6 KEY ITEMS TO KNOW ABOUT **DISCLOSURE REPORTS**

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EXECUTIVE **SUMMARY**

In July 2010, the Financial Accounting Standards Board (FASB) released a significant update, *Accounting Standards Update 2010-20, Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses (Topic 310).* This update requires swift change surrounding disclosure requirements involving the credit quality of financing receivables and the allowance for credit losses. More than two years later, however, bankers' interpretation of this update has been inconsistent and ill effective as a result of the quick implementation goals, the ambiguous descriptions in the update and a lack of FASB-published documentation needed to discern the new requirements. The information shared below is intended to address some of the questions and ambiguity surrounding FASB's Topic 310 update while presenting alternatives to the current challenges brought on by the newly required disclosure reports.

WHY THE **UPDATE?**

NOTE:

To see the latest comments on exposure drafts issued by FASB or to make a comment, visit

www.fasb.org

As stated in the FASB Accounting Standards Update No. 2010-20, "The main objective in developing this Update is to provide financial statement users with greater transparency about an entity's allowance for credit losses and the credit quality of its financing receivables."

Translation:

A portion of the bank fallout and financial crisis may have been avoided had financial institutions better understood and been more transparent about the credit quality within their loan portfolios. With the swift enactment of this update, the goal is for financial statement users at financial institutions (a term that broadly applies to users internally and externally, including the board of directors, investors, regulatory agencies, auditors, competitors, purchasers and partners) to better recognize credit weaknesses in an institution's loan portfolio. Armed with more complete information, the financial statement users can make more informed, strategic decisions about concentrations or thresholds, with the goal of preventing future weakness.

Provisions within ASU 2010-20 also allowed FASB to push for greater alignment between requirements in U.S. Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS). While U.S. GAAP only requires credit quality and allowance for credit losses to be presented on an aggregate basis, the new update calls for information to be presented in disaggregated form, which is similar to the disaggregation principles of IFRS.

WHAT ARE
"FINANCING RECEIVABLES?"

"Financing receivables" in the FASB update is defined as an institution's loan portfolio (loan = contractual right to receive money whether on demand, on a fixed date or a determinable date) void of term loans with maturity dates of less than one year from date of origination and void of credit card receivables. "Financing receivables" would include loans, trade accounts receivables, notes receivables and lease receivables.

Financing Receivables	
Included	**Excluded**
Loans	Short term loans with maturity dates of less than one year
Trade accounts receivables	Unconditional promises to give
Notes receivables	Debt securities as defined in FASB Statement No. 115
Lease receivables	Acquired beneficial interests

WHEN DID THESE
REPORTS BECOME REQUIRED?

A NOTE ABOUT IMPLEMENTATION:

- Public entities were required to begin following the new standards by **December 15, 2010**
- Non-public entities had until **December 15, 2011**

As Tom Danielson, partner at CliftonLarsonAllen LLP points out, ***"ASU 2010-20 now applies to all banks that have audited financial statements."*** But, for the record, public entities were required to begin following the new disclosure reporting standards by December 15, 2010. Non-public entities had until December 15, 2011, to execute the disclosures. Thus far, these reports are required to be completed on an annual basis.

DID YOU KNOW?

Sageworks ALLL users are able to satisfy disclosure requirements with a click of a buttom.

"The global financial crisis highlighted the need for additional information about a company's financial instruments, including loans and other financing receivables. This Update provides greater transparency for investors and other users of financial statements by requiring more information from companies about credit risk exposures for financing receivables and the related credit reserves."

-FASB Chairman Robert H. Herz

WHAT IF MY INSTITUTION FAILED TO MEET THE **ORIGINAL TIMELINE?**

A NOTE ABOUT ENFORCEMENT:

- The **SEC** enforces the FASB standards for **public entities**
- The **AICPA** enforces the FASB standards for **private entities**

Remember, while FASB sets accounting standards, they do not have the authority to enforce such standards. The SEC enforces the FASB standards for public entities. The new disclosure reporting has been enforced in entirety among public banks, but no known penalties have been reported.

For private institutions, the FASB standards are enforced by the American Institute of CPAs (AICPA), which is commonly represented by an institution's external auditors. Therefore, an institution should check with their auditors if they feel that they missed this original timeline. If their auditor did not respond accordingly or interpreted the FASB update differently, it should be noted that there has been little known enforcement and no reported penalties to this point.

