2024 AICPA Conference on Banks & Savings Institutions

Takeaways and Hot Topics From Our Specialists

October 2024

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Contents

Conference overview 3

Economic updates 4

Updates from the federal banking agencies 9

FASB updates 11

SEC updates 17

PCAOB updates 19

Technology, AI, and blockchain 22

Other items of relevance for banks 24

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Conference overview

The 49th annual American Institute of Certified Public Accountants (AICPA) and Chartered Institute of Management Accountants (CIMA) Conference on Banks & Savings Institutions was held Sept. 9 through 11, 2024, in National Harbor, Maryland. The event included remarks from industry leaders, regulators and standard-setters, economists, and other industry stakeholders on key accounting, regulatory, and other topics.

Participants discussed the current economic landscape, trends in consumer debt and real estate, and operating in what many expect to be a declining interest rate environment at length. They explored generative artificial intelligence (GenAI) and its application in the banking sector. Cybersecurity was another hot topic as presenters cited an uptick in fraud and reminded institutions to remain diligent in their cybersecurity systems and risk assessment procedures. Accounting for current expected credit losses (CECL) continued to be a focal point of the conference, as it has been for many years.

On Monday:

- Barry Melancon, president and CEO, AICPA, and CEO, Association of International Certified Professional Accountants, discussed the current landscape for the AICPA's members, including remarks on effects of global political changes and economic conditions on the accounting profession, technological and demographic trends, and the future of the profession.
- Marci Rossell, former CNBC chief economist, presented a session titled "The Economy 2025: Monetary and Fiscal Policy in a New Era." Rossell discussed the correlation between consumer spending and residential real estate prices, the latest trends affecting the global economy, and AI.
- Thomas Vartanian, executive director for the Financial Technology & Cybersecurity Center, delivered a presentation titled "21st Century Internet Alert: Tech Is Just as Destructive as Transformative!" Vartanian spoke on the risks of being on the internet, the "hacked hall of fame," online surveillance, and how AI plays a role in the internet of the future.

On Tuesday:

- Doug Duncan, chief economist at the Federal National Mortgage Association (Fannie Mae), delivered an economic update on the U.S. real estate market. Duncan cited numerous statistics and indicators supporting the idea that the economy is not currently nearing a recession, despite concerns related to rising credit card debt, a decline in the availability of jobs, and the current savings levels of average households. The economy is still benefiting from "the lock-in effect" of low interest rates as homeowners hold onto their low-interest rate mortgages, increasing economic productivity, and continued appreciation of real estate due to the limited supply, largely supported by an imbalance between supply and demand.
- Lamont Black, associate professor of finance at DePaul University, delivered a keynote address entitled "Our Digital Future: AI, Blockchain, and Beyond." Black shared his view of the current financial landscape and provided financial institutions with both a framework for AI adoption and practical use cases for blockchain in the banking sector.

Throughout the conference, industry leaders explored issues facing banks today. Participants received updates on current activities from the chief accountants of the federal banking regulators, the Securities and Exchange Commission (SEC), the Financial Accounting Standards Board (FASB), and the Public Company Accounting Oversight Board (PCAOB). Other matters included accounting for tax credits, bank-fintech partnerships, balance sheet management strategies, and climate reporting.

The 2025 conference will take place Sept. 15 through 17, 2025, online and on-site, again at the Gaylord National Resort & Convention Center in National Harbor. As was the case in 2024, the conference will be co-located with the AICPA & CIMA Conference on Credit Unions.

We hope you find this summary useful and welcome your feedback.

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Economic updates

State of the economy

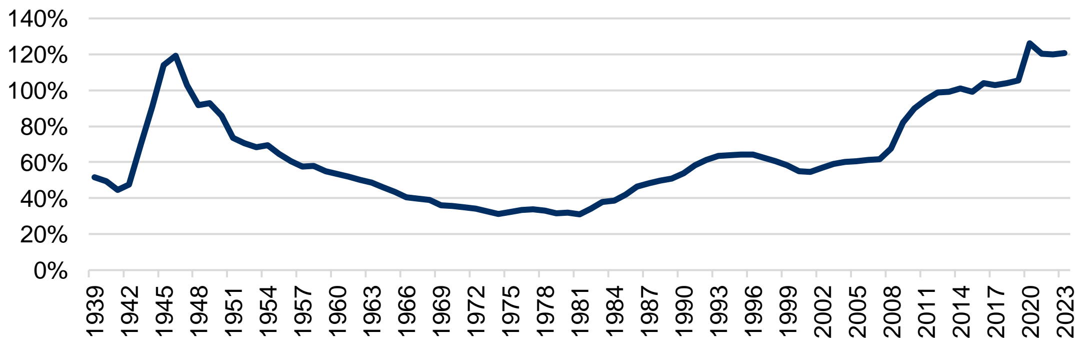
On the first day of the conference, keynote speaker and former CNBC chief economist Marci Rossell discussed the economy, focusing on the housing market and affordability, the impact of inflation, and trends in consumer behavior, among other matters. On the second day, Doug Duncan, chief economist at Fannie Mae, gave a keynote presentation on the economy, focusing on interest rates, inflation, fiscal policy, real estate, and an overall economic outlook.

Both economists emphasized that the U.S. is not nearing a recession. Rossell discussed previous recessions, citing that recessions are not caused by what people perceive or expect will cause a recession, such as a rise in interest rates or consumer debt, but rather unexpected events such as a global pandemic, dot-com bust, or housing crisis. Duncan forecasted an economic slowdown but not a recession. He cited that while savings rates are down, credit card debt, productivity and gross domestic product (GDP) are all higher. He stated that approximately 70% of national income (defined as the total value of all goods and services produced in the U.S. in a given year) comes from the service sector, with the remaining 30% from the goods sector. While the goods sector, which includes housing, has shown signs of deterioration, the service sector remains strong and is less cyclical.

National debt and GDP

In 2024, federal spending to service interest payments on U.S. national debt surpassed the United States' national defense budget.[1] While some economists believe that this might cause concern in the future, the financial markets have not reacted to this news. Rossell clarified that a reaction by the market would be a "premium" on debt issued by the U.S., likely resulting in higher interest rates on U.S. debt to reflect the greater risk. The federal debt relative to GDP is currently at the same level as it was during WWII. Duncan suggested that rising GDP would help alleviate the national debt, as a rise in GDP would result in increased income tax revenue. In 2022, GDP was $25 trillion, and it has grown to $28 trillion in 2024. Investments in technology such as AI are expected to drive further growth in GDP.

U.S. public debt outstanding, as a percentage of GDP



Source: Federal Reserve Bank of St. Louis, retrieved Oct. 15, 2024.[2]

[1] https://www.crfb.org/blogs/do-we-spend-more-interest-defense
[2] https://fred.stlouisfed.org/series/GFDGDPA188S

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Fed's fiscal policy, inflation, and interest rates

The Federal Reserve (Fed) policy on interest rates is expected to make a shift in late 2024. Fed Chair Jerome Powell recently made a statement[3] that now is the time to change the direction of monetary policy, indicating rate cuts are on the horizon. Rossell stressed the importance of the Sept. 17-18, 2024, Federal Open Markets Committee (FOMC) meeting and the potential decision to cut interest rates, which had not occurred since March 2020 when the COVID-19 pandemic started. She questioned the impact elevated interest rates have had on the economy, citing that inflation has decreased from 8.5% in March 2022 to 2.5% in August 2024. Rossell noted that the Fed set a target range for inflation between 1% and 3% and that the current inflation of 2.5% is within that range, indicating the Fed has met the policy goal it set out to achieve. Rossell expected the Fed to cut rates by 25 basis points. Duncan echoed that forecast, also expecting a rate cut of 25 basis points in September and another 25 in December, with 2025 forecasted to have one cut of 25 basis points each quarter.

Update: On Sept. 18, 2024, the FOMC lowered the target range for the federal funds rate by 50 basis points to a range of 4.75% to 5%.

