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2023 AICPA & CIMA Conference on Banks & Savings Institutions

FORVIS Highlights

September 2023

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Introduction

The American Institute of CPAs (AICPA) and Chartered Institute of Management Accountants (CIMA) held the annual Conference on Banks & Savings Institutions in person and virtually on September 11–13, 2023. **FORVIS** was honored to be an event sponsor again this year. The following are selected comments from various speakers at the conference. This summary doesn't capture all discussions presented during the three-day period; rather, it's intended to highlight trending topics and recurring themes. The selections below are our interpretation of the speakers' comments and do not necessarily represent the opinion of FORVIS.

FASB, SEC, & PCAOB Updates

FASB Update: 2023 & Beyond

Hillary Salo – Technical Director, FASB
Daniel Stuhlemmer – Project Manager, FASB
Chase Hodges – Practice Fellow, FASB

CECL

After a recap on the technical agenda projects, the panel discussed the post-implementation review work related to the adoption of CECL, specifically the new standard regarding troubled debt restructurings and changes to vintage disclosures that was effective earlier this year, which was issued in response to feedback from the original standard. An update was provided on the proposed accounting standards update (ASU) related to purchased financial assets (PFAs) for which the comment period just ended. The proposed amendment eliminates the assessment of credit deterioration at acquisition and applies the purchased credit-deteriorated (PCD) gross-up approach to all financial assets acquired in a business combination. For an asset acquisition, the concept of "seasoning" is introduced to determine if the financial assets are considered acquired or originated. Preliminary feedback related to the proposed standard has expressed concern about operability issues related to certain asset types such as credit cards and revolving loans, as well as the proposed modified retrospective transition approach.

Near-Term

The panel provided a standard-setting update regarding several near-term projects:

- **Accounting & Disclosure of Crypto Assets** – The final ASU is expected to be issued during the fourth quarter of 2023, which would improve the subsequent measurement, presentation, and disclosure of certain crypto assets. In-scope crypto assets would be subsequently measured at fair value through net income with separate presentation from other intangibles on the balance sheet. There also would be separate presentation of gains/losses from amortization and impairment of intangible assets on the income statement.
- **Targeted Improvements to Income Tax Disclosures** – The final ASU is expected to be issued during the fourth quarter of 2023, which would improve the transparency and usefulness of income tax disclosures. The current proposal amends required disclosure of individual reconciling items in the rate reconciliation, such as specific categories and other categories meeting a quantitative threshold, as well as disclosure of income taxes paid by jurisdiction.
- **Segment Reporting** – The final ASU is expected to be issued in October 2023, which would require enhanced disclosure of significant segment expenses, disclosure of other segment items for each reportable segment,

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and require all entities to provide segment disclosures, including single-segment entities, as well as create more interim disclosures around segments.

On the Horizon

The panel discussed projects that FASB is considering in the future, including accounting and disclosure of software costs, hedge accounting improvements, and disaggregation of income statement expenses.

SEC Updates From the Office of the Chief Accountant

Paul Munter – Chief Accountant, Office of the Chief Accountant at SEC

Jonathan Wiggins – Deputy Chief Accountant, Office of the Chief Accountant at SEC

According to the Office of the Chief Accountant (OCA), its primary focus is on high-quality financial reporting and the importance of high-quality information to the marketplace in consideration of economic uncertainties and geopolitical uncertainties and how such uncertainties might affect financial reporting.

The OCA discussed its views on high-quality financial reporting and also provided its perspective on the following topics:

- The importance of risk assessment and its influence on financial reporting and the effectiveness of internal controls over financial reporting,
- Its oversight responsibility of the PCAOB and FASB, and
- The auditor’s responsibility for the detection of fraud in the audit process.

High-Quality Financial Reporting

The OCA reiterated that the SEC approaches its role with an investor-focus mindset, while banking regulators are focused on safety and soundness. The different approaches are complementary to each other, but they are not the same and often result in important differences in focus and priorities.

Also discussed was the uniqueness of the banking sector as both provider of capital to the public markets and as a consumer of financial reporting information, which would give it a vested interest in preparing and consuming high-quality financial information.

The OCA went on to highlight the following three characteristics of high-quality financial information:

- Availability of high-quality accounting standards, rules, and requirements
- High-quality application of an issuer’s fact pattern against those standards
- High-quality audit of financial information

The OCA explained that its role is to facilitate the three components of high-quality information through its interactions with standard setters to drive high-quality standards, its engagement with stakeholders on specific fact patterns for complex and novel issues, and by helping external auditors and registrants work through issues that convey the economic consequences of complex matters to investors.

