Audit & Assurance Hot Topics

Marshall Trull
Shareholder
Elliott Davis
marshall.trull@elliottdavis.com

Brandon Paul
Principal
Elliott Davis
brandon.paul@elliottdavis.com

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agenda:

1 Mergers & Acquisitions Update

2 Final Rule – FDICIA Thresholds

3 Earnings Enhancements & Balance Sheet Restructuring

Mergers & Acquisitions Update

Accounting Standards Update (ASU) 2025-08

- Resolves the issue of day-one credit loss expense and double counting in business combinations or asset acquisitions
- Originally referred to as Purchased Financial Assets (PFA), has been renamed Purchased Seasoned Loans (PSL)
- No changes to PCD Accounting
  - Still apply existing PCD/Non-PCD determination
- No new disclosures
- Only changing assets subject to "PSL" model
  - Seasoned loan receivables ONLY
  - "Seasoned"
    - Acquired via business combination, or
    - Purchased > 90 days after origination with the purchaser having no

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PCD vs. PSLs

	Unchanged Guidance	Previous Approach	Revised Approach
	Purchased Credit Deteriorated (PCD)	**Non-Purchased Credit Deteriorated (Non-PCD)**	**Purchased Seasoned Loans (PSL)**

Scope	• Loans which have experienced a "more than insignificant deterioration" in credit quality since origination
	  ◦ Flexible definition
	  ◦ Determined by company policy
	  ◦ Inconsistent approaches
		• Loans not meeting Company policy for PCD	• "Seasoned" loan receivables ONLY
			• Excludes: credit cards, loan commitments, leases, forward contracts, trade account receivables, and HTM debt securities

Recognition	• **Gross-up Approach**
	  ◦ Amortized Cost + Expected Credit Loss = Initial Recognition
	  ◦ ACL recognized through Day 1 entries
	  ◦ No Credit Loss Expense
		• Non-gross-up Approach
		  ◦ Amortized Cost = Purchase Price (net of discounts)
		  ◦ Day 2 Credit Loss Expense to establish ACL
			• **Gross-up Approach**
			  ◦ Amortized Cost + Expected Credit Loss = Initial Recognition
			  ◦ ACL recognized through Day 1 entries
			  ◦ No Credit Loss Expense

PSLs: Recognition and Measurement

Initial Amortized Cost Basis

- Purchase price + initial ACL (measured at acquisition date)

Interest Income Recognition

- Apply the interest method to recognize as interest income noncredit discount (or premium)

Accrual Guidance

- Existing non-accrual guidance applies
- No requirement to demonstrate a reasonable expectation of collection to recognize interest income

Recovery Cap Guidance

- ACL for seasoned assets will **not** be subject to a recovery cap

Same as PCD

Different for PSLs

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PCD vs. PSLs

Current Non-PCD Accounting	PCD/PSL "Gross Up" Accounting
1/1/25 to record acquisition	
DR Loan 1,000,000 CR Discount 100,000 CR Cash 900.000	DR Loan 1,000,000 CR Noncredit Discount 80,000 CR ACL 20,000 CR Cash 900.000
3/31/25 to record estimate of ACL at reporting date	
DR Provision Expense 20,000 CR ACL 20,000	No entry (already recorded as an adjustment to the initial carrying amount of the loan / reduction of noncredit discount)
3/31/25 recap of income statement income impact	
Interest income (9.43%) 20,940 Credit expense (20,000)	Interest income (8.49%) 19,266

Facts:
Price $900,000
Par $1,000,000
Discount ($100,000)

Stated Rate 5%
Term remain 5 years
Initial ACL estimate $20,000

Impact on Capital

	Current Non-PCD Accounting	PCD/PSL “Gross Up” Accounting
Tangible Common Equity	$280,000	$300,000
Tangible Assets	$2,980,000	$3,000,000
TBV Ratio	9.40%	10.00%

- PSL accounting results in **less** TBV dilution and **more** capital at close.
- Since the ACL is established with the gross up of the purchase price, no provision expense is recorded in connection with deal closing.
- Subsequent quarter’s fair value accretion will only be rate-driven which better mirrors the current rate environment.

