Audit and Accounting Guide

Depository and Lending Institutions: Banks and Savings Institutions, Credit Unions, Finance Companies, and Mortgage Companies

July 1, 2017

Audit and Accounting Guide

Depository and Lending Institutions: Banks and Savings Institutions, Credit Unions, Finance Companies, and Mortgage Companies

July 1, 2017

Copyright © 2017 by
American Institute of Certified Public Accountants, Inc.
New York, NY 10036-8775

All rights reserved. For information about the procedure for requesting permission to make copies of any part of this work, please e-mail copyright@aicpa.org with your request. Otherwise, requests should be written and mailed to the Permissions Department, AICPA, 220 Leigh Farm Road, Durham, NC 27707-8110.

1 2 3 4 5 6 7 8 9 0 AAP 1 9 8 7

ISBN 978-1-94549-840-4

Preface

(Updated as of July 1, 2017)

About AICPA Audit and Accounting Guides

This AICPA audit and accounting guide has been developed by the AICPA Guides Combination Task Force to assist management in the preparation of their financial statements in conformity with U.S. generally accepted accounting principles (GAAP) and to assist practitioners in performing and reporting on their audit or their attestation engagements.

AICPA Guides may include certain content presented as "Supplement," "Appendix," or "Exhibit." A supplement is a reproduction, in whole or in part, of authoritative guidance originally issued by a standard setting body (including regulatory bodies) and applicable to entities or engagements within the purview of that standard setter, independent of the authoritative status of the applicable AICPA Guide. Both appendixes and exhibits are included for informational purposes and have no authoritative status.

The Financial Reporting Executive Committee (FinREC) is the designated senior committee of the AICPA authorized to speak for the AICPA in the areas of financial accounting and reporting. Conforming changes made to the financial accounting and reporting guidance contained in this guide are approved by the FinREC Chair (or his or her designee). Updates made to the financial accounting and reporting guidance in this guide exceeding that of conforming changes are approved by the affirmative vote of at least two-thirds of the members of FinREC.

This guide does the following:

- Identifies certain requirements set forth in the FASB *Accounting Standards Codification*® (ASC).
- Describes FinREC's understanding of prevalent or sole industry practice concerning certain issues. In addition, this guide may indicate that FinREC expresses a preference for the prevalent or sole industry practice, or it may indicate that FinREC expresses a preference for another practice that is not the prevalent or sole industry practice; alternatively, FinREC may express no view on the matter.
- Identifies certain other, but not necessarily all, industry practices concerning certain accounting issues without expressing FinREC's views on them.
- Provides guidance that has been supported by FinREC on the accounting, reporting, or disclosure treatment of transactions or events that are not set forth in FASB ASC.

Accounting guidance for nongovernmental entities included in an AICPA Guide is a source of nonauthoritative accounting guidance. As discussed later in this preface, FASB ASC is the authoritative source of U.S. accounting and reporting standards for nongovernmental entities, in addition to guidance issued by the SEC.

An AICPA Guide containing auditing guidance related to generally accepted auditing standards (GAAS) is recognized as an interpretive publication as defined in AU-C section 200, *Overall Objectives of the Independent Auditor and*

©2017, AICPA

the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards (AICPA, *Professional Standards*). Interpretive publications are recommendations on the application in specific circumstances, including engagements for entities in specialized industries.

Interpretive publications are issued under the authority of the AICPA Auditing Standards Board (ASB) after all ASB members have been provided an opportunity to consider and comment on whether the proposed interpretive publication is consistent with GAAS. The members of the ASB have found the auditing guidance in this guide to be consistent with existing GAAS.

Although interpretive publications are not auditing standards, AU-C section 200 requires the auditor to consider applicable interpretive publications in planning and performing the audit because interpretive publications are relevant to the proper application of GAAS in specific circumstances. If the auditor does not apply the auditing guidance in an applicable interpretive publication, the auditor should document how the requirements of GAAS were complied with in the circumstances addressed by such auditing guidance.

The ASB is the designated senior committee of the AICPA authorized to speak for the AICPA on all matters related to auditing. Conforming changes made to the auditing guidance contained in this guide are approved by the ASB Chair (or his or her designee) and the Director of the AICPA Audit and Attest Standards Staff. Updates made to the auditing guidance in this guide exceeding that of conforming changes are issued after all ASB members have been provided an opportunity to consider and comment on whether the guide is consistent with the Statements on Auditing Standards (SASs).

Any auditing guidance in a guide appendix or exhibit (whether a chapter or back matter appendix or exhibit), though not authoritative, is considered an "other auditing publication." In applying such guidance, the auditor should, exercising professional judgment, assess the relevance and appropriateness of such guidance to the circumstances of the audit. Although the auditor determines the relevance of other auditing guidance, auditing guidance in a guide appendix or exhibit has been reviewed by the AICPA Audit and Attest Standards staff and the auditor may presume that it is appropriate.

An AICPA Guide containing attestation guidance is recognized as an interpretive publication as defined in AT-C section 105, *Concepts Common to All Attestation Engagements* (AICPA, *Professional Standards*). Interpretive publications are recommendations on the application of Statements on Standards for Attestation Engagements (SSAEs) in specific circumstances, including engagements for entities in specialized industries. Interpretive publications are issued under the authority of the ASB. The members of the ASB have found the attestation guidance in this guide to be consistent with existing SSAEs.

A practitioner should be aware of and consider the guidance in this AICPA guide applicable to his or her attestation engagement. If the practitioner does not apply the attestation guidance included in an applicable AICPA guide, the practitioner should be prepared to explain how he or she complied with the SSAE provisions addressed by such attestation guidance.

Any attestation guidance in a guide appendix or exhibit (whether a chapter or back matter appendix or exhibit), though not authoritative, is considered an "other attestation publication." In applying such guidance, the practitioner should, exercising professional judgment, assess the relevance and appropriateness of such guidance to the circumstances of the engagement. Although the practitioner determines the relevance of other attestation guidance, such

 ©2017, AICPA

guidance in a guide appendix or exhibit has been reviewed by the AICPA Audit and Attest Standards staff and the practitioner may presume that it is appropriate.

The ASB is the designated senior committee of the AICPA authorized to speak for the AICPA on all matters related to attestation. Conforming changes made to the attestation guidance contained in this guide are approved by the ASB Chair (or his or her designee) and the Director of the AICPA Audit and Attest Standards Staff. Updates made to the attestation guidance in this guide exceeding that of conforming changes are issued after all ASB members have been provided an opportunity to consider and comment on whether the guide is consistent with the SSAEs.

Purpose and Applicability

This AICPA guide has been prepared to assist financial institutions in preparing financial statements in conformity with GAAP and to assist independent accountants in reporting on financial statements (and, as discussed in appendix A, "FDI Act Reporting Requirements," other written management assertions) of those entities.

Chapters of the guide are generally organized by financial statement line item into four sections:

a. An *introduction* that describes the general transactions and risks associated with the area. (The introduction does not address all possible transactions in each area.)

b. *Regulatory matters* that may be of relevance in the preparation and audit of financial statements. Other regulatory matters may exist that require attention in the preparation and audit of financial statements following the general guidance on regulatory matters. Further, the guide does not address regulations that are not relevant to the preparation and audit of financial statements and certain of the regulatory requirements discussed may not be applicable to uninsured institutions.

c. *Accounting and financial reporting* guidance that addresses accounting and financial reporting issues. FASB ASC 105, *Generally Accepted Accounting Principles*, establishes FASB ASC as the source of authoritative GAAP recognized by FASB to be applied by nongovernmental entities.

d. *Auditing* guidance that includes objectives, planning, internal control over financial reporting and possible tests of controls, and substantive tests.

Scope

This guide applies to all banks, savings institutions, credit unions, finance companies, and other entities (including entities with trade receivables). That population includes the following:

a. Finance companies, including finance company subsidiaries

b. Entities that do not consider themselves to be finance companies that engage in transactions that involve lending to or financing the activities of others (including trade receivables and independent and captive financing activities of all kinds of entities)

c. Depository institutions insured by the FDIC's Deposit Insurance Fund or the National Credit Union Administration's National Credit Union Share Insurance Fund

d. Bank holding companies

e. Savings and loan association holding companies

f. Branches and agencies of foreign banks regulated by U.S. federal banking regulatory agencies

g. State chartered banks, credit unions, and savings institutions that are not federally insured

h. Foreign financial institutions whose financial statements are purported to be prepared in conformity with GAAP

i. Mortgage companies

j. Entities that do not consider themselves to be mortgage companies that engage in transactions that involve mortgage activities or transactions

k. Corporate credit unions

l. Financing and lending activities of insurance companies

This guide does not apply to the following:

a. Investment companies, broker dealers in securities, employee benefit plans and similar entities that carry loans and trade receivables at fair value with the unrealized gains and losses included in earnings

b. Governmental or federal entities that follow the principles of GASB or the Federal Accounting Standards Advisory Board

As used in this guide, the term *depository institution* means a bank, credit union, and savings institution. The terms *financial institutions* or *institutions* refer to all entities covered by this guide.