Considering the current environment, the OCA then explained the impact of the risk of uncertainties resulting from economic and geopolitical uncertainties in the marketplace on financial reporting. The OCA pointed to the interest rate environment and the impact on the valuation of investments and the related unrealized losses on fixed-income securities and the related impact on a bank’s liquidity position. The OCA also noted that the high-interest-rate environment could impact borrowers’ ability to repay their debt.

In light of the current environment, the OCA indicated that registrants should assess whether changes in interest rates, operational changes, and increased estimation uncertainty may result in an increase in the risk of material misstatements to financial reporting, which also may increase the risk of fraud.

The OCA shared several best practices and questions to consider, including the following:

Best Practices

1. Preparers of financial information should take a new look at risk disclosures to help ensure information is sufficient to address significant risks that may result from current events.
2. Consider ways in which the MD&A disclosure can address trends, risks, and uncertainties, as well as how accounting estimate disclosures might allow investors to understand how future performance can be impacted by current events.

Questions

1. Can the investor understand from the disclosures why an accounting estimate is critical?
2. Does the disclosure include both quantitative and qualitative information as it might be difficult for investors to understand the estimation uncertainty in the absence of such information?
3. Does the disclosure adequately convey information that is incremental to the accounting policies and is neither subjective nor duplicative of accounting policy disclosures?

Importance of Risk Assessment

With respect to risk assessment, the OCA referred attendees to its August 2023 statement, titled "The Importance of a Comprehensive Risk Assessment by Auditors and Management,"[1] while noting the linkage between risk assessment and high-quality financial reporting and the effectiveness of internal controls over financial reporting (ICFR).

The OCA indicated it has seen reports and fact patterns suggesting there are a variety of red flags in an issuer's business or operating environment that the external auditors weren't aware of, and the issuers weren't responsive to those red flags in terms of disclosures and in their evaluation of the ICFR's effectiveness.

The OCA further noted that, at times, management and auditors bring a narrow focus to the evaluation of issues, which can result in a mindset that is biased to a conclusion that indicates there isn't a material weakness in internal controls or a material error in the financial statements. The OCA cautioned that evaluation of issues should be unbiased from the perspective of a reasonable investor and an overreliance on qualitative factors can lead to an inappropriate conclusion as to why a material error is not material.

Lastly, the OCA highlighted the audit committee's role in this process, indicating that the role of the audit committee when done properly can be an important tool in driving audit quality. For example, the OCA noted that committee members should view themselves as the representatives of investors and leverage their oversight responsibility to help evaluate the tone and the approach of management with the auditor to help drive high-quality information.

Oversight Responsibility of the Standard-Setting Bodies

FASB

The OCA discussed its approach and engagement with FASB, noting it continues to support the SEC's oversight of the FASB consistent with the SEC's 2003 policy statement.[2]

[1] "The Importance of a Comprehensive Risk Assessment by Auditors and Management," sec.gov. August 25, 2023.

[2] "Policy Statement: Reaffirming the Status of the FASB as a Designated Private-Sector Standard Setter," sec.gov, modified July 28, 2023.

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The OCA noted that the FASB's stakeholder engagement is required for the FASB to issue high-quality standards, which improve the accuracy of high-quality information. The OCA referred to the FASB's reprioritization agenda,[3] which is geared toward investor needs, and pointed to the FASB's disaggregation of income statement expenses presentation and disclosure project[4] as an example of the result of the reprioritization. The OCA indicated the proposal includes an example for banks and was encouraged by level of stakeholder engagement and collaboration on potential approaches to produce information that is cost-effective.

The OCA highlighted and delved into the FASB's statement of cash flows (SCF) research project, noting that both the FASB and the International Accounting Standards Board received feedback that the SCF was an important area requiring improvement.

The OCA provided the following observations related to the presentation format of the SCF and the degree of attention it receives from preparers and auditors.

- **Presentation Format** – The OCA noted that while most issuers use the indirect method to present cash flow activities in the SCF, investors have asked for a more direct presentation of operational activities in the SCF. The OCA encouraged preparers to consider whether there are better ways to present cash flow activities within the confines of existing GAAP that might better convey information about cash inflow and outflow related to operational activities.
- **SCF Importance** – With respect to SCF preparation, the OCA noted that one thing it finds troubling regarding the SCF is the level of attention the statements receive from both preparers and auditors from an internal control perspective relative to other components of the financial statements. The OCA reiterated that the SCF has the same level of priority as other components of the financial statements and should be given the same attention from management and the auditors from a preparation-and-audit standpoint and in the level of internal controls.