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Why this matters for acquirers

- Lower goodwill recognition
- Positive impact on regulatory capital
- More consistent treatment of acquired loans
- Simplified accounting

m&a accounting best practices

- Allowance for credit losses
  - Credit mark
    - Ensure the model utilized to calculate the PCD and Purchased Seasoned Loan credit mark is reasonable and supportable
    - The actual ACL recorded may be different than the credit mark, but it shouldn’t be **materially** different
  - Impact of acquired portfolio on ACL model
    - New loan segments
    - Impact to qualitative factors
    - Impact on peer group

Final Rule – FDICIA Thresholds

Current Requirements

	Total Assets less than $500 million	Total Assets greater than $500 million and less than $1 billion	Total Assets greater than $1 billion	Total Assets greater than $5 billion
Audited Comparative Financial Statements		✔	✔	✔
Independent public accountant's report on those financial statements		✔	✔	✔
Management Report/Assessment of ICFR			✔	✔
Independent public accountant's attestation report on ICFR			✔	✔
Independent Audit Committee			✔	✔
Audit Committee Members with Financial Expertise and Independent Counsel				✔

Final Threshold Changes

	Old	New
General Applicability Threshold for 363	$500 million	$1 billion
Internal Controls over Financial Reporting Threshold	$1 billion	$5 billion
Audit Committee Composition Threshold	$500 million	$1 billion

Updated Requirements

	Total Assets less than $500 million	Total Assets greater than $500 million and less than $1 billion	Total Assets greater than $1 billion	Total Assets greater than $5 billion
Audited Comparative Financial Statements			✔	✔
Independent public accountant's report on those financial statements			✔	✔
Management Report/Assessment of ICFR				✔
Independent public accountant's attestation report on ICFR				✔
Independent Audit Committee				✔
Audit Committee Members with Financial Expertise and Independent Counsel				✔

Final Ruling Implications

- Considerable impact for community banks
  - Substantial compliance relief
  - Independence requirements
  - Compliance with HUD
- Implementation timing
  - Measurement date: January 1, 2026
  - Can be effective for the current fiscal period
- Indexing methodology

Final Ruling – Expected Impacts

- Important impact for community banks:
  - Substantial compliance relief
    - Independence
    - Reduces requirement for an ICFR audit opinion for most community banks
    - Option to continue the ICFR audit to ensure control environment
    - Community banks ≠ Big banks
  - Operational flexibility – simplifies governance for community banks
  - HUD Requirement likely pushed for only banks greater than $1B
- Hundreds of community banks will be removed from Part 363 requirements, resulting in significant cost savings and operational relief, without compromising safety and soundness.

Final Ruling – Timing

- The final ruling from the FDIC provides effective date considerations:
  - Effective Date for the final rule implementation: January 1, 2026
  - IMPORTANT TRANSITION RELIEF:
    - With respect to part 363, the final rule clarifies that IDIs that have prospective filing and compliance requirements based on thresholds in place in 2025, but will no longer be subject to such requirements as a result of the updated thresholds that will be in effect as of January 1, 2026, **are no longer required to comply with such part 363 requirements**.
    - The amendments to part 363 do not relieve public companies or subsidiaries of public companies of their obligation to comply with the internal control assessment requirements imposed by section 404 of the Sarbanes-Oxley Act in accordance with the effective dates for compliance set forth in the SEC’s implementing rules
- The asset threshold will continue to be a “point in time” assessment made at the beginning of the fiscal year – explicitly retained within the final ruling.

