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Kevane Grant Thornton Mailbag

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Dear clients and friends:

The Kevane Grant Thornton Mailbag is your link to all our communications related to the operations of businesses in Puerto Rico. Our purpose is to offer you with up-to-date information concerning audit, tax, advisory and accounting matters that might have an impact on individuals or in the way you conduct your business in Puerto Rico.

All our previous Alerts publications can be accessed in our webpage or you can also receive them by downloading our business and tax mobile application for free through the App Store or Google Play. We welcome your feedback at kgt@pr.gt.com

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Audit Alert: FASB posts highlights from May 24 meeting

June 14, 2017

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The FASB met on May 24 to discuss the results of staff research on the reporting performance and cash flows subtopics in Chapter 4 of the Invitation to Comment, Agenda Consultation. The discussions were educational and no decisions were made. All decisions reached at Board meetings are tentative and may be changed at future meetings. The Board also discussed the potential new projects summarized below.

Segment reporting
The Board discussed potential improvements to segment reporting related to the aggregation criteria and the disclosure requirements. The Board asked the staff to consult with financial statement preparers to better understand their segment reporting processes as well as the impact of narrow-scope improvements to these areas.

Performance statement – structure and disaggregation
The Board discussed alternatives to operating performance measures related to the structure of the income statement, and asked the staff to further study developing an operating performance measure.

The Board also asked the staff to research operating income measures used by both financial entities and nonfinancial entities and to determine which items are currently being included and excluded from those measures.

Alternative ways to require more disaggregation of performance information, through either presentation in the performance statement or disclosures related to the performance statement, were also discussed. The Board asked the staff to provide additional analysis on the following alternative approaches:

- to disaggregate functional lines into natural components
- to redefine infrequency of occurrence
- to define and separate remeasurements
- to describe the aggregation process

Cash flow statement – structure and classification

The Board discussed whether to revise the definitions of operating, investing, and financing activities, but requested no additional research on the topic.

Improvements to the classification guidance related to certain types of cash flows for which the existing guidance is either unclear or does not exist were also discussed, and the Board directed the staff to prepare an agenda request for a potential new project on targeted cash-flow classification improvements.

Articulation

The Board discussed how information was articulated in the financial statements and how improved presentation could make the interrelationships between the individual financial statements more apparent. The Board did not request that any additional work be performed on this subject, but stated that it might revisit this area, depending on the level of progress on the structure of the performance statement.

Source: Grant Thornton, *On the Horizon,* June 1, 2017.

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Percentage

Economy

Pie chart

Tax Alert: Governor Rosselló addresses Tax Reform on 2017-2018 budget

June 15, 2017

On May 31, 2017, the Governor of Puerto Rico, Ricardo Rosselló, presented the legislature with his administration's budget for the Fiscal Year 2017-2018 – the first to fall within the Fiscal Oversight Board's purview.

Besides touting its formulation by employing zero-base budgeting (see Executive Order No. 2017-005), and enumerating the various fiscal decisions that have been taken to comply with the Board's requests and safeguard the population's well-being, the current financial plan calls for an overhaul of the current tax system in Puerto Rico. Namely, the Rosselló Administration is aiming to:

- provide tax relief to salaried individuals by reducing the effective tax rate and broadening the types of income;
  - A corollary of the tax rate decrease is that many salaried individuals – as well as self-employed individuals who chose so – will not need to file an Income Tax Return since their particular fiscal responsibility will be covered by the salary withholding at source;
- exempt from taxation the first $12,500 earned by a taxpayer;
- increase retirement benefits exemption from $15,000 to $25,000;
- establish a $100 credit per Dependent for taxpayers whose income does not exceed $80,000 (it does not state if it gross or net income)
- reduce the Special 4% Sales & Use Tax on Business to Business transactions to 2%.

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Although not mentioned during the address, the Administration is pushing for the evaluation, review and harmonization of the various Puerto Rico tax incentives acts into a single and comprehensive Tax Incentives Code. Such an endeavour would greatly assist towards the necessary (and much longed for) simplicity that efficient tax systems possess.

We will be attentive to the filing of the bill, and when this occurs we will provide you with more details.

Note: As highlighted in our July 1, 2016 Tax Alert, PROMESA seeks to provide Puerto Rico with fiscal and economic discipline through the creation of a control board, among other things. Virtually every fiscal decision by the Government of Puerto Rico will be made or approved by the Oversight Board created by PROMESA. On this regard, the board has authority to prevent the execution or enforcement of a contract, rule, executive order or regulation to the extent that it is inconsistent with the approved fiscal plan.

Please contact our Tax Department should additional information is required regarding this or any other tax issue. We will be glad to assist you.