Despite the update outlining a timeline for quick implementation, there seems to be an understanding (not documented) in the financial reporting world that allows these timelines to be more of an ideal goal rather than a strict rule. While the exact timeline may be unknown, enforcement will be more strictly implemented as reliance on these disclosure reports increases. Additionally, the disclosures were specifically noted as a continued requirement in FASB's recent exposure draft for the Current Expected Credit Loss (CECL) Model.

WHAT KEY ITEMS
MUST BE PRODUCED?

There are several items that must be produced as part of the new reporting, including new, additional disclosures and updates to existing ones.

New, Additional Disclosures

1. Credit quality indicators by loan class, whether that is one or a combination of risk grade, risk profile or performing vs. nonperforming.

Credit Risk Profile by Risk Grade by Class

Loan Type Code	Pass	Special Mention	Substandard	Doubtful	Total
COMMERCIAL	$183,062,565.27	$25,689,256.79	$48,230,354.03	$8,226,496.66	$341,833,552.99
CONSUMER	$324,717,622.38	$1,723,763.29	$10,089,685.16	$0.00	$348,974,552.09
CRE	$480,441,665.40	$19,377,764.47	$47,610,096.45	$20,967.76	$600,804,315.89
Total:	**$988,221,853.05**	**$46,790,784.55**	**$105,930,135.64**	**$8,247,464.42**	**$1,291,612,420.97**

2. Aging of past due loans by loan class.

Disclosure- Aging Analysis of Loans by Class

Call Code	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due	Total Past Due	Current	Total Loans	Total Loans >90 Days and Still Accruing	Total Nonaccrual Loans
	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
1a1	$0.00	$0.00	$0.00	$0.00	$639,741.65	$639,741.65	$0.00	$0.00
1a2	$386,157.36	$175,092.89	$1,300,000.00	$1,861,250.25	$11,657,201.26	$13,518,451.51	$1,300,000.00	$2,004,301.94
1b	$0.00	$0.00	$0.00	$0.00	$160,000.00	$160,000.00	$0.00	$0.00
1c1	$411,602.55	$70,679.15	$182,873.54	$665,155.24	$24,104,551.02	$24,769,706.26	$182,873.54	$0.00
1c2a	$707,087.52	$155,533.29	$232,354.73	$1,094,975.54	$24,881,144.61	$25,976,120.15	$232,354.73	$588,076.29
1c2b	$36,605.24	$61,545.68	$0.00	$98,150.92	$2,208,801.61	$2,306,952.53	$0.00	$0.00
1d	$0.00	$0.00	$0.00	$0.00	$2,329,074.88	$2,329,074.88	$0.00	$0.00
1e1	$171,852.01	$624,063.27	$1,510,503.06	$2,478,979.51	$33,968,344.00	$36,447,323.51	$1,495,390.05	$379,208.92
1e2	$582,091.24	$0.00	$709,255.39	$1,291,346.63	$13,572,292.51	$14,863,639.14	$709,255.39	$280,942.37
4a	$444,638.04	$0.00	$249,614.32	$694,252.36	$33,737,604.42	$34,431,856.78	$36,146.41	$531,480.35
6a	$0.00	$0.00	$0.00	$0.00	$23,927.77	$23,927.77	$0.00	$0.00
6b	$0.00	$0.00	$18,239.31	$18,239.31	$1,998,059.30	$2,016,298.61	$0.00	$0.00
6c	$20,320.45	$0.00	$5,738.64	$26,059.09	$643,371.14	$669,430.23	$0.00	$5,738.64
6d	$0.00	$0.00	$485,000.00	$499,263.88	$3,391,253.63	$3,890,517.51	$0.00	$540,612.08
Total	**$2,760,354.41**	**$1,086,914.28**	**$4,693,578.99**	**$8,727,672.73**	**$153,315,367.80**	**$162,043,040.53**	**$3,956,020.12**	**$4,330,360.59**

WHAT KEY ITEMS **MUST BE PRODUCED?** (CONT.)

