

Tax and A&A

# ACCOUNTING STANDARDS UPDATE

Presented By:

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# REVENUE RECOGNITION

## › Core Principle

Recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

## » Effective Date

Effective date of ASC 606	Calendar year end entities	June 30 year end entities
Public entities*, quarter and year beginning...	January 1, 2018	July 1, 2018
Other entities, year ending...	December 31, 2019	June 30, 2020
Early adoption of ASC 606		
Allowed for both public entities and other entities...	As early as January 1, 2017	As early as July 1, 2017

## › AICPA Task Forces

- Aerospace and defense
- Airlines
- Asset management
- Broker-dealers
- Construction contractors
- Depository institutions
- Gaming
- Health care
- Hospitality
- Insurance
- Not-for-profit
- Oil and gas
- Power and utility
- Telecommunications
- Software
- Timeshare

## › Scope

- All revenue-generating contracts with customers are within the scope of ASC 606, except for:
  - Leases
  - Contracts within the scope of ASC 944 (insurance)
  - Various contractual rights or obligations related to financial instruments
  - Guarantees other than warranties
  - Certain non-monetary exchanges

# Key Steps



# » Early and Public Company Adopters – What We Have Learned

- Financial statement impacts
  - Some industries more than others
  - Do not appear overly material
- Trigger issues
  - Multiple obligations
  - Variable consideration
  - Right of return
  - Custom manufacturing
  - Agent vs. principal

## › Transition Methods

- **Entities may choose to apply one of the following transition methods:**
- Full retrospective application of ASC 606 to all periods presented
  - Several practical expedients provided
- Modified retrospective application as of the date of initial application of ASC 606

## ➤ Full Retrospective Transition Method

- **Full retrospective application to all periods presented**
- Practical expedients
  - One or more of the four provided may be elected
  - Consistent application of each one elected to all contracts in all reporting periods presented is required
  - If one or more are elected, incremental disclosures are required
- With limited exceptions, the disclosures in ASC 250 related to a change in accounting principle are required

## ➤ Modified Retrospective Transition Method

- **Recognition of a cumulative effect adjustment as of the date of initial application**
- **Prior periods are not adjusted**
- Date of initial application is the first day in the period of adoption
  - **January 1, 2019 for a calendar year end non-public entity that does not early adopt – adjustment basically at December 31, 2019**
- ASC 606 may be applied to either:
  - (a) all contracts at the date of initial application
  - (b) only contracts not completed at the date of initial application
    - Must disclose which approach was taken

# PRACTICAL EXPEDIENTS NON PUBLIC ENTITIES

# › Accounting Practical Expedients or Policy Election

- ***Significant financing component (ASC 606-10-32-18):*** An entity does not need to adjust the promised amount of consideration for the effects of a significant financing component if it expects, at contract inception, that the period between the entity's transfer of a promised good or service to a customer and the customer's payment for that good or services will be one year or less
- ***Sales taxes (ASC 606-10-32-2A):*** An entity may elect to exclude from its transaction price any amounts collected from customers for all sales (and other similar) taxes – **policy election**

# › Accounting Practical Expedients

- ***Costs of obtaining a contract (ASC 340-40-25-4)***: An entity “may recognize the incremental costs of obtaining a contract as an expense when incurred if the amortization period of the asset that the entity otherwise would have recognized is one year or less”
- ***Shipping and handling (ASC 606-10-25-18B)***: An entity may elect to account for shipping and handling activities that occur after control of the related good transfers as fulfillment activities instead of assessing such activities as performance obligations – **policy election**

## ➤ Accounting Practical Expedients

- ***Portfolio approach (ASC 606-10-10-4):*** An entity may apply the new revenue standard to a portfolio of contracts (or performance obligations) with similar characteristics if it reasonably expects that the effects on the financial statements of applying this guidance to the portfolio would not differ materially from applying this guidance to the individual contracts (or performance obligations) within that portfolio