Final Ruling – Indexing Methodology

- Going forward the thresholds will be subjected to inflation considerations:
  - FDIC noted within the final rule that thresholds had become stagnant and did not maintain alignment with original policy objectives.
  - Future threshold determination will be made by the FDIC and effective **October 1** using data CPI-W data through August of the same year (no notice-and-comment period required for these updates).
    - The inflation adjustment will be made every <u>**two**</u> years.
    - The next inflation adjustment will occur October 1, 2027.
    - Interim adjustments are allowable in the event recorded inflation exceeds 8% in any year.
    - There will be no downward adjustments in the event of "deflation".

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Earnings Enhancements & Balance Sheet Restructuring

Securities Portfolio Restructures

Source: S&P Capital IQ Pro and Company Filings

Company	Ticker	Total Assets ($M)[2]	Intent	Amount Sold ($M)	% of Total Portfolio[3]	Pre-Tax Loss/Secs Sold (%)	Pre-Tax Loss ($M)	Use of Proceeds	Spread	Earnback Period	Accompanying Event	Net Interest Margin as of 3Q24	8-K Announce?	Prior Restructure?	1 Day Relative Stock Performance	3 Day Relative Stock Performance	7 Day Relative Stock Performance
AB	AFBI	$867	AFS	$10	12.9%	-4%	($0.4)	Loan Reinvestment				3.49			(0.89)%	(0.87)%	(1.19)%
amalgamated bank	AMAL	$8,260	AFS	NA	NA		($1.0)					3.53		Yes	(4.41)%	(7.81)%	(5.91)%
AMERANT BANK	AMTB	$9,881	AFS	NA	NA		($8.1)	Deleverage and Reinvestment			Gain from FHLB prepay and sale of Houston Franchise	3.55		Yes	5.33%	3.87%	2.19%
ARROW Financial Corporation	AROW	$4,295	AFS	$75	17.6%	-4%	($3.0)	Securities Reinvestmet	~380bps	1.1yrs		2.78	Yes		--	--	--
Associated Bank	ASB	$42,966	AFS	$1,300	16.4%	-11%	($148.2)	Securities Reinvestment	~321bps	~3.55yrs	Common Equity Raise, Loan Sale	2.76	Yes	Yes	0.77%	0.91%	0.91%
Central Pacific Bank	CPF	$7,460	AFS	$107	8.0%	-9%	($9.9)	Securities Reinvestment	~280bps	3.5yrs		3.17		Yes	(1.69)%	4.13%	3.53%
Citizens Business Bank	CVBF	$15,161	AFS	$155	3.2%	-11%	($16.7)	Securities Reinvestment			Sale Leaseback	2.96		Yes	0.36%	0.42%	(0.65)%
City National Bank	CHCO	$6,438	AFS	NA	NA		($2.8)					3.79		Yes	0.43%	0.09%	(2.01)%
Colony Bank	CBAN	$3,099	AFS	$8	1.0%	-5%	($0.4)	Reinvestment		< 2yrs		2.71		Yes	8.53%	7.62%	5.95%
Columbia Bank	CLBK	$10,472	AFS	$321	20.1%	-11%	($34.6)	Securities and Loan Reinvestment, Deleverage		3.1yrs		1.89	Yes	Yes	(0.55)%	(1.15)%	(1.83)%
Comerica	CMA	$79,332	AFS	$827	5.2%	-2%	($20.0)	Securities Reinvestment		< 1yr		2.88			(4.61)%	(3.73)%	0.91%
Commencement Bank	CBWA	$650	AFS	$13	14.0%	-7%	($0.9)	Securities Reinvestment	~243bps	2.5yrs	BOLI Restructure	3.28			2.06%	4.01%	7.41%
customers bank	CUBI	$22,296	AFS	$480	13.9%	-5%	($26.3)	Securities and Loan Reinvestment				3.10		Yes	13.40%	11.85%	11.91%
DIME	DCOM	$14,337	AFS	$379	27.7%	-11%	($42.8)	Securities Reinvestment	~388bps	Implied ~3yrs	Common Equity Raise, BOLI Restructure	2.62	Yes	Yes	1.39%	2.02%	5.61%
Eastern Bank JOIN US FOR GOOD	EBC	$25,552	AFS	$116	2.5%	-8%	($9.2)	Securities Reinvestment			Gain on Sale of Equity Investment	2.88		Yes	0.92%	1.62%	2.88%
FM	FMBL	$11,690	AFS and HTM	$201	4.8%	-5%	($10.1)	Securities Reinvestment	~207bps	Implied ~2.4yrs		2.02			0.22%	0.04%	0.57%
Franklin Financial Services Corporation	FRAF	$2,197	AFS	$47	10.0%	-9%	($4.3)	Securities Reinvestment	~336bps	2.3yrs		3.07	Yes	Yes	1.60%	1.20%	9.27%
FB	FFBB	$1,504	AFS	$13	3.7%	-4%	($0.5)	Securities Reinvestment		1yr		5.28		Yes	(16.11)%	(16.16)%	(13.69)%