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Advisory
Economy
Banking

Advisory Alert: The road to financial services deregulation

June 15, 2017

President Trump met with a group of community bankers in March 2017, and stressed the need to reduce the regulatory burden on financial institutions and indicated a desire to tailor regulations more to the size of banks.

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Whether the Trump administration can reverse or simply bend the regulatory trend that began with the 2008-2009 financial crisis and continued through the 2010 passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) remains to be seen. However, the President's stated aims and the levers available to the administration and Congress clearly indicate that some degree of financial deregulation is forthcoming.

One lever is President Trump's executive order to all regulatory agencies to eliminate two existing rules or regulations for every new one they implement. This January 30, 2017, order could be quite effective in agencies with numerous rules and regulations, such as the Federal Reserve, FDIC, Office of the Comptroller of the Currency (OCC) and Security and Exchange Commission (SEC). Acting on this directive could be more difficult at agencies with relatively few rules, such as the Consumer Financial Protection Bureau (CFPB).

Another lever is the President's February 24, 2017, executive order calling for a regulatory reform task force and regulatory reform officer within each federal agency. This order directs every federal agency to establish a task force to research all regulations and reduce those deemed burdensome to the U.S. economy. It also calls for designating a regulatory reform officer in each agency within 60 days and issuing a progress report within 90 days.

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Perhaps the most powerful lever is the President's ability to appoint regulatory agency leaders, including, potentially, individuals from the financial services industry who will share his appetite for deregulation. With many senior-level vacancies at agencies such as the Federal Reserve, U.S. Treasury Department, OCC and the SEC, and the head of several key agencies such as the FDIC nearing the ends of theirs terms, the administration should have ample opportunity to appoint new leaders. New leadership brings the prospect of relatively quick change in the agency's approach to supervision of the financial services industry. If the President's appointees to date can be taken as indicative, those new leaders can be expected to be businesspeople willing to initiate vigorous change in the priorities and even missions of their agencies, with the goal of decreasing federal involvement in business operations and providing substantial regulatory relief.

Also powerful is the ability of Congress, in concert with the President, to set regulatory agency budgets or impose hiring freezes, which directly affect staffing and other resources and thus an agency's supervisory activities. For example, although bank examinations are mandated, limited resources may lead to limited-scope examinations.

Finally, an agency can decide if it wants to adopt or implement rules that have been proposed but not yet enacted. Three major rules that have been proposed, but which may not be adopted or could be delayed or subject to revisions, include the Incentive Compensation Rule, the Net Stable Funding Ratio rule and the Department of Labor's Fiduciary Rule. (The latter has been issued, but at this point it appears that it will not be implemented.) While this lever does not reduce existing regulation, it does forestall further regulation and eliminates the need for institutions to comply with rules they may have been expecting.

These levers, employed in an atmosphere in which regulatory rollback has broad political and industry support, can almost certainly enable some level of deregulation. Yet deregulation has been driven by laws passed by Congress. Those laws have been translated into rules and regulations by the relevant agencies, with public comment from the industry, consumer groups and other stakeholders. Those laws may not be easily rolled back. In addition, they have arguably generated benefits, and much of the industry has learned to live with the current levels of regulation.

So, what can be expected?

Paving the way

For a window on priorities and possible outcomes of deregulation, we can turn to legislation recently reintroduced by Chairman of the House Financial Services Committee Rep. Jeb Hensarling (R-TX) — H.R. 10, the Financial CHOICE Act, in which CHOICE stands for Creating Hope and Opportunity for Investors, Consumers and Entrepreneurs.

Conceived as an amendment to the Dodd-Frank Act, the bill provides the best indicator of Republican plans for deregulation. It would:

- repeal the Volcker rule, which restricts banks from making certain speculative investments
- eliminate the FDIC's Orderly Liquidation Authority and establish new provisions regarding financial institution bankruptcy
- restructure the CFPB and limit its authority to take action against entities for abusive practices
- repeal the Durbin Amendment, which limits the fees that may be charged to retailers for debit card processing
- eliminate the Office of Financial Research within the Department of the Treasury
- revise provisions related to capital formation, insurance regulation, community financial institutions and civil penalties for securities laws violations.

This bill would also enable banks to elect to become eligible for certain relief from current regulatory requirements and be deemed well-capitalized for purposes of corrective action if the institution: (a) maintains a leverage ratio of at least 10% and (b) has a composite CAMELS rating of 1 or 2.

