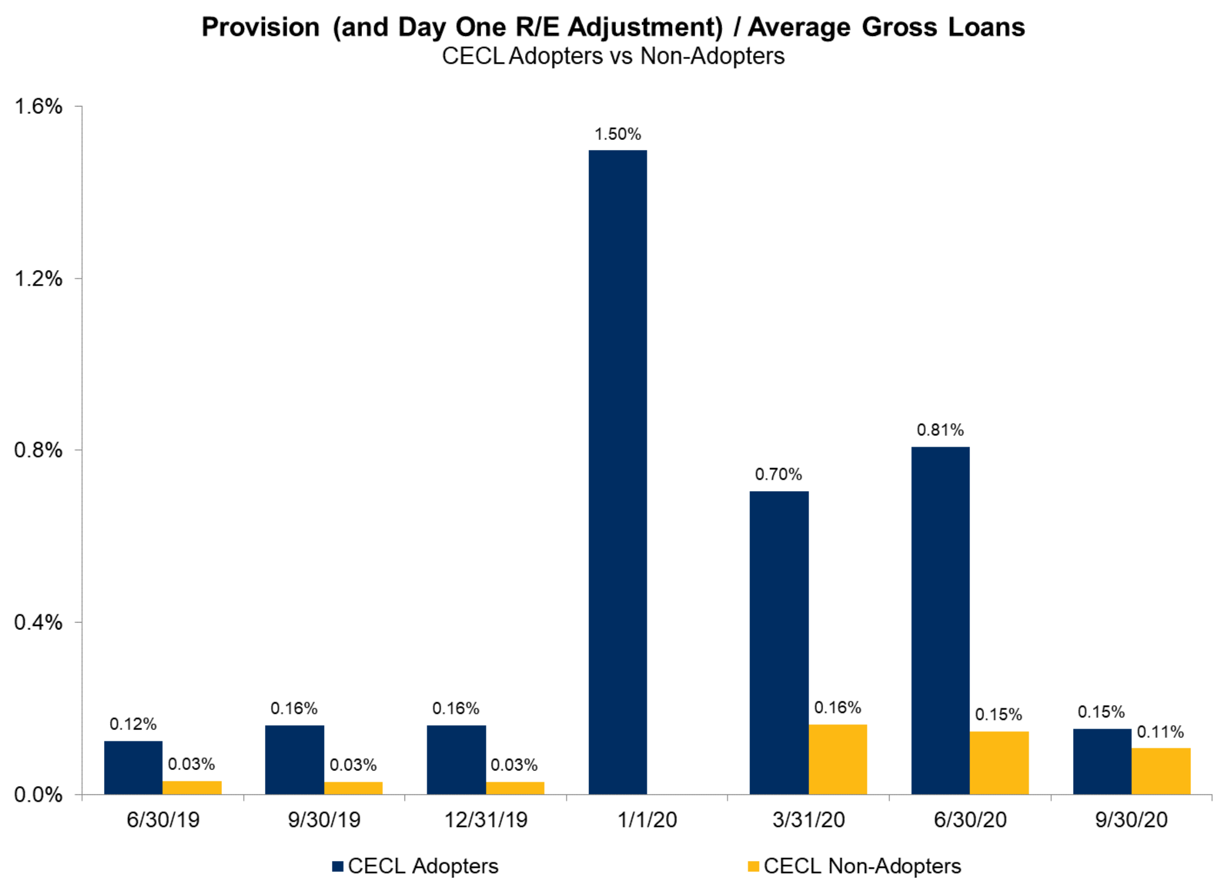

Source: S&P Global Market Intelligence and Crowe analysis, Sept. 30, 2020.

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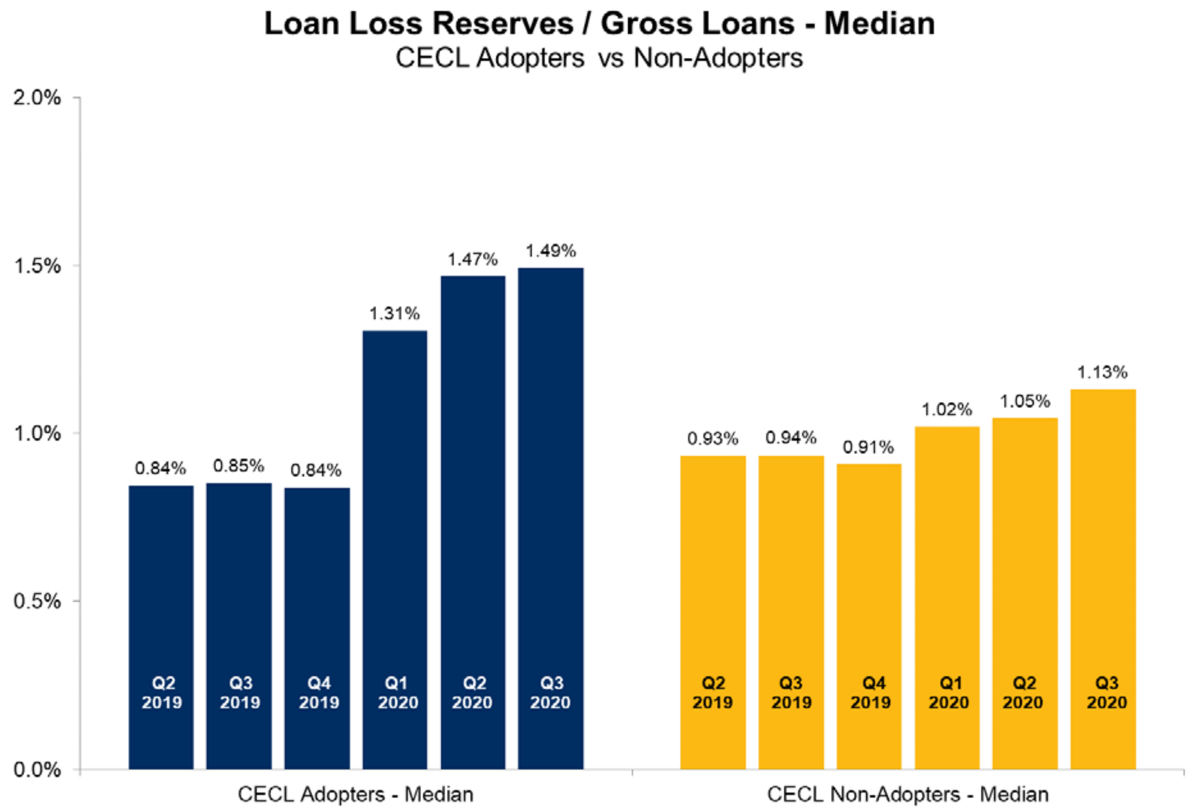


Source: S&P Global Market Intelligence and Crowe analysis, Sept. 30, 2020.

