Accounting Update

Joanne Wakim

Chief Accountant
Federal Reserve Board

Disclaimer

The opinions expressed in this presentation are intended for informational purposes and are not formal opinions of, nor binding on the Board of Governors of the Federal Reserve System.

Topics

- Accounting for Credit Losses
  - Current expected credit loss model (CECL)
- Revenue Recognition
- Definition of a Public Business Entity

Current Expected Credit Loss (CECL) Model

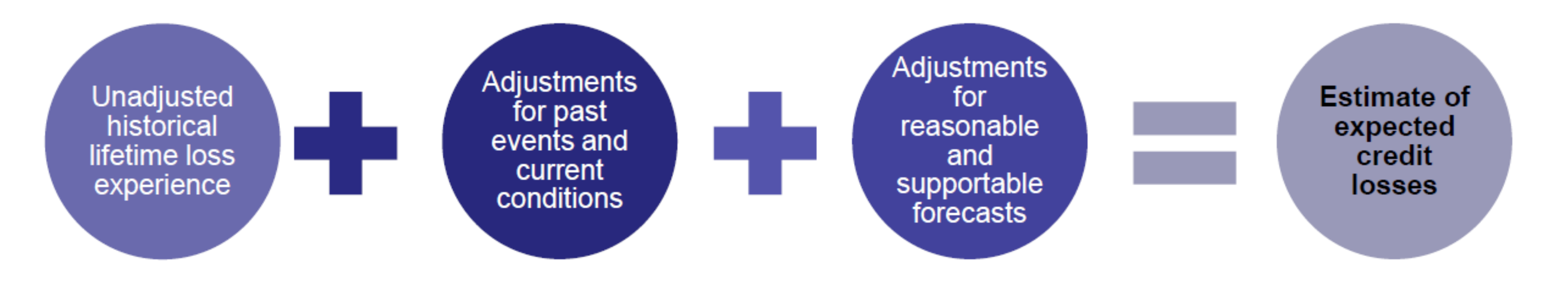
- CECL is applicable to loans and debt instruments held at amortized cost, as well as receivables, lease receivables, and loan commitments
- Expected credit losses = current estimate of all contractual cash flows not expected to be collected

Elements of proposed standard

- Aims at quicker recognition of losses
  - Changes in allowance balances reflect changes in credit quality and flow through bank earnings
  - Forward-looking
  - Longer horizon
  - Removes “incurred” threshold
- Simple and Practical Methods Allowed, for example:
  - Loss Rate x Principal Balance
  - Roll Rate

Elements of proposed standard

- A current estimate of all contractual cash flows not expected to be collected should incorporate:
  - Internally and externally available information
  - Information about past events, current conditions, and reasonable and supportable forecasts
  - Quantitative and qualitative factors specific to borrowers and the economic environment including underwriting standards



Timeline of proposed standard

- Finalized standard expected to be issued by the Financial Accounting Standards Board (FASB) in second quarter 2016

- Effective Date
    - 1Q2019 for public business entities (PBEs) that are SEC filers.
    - 1Q 2020 for all other PBEs.
    - YE 2020 for all other entities.

FRB Resources

- Ask the Fed
  - *Accounting Hot Topics (10/28/2014)*
  - *Loss Data, Data Analysis, and the Current Expected Credit Loss (CECL) Model (10/22/2015)*
- Fed Perspectives
  - *An Overview of the Current Expected Credit Loss Model (CECL) and Supervisory Expectations(10/30/2015)*

https://bsr.stlouisfed.org/askthefed

Supervisory Expectations

Financial institutions are encouraged to:

- Become familiar with the proposed accounting standard
- Discuss the proposed accounting changes with external auditors, industry peers and regulators
- Involve all relevant business lines in preparation for the implementation of the CECL model
- Review current ALLL and credit risk management practices to identify processes that might be leveraged

Supervisory Expectations

Financial institutions are encouraged to:

- Consider data that might be used in a lifetime expected credit loss model (such as origination and maturity dates, initial and subsequent charge-off dates and amounts, and cumulative loss amounts by financial asset category)
- Determine the data currently collected and how best to collect the additional data that may be needed

Revenue Recognition

- Revenue from Contracts with Customers
  - ASU 2014-09 - Issued May 2014
  - Replaces numerous, industry-specific GAAP revenue recognition requirements
  - Public Business Entities – 2018
  - All other – 2019
  - Early adoption permitted

Revenue Recognition

- Core Principle
  - Recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services
- Requires use of greater judgment and estimates

1. Identify the contract with a customer
2. Identify the performance obligations (promises) in the contract
3. Determine the transaction price
4. Allocate the transaction price to the performance obligations in the contract
5. Recognize revenue when (or as) the reporting institution satisfies a performance obligation

Revenue Recognition

- Limited impact to most financial institutions as income from core lines of business are scoped out of the standard (interest income, loan origination fees, gains and losses on financial assets, etc.)
- May impact financial institutions on:
  - Sales of OREO
  - Credit cards arrangements (annual card fees, rewards, interchange, merchant acquirer fees)
  - Securities trade commissions
  - Asset management fees
  - Deposit related fees

Private Company Council ("PCC")

- What is the PCC?
  - Offers a set of alternative "simplified" accounting standards for private entities
- Who does it affect?
  - Private entities.
  - Establishes a definition of "Public Business Entity" for financial reporting purposes. (Different from legal definition).

Private Company Council ("PCC")

- Implications
  - Effective dates
  - Disclosure
  - Recognition and measurement (PCC Alternatives)

Definition of a PBE

- It has one or more securities that are **not subject to contractual restrictions** on transfer, **and** it is required by law, contract, or regulation to prepare **U.S. GAAP financial statements** (including footnotes) and **make them publicly available** on a periodic basis (for example, interim or annual periods). An entity must meet both of these conditions to meet this criterion.

Definition of a PBE

- **Is your bank a public business entity (PBE)?**
  - Yes, if the bank stock is unrestricted and it is required to file financial statements as part of FDICIA Part 363 Annual Report ($\geq$\$500 million in total assets).
  - Yes, if the bank stock is unrestricted and it is required to make financial statements available because of state laws, regulations, or other contracts.
- **If a PBE, a bank cannot avail itself of the Private Company Council accounting standards nor delayed PBE effective dates in general standards.**

**See the September 2015 Supplemental Instructions to the Call Report for additional information.*