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Hot topics

Takeaways from the 2023 AICPA & CIMA Conference on Credit Unions

Nov. 13, 2023

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Conference overview

The annual American Institute of Certified Public Accountants (AICPA) and Chartered Institute of Management Accountants (CIMA) Conference on Credit Unions was held Oct. 23-25, 2023, at the Grand Hyatt Denver. The conference included remarks from representatives of the National Credit Union Administration (NCUA), the Financial Accounting Standards Board (FASB), and other industry leaders.

The conference examined the current economic landscape, including liquidity concerns and costs of funds in a high-interest-rate environment. Fintech, payment modernization, and artificial intelligence (AI) were common themes, with a focus on how technology affects the credit union industry. Industry hot topics such as the current expected credit losses (CECL) model, collateral assignment split-dollar policies, and employee retention credits (ERCs) were covered, as in prior years.

Keynote speaker Anne Arvia of Cornerstone Advisors launched the conference on Monday, providing an economic and credit union industry update for 2023 and beyond. On Tuesday, economist Robert Eyler, Ph.D of Sonoma State University offered a deeper dive into the economic outlook. Both shared insights into current trends and discussed the key factors that could lead to a recession.

On Monday, Rob Johnson, president of C. Myers, presented “Elevating Your Leadership Is Urgent,” noting that anyone can be a leader and providing ways to cultivate leadership potential. On Tuesday, author Mary Kay Mueller spoke energetically about “How to Feel Good and Stay Positive, No Matter What.” The last day of the conference kicked off strong with Dave DeFazio of StrategyCorps sharing “How Fintechs Are Transforming the Financial Services Industry.”

Panelists highlighted the ever-changing landscape of the credit union industry and the need to be agile. In addition, speakers discussed hedging and derivatives, regulatory and compliance updates, and other credit union hot topics.

The 2024 conference is slated for Sept. 9-11, 2024, online and on-site, at the Gaylord National Resort & Convention Center in National Harbor, Maryland, which is located just south of Washington, DC.

We hope you find this summary useful.