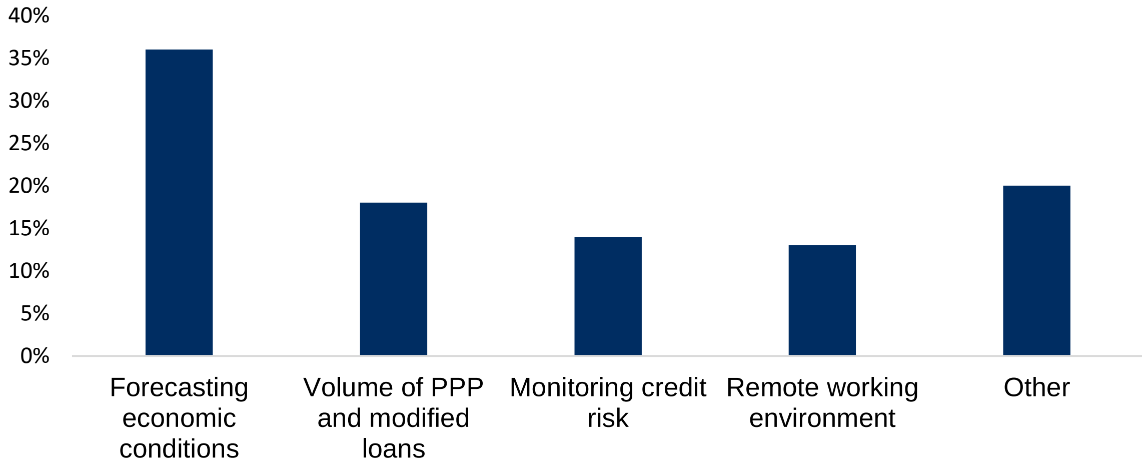
Conference panelists indicated that many ACL models were created based on what happened during the Great Recession, using unemployment and the house price index. Because of the pandemic, these ACL models are experiencing out-of-range economic variables not seen during the prior crisis and are significantly underperforming. Additionally, government stimulus is unprecedented and hard to model. A key lesson learned is that models and processes need to be more agile and able to support on-demand analysis and sensitivity testing to adapt the model to different conditions.

Bank representatives shared some of the additional challenges experienced in connection with CECL adoption:

- Effectiveness of models. Extreme economic circumstances challenged the effectiveness of many models built for CECL that were primarily driven by declines in home price index.
- Developing a reasonable and supportable forecast. As it is, developing a forecast and interaction with the model is the most difficult part of applying the standard. The pandemic significantly added to forecast uncertainty, especially in estimating the impacts of announced and potential fiscal stimuli as well as the impacts of loan modification efforts.
- Rapidly changing economic conditions. Economic forecasts changed significantly during the first quarter and into April 2020. Significant pressure was placed on banks to communicate which economic conditions were captured in their estimate and to provide expectations of how the changing economic environment would affect second quarter results.

A survey of the audience on the most difficult COVID-19-related challenges provided the following results:

Which of the following challenges related to COVID-19 has been most difficult?



Source: Audience poll results during the September conference.

Advice to nonadopters

Early adopters, auditors, and regulators offered additional implementation advice to future adopters:

- Banks should run their model through stressed scenarios so they can determine if or when the model will "break" in advance, which will allow for the development of a contingency plan.
- Banks should spend more time on documentation in advance. Often, banks prepare documentation concurrently with running the models. This is not advisable – adopters need to be able to demonstrate the end-to-end thought process to other stakeholders.
- Banks should not ignore unique pockets of portfolios that might warrant separate segmentation or other considerations.
- Bank regulators advised that there is no indication that CECL is going away anytime soon. Banks adopting CECL in 2023 should not count on substantive changes to the accounting model.
- Banks should not forget that held-to-maturity securities are also subject to CECL.
- Banks should keep in mind that more parallel runs are best.

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December update

In the December session, the OCC's Geer noted that the allowance coverage ratios as of Sept. 30, 2020, were largely in line with his expectations. The Fed's Lara Lylozian commented that the impact of CECL on common equity tier 1 (CET-1) capital ratios was on average less than 1%, adjusting for the impact of regulatory capital relief for the adoption of CECL.

Federal Deposit Insurance Corp. (FDIC) Chief Accountant John Rieger reminded participants that there is not a requirement nor an expectation to refile prior period call reports for banks that elected relief from CECL under Section 4014 of the CARES Act and will adopt CECL in their December 2020 call reports, effective as of the beginning of the fiscal year.

Conference takeaway: Banks that elected relief from CECL under Section 4014 of the CARES Act are not required to restate and refile previously issued call reports for the adoption of CECL as of the beginning of their most recent fiscal year.

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Crowe observation: Although not discussed in the December session, Crowe believes that, based on discussion with SEC staff, registrants that elected to delay the adoption of CECL under Section 4014 of the CARES Act are allowed but not required to restate any quarterly information presented in Form 10-K. Similarly, issuers are allowed but are not required to restate prior comparative quarters in 2021 Form 10-Q filings. While there is no requirement to revise 2020 quarters in either Form 10-K or in 2021 Form 10-Q, the SEC staff would encourage registrants to do so. In addition, the SEC staff suggests disclosures on those decisions.

Geer remarked that the OCC has not issued a matter requiring attention (MRA) related to the adequacy of the ACL but has made written recommendations on the level of documentation maintained to support management's decisions on the ACL levels. Specifically, Geer noted that robust documentation should be maintained on key assumptions, forecasts, and the overall estimation process, especially related to COVID-19 adjustments, both qualitative and quantitative in nature.

The December session included a panel consisting of AICPA Depository Institution Experts Panel members. In this session, Wells Fargo's Mario Mastrantoni commented that the CECL estimate has become more art than science due to COVID-19 and that banks must comprehensively understand what is in their models so they can appropriately generate qualitative overlays to address the impact of the pandemic not captured in current modeling.

Looking ahead

Bank representatives noted they are seeing positive migration out of loan deferrals and modifications, but many remain skeptical as to whether this represents an actual recovery or a temporary phenomenon. While forecasts might show improvement and from a quantitative basis might suggest reserve releases are warranted, the expectation is that banks will support more of the reserve through qualitative factors until this uncertainty resolves. Panelists reiterated the importance of considering internal control over financial reporting (ICFR) over modifications and model adjustments to have well-defined performance monitoring plans and to understand model sensitivity to changes in various inputs.

FASB resources

FASB representatives informed the audience the FASB is currently assessing costs and benefits to institutions that have already adopted CECL. The speakers then expressed their opinion on common questions received. Of note, FASB staff said that credit loss expense related to the allowance for unfunded commitments can be included either in provision for credit losses or in noninterest expense.

As part of its Post-Implementation Review (PIR), the FASB plans to hold a roundtable on accounting for credit losses in late 2020 or early 2021. This roundtable will help the FASB board members determine how best to serve entities adopting CECL in 2023 and determine any necessary changes for those entities that have already adopted.

Conference takeaway: The FASB noted that the income statement geography of credit loss expense is not addressed in the standard. As such, the provision for credit losses on unfunded commitments can be included either in the provision for credit losses or in noninterest expense.

COVID-19-related accounting topics

Loan modifications
At the federal banking agencies' chief accountants panel, speakers reiterated that unlike the CARES Act Section 4013, Interagency Statement (IAS) guidance dated April 7, 2020, did not suspend TDR accounting. Geer stated that it may be difficult to continue to assert that loan modifications greater than six months in the aggregate are not experiencing financial difficulty. However, they further emphasized that regardless of the TDR evaluation method, banks still have to risk rate and estimate allowances appropriately on these loans. Rieger noted that, with respect to pandemic-related loan modifications not accounted for as TDRs under regulatory or CARES Act guidance, institutions still must ensure that interest accrual and allowances for credit losses/allowances for loan and lease losses are appropriate. Agencies are still encouraging banks to work with borrowers, despite the fact that the pandemic is not going to be short term in nature. Agencies view modifications, when done prudently, as positive actions.