Commercial real estate

According to sentiment in the financial institutions industry, prolonged weakness in the commercial real estate (CRE) market might be on the horizon. Specifically, there are concerns about the commercial office space sector, which has been affected by changes in how employees work, as well as the potential ripple effect that a decline in this sector could have on the U.S. economy at large. The COVID-19 pandemic introduced a rise in flexible work arrangements, which has lowered the demand for commercial office space since the pandemic. Coupled with the decline in office use by white-collar employees, Rossell noted that approximately "30% of commercial real estate debt comes due by 2026." A majority of current CRE debt was negotiated in periods of lower interest rates, and refinancing at higher interest rates will increase service costs. As such, industry stakeholders are concerned about the mismatch of lower revenues and higher expenses and the potential for significant credit losses for financial institutions. Regional data suggests that risk of credit losses depends, in part, on the geography in which the CRE is located, with cities such as San Francisco forecasting greater potential losses than other metropolitan markets like Chicago.

Rossell compared the potential impact of office CRE credit losses to the housing market crash in 2008, highlighting that CRE office space is roughly a quarter of the size of the housing market. Therefore, a stressed office CRE sector is unlikely to have the same impact on the U.S. economy as the previous housing market crash.

Residential real estate

Both economists shared information on the residential real estate market, citing that real estate has become less affordable for the average American household. Although the rate of home price increases has slowed down, home prices are still rising. They identified several reasons for the housing shortage.

- When the Fed lowered the target fed funds rate to near zero in 2020, homes were purchased and refinanced at rates lower than the current market rates, creating a "lock-in effect" for existing homeowners.
- There is a significant shortage of homes being built in the U.S., leading to a gap of about 3 million homes, as cited by Rossell.
- Supply is the primary factor contributing to elevated home prices.

Duncan suggested a supply-side policy update is needed to address the housing shortage, as he believes that providing incentives to potential homebuyers would exacerbate the mismatch between housing supply and demand. Rossell stated she believes the biggest challenge facing the American economy is that "we do not have enough houses to put roofs over the heads of every single person in this country, and the solution is to build." Both Rossell and Duncan said they expect the demand for housing to remain consistent for at least another decade.

[3] https://www.federalreserve.gov/newsevents/speech/powell20240823a.htm

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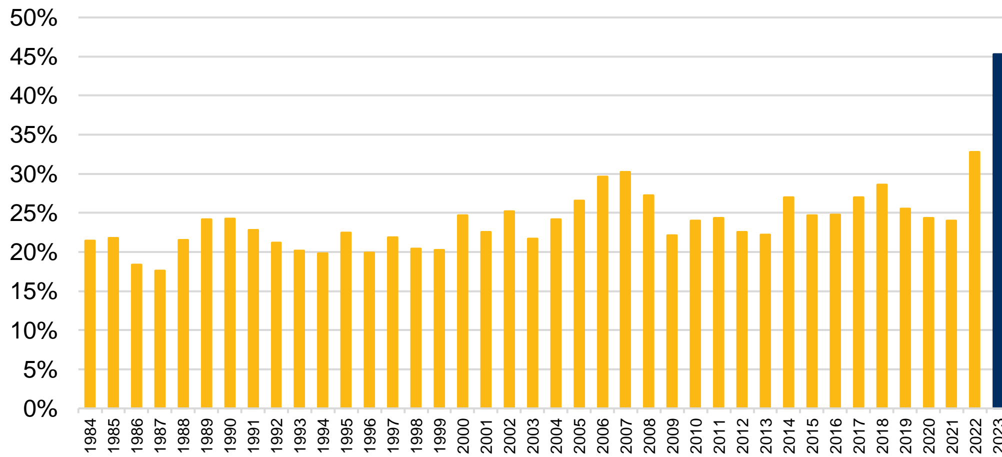
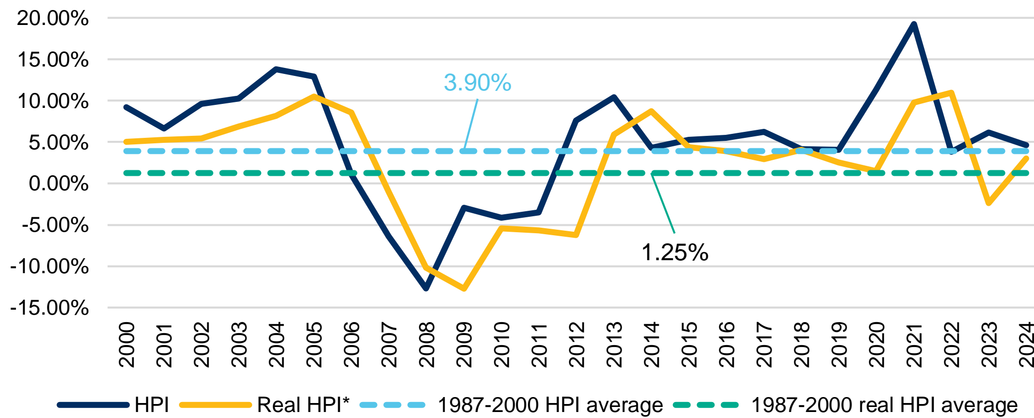


Source: Federal Reserve Bank of St. Louis, retrieved Oct. 15, 2024.[4]



* HPI = Home Price Index. Real HPI is calculated by dividing the Case-Shiller U.S. National Home Price Index by the consumer price index.
Source: Bureau of Labor Statistics[5] and Federal Reserve Bank of St. Louis, retrieved Oct. 15, 2024.[6]

The impact of technology and AI on the economy

Technological advancements like smartphones and chatbots have significantly changed consumer behavior and access to information. These changes have implications for economic forecasting and productivity as there is now a potential for AI to transform low-skilled workers into medium- or high-skilled workers, boosting overall economic productivity.

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[4] https://fred.stlouisfed.org/series/MEHOINUSA672N#0; https://fred.stlouisfed.org/series/MSPUS; https://fred.stlouisfed.org/series/MORTGAGE30US#0
[5] https://data.bls.gov/pdq/SurveyOutputServlet
[6] https://fred.stlouisfed.org/series/CSUSHPINSA

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Rossell observed that as the U.S. population ages and birth rates fall, the U.S. will not have enough people to maintain its standard of living. AI can help, both by doing the work for humans and by raising the skill level of the humans doing the work. She cited a Harvard study,[7] conducted with the Boston Consulting Group, that observed two groups performing similar tasks. One group used a large language model (LLM) for assistance, leading to around a 40% improvement in work quality compared to the control group. The experimental group also completed its tasks more than 20% faster. Rossell said this study demonstrates that low-skilled workers can work at medium or high skill levels with AI, potentially resulting in higher wages for these workers.

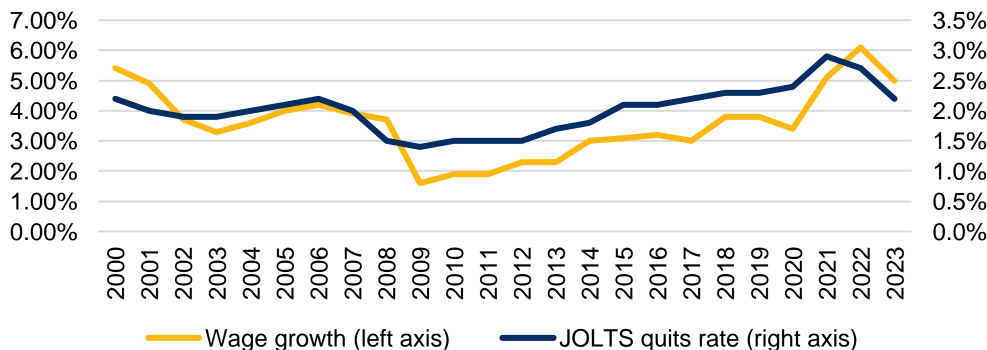
Rossell identified which sectors she believes have the greatest impact from AI: healthcare, education, consulting, legal, and accounting. She emphasized that AI will not eliminate all jobs in these industries but will instead lead to rearrangement of jobs. Duncan also commented on technology's role in the economy, noting that Moore's Law (the number of transistors on an integrated circuit will double about every two years) might be exhausted as we can now manipulate computer microchips at subatomic levels.

Crowe takeaway: AI is here to stay, and it is important for financial institutions to understand how to leverage the evolving technology opportunities presented while also minimizing potential risks.

