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The Auditor's Report

In this issue

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CECL Is Coming - Accounting Standards Update (ASU) 2016-13 Update

We have talked about CECL before, but there are new issues to discuss. Of course, we are talking about the change in the allowance for loan and lease losses (ALLL) calculation from today's incurred model, meaning the ALLL balance should equal incurred loan losses in the loan portfolio at a given point in time to the expected loan loss model. The expected loan loss model which will require the ALLL balance to equal expected loan losses over the life of the loan portfolio. Recently there has been more support for simplistic solutions that can be calculated in Excel. Note: Our exit briefing uses "allowance for loan and lease account" (ALLL).

The ASU states that loan portfolios with simple loan characteristics can use a simple solution in implementing CECL. Most credit union's loan portfolios do have characteristics of a simple loan portfolio. Meaning loans are comprised of consumer loans (i.e., credit cards, vehicle, and mortgage loans). Some of the simple methods of calculating CECL are referred to as "Loss-Rate" methods.

Loss-Rate methods include "Vintage," "Weighted Average Remaining Maturity," "Open Pool," and "Static Pool" approaches. All these calculations can be performed using Excel. They are largely based on historical data of loan balances, charges-offs and recoveries, like today's incurred loan loss method.

The Federal Deposit Insurance Corporation provided a very useful presentation which is available on-line at https://www.webcaster4.com/Webcast/Page/583/24368. This presentation named "Ask the Regulators: CECL Teleconference for Bankers: Practical Examples of How Smaller, Less Complex Community Banks can Implement CECL" applies to credit unions as well as banks. It provides a hands-on, approach to a simple approach to CECL. The presentation provides calculation examples, but one thing to remember is CECL will require not only a mathematical change, it will require a more comprehensive approach to understanding how environmental (EV) factors will affect the ALLL balance. While not addressed in the presentation, all financial institutions will have to consider EV factors under CECL.

Additionally, the Financial Accounting Standards Board (FASB) discussed changing the implementation date for credit unions, but no decision has been made. The FASB Board discussed a proposal to extending the effect date for non-public business entities (PBEs) by amending paragraph 326-10-65-1 to require that non-PBEs adopt the amendments in ASU 2016-13 for fiscal years beginning after December 15, 2021. Essentially delaying CECL implantation for one year. The FASB has put this potential change out for a 30-day comment period.

Chris Vallez, CPA, MBA, Partner
Nearman, Maynard, Vallez, CPAs

The New Lease Accounting

The Financial Accounting Standards Board (FASB) has issued new guidance that will make the adoption of the new leases standard, ASC 842, Leases, easier. Under a new transition method, comparative periods presented in financial statements in the period of adoption will not need to be restated. Instead, a reporting entity would:

- Initially apply the new lease requirements at the effective date (e.g., January 1, 2019 for a calendar year-end public company), and recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption.
- Continue to report comparative periods presented in the financial statements in the period of adoption under current Generally Accepted Accounting Standards (GAAP) (i.e., ASC 840, Leases).
- Provide the required disclosures under ASC 840 for all periods presented under ASC 840.

The new lease standard will require revised accounting for all leases greater than a year in term. An entity will still need to apply the modified transition approach when implementing the new guidance. Credit Unions must adopt the new standard no later than annual periods beginning after December 15, 2019 (i.e., January 1, 2020).

Chris Vallez, CPA, MBA, Partner
Nearman, Maynard, Vallez, CPAs

League Conference Recap

We would like to thank everyone who visited our booth at the following conferences: Cornerstone Credit Union League in Little Rock, the Tennessee Credit Union League in Chattanooga, the Georgia Credit Union Affiliates in Savannah, the League of Southeastern Credit Unions in Orlando, and the Association of Credit Union Internal Auditors in Chicago. We really enjoy seeing old friends and making new friends in the credit union industry.

Stay tuned to where we will be in 2019. We hope to see you out and about.

CORNERSTONE CREDIT UNION LEAGUE

TENNESSEE Credit Union League

GEORGIA CREDIT UNION Affiliates

LSCU League of Southeastern Credit Unions & Affiliates

ACUIA Association of Credit Union Internal Auditors

"Exclusively Serving The Credit Union Industry"

ACH Fraud Schemes 101

As consumers and businesses move to more electronic payments due to the ease and quickness, an increase in ACH (Automated Clearing House) fraud can be expected. ACH fraud is easy to perpetrate since only two pieces of information are needed to generate an ACH; the routing number of the credit union and the account number at that credit union. Since credit union routing numbers are easily found on the internet, a fraudster only needs to know the credit union name and the account number of the target account to commit ACH fraud. ACH fraud schemes can be perpetuated by both an external fraudster or an insider at a credit union.

External Frauds

Criminals can obtain this information easily through phone scams or phishing attacks. Phishing is the attempt to acquire sensitive information such as usernames, passwords, and account or credit card information, by masquerading as a trustworthy entity in an electronic communication. Once this information is obtained the fraudster uses it to initiate payments for purchases or funds transfers.

One of the most common schemes, especially at the beginning of each year is an email that is received appearing to be from the Internal Revenue Service (IRS). This email states the person or entity owes the IRS money and must settle the account immediately. This tactic scares the person into giving their bank account information to the fraudster and thus, the account gets compromised.

Another common scheme is consumers receive an email that they believe is from their credit union with a link. Once the link is clicked, the person has unknowingly installed malware onto their computer that is logging every keystroke. The fraudsters then wait to capture online credit union login information and utilize that to send out fraudulent ACH payments.

Internal Frauds

An employee with access to the ACH edit files can steal funds by either:

- Modifying the ACH edit file by adding a fictitious credit entry prior to posting
- Creating a fictitious ACH edit file and posting it
- Modifying the account numbers in the ACH edit file prior to posting.

The employee may either have access to the account where they have placed the funds or have a relative or friend withdrawal the funds for them. This internal ACH fraud can go undetected for a very long period without timely reconciliation procedures.

An employee with access to initiate an ACH origination file adds fraudulent entries debiting another account at another credit union or bank and places the money in an account at the credit union where they are employed. The employee may either have access to the account where they have placed the funds or have a relative or friend withdrawal the funds for them.

This internal ACH fraud would only be found by the timely review of the account activity by the victim of the fraud at the other credit union or bank.

Consumers, businesses, and credit unions can help protect themselves from ACH fraud by shredding used checks and other documents with the credit union's name and account number on it, reviewing account activity frequently, reconciling accounts frequently, using strong passwords and changing them often. Credit unions can help prevent ACH fraud by restricting access to computers that are used for originating ACH files, reconciling their ACH settlements daily, and having segregation of duties between posting ACH files and reconciling the settlement accounts.

Failing to monitor ACH activity can be costly both for the customer as well as the credit union. There have been cases of customers suing their financial institution as well as the financial institution suing their customers for lost funds due to fraudulent ACH activity. Thus, it is everyone's responsibility to help prevent and detect ACH fraud.

Jennifer N. Hoskins, CPA, MPA, Partner
Nearman, Maynard, Vallez, CPAs

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