Tax and A&A

ACCOUNTING STANDARDS UPDATE

Presented By:

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REVENUE RECOGNITION

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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

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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.

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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

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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

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Key Steps

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What We Have Learned The Last Few Years

- Financial statement impacts
  - Some industries more than others
  - Probably immaterial
- Trigger issues
  - Multiple obligations
  - Variable consideration
  - Right of return
  - **Custom manufacturing**
  - Agent vs. principal

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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 – **probably preferred method**

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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

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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

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PRACTICAL EXPEDIENTS NON PUBLIC ENTITIES

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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**

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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**

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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

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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

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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

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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

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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

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Revenue Recognition

RKL Client Revenue Recognition Guidance - 2019

Practical Expedients

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

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Revenue Recognition

RKL Client Revenue Recognition Guidance - 2019

Building a company narrative:

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

Disclosures:

- Practical expedients for RKL clients
- RKL will review and discuss and assist in development

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THE NEW LEASE ACCOUNTING STANDARD

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Agenda

- Introduction
- Lease Identification and Classification
- Lessee Accounting

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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
    a. Operating lease
    b. Capital lease
- Users seeking transparency & comparability
  - **Structured transactions**
  - Inconsistent 'add-backs' in the creditor & investor community for off-balance-sheet leases
  - Financing & leverage comparisons between similar firms

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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).

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Introduction

Effective Date, Scope and Transition

- Effective Date will be for year ends **beginning** after December 15, 2020 for private companies (December 31, 2021 year-ends), just extended!
- Early adoption is permitted
- Some lease exceptions exist

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Introduction

Effective Date, Scope and 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
  - But ALL are recognized on the balance sheet

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Key Provisions

- Lease identification
- Classifying a lease
  - Financing or operating
- Accounting for leases - lessee
  - Initial & subsequent
- Presentation of leases - lessee

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Lease Identification and Classification

Lease Identification

At inception of a contract, an entity should determine whether the contract is or contains a lease

Lease Definition:

A contract, or part of a contract, that conveys the **right to control the use** of identified property, plant, or equipment (***an identified asset***) for a period of time in exchange for consideration

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Lease Identification and 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

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Lease Identification and Classification

Lease Classification (continued)

Finance

4 - Net present value of the lease payments is 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.

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Lessee Accounting

At commencement, lessees record ALL leases as follows (Finance and Operating):

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

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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

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Lessee Accounting

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

1. **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)

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Lessee Accounting

2) 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

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Lessee Accounting

2) 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

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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)

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Lessee Accounting

Subsequent Accounting (continued)

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

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Illustration – Financing Lease

Company enters three-year equipment leases on Jan 1, Year1; fixed payments as follows; implicit rate is 4.235%;
qualifies as financing lease

Payments		
Dec 31, Year1	$	10,000
Dec 31, Year2	$	12,000
Dec 31, Year3	$	14,000
	$	36,000
Implicit Rate		4.235%
Present value, Jan 1, Year1	$	33,000

Illustration – Financing Lease (continued)

		Debit	Credit
Lease Commencement:			
January 1, Year1		**Debit**	**Credit**
	Right of Use Asset	33,000	
	Lease liability		33,000
	Present value of lease payments at 4.235% discount rate		
First-year Accounting Entries:			
December 31, Year1		**Debit**	**Credit**
	Lease liability	8,602	
	Interest expense	1,398	
	Cash		10,000
	Amortization of lease liability per schedule		
	Amortization expense	11,000	
	Right of Use Asset		11,000
	Straight-line amortization of ROU asset, $33,000 / 3 years		

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Illustration – Operating Lease

Company enters three-year equipment leases on Jan 1, Year1; fixed payments as follows; implicit rate is 4.235%; **qualifies as operating lease**

Payments	
Dec 31, Year1	$ 10,000
Dec 31, Year2	$ 12,000
Dec 31, Year3	$ 14,000
	$ 36,000
Implicit Rate	4.235%
Present value, Jan 1, Year1	$ 33,000

Same fact pattern and calculations as financing illustration

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Illustration – Operating Lease (cont.)