The OCA ended its remarks on the SCF by stating that often when the OCA is engaged with stakeholders around SCF errors, the discussion tends to focus on all the reasons why the error couldn't be a material misstatement and, therefore, a little "r" is more appropriate. According to the OCA, under those circumstances, an objective evaluation of the facts and circumstances may not be occurring and, secondly, it often hears arguments that the misstatement is just a classification error. To emphasize that the SCF should be given the same level of importance as other financial statements, the OCA noted that all errors in the SCF are classification errors because the SCF is "all about classification."

Lastly, the OCA noted that if a preparer has a classification error in the SCF, that error may be significant in terms of conveying useful information to investors because information about operating activities is different from investing and financing activities and should be viewed through an objective and reasonable investor lens.

PCAOB

The OCA reiterated the importance of the PCAOB's role and responsibilities, including its role in the publication of standards auditors are responsible for executing against.

With respect to the standard-setting agenda, the OCA highlighted that the PCAOB is very active, and its level of activity is unprecedented. The OCA noted the PCAOB was established more than 20 years ago and most of its standards were brought in as interim standards from existing AICPA standards, many of which were issued prior to 2003.

[3] "Accounting Standard Setting in a Rapidly Evolving Business Environment: A Focus on the Timely Delivery of Investor Priorities," sec.gov, February 14, 2023.

[4] "Disaggregation—Income Statement Expenses," fasb.org, updated on August 1, 2023.

The OCA indicated it was supportive of the PCAOB's standard-setting agenda and that there are a number of projects which have the potential to significantly improve the quality of auditing standards and audit quality, and it's important that it continue to receive feedback from across the stakeholder ecosystem.

Such projects include:

- Proposal of a new quality control standard[5]
- Proposal regarding a new standard for the auditor's use of confirmation[6]
- Proposal to amend aspects of designing and performing audit procedures that involve technology-assisted analysis of electronic information[7]
- Proposal on noncompliance with laws and regulations[8]

The OCA noted that while the comment period has ended, stakeholders should continue to engage with the PCAOB on outstanding proposals as the targeted finalization date approaches for standards expected to be finalized before the end of 2023.

Detection of Fraud in the Audit Process

- The OCA noted that the auditor's responsibilities for the detection of fraud included in the existing auditing standard goes back to 1980 and includes guidance regarding the auditor's responsibility for evaluating whether financial statements are reasonable and free from material misstatement due to error or fraud. The OCA then reiterated that auditors do have a responsibility for the detection of fraud that could result in misstatement.
- The OCA indicated it has seen, through PCAOB inspection or otherwise, instances where auditors have either not done a sufficiently robust risk assessment to identify the risk of fraud or risk factors and, therefore, failed to capture the risk factors in the audit plan and execution of the audit or have failed to identify red flags, which might be rooted in the auditors' mindset. The OCA has observed that auditors tend to talk about the responsibility for the detection of fraud in terms of what auditors are not responsible for. Instead, the auditors should take responsibility for what they are responsible for and not approach the audit from the standpoint of minimizing their responsibilities for the detection of fraud as that can impact the auditor's level of professional skepticism.

PCAOB Update

Glenn Tempro, CPA – PCAOB Associate Director
Lisa Busedu, CPA – PCAOB Associate Chief Auditor

During the conference, the PCAOB provided a PCAOB standard-setting update and an update on the Division of Registration and Inspections. During the standard-setting update, the PCAOB provided an update on the following five proposed standards in order of issuance:

- Quality Control
- Confirmation
- General Responsibilities of the Auditor in Conducting an Audit – AS 1000

[5] "PCAOB Release No. 2022-006," assets.pcaobus.org, November 18, 2022.
[6] "PCAOB Release No. 2022-009," assets.pcaobus.org, December 20, 2022.
[7] "PCAOB Release No. 2023-004," assets.pcaobus.org, June 26, 2023.
[8] "PCAOB Release No. 2023-003," assets.pcaob.org, June 6, 2023.

