



2011 FMS Annual Accounting Update

John Doherty
September 27, 2011

FASB Updates

Fair Value Measurements and Disclosures (Topic 820) – Improving Disclosures About Fair Value

All disclosures were effective in 2010, except as noted below:

- In the reconciliation of Level 3 fair value measurements, information about purchases, sales, issuances, and settlements should be presented separately. Previously, all of these items could be reported net in the reconciliation table.
- Effective for annual periods beginning after 12/15/10 and interim periods within those years.

ASU 2010-20 Receivables

Receivables (Topic 310) - Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses

Effective Date

- Public Entity
 - Partial applicability in 12/31/10, full adoption fye 12/31/11
- Non-public Entity
 - First annual reporting period ending on or after December 15, 2011.
- Comparative disclosures not required in year of adoption

ASU 2010-20 Receivables

Summary: Significantly increased disclosures related to loans and the allowance for loan losses

No Changes from Current Accounting Practices

Key concepts:

- Portfolio segment – level at which allowance is calculated (i.e. consumer loans)
- Portfolio class – level at which credit risk is evaluated (i.e. auto loans, personal loans, etc.)

Disclosures required by **class**:

- Policies:
 - Policy for placing loans on nonaccrual status
 - Policy for recording payments received
 - Policy for resuming accrual of interest
 - Policy for determining delinquency or past due status
- Quantitative information:
 - Recorded investment in nonaccrual loans
 - Loans past due > 90 days and still accruing
 - Analysis of aging of past due loans

Disclosures required by **class** (continued):

- Impaired Loans - Qualitative Information:
 - Policy for determining which loans are assessed for impairment
 - Factors considered in determining that the loan is impaired
 - Policy for recognizing interest income on impaired loans, including how cash receipts are recorded

Disclosures required by **class** (continued):

- Impaired Loans – Quantitative information
 - Recorded investment in impaired loans as of BS date – not net of specific reserve
 - With allowance, and amount of allowance
 - Without allowance
 - Total unpaid principal balance as of BS date – balance before partial charge-off
 - Average recorded investment during period
 - Interest income recognized during time loan impaired, and if practicable, amount on cash-basis

Disclosures required by **segment**:

- **Methodology used to estimate ALL**
 - Description of factors used, including historical losses and existing economic conditions
 - Risk characteristics relevant to each portfolio segment
 - Changes from prior period and rationale for change
- **Policy for charging off uncollectible loans**
- **Activity in the ALL**
 - Beginning balance
 - Provisions
 - Write-downs
 - Recoveries

ASU 2010-20 Receivables

Disclosures required by **segment** (continued):

- Quantitative ALLL disclosures
 - If methodology was changed, impact on provision as a result of change
 - Amount of significant purchases
 - Amount of significant sales or transfers to LHFS
 - Balance of ALL at end of period disaggregated on basis of impairment method
 - Amounts collectively evaluated for impairment
 - Amounts individually evaluated for impairment
 - Amounts related to loans acquired with deteriorated credit quality
 - Amount of loans at end of period related to each balance in ALL disaggregated above

ASU 2010-20 Receivables

Disclosures required by **segment** (continued):

- Quantitative ALLL disclosures (concluded)
 - Balance of ALLL at end of period disaggregated on basis of impairment method
 - Amounts collectively evaluated for impairment
 - Amounts individually evaluated for impairment
 - Amounts related to loans acquired with deteriorated credit quality
 - Amount of loans at end of period related to each balance in ALLL disaggregated above

Credit Quality Information (i.e. risk ratings)

- Disclose by **class**
 - Description of credit quality indicator
 - Recorded investment in loans by credit quality indicator
 - For each credit quality indicator, date or range of dates in which the information was updated for that credit quality indicator
 - If internal risk ratings disclosed, how they relate to likelihood of loss

ASU 2010-20 Receivables

Modifications (TDR's) – for each period disclose:

