

# Acquisition Accounting: Day Two Issues



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# Agenda

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- Business Combinations
  - Management Responsibilities
  - Day 1 Accounting
  - Day 2 Accounting
  - Challenges
  - FDIC Assisted Transactions and Loss Sharing Agreements
  - Regulatory Reporting and Guidance

# Business Combinations

## *Management Responsibilities*

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- Management responsibilities

- Plan

- Accounting guidance
  - Day 1 vs. Day 2
  - Measurement period
- Loss Sharing agreement requirements
- Operational considerations
  - Chart of Accounts
  - Integration
- Staffing

# Business Combinations

## *Management Responsibilities (Cont'd)*

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- Accounting guidance
  - ASC 805 (formerly SFAS 141(R))
  - ASC 820 (formerly SFAS 157)
  - ASC 815 (formerly SFAS 133)
  - ASC 310-20 (formerly SFAS 91) unimpaired loans
  - ASC 310-30 (formerly SOP 03-3) impaired loans

# Business Combinations

## *Management Responsibilities (Cont'd)*

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ASC 805 requires the application of the acquisition method to all business combinations, including assisted acquisitions.

The acquisition method entails:

- 1) Identifying the acquirer;
- 2) Determining the acquisition date;
- 3) Recognizing and measuring the identifiable assets acquired, liabilities assumed, and any noncontrolling interest in the acquiree; and,
- 4) Recognizing and measuring goodwill or a gain from a bargain purchase.

Generally, these steps require the exercise of significant judgment

# Day 1 Accounting

# Business Combinations

## *Day 1 Accounting*

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- Day 1: Fair value assets acquired and liabilities assumed
  - Valuation techniques required due to illiquid nature and lack of quoted market prices
    - Appropriateness of inputs
    - Appropriate selection and use of valuation technique
  - Based on market participant's view
  - Determination of Goodwill or Bargain Purchase

# Business Combinations

## *Day 1 Accounting (Cont'd)*

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- Day 1: Loans
  - Choice of following ASC 310-20 (formerly FAS 91) or ASC 310-30 (formerly SOP 03-30)
    - ASC 310-20 – accrete entire discount into income over expected life of loan
    - ASC 310-30 – accrete discount not related to credit risk into income over expected life of loan
      - must comply with all accounting and disclosure requirements
  - This is a **permanent** decision

# Business Combinations

## Day 1 Accounting (Cont'd)

Example of Combination		(000's)	
Net Equity of Failed Bank and Cash from FDIC		95,100	
Investment Securities	(2,500)		Expected Cash Flows
Loans	(213,500)		
Foreclosed real estate	(3,000)		Appraisals
FDIC Indemnification asset	152,350		
Deposits	(3,700)		Measured same basis as indemnified item
FHLB Advances	(3,000)		
Core deposit intangible	3,000		
Deferred taxes	(9,800)		
Other adjustments	1,750		
Net assets acquired/Bargain Purchase Gain		\$16,700	

# Day 2 Accounting

# Business Combinations

## *Day 2 Accounting*

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- Day 2: Accounting and Reporting
  - Gather same level information as Day 1
  - Data integrity
  - Separation of originated and acquired assets
  - Measurement period
    - Adjustments to fair value based on facts and circumstances that existed at the acquisition date
  - Internal training

# Business Combinations

*Day 2 Accounting (Cont'd)*

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- Day 2: Nonperforming/Impaired loans
  - Unaccretable yield
  - Accretable yield
  - Past due reporting (RC-N item 10)
  - Nonaccrual reporting
  - ALLL – timing of impairment recognition

# Business Combinations

## *Day 2 Accounting (Cont'd)*

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- Day 2: Performing/Nonimpaired loans
  - Discount/premium accretion
  - ALLL – incurred losses **after** acquisition date
  - Past due reporting (RC-N item 10)