Labor market trends

Rossell provided insights on the influence rising rates have had on the labor market. The U.S. labor market has weakened, with the unemployment rate rising over the past two years from 3.5% (as of December 2022) to 4.2% (as of August 2024).[8] Despite this, GDP has grown from $25 trillion in Q1 2022 to more than $28 trillion in Q2 2024,[9] indicating underlying economic strength. Rossell commented that talent also has become easier to find and retain as the unemployment rate has increased. Businesses are no longer "hoarding" workers as they were when workers were shifting locations and working remotely. Trends in the labor market do not directly determine whether the economy is in a recession, however, as that is measured by productivity and GDP, which are still growing. Duncan provided some insights into wage growth as well, noting it was strong during the pandemic but continues to cool down, as indicated in the following graphs.

Job Openings and Labor Turnover Survey (JOLTS) quits rate versus wage tracker



Source: U.S. Bureau of Labor Statistics[10] and Federal Reserve Bank of Atlanta, retrieved Oct. 15, 2024.[11]

[7] Fabrizio Dell'Acqua, Edward McFowland III, Ethan Mollick, Hila Lifshitz-Assaf, Katherine C. Kellogg, Saran Rajendran, Lisa Krayer, François Candelon, and Karim R. Lakhani, "Navigating the Jagged Technological Frontier: Field Experimental Evidence of the Effects of AI on Knowledge Worker Productivity and Quality," Harvard Business School, Sept. 22, 2023, https://www.hbs.edu/ris/Publication%20Files/24-013_d9b45b68-9e74-42d6-a1c6-c72fb70c7282.pdf

[8] https://www.bls.gov/charts/employment-situation/civilian-unemployment-rate.htm

[9] https://www.bea.gov/itable/national-gdp-and-personal-income

[10] Quits rate, Total nonfarm, seasonally adjusted - JTS000000000000000QUR at https://data.bls.gov/toppicks?survey=jt

[11] https://www.atlantafed.org/chcs/wage-growth-tracker

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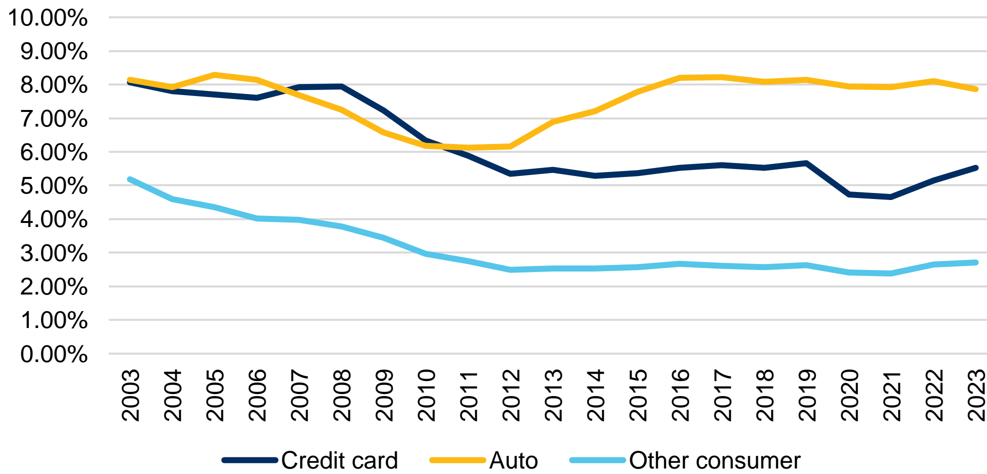
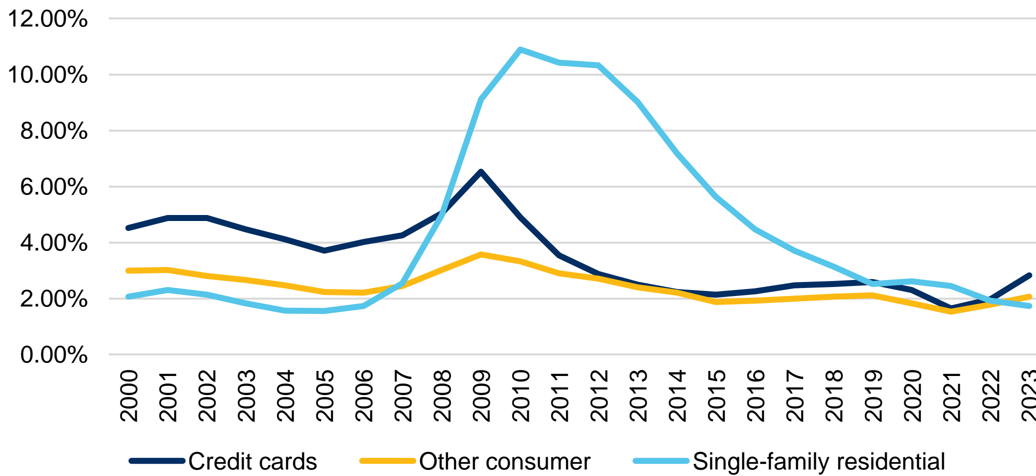
Consumer behavior

Duncan said that the economy is not heading toward a recession, citing consumers' ability to maintain spending levels despite slower wage growth. Consumer spending – as measured by personal consumption expenditures (PCE), the value of goods and services purchased by, or on behalf of, U.S. residents – has continued to increase despite the slowed wage growth.[12] Credit card debt has risen significantly since the pandemic. The ratio of outstanding credit card debt to disposable personal income is near pre-pandemic levels, which raises the question of whether 2019 should be the period economists compare to as "normal." Duncan did not suggest a different period for future comparisons.



Source: Federal Reserve Bank of New York[13] and Federal Reserve Bank of St. Louis, retrieved Oct. 15, 2024.[14]



Source: Federal Reserve Bank of St. Louis, retrieved Oct. 15, 2024.[15]

[12] https://www.bea.gov/data/consumer-spending/main
[13] https://www.newyorkfed.org/microeconomics/hhdc#:~:text=Credit%20Panel%2FEquifax-,Credit%20card%20balances%2C%20which%20are%20now%20at%20%241.14%20trillion%20outstanding,now%20stand%20at%20%241.63%20trillion.
[14] https://fred.stlouisfed.org/series/DSPI
[15] https://fred.stlouisfed.org/series/DROCLACBS#0; https://fred.stlouisfed.org/series/DRSFRMACBS#0; https://fred.stlouisfed.org/series/DRCCLACBS#0

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Crowe takeaway: While credit card debt and delinquencies are rising, they remain relatively stable compared to previous recessions and do not indicate future shifts in consumer behavior.

Updates from the federal banking agencies

On Sept. 9, the chief accountants of the federal banking agencies, Shannon Beattie [Federal Deposit Insurance Corp. (FDIC)], Amanda Freedle [Office of the Comptroller of the Currency (OCC)], and Lara Lylozian (Fed) held a fireside chat. The speakers began by discussing risks arising from the continued elevated interest rate environment and inflationary pressures. The chief accountants remarked how the current economic environment creates unique pressures on institutions to find additional ways to improve earnings and reduce balance sheet risk and discussed how the various regulatory bodies work together to provide guidance to banks to assess, monitor, and manage risks. Topics also included bank-owned life insurance (BOLI) transactions, fintech partnerships, and available-for-sale (AFS) to held-to-maturity (HTM) transfers. Some of these topics also were discussed in various sessions throughout the conference.

In addition, the chief accountants shared views on topics discussed at this conference over the past several years, including remarks on application of the CECL standard.

The majority of banks adopted Accounting Standards Updates (ASU) 2016-13 (CECL) in 2023. Interestingly, the chief accountants noted that their offices received very few questions from banks on the CECL standard. They stressed their expectation of continuous improvement when it comes to the allowance for credit losses (ACL) estimate process. The chiefs noted that at adoption, the expectation for institutions was a “best-efforts” or “good faith” basis; however, they said the agencies expect improvement in model documentation over time.

The chief accountants reminded participants that the following items are also expected to be a focus of both auditors and bank examiners in their review of the appropriateness of the ACL.

- **Sufficiently robust documentation to support the ACL:** While quantitative support is not required for every adjustment to the ACL, speakers discussed the need for banks to continue enhancing the robustness of documentation supporting qualitative adjustments made by management. Freedle noted that these qualitative adjustments require professional judgment; however, the use of complicated frameworks or models to anchor qualitative factors is not necessary. The chief accountants also noted situations when a bank’s methodology results in little or no qualitative adjustments and the need to maintain documentation supporting why the methodology and model used do not require a significant qualitative overlay. Regardless of the model used to estimate expected credit losses or the overall methodology deployed, banks are ultimately responsible for maintaining adequate documentation to support the ACL estimate.