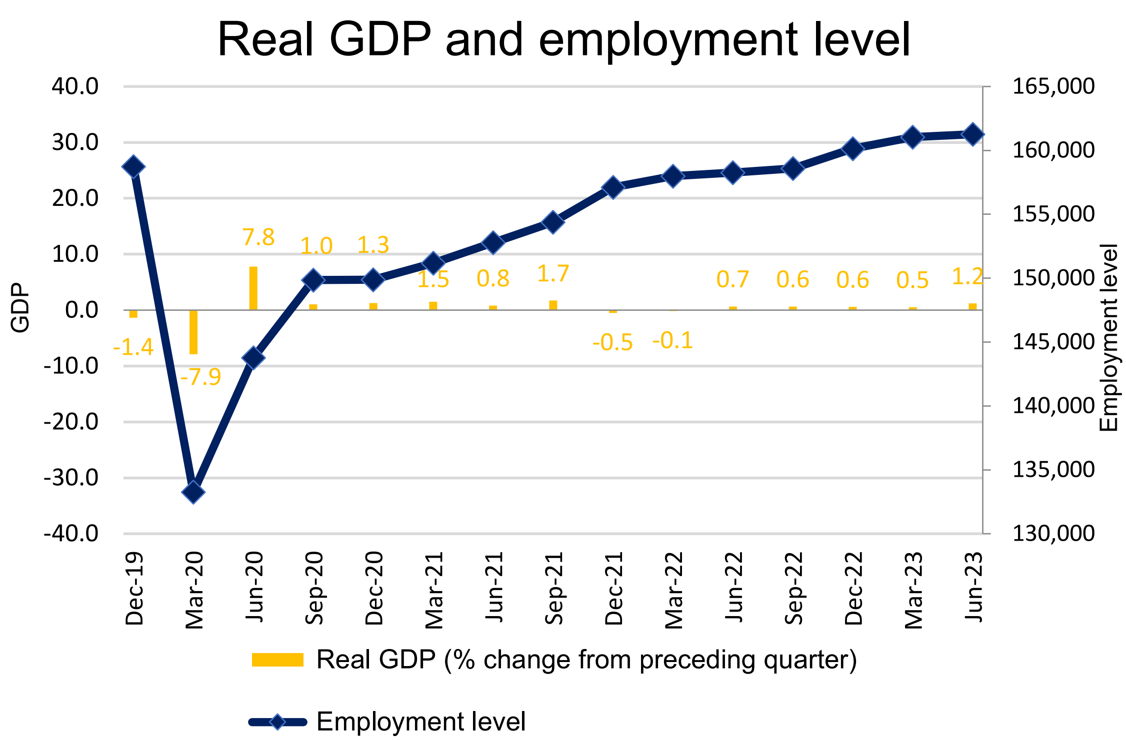
Economic updates

Both Arvia on Monday and Eyler on Tuesday said that the United States is not currently in a recession primarily due to the strength of its labor market, but one could be on the horizon. A poll of attendees showed 64% believed there will be a recession and 36% expected a "soft landing."

Employment, GDP, and inflation

The U.S. currently has a higher employment level than it did before the COVID-19 pandemic, which is bolstering the economy. The downtrend in employment that began in November 2007 with the Great Recession was drawn out, lasting until September 2014 before returning to the previous peak.[1] The recession seen at the start of the pandemic was very different, with a steep dive in employment followed by a period of recovery, and employment levels returned to pre-pandemic levels by December 2022.[2] Arvia said that as employment levels and the labor market are key drivers of the economy, the U.S. has continued to avoid a recession.

The real gross domestic product (GDP) has changed little, quarter-over-quarter, since June 2022. Eyler said annual projections by the Federal Reserve Bank of Philadelphia in August 2023 showed that forecasters have made upward revisions, indicating the economy is more resilient than previously estimated. Real GDP annual percentages (based on annual average levels) have increased from the previous forecasts for 2023 and 2024, while showing a slight decrease in the forecast for 2025 and a larger decrease in the forecast for 2026.[3]



Source: St. Louis Fed[4]

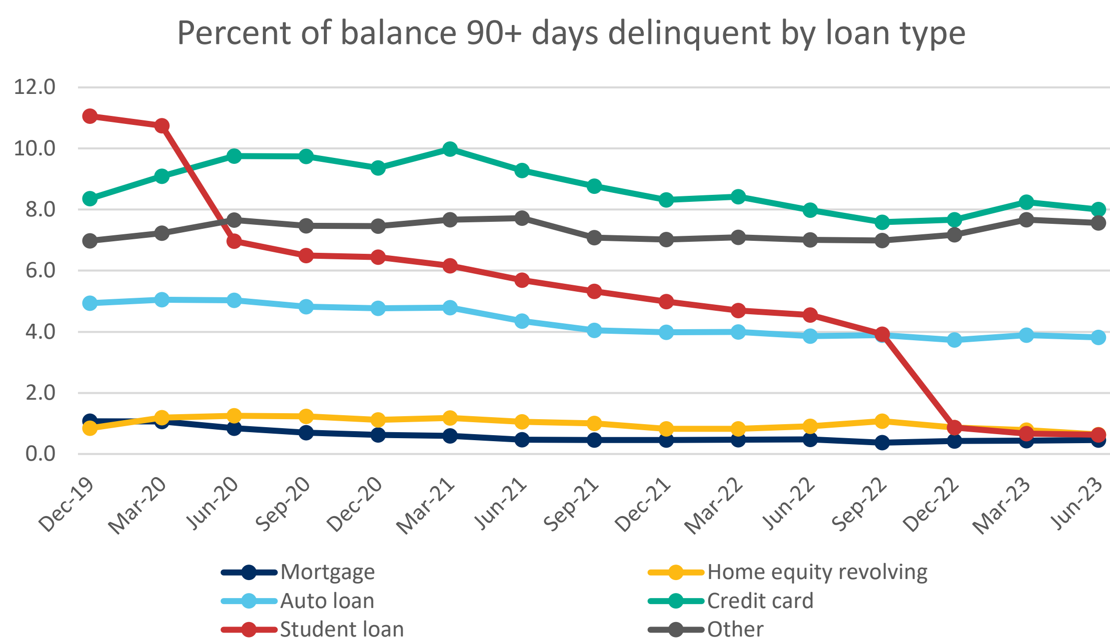
Both Arvia and Eyler pointed to the uniqueness of our current federal funds rates based on both the speed with which they increased and the actual federal funds rate level itself. Federal funds rates

[1] https://fred.stlouisfed.org/series/CE16OV
[2] Ibid.
[3] https://www.philadelphiafed.org/surveys-and-data/real-time-data-research/spf-q3-2023
[4] https://fred.stlouisfed.org/series/CE16OV; https://fred.stlouisfed.org/series/GDPC1

increased 525 basis points from February 2022 to October 2023[5] as an effort to combat inflation. Eyler said that the Federal Reserve (Fed) likely will not lower rates until job losses begin and the core personal consumption expenditure price index falls. However, much uncertainty still surrounds the current environment.

