

Accounting Standards and Tax Updates: Proactive Strategies for Institutional Preparedness

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Presenters



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Senior Manager | CISA

A Senior Manager in BerryDunn's Financial Services Practice Group, Lindsay helps clients identify improvements in IT general controls, vendor due diligence, and assessing risks.



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Senior Manager | CPA, MSA

A Senior Manager in BerryDunn's Financial Services Practice Group, Kaylyn brings more than a decade of audit and accounting experience to publicly and privately held bank clients.



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A Principal in BerryDunn's Tax Consulting and Compliance Practice Group. Kristen specializes in providing tax consulting and compliance services for clients in the financial services industry.



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Senior Manager | CPA, MBA, CFE

A Senior Manager in BerryDunn's Financial Services Practice Group. David provides accounting and audit services to broker-dealers, mutual holding companies, community banks, and other financial services providers.



Agenda

-  **1** Vendor management
Risk and cybersecurity
-  **2** Accounting and audit update
-  **3** General tax update



Learning objectives



- ▲ Gain insight on assessing financial system vendors and regulatory guidance available on vendor risk and cybersecurity.
- ▲ Understand upcoming accounting and audit changes and how they will impact their financial institutions.
- ▲ Understanding of the tax implications of new accounting pronouncements and regulatory proposals.



Section 1

Vendor management
Risk and cybersecurity

Polling question



Collaborative approach to vendor management

Each team brings a required perspective to appropriately analyze software vendor risks

Finance



Review financial statements and SOC 1 reports

**Risk/Legal/
Compliance**



Review contracts and insurance

IT



Review SOC 2 reports, disaster recovery/business continuity plans, and other IT-related reports





Collaborative approach to vendor management

Reviewing SOC 1 and SOC 2 reports

- ▲ Include both Finance and IT
- ▲ SOC 1 covers internal controls over financial reporting
 - Some IT controls are also included
- ▲ SOC 2 covers security controls
 - Limited finance controls

SOC report due diligence considerations

1

Is the reviewer the right person to analyze any testing exceptions?

2

Do you know when they are applicable to you?

3

For a SOC 1 report, this could involve both Finance and IT to understand implications for your organization.

SOC report due diligence considerations

4

Have you considered each complementary user entity control (CUEC) listed in the report?

5

Have you documented each of your controls that address the applicable CUECs?

6

Have you addressed the risks associated with not having controls to cover the CUEC responsibilities?



SOC report due diligence considerations

Common CUECs

1

Do you perform regular user access reviews to help ensure only appropriate employees and vendor contacts have access to the system?

2

Do you perform testing to help ensure vendor software updates did not cause a hiccup with your data?

3

Do you perform reconciliations to catch any system errors?

4

Do you keep your documentation up-to-date when the vendor makes changes?

5

Do you perform data backups if the software is located at your facility?

Additional due diligence considerations

For financial reporting software, are you considering the following?

1

Which team understands the access permissions for performing financial transactions in the system?

2

Is that team reviewing user access profiles to look for conflicts in segregation of duties (e.g., preparing and posting a journal entry, creating and approving ACHs)?

3

Does this happen at least annually?



Additional due diligence considerations

During contract negotiations, do you consider?

1

Who owns your data—do you have rights to retain it after the vendor contract ends?

2

Who owns the risk if a cybersecurity event occurs?

3

Do you have a right to audit clause included?



Regulatory guidance on third-party risk management

FDIC, OCC, and Federal Reserve guidance

- ▲ Issued June 6, 2023
- ▲ Importance of risk management controls throughout the life cycle of the vendor relationship





Regulatory guidance on third-party risk management

FDIC, OCC, and Federal Reserve guidance

- ▲ Proper oversight and accountability for risk management program, include annual evaluation of vendor risks
- ▲ Ongoing due diligence depends on the criticality or risk level
- ▲ Use of third parties to analyze vendor risk does not remove your responsibilities

Regulatory guidance on cybersecurity

SEC guidance

- ▲ Cybersecurity Risk Management, Strategy, Governance, and Incident Disclosure
- ▲ Issued September 5, 2023
- ▲ Standardize disclosures on cybersecurity incidents and risk controls



Regulatory guidance on cybersecurity

SEC guidance

Required disclosures:





