

The Auditor's Report



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Understanding Trouble Debt Restructuring (TDRs)

What is a Trouble Debt Restructuring (TDR) loan? Codification 320-40-15, formerly Financial Accounting Standards Board (FASB) 15, considers a restructuring of debt as a TDR if the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider. In order to determine whether a restructuring is considered a TDR, a creditor must determine if the debtor is experiencing financial difficulties and whether the restructuring constitutes a concession.



In order to decide whether a debtor is experiencing financial difficulties, the creditor has to consider several different factors. A few of which are listed below:

- Is the loan currently in default or is it likely that the debtor will be in default in the near future without a modification?
- Is the debtor delinquent to other financial institutions?
- Has the debtor declared bankruptcy or in the process of declaring bankruptcy?

This is not a comprehensive list but covers a few items that should be considered when determining financial difficulties. In order to determine whether a concession should be granted, the creditor has to consider a few different factors:

- Does the creditor expect that they will not be able to collect the full amount of the original loan including interest?

- Does the creditor receive additional collateral or guarantees from the debtor?
- Is there a reduction in the interest rate to levels below – market?

Once it is determined the debtor is experiencing financial difficulties and a concession has been made, the creditor now has a TDR and it needs to be accounted for pursuant to Generally Ac-

cepted Accounting Principles (GAAP). According to GAAP, a provision should be reserved in the Allowance for Loan and Lease Losses (ALLL) to protect the Credit Union from TDRs that may become impaired. The provision is determined by calculating the Net Present Value (NPV) of Future Cash Flows. Figuring out the NPV can be a difficult process so it is recommended that software such as TValue™ Amortization Software is used. TValue™ allows the user to quickly calculate the NPV at various interest rates to determine what the allowance for loan loss should be. Additional information is available at www.timevalue.com.

For example, we will assume a loan has an original loan amount \$150,000, interest rate of 6.5%, and a remaining term of 25 years. Using the restructured rate of 5% and the remaining term of 25 years, the new payment is calculated at \$876.89 a month.

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What To Expect During An Audit

It's that time of the year again – another audit. There is no doubt that audits can be trying as they require numerous amounts of time and resources to provide all the information requested by your auditors. What can you expect from us as auditors? In turn, how can you contribute to a smooth running audit process that minimizes disruption of the credit union's daily operations? Let's look at a timeline of what to expect during each phase of the audit.

Approximately 3-4 Months Prior to the Audit Date:

Here at Nearman, Maynard, Vallez, CPAs, we usually start the audit process by providing the Credit Union with an interim client participation schedule that details the list of items we will need for the planning stages of our audit and to start preliminary audit work. Our interim request list includes items needed for the interim period leading up to the quarter prior to your audit date. We usually request that this information is uploaded to our ShareFile™ site approximately three weeks following the close of the penultimate quarter.

We prefer to perform the verification of member accounts in the quarter preceding the audit year end. This

enables sufficient time to send out verification requests, receive adequate responses and resolve any issues before field work begins.

During this period, we will also request the credit union to provide us with a current list of all the pertinent information needed to send out requests for the confirmation of third party accounts as of the audit date. It is important to get this updated list as soon as possible as here at Nearman, Maynard, Vallez, CPAs, we create all confirmation letters that will need to be sent out for the audit.

Approximately 1 Month Prior to the Audit Date:

A final and much more comprehensive client participation list will be sent with all remaining items needed for your audit. Depending on your date of field work, we typically like to start working on your audit a month prior to your field work date. Therefore, it is important to provide as much requested information as possible by the due dates noted on your client participation schedule. Remember, the earlier our requested information is provided to us, the more we can complete before your actual field work date.



During Fieldwork:

During field work, we will be working on completing all open areas of your audit. It is important that all requested items are provided by the start of field work in order for us to complete our work. In addition, we will provide our findings to Management and the Supervisory Committee.

The credit union plays an important role in how the day to day operations will be affected during an audit. By obtaining pertinent and timely information when requested, we can both contribute to having an efficient and effective audit with minimal disruption.

*Nichole Lee, Audit Manager
Nearman, Maynard, Vallez, CPAs*

Associate Spotlight

We would like to announce the promotions of Lynn Franzosa, CPA, MA to Internal Audit Manager and Paul Edwards, MBA, MAFM, CICA to Audit Supervisor. Both Associates have shown growth, professionalism, and dedication in their positions.