# Business Combinations

## Day 2 Accounting (Cont'd)

Example of Combination		(000's)	Measurement Period Adjusted
Net Equity of Failed Bank and Cash from FDIC		95,100	95,100
Investment Securities	(2,500)		(5,500)
Loans	(213,500)		(225,500)
Foreclosed real estate	(3,000)		(3,000)
FDIC Indemnification asset	152,350		164,350
Deposits	(3,700)		(4,800)
FHLB Advances	(3,000)		(3,250)
Core deposit intangible	3,000		4,500
Deferred taxes	(9,800)		(9,800)
Other adjustments	1,750		1,750
Net assets acquired/Bargain Purchase Gain		\$16,700	\$13,850

# Challenges

# Business Combinations

## *Challenges*

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- Obtaining key data
  - Access to acquiree's loan system is critical
  - Appraisals for loans, OREO, and premises
  - Deposit and assumed debt obligations
- Creation of acquisition policy and procedures
  - Initial decisions made will affect operations and accounting
  - Permanent decision

# Business Combinations

## *Challenges (Cont'd)*

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- Resources
  - Internal vs. External
- Proper recognition of valuation to general ledger
  - Loan system to general ledger
  - Financial reporting

# FDIC Assisted Transactions and Loss Sharing Agreements

# Business Combinations

## *Failing Bank Acquisition – FDIC Loss Sharing Agreements*

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- Similar accounting rules followed for FDIC assisted business combinations
- Loss sharing agreement creates an indemnification from the FDIC recorded as a derivative or indemnification asset
  - Derivative ASC 815 (SFAS 133) or an indemnification asset ASC 805 (SFAS 141(R))
    - Either approach appropriate
    - Covered assets and agreement are separate units of account

# Business Combinations

## *Failing Bank Acquisition – FDIC Loss Sharing Agreements (Cont'd)*

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- Subsequent accounting differs for derivative and indemnification approaches
  - Derivative accounted for at fair value with changes recognized in earnings
  - Indemnification asset accounted for on the same basis as the indemnified asset subject to an assessment of collectability

# Business Combinations

## *Failing Bank Acquisition – FDIC Loss Sharing Agreements (Cont'd)*

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- Monthly/Quarterly reporting and claims reporting
  - Single-family loans
  - Non single-family loans
- Audit requirements
  - Internal audit
  - External audit
  - FDIC or third-party designee
- Record retention requirements
  - Failed institution records

# Business Combinations

## *Failing Bank Acquisition – FDIC Loss Sharing Agreements (Cont'd)*

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- Identified Weaknesses
  - Began hiring special assets staff 3 months after acquisition date
  - Set up general ledger six months after acquisition date
  - Used origination date as key field – did not realize date changes with restructuring
  - Combined covered assets and indemnification as one unit of account for reporting
  - Poor communication between accounting staff and valuation team

# Regulatory Reporting and Guidance

# Business Combinations

## *Regulatory Reporting and Guidance*

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- Appendix B of the Interagency Supervisory Guidance on Bargain Purchases and FDIC- and NCUA-Assisted Activities
  - Delinquency status of purchased loans
    - RC-N, item 10 – loans covered by loss-sharing agreement
    - RC-N, Memorandum item 7, nonaccrual added during reporting period
  - Goodwill and bargain purchase gains
  - Risk-Weighted assets – 20 percent
  - Additional disclosures
    - Indemnification agreement – Schedule RC-F, Other Assets, item 6, “all other assets”
    - Assets covered by FDIC loss share – RC-M, items 13.a through 13.d
    - ASC 310-30/SOP 03-3 loans – RC-C, Memorandum item 7
    - ASC 310-20/SFAS 91 loans – RC-C, Memorandum item 2

# Business Combinations

*Regulatory Reporting and Guidance (Cont'd)*

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- Interagency Supervisory Guidance on Bargain Purchases and FDIC- and NCUA-Assisted Activities
- FDIC supervisory insights article – Summer 2010
  - Loss Sharing Primer
- Technical practice aid (TPA) 9110.16, *Example Reports on Federal Deposit Insurance Corporation Loss Sharing Purchase and Assumption Transactions*