3. In-depth Troubled Debt Restructuring (TDR) report by loan class for occurrences during the reporting period.

TDR Pre & Post Modification Report

12/31/2012

Loan Type Code	Number of Contracts	Pre Modification Recorded Investment	Post Modification Recorded Investment
Commercial Ln Non-RE	5	$137,713.63	$124,551.17
Commercial RE	5	$3,015,830.96	$2,961,758.08
Consumer Ln Non-RE	5	$110,599.97	$69,985.59
Multi Family and Rental RE	3	$227,981.78	$181,826.42
Residential RE	3	$618,607.99	$618,869.67
Retail TDR and Impaired	0	$0.00	$0.00
Totals:	21	$4,110,734.33	$3,956,990.93

4. Report of TDR defaults in the past 12 months by loan class and their impact upon the allowance for loan and lease losses (ALLL).

TDR Re-default Report

12/31/2012

Loan Type Code	Number of Contracts	Recorded Investment
Commercial Ln Non-RE	3	$307,806.48
Commercial RE	2	$99,845.23
Consumer Ln Non-RE	3	$55,692.18
Multi Family and Rental RE	0	$0.00
Residential RE	1	$14,156.00
Totals:	9	$477,499.89

5. Listing of significant loan purchases and sales of loans separated by portfolio segment.

WHAT KEY ITEMS **MUST BE PRODUCED?** (CONT.)

Updates to Existing Disclosures

1. Roll-forward schedule for the allowance for credit losses now disaggregated on the basis of the loan class.

Loan Class	Total ending ALLL balance as of Dec 31, 2011	2012 Charge-offs	2012 Recoveries	2012 Provision increase	Total ending ALLL balance as of Dec 31, 2012
Commerical	$348,000.00	$0.00	$0.00	($256,878.84)	$91,121.16
Commercial Real Estate	$971,000.00	$97,890.00	$74,844.43	($49,615.81)	$898,338.62
Faith-Based Non-Profit	$1,128,000.00	$0.00	$0.00	$146,014.35	$1,274,014.35
Residential Real Estate	$1,299,000.00	$495,775.89	$21,133.57	$126,403.95	$950,761.63
Consumer	$62,000.00	$2,999.08	$3,869.19	($33,419.69)	$29,450.42
Other Loans	$42,000.00	$32,575.67	$11,801.45	$33,768.38	$54,994.16
Total:	$3,850,000.00	$629,240.64	$111,648.64	-$33,727.67	$3,298,680.33

As of 3/31/2013, institutions greater than $1 billion in total assets are required to complete a new Call Report Schedule RI-C, which disaggregates ALLL data by general loan categories.

Call Report	FAS 114 Loan Balance	FAS 114 ALLL Balance	FAS 5 Loan Balance	FAS 5 ALLL Balance
1.) Real Estate loans				
a.) Construction Loans	$ -	$ -	$ 61,167,812	$ 699,328
b.) Commercial real estate loans	$ 5,058,125	$ 832,479	$ 419,817,737	$ 4,884,499
c.) Residential real estate loans	$ -	$ -	$ 201,303,222	$ 3,022,983
2.) Commercial loans (inc Ag)	$ 1,993,942	$ 146,168	$ 278,873,304	$ 3,199,624
3.) Credit Cards	$ -	$ -	$ -	$ -
4.) Other consumer loans	$ -	$ -	$ 353,442,213	$ 3,773,055
5.) Unallocated, if any				$ 705,433
6.) Total	$ 7,052,067	$ 978,647	$ 1,314,604,288	$ 16,284,922

WHAT KEY ITEMS **MUST BE PRODUCED?** (CONT.)

2. For each disaggregated balance in #1, each corresponding loan's total recorded investment must be listed out (see chart from New, Additional Disclosures #2).

3. The nonaccrual status of loans by loan class.

4. Impaired loans by loan class with and without reserve required; required to also disclose Interest Income recognized and Average Recorded Investment by loan class.