## › Accounting Practical Expedients

- ***Right to invoice (ASC 606-10-55-18):*** For performance obligations satisfied over time, if an entity has a right to consideration from a customer in an amount that corresponds directly with the value to the customer of the entity's performance complete to date (for example, a service contract in which an entity bills a fixed amount for each hour of services provided), the entity may recognize revenue in the amount to which the entity has a right to invoice

# › Revenue Recognition

## **RKL Client Revenue Recognition Guidance - 2019**

### **Five Steps**

1. Contract
2. Performance
3. Price
4. Price Allocation
5. Recorded – point in time – over time

# › Revenue Recognition

## **RKL Client Revenue Recognition Guidance - 2019**

### **Using a number of tools:**

- RKL questionnaire
- RSM questionnaire
- RSM whitepaper
- Interviews/discussions
- Existing RKL knowledge of client
- Focus on key issues

# › Revenue Recognition

## **RKL Client Revenue Recognition Guidance - 2019**

### **Building a company narrative:**

- Covering the five steps
- Policy adoptions
- Practical expedients
- Client's conclusions

# › Revenue Recognition

## **RKL Client Revenue Recognition Guidance - 2019**

### **Focusing on certain issues**

- Multiple deliverables
- Variable consideration
- Right of return
- Custom manufacturing
- Warranties
- Point in time vs. over time recognition
- Agent vs. Principal

# › Revenue Recognition

## **RKL Client Revenue Recognition Guidance - 2019**

### **Practical Expedients**

- Shipping
- Sales tax
- Portfolio approach
- Costs to obtain contract
- Financing components
- Disclosures

# THE NEW LEASE ACCOUNTING STANDARD

# » Why is the new lease standard & what are some potential major impacts?

- **Why?** - The Financial Accounting Standards Board (FASB) felt that the previous leasing guidance did not meet the needs of users of financial statements because it did not always provide a faithful representation of leasing transactions. In particular, **it did not require lessees to present assets and liabilities arising from operating lease activities.**
- **Potential major impacts**
  - Most common operating leases will be added to the balance sheet as an asset and liability
  - Impact to financing covenants, historical financial metrics and other business documents that might reference Generally Accepted Accounting Principle (GAAP) financials

# ➤ Introduction

## Current Environment

- Operating leases not recognized on the balance sheet
  - Most leases are off-balance-sheet but disclosed in footnotes
  - Existing GAAP contains two very different accounting outcomes for economically similar transactions
- Users seeking transparency & comparability
  - Structured transactions
  - Inconsistent “add-backs” in the creditor & investor community for off-balance-sheet leases
  - Financing and leverage comparisons between similar firms

# › Introduction

## Financial Statement Impact

- Lessees are **required** to recognize lease assets and lease liabilities on the balance sheet for all leases with terms **longer than 12 months**. Lease terms of 12 months or less at commencement that do not include an option for the lessee to purchase the underlying asset that is reasonably certain to be exercised will continue to be expensed as incurred.
- Classified as either **finance** or **operating** (classification affects pattern of expense recognition in income statement)

# ➤ Introduction

## Effective Date, Scope & Transition

- Effective date will be for year ends **beginning** after December 15, 2019 for private companies (12/31/2020 year-ends); one year earlier for public business entities
- Early adoption is permitted

# ➤ Introduction

## **Effective Date, Scope & Transition** (continued)

- Will apply to all applicable leases existing at “the beginning of the first comparative period” present upon adoption
  - No grandfathering of existing leases
- Transition of existing leases
  - Existing operating leases remain operating leases
  - Existing capital leases become finance leases

# ➤ Lease Identification & Classification

## Lease Classification

### Finance or Operating?

#### FINANCE lease if ONE of the following applies:

- 1 - The lease transfers ownership of the underlying asset to the lessee by the end of the lease term.
- 2 - The lease grants the lessee an option to purchase the underlying asset that the lessee is reasonably certain to exercise
- 3 - The lease term is for the major part of the remaining economic life of the underlying asset

# ➤ Lease Identification & Classification

## Lease Classification

### Finance (continued):

**4** - Net present value of the lease payments in substantially all of the fair value of the underlying asset

**5** - The underlying asset is of such a specialized nature that it is expected to have no alternative use to the lessor at the end of the lease term

### Operating:

- When **1** through **5** are not met, a lessee will classify the lease as an Operating lease.