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- Noncompliance with Laws and Regulations
- Amendments Related to Certain Aspects of Designing and Performing Audit Procedures That Involve Technology-Assisted Analysis of Information in Electronic Form

Additional short- and mid-term projects also were discussed. Additional information on the proposed standards and projects can be found on the PCAOB website.[9]

During 2022, the PCAOB inspected 157 audit firms and reviewed portions of approximately 710 audits of public companies, including financial institutions. Considering all inspections, globally, the PCAOB issued approximately 23% more comment forms in 2022 than in 2021. The most frequent areas of audit deficiencies on banking inspections relate to auditing of the allowance for credit losses (ACL) and other accounting estimates, including fair value measurements and the auditing of investment securities.

Regulatory Updates

Federal Banking Agencies: A Fireside Chat With the Chief Accountants

Shannon Beattie – FDIC
Amanda Freedle – OCC
Lara Lylozian – Federal Reserve

The chief accountants for the Federal Reserve, the Office of the Comptroller of the Currency (OCC), and FDIC were present to provide their insights on CECL, call report updates, new accounting pronouncements, and climate risk.

CECL

The examiners spent some time discussing observations on CECL implementations they have examined. When discussing the impact of the January 2023 adopters of CECL, Lylozian noted there was an 11% increase in the ACL for banks of all sizes at adoption and that for banks with assets of less than $10 billion, the impact of adoption was a 5% increase in the ACL.

Freedle said she does not view the examination process under CECL any differently from how it was under the incurred loss accounting model. The regulators will be looking at methodology, quality of data, governance, internal control, and documentation for policies and procedures, and they will look at qualitative factors like they always have. They are expecting good faith efforts from the institutions in adopting CECL. Freedle noted that the OCC Comptrollers Handbook has detailed examination procedures that banks can review.

Freedle said there are no unique model validation requirements for CECL. She said the requirements for ACL model validations are still subject to regulatory model risk management requirements and that the level of work depends on the size and complexity of the model used.

Call Report

Beattie noted some institutions are not reporting uninsured deposits in accordance with instructions for Schedule RC-L as some institutions were reducing the amount for those collateralized by pledged assets. Some institutions also were inappropriately excluding intercompany deposits. Beattie noted that instructions to the call report do address the definition of uninsured deposits. She also said the reason that intercompany deposits should be included is because call reports are prepared on an individual institution basis, which is on a separate certificate basis, so it's not appropriate to eliminate intercompany deposits with other sister banks.

[9] "Standard-Setting, Research, and Rulemaking Projects," pcaob.org, 2023.

Beattie noted a new topic was added to supplemental instructions in March 2023, which provides guidance in response to questions the FDIC had been receiving on securities transfers.

New Accounting Pronouncements

Freedle discussed FASB's proposed standard on PFAs, which expands the "gross-up" approach to accounting for PCD assets to all PFAs. Freedle said the agencies wrote a comment letter stating concerns about the expansion of the model to all financial assets. Those concerns include:

- The agencies have had a long-standing position of earlier recognition of credit loss.
- The gross-up approach makes it more difficult and challenging to examine a bank's financial condition. Capital levels that result may not be reflective of institutions' ability to absorb losses.
- Credit loss expense and interest get commingled in the gross-up approach. The regulators believe it is more beneficial to users of financial statements to keep them separate.
- There may be incentive to overstate credit losses at acquisition in the credit loss gross-up and overstate earnings in future periods with amortization of credit loss gross-up.
- The timing of this change is coming very soon after the adoption of the CECL model to which this change applies.

Other Regulatory Matters

Beattie discussed the special assessment proposal issued in the **Federal Register** in May 2023. She noted there is guidance on proper accounting treatment for special assessments included in the proposal, which refers to Accounting Standards Codification (ASC) Topic 450 on accounting for loss contingencies. Beattie said the FDIC is currently reviewing the comments received on the proposal, but she was unable to provide any insight on a proposed effective date of the assessment.

The OCC's Bank Accounting Advisory Series manual was updated in August 2023. Changes predominantly relate to CECL and loan modification accounting. There also are updated questions and answers on intangible assets and goodwill. The chapters for other-than-temporary impairment and old lease accounting under ASC Topic 840 were removed as they are no longer relevant.

Lylozian said novel activities are a priority to the Federal Reserve, and it has established a Novel Activities Supervision Program. As discussed in the Fed's Supervision and Regulation Letter 23-7, the purpose of the program is to help ensure the Fed is staying current on all new technologies and activities that banks are using to deliver services.

Climate Risk

Lylozian said the Federal Reserve is engaging with large banks and supervisory authorities outside the U.S. to monitor this topic. She said that to date, there has been a pilot climate scenario analysis exercise conducted with the six largest U.S. banks to learn more about banks' existing risk management practices and to learn how to better manage risk. She noted that all federal banking regulatory agencies are working together to issue one set of guidance on this topic in the future. She emphasized that the focus for any forthcoming requirements is directed toward large banks.