- TDR's that occurred during period:
 - By class, how loans were modified and financial effects of modifications
 - By portfolio segment, qualitative information about how modifications are factored into determination of ALL
- TDR's that occurred during previous 12 months and there was a payment default during the period:
 - By class, the types and amounts of loans that defaulted
 - By portfolio segment, qualitative information about how such defaults are factored into determination of ALL

Off-Balance-Sheet Credit Exposures

- Disclose a description of the accounting policies and methodology used to estimate the liability for off-balance-sheet credit exposures
 - Loan commitments
 - Guarantees
 - Standby letters of credit

Receivables (Topic 310) – A Creditor's Determination of Whether a Restructuring is a TDR

Effective Dates

- Public companies – first interim or annual period beginning on or after June 15, 2011. Applied retrospectively to beginning of fiscal year of adoption, with measurement occurring in period of adoption.
- Non-public companies – first annual period ending after December 15, 2012.
- Early adoption is permitted.

ASU 2011-02 TDR's

Summary – Clarification of existing guidance. No changes in the definition of what constitutes a TDR (borrower with financial difficulties for which the bank provides a concession)

Key points:

- Effective interest test no longer the determining factor in determining TDR status.
- Includes additional guidance in determining an insignificant delay in payments.

ASU 2011-02 TDR's

In evaluating whether a restructuring constitutes a troubled debt restructuring (“TDR”), a creditor must separately conclude that both of the following exist:

1. The debtor is experiencing financial difficulties
2. The restructuring constitutes a concession

A creditor shall not apply the effective interest rate test contained in the debtor's guidance in ASC 470-60-55-10 (EITF 02-04) to determine if a restructure is a TDR

ASU 2011-02 TDR's

In determining if the debtor is experiencing financial difficulties, a creditor must consider the following:

- The debtor is in payment default on any of its debt.
- It is probable that the debtor will be in payment default on any of its debt in the foreseeable future without the modification.
- The debtor has declared or in the process of declaring bankruptcy.
- There is substantial doubt as to whether the debtor will continue to be a going concern.

ASU 2011-02 TDR's

- The creditor forecasts that the debtor's entity-specific cash flows will be insufficient to service any of its debt in accordance with the contractual terms for the foreseeable future.
- Without the current modification, the debtor cannot obtain funds from sources other than the existing creditor at an effective interest rate equal to the current market interest rate for similar debt for non-troubled debtors.
- The debtor has securities that have been, or are in the process of being, delisted.

ASU 2011-02 TDR's

What constitutes a concession? A concession is deemed to be granted:

- When, as a result of the restructuring, the creditor does not expect to collect all amounts due, including interest accrued at the original contract rate
 - If repayment of the loan upon maturity is collateral dependent, the current value of collateral should be assessed in the repayment determination.
- When additional collateral or guarantees received do not serve as adequate compensation for other terms of the restructuring

ASU 2011-02 TDR's

- Other items to consider:
 - Restructuring with a below-market rate may indicate a concession; does the borrower have access to funds at the restructured rate?
 - Restructuring with a temporary or permanent increase in rate does not preclude TDR status, as the higher rate may still be below market for similar risk.

ASU 2011-02 TDR's

An insignificant delay in payment is not considered a concession. Indicators of an insignificant delay in payment are:

- The restructured payments subject to delay are insignificant relative to unpaid principal or collateral value and will result in an insignificant shortfall in the contractual amount due.
- A timing delay is insignificant relative to the following:
 - The frequency of payments due under the debt
 - The debt's original contractual maturity
 - The debt's original expected duration

The cumulative effect of previous restructurings should also be considered.

ASU 2011-02 TDR's

Example 1 – Residential loan with insignificant delay

- Debtor obtains 30-year mortgage. In year 4, debtor misses two payments and is experiencing financial difficulty.
- Debtor and creditor enter into forbearance arrangement and repayment plan, such that debtor will increase next four payments to cover the two payments missed.
- This is not a TDR as this is considered an insignificant delay in payment.