## › Lessee Accounting

**At commencement, lessee's record ALL leases as follows (Finance and Operating):**

- Recognize right-of-use (ROU) asset
- Record a lease liability for future rental payments

# › Lessee Accounting

**Measure BOTH the asset and the liability at present value (PV) of future lease payments,**

- Based on both lease term and lease payments
- Discount at implicit interest rate within the lease:
  - If implicit rate is not readily determinable the lessee could use its incremental borrowing rate (the rate the company would incur for a similar debt instrument and related terms)
  - Lessees that are **not public entities** could make an accounting policy election and elect to use the **risk-free rate** - using a period similar to the lease term

# › Lessee Accounting

## Two Elements Form the Basis for PV of Future Lease Payments:

### Lease Term:

- Periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option
- Periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option
- Periods covered by an option to extend (or not to terminate) the lease in which exercise of the option is controlled by the lessor.  
(assume the lessor will not cancel the lease)

# › Lessee Accounting

## **Lease Payments Include:**

- Fixed payments
- Variable lease payments that depend on an index or a rate
- The exercise price of an option to purchase the underlying asset if the lessee is reasonably certain to exercise that option

## › Lessee Accounting

### **Lease Payments Include** (continued):

- Payments for penalties for terminating the lease
- Fees paid by the lessee to the owners of a special-purpose entity for structuring the transaction
- For a lessee only, amounts **probable** of being owed by the lessee under residual value guarantees

# › Lessee Accounting

## Subsequent Accounting For Finance Leases

### Amortize ROU Asset

- **Method:** straight-line basis, unless another basis is more representative
- **Period:** shorter of the estimated lease term or underlying asset's useful life

### Separately Reflect in the Income Statement:

- Interest expense component of the lease liability
- Amortization of ROU asset
- Variable lease payments incurred after commencement (that were not included in the original lease asset/liability)

# › Lessee Accounting

## Subsequent Accounting For Operating Leases

### Amortize ROU Asset

- Difference between periodic lease cost and effective interest on lease liability
  - i.e. asset amortization is a “backed into amount”
- Reflect a single lease cost on the income statement
  - Combine effective interest on lease liability with amortization of ROU asset, so the remaining cost of the lease is allocated over the remaining lease term on straight-line basis

# › Lessee Accounting

## **What you need to do now**

- Understand the standard
- Build a lease data base
  - By lease
  - Term (may need to develop a policy)
  - Payments (as defined by the standard)
  - Understand implicit interest rate

# › Lessee Accounting

## **RKL Client Assistance**

- Educating clients
- Educating bankers
- Developing spreadsheets to assist data collection – release first quarter 2019
- Researching software – recommendation expected by June 30, 2019
  - Client use
  - RKL outsourced

# BUSINESS COMBINATIONS

# › Business Combinations

## **ASU 2014-02 Intangibles Goodwill and Other**

- **Private companies only**
- Effective years beginning after 12/15/14
- Ability to amortize goodwill over 10 years (Potentially less)
- No need for impairment test (unless a triggering event occurs)

# › Business Combinations

## **ASU 2014-18 Accounting for Identifiable Intangible Assets**

- **Private companies only**
- Effective years beginning after 12/15/15
- No need to recognize customer related or non-compete agreements
- They are included in goodwill
- If elected, you must amortize goodwill

# › Business Combinations

## ASU 2015-16 Simplifying the Accounting for Measurement Adjustments

- Effective years beginning after 12/15/2015 (public), 12/15/2016 (private)
- Early adoption allowed
- Prior guidance required restatement of prior periods for provisional amounts when measurements were incomplete at year end (*for instance, measurement of intangible*) as long as that information is obtained within one year of the measurement date (*transaction date*)