As stated in the previous list, this guide applies to the financing activities of all kinds of enterprises. Certain entities may have financing activities but are not otherwise covered by this guide—for example, the financing subsidiary, unit, or division of a manufacturing company or retailer. Only those sections and chapters of this guide related to financing activities are intended to apply to such entities. The remaining portions are not intended to apply to such entities, but may otherwise be useful to financial statement preparers and auditors.

Certain terms are used interchangeably throughout the guide as follows:

- Credit unions often refer to *shares, dividends on shares, and members*, which are equivalent to *deposits, interest on deposits, and customers* for banks and savings institutions.
- Finance companies often refer to *finance receivables*, which are equivalent to *loans* or *loans receivable* for other entities. A *credit officer* of a finance company is the same as a *loan officer*.
- A *supervisory committee* of a credit union is the functional equivalent of an *audit committee* of other entities.

Limitations

In July 1990, the AICPA's Board of Directors authorized the AICPA staff to make conforming changes to the Audit and Accounting Guides with the approval of the chairman of the ASB or the chairman of FinREC, as appropriate.

©2017, AICPA

The board resolution defines *conforming changes* as "revisions intended to effect changes necessitated by the issuance of authoritative pronouncements." Conforming changes are carefully and judiciously made and normally limited to items that result from the issuance of new authoritative literature. Conforming changes also include nonaccounting and nonauditing revisions that modify, add, or delete regulatory guidance and industry background information in response to changes in the regulatory and industry environment. Conforming changes do not include recent legislative programs or other governmental measures or industry actions that may have been taken as a result of the current economic environment.

Recognition

AICPA Senior Committees

Auditing Standards Board

Jay Brodish, Jr., Member
Michael J. Santay, *Chair*

Financial Reporting Executive Committee

Muneera Carr, *Member*
Jim Dolinar, *Chair*

The AICPA gratefully acknowledges those members of the AICPA Depository and Lending Institutions Expert Panel (2016–2017) who reviewed or otherwise contributed to the development of this edition of the guide:

Sydney Garmong, *Chair*
Larry Gee
Mike Lundberg
Jeffrey C. Skumin
Lindsay Stevenson
Chris Vallez

In addition to the 2015–2016 expert panel members listed, the AICPA gratefully acknowledges those who reviewed and otherwise contributed to the development of this guide: Tom Canfarotta, Kathleen Healy, Jeff Honeycutt, Scott Klitsch, John G. Klinge, Jennifer Lauer, Randy Morse, Randy Oberdiek, and Barry M. Pelagatti.

AICPA Staff

Teresa Brenan
Manager
Product Management & Development—Public Accounting

Kim Kushmerick
Associate Director
Accounting Standards—Public Accounting

Jason T. Brodmerkel
Senior Technical Manager
Accounting Standards
and
Staff Liaison to the AICPA Depository and Lending Institutions Expert Panel

Guidance Considered in This Edition

This edition of the guide has been modified by the AICPA staff to include certain changes necessary due to the issuance of authoritative guidance since the guide was originally issued, and other revisions as deemed appropriate. Relevant guidance issued through July 1, 2017, has been considered in the development of this edition of the guide. However, this guide does not include all audit, accounting, reporting, and other requirements applicable to an entity or a particular engagement. This guide is intended to be used in conjunction with all applicable sources of relevant guidance.

Relevant guidance that is issued and effective on or before July 1, 2017, is incorporated directly in the text of this guide. Relevant guidance issued but not yet effective as of July 1, 2017, but becoming effective on or before December 31, 2017, is also presented directly in the text of the guide, but shaded gray and accompanied by a footnote indicating the effective date of the new guidance. The distinct presentation of this content is intended to aid the reader in differentiating content that may not be effective for the reader's purposes (as part of the guide's "dual guidance" treatment of applicable new guidance).

Relevant guidance issued but not yet effective as of the date of the guide and not becoming effective until after December 31, 2017, is referenced in a "guidance update" box; that is, a box that contains summary information on the guidance issued but not yet effective.

In updating this guide, all guidance issued up to and including the following was considered, but not necessarily incorporated, as determined based on applicability:

- FASB Accounting Standards Update (ASU) No. 2017-10, *Service Concession Arrangements (Topic 853): Determining the Customer of the Operation Services (a consensus of the FASB Emerging Issues Task Force)*
- SAS No. 132, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern* (AICPA, *Professional Standards*, AU-C sec. 570)
- Interpretation No. 3, "Reporting on Audits Conducted in Accordance With Auditing Standards Generally Accepted in the United States of America and International Standards on Auditing" (AICPA, *Professional Standards*, AU-C sec. 9700 par. .08–.13), of AU-C section 700, *Forming an Opinion and Reporting on Financial Statements*
- Revised interpretations issued through July 1, 2017, including Interpretation No. 3, "Appropriateness of Identifying No Significant Deficiencies or No Material Weaknesses in an Interim Communication" (AICPA, *Professional Standards*, AU-C sec. 9265 par. .08–.10), of AU-C section 265, *Communicating Internal Control Related Matters Identified in an Audit*
- Statement of Position 13-2, *Performing Agreed-Upon Procedures Engagements That Address the Completeness, Mapping, Consistency, or Structure of XBRL-Formatted Information* (AICPA, *Professional Standards*, AUD sec. 55)
- SSAE No. 18, *Attestation Standards: Clarification and Recodification* (AICPA, *Professional Standards*)

©2017, AICPA

- Interpretation No. 4, "Performing and Reporting on an Attestation Engagement Under Two Sets of Attestation Standards" (AICPA, *Professional Standards*, AT-C sec. 9105 par. .31–.35), of AT-C section 105, *Concepts Common to All Attestation Engagements*
- PCAOB Auditing Standard No. 18, *Related Parties* (AICPA, *PCAOB Standards and Related Rules*)

Users of this guide should consider guidance issued subsequent to those items listed previously to determine their effect, if any, on entities and engagements covered by this guide. In determining the applicability of recently issued guidance, its effective date should also be considered.

The changes made to this edition of the guide are identified in appendix H, "Schedule of Changes Made to the Text From the Previous Edition." The changes do not include all those that might be considered necessary if the guide were subjected to a comprehensive review and revision.

PCAOB quoted content is from PCAOB Auditing Standards and PCAOB *Staff Audit Practice Alerts*, ©2015, Public Company Accounting Oversight Board. All rights reserved. Used by permission.

FASB standards quoted are from the FASB *Accounting Standards Codification* ©2015, Financial Accounting Foundation. All rights reserved. Used by permission.

FASB ASC Pending Content

Presentation of Pending Content in FASB ASC

Amendments to FASB ASC (issued in the form of ASUs) are initially incorporated into FASB ASC in "pending content" boxes that follow the paragraphs being amended with links to the transition information. The pending content boxes are meant to provide users with information about how the guidance in a paragraph will change as a result of the new guidance.

Pending content applies to different entities at different times due to varying fiscal year-ends, and because certain guidance may be effective on different dates for public and nonpublic entities. As such, FASB maintains amended guidance in pending content boxes within FASB ASC until the roll-off date. Generally, the "roll-off" date is six months following the latest fiscal year end for which the original guidance being amended could still be applied.

Presentation of FASB ASC Pending Content in AICPA Guides

Amended FASB ASC guidance that is included in pending content boxes in FASB ASC on July 1, 2017, is referenced as "Pending Content" in this guide. Readers should be aware that "Pending Content" referenced in this guide will eventually be subjected to FASB's roll-off process and no longer be labeled as "Pending Content" in FASB ASC (as discussed in the previous paragraph).

Terms Used to Define Professional Requirements in This AICPA Guide

Any requirements described in this guide are normally referenced to the applicable standards or regulations from which they are derived. Generally, the terms used in this guide describing the professional requirements of the referenced standard setter (for example, the ASB) are the same as those used in the

applicable standards or regulations (for example, "must" or "should"). However, where the accounting requirements are derived from FASB ASC, this guide uses "should," whereas FASB uses "shall." In its resource document "About the Codification" that accompanies FASB ASC, FASB states that it considers the terms "should" and "shall" to be comparable terms and to represent the same concept—the requirement to apply a standard.

Readers should refer to the applicable standards and regulations for more information on the requirements imposed by the use of the various terms used to define professional requirements in the context of the standards and regulations in which they appear.

Certain exceptions apply to these general rules, particularly in those circumstances where the guide describes prevailing or preferred industry practices, or both, for the application of a standard or regulation. In these circumstances, the applicable senior committee responsible for reviewing the guide's content believes the guidance contained herein is appropriate for the circumstances.

Applicability of GAAS and PCAOB Standards

Appendix A, "Council Resolution Designating Bodies to Promulgate Technical Standards," of the AICPA Code of Professional Conduct recognizes both the ASB and the PCAOB as standard setting bodies designated to promulgate auditing, attestation, and quality control standards. Paragraph .01 of the "Compliance With Standards Rule" (AICPA, *Professional Standards*, ET sec. 1.310.001 and 2.310.001) requires an AICPA member who performs an audit to comply with the applicable standards.

Audits of the financial statements of those entities subject to the oversight authority of the PCAOB (that is, those audit reports within the PCAOB's jurisdiction as defined by the Sarbanes-Oxley Act of 2002, as amended) are to be conducted in accordance with standards established by the PCAOB, a private sector, nonprofit corporation created by the Sarbanes-Oxley Act of 2002. The SEC has oversight authority over the PCAOB, including the approval of its rules, standards, and budget. In citing the auditing standards of the PCAOB, references generally use section numbers within the reorganized PCAOB auditing standards and not the original standard number, as appropriate.