▲ Section 2

Accounting and
audit update



Proposed accounting standards update

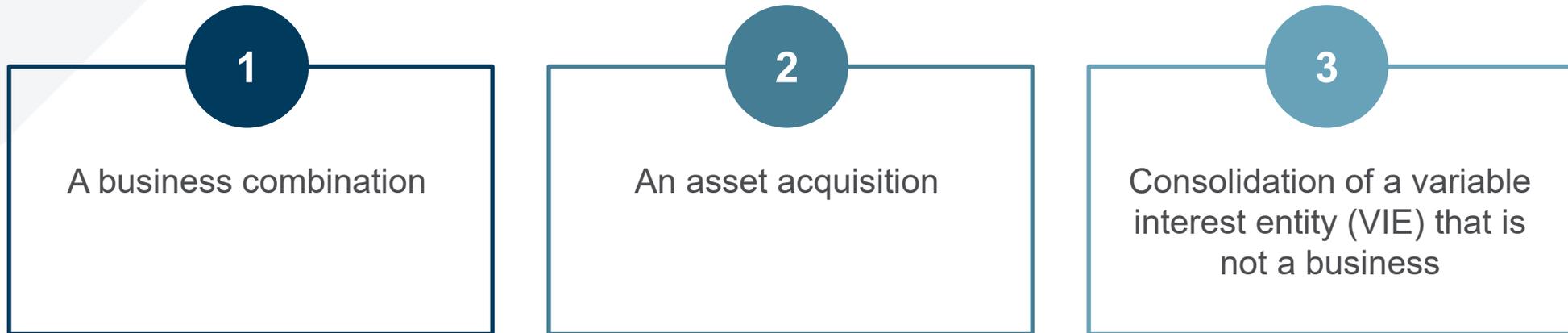
Financial Instruments – Credit Losses
(Topic 326): Purchased Financial Assets

- ▲ Issued June 27, 2023, as part of the FASB's Post-Implementation Review (PIR)
- ▲ Would apply to all entities subject to the guidance in Topic 326

Purchased financial assets

Current accounting

Financial assets acquired through:



Are recorded at fair value, and an allowance for expected credit losses is separately recognized.

Purchased financial assets

Current accounting



- ▶ Must identify purchased financial assets with credit deterioration (PCD) vs. those financial assets without credit deterioration (non-PCD).
- ▶ PCD assets have experienced a more-than-insignificant deterioration in credit quality since origination based on an assessment by the acquirer as of the date of acquisition.
- ▶ “More-than-insignificant” is not defined.



Purchased financial assets

Current accounting – Non-PCD

- ▲ Accounted for in a manner consistent with originated financial assets.
- ▲ The amount embedded in the purchase price that is attributed to expected credit losses is recognized as a “Day 1” credit loss expense in the income statement.



Purchased financial assets

Current accounting – PCD

- ▶ An entity records an allowance and also records the offsetting entry as an addition to the amortized cost basis.
- ▶ Thus, the initial amortized cost basis for PCD assets is an amount equal to the sum of the purchase price and the ACL.
- ▶ This is commonly referred to as the “gross-up approach.”
- ▶ The difference, if any, between the amortized cost basis and par value is a noncredit discount which is accreted or amortized to interest income.



Purchased financial assets

Current accounting – what's the issue?

- ▲ Creates unnecessary complexity
- ▲ Reduces comparability
- ▲ Unintuitive
 - A day 1 loss is recorded on non-PCD assets but not PCD assets
- ▲ **The proposed ASU addresses the complexity and comparability concerns**

Purchased financial assets

Proposed accounting

- ▲ Eliminates the PCD vs. non-PCD determination.
- ▲ The gross-up approach would be applied to all financial assets that are part of a business acquired in a business combination.



Accounting Standards Update 2023-08

Goodwill and Other – Crypto Assets (subtopic 350-60): Accounting For and Disclosure of Crypto Assets

- ▲ Issued December 13, 2023
- ▲ Applies to all entities holding assets that meet the criteria
- ▲ Effective for all entities for fiscal years beginning after December 15, 2024, including interim periods within those fiscal years.
- ▲ Early adoption is permitted





Accounting for and disclosure of crypto assets

What are the criteria?

- ▲ Meet the definition of *intangible assets* as defined in the ASC
- ▲ Do not provide the asset holder with enforceable rights to or claims on underlying goods, services, or other assets
- ▲ Are created or reside on a distributed ledger based on blockchain or similar technology
- ▲ Are secured through cryptography
- ▲ Are fungible
- ▲ Are not created or issued by the reporting entity or its related parties



Accounting for and disclosure of crypto assets

If the criteria are met...