# › Business Combinations

## ASU 2015-16 Simplifying the Accounting for Measurement Adjustments

- New guidance allows those adjustments to be run through the current year (changes to balance sheet items and updated amortization amounts, etc.)
- **New guidance still requires any new information after one year or information not known at time of measurement that changes measurement assets be all recognized through the income statement**

# › Business Combinations

## **ASU 2017-01 Clarifying Definition of a Business**

- All companies
- Effective years beginning after 12/15/17 (public), 12/15/18 (private)
- Early adoption is permitted

# › Business Combinations

## ASU 2017-01 Clarifying Definition of a Business

- FASB believes too many transactions being classified as business purchase
- **Premise:** If substantially all the value of the gross assets acquired is concentrated in a single or group of similar assets the acquisition is not an acquisition of a “business”
  - It is an “asset purchase”

# › Business Combinations

## **ASU 2017-01 Clarifying Definition of a Business**

### **Asset Purchase Accounting**

- Purchase price equals price paid plus transaction costs
- Must value potentially recognize intangibles such as:
  - Assembled workforce and others
- No goodwill or bargain purchase can be recognized in an asset purchase

# › Business Combinations

## **ASU 2017-04 Intangibles – Goodwill and Other**

- Simplified impairment test
- Effective years beginning after 12/15/19 (public), 12/15/21 (private)
- Early adoption allowed
- One step test if fair value of entity is less than carrying value of entity, charge goes directly to goodwill, limited to goodwill amount
- If private companies have elected to amortize goodwill impairment only tested upon a “triggering event”

# › Business Combinations

## **ASU 2018-17 Consolidation: Targeted Improvements to Related Party Guidance of Variable Interest Entities**

- **Private companies only**
- Effective for fiscal years beginning after 12/15/20
- Early adoption allowed
- Previous ASU 2014-07 allowed private companies an exclusion for common control leasing arrangements
- This ASU expands this exclusion to potentially all common control arrangements
- Back to voting model

# FINANCIAL INSTRUMENTS

# › Financial Instruments

## **ASU 2016-01 Financial Instruments – Recognition and Measurement**

- Effective years beginning after 12/15/17 (public), 12/15/18 (private)
- Private can early elect the provision that eliminates the fair value disclosures of financial instruments not recognized at fair value
- Does not apply to certain entities:
  - Broker/dealers
  - Defined benefit plans and post retirement plans
  - Investment companies

# › Financial Instruments

## ASU 2016-01 Financial Instruments – Recognition and Measurements

### Key Elements:

- Does not change guidance relative to measuring investments in debt securities or loans
- **Equity investments – unrealized gains and losses go through net income (no AFS)**
- Excludes equity investments accounted for using the equity method of accounting (typically 20% to 50% ownership)
- Opt out for equity investments without readily determinable fair values based on cost, less impairment
- Eliminates the fair value disclosures of financial instruments not recognized at fair value for nonpublic entities

# ASU 2016 -13 Financial Instruments: Measurement of Credit Losses on Financial Instruments

FASB released proposal December 2012

CECL = Current Expected Credit Loss

What's changed from Incurred Loss Model?

1. **Forward-looking requirements** - The proposal requires that forward looking information and forecasts are considered for the estimation of credit losses. This is a critical change from the current model's reliance on "incurred" losses to estimate loss rates.
2. **"Probable loss" threshold removed** - The "probable" threshold for loss recognition used in the current guidance is removed, leaving institutions to evaluate whether or not a loss exists **at that time for the financial asset**. The removal of this threshold could accelerate the timing for when institutions are required to recognize impairment.