The agencies' representatives were asked if it is permissible to continue to accrue interest as long as the loan is not past due because it is in a COVID-19-related workout situation, and they responded that interest that is not expected to be collected should not continue to accrue. Regulators further advised that banks need to continue to look at information other than days past due to determine collectibility. Ultimate collectibility trumps reported past due status. They proceeded to recommend that for loans coming out of a deferral going onto another accommodation, banks might want to have a policy that indicates they are going to stop accruing interest at the time of the additional accommodation rather than waiting for another 90 days.

Crowe observation: Although not presented at the conference, the following charts illustrate the amount of loans modified and in deferral.

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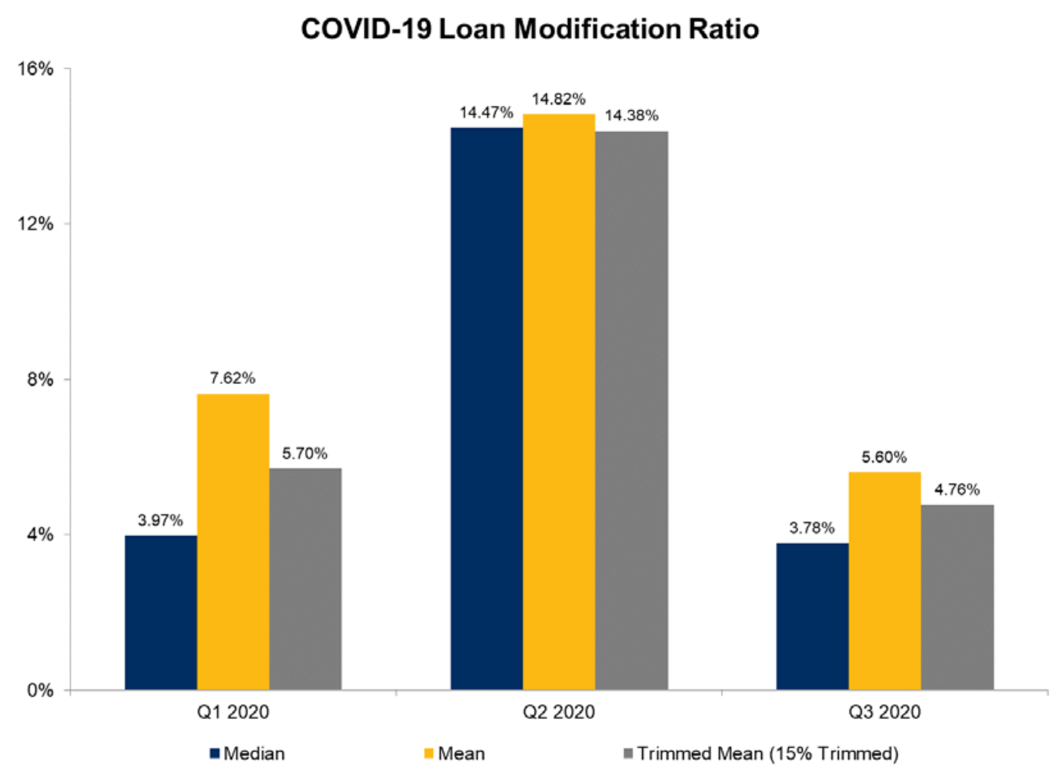

Source: S&P Global Market Intelligence and Crowe analysis, Sept. 30, 2020.

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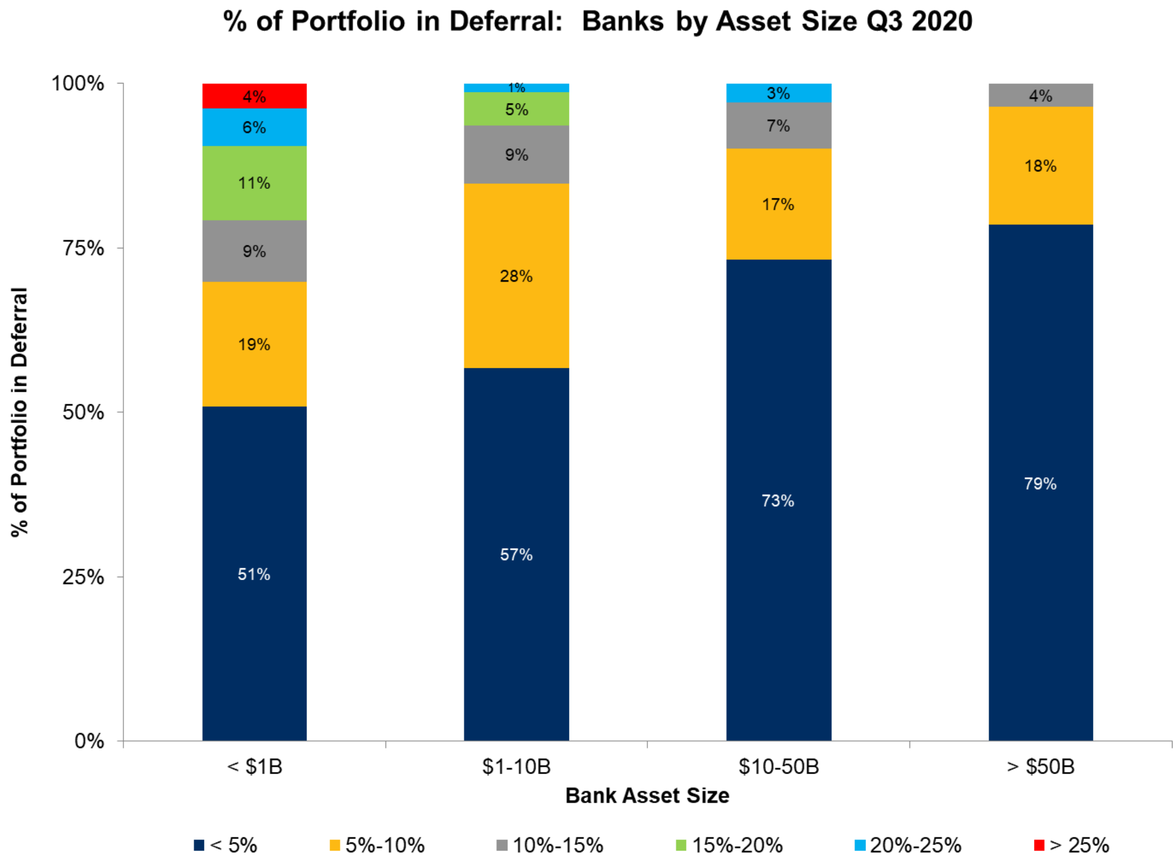

Source: S&P Global Market Intelligence and Crowe analysis, Sept. 30, 2020.

At the Community Banks Hot Topics session, panelists commented that institutions can use the CARES Act Section 4013 for any qualifying loan modification, regardless of whether the loan was modified previously under Section 4013 or the IAS. As a reminder, the ability to qualify for a loan modification under the CARES Act requires an objective evaluation of whether the criteria are met. Panelists also indicated banks are closely monitoring levels of customers requesting a second deferral and have indicated that the evaluation of a borrower before being granted a second deferral is much more stringent than the evaluation before the first deferral. Banks are actively monitoring loan deferrals and trying to determine how much reliance can be placed on past due status. Given the significant amount of payment deferrals granted, banks are looking at 30, 60, and more than 90 days past due in a much different manner than they did during pre-COVID-19 times. In today's environment, a deferred loan that is 15 or 30 days past due would be cause for much more concern. The OCC's Geer noted that banks should be looking at past due status immediately when loans get out of modification status and should likely begin to have concern when loans become 30 days past due.

