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The Auditor's Report

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CECL Model for Credit Loss Reserves

The votes are in and the Financial Accounting Standards Board (FASB) has elected to go forward with the Current Expected Credit Loss (CECL) model for estimating future credit loss reserves. FASB issued Accounting Standards Update (ASU) 2016-13, "Financial Instruments-Credit Losses," (Topic 326) (the ASU) requires a new approach to estimate credit losses based on expected losses on certain types of financial instruments. It modifies the impairment model for loans and all financial instruments carried at amortized cost including Held-to-Maturity (HTM) debt securities, as well as off-balance-sheet credit exposures including loan commitments, standby letters of credit, and financial guarantees. The new accounting standard does not apply to trading assets, loans held for sale, financial assets for which the fair value option has been elected, or loans and receivables between entities under common control. The new accounting standard also makes improvements to the accounting for credit losses on Available-for-Sale (AFS) debt securities. While this does not go into effect for years, credit unions should start moving forward in preparations for the new model. Now is the time to understand the models available and the data needed to fuel those models.

The ASU does not prescribe the use of specific estimation models. Rather, it allows for credit loss allowances to be determined using various models that reasonably estimate the expected collectability of financial assets. Acceptable models include loss rate, roll-rate, vintage analysis, discounted cash flow, and probability of default/loss given default models. Neither a vintage nor a discounted cash flow model is required for estimating expected credit losses. Additionally, a credit union may apply different estimation models to different groups of financial assets. To properly apply an acceptable estimation model, a credit union's credit loss estimates must be well supported. The ASU allows for smaller and less complex institutions to be able to adjust their existing allowance models to meet the requirements of the new accounting standard without the use of costly and/or complex modeling techniques. This is great news for most credit unions because they do not have complex loan portfolios.

CECL requires credit unions to measure expected credit losses on financial assets carried at amortized cost on a collective or pool basis when similar risk characteristics exist. Similar risk characteristics may include one or a combination of credit scores, risk ratings, collateral type, vintage, geographical location, term, or expected credit loss. Although the new accounting standard provides examples of similar risk characteristics, smaller and less complex institutions may conclude that the segmentation practices they have used under the incurred loss methodology are also appropriate under the expected loss methodology.

If a financial asset does not share risk characteristics with other financial assets, the new accounting standard requires the expected credit losses on that asset to be measured on an individual asset basis. As under the incurred loss methodology, financial assets on which expected credit losses are measured on an individual basis should not also be included in a collective assessment of expected credit losses.

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The approach to identifying a troubled debt restructured loan (TDR) does not change under the ASU, but the options for estimating impairment does change. When loan terms are modified due to the borrower's financial hardship resulting in a concession granted by the lender, those modifications are considered TDRs. However, credit losses on TDR s under the new CECL model are calculated under the same expected credit loss methodology applied to other financial assets carried at amortized cost. This is different from current guidance, which requires that impairment on TDR loans be measured using specific methods applicable to individually impaired loans (e.g., discounted cash flow and fair value of collateral).

The CECL model will require that credit losses on HTM securities be recorded when they exist. This is different to today's accounting for HTM securities. Also, the CECL model will change the accounting for AFS securities. The accounting for credit losses associated with AFS securities will improve allowing for credit losses to be recorded using an allowance for credit losses rather than the current practice of write-downs on other-than-temporary impairments that cannot be recouped. Using an allowance for credit losses will allow for impairments to reversed if conditions change for the better.

The implementation date for "private" companies, which includes credit unions, is for fiscal years beginning after December 15, 2020. Early application of the standard is permitted for fiscal years beginning after December 15, 2018. Thus, credit unions not opting early application, must first apply the new credit losses standard in its financial statements and regulatory reports (e.g., the Call Report) for the quarter ended March 31, 2021. Until adoption, credit unions must continue to use the existing U.S. GAAP incurred loss methodology until CECL becomes effective. It is not appropriate to begin increasing allowance levels beyond those appropriate under existing Generally Accepted Accounting Principles (GAAP) in advance of CECL's effective date. When estimating allowance levels before CECL's effective date, the implementation of the CECL methodology is a future event. It is therefore inappropriate to treat CECL as a basis for qualitatively adjusting allowances measured under the existing incurred loss methodology.

Credit unions should prepare for the change in accounting by first understanding the new accounting standard, the models available, and the data needed for implementation. While 2020 is years away, years of data will be needed to accurately implement this standard.

Should you have any questions regarding this new accounting standard, please do not hesitate to contact our firm.

Chris Vallez, CPA, MBA
Partner

2017 Credit Union Conferences

Nearman, Maynard, Vallez, CPAs will be "out and about" visiting with the credit union community this year. If you plan on attending any of the following conferences, please stop by our booth. We would love to meet you and discuss your credit union's auditing needs.

- Cornerstone League—April 11-12, 2017—Fort Worth, TX
- Tennessee Credit Union League—May 1-2, 2017—Gatlinburg, TN
- Georgia Credit Union Affiliates - May 17-20, 2017 - Savannah, GA
- Carolinas Credit Union League - June 4-6, 2017 - Pinehurst, NC
- League of Southeastern Credit Unions - June 14-15, 2017 - Orlando, FL
- ACUIA - June 20-23, 2017 - San Antonio, TX
- AICPA National Conference on Credit Unions - October 23-25, 2017 - New Orleans, LA

2016 Year End Review of FASB

Established in 1973, the Financial Accounting Standards Board (FASB) is the independent, private sector, not-for-profit organization based in Norwalk, Connecticut, that establishes financial accounting and reporting standards for public and private companies and not-for-profit organizations that follow Generally Accepted Accounting Principles (GAAP).