Debt balances and delinquencies

The U.S. consumer debt balance has been steadily increasing since 2013, and on June 30, 2023, was $14.5 trillion.[6] As debt balances continue to rise, so do credit card and auto loan delinquencies greater than 90 days, which can be a predictor of a recession. Mortgage loans, home equity lines of credit (HELOCs), and student loans have not yet shown increases in delinquencies. Student loan payments have recently resumed, and it is too early to project what delinquencies will look like in the near term. Mortgage loans, HELOCS, and student loans make up most of the consumer debt and as such the lack of delinquencies supports a relatively stable market.

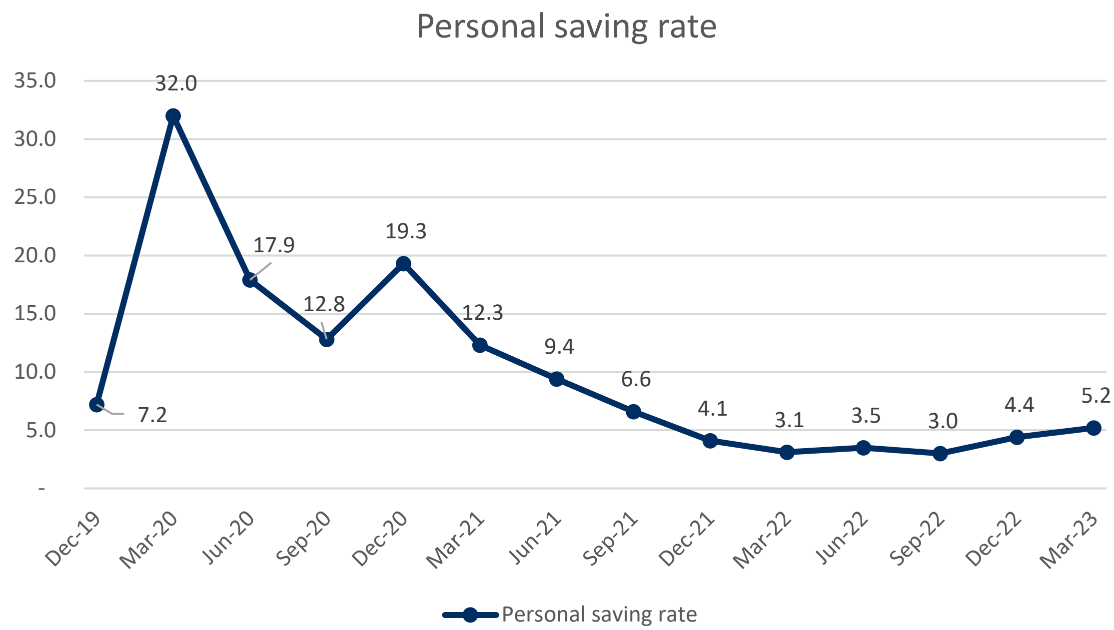


Source: New York Fed[7]

Personal saving rate

The amount of money consumers save has changed over recent years. Near the onset of the COVID-19 pandemic, consumers were flush with cash from government stimulus payments, and spending declined at the height of the pandemic. Personal saving rates were as high as 32% in April 2020. From January 2014 through December 2019, rates ranged from 4.9% to 8.5%, with an average of 6%.[8] Personal saving rates have been lower than the pre-pandemic average since December 2021.

[5] https://fred.stlouisfed.org/series/FEDFUNDS
[6] https://www.newyorkfed.org/microeconomics/hhdc
[7] Ibid.
[8] https://fred.stlouisfed.org/series/PSAVERT



Source: St. Louis Fed[9]

Commercial real estate

Eyler said that the commercial real estate market, specifically office space, has become an area of interest for economists. Vacancy rates continue to be elevated as credit unions and members consider relocating from urban areas, and whether jobs will allow work-from-home permanently. Eyler noted that metro areas most at risk are New York City, San Francisco, and Seattle. Less at risk due to recent population growth are Austin, Texas; Charlotte, North Carolina; and New Jersey (outside of the New York City metropolitan area). Credit unions should consider whether member business loans face a rising risk based on location and type of commercial loan.