Conference takeaway: Institutions can use the CARES Act Section 4013 for any qualifying loan modification, regardless of whether the loan was modified previously under Section 4013 or the IAS. As a reminder, the ability to qualify for a loan modification under the CARES Act requires an objective evaluation of whether the criteria are met.

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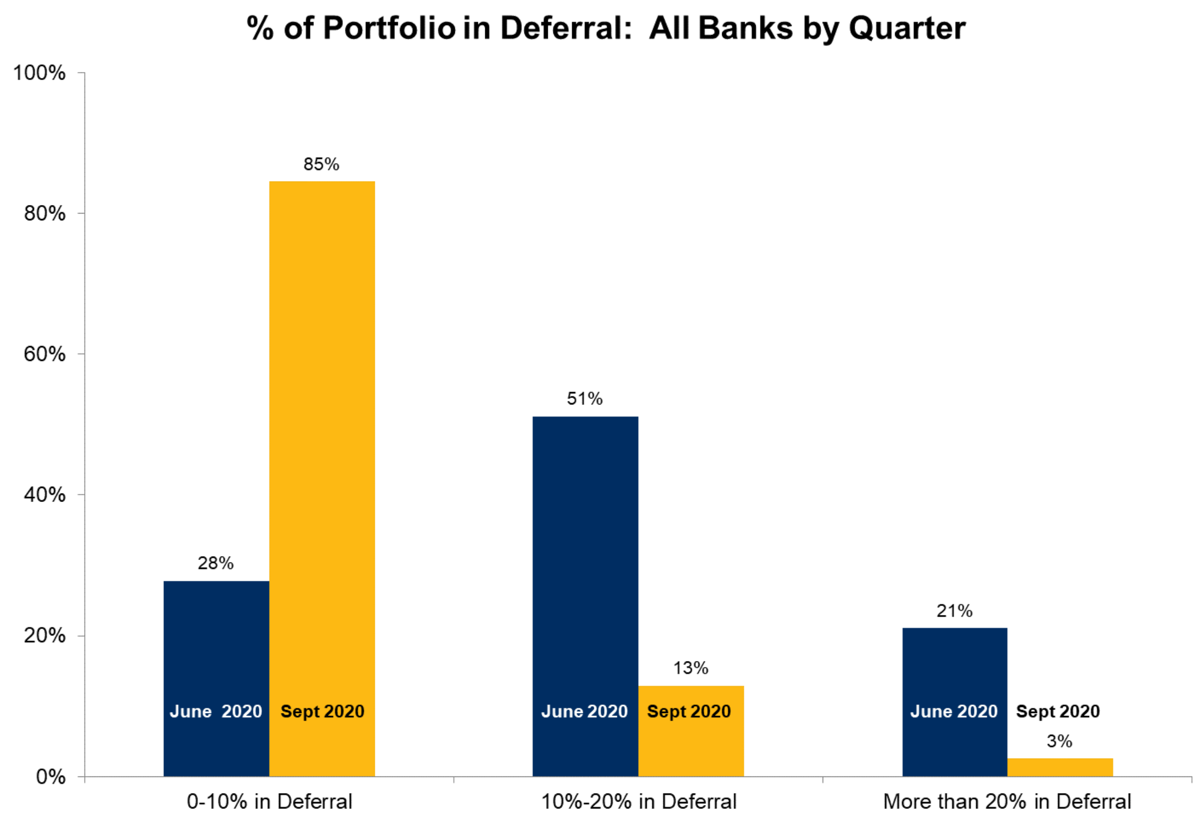
At the December conference, panelists in the loan modifications session noted that the amount of loans on deferral status has declined sharply. The following chart shows the change in loans on deferral from June to September 2020.



Source: S&P Global Market Intelligence and Crowe analysis, Sept. 30, 2020.

Of note, the Fed's Lylozian commented that with respect to interest income on loans with deferred repayment terms, it may no longer be appropriate to rely solely on mechanical triggers for nonaccrual treatment.

Conference takeaway: The Fed's Lylozian commented that with respect to interest income on loans with deferred repayment terms, it may no longer be appropriate to rely solely on mechanical triggers for nonaccrual treatment.

The OCC's Geer emphasized the August 2020 Federal Financial Institutions Examination Council "Joint Statement on Additional Loan Accommodations Related to COVID-19,"[2] which noted, among other things, that a loan's modification date can be used in lieu of a program modification date when determining whether a loan qualifies for TDR relief under the April 7 IAS. As banks might be modifying loans into 2021, this observation provides a path to use the prior IASs as long as the cumulative modifications for a loan are all COVID-19 event related and in total represent short-term modifications (e.g., six months or less combined) – in addition to the loan being current,

On Dec. 1, 2020, the Fed posted a set of frequently asked questions related to loan modifications.[3]

[2] https://www.ffiec.gov/press/PDF/Statement_for_Loans_Nearing_the_End_of_Relief_Period.pdf
[3] https://www.federalreserve.gov/covid-19-supervisory-regulatory-faqs.htm

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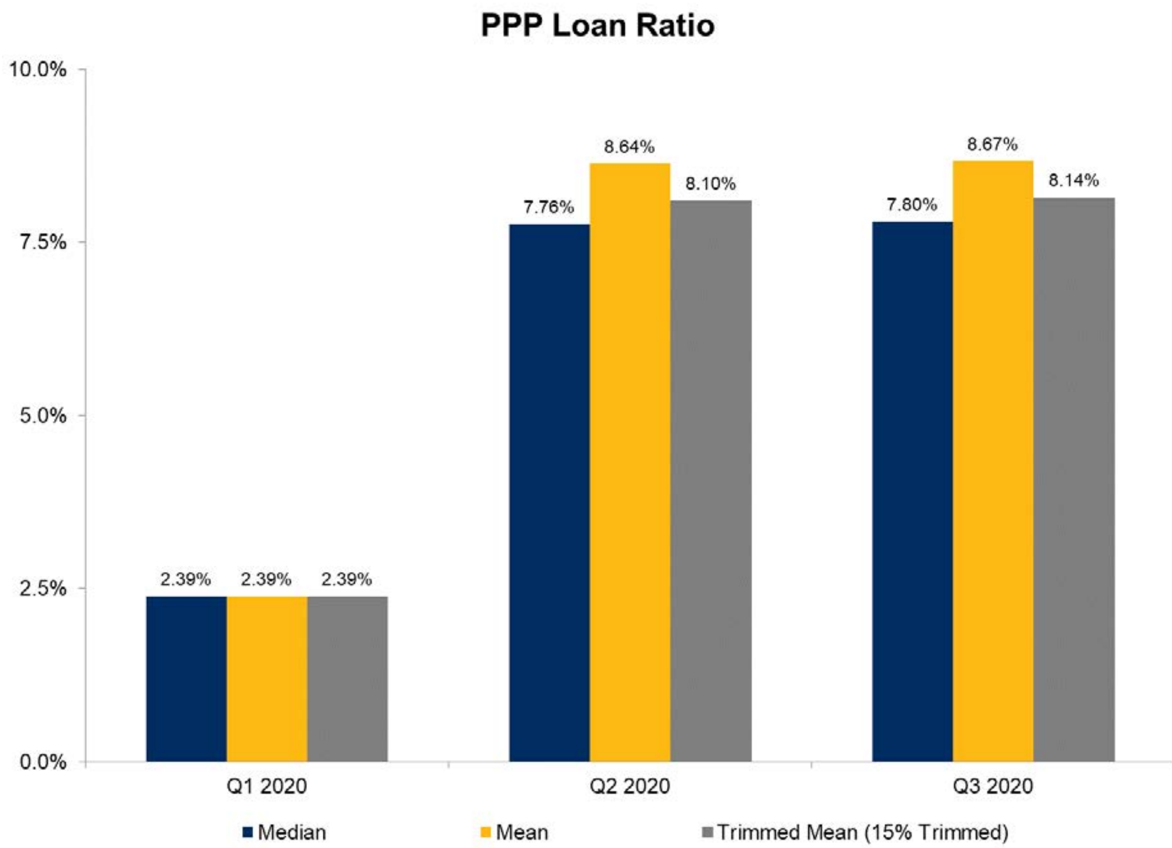
Accounting for PPP loans
More than four out of five community banks (82 percent) participated in the PPP during the second quarter of 2020. At the Chief Accountants' panel, speakers expressed their surprise at the volume of PPP loans at community banks, which are summarized in the following graphs (updated for third quarter reporting):