ASU 2011-02 TDR's

Example 2 – Residential loan with insignificant delay

- Debtor obtains 30-year mortgage. In year 4, debtor is experiencing financial difficulty.
- Debtor and creditor enter into an agreement that interest only payments will be made for 6 months
- This is not a TDR as this is considered an insignificant delay in payment.
- 6 months represents ~ 2% of the total number of payments
- Amount of deferred principal insignificant to unpaid principal


ASU 2011-02 TDR's

Example 3 – Insignificant delay, however, collateral shortfall

- A creditor originated a 7-year commercial loan with the expectation that at the end of the 7 years, the loan would be paid back by refinancing the debt.
- Prior to maturity, the fair value of collateral is less than the principal amount due and the debtor is unable to refinance the debt. The debtor is experiencing financial difficulty.
- The debtor requests a 3-month extension of maturity in order to liquidate the collateral.
- Although the payment delay is insignificant, this is a TDR due to the significant shortfall in cash flows relative to the contractual amount due when the property is sold.

ASU 2011-02 TDR's

Example 4 – Construction loan with maturity extension

- Debtor obtains a construction loan for a spec house for \$300,000.
 - Repayment of loan is to come from sale of the house.
 - Loan is interest only through June 30, 2011.
 - Debtor and creditor enter into an agreement to extend the interest only period for 6 months (2nd time this has been done).
 - Value of house has declined to \$275,000.
 - This is a TDR as the collateral value is insufficient to repay the loan in full.
- 

***Intangibles – Goodwill and Other (Topic 350) –
When to Perform Step 2 of the Goodwill
Impairment Test for Reporting Units with Zero or
Negative Carrying Amounts***

ASU 2010-28 Goodwill

Effective Dates:

- Public entity – effective for fiscal years, and interim periods within those years, beginning after 12/15/10
- Non-public entity – effective for fiscal years, and interim periods within those years, beginning after 12/15/11 (early adoption permitted using public company effective date).
- If impairment, cumulative-effect adjustment to beginning retained earnings in period of adoption.

ASU 2010-28 Goodwill

- If an entity has a zero or negative carrying value, step 2 of the impairment test must be performed if it is more likely than not that goodwill impairment exists.
 - Refer to ASC 350-20-35-30 for events or circumstances indicating goodwill may be impaired
 - Legal factors
 - Regulatory action
 - Unanticipated competition
 - Loss of key personnel
 - Expected sale or disposal of reporting unit

Business Combinations (Topic 805) – Disclosure of Supplementary Pro Forma Business Combinations

Summary: Clarifies proforma disclosure requirements for public entities as there is divergence in practice

Effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 12/15/10.

ASU 2010-29 Proforma F/S

- A public entity that presents pro forma information should disclose revenue and earnings of the combined entity as though the business combination that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only.
- Expands disclosures to include description of nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination.

Transfers and Servicing (Topic 860) – Reconsideration of Effective Control For Repurchase Agreements

- Effective for first interim or annual periods beginning on or after December 15, 2011.
- Guidance applied prospectively to transactions or modification of existing transactions occurring after effective date.
- Early adoption is not permitted.

ASU 2011-03 Repo's

Summary: this ASU removes from the assessment of effective control:

- (1) the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the transferee, and
- (2) the collateral maintenance implementation guidance related to that criterion.
- Other criteria applicable to the assessment of effective control are not changed by the amendments in this update.

Generally not an issue for community banks as repo's are recorded as financing activities.

Fair Value Measurement (Topic 820) – Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS

Effective dates

- Public entities – Effective during interim and annual periods beginning after December 15, 2011. Early application is not permitted.
- Non-public entities – Annual periods beginning after December 15, 2011. Early application is permitted, but no earlier than interim periods beginning after December 15, 2011.

ASU 2011-04 FV Measurement

Summary: to improve comparability of fair value measurements presented and disclosed in F/S prepared in accordance with US GAAP and IFRS.

- Removes the concept that a fair value measurement of a financial asset or liability needs to take into account the highest and best use of the financial asset or liability.
 - Board decided such items do not have alternative uses and FV does not depend on their use within a group of other assets or liabilities.