Securities Portfolio Restructures

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Company	Ticker	Total Assets ($M)[2]	Intent	Amount Sold ($M)	% of Total Portfolio[3]	Pre-Tax Loss/Secs Sold (%)	Pre-Tax Loss ($M)	Use of Proceeds	Spread	Earnback Period	Accompanying Event	Net Interest Margin as of 3Q24	8-K Announce?	Prior Restructure?	1 Day Relative Stock Performance	3 Day Relative Stock Performance	7 Day Relative Stock Performance
FIRST BANK	FBNC	$12,148	AFS	$280	11.5%	-13%	($36.8)	Securities Reinvestment	~371bps	Implied ~ 3.5yrs		2.97		Yes	(1.77)%	(0.32)%	(1.71)%
First Commerce Bank	CMRB	$1,551	AFS	$6	7.8%	-4%	($0.2)	Securities Reinvestment		2yrs		2.36			2.06%	(3.32)%	(3.08)%
FIRST HORIZON	FHN	$81,866	AFS	$1,200	12.5%	-8%	($91.5)	Securities Reinvestment	~320bps	2.5yrs		3.28			0.47%	0.09%	(2.26)%
First Merchants Bank	FRME	$18,299	AFS	$110	3.0%	-11%	($11.6)				Gain from Branch Sale	3.17		Yes	2.57%	8.16%	6.51%
First National Bank	FNB	$48,447	AFS	$231	3.2%	-15%	($34.0)	Securities Reinvestment	~337bps	Implied ~4.4yrs	Senior Debt Issuance	3.13		Yes	(1.38)%	(1.31)%	(1.13)%
Financial Institutions, Inc.	FISI	$6,081	AFS	$636	63.0%	-16%	($100.1)	Securities Reinvestment	~352bps	Implied ~4.5yrs	Common Equity Raise	2.97	Yes	Yes	7.70%	8.22%	8.66%
FLUSHING Bank	FFIC	$9,047	AFS	$445	26.4%	-16%	($72.3)	Securities Reinvestment	~369bps	Implied ~4.4yrs	Common Equity Raise, Loan Sale	2.26	Yes	Yes	(12.02)%	(10.78)%	(11.49)%
Heritage Financial Corporation	HFWA	$7,102	AFS	$36	2.3%	-11%	($3.9)	Loan Reinvestment			BOLI Restructure	3.31		Yes	1.52%	2.69%	3.09%
HORIZON BANK	HBNC	$7,775	AFS	$332	13.7%	-12%	($39.1)	Loan Reinvestment and Deleverage		< 4yrs	Released Tax Valuation Allowance	2.70		Yes	5.15%	7.94%	5.56%
LEDYARD	LFGP	$950	AFS	$28	9.3%	-4%	($1.1)				Sale Leaseback	2.26		Yes	1.78%	(1.31)%	1.66%
Mid-Southern Savings Bank, FSB	MSVB	$225	AFS	NA	NA		($11.1)					3.35			NA	NA	NA
National Bank Holdings	NBHC	$9,771	AFS	$130	10.4%	-5%	($6.6)	Securities Reinvestment				3.83	Yes		(0.02)%	(0.16)%	(0.71)%
Origin Bank	OBK	$9,588	AFS	$188	16.1%	-8%	($14.6)	Securities Reinvestment	~371bps	2.4yrs		3.18		Yes	5.31%	9.55%	5.86%
pathward	CASH	$7,617	AFS	$161	9.0%	-10%	($15.7)	Loan Reinvestment and Deleverage			Gain from Sale of Insurance Business	6.82		Yes	(0.48)%	2.66%	2.00%
Rhinebeck Bank	RBKB	$1,256	AFS	$21	12.4%	-19%	($4.0)	Securities Reinvestment	306bps	Implied ~6yrs		3.21	Yes	Yes	1.85%	2.62%	1.03%
S&T Bancorp	STBA	$9,653	AFS	$45	4.5%	-6%	($2.6)	Securities Reinvestment		2yrs		3.83		Yes	(0.05)%	4.06%	4.58%
Seacoast	SBCF	$15,167	AFS	$113	4.0%	-7%	($8.0)	Securities Reinvestment	~260bps	< 3yrs		3.16		Yes	4.66%	3.70%	5.61%