Audits of the financial statements of those entities not subject to the oversight authority of the PCAOB (that is, those audit reports not within the PCAOB's jurisdiction as defined by the Sarbanes-Oxley Act of 2002, as amended)—hereinafter referred to as *nonissuers*[1]—are to be conducted in accordance with GAAS as issued by the ASB. The ASB develops and issues standards in the form of SASs through a due process that includes deliberation in meetings open to the public, public exposure of proposed SASs, and a formal vote. The SASs and their related interpretations are codified in AICPA *Professional Standards*. In citing GAAS and their related interpretations, references generally use section numbers within the codification of currently effective SASs and not the original statement number, as appropriate.

The auditing content in this guide primarily discusses GAAS issued by the ASB and is applicable to audits of nonissuers. Users of this guide may find the

---

[1] See the definition of the term *nonissuer* in the AU-C Glossary (AICPA, *Professional Standards*).

 ©2017, AICPA

tool developed by the PCAOB's Office of the Chief Auditor helpful in identifying comparable PCAOB standards. The tool is available at https://pcaobus.org/Standards/Auditing/Pages/FindAnalogousStandards.aspx.

Considerations for audits of entities subject to the oversight authority of the PCAOB may also be discussed within this guide's chapter text. When such discussion is provided, the related paragraphs are designated with the following title: *Considerations for Audits Performed in Accordance With PCAOB Standards*. PCAOB guidance included in an AICPA guide has not been reviewed, approved, disapproved, or otherwise acted upon by the PCAOB and has no official or authoritative status.

Applicability of Quality Control Standards

QC section 10, *A Firm's System of Quality Control* (AICPA, *Professional Standards*), addresses a CPA firm's responsibilities for its system of quality control for its accounting and auditing practice. A system of quality control consists of policies that a firm establishes and maintains to provide it with reasonable assurance that the firm and its personnel comply with professional standards, as well as applicable legal and regulatory requirements. The policies also provide the firm with reasonable assurance that reports issued by the firm are appropriate in the circumstances.

QC section 10 applies to all CPA firms with respect to engagements in their accounting and auditing practice. In paragraph 13 of QC section 10, an *accounting and auditing practice* is defined as "a practice that performs engagements covered by this section, which are audit, attestation, compilation, review, and any other services for which standards have been promulgated by the ASB or the AICPA Accounting and Review Services Committee under the "General Standards Rule" (AICPA, *Professional Standards*, ET sec.1.300.001) or the "Compliance With Standards Rule" (AICPA, *Professional Standards*, ET sec. 1.310.001) of the AICPA Code of Professional Conduct. Although standards for other engagements may be promulgated by other AICPA technical committees, engagements performed in accordance with those standards are not encompassed in the definition of an *accounting and auditing practice*."

In addition to the provisions of QC section 10, readers should be aware of other sections within AICPA *Professional Standards* that address quality control considerations, including the following provisions that address engagement level quality control matters for various types of engagements that an accounting and auditing practice might perform:

- AU-C section 220, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards* (AICPA, *Professional Standards*)
- AT-C section 105, *Concepts Common to All Attestation Engagements* (AICPA, *Professional Standards*)
- AR-C section 60, *General Principles for Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services* (AICPA, *Professional Standards*)

Because of the importance of engagement quality, this guide includes appendix D, "Overview of Statements on Quality Control Standards." This appendix summarizes key aspects of the quality control standard. This summarization should be read in conjunction with QC section 10, AU-C section 220, AT-C section 105,

©2017, AICPA

AR-C section 60, and the quality control standards issued by the PCAOB, as applicable.

Alternatives Within U.S. GAAP

The Private Company Council (PCC), established by the Financial Accounting Foundation's Board of Trustees in 2012, and FASB, working jointly, will mutually agree on a set of criteria to decide whether and when alternatives within U.S. GAAP are warranted for private companies. Based on those criteria, the PCC reviews and proposes alternatives within U.S. GAAP to address the needs of users of private company financial statements. These U.S. GAAP alternatives may be applied to those entities that are not public business entities, not-for-profits, or employee benefit plans.

The FASB ASC Master Glossary defines a *public business entity* as follows:

> A public business entity is a business entity meeting any one of the criteria below. Neither a not-for-profit entity nor an employee benefit plan is a business entity.
>
> a. It is required by the SEC to file or furnish financial statements, or does file or furnish financial statements (including voluntary filers), with the SEC (including other entities whose financial statements or financial information are required to be or are included in a filing).
>
> b. It is required by the Securities Exchange Act of 1934 (the Act), as amended, or rules or regulations promulgated under the Act, to file or furnish financial statements with a regulatory agency other than the SEC.
>
> c. It is required to file or furnish financial statements with a foreign or domestic regulatory agency in preparation for the sale of or for purposes of issuing securities that are not subject to contractual restrictions on transfer.
>
> d. It has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market.
>
> e. It has one or more securities that are not subject to contractual restrictions on transfer, and it is required by law, contract, or regulation to prepare U.S. GAAP financial statements (including footnotes) and make them publicly available on a periodic basis (for example, interim or annual periods). An entity must meet both of these conditions to meet this criterion.
>
> An entity may meet the definition of a public business entity solely because its financial statements or financial information is included in another entity's filing with the SEC. In that case, the entity is only a public business entity for purposes of financial statements that are filed or furnished with the SEC.

Considerations related to alternatives for private companies may be discussed within this guide's chapter text. When such discussion is provided, the related paragraphs are designated with the following title: *Considerations for Private Companies That Elect to Use Standards as Issued by the Private Company Council*.

©2017, AICPA

AICPA.org Website

The AICPA encourages you to visit the website at www.aicpa.org and the Financial Reporting Center at www.aicpa.org/FRC. The Financial Reporting Center supports members in the execution of high-quality financial reporting. Whether you are a financial statement preparer or a member in public practice, this center provides exclusive member-only resources for the entire financial reporting process, and provides timely and relevant news, guidance and examples supporting the financial reporting process. Another important focus of the Financial Reporting Center is keeping those in public practice up to date on issues pertaining to preparation, compilation, review, audit, attestation, assurance and advisory engagements. Certain content on the AICPA's websites referenced in this guide may be restricted to AICPA members only.

Select Recent Developments Significant to This Guide

Attestation Clarity Project

To address concerns over the clarity, length, and complexity of its standards, the ASB established clarity drafting conventions and undertook a project to redraft all the standards it issues in clarity format. The redrafting of Statements on Standards for Attestation Engagements (SSAEs or attestation standards) in SSAE No. 18, *Attestation Standards: Clarification and Recodification*, represents the culmination of that process.

The attestation standards are developed and issued in the form of SSAEs and are codified into sections. SSAE No. 18 recodifies the "AT" section numbers designated by SSAE Nos. 10–17 using the identifier "AT-C" to differentiate the sections of the clarified attestation standards (AT-C sections) from the attestation standards that are superseded by SSAE No. 18 (AT sections).

The AT sections in AICPA *Professional Standards* remain effective through April 2017, by which time substantially all engagements for which the AT sections were still effective are expected to be completed. The clarified attestations found in AT-C sections are effective for practitioners' reports dated on or after May 1, 2017.

TABLE OF CONTENTS

Chapter		Paragraph
1	Industry Overview—Banks and Savings Institutions	.01-.112
	Description of Business	.01-.07
	Regulation and Oversight	.08-.63
	Regulatory Background	.15-.23
	Deposit Insurance Fund	.24-.30
	The Dodd-Frank Act	.31-.63
	Regulatory Capital Matters	.64-.85
	Capital Adequacy	.66-.74
	Prompt Corrective Action	.75-.85
	Annual Independent Audits and Reporting Requirements	.86-.111
	Additional Regulatory Requirements Concerning the Sarbanes-Oxley Act, Corporate Governance, and Services Outsourced to External Auditors	.99-.111
	Other Reporting Considerations	.112
2	Industry Overview—Credit Unions	.01-.62
	Description of Business	.01-.10
	The Board of Directors	.07
	The Supervisory Committee	.08-.09
	The Credit Committee	.10
	Charters, Bylaws, and Minutes	.11-.17
	Financial Structure	.12-.13
	Credit Union System	.14-.16
	Corporate Credit Unions	.17
	Regulation and Oversight	.18-.23
	Government Supervision	.18-.20
	NCUA	.21-.23
	Regulatory Capital Matters	.24-.54
	Natural Person Credit Unions	.24-.44
	Corporate Credit Unions	.45-.54
	Annual Audits	.55-.62
	Other Reporting Considerations	.62
3	Industry Overview—Finance Companies	.01-.20
	Description of Business	.01-.11
	Debt Financing	.08-.11
	Regulation and Oversight	.12-.20
4	Industry Overview—Mortgage Companies	.01-.41
	Description of Business	.01-.20
	Regulation and Oversight	.21-.36

Chapter Paragraph

4 Industry Overview—Mortgage Companies—continued
Reporting Considerations .... .37-.41
HUD Programs .... .37-.39
Asset Servicing for Investors .... .40-.41