ASU 2011-04 FV Measurement

- Fair value of an instrument classified in a reporting entity's shareholders' equity should be measured from the perspective of market participant that holds the asset.
 - Previously, no guidance on measuring FV in s/e.
- Application of premiums and discounts in a fair value measurement is related to the unit of account.
 - Premiums/discounts related to size of holding rather than as characteristic of asset/liability (i.e. control premium) are not permitted in FV measurement

New Disclosure Requirements - Public entity

- Items for which fair value is only disclosed in the financial statements, but not recorded (FAS 107/Topic 820), disclose the following information:
 - Level within FV hierarchy
 - Level 2 and 3, description of valuation techniques and inputs used in FV measurement
- Level 3 – narrative description of sensitivity to changes in unobservable inputs

New Disclosure Requirements – All entities

- Level 2 and Level 3 recurring and non-recurring
 - Description of valuation techniques and inputs used
 - Level 3 – quantitative information about significant unobservable inputs
 - Ex. If using discount rates, prepayment speeds, loss severity rates, disclose the ranges of the inputs that are used (i.e. 6%-10%)

Comprehensive Income – Presentation of Comprehensive Income

Effective Dates

- Public entity – Fiscal years, and interim periods within those years, beginning after December 15, 2011
- Non-public entity – Fiscal years ending after December 15, 2012
- Requires retrospective application
- Early adoption is permitted
- No transition disclosures required

ASU 2011-05 Comp. Income

- Currently 3 alternatives to reporting OCI
 - In statement of changes in stockholders equity
 - In the income statement
 - Separate statement
- Eliminates the option of reporting in statement of changes in stockholders equity.
- Does not change components of OCI
- Requires reclassification from OCI to net income be presented on face of the financial statements
- Tax effects still required for each item of OCI, but can be provided in notes to FS

ASU 2011-05 Comp. Income

- Under new guidance, must report comprehensive income:
 - Single continuous financial statement, with section for net income and other comprehensive income
 - Two separate, but consecutive statements
 - Statement of Net Income
 - Statement of Other Comprehensive Income

Goodwill and Other (Topic 350) – Testing Goodwill for Impairment

Summary: to simplify how entities, public and nonpublic, test goodwill for impairment

- Effective for annual and interim goodwill impairment tests for fiscal years beginning after December 15, 2011. Early adoption permitted.

ASU 2011-08 G/W Imp. Testing

- First perform a qualitative analysis to determine if it is more likely than not (> 50% chance) that the fair value of a reporting unit is less than its carrying amount.
 - Sign. adverse change in legal factors or business climate
 - Unanticipated competition
 - Loss of key personnel
 - More-likely-than-not expectation of sale/disposal
- If impairment is unlikely, do not have to perform 2 step test for impairment
- No requirement to perform qualitative, can go right to 2 step test.

Compensation – Retirement Benefits – Multiemployer Plans (Sub Topic 715-80) – Disclosures about an Employer’s Participation in a Multiemployer Plan

Summary – new disclosures regarding entities
involvement in multiemployer pension plans

Effective Dates:

- Public entities – Fiscal years ending after December 15, 2011.
- Non-public entities - Fiscal years ending after December 15, 2012.
- Retrospective application required.
- Early adoption permitted

Key disclosures

- For material plans
 - Legal name and EIN
 - Most recent certified fund status
 - Expiration dates of collective bargaining agreements and any minimum funding requirements
 - Indication of whether entity's contributions > 5% of total plan contributions
 - Indication of plans subject to funding improvement plan
- Amount of contributions (material plan and all others)
- Description of nature and effect of any changes affecting comparability from period to period (IS periods presented)

Other

- Small Business Lending Fund
- Private Company Financial Reporting
- Proposed PCAOB Audit Standards re: confirmations

In the Hopper:

- Leases
- Allowance for Loan Losses
- Financial Instruments

Small Business Lending Fund

- Aims to stimulate small business by providing capital
- Dividend rate paid on SBLF funding reduced as participating bank increases lending to small business
- Quarterly supplemental reports and annual certification by auditor

Private Company Financial Reporting

- Financial Accounting Foundation (oversees FASB) created Blue Ribbon Panel to address PCFR
- Blue Ribbon Panel reported findings in January, 2011
- FAF has established a working group that is currently conducting outreach to stakeholders
 - Results expected to be reported in fall of 2011