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Technical Accounting Topics

CECL – Best Practices for 2020 Adopters & a Look at 2023 Adopters

Shannon J.P. Shelly, CPA – Crowe LLP
Patrick Vernon, CPA, ABV – Crowe LLP

This session summarized the overall impact of the initial adoption of the CECL standard (Topic 326), as well as what our industry has witnessed related to the 2020 and 2023 adopters. The session also touched on ASU 2022-02 troubled debt restructurings (TDRs) and the proposed changes to the CECL standard to address PFAs under Topic 326.

Three big key takeaways from this session include, in no specific order:

The ASU 2022-02 TDR update will be in play very soon and will require significant discussion and consideration from management, the accounting team, and the credit administration team. TDR and TDR-related disclosures will be going away; however, enhanced disclosure requirements are being added with this update that will require a financial institution to identify, monitor, and report on all loan modifications made to borrowers who are experiencing financial difficulty and the modification results in a direct change in contractual cash flows. Both attributes must be present to warrant disclosure consideration. **For more information on ASU 2022-02, view our FORsights™ article, "FASB Ends TDR Accounting for CECL Adopters."**

FASB's proposed update to Topic 326 to remove "the double count issue" associated with PFAs could significantly impact (benefit) the overall Day 1 and Day 2 accounting related to acquired financial assets. This will reduce the income statement impact associated with assessing the Day 2 ACL on acquired financial assets, specifically PCD and non-PCD loans acquired. **For more information on PCD accounting, view our FORsights article, "Changes Coming for Acquired Financial Assets Accounting?"**

A reminder that the CECL models adopted in 2020 and in 2023, regardless of whether a third-party vendor was/is utilized or not, should be viewed as ever-evolving models with re-assessments and enhancements performed by management on a regular basis. The overall intent of CECL was to bring a more fluid and consistently applied ACL model into our industry. A lot of volatility was noted in the ACL models of the 2020 adopters. One way to assist with the potential volatility issues is to make sure the ACL model is reviewed and "refreshed" on a periodic basis to help ensure key information relied upon and key inputs are still relevant to the overall risk of the loan portfolio. Questions to continually ask yourself include:

- Is loan segmentation still appropriate to capture risk of similar assets?
- Are prepayment speeds still appropriate based on our current environment?
- Is the loss lookback period still appropriate based on our current environment, or should we be considering weighting of various periods?
- Is the data that is relied upon for establishing movement in the qualitative factors still applicable to our institution in our current environment?
- Is our forecast period still reasonable and supportable?
- Is the data that is relied upon for supporting our forecast period still applicable to our institution in our current environment?

Emerging Tax Developments Impacting Your Institution

David Thornton, CPA – Crowe LLP

This presentation covered four topics:

- Tax Planning in a Rising Interest Rate Environment
- 1% Federal Excise Tax on Stock Repurchases
- IRS Audit Exposure Areas
- Miscellaneous Developments

Tax Planning in a Rising Interest Rate Environment

The discussion focused on two types of planning ideas to consider during the current rising interest rate environment: 1) Strategies directly impacted by rising interest rates/interest expense and 2) Strategies that defer the payment of income taxes by accelerating deductions and deferring taxable income recognition.

Strategies Directly Impacted by Rising Interest Rates/Interest Expense

Minimize the bank's *Tax Equity and Fiscal Responsibility Act of 1982* (TEFRA) interest expense disallowance. When looking at forecasted effective tax rates for several banks, the interest expense disallowance is five or six times more than in 2022.

- One strategy is investing in bank-qualified obligations instead of nonbank qualified. If a bank qualified, the TEFRA disallowance is limited to 20% as opposed to the full disallowance for nonbank-qualified investments.
- Since the TEFRA disallowance only applies to banks, another strategy is to separate tax-exempt obligations from the bank and put them in a direct subsidiary of the bank. The idea is that if the tax-exempt obligations are separated from the bank, then they are removed from the interest expense disallowance calculation.