Source: S&P Global Market Intelligence and Crowe analysis, Sept. 30, 2020.

Crowe observation: In its "Quarterly Banking Profile" covering the second quarter of 2020, the FDIC noted loan growth was mostly driven by the PPP:

> "Total loan and lease balances increased by $33.9 billion (0.3 percent) from the previous quarter, led by C&I loan portfolio, which rose by $146.5 billion (5.8 percent). The rise in C&I loan portfolio was attributable to the implementation of the Small Business Administration-guaranteed Paycheck Protection Program (PPP), with $482.2 billion in PPP loans on banks' balance sheets at the end of the quarter. The increase in total loan and lease balances was partially offset by consumer loans, which includes credit cards (down $67.1 billion, or 3.8 percent)."

Panelists reminded banks that there are financial, legal, and reputational risks from originating a high level of PPP loans. They further advised banks to consider *Bank Secrecy Act*, anti-money laundering, fair lending, and other regulations and whether they have capacity to review documentation submitted for forgiveness, to prepare the paperwork for the SBA, and to service these loans without disrupting other processes and controls. Rieger verified that PPP loans confirmed by the SBA as eligible for forgiveness should continue to be accounted for as loans until the obligation has been settled in full by the SBA.

Conference takeaway: Rieger verified that PPP loans confirmed by the SBA as eligible for forgiveness should continue to be accounted for as loans until the obligation has been settled in full by the SBA.

At the Community Banks Hot Topics session, panelists discussed the AICPA Depository Institution Expert Panel (DIEP)'s four Technical Q&As in Section 2130 on the PPP – three issued on June 30 and one on Aug. 28, 2020 – and summarized the following topics:

- AICPA TQA 2130.42, "Classification of Advances Under the Paycheck Protection Program." The Q&A clarifies that a loan advanced under the PPP is legally a loan with stated principal, interest, and maturity date, for which institutions are expected to collect amounts due from either the borrower or the SBA. As a result, institutions should account for the instruments as loans rather than a facilitation of a government grant.
- AICPA TQA 2130.43, "Consideration of the SBA Guarantee Under the Paycheck Protection Program." Pertaining to an inquiry about the SBA guarantee being considered "embedded" as opposed to a "free-standing contract" and thus being considered in estimating credit losses on the loan, the Q&A clarified the guarantee is not legally detachable from the contract. As a result, the guarantee is considered embedded and would, therefore, be considered when estimating credit losses on the loan.
- AICPA TQA 2130.44, "Accounting for the Loan Origination Fee Received From the SBA." The Q&A clarified that upon funding the loan, the fee should be accounted for as a nonrefundable loan origination fee under FASB Accounting Standards Codification (ASC) 310-20, "Receivables – Nonrefundable and Other Costs." As a result, it should be offset against loan origination costs and deferred and amortized oved the contractual life of the loan as an adjustment yield. Panelists observed the TQA simply refers to generally accepted accounting principles (GAAP), which includes estimating prepayments to shorten the life. The consensus of the DIEP was estimating prepayments to shorten the life would be challenging given the lack of history and bespoke nature of these loans to create pools required under GAAP to estimate prepayments. The TQA also refers to the guidance in FASB ASC 450, "Contingencies," related to fees that may be subject to clawback or not yet received.
- AICPA TQA 2130.45, "Accounting for Loan Repayment or Forgiveness by the SBA." The Q&A addresses whether the lender should reclassify some or all of the borrowed funds, upon submission to the SBA for forgiveness, from a loan to an other receivable. Because the SBA is considered a counterparty to the contract, payments received from the borrower or the SBA prior to the maturity of the loan are considered prepayments. As such, the loan should be classified as an interest-bearing loan through receipt of payment from the borrower or the SBA.

Focus on future examinations

Regarding upcoming examinations, panelists indicated examiners would exercise flexibility and place additional focus on how management has considered the risks and response to the pandemic, and they provided the following considerations and points of focus:

- Examiners will place emphasis on how management has considered the risks and responses to COVID-19 as well as the reasonableness of management's response to the pandemic and, as new information becomes available, how management has evaluated and addressed the impact of the pandemic on longer-term business strategies.
- Examiners will assess whether identified weaknesses are a result of external factors beyond management's control as opposed to a result of a deficiency in management's risk management or governance processes.
- Examiners will place emphasis on whether institutions are making accurate and timely assessments of asset quality. Regardless of whether TDRs are modified under the interagency statement guidance or CARES Act Section 4013, there needs to be a focus on properly downgrading loans as soon as institutions learn that the modification alone will not contribute to the borrower's financial performance improvement.
- Examiners will not criticize institutions for working with borrowers in a safe and sound manner, even if those loans ultimately develop weaknesses or are subsequently downgraded. However, examiners will be focused on whether institutions are making accurate and timely assessments of asset quality.
- Examiners will place special attention on how customers are emerging out of forbearance and whether a second deferral or modification is going to be necessary.
- Related to CECL, in addition to assessing the adequacy of qualitative adjustments, examiners will pay special attention to macroeconomic inputs, specifically, identification of the assumptions underlying the macroeconomic forecast and how these assumptions are used. This would include consideration of how the government stimulus has been factored into the model or estimate and the related impact.
- Examiners also will be focused on whether appropriate governance practices and effective challenge and review continue to occur while institutions remain in a remote work environment.

Conference takeaway: Examiners will not criticize institutions for working with borrowers in a safe and sound manner, even if those loans ultimately develop weaknesses or are subsequently downgraded. However, examiners will be focused on whether institutions are making accurate and timely assessments of asset quality.

COVID-19 operations impact

Chief Financial Officer (CFO) and Chief Accounting Officer (CAO) panelists indicated that technology issues were considered one of the largest challenges for their bank operations to overcome in adapting to the COVID-19-induced remote work environment. These challenges included institutions maintaining the necessary inventory of laptops, maintaining sufficient VPN licenses to allow a significant number of employees to work remotely, and transitioning from paper to electronic evidence. While panelists believed this transition to be a positive change, they have experienced challenges in documenting proper evidence surrounding their precision of review controls. Panelists have placed additional emphasis on ensuring segregation of duties remains in place despite changes in roles. Some panelists expressed concern over the remote work environment causing them to lose that "community bank feel" and being able to regain that feeling, while others were concerned about the impact on employee morale, indicating increased communication and meetings are taking place as a response.