Confirmations

Key points

- Expands requirement to confirm receivables to loans and credit sales
- Requires confirmation of cash accounts – also must gain understanding of treasury function
- Does not allow use of internal audit
- Auditor must perform procedures to verify/validate addresses used in confirmation requests

Proposed in 2010, still in deliberation stage

Leases

- FASB and IASB agreed to re-expose the proposals after much revision from August 2010 proposal
- Boards do agree on right-of-use model, which requires recognition of both a right-of-use asset and a liability for the lease payments for the lessee.

Allowance - Impairment

- Part of financial instruments project
- FASB and IASB trying to cooperate but have differing objectives.
- FASB objective is to cover losses now (incurred loss model)
- IASB objective is to recognize the estimated losses over the life of the asset as a yield adjustment (expected loss model)
- Most recent proposal is an attempt to reconcile and satisfy both objectives

Allowance - Impairment

- **Three “buckets”**
 - The good bucket
 - The bad bucket
 - The impaired bucket
- **Alternatives for the good bucket**
 - 12 months or 24 months of expected losses (Board continuing to discuss this issue)
 - Trying to make it as simple as possible

FV measurement of assets based on characteristics of the instrument and entity's business strategy

- Amortized cost (i.e. Loans)
 - Strategy is to:
 - Manage instrument through customer financing or lending activities (collection of cash flows)
 - Manage credit risk by negotiating potential adjustment of cash flows with counterparty
- FV changes through OCI (i.e. Debt Securities)
 - Strategy is to invest cash to:
 - Maximize total return by collecting contractual cash flows or selling asset
 - Manage interest rate or liquidity risk by holding or selling asset

Financial Instruments

- FV changes through IS (ex. Equity Securities)
 - Strategy is to:
 - Hold assets for sale at acquisition
 - Actively manage and monitor fair value basis and do not qualify for FV-OCI

Financial liabilities are generally recorded at amortized cost unless:

- Strategy is to subsequently transact at FV
- Short sales

Currently working on applicable disclosure requirements



Questions?

jdoherly@wolfandco.com

617-261-8172



2011 FMS Annual Bank Tax Update

Mike Rowe
September 27, 2011

AGENDA

- Expiring Depreciation Provisions
- Success Based Fees
- IRS Audit Issues
- Information Reporting Changes
- State Tax Issues
- Proposed Legislation

Depreciation

- **Bonus Depreciation:**
 - 50% depreciation on qualified property placed in service before 1/1/2013
 - However, 100% depreciation on qualified property placed in service after 9/8/2010 and before 1/1/2012
 - Federal only – Mass. and most states have decoupled from the bonus depreciation rules.

Depreciation

- Qualified Property for bonus depreciation purposes
 - Generally, all depreciable fixed assets and software, but not buildings and their structural components
 - However, includes certain leasehold improvements

Depreciation

- **Section 179 Deduction**
 - First year expensing for personal property placed in service during the year
 - Limit = \$500,000 for property placed in service during tax years beginning in 2011
 - Phase-out = dollar-for-dollar to the extent personal property additions exceed \$2,000,000

Depreciation

- **Section 179 Deduction**
 - Limit = \$125,000 for years beginning in 2012, and \$25,000 for years beginning after 2012
 - Phase-out = dollar-for dollar to the extent personal property additions exceed \$500,000 for years beginning in 2012, and \$200,000 for years beginning after 2012
 - Rules apply to both Federal and Mass.