FASB standards are recognized as authoritative by many organizations, including state Boards of Accountancy and the American Institute of CPAs (AICPA). The FASB develops and issues financial accounting standards through a transparent and inclusive process intended to promote financial reporting that provides useful information to investors and others who use financial reports. Prior to the final standard, the proposed standard comes in the form of an exposure draft.

An exposure draft represents a proposed standard as a result of the FASB technical project. The FASB invites individuals, organizations and others to provide comments expressing agreement or disagreement on a matter in the proposed draft. These exposure drafts are structured in a document that can be used to solicit input on issues addressed in the project. This document also is used to solicit input on a variety of matters which include but are not limited to matters specific to a possible agenda topic or other document issued for public comment.

The FASB has been quite busy in 2016 issuing new Accounting Standards Updates (ASUs) as well as proposed Accounting Standard Updates. The following concentrates first on the new finalized Accounting Standard Updates. During 2016, FASB issued 20 new updates versus 17 issued in 2015. Below is a table of those ASUs issued in 2016 that have or could have a significant impact on most Credit Unions.

ASU	Title	Effective Date
2016-01	***Financial Instruments*** – Overall – Recognition and Measurement of Financial Assets and Financial Liabilities	Fiscal years beginning after December 15, 2018*
2016-02	***Leases*** (Topic 842)	Fiscal years beginning after December 15, 2019
2016-03	***Intangibles*** - Goodwill and Other (Topic 350), Business Combinations (Topic 805), Consolidation (Topic 810), Derivatives and Hedging (Topic 815): Effective Date and Transition Guidance (a consensus of the Private Company Council)	The amendments in this Update are effective immediately upon issuance.
2016-13	***Financial Instruments -*** Credit Losses (Topic 326) Measurement of Credit Losses on Financial Instruments	Fiscal years beginning after December 15, 2020
2016-15	***Statement of Cash Flows*** (Topic 230) - Classification of Certain Cash Receipts and Cash Payments	Fiscal years beginning after December 15, 2018

*Many ASUs are available to implement early, please refer the standard issued or contact our firm for additional clarification.

All complete Accounting Standard Updates can be found at FASB's website at: http://www.fasb.org/jsp/FASB/Page/SectionPage&cid=1176156316498. In addition to final ASUs that are issued which are changes to the codification, FASB also issues Proposed Accounting Standard Updates in exposure documents. These are documents released by FASB issued for public review and comment. During 2016 FASB issued 21 proposed ASUs verses 23 in the prior year. Until Accounting Standard Updates are issued final, changes can occur as well as be re-exposed (issued) for additional public comment.

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Nearman Maynard•Vallez
Certified Public Accountants

About Us

Since 1979, Nearman, Maynard, Vallez, CPAs has provided auditing and consulting services exclusively to credit unions throughout the United States. Our dedication to credit unions has given us the unique ability to provide exceptional service at a reasonable price. Our primary objective is to assist our clients in accomplishing their goals through our experience, service, & commitment. If your Supervisory/ Audit Committee or Management is interested in obtaining information on the subjects in this issue or about our many services, call or email us today.

Website:
www.nearman.com
E-mail: info@nearman.com
Toll-free: 800.288.0293

Atlanta: 205 Brandywine Blvd., Suite 100,
Fayetteville, GA 30214
770.461.5706

Miami: 10621 N. Kendall Dr., Suite 219,
Miami, FL 33176
305.598.1730

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Proposed Accounting Standard	Comment Deadline
*Proposed Accounting Standards Update—**Distinguishing Liabilities from Equity** (Topic 480): I. Accounting for Certain Financial Instruments with Down Round Features and II. Replacement of the Indefinite Deferral for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests with a Scope Exception*	February 17, 2017
*Proposed Accounting Standards Update—**Debt** (Topic 470): Simplifying the Classification of Debt in a Classified Balance Sheet (Current versus Noncurrent)*	May 5, 2017

This is a very important part of codification update process and provides individuals as well as institutions an opportunity to express their views, concerns, or approval of a proposed accounting changes. We urge our clients to review proposed Accounting Standard Updates (exposure documents) and comment on significant proposals. You can see a complete list of exposure documents on FASB's website at: http://www.fasb.org/jsp/FASB/Page/SectionPage&cid=1175805074609.

Nearman, Maynard, Vallez also periodically updates the "news" page of our website with important FASB updates. Visit our website at http://www.nearman.com/news.htm for the latest updates. And as always, if you have any questions and would like to discuss any of the accounting changes, please contact us at 800-288-0293 or via email at info@nearman.com.

Ellen Vargo, CPA, CFE, FCPA
Partner

Compliance Deadline Reminder

Don't forget the due dates for the following required annual audits for 2017.

ACH Compliance Audit: Due date December 31st of each year.

BSA Compliance Audit: Audit is due every 12-18 months.

Safe Act Review: Due prior to the annual mortgage licensing renewal period (November 1 - December 31st) each year.

HUD Audit: For those December 31st audit clients with a HUD audit requirement, the filing deadline for uploading your audited financial statements and HUD audit reports in the Lender Electronic Assessment Portal (LEAP) is March 31, 2017.

If you haven't planned for these audits, be sure to contact your auditor now to get your reviews scheduled.