Outlook

Arvia and Eyler both indicated that a recession-like economy is coming, but timing in 2024 or 2025 is unknown. Eyler expects that the recession will hit smaller businesses and lower-wage employees first, and the lower spending from those groups will create a snowball effect that will ripple through the rest of the economy. The presidential election in 2024, geopolitics, and migration patterns could all have an impact on forecasts and are matters economists will continue to monitor.

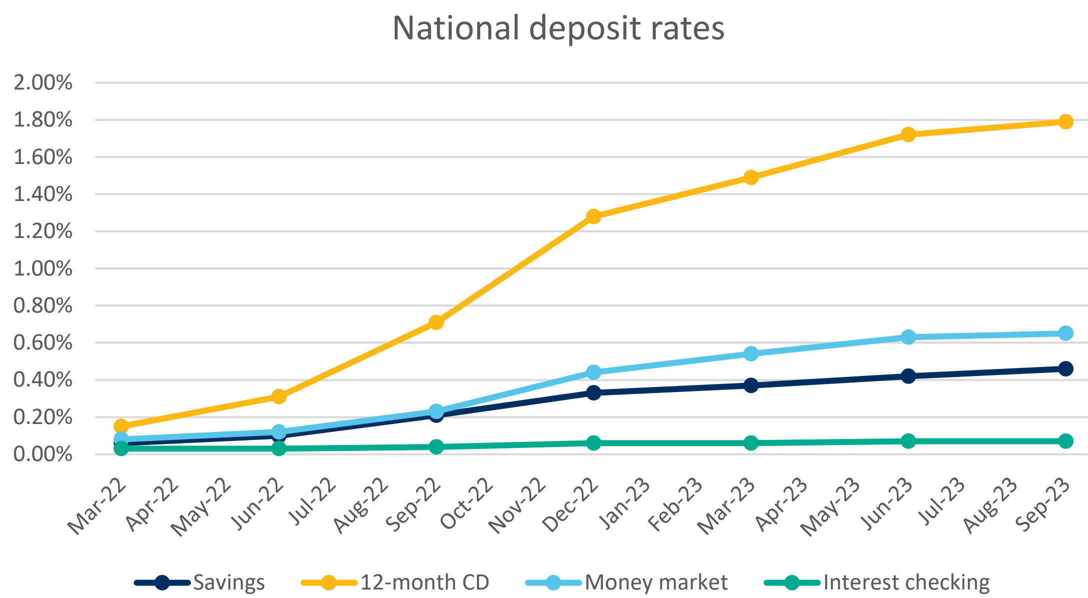
Credit union industry

In addition to updates on the economy, Arvia also discussed the current credit union industry, addressing a key concern in the banking industry today – liquidity. The bank failures in early 2023 caused uncertainty, demand for cash increased, investors lost confidence in the sector, and rate hikes continued to wreak havoc on fair value adjustments to unrealized losses. Deposits, which had a large influx in 2020 and 2021, are more difficult to attract and retain due to rate competition, and Arvia believes retaining and growing deposits for the remainder of 2023 and beyond will continue to be a challenge. Uncertainty in the economy has caused tightening of credit as interest rates continue to rise.

[9] Ibid.

Arvia emphasized that credit union mergers are starting to increase, with the highest level of credit union-bank deals occurring in 2022 at 15. In 2023, 10 credit union-bank deals have occurred through Oct. 31.

A panel of credit union employees discussed challenges and opportunities that they are facing in the current economic environment, with liquidity and cost of funds being at the forefront. National deposit rates, especially higher yielding CD products, continue to rise, creating concerns about competition and prolonged higher deposit costs. Panelists highlighted the need for credit unions to focus on key risks, understand that no one can fully predict the future, and use the tools they currently possess or can acquire to work through the current environment.



Source: St. Louis Fed[10]

[10] https://fred.stlouisfed.org/series/SNDR, https://fred.stlouisfed.org/series/NDR12MCD, https://fred.stlouisfed.org/series/MMNDR, https://fred.stlouisfed.org/series/ICNDR

CECL

Many sessions throughout the conference focused on FASB Accounting Standards Update (ASU) 2022-02, "Financial Instruments – Credit Losses (Topic 326): Troubled Debt Restructurings and Vintage Disclosures."