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FDICIA Part 363 and other regulatory reporting relief
At the December conference, the FDIC's Rieger highlighted that, on Oct. 20, 2020, the FDIC issued an interim final rule (IFR), "Applicability of Annual Independent Audits and Reporting Requirements for Fiscal Years Ending in 2021,"[4] that provides relief from complying with Part 363 of the *Federal Deposit Insurance Corporation Improvement Act* (FDICIA). Under the guidance of the FDIC rule, banks are allowed to measure their total assets as of either Dec. 31, 2019, or Jan. 1, 2021, for purposes of complying with Part 363 for their 2021 fiscal year. Among other things, Part 363 introduces increased independence requirements for a bank's external auditor and attestation of internal controls by the external auditor. The IFR was posted in the Federal Register on Oct. 23, 2020, and is effective Oct. 23, 2020, through Dec. 31, 2021, unless extended by the FDIC. The comment period closed Nov. 23, 2020.

In the IFR, the FDIC retained a reservation of authority for banks that exceed total asset triggers due to mergers and acquisitions. Banks that exhibit this fact pattern should first perform a self-assessment and then contact their regional FDIC accountant. The use of this reservation of authority by the FDIC will be communicated in writing to the bank.

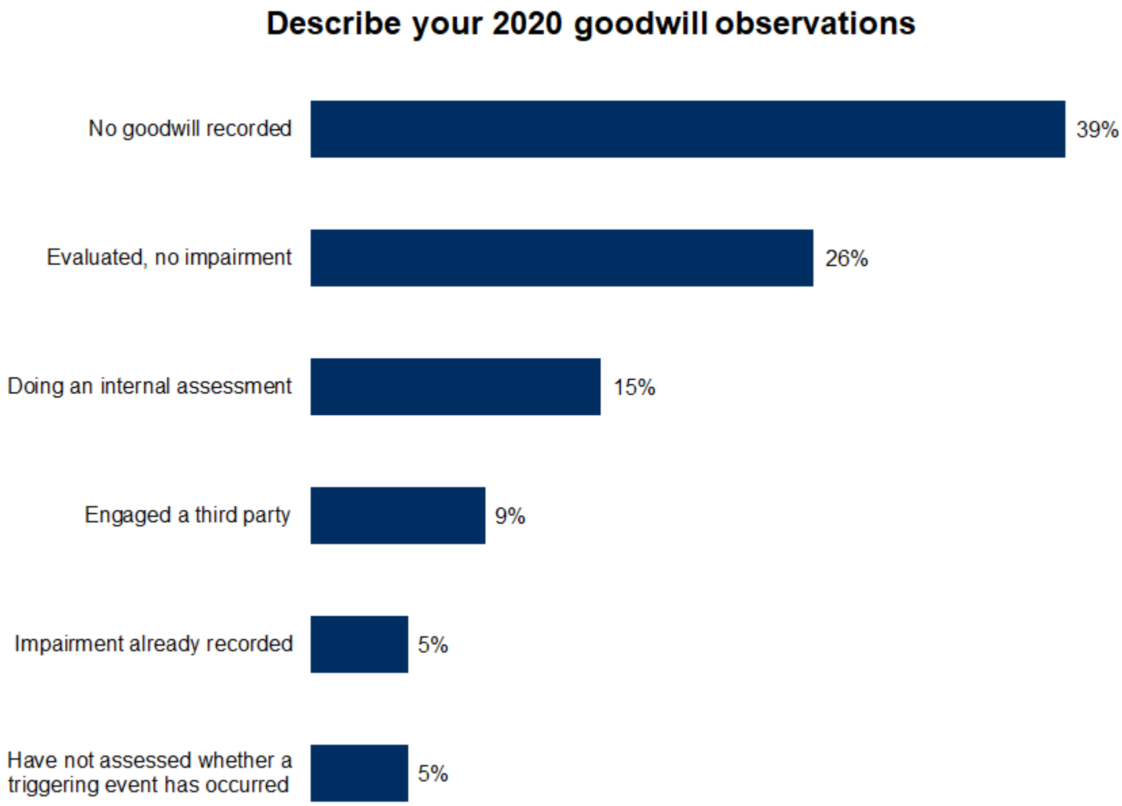
A separate IFR, "Temporary Asset Thresholds,"[5] was issued by the Fed, the FDIC, and the OCC on Nov. 20, 2020. The IFR was published in the Federal Register and effective on Dec. 2, 2020. The IFR provides other temporary forms of relief, including raised asset thresholds for community bank leverage ratio (CBLR) availability, use of the small-bank call report (Form 051), frequency of examinations, and management official interlocks. Comments are due Feb. 1, 2021.

Other banking industry hot topics

Asset impairment
All large bank representatives indicated they have done some form of goodwill impairment tests in both the first and second quarters of 2020, and they expect these to continue to be performed quarterly for the foreseeable future. They expressed that their biggest challenge is their evaluation related to assumptions in estimates, particularly cash flows, discount rate, and how aggressive or conservative an approach to take with the assumptions. A couple of representatives commented on their interaction with auditors when it came to the quantitative approach, noting there were contentious conversations regarding certain estimates such as control premium and cash flows.

[4] https://www.fdic.gov/news/press-releases/2020/pr20114.html
[5] https://www.fdic.gov/news/press-releases/2020/pr20127.html

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



Source: Audience poll results during the September conference.

Panelists noted they have seen an increase in mortgage servicing rights (MSR) impairment. Both the drop in interest rates and increase in delinquencies have placed downward pressure on MSR values. Panelists encouraged banks to plan for extra time to work through valuations this year, including documentation of management's review and related controls.

LIBOR transition

LIBOR will continue to be published through the end of 2021. Panelists discussed LIBOR transition preparedness, citing that LIBOR is currently referenced by $400 trillion in contracts. While panelists agreed the accounting impact is not expected to be material, the biggest challenge is identifying a complete inventory of all contracts.

Regulators indicated institutions should expect to see an increase in supervisory activities during 2020 and 2021 focused on evaluating LIBOR transition preparedness, particularly for institutions with significant LIBOR exposure or less developed transition processes. Regulators further stated supervisory focus will be on the identification of efforts to include fallback language or use alternative reference rates in new contracts, operational preparedness, and consumer protection.

Conference takeaway: Institutions should expect to see an increase in supervisory activities during 2020 and 2021 focused on evaluating LIBOR transition preparedness, particularly for institutions with significant LIBOR exposure or less developed transition processes.

SEC updates

Remarks from SEC staff were largely centered around rules and regulations newly issued by the Division of Corporation Finance (Corp Fin), updates on accounting consultations submitted to the Office of the Chief Accountant (OCA), and disclosure considerations around CECL and COVID-19.

The SEC has been very active over the past 12 months, issuing a number of rules related to accelerated filer status, updates to required disclosures, and a revision to Industry Guide 3 (statistical disclosures by bank holding companies).

Rulemaking	Selected highlights

Accelerated Filer and Large Accelerated Filer definitions
 	
Rule 12b-2 under the *Securities Exchange Act of 1934* (Exchange Act)
	• The amendments tailor the types of issuers that are included in the categories of accelerated and large accelerated filers.
	• Excludes from accelerated filer (AF) and large accelerated filer (LAF) definitions an issuer that is eligible to be a Smaller Reporting Company (SRC) and had annual revenues of less than $100 million in the most recent fiscal year.
	• Increases the public float transition exit thresholds:
	  o From $50 million to $60 million to exit AF status
	  o From $500 million to $560 million to exit LAF status
	• Adds a revenue test to the transition thresholds for exiting both AF and LAF status.
	• Adds a check box to the cover pages of annual reports on Form 10-Ks, 20-Fs, and 40-Fs to indicate whether an ICFR auditor attestation is included in the filing.