- **Individually evaluated and collateral dependent loans:** Speakers reminded institutions of the requirements in Accounting Standards Codification (ASC) 326-20 to individually evaluate loans that do not share risk characteristics with collectively evaluated loans. They noted that not all individually evaluated loans are collateral dependent (as defined in ASC 326), but all collateral-dependent loans are individually evaluated for purposes of estimating credit losses.

- **Loan modifications (ASU 2022-02, “Financial Instruments – Credit Losses (Topic 326): Troubled Debt Restructurings and Vintage Disclosures”):** The chief accountants discussed newly issued guidance on loan modifications and emphasized that banks should consider the bespoke facts and circumstances for each loan modification to evaluate the impact of problem loan modifications on the ACL estimate as well as to ensure accurate financial reporting.

Crowe observation: Institutions should deploy an allowance methodology that is appropriate to estimate their current expectations of credit losses. While no specific method or model is prescribed, an institution is responsible for ensuring that the ACL represents management’s best estimate and that the methodology is suitable based on the size and complexity of the institution.

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The panelists also cautioned banks against focusing on budgeted provision for credit losses in the ACL estimation process. Institutions should maintain documentation to support the overall adequacy of the ACL. Attendees were encouraged to review the "Interagency Policy Statement on Allowances for Credit Losses"[16] released in 2023. This statement describes the measurement of expected credit losses under the CECL methodology and the accounting for impairment on AFS debt securities in accordance with Topic 326; the design, documentation, and validation of expected credit loss estimation processes, including the internal controls over these processes; the maintenance of appropriate ACLs; the responsibilities of boards of directors and management; and examiner reviews of ACLs.

Crowe observation: The "Interagency Policy Statement on Allowances for Credit Losses" requires institutions to adopt the practical expedient for collateral-dependent loans in ASC 326-20-35-5 for purposes of filing their call report.

The chiefs discussed other accounting issues observed over the past year, including BOLI restructuring transactions where surrender enhancements are present and accounting matters surrounding investment securities. With respect to BOLI, the panel highlighted the need for banks to carefully evaluate underlying fact pattern to ensure the proper accounting treatment is applied. While these transactions might result in an increase to the stated cash surrender value upon restructuring based on the associated surrender enhancements, the chief accountants emphasized the need for banks to carefully evaluate the unique facts and circumstances to ensure the transaction is properly accounted for under U.S. GAAP and call report instructions.

Crowe observation: Interagency guidance on BOLI does not address the accounting for restructuring transactions that may result in immediate income recognition. Banks exploring similar restructuring transactions should consult with their auditor and/or primary federal regulator on the accounting conclusions reached. Generally, banks should be skeptical of a transaction that lacks economic substance and results in immediate income recognition.

The chief accountants discussed considerations around banks' intent and ability to hold impaired AFS securities until the securities' cost is recovered as well as banks' intent and ability to hold HTM securities until maturity. They discussed the need for banks to consider all relevant factors when transferring AFS securities to HTM, including risks of tainting HTM portfolios if sales are required prior to maturity.

They commented on the rise in recent years of partnerships between banks and fintech companies. Lylozian discussed the recently released interagency statement on the topic, highlighting potential risks in the area, including lack of expertise or resources at the bank to manage the relationship. She emphasized not ignoring accounting and reporting considerations as part of banks managing the overall relationship with associated fintechs.

Panelists fielded questions about coordination among the agencies on accounting-related issues. Freedle discussed the OCC's publication of the agency's "Bank Accounting Advisory Series" (BAAS), noting that proposed changes in the BAAS are shared among the agencies to avoid the OCC operating "in a vacuum." However, Freedle reminded the audience that the BAAS is agency-specific, rather than interagency, guidance on accounting for specific fact patterns and transactions.

[16] https://www.federalregister.gov/documents/2023/04/27/2023-08876/interagency-policy-statement-on-allowances-for-credit-losses-revised-april-2023

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Conference observation: Freedle noted the most recent version of the BAAS, published in August 2024, made numerous clarifying edits to the fact patterns, questions, and answers published in previous versions; however, these edits did not change the OCC's conclusions published in prior editions. Furthermore, Freedle said that while no new questions were added, some sections were superseded as a result of no longer being applicable.

The most recent BAAS publication can be found on the OCC's website.

FASB updates

FASB technical director Jackson Day, along with board member Fred Cannon and senior project adviser Rosemarie Sangiuolo, provided an update on the FASB's current standard-setting agenda,[17] including current priorities. They focused on the technical agenda items that they believe to be the most impactful to participants.

Technical agenda update

The FASB's technical agenda is being driven by the results of the agenda consultation that concluded in mid-2022. In addition to the two ASUs that have been released in 2024 to date, the FASB anticipates issuing two final ASUs and nine exposure drafts prior to year-end.
Final ASUs issued in 2024:

- ASU 2024-01, "Compensation – Stock Compensation (Topic 718): Scope Application of Profits Interest and Similar Awards"
- ASU 2024-02, "Codification Improvements – Amendments to Remove References to the Concepts Statements"

Final ASUs expected in 2024:

- Induced conversions of convertible debt instruments
- Disaggregation – income statement expenses

Exposure drafts issued or expected to be issued in 2024:

- Accounting for and disclosure of software costs
- Accounting for environmental credit programs
- Accounting for government grants
- "Derivatives and Hedging (Topic 815) and Revenue From Contracts With Customers (Topic 606): Derivatives Scope Refinements and Scope Clarification for a Share-Based Payment from a Customer in a Revenue Contract" (proposed ASU issued July 23, 2024)
- "Derivatives and Hedging (Topic 815): Hedge Accounting Improvements" (proposed ASU issued Sept. 25, 2024)
- Determining the acquirer in the acquisition of a variable interest entity
- "Compensation – Stock Compensation (Topic 718) and Revenue From Contracts With Customers (Topic 606): Clarifications to Share-Based Consideration Payable to a Customer" (proposed ASU issued Sept. 30, 2024)
- Codification improvements (next phase)
- Interim reporting – narrow-scope improvements

Other items on the technical agenda currently being deliberated by the board include:

- Targeted cash flow statement improvements
- Purchased financial assets (PFAs)

[17] https://www.fasb.org/projects/current-projects

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Purchased financial assets

Notably absent from the list of expected exposure drafts in 2024 is PFAs. While a proposed ASU was issued in 2023, feedback from comment letters received led the FASB to reconsider certain aspects of the proposed ASU. These deliberations are ongoing. The project currently does not have a target date set for a new exposure draft.

As a reminder, the PFA project is the result of the CECL post-implementation review (PIR) function, which concluded in 2022. Sangiuolo discussed the current status of the project, noting the overall goal remains that all “seasoned” PFAs will be subject to the “gross-up” approach, where the credit loss component of the fair value adjustment (for financial assets subject to ASC 326-20 acquired in a business combination or an asset acquisition) is recorded directly to the ACL rather than being recorded as a component of the net premium or discount on acquired financial assets. Current GAAP permits the gross-up approach to be applied only to purchased credit deteriorated (PCD) assets.

Sangiuolo noted that the original intention of the PCD approach was that the application of the “more than insignificant” threshold would result in most acquired financial assets being considered PCD, with the remaining non-PCD consisting of mainly “newly originated assets with very little credit embedded in the purchase price.”

However, Sangiuolo stated that in practice the percentage of acquired loans in acquired portfolios designated as PCD varied “pretty significantly, and in some cases the percentage of non-PCD loans exceeded 80%, which was much higher than the board would have anticipated.” Sangiuolo discussed one of FASB’s objectives in expanding the PCD model is to minimize inconsistencies among entities’ disclosures and yield more intuitive outcomes, as the component of interest income resulting from the amortization of any premiums or discounts on PFAs is commonly excluded from analysts’ evaluation of net interest margin.

Additional items the FASB is reconsidering relate to the scope of financial assets subject to the model as well as implementation matters. Items being considered by the FASB include the potential exclusion of credit cards and revolving loans from the project’s scope as well eliminating the proposed retrospective adoption guidance. These items are the direct result of comment letters from stakeholders of all types.