General comments

Most credit unions have adopted the current expected credit losses (CECL) methodology or will adopt it in the current year, so that proved to be a topic of interest. Crowe representatives Kevin Brand, Sarah Paxton, and Rick Anderson walked participants through the "AICPA Audit and Accounting Guide: Credit Losses," highlighting key components, such as:

Portfolio segmentation	Modeling	Relevance and reliability of data
Adjustments to historical loss	Adjustments to forecasts	Implementing reversion
Evaluating estimation uncertainty	Management bias	Specialists

A representative from the FASB noted that it continues its post-implementation review (PIR) of CECL since October 2022 by performing outreach with stakeholders on various implementation issues and technical inquiries.

Panelists discussed best practices and highlighted key areas, including:

- **Qualitative factors.** Qualitative factors still play an important role in modeling and often are necessary given the current environment and low level of charge-offs in the past few years throughout the industry. Model limitations should be considered in the qualitative factor adjustment as well.
- **Sensitivity.** Depending on the type of model and underlying factors, the CECL model can be highly sensitive, and it's imperative to understand what levers drive the calculation.
- **Documentation.** CECL requires many judgments and decisions; documented policies, procedures, and underlying support will allow for auditors and regulators to understand key decisions made by the credit union.
- **Disclosures.** New disclosures are required as of the credit union's year-end. Credit unions and auditors should be aware of the requirements.

Crowe takeaway: In November 2022, Crowe published a resource for financial institutions, "Example CECL Disclosures." In addition, look for an updated version of Crowe illustrative financial statements in December 2023 at www.crowe.com.

Modifications for borrowers experiencing financial difficulty

Several panels addressed adoption of ASU 2022-02. Sydney Garmong, Crowe partner, said that although the accounting in ASU 2022-02 related to modifications made to borrowers experiencing difficulty is more objective than the "concession"-based guidance in legacy troubled debt restructuring (TDR) guidance, the objective reporting requirements in ASU 2022-02 require many changes to policy and procedure. She emphasized the need to disclose only those modifications that directly affect contractual cash flows.

ASU 2022-02 includes a decision of whether a modification under ASU 2022-02 represents the continuation of an existing loan or a new loan for modifications made to troubled borrowers. Under legacy TDR guidance, a concession granted to a troubled borrower was, by definition, a continuation of the existing loan. If the modification suggests that the instrument's modified contractual terms are indicative of a new loan, the institution must recognize unamortized fees or costs from the original loan and any prepayment penalties in interest income when the new loan is granted.

Conference observation: NCUA Chief Accountant Chris McGrath stated that the call report instructions are expected to change in December. Credit unions should report modifications made for a minimum period of 12 months from the modification until a current well-documented credit evaluation supports that the borrower is no longer experiencing financial difficulty or until the loan is paid off, charged off, sold, or otherwise settled.

Jason Naber, Crowe partner, walked participants through expected disclosures, highlighting additional information required to be disclosed related to modifications to an existing loan for principal forgiveness, interest-rate reduction, other-than-insignificant payment delay, term extension, or any combination of these four. Modifications should be reported in the financial statements for 12 months from date of modification.

Crowe takeaway: In June 2023, Crowe published "Goodbye TDRs, Hello Loan Mods and Vintage Disclosures: FAQ."

Purchased financial assets (PFA)

Under existing GAAP, entities that acquire financial assets within the scope of Topic 326 must classify the assets as either purchased credit deteriorated (PCD) assets or non-PCD assets, depending on the level of credit deterioration that a PFA has experienced since its origination. While this distinction does not affect how expected credit losses are measured, it does affect how the allowance for credit losses (ACL) is initially recognized, which ultimately affects the effective yield recognized on the acquired assets. Under current GAAP, non-PCD assets are recorded at fair value, with the entire difference between par value and fair value recorded as a premium or discount; subsequently, the entity must record an ACL on the amortized cost basis through credit loss expense. Fair value includes a credit loss component, thus recording the full fair value premium or discount as an adjustment to amortized cost of the financial asset and recording an ACL on the same asset results in presentation of the acquired asset on the balance sheet at an amount that is lower than the amount expected to be collected. As part of its CECL PIR, the FASB received feedback that the requirement to classify PFAs as either PCD assets or non-PCD assets is complex, requires significant judgment, and has led to reduced comparability among entities. Stakeholders also have asserted the requirement to recognize the allowance for non-PCD assets through a charge to earnings is unintuitive.