5 Audit Considerations and Certain Financial Reporting Matters .01-.257
Overview .... .01-.09
An Audit of Financial Statements .... .04-.05
Audit Risk .... .06-.09
Terms of Engagement .... .10-.13
Audit Planning .... .14-.15
Materiality .... .16-.20
Performance Materiality .... .19-.20
Use of Assertions in Assessment of Risks of Material Misstatement .... .21-.22
Risk Assessment Procedures .... .23-.75
Risk Assessment Procedures and Related Activities .... .25-.32
Understanding the Entity and Its Environment, Including the Entity's Internal Control .... .33-.75
Risk Assessment and the Design of Further Audit Procedures .... .76-.98
Identifying and Assessing the Risks of Material Misstatement .... .77-.81
Designing and Performing Further Audit Procedures .... .82-.98
Evaluation of Misstatements Identified During the Audit .... .99-.101
Audit Documentation .... .102-.109
Timely Preparation of Audit Documentation .... .105
Documentation of the Audit Procedures Performed and Audit Evidence Obtained .... .106-.108
Assembly and Retention of the Final Audit File .... .109
Using the Work of an Auditor's Specialist .... .110-.115
Using the Work of a Management's Specialist .... .116-.119
Processing of Transactions by Service Organizations .... .120-.122
Consideration of Fraud in a Financial Statement Audit .... .123-.151
Professional Skepticism .... .126-.128
Discussion Among the Engagement Team .... .129-.132
Risk Assessment Procedures and Related Activities .... .133-.136
Identification and Assessment of the Risks of Material Misstatement Due to Fraud .... .137-.139
Responses to the Assessed Risks of Material Misstatement Due to Fraud .... .140-.143
Evaluation of Audit Evidence .... .144-.147
Auditor Unable to Continue the Engagement .... .148
Communications to Management and With Those Charged With Governance .... .149
Communications to Regulatory and Enforcement Authorities .... .150

 ©2017, AICPA

Chapter Paragraph

5 Audit Considerations and Certain Financial Reporting Matters—continued

Documentation .151
Compliance With Laws and Regulations .152-.162
Responsibility for Compliance With Laws and Regulations .153-.156
The Auditor's Consideration of Compliance With Laws and Regulations .157-.162
Going-Concern Considerations .163-.179
Evaluating Whether Substantial Doubt Exists .165-.174
Written Representations .175
Consideration of the Effects on the Auditor's Report .176-.178
Documentation .179
Written Representations .180-.189
Written Representations as Audit Evidence .181
Management From Whom Written Representations Are Requested .182-.183
Written Representations About Management's Responsibilities and Other Written Representations .184-.186
Date of, and Period(s) Covered by, Written Representations .187
Form of Written Representations .188
Doubt About the Reliability of Written Representations and Requested Written Representations Not Provided .189
Information Other Than Financial Statements .190-.192
Certain Financial Reporting Matters .193-.211
Disclosures of Certain Significant Risks and Uncertainties .193-.209
Segment Reporting .210-.211
Regulation and Supervision of Depository Institutions .212-.257
Introduction .212-.220
Rule Making .221-.222
Examinations .223-.228
Enforcement .229-.236
Planning .237
Detection of Errors and Fraud .238-.239
Evaluation of Contingent Liabilities and Related Disclosures .240
Going-Concern Considerations .241-.242
Regulatory Reporting Matters—Interpretation and Reporting Related to GAAP .243-.247
Auditor and Examiner Relationship .248-.257

6 Cash and Cash Equivalents .01-.42

Introduction .01-.08
CIPC and Cash Equivalents .02
Deposits With Other Financial Institutions .03-.05
Balances With Federal Reserve Banks and FHLBs .06

Chapter		Paragraph
6	Cash and Cash Equivalents—continued	
	Federal Funds Sold	.07
	Cash on Hand	.08
	Accounting and Financial Reporting	.09-.33
	Definition of *Cash* and *Cash Equivalents*	.09-.11
	Classification of Cash Flows	.12-.22
	Acquisition and Sales of Certain Securities and Loans	.23-.24
	Gross and Net Cash Flows	.25-.28
	Cash Receipts and Payments Related to Hedging Activities	.29
	Financial Statement Presentation and Disclosure	.30-.33
	Auditing	.34-.42
	Objectives	.34
	Planning	.35
	Internal Control Over Financial Reporting and Possible Tests of Controls	.36-.40
	Substantive Tests	.41-.42
7	Investments in Debt and Equity Securities	.01-.163
	Introduction	.01-.65
	U.S. Government and Agency Obligations	.05-.07
	Municipal Obligations	.08-.11
	Asset-Backed Securities	.12-.49
	Other Structured Credit Products	.50-.59
	Issues of International Organizations and Foreign Governments	.60
	Other Securities	.61
	Transfers of Securities	.62-.65
	Regulatory Matters	.66-.82
	Bank Accounting Advisory Series	.82
	Accounting and Financial Reporting	.83-.137
	Introduction	.83-.91
	OTTI	.92-.103
	Unrealized Gains and Losses	.104-.106
	Premiums and Discounts	.107-.113
	Interest Income	.114
	Consolidation	.115
	Special Areas	.116-.118
	Transfers and Servicing of Securities	.119-.121
	Troubled Debt Restructurings	.122-.124
	Loans and Debt Securities Acquired With Deteriorated Credit Quality	.125
	Financial Statement Presentation and Disclosure	.126-.137
	Auditing	.138-.163
	Objectives	.138

 ©2017, AICPA

Chapter Paragraph

7 Investments in Debt and Equity Securities—continued
Planning .139-.143
Internal Control Over Financial Reporting and Possible Tests of Control .144-.154
Substantive Tests .155-.163

8 Loans .01-.230
Introduction .01-.56
The Lending Process .02
Credit Strategy .03-.04
Credit Risk .05-.07
Lending Policies and Procedures .08-.16
Types of Lending .17-.18
Commercial, Industrial, and Agricultural Loans .19-.30
Consumer Loans .31-.39
Residential Real Estate Loans .40-.43
Lease Financing .44-.48
Trade Financing .49-.50
CRE and Construction Loans .51-.53
Foreign Loans .54
Loans Involving More Than One Lender .55-.56
Regulatory Matters .57-.88
Real Estate Lending Standards .57-.67
Retail Credit Loans and Residential Mortgage Loans .68-.70
Troubled Debt Restructurings .71-.75
Credit Card Lending .76-.77
Nontraditional Mortgage Products .78
Correspondent Concentration Risks .79
Leveraged Lending .80
Income Recognition on Problem Loans .81-.82
Credit Union Lending Restrictions .83
Lending Statutes .84
Uniform Commercial Code .85-.87
Bank Accounting Advisory Series .88
Accounting and Financial Reporting .89-.181
Interest Income, Delinquency Fees, Prepayment Fees, and Rebates .95-.100
Loan Fees, Costs, Discounts, and Premiums .101-.122
TDRs .123-.138
Real Estate Investments .139
Lease Financing .140
Foreign Loans .141-.144
Commitments .145-.152
Financial Statement Presentation and Disclosure .153-.181

Chapter Paragraph

8 Loans—continued
Auditing .182-.230
Objectives .182
Planning .183-.184
Internal Control Over Financial Reporting and Possible Tests of Controls .185-.198
Substantive Tests .199-.230

9 Credit Losses .01-.111
Introduction .01-.22
Management's Methodology .04-.12
Loan Reviews .13-.15
Loans Individually Evaluated for Impairment .16
Loans Collectively Evaluated for Impairment .17-.18
Estimating Overall Credit Losses .19-.22
Regulatory Matters .23-.37
Credit Unions .34-.37
Accounting and Financial Reporting .38-.61
Sources of Applicable Guidance .38-.40
Allowance for Loan Losses .41-.47
Loss Contingencies .48-.51
Financial Statement Presentation and Disclosure of Loan Impairment and Allowance for Credit Losses .52-.61
Auditing .62-.111
Objectives .62
Planning and Risk Assessment .63-.67
Internal Control Over Financial Reporting and Possible Tests of Controls .68-.74
Substantive Tests .75-.111

10 Transfers and Servicing and Variable Interest Entities .01-.123
Introduction .01-.08
Asset-Backed Securitizations .06
Loan Participations and Loan Syndications .07
Loan Servicing .08
Regulatory Matters .09-.15
Accounting and Financial Reporting .16-.109
Mortgage Loans and MBSs Held for Sale .16-.25
Transfers and Servicing of Financial Assets .26-.38
Sale of Financial Assets .39-.44
Transfers of Loans With Recourse .45-.46
Servicing Assets and Liabilities .47-.65
Secured Borrowings and Collateral .66-.69
Loans Not Previously HFS .70-.74
Financial Statement Presentation .75-.81

 ©2017, AICPA

Chapter Paragraph

10 Transfers and Servicing and Variable Interest Entities—continued
Financial Statement Disclosure .82-.92
VIEs .93-.109
Auditing .110-.123
Objectives .110
Planning .111-.114
Internal Control Over Financial Reporting and Possible Tests of Controls .115-.121
Substantive Tests .122-.123