Crowe takeaway: To learn more about the FASB proposal on PFA, please visit our “Take Into Account” accounting and financial reporting hub, where you can find updates on current FASB projects.

Targeted cash flow statement improvements: Financial institutions

Cannon addressed the FASB’s ongoing deliberations related to targeted improvements to the statement of cash flows for financial statement users. The project, focused on financial institutions, aims to reclassify cash flows between operating, financing, and investing sections as well as to further disaggregate certain cash flows. Cannon emphasized areas for potential improvements to disclosures of cash flows to provide more transparency and consistency, including:

- The disclosure of cash interest received (in addition to the existing cash interest paid disclosure)
- A reconciliation of net interest received in cash to net interest income as presented on the income statement
- Disaggregation of purchased financial asset accretion and noncash gain on sales of loans

The FASB is performing additional research and outreach to determine the scope of entities that would be affected and exploring potential changes to the definitions of investing and financing activities.

Accounting for software costs

Sangiuolo discussed the FASB’s project on the accounting for software costs for internally developed software. The project was initially started to identify a single model for all software capitalization, but the FASB’s ongoing deliberations instead resulted in targeted improvements for internally developed software.

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Both preparers and auditors provided feedback that the current rules for capitalizing internal use software costs that are based on a sequential development method are outdated and do not reflect modern software development practices. This is due to the shift toward more iterative "agile" development methods, which for many companies can result in an "expense all" model. The FASB is working to better align with current practices.

The proposed changes would remove the project development stages that are viewed as difficult and outdated. Initial capitalization thresholds would be clarified to specify that entities would begin capitalizing when management has authorized and committed to funding the software and it is probable that the project will be completed and used to perform the intended function.

The proposal will provide guidance for determining whether it's probable that a project will be completed if it does not clearly meet the initial capitalization threshold, considering two factors related to significant development uncertainties: whether the software is novel or unproven and whether the entity has identified the significant performance requirements of the software.

The board also decided to enhance disclosures, including presentation of cash paid for capitalized internal use software within the statement of cash flows, which is expected to provide greater transparency to investors and will appear as a separate line item in the investing section of the statement of cash flows.

Board deliberations are completed, and a proposed ASU is expected to be issued in Q4 2024.

Conference takeaway: FASB panelists noted that the movement from a broad overhaul of the software accounting guidance to the narrow-scope improvements was driven by input from both investors and preparers and the desire for improved transparency.

The panelists said they believe the narrower scope of the project still accomplishes modernization goals and do not expect that institutions in attendance to see any meaningful change in financial outcomes.

Accounting for government grants

FASB panelists discussed a forthcoming proposed standard on grants, where no direct GAAP currently exists. The FASB opted to use the accounting framework within International Accounting Standard (IAS) 20, "Accounting for Government Grants and Disclosure of Government Assistance," for government grants. IAS 20 was chosen as many business entities analogize to either this standard or the guidance for not-for-profit entities.

Sangiuolo noted the FASB undertook the project because stakeholders highlighted the issue as lacking specific guidance. Grants are impactful to certain banks that currently receive or previously received government grants (for example, awards granted in connection with programs stemming from COVID-19 responses and programs such as the Community Development Financial Institutions Fund).

Crowe observation: Nongovernmental grants received by entities (including both for-profit and not-for-profit entities) are accounted for under ASC 958-605. Although no specific guidance exists on the accounting for government grants received by for-profit entities, current regulatory reporting (call report) instructions require banks to apply the accounting guidance in ASC 958-605 by analogy for grants received by government entities.

Further interpretation can be found in the most recent OCC BAAS publication (Topic 11E, "Grants Received by Banks").

The scope of the proposal is expected to narrow the scope of IAS 20 by including transfers of monetary and tangible nonmonetary assets, including forgivable loans, from a government to a business entity while excluding exchange transactions, income tax transactions, below-market interest rate loans, and government guarantees.

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Cannon discussed the decision to maintain the optionality present in IAS 20 related to the cost accumulation approach versus the gross approach for asset grants. Cannon provided an example of each approach using an asset valued at $10 million with $5 million granted thus far, as illustrated here:

	Approach	
	Cost accumulation	Gross
Recorded amount	$5,000,000	$10,000,000
Offsetting adjustment	-	($5,000,000)
Net value	$ 5,000,000	$ 5,000,000

While each approach results in the same ending amount, the view of the staff was that while the gross approach provides more transparency, the cost accumulation approach better reflects the transaction economics. As a result, the board voted to provide for the optionality of either approach.

Alternative views considered an expansion of the current not-for-profit guidance in GAAP to for-profit entities as well as requiring additional disclosures reconciling the gross and cost accumulation approach.

A proposed ASU is expected to be issued in Q4 2024.

Accounting refinements and improvements to Topic 815

The panelists discussed a number of refinements and improvements to Topic 815, including refinements to the scope of a derivative to align hedge accounting guidance with entities' risk management objectives. The hedge accounting project aims to address issues such as changes in hedged risk, nonfinancial forecasted transactions, and net written options.

Refining the scope of a derivative

The FASB released a proposed ASU on July 23, 2024, to refine the scope of Topic 815 through the expansion of derivative scope exceptions. The 90-day comment period ended Oct. 21, 2024.

Sangiuolo noted that stakeholder feedback indicated that a number of items currently captured in the scope of derivatives [for example, environmental, social, and governance (ESG)-linked instruments] suggests the current bifurcation criteria in Topic 815 is unintuitive and leads to unintended outcomes.

Sangiuolo discussed an example ESG-linked loan or bond that is tied to the issuer's ESG performance levels via a contingent interest rate adjustment feature. In one example, the interest rate of an ESG-linked note is based on whether the debt issuer meets certain performance targets, such as greenhouse gas emissions reduction targets. Under current accounting guidance, the contingent feature would be accounted for as bifurcated derivative and measured at fair value. The panel noted similar issues were identified in other contracts reviewed (for example, research and development funding arrangements and litigation funding arrangements).

To provide relief, the FASB determined that principles-based guidance was the best way to address a class of contracts with common characteristics. Through research and deliberation, the FASB added a scope exception to the derivative guidance in ASC 815 that would be applicable to non-exchange-traded contracts with underlying features based on the operations or activities specific to one of the parties to the contract.

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The FASB also considered alternatives including other targeted scope exceptions or a change to the definition of a derivative in ASC 815, but FASB member raised concerns about unintended consequences and the ability for targeted amendments to the accounting literature to be a long-lasting solution.

The proposal permits an entity to elect the fair value option at transition. It also includes a prospective transition approach for new contracts with the option to elect a modified retrospective approach in order to provide relief for entities that currently have ESG-linked or other qualifying loans or bonds that otherwise would have qualified for the exception.

Conference takeaway: Sangiuolo emphasized that the goal of ESG-related projects was not to create an ESG standard but rather to provide a principles-based approach to account for financial instruments with ESG-linked features.

Hedge accounting improvements

A proposed ASU to make targeted improvements to the hedge accounting guidance in Topic 815 is based on issues raised by stakeholders. The proposal addresses the following five discrete issues:

- Change in hedged risk (considerations for “choose-your-rate” debt)
- Cash flow hedges of nonfinancial forecasted transactions
- Dual hedges
- Shared risk assessment in cash flow hedges
- Net written options as hedging instruments

The first three items were considered in a 2019 FASB exposure draft intended to further clarify the targeted updates to hedging guidance (ASU 2017-12). The latter two arose as a result of feedback received in the FASB’s 2021 agenda consultation.

In the session, the panelists discussed a few of the items:

Change in hedged risk

Sangiuolo discussed situations where entities would have a missed forecast if the risk in the hedging relationship had changed but the revised risk remained highly effective. The proposal was ultimately narrowed to apply only to hedges of existing debt instruments issued by an entity where the terms of the debt identify all of the potential interest rate indexes or interest rate tenors that an entity can change to during the life of the instrument. This is commonly referred to as “you pick ’em” or “choose your rate” and was viewed by FASB as a “natural fit” for change in hedged risk accounting improvements.

Shared risk assessment in cash flow hedges

Sangiuolo remarked that the FASB is attempting to find an alternative approach to allow entities to change from one interest rate index to another in a cash flow hedge without creating the risk of a missed forecast. To achieve that, the board decided to allow multiple risks to be included in a single pool by permitting entities to broaden hedged pools to include multiple risks, therefore making hedging transactions more efficient. One of the goals is to help entities avoid unintended outcomes beyond the entities’ control that could trigger a missed forecast, such as a situation where a customer changes its preferences on an interest rate.