The proposed ASU expands concepts in current PCD treatment to all "seasoned" purchased assets. Under the proposal, the ACL for PFAs that are considered "seasoned" would be established by adjusting the initial carrying amount of the PFA, which has the result of allocating the credit component of the purchase price directly to the ACL. For all other PFAs, the ACL would be established through a charge to earnings. A PFA would be considered seasoned when either one of the following two conditions is met: 1) the PFA is part of a business that was acquired in a business combination accounted for in accordance with Topic 805, “Business Combinations”; or 2) the PFA was acquired more than 90 days after origination and the entity did not have involvement with the origination of the PFA.

Credit unions would be required to adopt the proposed ASU using a modified retrospective transition approach. Under that approach, the proposed guidance would be applied retrospectively to all PFAs occurring since the first reporting period in which an entity adopted ASU 2016-13, “Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.”

The FASB’s comment period on the proposed ASU on PFA has ended, and the FASB staff is reviewing comments. No prevailing consensus in favor of or against the proposal existed; however, consensus is forming on changes which should be made if the FASB proceeds with the project (e.g., removing revolvers with current privileges from the scope, permitting or requiring prospective adoption and amending “substantially all” when evaluating acquired pools).

Crowe takeaway: In June 2023, Crowe published an article related to the FASB’s proposed ASU over purchased financial assets, “FASB Proposes Acquired Financial Asset Reporting Changes.”

FASB updates

In conjunction with other accounting updates, FASB Assistant Director Jeffrey Mechanick provided an update on the FASB’s current standard-setting agenda. In 2023, there have been five exposure drafts issued, five ASUs released to date, and four more anticipated by the end of the year, including one related to accounting for and disclosure of crypto assets.

Projects on the technical agenda that are not expected to be finalized in 2023 that might be of interest to credit unions include:

- Accounting for and disclosure of software costs
- Accounting for environmental credit programs
- Credit losses: PFAs
- Hedge accounting improvements

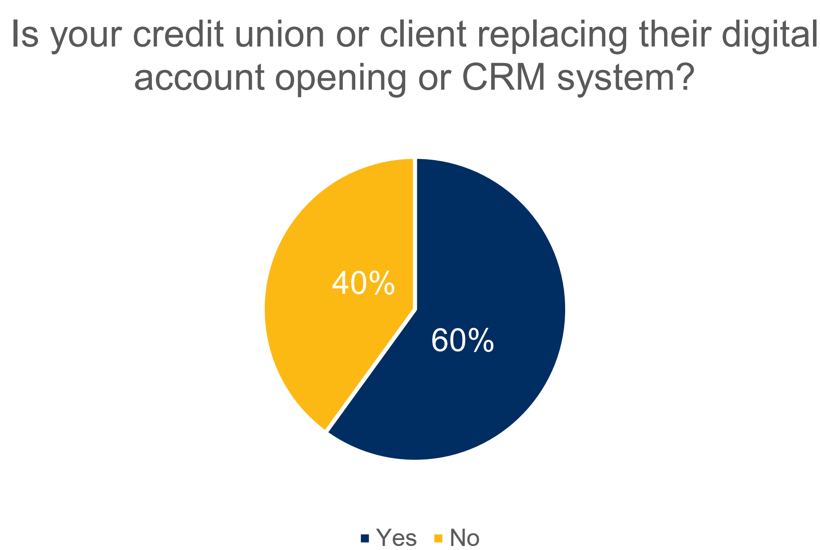
With respect to software costs, the project aims to modernize the accounting for and enhance transparency about an entity’s software costs, for both internally developed and acquired software. The board is further exploring a model where all direct software costs would be capitalized at the time it is probable that the software project will be completed until it is substantially complete. Additional research and outreach will occur before continued discussion at a future board meeting.

Other topics discussed by Mechanick included projects related to environmental, social, and governance (ESG) financial reporting; the definition of a derivative research project to consider potential refinements to scope of Topic 815, and ERCs. Please refer to the “Other industry and conference hot topics” section of this publication for more.

Technology and fintech

Technology, AI, payment modernization, and fintechs were common topics throughout the conference this year.