Securities Portfolio Restructuring

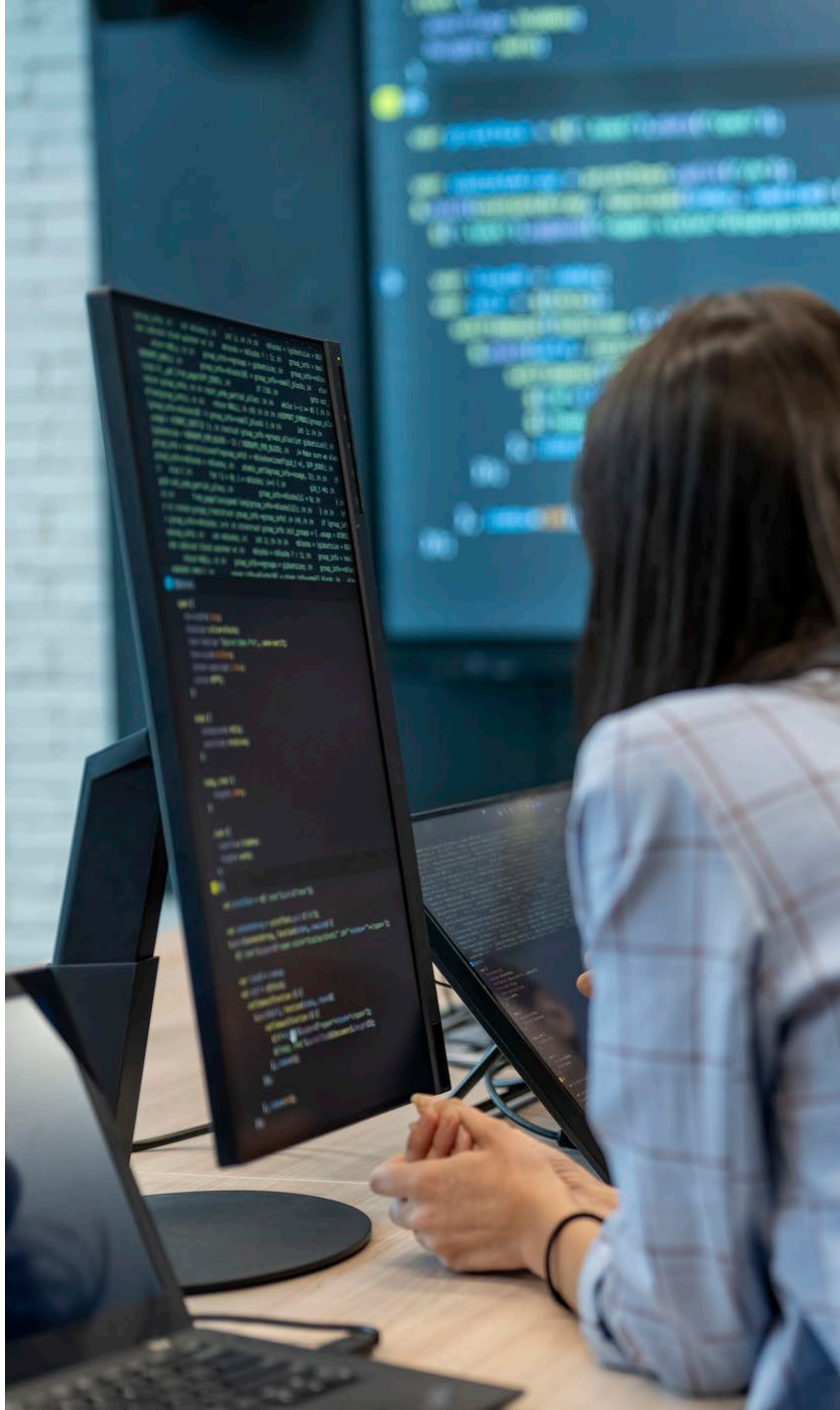
- **CECL for Available for Sale Securities**
  - No consideration for length of time in an unrealized loss
  - Allowance approach vs. direct write down for credit impairment
  - Maximum credit loss = total amount of unrealized loss
- **Transfers to/from Held to Maturity**
  - Transfers from HTM to AFS for liquidity or yield taints the portfolio
  - Unrealized loss at date of transfer becomes a component of AOCI
    - AFS >> HTM, amortized over life of securities transferred
    - HTM >> AFS, mark to market in subsequent quarters
- **Planned Securities Sales**
  - To the extent a decision has been to sell a specific bond, the loss should be recognized at that time
    - Previously recognized ACL is charged off and incremental impairment recorded in earnings
  - Be aware of documentation in minutes, budgets, etc.