Under the proposal, the quantitative threshold necessary to determine that a group of individual forecasted transactions has a similar risk exposure will be consistent with the highly effective threshold. Furthermore, entities would be permitted to conclude that a group of individual forecasted transactions has a similar risk exposure if the hedging instrument is highly effective against each risk in the group. However, entities are permitted to perform separate tests for risk assessment and hedge effectiveness purposes.

Sangiuolo emphasized that the proposals are in the context of the existing hedge accounting model, which possesses a number of restrictions. As such, it is important for stakeholders to understand that these improvements will not solve for every issue that could arise in hedge accounting.

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Net written options as hedging instruments

Passing the net written option test is required whenever an entity wants to designate a written option as a hedging instrument and serves as a "gating condition" prior to when a hedge begins. For an entity to pass this test, gain and loss potential of the combination of the hedged item and the net written option must be symmetrical.

Sangiuolo commented on an accounting issue that arose after the cessation of the London Interbank Offered Rate (LIBOR), whereby a swap with a written floor is used as a hedging instrument against a loan with a floor. The swap and the loan may have different interest rates [for example, Secured Overnight Financing Rate overnight index swap (SOFR OIS) in the swap and SOFR Term in the loan], which might result in the swap failing to achieve hedge accounting treatment, despite that the addition of the written floor and the swap results in a better economic hedge and a more highly effective accounting hedge.

The FASB proposed a solution that addresses circumstances where a hedging instrument is made up of a written option and a swap. In the FASB's proposal, entities can assume that certain terms are matched for purposes of applying the test. Sangiuolo noted that the FASB acknowledges that this represents a narrow fix in ASC 815 and will not address all situations where entities are trying to designate written options as hedging instruments. As a result, the board is including a question in the exposure draft to solicit feedback.

Cannon reminded participants that the proposed improvements are narrow, as broader solutions tended to run into the core pillars of the existing hedge accounting framework, despite many stakeholders' interest in broader solutions.

Transition would be prospective, with elections for certain situations including adding new risks to existing hedges, migrating forecasted transactions to new pools, and reassigning hedging instruments.

Crowe observation: On Sept. 25, 2024, the FASB issued a proposed ASU, "Derivatives and Hedging (Topic 815): Hedge Accounting Improvements." The amendments in the proposal would enable entities to apply hedge accounting to a greater number of highly effective economic hedges, thereby improving the decision-usefulness of information. The FASB is seeking public comments within a 60-day comment period ending Nov. 25, 2024.

Research agenda

The panel discussed certain topics on the FASB's research agenda, addressing feedback received from stakeholders on targeted improvements to deposits and liquidity disclosures. Cannon covered investor feedback related to exploring whether certain disclosure information on deposits and liquidity could be codified into GAAP to require consistent disclosures. Investor feedback indicated that in order for users to obtain a good interpretation of deposits and liquidity at institutions, they currently have to review information from call reports, management's discussion and analysis, and financial statements. Cannon noted that while this is not a current research agenda item, it could be considered in the future.

Crowe observation: The FASB's research agenda includes projects that FASB staff is actively working on to identify emerging issues in financial reporting. The research agenda is determined by the chair.

Items on the research agenda include:

- Accounting for and disclosure of intangibles
- Accounting for commodities
- Agenda consultation
- Consolidation for business entities
- Definition of a derivative
- Financial key performance indicators for business entities
- Statement of cash flows

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SEC updates

Representatives from the SEC's Office of the Chief Accountant (OCA) and Division of Corporation Finance (CorpFin) provided insight on emerging issues affecting SEC registrants and audits of publicly traded financial institutions. The presentation by Jonathan Wiggins, deputy chief accountant, and Gaurav Hiranandani, senior associate chief accountant, offered insights into various aspects of financial reporting, risk assessment, audit committees, standard-setting, and more. Although unable to attend the conference in person, Paul Munter, chief accountant, prepared remarks on recent consultations, including a specific Staff Accounting Bulletin (SAB) 121 fact pattern, that were shared with the conference virtually. Later in the conference, Amit Pande, accounting branch chief, CorpFin; Stephanie Sullivan, associate chief accountant, CorpFin; and Rachel Mincin, associate chief accountant, OCA, went into specific detail on activities in both CorpFin and the OCA.

During opening remarks, the speakers reinforced the SEC's emphasis on protecting investors, maintaining fair markets, and facilitating capital formation, focusing on high-quality financial reporting and audit quality. Wiggins reiterated that financial reporting serves as a vital communication tool between management and the financial markets. Consistent financial reporting conveys an organization's economic activities transparently and consistently. In both sessions, speakers focused on accounting and auditing issues, particularly related to crypto assets and recent developments in accounting standards.

Crypto assets consultations

Munter discussed the SEC's views on accounting for crypto assets under SAB 121, which addresses the accounting requirements for entities that have obligations to safeguard crypto assets for their platform users. One of SAB 121's main requirements is that in certain circumstances a safekeeping liability must be presented on the balance sheet of SEC registrants that perform these safekeeping activities, accompanied by a corresponding asset. This was particularly pivotal, as consultations post-SAB 121 saw entities seeking further guidance on various scenarios involving distributed ledger technology and the safeguarding of crypto assets. These consultations led to specific instances where SAB 121 was deemed not applicable. Munter provided detailed examples of recent accounting consultations with entities where the SEC staff did not object to the entities' conclusions that their arrangements were not within the scope of SAB 121.

Conference takeaway: Munter's speech is available on the SEC's website. SEC registrants who safeguard crypto assets are encouraged to read the speech, especially as it pertains to certain consultations on the applicability of SAB 121 in particular fact patterns.

Business combinations

Wiggins noted that the OCA has seen numerous consultations related to business combinations, particularly in identifying the accounting acquirer. Wiggins reminded conference participants that the accounting acquirer conclusion will affect the level of regulatory capital available for the combined entity. Recent consultations have involved fact patterns where the application of the guidance in ASC 810 on consolidations did not provide a clear indication of which of the combining entities is the accounting acquirer, and as such, registrants evaluated factors that are laid out in the implementation guidance in ASC 805, which require significant judgment.

CorpFin observations

Representatives from CorpFin discussed their current focus on regulatory activities and rulemaking objectives. The presenters highlighted areas of recent comment focus by the SEC, including comments related to credit risk concentrations, asset quality and the ACL, and related risk-management disclosures.

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CorpFin representatives highlighted areas of focus when CorpFin staff members review corporate disclosures. CorpFin's recent reviews and related comments have centered on various risk-related disclosures, which are categorized into specific areas of focus:

- **Risk management.** CorpFin emphasized the expectation that disclosures go beyond boilerplate language and provide specific details regarding risk management processes. Examples include disclosing policies or controls related to timing of appraisals on loans; information on risk management strategies, procedures, or other actions taken or planned to be taken by management in response to the current credit environment; and how particular risks manifest in the issuer's specific circumstances.
- **Weighted average yield.** Banks are expected to disclose key inputs and assumptions related to the weighted average yield on debt securities (Item 1403 of Regulation S-K). The staff emphasized the importance of regularly reassessing these inputs, particularly when derivatives are used for hedging deposit relationships.
- **Credit risk concentration.** A heightened focus remains on credit risk concentration, particularly in the context of CRE loans. Banks are expected to provide investors with the appropriate mix of information to better understand the risk and related exposure. Accordingly, CorpFin expects banks to provide expanded information about risks associated with material concentrations and how these risks are being managed. Examples include disaggregated disclosures of CRE loans by borrower type, geographic location, and property category.
- **Expanded credit risk.** Banks might be asked to disclose the process and controls surrounding the timing of ordering appraisals, as well as what procedures are performed on fair value when appraisals are not ordered. Banks also are encouraged to address their policies regarding how and when loan-to-value (LTV) figures are calculated, as original LTV can differ significantly from current LTV.
- **ACL (critical accounting estimate).** Banks are expected to adequately disclose information related to qualitative factors, including ensuring the disclosure reflects the qualitative factors that are being considered for each segment for that period, quantifying how the qualitative component has changed from the prior period, and disclosing drivers for any material changes in the qualitative factors.
- **Consistency in earnings and filings.** CorpFin encourages registrants to avoid misleading investors by ensuring consistency between information disclosed in earnings presentations and information in periodic filings.