11 Real Estate Investments, Real Estate Owned, and Other Foreclosed Assets .01-.72
Introduction .01-.03
Foreclosed Assets .02
Real Estate Investments .03
Regulatory Matters .04-.15
Accounting and Financial Reporting .16-.54
Foreclosed Assets .16-.22
Accounting and Reporting for Long-Lived Assets to Be Disposed of by Sale .23-.32
Accounting and Reporting for Long-Lived Assets to Be Held and Used .33-.39
Real Estate Investments .40-.42
Sale of Real Estate Assets .43-.44
Development Costs .45-.48
Allocation of Income and Equity Among Parties to a Joint Venture .49-.54
Auditing .55-.72
Objectives .55
Planning .56
Internal Control Over Financial Reporting and Possible Tests of Controls .57-.60
Substantive Tests .61-.72

12 Other Assets, Other Liabilities, and Other Investments .01-.91
Introduction .01-.10
Premises and Equipment, Net .03
FHLB or FRB Stock .04-.05
Identifiable Intangibles .06-.07
Goodwill .08
Customers' Liabilities on Acceptances .09
Other Miscellaneous Items .10
Regulatory Matters .11-.15
Accounting and Financial Reporting .16-.76
Premises and Equipment, Net .16-.26

Chapter		Paragraph
12	Other Assets, Other Liabilities, and Other Investments—continued	
	FHLB or FRB Stock	.27-.34
	Goodwill and Other Intangible Assets	.35-.50
	Exit or Disposal Activities	.51-.52
	Asset Retirement Obligations	.53-.56
	Customers' Liabilities on Acceptances	.57
	Mortgage Servicing Advances	.58
	Impairment of Long-Lived Assets	.59
	NCUSIF Deposit	.60-.66
	Other Investments	.67-.72
	Contributed Assets	.73-.76
	Auditing	.77-.91
	Objectives	.77-.78
	Planning	.79
	Internal Control Over Financial Reporting and Possible Tests of Controls	.80-.82
	Substantive Tests	.83-.91
13	Deposits	.01-.70
	Introduction	.01-.32
	Demand Deposits	.04
	Savings Deposits	.05
	Time Deposits	.06-.10
	Brokered Deposits	.11-.13
	Dormant Accounts	.14
	Closed Accounts	.15
	Other Deposit Services	.16
	The Payments Function and Services	.17-.32
	Regulatory Matters	.33-.40
	Limitations on Brokered Deposits	.33-.38
	Classification of Deposits of Credit Unions	.39-.40
	Accounting and Financial Reporting	.41-.46
	Auditing	.47-.70
	Objectives	.47
	Planning	.48-.49
	Internal Control Over Financial Reporting and Possible Tests of Controls	.50-.55
	Substantive Tests	.56-.70
14	Federal Funds and Repurchase Agreements	.01-.69
	Introduction	.01-.25
	Federal Funds Purchased	.02-.03
	Repos	.04-.25
	Regulatory Matters	.26

 ©2017, AICPA

Chapter Paragraph

14 Federal Funds and Repurchase Agreements—continued
Accounting and Financial Reporting .27-.47
Auditing .48-.69
Objectives .48
Planning .49-.53
Internal Control Over Financial Reporting and Possible Tests of Controls .54-.58
Substantive Tests .59-.69

15 Debt .01-.77
Introduction .01-.31
Long Term Debt .06-.09
Short Term Debt .10-.31
Regulatory Matters .32-.33
Accounting and Financial Reporting .34-.57
Auditing .58-.77
Objectives .58
Planning .59
Internal Control Over Financial Reporting and Possible Tests of Controls .60-.63
Substantive Tests .64-.77

16 Income Taxes .01-.36
Introduction .01-.13
Banks and Savings Institutions .03-.09
Other .10-.12
Credit Union .13
Regulatory Matters .14-.17
Accounting and Financial Reporting .18-.30
Deferred-Tax Assets and Liabilities .21-.23
Temporary Differences .24-.26
Financial Statement Presentation and Disclosure .27-.30
Auditing .31-.36
Objectives .31
Planning .32
Internal Control Over Financial Reporting and Possible Tests of Controls .33-.34
Substantive Tests .35-.36

17 Equity and Disclosures Regarding Capital Matters .01-.115
Introduction .01
Banks and Savings Institutions .02-.46
Introduction .02
Equity .03-.10
Holding Company Equity and Regulatory Capital .11-.27

Chapter Paragraph

17 Equity and Disclosures Regarding Capital Matters—continued
- Disclosures for Banks and Savings Institutions .... .28-.37
- Disclosure for Holding Companies .... .38-.40
- Illustrative Disclosures for Banks and Savings Institutions (The example disclosures that follow are for illustrative purposes only) .... .41-.46
- Credit Unions .... .47-.64
  - Introduction .... .47
  - Members' Equity .... .48-.54
  - New Credit Unions and Low Income Designated Credit Unions .... .55
  - Disclosures for Natural Person Credit Unions .... .56-.60
  - Illustrative Disclosures for Natural Person Credit Unions .... .61-.64
- Corporate Credit Unions .... .65-.79
  - Introduction .... .65
  - Equity .... .66-.71
  - Disclosures for Corporate Credit Unions .... .72-.76
  - Illustrative Disclosures for Corporate Credit Unions .... .77-.79
- Mortgage Companies and Mortgage Banking Activities .... .80-.84
  - Introduction .... .80
  - Disclosure for Mortgage Companies and Mortgage Banking Activities .... .81-.83
  - Illustrative Disclosures for Mortgage Companies and Mortgage Banking Activities .... .84
- Regulatory Capital Matters for All Entities .... .85-.88
  - Regulatory Capital Disclosures for Branches of Foreign Institutions .... .85-.86
  - Regulatory Capital Disclosures for Trust Operations .... .87-.88
- Auditing .... .89-.115
  - Banks, Savings Institutions, and Credit Unions .... .89-.105
  - Mortgage Companies and Activities .... .106-.115

18 Derivative Instruments: Futures, Forwards, Options, Swaps, and Other Derivative Instruments .01-.101
- Introduction .... .01-.69
  - Risks Inherent in Derivatives .... .05-.13
  - Types of Derivatives .... .14-.52
  - Uses of Derivatives to Alter Risk .... .53-.64
  - Variations on Basic Derivatives .... .65-.69
- Regulatory Matters .... .70-.78
- Accounting and Financial Reporting .... .79-.100
  - Financial Statement Disclosures .... .95-.100
- Auditing Considerations .... .101

 ©2017, AICPA

Chapter Paragraph

19 Business Combinations .01-.41
Introduction .01
Regulatory Matters .02-.07
Accounting and Financial Reporting .08-.30
Purchase of a Loan or Group of Loans .18-.20
Loans and Debt Securities Acquired With Deteriorated Credit Quality .21
Special Considerations in Applying the Acquisition Method to Combinations of Mutual Entities .22-.25
Impairment and Disposal Accounting for Certain Acquired Long Term Customer Relationship Intangible Assets .26-.27
Branch Acquisitions .28-.30
Auditing Considerations .31-.41

20 Fair Value .01-.68
Introduction .01
Accounting and Financial Reporting .02-.63
Definition of *Fair Value* .02-.27
Valuation Techniques .28-.30
Present Value Techniques .31-.33
The Fair Value Hierarchy .34-.37
Measuring the Fair Value of Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent) .38-.41
Measuring Fair Value When the Volume or Level of Activity for an Asset or a Liability Has Significantly Decreased .42-.47
Using Quoted Prices Provided by Third Parties .48
Disclosures .49-.60
Fair Value Option .61-.63
Auditing Considerations .64-.68

21 Trust and Asset Management Activities .01-.30
Introduction .01-.12
Personal Trusts .08-.09
Corporate Trusts .10
Employee Benefit Trusts .11
Common or Collective Trust Funds .12
Regulatory Matters .13-.14
Accounting and Financial Reporting .15-.16
Auditing .17-.30
Objectives .17
Planning .18
Internal Control Over Financial Reporting and Possible Tests of Controls .19-.21

Chapter		Paragraph
21	Trust and Asset Management Activities—continued
Financial Reporting Controls of the Trust	.22
Substantive Tests Related to Financial Statement Audits	.23-.24
Substantive Procedures Related to the Trust	.25-.29
Audits of Unit Investment Trusts	.30
22	Insurance Activities	.01-.70
Introduction	.01-10
Types of Insurance Coverage	.02
Credit Life	.03-.05
Credit Accident and Health	.06
Property and Liability	.07
Writing Policies	.08-.09
Commissions	.10
Regulatory Matters	.11
Accounting	.12-.68
Premium Income	.13-.17
Acquisition Costs	.18-.50
Investment Portfolios	.51-.54
State Laws	.55
Commissions	.56-.59
Consolidation Policy	.60-.64
Financial Statement Presentation	.65-.68
Auditing	.69-.70
23	Reporting Considerations	.01-.38
Introduction	.01
Forming an Opinion on the Financial Statements	.02-.04
Reports	.05-.37
Unmodified Opinion	.05-.06
EOM and Other-Matter Paragraphs Added to the Independent Auditor's Report	.07-.14
Modified Opinions	.15-.21
Financial Statements Prepared in Accordance With a Special Purpose Framework	.22-.23
Members' Shares Reported as Equity	.24
Communication of Internal Control Related Matters	.25-.27
Reports on Supervisory Committee Audits	.28-.33
Example Report on the Application of Agreed-Upon Procedures Performed in Connection With a Supervisory Committee Audit	.34
Example Reports on the FDIC Loss Sharing Purchase and Assumption Transactions	.35-.36
Small Business Lending Fund Auditor Certification Guidance	.37
Appendix A—Illustrative Unqualified PCAOB Reports	.38

 ©2017, AICPA

Chapter Paragraph

Appendix

A FDI Act Reporting Requirements

B Regulatory Reporting Matters—Interpretation and Reporting Related to U.S. GAAP

C Information Sources

D Overview of Statements on Quality Control Standards

E The New Revenue Recognition Standard: FASB ASC 606

F The New Leases Standard: FASB ASU No. 2016-02

G Accounting for Financial Instruments

H Schedule of Changes Made to the Text From the Previous Edition

Index of Pronouncements and Other Technical Guidance

Subject Index

Chapter 1

Industry Overview—Banks and Savings Institutions

Description of Business

1.01 Banks and savings institutions provide a link between entities that have capital and entities that need capital. They accept deposits from entities with idle funds and lend to entities with investment or spending needs. This process of financial intermediation benefits the economy by increasing the supply of money available for investment and spending. It also provides an efficient means for the payment and transfer of funds between entities.