Even without legislation along these lines, the above-noted levers could, in effect, bring about some of these changes to varying degrees. Changes in agency leadership and priorities could, for example, increase the threshold for Dodd-Frank Act stress testing from the current $10 billion in assets to $25 billion or $50 billion. Similarly, the asset threshold for compliance examination authority for banks by the CFPB could be raised. Changes short of new legislation could also temper the more intrusive forms of supervision, such as multitier examinations by the Federal Reserve, the FDIC and the OCC.

Of course, a rollback in regulations will affect various institutions differently. The leadership at each institution must therefore carefully monitor developments and consider the likely impact of any specific steps toward deregulation.

The road ahead

Although financial and economic performance has varied among institutions and regions, the industry is poised for deregulation at a time when it has, overall, registered record profits and the U.S. economy is in its eighth year of expansion. While the costs and compliance burdens have been enormous, financial institutions have clearly realized benefits. Among the most important of these have been enhanced risk management and governance, improved risk-based decision-making, and adoption of less risky business models.

To the extent that these regulatory byproducts have benefitted institutions and their stakeholders, they might be retained. Indeed, with a reduction in the associated compliance and reporting burdens, they may become downright attractive. As regulatory demands proliferated, well-managed institutions worked hard and invested much to achieve operational, process and internal reporting enhancements while pursuing compliance. Those institutions have probably experienced the greatest operational and risk-related benefits as a result of their compliance efforts.

For example, consider the value protected and generated at financial institutions that have:

- established chief risk officers and enterprise-wide risk management functions
- enhanced their risk governance, risk cultures and tone at the top
- bolstered the three lines of defense in risk management and internal audit's risk-related role
- improved the quality of, and access to, risk-related data and monitoring of risk appetite, tolerances and profile
- enhanced risk-based decision-making capabilities and recognized operational risks that extend beyond those they have long been managing.

In addition, any road to deregulation will pass through a challenging risk landscape. Since 2010, cyber threats have skyrocketed with the proliferation of devices, payment mechanisms and online banking. Conduct risk — a term virtually unheard of before the crisis — has been recognized as a threat from within organizations and third parties. Both cyber and conduct risk events regularly make headlines, contributing to reputation risk (another new term).

Reliance on third parties has intensified in financial services, with the adoption of data warehouses, cloud computing and software as a service. Many third-party relationships in banking are now rooted in fintech — technology-enabled financial services. As institutions consider fintech opportunities and threats, they need methods for assessing and managing both, particularly when doing business with third parties in this rapidly evolving industry.

Financial services regulations, for all their detail, tend to address actual risk at fairly high levels — capital adequacy, risk disclosures and board practices — leaving institutions to manage their specific risks as they see fit. Therefore, institutions that have enhanced their risk management infrastructures and practices might think deeply before dismantling them or re-risking their institutions.

Moreover, given the disruption and change we've seen in financial services and politics, it is all too likely that another change in direction — perhaps toward re-regulation — may occur at some point in the not-too-distant future. While complying with regulatory demands that cease to exist would be wasteful, it may be equally wasteful to dismantle the risk management and governance infrastructures that have come about as a result.

Source: https://www.grantthornton.com/library/articles/financial-services/2017/BK/road-to-financial-services-deregulation.aspx

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People

Checklist

Operational excellence

Outsourcing Alert: State Insurance Fund – annual payroll statement

June 19, 2017

It is the duty of every employer to his/her employees against all work-related injuries, illnesses or death with the Puerto Rico State Insurance Fund Corporation (CFSE) Worker's Insurance.

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Annual payroll statement - next due date

The Annual Payroll Statement (Form FSE 693) must be filed with the CFSE on or before July 20, 2017. The same must show the number of employees, occupation or industry classification and the respective total amount of wages paid during the immediately preceding fiscal year ended June 30.

Employers should be receiving the Annual Payroll Statement by mail during the next month. Also, the statement can be completed and filed through the CFSE internet portal. Please note that tax payments are due regardless of this website's availability.

Filing changes

Employers must provide with the Payroll Statement one of the following documents:

- Quarterly Unemployment & Disability Insurance Tax Report submitted to the Department of Labor for the quarters of September 2016, December 2016, March 2017 and June 2017.
- Employer's Quarterly Return of Income Tax Withheld for the quarters of September 2016, December 2016, March 2017 and June 2017.
- Employer's Quarterly Federal Tax Return (Form 941) for the quarters of September 2016, December 2016, March 2017 and June 2017.

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Access the CFSE link for Internet Portal http://web.fondopr.com/es/transacciones-linea

If the employer submits the Payroll Statement using the CFSE Internet Portal, will have an access to upload the require documents. If the information requested is not provided, the employer recognizes and accepts that the CFSE could make the necessary arrangements to obtain the information and make any premium adjustments.

These requirements do not apply to employers whose policies only cover domestic activities.

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