# ASU 2016 -13 Financial Instruments: Measurement of Credit Losses on Financial Instruments

What's changed from Incurred Loss Model? (continued)

3. **Need for accessible, loan-level data**
4. **Longer loss horizon - Loss estimates would use the lifetime of the credit instrument as the time horizon as opposed to the next 12-month period.** These forecasted estimates will need to be defensible which could be particularly challenging for longer-term loans.
5. **Makes ALL more institution-wide calculation – not just accounting anymore**

## › CECL

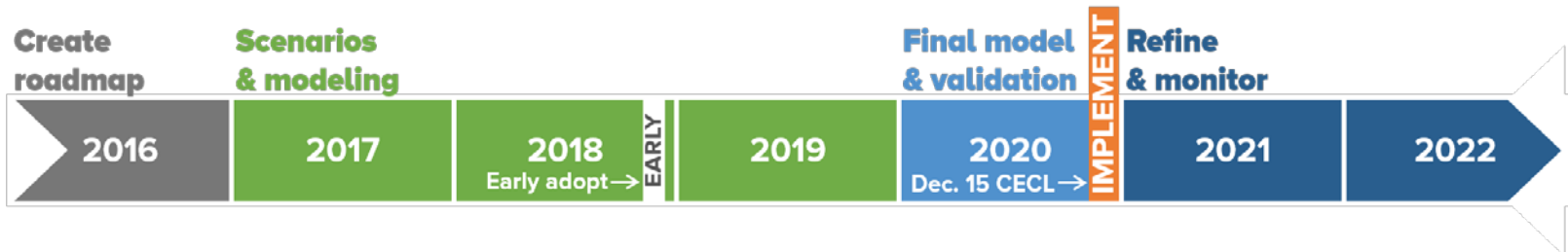
- Relates mainly to financial institutions (loans)
- Commercial and other entities – accounts receivable

# CECL Implementation Timelines

## 1. SEC Filing Institutions.



## 2. Non-SEC Filing Public Business Entities.



## 3. All Other Entities + Not-For-Profit Organizations.



# DEFERRED TAXES

## › Deferred Taxes

### **ASU 2015-07 Balance Sheet Classification of Deferred Taxes**

- Effective years beginning after 12/15/16 (public), 12/15/17 (private)
- Early adoption is allowed

## › Deferred Taxes

### **ASU 2015-07 Balance Sheet Classification of Deferred Taxes**

- Deferred taxes assets/liabilities classified as long term
- Only allowed to offset assets/liabilities within jurisdictions
- Could impact working capital (i.e. large “current” NOL)

NOT-FOR-PROFIT

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**ASU 2016-14  
PRESENTATION OF  
FINANCIAL STATEMENTS OF  
NOT-FOR-PROFIT ENTITIES**

## › Effective Dates

- Fiscal years beginning after December 15, 2017 (**December 31, 2018** or fiscal 2019 year ends)
- Interim financials for the following year
- Early adoption is permitted, but must apply the regular transition provisions

# › Transition Guidance

- In the year of adoption, apply all provisions retrospectively
- For comparative presentations, option to omit the following for the periods presented before the period of adoption:
  - Analysis of expenses by nature and function (except for Voluntary Health and Welfare Entities that are required under current GAAP to present Statement of Functional Expenses), and/or
  - Disclosures around liquidity and availability of resources
- Disclose the nature of any reclassifications or restatements and their effects, if any, on changes in the net asset classes for each period presented

# ➤ Primary Changes in the New ASU

- **Net Asset Classifications**
- Underwater Endowment Funds
- Placed in Service Approach for Reporting Expirations of Restrictions on Gifts for Acquisition of Long-Lived Assets
- **Liquidity and Availability of Resources**
- **Expense Reporting**
- **Investment Return**
- Statement of Cash Flows

# ➤ Change in Asset Classifications

## Current Presentation (Three Classes):



## New Presentation (Two Classes):



# › Liquidity and Availability of Resources

## “Liquidity” Disclosure:

- Qualitative information in the notes that is useful in assessing an entity’s liquidity and communicates how an NFP **manages its liquid resources** available to meet cash needs for general expenditures within one year.

## “Availability” Disclosure:

- Quantitative information either on the face of the statement of financial position or in the notes, and additional qualitative information as necessary, that communicates the **availability of an NFP’s financial assets** at the date of the statement of financial position to meet cash needs for **general expenditures within one year**.

# » Disclosure Example

## Note 5 – Information and Liquidity

The organization manages its liquidity by managing its working capital and having available a line of credit with a bank.