Sale/Leaseback Transactions

- **Does the transaction qualify as a sale?**
  - Need to assess contract considerations under ASC 606
    - Contract existence
    - Control of the property is transferred to buyer/lessor
- **Common causes of failure to qualify as a sale:**
  - Leaseback is classified as a finance lease
    - Lease term constitutes a major part of the economic life of the asset
    - Present value of future lease payments > 90% of property fair value
  - The transaction includes a repurchase option
- **Be aware of significant judgement inherent in lease assessment:**
  - Lease term, lease payments, & discount rate used to present value future lease payments
  - Fair value source (i.e. buyer's offer vs. independent appraisal)
- **Why this matters**
  - Failed sales accounting can impact earnings and liquidity strategy

BOLI/CUOLI Restructuring Gains

- Brokers are offering products to restructure BOLI into higher yielding BOLI products with earnings enhancements
- The increase in Cash Surrender Value appears to indicate a Day 1 accounting gain
- Marketed as a means to offset losses from securities sales
- The enhancement is immediately receivable upon surrender on Day 1, **if certain conditions are met**



BOLI/CUOLI Restructuring Gains

- Example conditions of surrender:
  - Not involved in a 1035 tax free exchange
  - Cannot acquire another BOLI/CUOLI product for 5 years following surrender
  - Institution is at least adequately capitalized for year prior to the surrender request
  - Institution has not been subject to a credit event for the year prior to the surrender request
  - Institution has maintained the insurance carrier as its agent of record on the policies for the period of time leading up to the surrender request
- ASC 450-30-25-1: contingent gains should not be recognized prior to the gain being “realized” or “realizable”

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thank you

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