  Some items to note on this planning strategy:

  1. The subsidiary needs to be debt free to help ensure that no interest expense is directly allocated to the munis.
  2. The presenter believes the taxpayer-favorable ruling in *PSB Holdings, Inc. v. Commissioner*, 129 T.C. No. 15 (November 1, 2007), supports this planning strategy. However, the speaker did note that PSB only dealt with munis acquired directly by the subsidiary. The court never ruled on the contribution of munis by the bank to the newly formed subsidiary. The rationale for the favorable ruling was based on the subsidiary not being a bank and did not address how the munis were placed into the subsidiary instead of the bank.
  3. Risks involved with this strategy – One risk with this strategy is that once the tax-exempt obligations are separated from the bank, they are no longer covered by protection of Internal Revenue Code (IRC) Section 582(c), which generally provides that losses in a bank are treated as ordinary. Once you push outside of the bank, the protection goes away. And, if there are losses in the subsidiary (charge offs), they will likely be capital losses. Another risk is that the IRS may challenge the substance of the subsidiary. The subsidiary needs to be a legitimate functioning sub with its own employees (or services agreement) and board of directors. Also, it's strongly recommended that there is another business purpose for creating the subsidiary other than tax savings—for example, state tax savings, offering a more competitive advantage if able to underwrite the muni loans at a lower rate since the subsidiary doesn't have to absorb TEFRA, etc.

- IRC Section 163(j) imposes an annual limitation on net business expense. Typically, a bank is in a net interest income position, so application of §163(j) to a bank is rare. However, the speaker did note that when

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applicable, taxpayers are looking at ways to mitigate the interest expense disallowance. Companies are pursuing planning strategies where they capitalize interest expense to the balance sheet and take the deduction through the basis in the asset.

Strategies That Defer the Payment of Income Taxes by Accelerating Deductions & Deferring Taxable Income Recognition

The second type of tax planning strategy discussed during the presentation focused on reducing cost of funds by deferring the cash payment of income taxes. The strategy here is to accelerate deductions and defer income with low-risk strategies, which save cash. Banks can maximize the reduction of the deferred tax asset (DTA) instead of paying taxes with borrowed money. It also was noted that these strategies could create a regulatory capital benefit if banks currently have disallowed DTAs.

Here are the low-risk strategies that were discussed:

- Accelerate deductions for prepaid expenses
- Defer market discount
- Elect bad debt conformity
- Deduct qualifying loan origination costs
- Elect bonus depreciation (leasing portfolios provide significant cash tax savings)
- Consider cost segregation analysis

1% Federal Excise Tax on Stock Repurchases

The new 1% excise tax is effective for repurchases of stock occurring after December 31, 2022 and applies to all corporations whose stock is traded on an established securities market, *e.g.*, pink sheets, OTC, any exchange that has a readily determinable FMV, etc.

The presenter noted the following considerations related to the new tax:

- There is a $1 million threshold for determining whether the tax is applicable. If repurchases are less than $1 million, no excise tax is due. However, if repurchases exceed $1 million, the excise tax is applicable. Also, the first $1 million is not exempt, the $1 million is just a threshold amount.
- Calculation of the taxable amount starts with gross repurchases for the corporation's taxable year less the value of shares issued that year, less the value of shares issued or provided to employees, and less the value of shares contributed to an employer-sponsored retirement plan.
- Guidance on this topic thus far: IRS Notice 2023-2 and IRS Announcement 2023-18 have been issued and Treasury regulations are pending.
- File and pay the excise tax on Form 720, due at the end of the month following the first quarter after the close of the taxable year (first due date for calendar-year taxpayer is April 30, 2024).
- Consider whether cash used to buy stock in a merger will trigger the tax.
- The excise tax is not deductible for federal income tax.
- In general, the GAAP treatment is to record the excise tax as a debit to equity, cost of treasury stock.

IRS Audit Exposure Areas

The Inflation Reduction Act gave the IRS new funding of $80 billion, which will be used to achieve two goals of

modernization to improve customer interface and expanded enforcement. Over half of the $80 billion will be directed to enforcement. The IRS expects an additional $200 billion collected over 10 years because of new enforcement efforts. This discussion focused on IRS audit areas where the presenter believes the IRS will focus—Employee Retention Credit (ERC), captive insurance companies, and research and development (R&D) tax credits.

Employee Retention Credit

The IRS has spoken publicly and issued warnings that there are a lot of overly aggressive ERC refund claims as the IRS has received a significant number of claims. The IRS has issued stern guidance against the frivolous claims and says it will audit these claims and assess not only interest for disqualified claims, but also will assess penalties. The IRS has added ERC claims to the "Dirty Dozen" list for this year. The speaker discussed how banks can qualify for the credit and emphasized that to qualify based on "shutdown pursuant to a government order," banks need to show there is a direct order from the government. Emphasis was added that direct order means the sheriff would take away branch manager in handcuffs if a lobby was opened while a government shutdown was in place.