1.02 Government, at both the federal and state levels, has long recognized the importance of financial intermediation by offering banks and savings institutions special privileges and protections. These incentives—such as access to credit through the Board of Governors of the Federal Reserve System (Federal Reserve) and federal insurance of deposits—have not been similarly extended to commercial enterprises. Accordingly, the benefits and responsibilities associated with their public role as financial intermediaries have brought banks and savings institutions under significant governmental oversight. Federal and state regulations affect every aspect of banks and savings institutions' operations. Similarly, legislative and regulatory developments in the last decade have radically changed the business environment for banks and savings institutions.

1.03 Although banks and savings institutions continue in their traditional role as financial intermediaries, the ways in which they carry out that role became increasingly complex in the most recent decade. Under continuing pressure to operate profitably, the industry adopted innovative approaches to carrying out the basic process of gathering and lending funds. The management of complex assets and liabilities, development of additional sources of income, reactions to technological advances, responses to changes in regulatory policy, and competition for deposits all added to the risks and complexities of the business of banking. These include the following:

- Techniques for managing assets and liabilities that allow institutions to manage financial risks and maximize income have evolved.
- Income, traditionally derived from the excess of interest collected over interest paid, became dependent on fees and other income streams from specialized transactions and services.
- Technological advances accommodated complex transactions, such as the sale of securities backed by cash flows from other financial assets.
- Regulatory policy alternately fostered or restricted innovation. Institutions have looked for new transactions to accommodate changes in the amount of funds they generally must keep in reserve or to achieve the desired levels of capital in relation to their assets.

©2017, AICPA

- Regulatory policy has expanded and become increasingly complex in response to increasing complexities in the industry and recent economic recessions.

1.04 In addition, competition arose from within the industry, and from other competitors such as investment companies, brokers and dealers in securities, insurers, and financial subsidiaries of commercial enterprises. These entities increased business directly with potential depositors and borrowers in transactions traditionally executed through banks and savings institutions. This disintermediation increased the need for innovative approaches to attracting depositors and borrowers.

1.05 Disintermediation also led to a sharp increase in consolidation within the financial institution industry, which created several large and highly complex financial holding companies. With the changes previously mentioned and the increased size of many financial institutions, a dramatic shift in lending, capital market activities, and sources of funding occurred. During this transformation of the industry, the regulatory system issued additional guidance in an effort to keep pace with the changes in the industry.

1.06 The economic recession, which officially began in 2007, revealed vulnerabilities in financial institutions and the regulatory system that contributed to unprecedented strain and stress on financial institutions and in financial markets. As a result, certain financial institutions either failed or came close to failure and many additional widespread repercussions affected or continue to affect this industry. Total assets of "problem" institutions reached their highest levels since 1993 during the first quarter of 2010, per the FDIC's Quarterly Banking Profile. In addition, the number of bank failures reached the highest level since 1992. The economic crisis fueled the demand for financial reform. As a result, on July 21, 2010, the president signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) into law in response to weaknesses in the financial services industry that were believed to have contributed to the economic recession. See further discussion of the Dodd-Frank Act beginning at paragraph 1.31.

1.07 The innovation and complexity related to this industry creates a constantly changing body of business and economic risks. These risk factors, and related considerations for auditors, are identified and discussed throughout this guide.

Regulation and Oversight

1.08 As previously discussed, the importance of financial intermediation has driven governments to play a role in the banking and savings institutions industry. Banks and savings institutions have been given unique privileges and protections, including the insurance of their deposits by the federal government through the FDIC and access to the Federal Reserve's discount window and payments system. (See chapter 2, "Industry Overview—Credit Unions," of this guide for the roles and responsibilities of the National Credit Union Administration [NCUA]). Currently, the federal oversight of institutions receiving these privileges falls to the following three agencies:

a. The Federal Reserve, established in 1913 as the central bank of the United States, which has supervisory responsibilities for bank and saving and loan holding companies, state chartered banks that are

 ©2017, AICPA

members of the Federal Reserve, and foreign banking organizations operating in the United States

b. The FDIC, established in 1934 to restore confidence in the banking system through the federal insurance of deposits, which has supervisory responsibilities for state chartered banks and savings institutions that are not members of the Federal Reserve

c. The Office of the Comptroller of the Currency (OCC), created in 1863, which regulates and provides federal charters for national banks and federal savings associations

1.09 The Federal Reserve and the FDIC are independent agencies of the federal government. The OCC is a bureau of the U.S. Department of Treasury (Treasury). Each state has a banking department and are members of an organization called the Conference of State Bank Supervisors.

1.10 Although each agency has its own jurisdiction and authority, the collective regulatory and supervisory responsibilities of federal and state banking agencies include the following:

- Establishing (either directly or as a result of legislative mandate) the rules and regulations that govern institutions' operations
- Supervising institutions' operations and activities
- Reviewing and approving organization, conversion, consolidation, merger, or other changes in control of the institutions and their branches
- Appraising (in part through on-site examinations) institutions' financial condition, the safety and soundness of operations, the quality of management, the adequacy and quality of capital, asset quality, liquidity needs, and compliance with laws and regulations

1.11 Given the nature of their duties to consider a bank's risk characteristics and loss behavior, the banking agencies also have significant influence in aiding banks and savings institutions with technical details on the application of U.S. generally accepted accounting principles (GAAP) in regulatory reporting. For example, the agencies also have certain authority over the activities of auditors serving the industry. Further, the Federal Reserve, the FDIC, the OCC, and the NCUA constitute the Federal Financial Institutions Examination Council (FFIEC). The FFIEC sets forth uniform examination and supervisory guidelines in certain areas related to banks' and savings institutions' and credit unions' activities, including those involving regulatory reporting matters.

1.12 This chapter discusses the current regulatory approach to the supervision of banks and savings institutions and provides an overview of major areas of regulation and related regulatory reporting. Legislative efforts over time to regulate, deregulate, and reregulate banks and savings institutions are also addressed in this chapter. Other specific regulatory considerations are identified throughout this guide in the relevant chapters.

1.13 In addition to supervision and regulation by the federal and state banking agencies, publicly held holding companies are generally subject to the requirements of federal securities laws, including the Securities Act of 1933 and the Securities Exchange Act of 1934 (the 1934 Act). Holding companies whose securities are registered under the 1934 Act must comply with its reporting requirements through periodic filings with the SEC. Publicly held institutions that are not part of a holding company are required under Section 12(i) of the

©2017, AICPA

1934 Act to make equivalent filings directly with their primary federal regulators. Each of the agencies has regulations that provide for the adoption of forms, disclosure rules, and other registration requirements equivalent to those of the SEC as mandated by the 1934 Act.

1.14 Both the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) and the FDIC Improvement Act of 1991 (FDICIA) were adopted to protect the federal deposit insurance funds through the early detection and intervention in problem institutions, with an emphasis on capital adequacy.

Regulatory Background

1.15 Declining real estate markets in the mid-1980s contributed heavily to widespread losses in the savings institutions industry, evidenced by the insolvency of the savings industry's federal deposit insurance fund. The FIRREA provided funds for the resolution of thrift institutions, replaced the existing regulatory structure, introduced increased regulatory capital requirements, established limitations on certain investments and activities, and enhanced regulators' enforcement authority. The FIRREA redefined responsibilities for federal deposit insurance by designating separate insurance funds, the Bank Insurance Fund (BIF), and the Savings Associations Insurance Fund (SAIF). The FIRREA also established the Resolution Trust Corporation (RTC) to dispose of the assets of failed thrifts. The RTC is no longer in existence and its work is now being done by the FDIC.

1.16 As the 1980s came to a close, record numbers of bank failures began to drain the BIF. The FDICIA provided additional funding for the BIF but also focused the least-cost resolution of and prompt corrective action (PCA) for troubled institutions and improved supervision and examinations. The FDICIA also focused the regulatory enforcement mechanism on capital adequacy. Many of the FDICIA's provisions were amendments or additions to the existing Federal Deposit Insurance Act (FDI Act).