Conference takeaway: CorpFin representatives indicated that disclosures in periodic filings (Form 10-Q and Form 10-K) should not be inconsistent with information disclosed in other public financial disclosures. Registrants should evaluate disaggregated information disclosed in earnings releases or investor presentations to ensure consistent disclosures are made in Form 10-Q and Form 10-K. As with all financial disclosures, registrants should ensure that proper financial reporting controls operate over any disaggregated data presented in periodic filings.

OCA observations

OCA representatives addressed the importance of auditor independence, noting that they receive almost as many consultations for independence-related matters as for accounting matters. OCA representatives also discussed reasonable judgment, emphasizing the importance of consideration of relevant authoritative literature, consistency with past determinations, and completeness of accounting policy disclosures. Lastly, OCA staff referred to SAB 119, which provides guidance on development, governance, and documentation of a systematic methodology for accounting practices related to ACL.

PCAOB updates

Chief Auditor Barbara Vanich provided an update on the PCAOB's standard-setting agenda, and Jason Bullington, regional associate director, spoke about the Division of Registration and Inspections.

Vanich opened the session by discussing recently issued PCAOB auditing standards (AS). On June 12, 2024, the PCAOB approved amendments to AS 1105, "Audit Evidence," and amendments to AS 2301, "The Auditor's Responses to the Risks of Material Misstatement," which relate to aspects of designing and performing procedures that involve technology-assisted analysis of information received in electronic form.

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Vanich then discussed AS 1000, "General Responsibilities of the Auditor in Conducting an Audit," which the PCAOB approved on May 13, 2024. AS 1000 will modernize, clarify, and streamline the general principles and responsibilities of auditors. Examples include:

- Clarifying the auditor's responsibility to evaluate whether the financial statements are presented fairly
- Clarifying the engagement partner's responsibility by adding specificity to certain audit performance principles
- Accelerating the document completion date from 45 days to 14 days

AS 1000 is effective for audits of financial statements for fiscal years beginning on or after Dec. 15, 2024, except for the 14-day documentation completion date requirement, which is as follows:

- Effective for audits of financial statements for fiscal years beginning on or after Dec. 15, 2024, for firms that issued audit reports with respect to more than 100 issuers during the calendar year ending Dec. 31, 2024
- Effective for audits of financial statements for fiscal years beginning on or after Dec. 15, 2024, for all other firms

Vanich also discussed the quality control (QC) standard QC 1000, "A Firm's System of Quality Control," which the board also approved on May 13, 2024. QC 1000 accomplishes the following:

- Introduces a balance between a risk-based approach to quality control and a set of mandates
- Requires all PCAOB-registered firms to design a QC system that complies with QC 1000
- Requires firms that perform audits of public companies or SEC-registered brokers and dealers to implement and operate the QC system
- Mandates that the firm annually evaluate the firm's QC system and report to the PCAOB on new "Form QC"
- Requires firms that audit more than 100 issuers annually to establish an external oversight function for the QC system

QC 1000 becomes effective on Dec. 15, 2025. The first evaluation period will be from Dec. 15, 2025, to Sept. 30, 2026. Form QC must be submitted to the PCAOB no later than Nov. 30, 2026.

Lastly, Vanich touched on the new confirmation standard AS 2310, "The Auditor's Use of Confirmation," which was approved by the SEC on Dec. 1, 2023, and will replace AS 2310, "The Confirmation Process," in its entirety. The new AS 2310 is designed to be a more risk-based standard than the existing standard, providing specific guidance on performing alternative procedures on nonresponse confirmations as well as guidance on evaluating results of confirmation procedures.

Bullington discussed the results of the 2023 inspection year, noting that the PCAOB uses a risk-based approach to selecting audits for inspection. Risks considered by the PCAOB were informed by the regional bank failures in March and April of 2023, and PCAOB inspections in the 2023 cycle focused on the audit areas sensitive to such risks. Risks considered by the PCAOB included:

- Impacts of inflation on the financial statements and related disclosures
- Exposure to interest rate risk and related impact on the financial statements and disclosures
- Rapidly changing technology
- Personnel and staffing issues and the ongoing impact of remote and hybrid work environments

With respect to the 2023 inspection cycle, Bullington said 227 audit firms were inspected, encapsulating 900 public company and broker-dealer audits, of which 18% relate to audits in the financial sector. For audits of banking companies, areas of focus included both nontraditional focus areas and risk-based areas. Focus areas in the 2023 inspection cycle included asset impairments, going concern assessments, ACL, and increased risk of fraud as well as nontraditional focus areas of deposits, debt, and cash and cash equivalents. All focus areas in the PCAOB's 2023 inspections of banking companies were audit considerations given the bank failures in early 2023. Common deficiencies noted in audits of banking companies were related to evaluation of the ACL – primarily the auditor's assessment of significant inputs and assumptions used in management's estimation process, the auditor's assessment of the reasonableness of management's fair value estimates on its investment securities portfolios, and the auditor's evaluation of sensitivity of management's assumptions for complex estimates.

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Additionally, common deficiencies in the auditing of internal controls over financial reporting include failure to test the design and operating effectiveness of controls that include a review element, failure to select controls for testing the completeness and accuracy of issuer-prepared reporting, and failure to appropriately evaluate the effect that identified deficiencies might have on audit procedures and related audit response.

Crowe takeaway: The PCAOB issued "Spotlight: Staff Update on 2023 Inspection Activities" in August 2024. The staff update presents key findings, the inspection approach, and common deficiencies identified.

In September 2024, the PCAOB also released "Spotlight: Bank Financial Reporting Audits," which provides observations from the PCAOB's inspection of banking company audits over recent years and responses to recent events including calibration of risk-based selection factors to select more audits of regional public company banks.

The PCAOB's Division of Registration and Inspections developed an inspection plan for the current year to address current risks perceived in the market, such as inflation, persistent high interest rates, personnel and staffing issues, rapidly changing technology, and areas with a higher risk of fraud, such as complex estimates. As a result of the failure of certain banks in 2023, the PCAOB is continuing to place added emphasis on audit areas sensitive to current risks present in the financial services sector.

Vanich provided an update on the PCAOB's short- and midterm standard-setting agendas. Projects on the short-term agenda include:

- Noncompliance with laws and regulations (NOCLAR)
- Attestation standards update as it pertains to interim standards
- Going concern
- Firm and engagement performance metrics
- Substantive analytical procedures
- Amendments related to inventory and other reporting circumstances

Conference takeaway: OCC Chief Accountant Amanda Freedle noted that the federal banking agencies are actively monitoring the status of the going concern project, particularly because of the unique characteristics of the banking industry (that is, the impact of customer confidence on the safety and soundness of insured depository institutions).

Midterm projects on the PCAOB's standard-setting agenda include:

- Fraud
- Interim standards
- Use of a service organization
- Interim financial information reviews
- Internal audit
- Interim standards

NOCLAR

A number of conference panelists discussed the PCAOB's proposed "Amendments to PCAOB Auditing Standards Related to a Company's Noncompliance With Laws and Regulations."

On June 6, 2023, the PCAOB proposed certain updates to existing audit standards related to an auditor's consideration of a company's NOCLAR. The PCAOB is "proposing to establish and strengthen requirements for (i) identifying, through inquiry and other procedures, laws and regulations with which noncompliance could reasonably have a material effect on the financial statements, (ii) assessing and responding to the risks of material misstatement arising from noncompliance with laws and regulations, (iii) identifying whether there is information indicating noncompliance has or may have occurred, and (iv) evaluating and communicating when the auditor identifies or otherwise becomes aware of information indicating that noncompliance with laws and regulations, including fraud, has or may have occurred."

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The proposal was accepted by the board by a 3 to 2 vote. Notably, both CPAs on the board dissented from exposing the proposed amendments to public comment. The comment period for the proposal closed on Aug. 7, 2023. Most of the respondents during the comment period opposed the proposed amendments as currently written.

Crowe takeaway: Crowe issued a comment letter on the NOCLAR proposal to the PCAOB, which was published on Aug. 7, 2023.