Required to subsequently measure assets at fair value with changes recognized in net income each reporting period.

Accounting for and disclosure of crypto assets

Disclosure requirements

- ▲ Crypto assets, including changes in fair value, must be presented separately from other intangible assets
- ▲ The name, cost basis, fair value, and number of units for each significant crypto asset holding and the aggregate fair values and cost bases of the crypto asset holdings that are not individually significant
- ▲ Information on any contractual sale restrictions
- ▲ A rollforward, in the aggregate, of activity in the reporting period
- ▲ The difference between the disposal price and the cost basis and a description of the activities that resulted in dispositions of crypto assets
- ▲ If gains and losses are not presented separately, the income statement line item in which those gains and losses are recognized
- ▲ The method for determining the cost basis of crypto assets



SEC climate disclosure rules

- ▲ On March 6, 2024, the SEC issued a final rule that requires registrants to provide climate disclosures in their annual reports and registration statements, including those for initial public offerings
- ▲ The requirements will be phased in depending on registration status

Large accelerated filers

Fiscal years beginning in 2025

Accelerated filers

Fiscal years beginning in 2026

Smaller reporting companies

Fiscal years beginning in 2027

SEC climate disclosure rules

Registrants must disclose, amongst other things:

- ▶ Material climate-related risks
- ▶ Activities to mitigate or adapt to such risks
- ▶ Information about the registrant's board of directors' oversight of climate-related risks and management's role in managing material climate-related risks
- ▶ Information on any climate-related targets or goals that are material to the registrant's business
- ▶ Scope 1 and/or Scope 2 greenhouse gas emissions on a phased-in basis by certain larger registrants when those emissions are material (will also need to get assurance on these disclosures)
- ▶ Financial statement effects of severe weather events and other natural conditions



SEC climate disclosure rules

Financial statement disclosures

- ▲ The capitalized costs, expenditures expenses, charges, and losses incurred as a result of severe weather events and other natural conditions, such as hurricanes, tornadoes, flooding, drought, wildfires, extreme temperatures, and sea level rise, subject to applicable one percent and de minimis disclosures, disclosed in a note to the financial statements
- ▲ The capitalized costs, expenditures expenses, and losses related to carbon offsets and renewable energy credits or certificates (RECs) if used as a material component of a registrant's plans to achieve its disclosed climate-related targets or goals, disclosed in a note to the financial statements
- ▲ If the estimates and assumptions a registrant uses to produce the financial statements were materially impacted by risks and uncertainties associated with severe weather events and other natural conditions or any disclosed climate-related targets or transition plans, a qualitative description of how the development of such estimates and assumptions was impacted, disclosed in a note to the financial statements





▲ **Section 3**

General tax update

Accounting Standards Update 2023-02

Investments – Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Tax Credit Structures Using the Proportional Amortization Method

Expansion of proportional amortization method (PAM)

- ▲ ASU 2014-01 introduced PAM in accounting for Low Income Housing Tax Credit (LIHTC) investments
- ▲ New ASU extends applicability to investments in other tax credit structures (NMTC, Renewable Energy, Rehab Credits)

Effective dates:

- ▲ Public entities; fiscal years beginning after December 15, 2023
- ▲ All other entities; fiscal years beginning after December 15, 2024
- ▲ Early adoption is permitted



Accounting Standards Update 2023-02

Investments – Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Tax Credit Structures Using the Proportional Amortization Method

PAM can be used if:

- ▲ Tax credit is probable
- ▲ Bank investor does not have significant influence over operating and financial policies of the underlying project
- ▲ Substantially all the projected benefits are from income tax credits and other income tax benefits (losses from depreciation, etc.)
- ▲ Bank is a limited partner whose liability can't exceed its capital investment

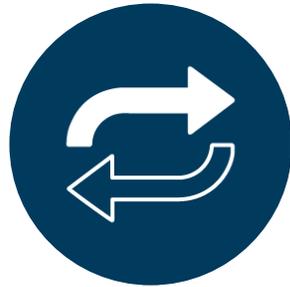
Accounting for investments using PAM:

- ▲ Cost basis is amortized in proportion to the income tax credits and other income tax benefits received.
- ▲ Amortization and tax credits presented net as a component of income tax expense.