1.17 In April 2006, the FDIC merged the BIF and the SAIF to form the Deposit Insurance Fund (DIF). This action was pursuant to the provisions in the Federal Deposit Insurance Reform Act of 2005 (Reform Act). Under the Reform Act, the FDIC may set the designated reserve ratio, calculated as the target insurance fund size as a percentage of estimated insured deposits, within a range of 1.15 percent to 1.50 percent of estimated insured deposits.

1.18 A desire to allow banks to serve a broad spectrum of customer financial needs caused Congress to pass legislation in 1999. The Gramm-Leach-Bliley Act (also known as the Financial Services Modernization Act) changed the types of activities that are permissible for bank holding company affiliates and for subsidiaries of banks. The bill created so-called financial holding companies that may engage in a broad array of activities. Financial holding company affiliates could provide insurance as principal, agent, or broker and may issue annuities. These affiliates may engage in expanded underwriting, dealing in, or making a market in securities, as well as engage in expanded merchant banking activities. The legislation affirmed the concept of functional regulation.

1.19 Federal banking regulators continue to be the primary supervisors of the banking affiliates of financial holding companies and state insurance authorities supervise the insurance companies, and the SEC and securities self-regulatory organizations supervise the securities business. Each functional

 ©2017, AICPA

regulator determines appropriate capital standards for the companies it supervises. The Treasury and the Federal Reserve have the authority to approve additional activities to be permissible for financial holding companies. To maintain financial holding company status, all of a bank holding company's insured deposit taking subsidiaries must be "well capitalized," "well managed," and have at least a satisfactory Community Reinvestment Act rating.

1.20 In 1970, the Bank Secrecy Act (BSA) was enacted to address the problem of money laundering. The BSA authorized the Treasury to issue regulations requiring financial institutions to file reports, keep certain records, implement anti-money-laundering programs and compliance procedures, and report suspicious transactions to the government. (See Title 31 U.S. *Code of Federal Regulations* [CFR] Chapter X). These regulations, promulgated under the authority of the BSA, and subsequently the USA-Patriot Act of 2001, are intended to help federal authorities detect, deter, and prevent criminal activity. The Financial Crimes Enforcement Network (FinCEN), an arm of the Treasury, administers these regulations.

1.21 On December 2, 2014, the FFIEC released the revised *Bank Secrecy Act/Anti-Money Laundering (BSA/AML) Examination Manual* (manual). The revised manual provides current guidance on risk-based policies, procedures, and processes for banking organizations to comply with the BSA and safeguard operations from money laundering and terrorist financing. The manual has been updated to further clarify supervisory expectations and incorporate regulatory changes since the manual's 2010 update.

1.22 In 2002, the Sarbanes-Oxley Act was enacted in response to high-profile business failures which called into question the effectiveness of the CPA profession's self-regulatory process as well as the effectiveness of the audit to uphold the public trust in the capital markets. The requirements of the Sarbanes-Oxley Act and the SEC regulations implementing the Act are wide-ranging. The banking regulatory agencies also passed regulations implementing certain provisions of the Sarbanes-Oxley Act. Paragraphs 1.99–.111 provide additional information regarding regulatory issuances related to the Sarbanes-Oxley Act. In addition, the Sarbanes-Oxley Act created the PCAOB, which has the authority to set and enforce auditing, attestation, quality control, and ethics (including independence) standards for auditors of entities subject to the oversight authority of the PCAOB. It also is empowered to inspect the auditing operations of public accounting firms that audit entities subject to the oversight authority of the PCAOB as well as impose disciplinary and remedial sanctions for violations of the board's rules, securities laws, and professional auditing and accounting standards.

1.23 Key economic issues affecting the regulations are centered on the ability of financial institutions to operate profitably—for example, the costs and benefits of regulations, the effects of unemployment and future corporate layoff plans, levels of interest rates, and the availability of credit.

Deposit Insurance Fund

1.24 On October 7, 2008, the FDIC established a Restoration Plan for the DIF to return the DIF to its statutorily mandated minimum reserve ratio of 1.15 percent within 5 years. In February 2009, the FDIC amended its Restoration Plan to extend the restoration period from 5 to 7 years. Congress then amended the statute governing the Restoration Plan, in May 2009, to allow the FDIC up to 8 years to return the DIF reserve ratio to 1.15 percent.

In September 2009, the FDIC amended the Restoration Plan consistent with the statutory change and, pursuant to the amended Restoration Plan, adopted a uniform 3 basis point increase in initial assessment rates effective January 1, 2011.

1.25 The Dodd-Frank Act requires the FDIC to set a designated reserve ratio of not less than 1.15 percent for any year and to increase the level of the DIF to 1.35 percent of estimated insured deposits by September 30, 2020.[1] In March 2016, the FDIC approved a final rule, effective July 1, to increase the DIF to the statutorily required minimum level of 1.35 on institutions with total consolidated assets of $10 billion or more while providing credits to institutions that have assets or less than $10 billion. Readers are encouraged to consult the full text of this final rule on FDIC's website at www.fdic.org. The Dodd-Frank Act also called for a revision to the definition of the deposit insurance assessment base. The intent of changing the assessment base was to shift a greater percentage of overall total assessments away from community institutions and toward the largest institutions.

1.26 In response to the provisions of the Dodd-Frank Act, in February 2011, the FDIC's board of directors, through the issuance of Financial Institution Letter (FIL)-8-2011, adopted the final rule *Deposit Insurance Assessment Base, Assessment Rate Adjustments, Dividends, Assessment Rates, and Large Bank Pricing Methodology* to redefine the deposit insurance assessment base, as required by the Dodd-Frank Act; alter the assessment rates; implement the Dodd-Frank Act's DIF dividend provisions; and revise the risk-based assessment system for all large insured depository institutions (IDIs).[2] The final rule

- redefines the *deposit insurance assessment base* as average consolidated total assets minus average tangible equity (the assessment base had previously been defined as total domestic deposits).
- makes generally conforming changes to the unsecured debt and brokered deposit adjustments to assessment rates.
- creates a depository institution debt adjustment.
- eliminates the secured liability adjustment.
- adopts a new assessment rate schedule which became effective April 1, 2011, and, in lieu of dividends, other rate schedules when the reserve ratio reaches certain levels.

1.27 In addition, the final rule establishes a new methodology for calculating deposit insurance assessment rates for highly complex and other large IDIs (commonly referred to as the Large Bank Pricing Rule). The new methodology combines capital adequacy, asset quality, management, earnings, liquidity, and sensitivity to market risk (CAMELS) ratings and financial measures to produce a score that is converted into an institution's assessment rate. The Large Bank Pricing Rule authorizes the FDIC to adjust, up or down, an institution's

---

[1] The Deposit Insurance Fund (DIF) is used to (*a*) insure the deposits of, and protect the depositors of, failed FDIC-insured institutions and (*b*) resolve failed FDIC-insured institutions upon appointment of the FDIC as receiver. The reserve ratio represents the ratio of the net worth of the DIF to aggregate estimated insured deposits of FDIC-insured institutions. The DIF is funded primarily through deposit insurance assessments.

[2] A large insured depository institution (IDI) has at least $10 billion in total assets. In general, a highly complex IDI will be (*a*) an IDI (other than a credit card bank) with more than $50 billion in total assets that is controlled by a parent or an intermediate parent company with more than $500 billion in total assets or (*b*) a processing bank or trust company with at least $10 billion in total assets.

 ©2017, AICPA

total score by 15 basis points. The final rule became effective on April 1, 2011. For further information, readers can access the final rule on the FDIC website at www.fdic.gov.

1.28 In September 2011, the FDIC adopted guidelines describing the process that the FDIC will follow to determine whether to make an adjustment, to determine the size of any adjustment, and to notify an institution of an adjustment made to its assessment rate score, as allowed under the Large Bank Pricing Rule. The guidelines also provide examples of circumstances that might give rise to an adjustment. Further information on the guidelines can be found in FIL-64-2011, *Assessments: Assessment Rate Adjustment Guidelines*, on the FDIC website at www.fdic.gov.

1.29 In October 2012, the FDIC's board of directors, through the issuance of FIL-44-2012, *Assessments: Final Rule on Assessments, Large Bank Pricing*, adopted a final rule to amend and clarify definitions related to higher risk assets as used by the deposit insurance pricing scorecards for large and highly complex IDIs. The rule applies only to institutions with $10 billion or more in assets. Specifically, the rule revises the definition of certain higher risk assets, such as leveraged loans and subprime consumer loans; clarifies the timing of identifying an asset as higher risk; clarifies the way securitizations (including those that meet the definition of nontraditional mortgage loans) are identified as higher risk; and further defines terms that are used in the large bank pricing rule adopted in February 2011. The final rule became effective on April 1, 2013. For further information, readers are encouraged to access the final rule in FIL-44-2012 on the FDIC website at www.fdic.gov.

1.30 In November 2014, the FDIC issued the *Assessments* final rule to revise the FDIC's risk-based deposit insurance assessment system to reflect changes in the regulatory capital rules. The final rule

- conforms the capital ratios and ratio thresholds in the small institution assessment system to the new PCA capital ratios and ratio thresholds.
- conforms the assessment base calculation for custodial banks to the new asset risk weights using the standardized approach in the regulatory capital rules.
- requires that all highly complex institutions measure counterparty exposure for the assessment purposes using the Basel III standardized approach credit equivalent amount for derivatives and the Basel III standardized approach exposure amount for securities financing transactions in the regulatory capital rules.