The following table reflects the organization's financial assets as of the balance sheet dates, reduced by amounts not available for general use because of contractual or donor-imposed restrictions within one year of the balance sheet date.

	20X2	20X1
Cash and cash equivalents	\$ 35,000	\$ 25,000
Investments	500,000	450,000
Accounts receivable	50,000	55,000
Total financial assets	585,000	530,000
Less amounts that are internally designated or externally restricted:		
Board-designated endowment	(150,000)	(140,000)
Donor restricted for specific purpose	(75,000)	(80,000)
Financial assets available to meet cash needs for general expenditures within one year	<u>\$ 360,000</u>	<u>\$ 310,000</u>

# › Expense Reporting

- **Required to present amounts of expenses by function and natural classification in one location**
  - May be presented on the face of the statement of activities, as a separate statement or in the notes
  - Voluntary Health & Welfare entities no longer required to prepare separate statement – ASU applies to all NFPs and requirement is for one of the methods noted above
- Include a **description of the method used to allocate costs** among program and support functions
- Disaggregate functional expense classifications by their natural expense classifications
- Improved guidance about management and general expenses

# › Investment Return

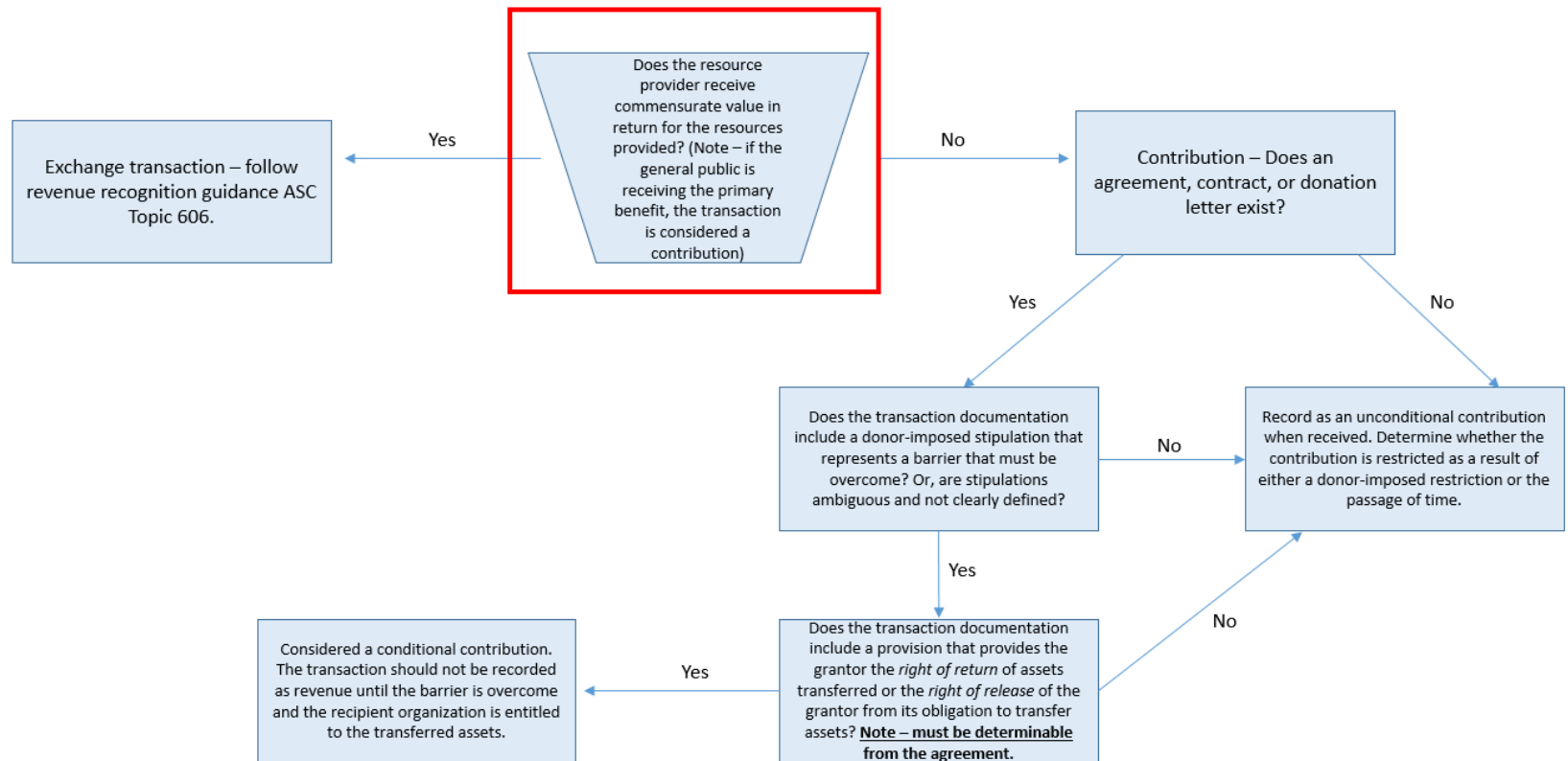
- Investment return reported net of external and direct internal investment expenses
- No longer required to disclose netted expenses
- Does not apply to programmatic investments
  - The activity of making loans or other investments that are directed at carrying out a not-for-profit entity's purpose for existence rather than investing in the general production of income or appreciation of an asset (for example, total return investing)
  - Example of programmatic investing would be a loan made to lower-income individuals to promote home ownership