Success Based Fees

- Deductions for success-based investment banker and other fees in acquisitions and reorganizations have been the source of disagreement between IRS and taxpayers
- Issue centers on documentation – IRS requires more documentation than investment bankers have

Success Based Fees

- IRS issued Revenue Procedure in April 2011
- Provides for an elective safe harbor to treat 70% as deductible, and 30% as facilitative (capitalized)
- Available for success-based fees paid or incurred in taxable years ending on or after 4/8/2011

Success Based Fees

- IRS issued a field directive in July 2011 indicating the IRS will not challenge deduction for success based fees for earlier years provided:
 - Deduction would have qualified under the safe harbor if incurred after the effective date
 - Capitalized portion is at least 30%
 - Deduction was on originally-filed return

IRS Audit Issues

- **Bad Debt Deductions – Book vs. Tax**
 - For tax purposes, all evidence, including value of collateral and financial condition of the debtor, is taken into account in determining worthlessness.
 - IRS may look to classification – if Loss, OK, but not Doubtful or Substandard
 - Conformity election – can elect same treatment for tax as for regulatory purposes, but must be classified as Loss, and receive a letter from regulators

IRS Audit Issues

- **Non-accrual Interest**
 - IRS position is that interest continues to accrue for tax purposes even though accrual is stopped for books
 - Sometimes accrual is not required – generally follows bad debt deduction – if a loan is a “good” tax charge-off, then the interest is deemed uncollectible

IRS Audit Issues

- Other Real Estate Owned
 - Write-downs of property subsequent to foreclosure are not deductible until the property is sold.
 - IRS wants expenses to be capitalized to the basis of the property, to be deducted upon the sale of the property
 - Exception – property operated for the production of income

IRS Audit Issues

- Deferred Compensation – deduction should be payments from the liability account, not the income statement accruals
- Payroll taxes on deferred compensation assessed as of the later of:
 - When the services are performed, or
 - When there is no longer a substantial risk of forfeiture

IRS Audit Issues

- 1040s of Senior Management
 - IRS will look at the 1040s filed by senior management to ensure that they are paying the tax on the compensation

Information Reporting

- Repeal of 2 provisions of 2010 Health Care Law that expanded reporting requirements for payments over \$600 per payee after 12/31/11:
 - Expansion of reportable payments to include purchases of property
 - Elimination of reporting exemption for payments made to corporations

State Tax Issues

- **Economic Nexus**
 - Holds that physical presence in a state is not necessary to trigger “nexus” – sufficient contact with a state to require filing of tax return
 - A growing number of states are becoming aggressive in imposing economic nexus rules

State Tax Issues

- Economic Nexus – New England States
 - Connecticut
 - Maine
 - Massachusetts
 - New Hampshire
 - Rhode Island
 - Vermont

State Tax Issues

- **Combined (unitary) vs. separate returns**
 - Some states require returns on a consolidated basis, even if only one entity has nexus. Other states require returns only from the entity with nexus.

State Tax Issues

- Financial Institution tax rates in Mass.:
 - 9.5% for years beginning in 2011
 - 9.0% for years beginning after 2011

Proposed Legislation

- **President's Proposal – Payroll Taxes**
 - For 2011, employee's share of Social Security tax reduced from 6.2% to 4.2%.
 - Proposal for 2012:
 - Employee share reduced to 3.1%,
 - Employer share reduced to 3.1% on up to \$5,000,000 of wages.
 - Employers that increase payroll in last quarter of 2011 and all of 2012 get a credit for full share of Social Security tax on extra wages.

Proposed Legislation

- President's Proposal – Depreciation
 - Extend 100% bonus depreciation for another year – through 12/31/2012.

Proposed Legislation

- President's Proposal – Revenue Offsets
 - For individuals with AGI over \$250,000 (MFJ) or \$200,000 (single), tax value of itemized deductions will be 28% rather than 36% or 39.6%, starting in 2013.

Deficit Reduction

- **President's Proposal**
 - Increase fees charged by FNMA and FHLMC by 10 basis points to lenders to guarantee repayment of new loans
 - Tax Reform
 - Lower tax rates
 - Cut Inefficient and Unfair Tax Breaks
 - Cut the deficit
 - Increase job creation and growth
 - Buffett Rule

Deficit Reduction

- Lower Corporate Tax Rates
 - There has been significant discussion about reducing the corporate rate from 34% or 35% to a lower rate (perhaps 25%).
 - Would be welcome, but beware of the reduction in the deferred tax asset that would affect income and capital.

Questions?

mrowe@wolfandco.com

617-428-5437