The speaker also noted that banks may still qualify If they weren't shut down but must substantiate that the bank suffered significant economic losses, proving significant losses may be difficult because banks typically had large profits during 2020 and 2021. The speaker pointed out that the IRS can issue a refund based on a filed claim, but as long as the statute remains open, the IRS can always audit the refund claim. If pursuing the ERC and a third-party advisor charges contingent fees, a bank needs to make sure there's recourse/clawback of fees in the event the IRS audits the claim and reduces the refund.

Captive Insurance Arrangements

Treasury recently issued regulations (REG - 109309-22, April 11, 2023) and, if finalized, the regulations will most likely shut down micro-captive insurance arrangements. Under the new regulations, Treasury will automatically designate micro-captive insurance companies as a listed transaction if they have an annual claim loss/premium ratio of less than 65% for a 10-year period. If the period during which the cumulative 65% loss ratio has not been met is less than 10 years, they will retain their current status as a "transaction of interest."

R&D Tax Credits

The speaker noted that the IRS often audits this area.

Miscellaneous Developments

- **Federal Tax Credit Developments** – For most energy tax credit investments on which construction begins on or after January 29, 2023, the federal tax credit percentage remains at 30% Investment Tax Credit but only if the investment meets two hurdles: 1) wage requirement and 2) apprenticeship requirement. A credit may qualify for an additional 10% boost if located in certain economically or environmentally distressed areas.
- **BOLI Transfers & Reportable Policy Sales** – After the *Tax Cuts and Jobs Act*, if a corporation transferred bank-owned life insurance (BOLI) to a new acquiror via merger, then it counted as a reportable policy sale and lost tax-exempt status. Final regulations were issued in 2019 and were intended to correct the issue but were still problematic. The speaker commented that the problem has been resolved with the proposed regulations issued in May 2023.
- **Law Changes for 2022** – There's a new requirement to capitalize internally developed software costs.
- **Law Changes for 2023** – The temporary allowance of deducting 100% of business meals goes back to 50% in 2023.

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Fintech Accounting & Audit Hot Topics

Kevin Jackson, CPA – PwC
Anna Kajirian, CPA – PwC
Dritan Muneka – Galaxy Digital Director
Erik Zhou – Brex Chief Accounting Officer

Fintechs continue to be sought out by organizations for partnering to provide a lower cost of funding and provide services. In addition, organizations continue to entertain business avenues in digital assets. Both items have been fluid in guidance and organizations are looking for further guidance in application.

Fintech

The main objective with a fintech partnership for banks is to provide a low cost of funding among many account holders held by the fintech. From a compliance standpoint, many fintechs seek to partner with banks for assistance in compliance requirements. It continues to be difficult for fintechs to have access to money rails and, difficult or not practical to get money transmitting licenses in each state, which is why partnering with a bank is often the best approach for fintechs.

Traditionally, the fintech maintains its own ledger and there are minimal accounts on the bank's subledger with settlement and clearing occurring each day between the fintech and bank. Banks and fintechs should plan for the impact of whether these will be on-balance sheet or off-balance sheet deposits and assets to each party. Each structure can be set up differently and consideration upfront should be given to the agreement's structure.

The panel also discussed the development of FedNow, with the general comments being that this was long overdue for the industry. In addition, the speakers reminded the audience of the importance of understanding the partnership and the need for consideration of the gross versus net recording on the balance sheet and income statement in consideration of principal versus agent relationships.

Digital Assets

This presentation also got into the landscape of digital assets. The following accounting pronouncements should be considered with digital assets:

1. ASC 350, Intangibles
2. ASC 326, CECL
   - Crypto lending
3. SAB 121
   - Recording of digital assets and liabilities at fair value for organizations that are safeguarding
4. DAWG Q&A 25 (AICPA digital asset working group Q&A 25)
5. FASB Digital Asset Project, expected to be issued in Q4 2023
   - Provides guidance on the balance sheet, income statement, cash flow, and disclosure presentation. Balance sheet and income statement items are to be presented in their own line items separate from other intangible assets. With respect to cash flow classification, if receiving crypto as noncash and converting to cash in short period of time, classification is operating activities. Disclosures of ASC Topic 820 apply along with additional disclosures, such as rollforward of activity by significant digital asset type, gains, and losses along with any restrictions of the digital assets.