Accounting Standards Update 2023-02

Investments – Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Tax Credit Structures Using the Proportional Amortization Method



Transition

- Modified retrospective method
 - Beginning of year of adoption
- Retrospective method
 - Beginning of earliest year presented
- LIHTC not accounted for using PAM are not required to be adjusted
 - Investor may apply a prospective approach



Disclosures

- Nature of investments
- Effect of recognition and measurement
- Amount of income tax credits and other benefits and where recognized in financial statements
- Amount of investment and where recorded in the balance sheet
- Amount of amortization recognized as a component of income tax expense (benefit)

Accounting Standards Update 2023-09

Income Taxes (Topic 740): Improvements to Income Tax Disclosures



- ▲ Amendments to enhance the transparency and decision usefulness of income tax disclosures.
- ▲ Effective dates:
 - Public entities; fiscal years beginning after December 15, 2024
 - All other entities; fiscal years beginning after December 15, 2025
 - Early adoption is permitted
- ▲ Main components
 - Rate reconciliation (public entities only)
 - Income taxes paid
 - Other disclosures

IRS News – Proposed Bad Debt Regulations

Proposed Regulation Section 1.166-2

- ▲ Because regulated financial companies must adhere to specific accounting standards, the IRS is proposing conformity with financial standards for determining bad debt.
- ▲ Current regulations do not define the term “worthless” as it pertains to bad debts.
- ▲ Proposed regulations update the standard used when determining whether a debt is conclusively presumed to be worthless and available for a bad debt tax deduction.
 - Define charge-off as occurring when the debt is recorded in whole or in part as a loss in the financial statements.



IRS News – Proposed Bad Debt Regulations

Proposed Regulation Section 1.166-2

- ▲ **NEW:** Allowance Charge-Off Method (ACM) – will require a change in accounting method (not an automatic change)
 - Banks generally are using the experience method (less than \$500M in total assets), specific charge-off method, or conformity method.
 - Under the ACM, debt held by regulated financial companies is conclusively presumed to have become worthless for IRS § 166 purposes to the extent that amounts are charged off under the Allowance for Credit Loss in accordance with GAAP.
 - Similar to conformity election when express determination letter received from regulators
 - ACM would no longer require the express determination letter
 - Additional guidance from IRS is needed.
 - How will non-accrual loan interest be impacted if no conformity election?
 - Is the ACM elective?





Tax Cuts & Jobs Act of 2017

Sunset provisions

- ▲ Bonus depreciation (already phasing out—gone by 2027)
- ▲ Section 199A Qualified Business Income Deduction
- ▲ Expanded Child Tax Credit
- ▲ Standard deduction (personal exemptions reinstated)
- ▲ SALT Cap
- ▲ Individual tax rates – back to pre 2018 rates after 2025 (top rate of 39.6%)
- ▲ Estate tax exemption (cut in half)



Tax proposals and policies to watch

President Biden's Fiscal Year 2025 Budget released on March 11, 2024

Highlights:

- ▲ Increase of corporate tax rate from 21% to 28% for tax years beginning after 12/31/23
- ▲ Increase of corporate AMT from 15% to 21% (applies to corporations with FS net income > \$1B)
- ▲ Increase stock buyback excise tax to 4%
- ▲ Denies corporate deductions of all compensation > \$1M per employee
- ▲ New tax credit for middle-class first-time homebuyers of up to \$10,000 over two years
- ▲ Unlock starter home inventory by providing a one-year credit up to \$10,000 to middle-class families who sell their starter home
- ▲ Provides funding for loan guarantees for renewable energy systems and energy efficiency improvements for farmers and rural small businesses



Tax proposals and policies to watch

H.R. 7024 – Tax Relief for American Families and Workers Act of 2024

Passed the House and being considered by the Senate. Business leaders encouraged by indication of bipartisan support.

Highlights:

- ▲ 100% Bonus Depreciation through end of 2025
- ▲ Expensing of Research and Experimental Expenditures
- ▲ EBITDA – Based Limitation for Section 163(j)
- ▲ Enhanced Child Tax Credit



What can we expect?

Complex and politically charged environment

- ▶ Significant opposition expected due to Republican control of House of Representatives and Democratic control of Senate.
- ▶ Tax proposals not likely to reach a resolution by October 1.
- ▶ Trump's campaign aims to extend or make permanent the tax cuts from TCJA.

Questions?

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Break

Next session:

Balance Sheets: Maximizing Benefits and
Minimizing Risks for Financial Institutions

Begins at

11:00 am

Presenter:



Ryan Henley