## ➤ ASU 2018-08

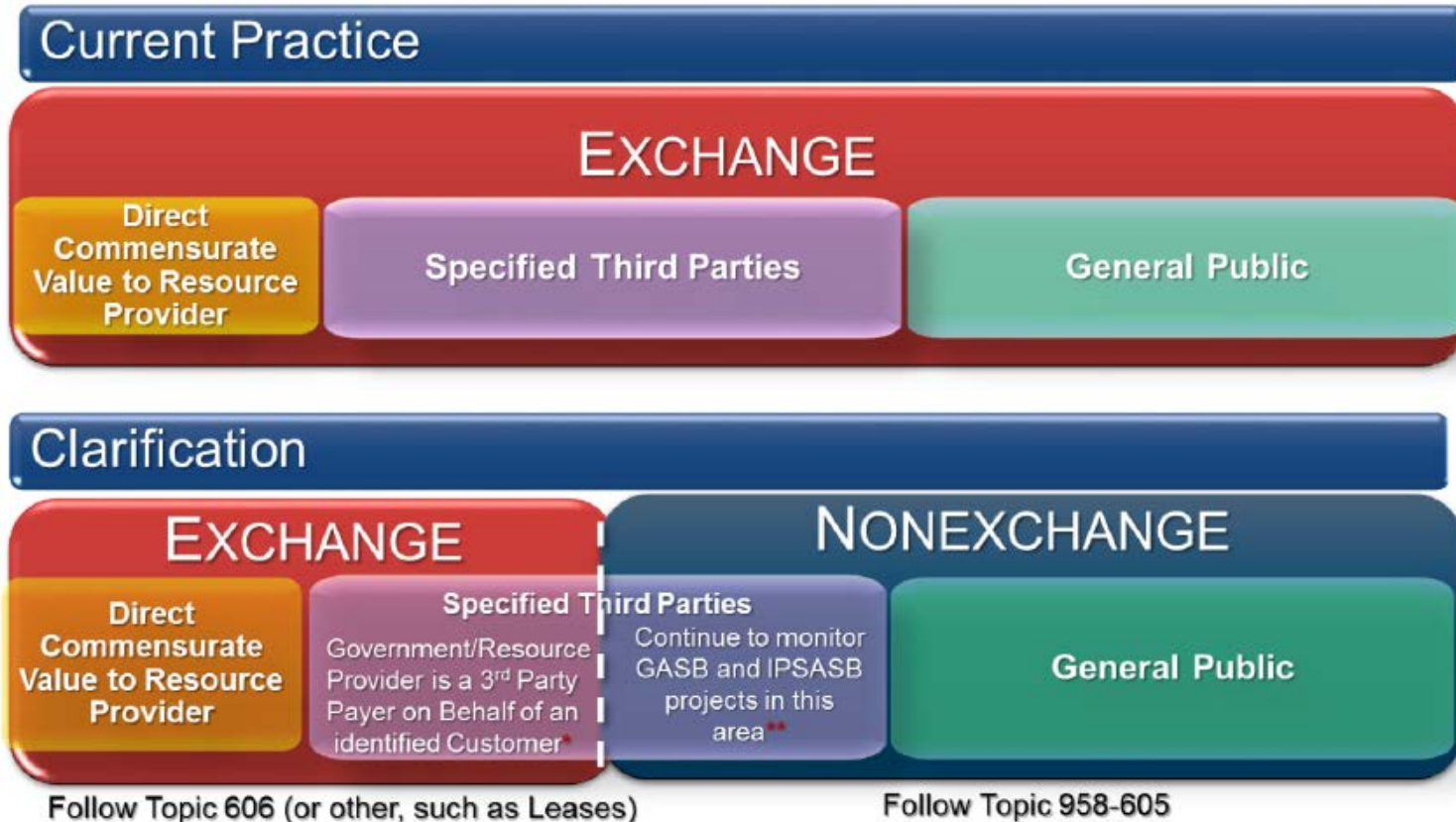
### ***ASU-2018-08, Clarifying the Scope and Accounting Guidance for Contributions Received and Contributions Made, finalized and released in June 2018***