Industry Guide 3 Effective for fiscal year ends ending on or after Dec. 15, 2021 (voluntary early compliance permitted, provided that the final rules are applied in their entirety from the date of early compliance)	• Final rule issued Sept. 11, 2020. • Eliminates disclosures that overlap with existing GAAP (i.e. certain investment, security, loan, and allowance disclosures). • Introduces new required credit ratio disclosures. • Requires disaggregation within the rate/volume table (e.g., federal funds purchased, securities sold under agreements to repurchase, and commercial paper). • The amount of uninsured deposits is required to be disclosed. • The new Guide 3 rules require disclosures only for the periods of the associated SEC filings o Historically, these disclosures were required for the previous five years.

Rulemaking	Selected highlights
Financial Disclosures About Guarantors and Issuers of Guaranteed Securities Rule 3-10 of Regulation S-X (partially relocated to Rule 13-01) Effective Jan. 4, 2021 (early adoption permitted)	• Rule 3-10 was amended and partly relocated to Rule 13-01 of Regulation S-X. • Replaces the condition that a subsidiary issuer or guarantor be 100 percent owned by the parent company with a condition that it be consolidated in the parent company's consolidated financial statements. • Replaces condensed consolidating financial information with certain new financial and nonfinancial disclosures. • Reduces the number of periods presented. • Permits the amended disclosures to be provided outside the footnotes to the parent company's audited annual and unaudited interim consolidated financial statements. • Requires the amended disclosures only for as long as an issuer or guarantor has an Exchange Act reporting obligation with respect to the guaranteed securities.

Financial Disclosures About Affiliates Whose Securities Collateralize a Registrant's Securities
 	
Rule 13-02 of Regulation S-X (previously codified in Rule 3-16)
 	
Effective Jan. 4, 2021 (early adoption permitted)
	• Removes the existing requirement to provide separate financial statements for each affiliate whose securities are pledged as collateral.
	  o Now requires both financial and nonfinancial disclosures about the affiliate(s) and the collateral arrangement.
	• Permits amended disclosures to be provided outside the footnotes to the registrant's audited annual and unaudited interim consolidated financial statements.
	• Requires registrants to provide disclosures in all cases, unless immaterial.
	  o Previously, disclosures were required only when pledged securities met or exceeded a numerical threshold.

Financial Disclosures About Acquired and Disposed Businesses Article 11 and Rules 1-02(w), 3-05, 3-14, 8-04, 8-05, and 8-06 of Regulation S-X; Rule 405 of the *Securities Act of 1933*; and Rule 12(b)-2 of the Exchange Act. Effective Jan. 4, 2021 (early adoption permitted)	• Updates the significance tests in Rule 1-02(w) of Regulation S-X, Rule 405 of the *Securities Act of 1933*, and Rule 12-b2 of the Exchange Act. • Reduces the financial statements of the acquired business to no more than the two most recent fiscal years. • Permits disclosure of abbreviated financial statements that omit certain expenses for certain acquisitions of a component of an entity. • No longer requires separate financial statements for acquired businesses that have been included in the registrant's post-acquisition financial statements for nine months or a complete fiscal year, depending on significance. • Eliminates the requirement in a registration statement to provide historical financial statements for insignificant business when aggregation applies, though certain historical financial statements of acquired businesses and pro forma information might be required. • Amends pro forma financial information requirements. • Makes corresponding changes to the smaller reporting company requirements in Article 8 of Regulation S-X, which will also apply to Regulation A filings.

COVID-19-related disclosures

Corp Fin Associate Chief Accountant Stephanie Sullivan spoke at length about the quality of disclosures communicating the impact of the pandemic on a registrant's business. Sullivan highlighted the statement "The Importance of Disclosure – for Investors, Markets and Our Fight Against COVID-19," issued on April 8, 2020. The statement urges companies to make adequate disclosures reflecting the current state of affairs and outlook. Sullivan noted that these disclosures should be made "through the eyes of management" and should provide as much information as possible for investor consumption. These disclosures should be refreshed on a quarterly basis, as needed. "We wouldn't expect to see the same type of disclosure that you had in your second quarter [Form] 10-Q," said Sullivan.
Sullivan also referred to COVID-19-related disclosure guidance issued in March of 2020. With respect to disclosures related to loans modified in response to the COVID-19 pandemic, Sullivan noted that regardless of the accounting model being followed, disclosures should provide investors with an understanding of the critical estimates and judgments that drove the changes in the allowance for credit losses for the period. Sullivan further reiterated the importance of disclosing significant modifications or forbearance activity and noted that these disclosures are becoming as relevant today as they were 10 years ago. Issuers may consider, among other things, the percentage of modified loans not in default or at risk of needing additional forbearance, how modified loans are risk rated, and the impact of modified loans on nonperforming and past due statistics.

Conference takeaway: Issuers should convey "through the eyes of management" as much information as possible on significant pandemic-related operational and financial challenges faced by the institution.

Crowe observation: Sullivan's remarks about disclosing significant modifications or forbearance activity relate to her remarks during the Dec. 2010 AICPA Conference on SEC and PCAOB Developments where she addressed, "Areas of Frequent Staff Comment – Financial Institutions."

OCA consultations

OCA Senior Associate Chief Accountant Kevin Vaughn discussed a number of the SEC's consultations from the past 12 months. Consultation topics include CECL implementation, revenue recognition, business combinations, consolidations, accounting for income taxes, the statement of cash flows, and discontinued operations. Vaughn specifically discussed the SEC's conclusion on a consultation related to the Federal Reserve's Main Street Lending Program.

OCA received a consultation request from the American Bankers Association related to whether the transfers of loans to the special-purpose vehicle that was established by the Federal Reserve Bank of Boston for the Main Street Lending facility would result in sales accounting under ASC Topic 860, "Transfers and Servicing." Specifically, the pre-clearance letter focused on the "legal isolation prong" of Topic 860. Based on the unique facts and circumstances described in the consultation, OCA did not object to the industry group's view that a bank would have a reasonable basis to conclude that the appropriate true sales opinion (i.e., legal opinion) would be obtained if requested. Vaughn reiterated that neither the consultation nor the associated response from the SEC addressed any other aspects of sales and accounting treatment under ASC 860 and that it would not be appropriate to analogize this conclusion with any other fact pattern.

Crowe observation: The consultation sought to understand if each participating bank can satisfy the legal isolation condition for each MSLP facility without the receipt of individual legal isolation opinions given several unique factors surrounding the MSLP. With the SEC's nonobjection, banks executing sales of loan participations with the special-purpose vehicles established by the Federal Reserve Bank of Boston under the MSLP can reach a conclusion that the legal isolation condition is met as the bank has a reasonable basis to conclude that appropriate legal opinion(s) would be given if requested.