Due to pushback from stakeholders, the PCAOB reopened the comment period for an additional period in early 2024. The PCAOB then hosted a virtual roundtable in March to gain additional insights from stakeholders, including investors, auditors, audit committees, and the legal community. The meeting included 22 participants from various sectors discussing topics like identification thresholds, attorney-client privilege, increased used of specialists, and the benefits and costs of the proposal.

Results of the roundtable revealed that auditors are willing to complete more procedures related to noncompliance, but they need more clarity on what that will entail, as making legal determinations on whether noncompliance with laws or regulations has occurred is not a core competency of auditors. Additionally, many comment letters and roundtable participants noted their belief that the NOCLAR standard, as currently proposed, would require auditors to perform procedures that extend beyond what is required of management under federal securities law and GAAP. The results also indicated that the PCAOB should re-propose the standard due to ongoing confusion about its goals.

Currently, the NOCLAR standard-setting project is on the PCAOB's short-term standard-setting agenda with an anticipated adoption in 2024.

Technology, AI, and blockchain

Lamont Black, Ph.D., associate professor of finance at DePaul University and a research fellow to the Filene Research Institute, provided a keynote address to participants on emerging technologies like AI and blockchain. His presentation was aimed at addressing the question many boards are now asking: "What are we doing with AI?" Black also explored how blockchain can enhance the market for mortgages and auto loans.

Emerging technologies

Black identified the financial landscape and options financial institutions face when considering new technologies such as instant payments, digital wallets, open banking, embedded finance, omnichannel, AI, and decentralized platforms. He said banks need to adapt and adopt new technologies in order to avoid obsolescence.

Black suggested boards should think about the risks posed by implementing these emerging technologies but also about how those same technologies can alleviate other risks. Cyberthreats create an opportunity for cybersecurity. Identity fraud creates opportunities for identity verification. Black's premise was that with the assistance of AI, impersonal customer experiences can be personalized, and disruption can lead to transformation. Black argued that personalization for the next generation is not about face-to-face handshakes and smiles but rather how well an institution understands its customers and their behaviors and can tailor services to customer expectations and situations. One example of this is how music streaming services can suggest songs they determine customers will like within playlists of music the customers created and already like.

Artificial intelligence

Specific to AI, Black observed ChatGPT's release in November 2022 was a tipping point for the industry and LLMs and generative AI (GenAI) are now household words. He said given the risks present as well as the potential opportunities provided, institutions across the country are debating whether the impact of AI on the workforce will turn out to be positive or negative. Of note, he said, bank boards are talking about this technology, considering relevant use cases for AI, and deciding how to take advantage of this technology. Black noted that appropriate governance and guardrails are equally important to couple with AI in order to limit risks.

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Some of the most practical use cases for banks are related to customer service, according to Black. He said every institution has a "knowledge base" of policies, procedures, and information repositories. LLMs can be used today by customer service representatives to answer customer questions they do not know the answer to, which will save their supervisors time and make call centers more efficient. He said chatbots are not always well received by customers, so banks should use AI to speed up rather than replace their customer service teams. Black said he expects in the near future, AI will be able to listen to recorded conversations and gather customers' sentiments based on their vocal tone and language rather than asking them to fill out a survey – thus providing real-time process improvement feedback to institutions.

Black suggested the future of education, whether in schools or training in the workplace, also will be supported by AI. Instead of trainees reading textbooks or watching lectures, they will have an interactive conversation with an LLM. Everyone will have access to their own personal tutors, which will make learning and skill advancement more engaging.

The future of AI in the workforce is moving employees away from doing routine tasks that can be automated and into higher-level thinking, Black said. He suggested that instead of a person assembling information to use in a financial forecast, AI can do that. AI also can prepare the forecasts and make predictions based on past events.

Crowe takeaway: Numerous use cases for AI are available to financial institutions today. It can research, write accounting memos, or even help draft performance evaluations.

Blockchain

According to Black, blockchain technology was designed to provide transparency to the markets and serve as a "single source of truth." Blockchain is a system for shared and decentralized recordkeeping. Generally, blockchain does not help any individual institution, because the data is all internal and does not require external validation. Where financial institutions will see a rise in the use of blockchain is on the secondary market, for buying, selling, and participating in loans.

Black explained how a blockchain for buying and selling loans would work from a technical perspective, mentioning that each loan would have its own non-fungible token (NFT) and unique attributes that loans are often pooled into. He said this technology will lower the cost of selling loans, remove the need for brokers and third parties to provide loan data, and provide institutions with more assurance because the data is on a decentralized platform.

Conference observation: Banks should start exploring how they can use artificial intelligence and invest in new technologies prudently to improve member experience and satisfaction.

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Other items of relevance for banks

Banking as a service and other fintech relationships

Banking as a service (BaaS) and other fintech relationships were a recurring theme of the conference, including a session focused on the different types of relationships as well as risk accounting considerations.

In the Sept. 10 session led by panelists Mandi Simpson (partner, Accounting Advisory & Finance Transformation Leader, Crowe), Sara Shackelford (CFO, Canapi Ventures), and Kirsten Muetzel (principal, KLM Advisory LLC), Simpson discussed the difference between fintech, embedded fintech, BaaS, and the bank of record.

She noted a fintech is typically defined as a nonbank company that uses technology to provide innovative financial products, services, and solutions. An embedded fintech, on the other hand, integrates these services directly into a traditional bank's offerings to enhance or add value for the bank's customers rather than sending customers to a third party. The most common model, where a financial institution (bank of record or sponsor bank) uses its bank charter to allow one or more nonbank financial services companies to provide products directly to its customers, is known as a BaaS relationship.

Simpson and Muetzel discussed the progression of fintech arrangements, noting that it has become increasingly common for fintechs to work with banks due to closely aligned corporate objectives. Panelists highlighted the importance of establishing clearly defined boundaries in these arrangements, where limitations and goals are set with intention. Additionally, Shackleford highlighted various investment structures observed in practice if a direct investment by the bank into the fintech is being contemplated, including some arrangements structured in the legal form of a limited partnership that offer *Community Reinvestment Act* credit through small-business investment corporations (SBICs). Shackleford warned that capital calls and returns on these investments might not be consistent or linear and that the timing of returns might not match the years of capital contributions, presenting additional challenges for banks in their management of liquidity and capital.

Simpson addressed accounting considerations in arrangements between banks and fintechs, specifically revenue recognition, unfunded commitments, and potential consolidation under the equity method (ASC 323). She emphasized that these issues depend on the structure of the investment, not just ownership percentage. The panel stressed that fintech arrangements are often unique and recommended consulting auditors on their unique aspects.

Additionally, the panel pointed out examples of other factors that might be overlooked when entering into an arrangement, including:

- Understanding who the customer is
- Revenue recognition and sales accounting considerations
- Identifying and accounting for any credit enhancements (and the impact on the ACL)

The panel also highlighted possible red flags that might need attention, such as:

- The sponsor bank not allocating adequate resources for management and board oversight of the arrangement
- The lack of cultural alignment between the sponsor bank and the BaaS (nonbank) entity
- The BaaS (nonbank) entity lacking adequate knowledge on banking rules and regulations
- The failure to properly identify and risk assess vendor relationships arising from the arrangement

Of note, Lara Lylozian from the Fed observed during her remarks that insufficient management expertise or resources at banks can heighten risk in fintech and similar arrangements.

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Crowe observation: Banking regulators have released additional resources this year for banks that currently have or are exploring third-party arrangements:

- OCC Bulletin 2024-11, "Third-Party Relationships: A Guide for Community Banks," May 3, 2024
- Fed, FDIC, OCC, "Joint Statement on Banks' Arrangements With Third Parties to Deliver Bank Deposit Products and Services," July 25, 2024

Credit risk transfers

Credit risk transfers (CRTs) often take the form of a credit default swap or a credit linked note in order to transfer credit risk from a bank to a third party. The bank pays a fee to compensate the third party for its assumption of credit risk. CRTs have gained popularity, and speakers emphasized the importance of understanding the accounting implications of entering into these types of arrangements, including understanding the structure of the agreement, whether credit risk has actually been transferred, and whether the CRT structure results in the recognition of either a stand-alone or an embedded derivative.

Banking regulators encouraged banks to reach out to their field supervisory teams with any questions related to the regulatory capital treatment of CRTs.

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