- Applies to all entities that receive or make contributions
- Applies to both contributions received by a recipient and contributions made by a resource provider
- The term used in the presentation of financial statements to label revenue is not a factor in determining whether an agreement is within the scope of guidance

# ➤ NFP Revenue Recognition Decision Process



## ➤ Issue 1: Who Receives the Benefit?



## ➤ Issue 1: Who Receives the Benefit?

- The resource provider is **not** synonymous with the general public, even a governmental entity. If a resource provider receives value indirectly by providing a societal benefit, this would be considered a nonreciprocal (or non-exchange) transaction.
- If the primary beneficiary of a grant or contribution is a third party, an NFP must use judgment to determine if the transaction is an exchange or non-exchange transaction.
- Furthering a resource provider's mission or "feel good" sentiment does not constitute commensurate value received.
- The type of resource provider should not override the substance of the transaction.

## ➤ Issue 2: Conditional vs. Unconditional Contributions

- For a donor-imposed condition to exist:
- A right of return/release must exist;

**AND**

- The agreement must include a barrier
  - Indicators include, but are not limited to, the following:
    - Inclusion of a measurable performance-related barrier.
    - Extent to which a stipulation limits discretion by the recipient on the conduct of an activity.
    - Extent to which a stipulation is related to the purpose of the agreement.

# Effective Date

Recipients*		Resource Providers	
<b>Annual periods beginning after June 15, 2018, including interim periods:</b> <ul style="list-style-type: none"> <li>Public Business Entities</li> <li>NFP that has issued, or is a conduit bond obligor for securities that are traded, listed, or quoted on exchange or an over-the-counter market.</li> </ul>	<b>Annual periods beginning after December 15, 2018, and interim periods beginning after December 15, 2019:</b> <ul style="list-style-type: none"> <li>All Other Entities</li> </ul>	<b>Annual periods beginning after December 15, 2018, including interim periods:</b> <ul style="list-style-type: none"> <li>Public Business Entities</li> <li>NFP that has issued, or is a conduit bond obligor for securities that are traded, listed, or quoted on exchange or an over-the-counter market.</li> </ul>	<b>Annual periods beginning after December 15, 2019, and interim periods beginning after December 15, 2020:</b> <ul style="list-style-type: none"> <li>All Other Entities</li> </ul>

*\*Effective dates generally the same as ASC 606. The Board delayed the effective date for public entities that are recipients, so as to avoid confusion about possible restatements. Early implementation is permitted*

*Obtained from AICPA Not-for-Profit Industry Conference*

# FOCUSED. ON YOU.

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