Non-GAAP disclosures

Sullivan spoke at length about non-GAAP disclosures. Participants were reminded that there have been no changes to the non-GAAP rules in Regulation G and Item 10(e) of Regulation S-K. Specifically, Sullivan noted the following:

- SEC staff will not object to the disclosure of pre-provision net revenue (PPNR), as the metric is used for bank regulatory purposes and historically has been disclosed in filings.
    - However, the staff will object to PPNR-based performance metrics (e.g., PPNR per share, PPNR reduced by charge-offs).
- If an issuer adjusts GAAP metrics for COVID-19 implications, then the issuer must adjust for both positive and negative effects.
- The SEC will not object to disclosures stating that an increase in the provision for credit losses is "primarily related to COVID" or "substantially related to COVID-19."
    - However, issuers who attempt to quantify a portion of the provision that was due to COVID-19 should go into detail as to how the numerical amount was determined.
- SEC staff believe it is inappropriate to present non-GAAP performance measures that adjust earnings to exclude the impact of CECL and instead substitute it with charge-offs.
- SEC staff also believe that adjusting the CECL provision to present what would have been recorded under a probable incurred methodology (i.e., legacy GAAP) is not appropriate.

Conference takeaway: It is inappropriate to present non-GAAP metrics that adjust earnings to exclude the impact of CECL. However, the SEC does not object to institutions disclosing "pre-provision net revenue," as the metric is grounded in bank regulatory reporting.

UPDATED

December update

In the December update, DIEP panelists noted that in many cases registrants have seen changes in their ICFR due to the pandemic and the related migration to work-from-home status. Panelists reminded the audience that Item 9A of Form 10-K elicits disclosure pursuant to Item 308(c) of Regulation S-K, which requires disclosure of "any change in the registrant's internal control over financial reporting that occurred during the registrant's last fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting." Registrants might have disclosed changes in ICFR pursuant to Item 308(c) in a prior Form 10-Q during fiscal 2020. Nevertheless, registrants should assess whether the fourth quarter included changes in ICFR disclosable under Item 308(c) for purposes of Form 10-K.

Crowe observation: Registrants might have disclosed changes in ICFR pursuant to Item 308(c) in a prior Form 10-Q during fiscal 2020. Nevertheless, registrants should assess whether the fourth quarter included changes in ICFR disclosable under Item 308(c) for purposes of Form 10-K.

PCAOB updates

Megan Zietsman, chief auditor of the PCAOB, provided an update on three projects on the PCAOB's research agenda (independence, quality control, and supervision of audits involving other auditors) and two projects on the research agenda (audit evidence and data/technology). From comments made by Zietsman, it was apparent that the PCAOB has a focus on the interplay of current technologies (including artificial intelligence) and current auditing standards. When speaking specifically on the quality control agenda item, Zietsman noted that the project is aimed at updating the standard to meet the technology currently employed by audit firms. When speaking on technology, Zietsman also noted that the PCAOB expects firms to maintain policies, procedures, and controls surrounding the use of data technology tools. These expectations include, but are not limited to, ensuring that staff with sufficient expertise is involved with certain technology tools being used on individual audits.

With respect to CECL, Chief Deputy Auditor Barb Vanich described the PCAOB's current monitoring efforts. Although some of the monitoring efforts have been "put on pause" because of the COVID-19 pandemic, outreach is ongoing. Much of the feedback received from the PCAOB's outreach with audit firms (including smaller firms) indicates that there will likely be difficulties in auditing CECL in the year the standard is adopted.

PCAOB staff spent a significant amount of time discussing the impact of COVID-19 on audits and audit quality. Vanich referenced the PCAOB's COVID-19 resource center and noted that firms would need to consider changes to their audit plans in light of the pandemic's impact on normal business operations. Some considerations offered by Vanich:

- More senior team members might be incorporated when the audited company's operating environment has changed substantially.
- The impact of new processes and controls created based on a rapidly changing work environment (e.g., work from home) should be understood.
- The impact of audit evidence being collected in new ways should be understood:
    - Control walk-throughs might need to be held virtually.
    - Electronic audit evidence might replace hard copy evidence.
- Materiality might need to be reconsidered due to the impact of COVID-19.

With respect to electronic audit evidence, Vanich reminded the audience that the auditing standards do not require auditors to be experts in document authenticity; however, there is a requirement to exhibit professional skepticism and due care.

The staff spent time discussing auditing estimates in light of the current period of economic uncertainty. The staff noted that there will be significant challenges in auditing estimates. Further, assumptions based on past experiences and management expectations might not be indicative of future events. Auditors also will need to consider the bank's ability and intent to carry on with a specific activity.

Conference takeaway: PCAOB Chief Auditor Megan Zietsman noted that assumptions based on past experiences or management expectations might not be indicative of future events.

PCAOB staff has performed extensive outreach with audit committees through the COVID-19 pandemic and noted audit committees have asserted that current impacts to the audit are minimal. However, committee members are contending with new and increased risks. Some of these risks include cybersecurity, employee safety and mental health, and estimates. Committees are citing more frequent communication with their internal and external audit firms.

Jason Bullington, regional associate director in the Division of Registration and Inspections, described the PCAOB's current inspection themes and activities. With respect to COVID-19, Bullington noted that the PCAOB has expanded its 2020 plan to consider the risk of the pandemic on audits. As a part of these activities, the PCAOB increased the number of March 31 and June 30 year-end audits in its inspection sample and is reviewing work papers associated with March 31 and June 30 interim reviews (in conjunction with Form 10-Qs) to better understand how auditors addressed the risks and challenges caused by COVID-19.

Bullington described the new inspection report that the PCAOB released in 2020. Per Bullington, the report has been streamlined to enhance the readability for investors. Among other changes, the report now includes more graphs and charts as well as a new deficiency classification system.

Representatives from two of the Big Four accounting firms provided an overview of recently issued audit standards, both of which are effective for audits of financial statements for fiscal years ending on or after Dec. 15, 2020. Auditing Standard (AS) 2501: "Auditing Accounting Estimates," strengthens and enhances current audit requirements by establishing a uniform, risk-based approach that emphasizes professional skepticism and focuses on potential management bias. Additionally, the new standard provides more specific direction on auditing fair values of financial instruments that are based on information from third-party pricing sources. Also, changes to standards on the auditor's use of the work of specialists strengthen the requirements for evaluating the work of a company's specialist, whether employed or engaged by the company. The revised audit standards also apply a supervisory approach to both auditor-employed and auditor-engaged specialists.

Critical Audit Matters (CAMs)

AS 3101, "The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion," became effective for audits of large accelerated filers in 2019. In complying with this standard, audit firms were required to include CAMs in their audit report on financial statements audited in accordance with PCOAB standards. The standard becomes effective for many more public company audits this year.

A CAM is any matter from the financial statement audit that was communicated or required to be communicated to the audit committee that 1) relates to accounts and/or disclosures that are material to the financial statements and 2) involves especially challenging, subjective, or complex auditor judgment. The determination of CAMs is principles based and depends on the facts and circumstances of each audit.

Panelists during the AICPA conference noted that during year one of implementation, CAMs were included in 641 large accelerated filers' auditor's reports, while the average CAM per auditor's report was 1.6.

For audits of banks, the most disclosed a CAM related to the ALLL. While not even close to frequency of the ALLL, the second most common CAM was on business combinations, followed closely by investments. Other CAMs cited include commitments and contingencies, income tax, goodwill and intangibles, CECL, insurance reserves, revenue recognition, and leases.

Selected takeaways from conference panelists regarding CAMs are as follows:

- Writing CAMs is challenging. Auditors have to strike a balance between adequately describing procedures and using language that is easily understandable by users of the financial statements.
- The determination of CAMs (i.e., quantity and types) is relative to each engagement.
- Auditors and management should communicate early and often on potential CAMs and related enhancement to financial statement disclosures.
- Auditors should begin drafting CAMs as soon as the matter has been identified.

Learn more

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