For further information, readers can access the final rule in FIL-57-2014, *Assessments: Final Rule*, on the FDIC website at www.fdic.gov.

The Dodd-Frank Act

1.31 The Dodd-Frank Act was signed into law by President Obama on July 21, 2010. It aims to promote U.S. financial stability by improving accountability and transparency in the financial system, putting an end to the belief that certain financial institutions were too big to fail, protecting American taxpayers by ending bailouts, and protecting consumers from abusive financial services practices. The Dodd-Frank Act contains many provisions; some highlights that may be of particular interest to readers are summarized in the following sections.

©2017, AICPA

1.32 A copy of the full Dodd-Frank Act, as signed by the president, can be found at www.gpo.gov. The AICPA is also following any developments related to the Dodd-Frank Act on its website at aicpa.org on the "Federal Issues" page under "Advocacy."

Financial Stability Oversight Council

1.33 The Dodd-Frank Act created a new systemic risk regulator called the Financial Stability Oversight Council (FSOC). The two main goals of the FSOC are to identify risks to the financial stability of the United States banking system and to promote market discipline by eliminating the moral hazard of "too big to fail." To meet these goals, the FSOC has many powers to identify any company, product, or activity that could threaten U.S. financial stability. The FSOC is chaired by the Secretary of the Treasury, and voting members are heads of nine federal financial regulatory agencies, including chairmen of the Federal Reserve, the FDIC, and the SEC, among others. The FSOC is authorized to facilitate regulatory coordination, facilitate information sharing and collection, designate nonbank financial companies for consolidated supervision, designate systemic financial market utilities and systemic payment, clearing or settlement activities, and recommend stricter standards for the largest, most interconnected firms, break up firms that pose a "grave threat" to financial stability, and recommend Congress close specific gaps in regulation. Further information on the FSOC and proposed rulings can be found at www.treasury.gov/initiatives/pages/fsoc-index.aspx.

Leverage and Risk-Based Capital Requirements

1.34 Title 1, "Financial Stability," of the Dodd-Frank Act requires the appropriate federal banking agencies to establish minimum leverage and risk-based capital requirements, on a consolidated basis, for IDIs, depository institution holding companies, and nonbank financial companies supervised by the Federal Reserve. The minimum leverage and risk-based capital requirements for IDIs established by the agencies under this section of the Dodd-Frank Act should not be less than the generally applicable requirements, which should serve as a floor for any capital requirements that the agencies may require, nor be quantitatively lower than the generally applicable requirements that were in effect for IDIs as of the date of enactment. The provisions of Section 171 of the Dodd-Frank Act regarding trust preferred securities can be found in paragraph 17.20 of this guide.

1.35 Title VI, "Improvements to Regulation," of the Dodd-Frank Act mandates stronger capital requirements for all IDIs, depository institution holding companies, and any company that controls an IDI and provides that any company in control be accountable for the financial strength of that entity.

Consumer Financial Protection Bureau

1.36 The Consumer Financial Protection Bureau (CFPB) is an independent agency that consolidates much of the federal regulation of financial services offered to consumers. The CFPB is expected to ensure that consumers receive clear, accurate information to shop for mortgages, credit cards, and other financial products (but not products subject to securities or insurance regulations); to provide consumers with one dedicated advocate; and to protect them from hidden fees and deceptive practices. The CFPB also oversees the enforcement of federal laws intended to ensure the fair, equitable, and nondiscriminatory access to credit for individuals. The director of the CFPB replaces the

©2017, AICPA

director of the Office of Thrift Supervision (OTS) on the FDIC board. The CFPB is led by an independent director appointed by the president and confirmed by the Senate and has a dedicated budget in the Federal Reserve.

1.37 The CFPB has the authority to examine and enforce regulations for banks and credit unions with assets of over $10 billion; all mortgage-related businesses (nondepository institution lenders, servicers, mortgage brokers, and foreclosure operators); providers of payday loans; student lenders; and other nonbank financial entities, such as debt collectors and consumer reporting agencies. Banks and credit unions with assets of $10 billion or less will be examined for consumer compliance by the appropriate regulator. The CFPB also can autonomously write rules for consumer protections governing all financial institutions (banks and nonbanks) offering consumer financial services or products.

1.38 For further information on the CFPB and the progress the agency has made since its inception, readers can access the CFPB website at www.consumerfinance.gov.

Derivatives Trading

1.39 The Dodd-Frank Act provided the SEC and the Commodity Futures Trading Commission (CFTC) with the authority to regulate over-the-counter derivatives and required central clearing and exchange trading for derivatives. The SEC has regulatory authority over specific security-based swaps (including credit default swaps), and the CFTC has primary regulatory authority over all other swaps, including energy-rate swaps, interest-rate swaps, and broad-based security group or index swaps. Standardized swaps will be traded on an exchange or in other centralized trading facilities, which will promote transparency; standardized derivatives will also have to be handled by central clearinghouses. The Dodd-Frank Act requires all cleared swaps to be traded on a registered exchange or board of trade.[3]

1.40 The Dodd-Frank Act also provided regulators the authority to impose capital and margin requirements on swap dealers and major swap participants.[4] The credit exposure from derivative transactions will be considered in banks' lending limits.

1.41 Banks can continue engaging in principal transactions involving interest-rate, foreign-exchange, gold, silver, and investment-grade credit default swaps, subject to Section 619 of the Dodd-Frank Act (commonly referred to as the Volcker Rule) limitations on proprietary trading. See discussion of the Volcker Rule in paragraph 1.48. For commodities, most other metals, energy, and equities, banks must shift their swap operations to a separately capitalized affiliate within the holding entity.

---

[3] The SEC has proposed numerous rulings related to the provisions on derivative trading included in the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). Readers are encouraged to visit the "Dodd-Frank Act Rulemaking: Derivatives" page on the SEC website to access further information.

[4] In November 2015, the Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (Federal Reserve), the FDIC, the Farm Credit Administration, and the Federal Housing Finance Agency (collectively, the agencies) issued the final rule *Margin and Capital Requirements for Covered Swap Entities* to implement Sections 731 and 764 of the Dodd-Frank Act. The final regulations establish minimum margin and capital requirements for registered swap dealers, major swap participants, security-based swap dealers, and major security-based swap participants for which one of the agencies is the prudential regulator. The final rule was effective April 1, 2016. Readers may access the full text of the regulation from any of the agencies websites.

©2017, AICPA

Lending Limits

1.42 Section 610 of the Dodd-Frank Act revises the statutory definition of loans and extensions of credit to include credit exposures arising from derivative transactions, repurchase agreements, reverse repurchase agreements, securities lending transactions, and securities borrowing transactions (collectively, securities financing transactions). This revised definition also is applicable to all savings associations.

1.43 In June 2013, the OCC finalized its lending limits interim rule, which consolidated the lending limits rules applicable to national banks and savings associations, removed the separate OCC regulation governing lending limits for savings associations, and implemented Section 610 of the Dodd-Frank Act. The final rule outlines the methods that banks can choose from to measure credit exposures of derivative transactions and securities financing transactions. A bank may choose which method it will use; however, the OCC may specify that a bank use a particular method for safety and soundness reasons. Banks may request OCC approval to use a different method to calculate credit exposure for certain transactions. If the Model Method[5] is used, the OCC must approve the use of the model and any subsequent changes to an approved model. The final rule continues to provide that loans and extensions of credit, including those that arise from derivative transactions and securities financing transactions, must be consistent with safe and sound banking practices.

1.44 *Derivative transactions.* Banks can generally choose to measure the credit exposure of derivatives transactions through

- the Conversion Factor Matrix Method.[6]
- the Current Exposure Method.[7]
- an OCC-approved internal model.

1.45 For credit derivatives (transactions in which banks buy or sell credit protection against loss on a third-party reference entity), the final rule provides a special rule for calculating credit exposure based on exposure to the counterparty and reference entity.

1.46 *Securities financing transactions.* The final rule specifically exempts securities financing transactions relating to Type I securities (such as U.S. or

---

[5] Under the Model Method, the credit exposure of a derivative transaction should equal the sum of the current credit exposure of the derivative transaction and the potential future credit exposure of the derivative transaction. See Title 12 U.S. *Code of Federal Regulations* (CFR) Part 32.9 for further discussion on the calculation of current credit exposure and the potential future credit exposure.

[6] Under the Conversion Factor Matrix Method, credit exposure arising from a derivative transaction should equal and remain fixed at the potential future credit exposure of the derivative transaction, which should equal the product of the notional principal amount of the derivative transaction and a fixed multiplicative factor utilizing the conversion factor matrix found in Table 1 to 12 CFR 32.9.

[7] Under the Current Exposure Method, credit exposure for derivative transactions is calculated by adding the current exposure (the greater of zero or the mark-to-market value) and the potential future credit exposure (calculated by multiplying the notional amount by a specified conversion factor taken from Table 4 of the Advanced Approaches Appendix of the capital rules, which varies based on the type and remaining maturing of the contract) of the derivative transactions. The current exposure method incorporates additional calculations for netting arrangements and collateral and utilizes multipliers that are more tailored to compute the potential future credit exposure of derivative transactions.

 ©2017, AICPA