Lynn started with the firm in 2006 and is part of our team that provides our clients with consulting/compliance services. Lynn has more than 20 years experience in accounting and auditing. Some of her responsibilities include planning and performing engagements for clients in such areas as internal auditing, NACHA compliance audits, BSA/OFAC compliance reviews, pension audits, and other special work as required. She is truly an asset to our firm and our clients.

Paul started his career with Nearman, Maynard, Vallez in 2010 as a Staff Auditor. Some of Paul's responsibilities in his new position of Audit Supervisor include planning the audit from start to completion, supervising and training staff, and reviewing work papers. He also assists in presenting client briefings of audit results and financial trend analyses. In addition, Paul prepares the financial statements and management reports detailing the audit results and our recommendations.

We value all our employees and are especially pleased to watch someone meet the challenges presented and grow into greater responsibilities. Please join us in congratulating Lynn and Paul on their new positions.



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The screenshot shows the TValue 5 - [Sample-TDR] window. The 'Cash Flow Data' tab is active. The label is 'Sample-TDR', compounding is 'Monthly', and the nominal annual rate is '5.000%'. The amortization schedule table is as follows:

	Event	Date	Amount	Number	Period	End Date
1	Loan	06/01/2013	150,000.00	1		
2	Payment	07/01/2013	876.89	300	Monthly	06/01/2038

Normal Amortization, 365 Day Year

Once the payment amount is recalculated the NPV of future cash flows is then calculated using the loan's original interest rate. Using the original rate of 6.5% and the restructured payment of \$876.89 for the remaining term, TValue™ calculates the NPV of the loan as \$129,869.77.

The screenshot shows the TValue 5 - [Sample-PV] window. The 'Cash Flow Data' tab is active. The label is 'Sample-PV', compounding is 'Monthly', and the nominal annual rate is '6.500%'. The amortization schedule table is as follows:

	Event	Date	Amount	Number	Period	End Date
1	Loan	06/01/2013	129,869.77	1		
2	Payment	07/01/2013	876.89	300	Monthly	06/01/2038

Normal Amortization, 365 Day Year

If you subtract the original loan amount of \$150,000 from the NPV of \$129,869.77, you get an ALLL of approximately \$20,130. In addition to the NPV allowance, the Credit Union should consider an allowance for re-default risk. It is also important to note that once a loan is considered a TDR, it will be a TDR for the life of the loan and should be tracked in a separate loan pool.

*Oran Cape, CFE, Auditor
Nearman, Maynard, Vallez, CPAs*

2014 Conference Recap

We would like to thank everyone that visited our booth earlier this year at the conferences below. We enjoyed meeting everyone and discussing your credit union's auditing needs.

- Georgia Credit Union Affiliates
- Carolinas Credit Union League
- League of Southeastern CUs
- ACUIA

Our firm will also be exhibiting at CUNA's Supervisory Committee & Internal Audit Conference - December 7-10, 2014 in Las Vegas. In addition, one of our partners, Chris Vallez, will be speaking. If you are planning on attending, please stop by our table and be sure to check out Chris' session on Accounting for Foreclosed and Repossessed Property.

Compliance Reminder

Don't forget the due dates for the following required annual compliance audits are fast approaching.

ACH and BSA Audits:
Due date December 31st of each year.

Safe Act Review: Due annually. (NCUA defines "annual" as within a calendar year)

If you haven't planned for these audits, be sure to contact your auditor now to get your reviews scheduled.



ABOUT US

Since 1979, Nearman, Maynard, Vallez, CPAs has provided auditing and consulting services exclusively to credit unions throughout the United States. Our dedication to credit unions has given us the unique ability to provide exceptional service at a reasonable price. Our primary objective is to assist our clients in accomplishing their goals through our experience, service, & commitment. If your Supervisory/ Audit Committee or Management is interested in obtaining information on the subjects in this issue or about our many services, call or email us today.

Website:
www.nearman.com
E-mail: info@nearman.com
Toll-free: 800.288.0293

Atlanta: 205 Brandywine Blvd., Suite 100, Fayetteville, GA 30214
770.461.5706
770.719.1888 fax

Miami: 10621 N. Kendall Dr., Suite 219, Miami, FL 33176
305.598.1730
305.595.9316 fax

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