Arvia said that the banking model has shifted to digital, and the biggest banks maintain their dominance by investing in technology, shifting customers to self-service models, and being proficient in digital sales. Credit unions, however, are investing more money into replacing digital account opening systems and replacing customer relationship management (CRM) systems. A poll of the audience supported this:



John Best of Best Innovation Group walked participants through real-life examples of the changing technology landscape while focusing on the benefits of technologies like AI, which can help employee productivity and reduce costs. In credit unions, AI can help make data-driven decisions, provide tailored services through personalization, and optimize pricing. CPAs also can embrace AI to assist with automation, efficiency, and analysis.

DeFazio talked about the shift from primary financial institution to primary financial interaction. A typical credit union member likely has multiple phone apps related to digital payments. DeFazio stated that the payment experience defines the relationship between the member and its credit union and the digital wallet space will continue to be an area of competition for credit unions. Credit unions should use the member data they have – first, to understand whether they are a member's primary institution and then to consider offers they can make to increase chances of becoming the member's primary institution.

Conference observation: Credit unions will need to continue to evolve technology to compete in the payment and digital wallet space. Understanding member needs is key to understanding future impacts and next steps for your specific credit union.

Other industry and conference hot topics

Employee retention credits

ERCs were discussed in multiple sessions and garnered many questions from participants. Eligibility is based on reduction in gross receipts and suspension of operations. While a credit union might be eligible in certain cases, the consensus view is that most credit unions are likely not eligible based on their continued operations, albeit many remote, and stable income during the pandemic.

> **Conference observation:** NCUA Chief Accountant Chris McGrath said the IRS recently announced details of a special withdrawal process to help those who filed an employee retention credit claim and are concerned about its accuracy. The IRS created the withdrawal option to help small-business owners and others who were pressured or misled by ERC marketers or promoters into filing ineligible claims. Claims that are withdrawn will be treated as if they were never filed, and the IRS will not impose penalties or interest. For more information, see the Crowe article "ERC Claim Withdrawal for Those Having Second Thoughts."

Collateral assignment split dollar

Collateral assignment split dollar has been a topic at the conference for many years, and this year was no different. An accounting session highlighted that current accounting requires that if a loan to an executive is nonrecourse and the cash surrender value (CSV) is less than the loan amount, the loan is written down to CSV. If the loan to the executive is with recourse, credit unions need to consider the underlying collateral, if any; the ability of the executive to repay; and the credit union's intent to seek collection. Credit unions and auditors were reminded that policies cannot be combined or offset. The most recent development is the introduction of surrender enhancement riders, which should be carefully evaluated.

Hedging and derivatives

As balance sheet management continues to be critical, hedging and derivatives can be viable tools for offsetting risk and higher interest-rate costs. With NCUA approval of a final derivatives rule, the use of interest-rate swaps in the credit union industry has increased, helping to lower the cost of funding, reduce asset-liability mismatch, and enhance risk management.

In addition, ASU 2022-01, "Derivatives and Hedging (Topic 815): Fair Value Hedging – Portfolio Layer Method," made targeted improvements to previously issued guidance by:

- Expanding the previous last-of-layer method, which permitted only one hedged layer, to allow for multiple hedged layers in a single closed portfolio. This was renamed as the portfolio layer method.
- Expanding the scope to include nonprepayable financial assets.
- Specifying that eligible hedging instruments in a single-layer hedge may include spot-starting or forward-starting constant-notional swaps, or spot- or forward-starting amortizing-notional swaps and that the number of hedged layers (that is, single or multiple) corresponds with the number of hedges designated.
- Providing additional guidance on the accounting for and disclosure of hedge basis adjustments that are applicable to the portfolio layer method whether a single hedged layer or multiple hedged layers are designated.
- Specifying how hedge basis adjustments should be considered when determining credit losses for the assets included in the closed portfolio.

Fraud schemes

Rene Perez, financial crimes consultant at Jack Henry & Associates, addressed consumer fraud and identity theft. In 2023, rates of identity theft and fraud increased, which has been particularly harmful to financial institutions. Recent popular fraud schemes include the use of fake IDs to open accounts at financial institutions. Mail fraud is up, the result of thieves using stolen USPS mailbox master keys. It is important that credit unions understand the latest fraud schemes and mitigate risks of fraud to protect themselves.

Other topics

Other conference sessions included these topics:

- Accounting and auditing issues
- Balancing loan growth and credit quality
- Mergers and acquisitions
- Remote auditing
- Auditing standards updates
- Regulatory compliance

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