Impaired Loans

as of December 31, 2012

Loan Type Code	Recorded Investment	Unpaid Principal Balance	Related Allowance	Avg Recorded Investment	Interest Income Recognized
Ag Production Loans					
With no related allowance recorded:	$0.00	$0.00	$0.00	$10,511.54	$0.00
With an allowance recorded:	$75,496.31	$75,496.31	$4,740.47	$90,784.18	$5,198.09
Total:	$75,496.31	$75,496.31	$4,740.47	$101,295.71	$5,198.09
AG Real Estate					
With no related allowance recorded:	$0.00	$0.00	$0.00	$417,755.26	$0.00
With an allowance recorded:	$1,643,830.55	$1,643,830.55	$103,571.71	$1,729,642.79	$35,741.01
Total:	$1,643,830.55	$1,643,830.55	$103,571.71	$2,147,398.05	$35,741.01
Commercial Ln Non-RE					
With no related allowance recorded:	$164,127.59	$169,796.36	$0.00	$168,621.64	$13,734.74
With an allowance recorded:	$211,913.49	$211,913.49	$15,237.37	$306,725.02	$14,357.69
Total:	$376,041.08	$381,709.85	$15,237.37	$475,346.66	$28,092.43
Commercial RE					
With no related allowance recorded:	$1,265,512.20	$1,265,512.20	$0.00	$1,311,784.13	$61,933.54
With an allowance recorded:	$13,073,104.28	$13,701,967.28	$1,306,716.64	$13,000,710.04	$590,982.70
Total:	$14,338,616.48	$14,967,479.48	$1,306,716.64	$14,312,494.16	$652,916.24

WHAT CHALLENGES WILL THE **NEW REQUIREMENTS PRESENT?**

Challenges certainly surround these new disclosure requirements. Financial institutions are faced with limited resources to appropriately receive and incorporate feedback regarding how to properly structure the new reports to fit with each institution's unique loan portfolio and ALLL methodology. One solution is for an institution to reach out to external auditors or a loan review firm. Until FASB provides more resources to answer the common questions of both private and public financial institutions, outside help from these specialized firms might be the best solution.

Also, these new disclosure requirements have certainly added more workload requirements to the surrounding ALLL calculation and individual impairment processes. To alleviate workload pressure, over the past year, some financial institution technology providers that currently serve the ALLL market have developed template disclosure reports with guidance from auditors, CPAs and loan review firms. These pre-built templates allow the institution to complete their ALLL calculation in the software and expedite the process of generating the disclosure reports. With some vendors, a financial institution only has to make a few clicks to access a fully completed disclosure report that is in accordance with the guidance from FASB and is suitable for proper reporting.

Harnessing this alternative report writing method serves FASB's purpose of swiftly providing more clarity and transparency. It can also significantly reduce a financial institution's workload surrounding the ALLL calculation and corresponding required disclosure reporting. Until financial institutions are equipped with both the personnel and expertise for the disclosures, an automated solution may be the easiest way to properly follow FASB guidance and demystify the update in FASB Topic 310.

ABOUT **SAGEWORKS & THE AUTHOR**

Sageworks (www.sageworks.com) is a financial information company working with financial institutions, accountants and private-company executives across North America to collect and interpret financial information. Thousands of bankers rely on Sageworks' credit risk management solutions to streamline credit analysis, risk rating, portfolio stress testing, loan administration and ALLL calculation. Sageworks is also an industry thought leader, regularly publishing whitepapers and hosting webinars on topics important to bankers.

Sageworks ALLL is the premiere automated solution for estimating a financial institution's reserve. It helps bankers automate their ALLL process and increase consistency in their methodology, making it defensible to auditors and examiners. Sageworks' risk management consultants also assist clients with the implementation of their ALLL models and guidance interpretation. To find out more, visit www.sageworksanalyst.com.

Ed Bayer is the managing director at Sageworks. He previously served as a senior risk management consultant, with a primary focus on allowance for loan and lease losses methodology (ALLL) and stress testing loan portfolios. He received his MBA from Vanderbilt University's Owen Graduate School of Management, and he received his bachelor's degree from the University of Tennessee.

ADDITIONAL **RESOURCES**

Developments in Allowance for Loan and Lease Losses (ALLL) and Troubled Debt Restructuring (TDR) Accounting and Disclosures; American Bankers Association; December 2011

FASB Accounting Standards Update, Receivables (Topic 310), Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses; Financial Accounting Standards Board of the Financial Accounting Foundation; No. 2010-20 July 2010

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FASB Exposure Update, Financial Instruments-Credit Losses (Subtopic 825-15); Financial Accounting Standards Board of the Financial Accounting Foundation; No. 2012-260; December 20 2012

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Rules Dig Deep into Financing Receivables; Robert Willens, CFO.com; July 2009

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