The panel also discussed the tokenization of financial products. There are efforts to try to token other financial assets such as real estate ownership and indexed funds. However, fiat currencies are still the most likely to be tokenized. The panel also discussed the digital assets that the SEC has asserted are securities.

Navigating FASB's Proposed ASU on PFAs

Michael Chang – KPMG LLP Managing Director, Deal Advisory – Accounting Advisory Services
Mario Mastrantoni, CPA – KPMG LLP

The proposed ASU for PFAs was a popular topic throughout the conference, not just at its standalone session. In summary, the proposed ASU calls for a single model when accounting for financial assets acquired in a business combination or other transaction. Accounting for all PFAs using the "gross-up" method (currently only applicable to those identified as PCD) would eliminate the "double dip" treatment non-PCD financial assets receive under the existing standard. The ASU also would eliminate the use of the gross-up method for available-for-sale debt securities with a credit loss at the acquisition date. Financial assets purchased outside of a business combination must meet a bright line "seasoned" test (acquired more than 90 days after origination and the acquirer was not involved with the origination).

Approximately 25 comment letters have been received from interested parties largely supporting the ASU, which was developed in response to post-implementation feedback from ASC Topic 326—Credit Losses.[10] However, not all aspects of the proposed ASU are supported, with the biggest concern related to its modified retrospective basis for transition. This would require companies to apply the accounting as of the beginning of the fiscal year in which a company adopted CECL. Criticism points to the overly burdensome task and incomplete data to recast the accounting impact on financial statements dating back to early 2020 for some entities. As a result, a prospective approach garners more support. Other comments voice concern related to credit cards and revolving credit, which are included in the proposed ASU. For these arrangements, there are at least two and potentially three separate units of account to consider, including future draws that are not subject to the proposed ASU.

Those opposing the proposed ASU include the four federal financial institutions' regulatory agencies. The official comment period ended August 28, 2023; however, members of FASB present at the conference indicated they may entertain additional feedback given the timing of the exposure draft and comment period overlapping with the reporting filing season.

Strategy & Planning

Community Bank Panel – Views From the C-Suite

Chris Black – Thread Bank – Chief Executive Officer & President
Bert Lopez – Grove Bank & Trust – EVP & CFO
Romolo Santarosa – Hanmi Financial Corporation – Senior Executive Vice President and CFO

The panelists discussed several areas that are top of mind for community banks and how their respective institutions are handling the current environment.

Liquidity

They felt liquidity risk is the most important item to their organizations after credit risk. They encouraged banks to take action on creating a larger liquidity cushion. It's important to understand what is actually occurring within the bank so that, based on this analysis, management can quickly determine what plans should be completed or

[10] "Financial Instruments—Credit Losses (Topic 326), Purchased Financial Assets," fasb.org, issued June 27, 2023

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modified. Underlying these items is communication with management, the board, customers, regulators, etc. The speed to which circumstances change is only increasing; therefore, it's important to continually assess these items and challenge the assumptions being used.

Securities Portfolio Repositioning

The next topic was regarding securities portfolio considerations. The panelists emphasized transparency when deciding to make loss trades or restructure portfolios. Even though there could be a negative public perception, these could be important actions to consider if the long-term gains will offset the short-term losses.

March Madness 2023 & Community Bank Strategic Options

They discussed how the bank failures beginning in March 2023 impacted their organizations and the changing environment they are operating within. While customers were, of course, concerned, from their perspective, most of their customers didn't have a hard time fitting within the $250,000 limit. However, for many companies (even some small businesses), with AP, payroll, operating accounts, etc., it's much harder to manage the $250,000 limit. The panelists stressed the importance of really getting to know customers and continuing to build those relationships. Consider pulling out your bank charter and your bank's strategic plan and challenge your organization to critically think about your customer base and how to continue to better serve them. Consideration should be given as to how to de-commoditize their services so that it's harder for customers to consider leaving. Especially from a community bank perspective, there are many things they can offer that larger banks can't, starting with the relationships in many cases. The speed at which customers can move is lightning fast now with banking that can easily be done on their phones.

Credit Portfolio

The last topic the panelists gave substantive attention to was the credit portfolio. Their banks are all experiencing the highest reserves since the second quarter of 2020 when the world was still considering the pandemic's effects. They indicated their focus has really been on office space and multifamily. They didn't feel like the credit concerns have materialized at this point, but they all agreed monitoring re-pricing risk as it gets closer will be critical to reacting quickly, if necessary.

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