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Accounting Standards

As the industry drives toward greater compliance, banks will scrutinize agreed-on covenants and reporting requirements.

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By Ane Ohm and Chris Marschka.

If the failures of Silicon Valley Bank, Signature Bank, and First Republic Bank illustrate anything, it's the fragility of trust that both bank customers and regulators are experiencing as a result of downturn fears. While a new era of regulatory scrutiny was dawning well before the collapse of SVB and Signature Bank in March, these

incidents brought into sharp focus the impact of rising interest rates and economic

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you can help your clients stay compliant and avoid additional scrutiny while ensuring the stability of their bank relationships.

If your clients do need GAAP exceptions for this year's financial statements, it's best to first ensure the bank is aware and has approved their use. Even if a bank accepts an exception this year, it will likely want customers to work toward compliance and keep it apprised of when compliance is expected. Bank regulators won't look kindly on too many exceptions for a bank's customers, particularly in this economic environment.

Adhering to the new [GAAP lease accounting standards](#) on your clients' financial statements reduces risk for your clients and their banks.

As the economy constricts, banks look more closely at their own risk profile than they would in times of growth and expansion. This means examining financial statement delays and exceptions – all the little things that banks must measure and track which become very important on the cusp of a slowdown.

Banks want their clients to adhere to GAAP standards, which includes standards for lease accounting, in order to minimize risk. To ensure timely delivery of financial statements, clients should prioritize submitting them early.

It's important for your clients to communicate proactively with their bank if there are any significant differences between their financial statements and their loan agreements or covenants. If they've chosen not to follow the new lease accounting standard and have issued statements with a GAAP exception (which is not recommended), it's crucial to have a conversation with the bank.

Following the new GAAP lease accounting standards will alleviate scrutiny.

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multiple periods in a row. In itself, needing an exception isn't problematic if the client's bank can get enough information to understand the material impact of it.

With respect to exceptions to lease accounting standards: larger, more sophisticated banking institutions have been incorporating off-balance-sheet leases into credit risk analysis for some time. Smaller banks have historically taken a simpler approach to analysis and enforcing covenant structures and may face greater scrutiny as a result.

When the level of risk goes up, businesses with weaker credit are going to need to take extra steps to safeguard their relationship with their bank. This may include restructuring credit agreements, collateral, covenant definitions or filing additional forms of support like guarantees.

Do banks care about client compliance with covenants? Absolutely. Regulators are going to look to see whether banks are following their own policies when underwriting loans and if customers are being held to the terms of their credit agreements, including reporting compliance and timeliness.

To maintain trust with their banking institutions, it's imperative that clients provide a thorough report that includes details of the exceptions and the buckets they fall into. By doing so, they are going to demonstrate transparency and help their banking institutions better understand the nature of the exceptions.

Remember that banks want to be your clients' trusted advisor. Bankers should be helping your clients understand what their peers are doing and what the bank is doing to help them adhere to their covenants.

Although applying the new GAAP lease accounting standards to your clients' upcoming financial statements may appear intimidating, you don't have to handle it

by yourself. [Software tools and consulting services](#) are readily available to aid in the

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