Lease Commencement:			
January 1, 2020		**Debit**	**Credit**
	Right of Use Asset	33,000	
	Lease liability		33,000
First-year Accounting Entries			
December 31, 2020		**Debit**	**Credit**
	Lease liability	8,602	
	Cash		10,000
	Rent/lease expense	12,000*	
	Right of Use Asset		10,602

*** $36,000 ÷ 3 years = $12,000 a year**

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Leases – Transition

- **Method A –** Standard is applied retrospectively to each reporting period with a cumulative-effect adjustment recognized as of the beginning of the earliest period presented. Example: for a comparative December 31, 2021 and 2020 financial statement, the cumulative adjustment would be recorded as of January 1, 2020.
- **Method B** – Standard is applied to the beginning of the period of adoption through a cumulative-effect adjustment recognized as of the beginning of that period. Example: for a comparative December 31, 2021 and 2020 financial statement the cumulative adjustment would be recorded as of January 1, 2021.
- Consider single presentation and **Method B.**

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Leases – Questions for Your Entity

- Status of leasing project? (New accounting standard)
- Inventory of existing leases:
  - Population
  - Terms
- Use of leasing software?
  - Captures all leases
  - Calculates accounting entities
- RKL support

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GASB 87 - Leases

- Similar to ASC 842, except:
  - Effective date is for years beginning after December 15, 2019 – December 31, 2020 financial statements
  - Leases are classified as financing, there are no "operating" leases

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BUSINESS COMBINATIONS

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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)

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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

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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)*

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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**

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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

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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"

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Business Combinations

ASU 2017-01 Clarifying Definition of a Business

Asset Purchase Accounting

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

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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"

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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

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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

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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.

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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

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CECL

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

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CECL Implementation Timelines

- Large SEC filers (think Wells Fargo) – years beginning after December 15, 2019.
- Smaller reporting entities and private companies (think credit unions) year beginning after December 15, 2022.

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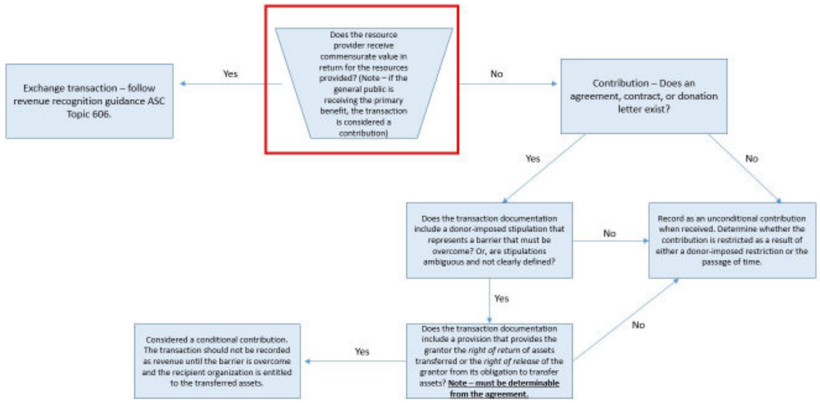
NON-PROFIT CONTRIBUTIONS

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



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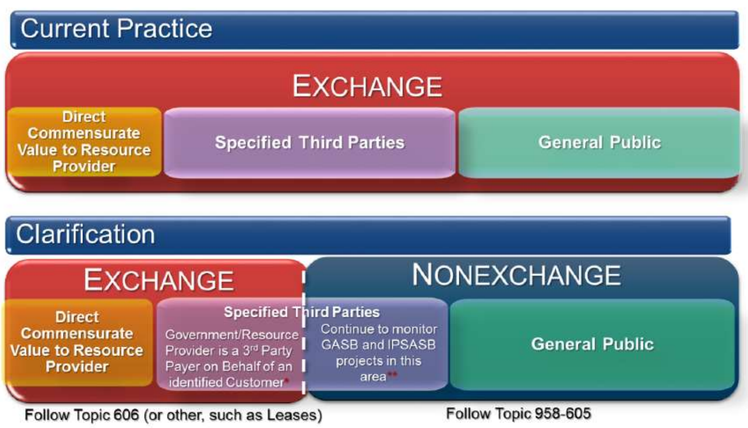
Issue 1: Who Receives the Benefit?



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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.

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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.

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Effective Date

Recipients*		Resource Providers	
Annual periods beginning after June 15, 2018, including interim periods: • Public Business Entities • 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.	**Annual periods beginning after December 15, 2018, and interim periods beginning after December 15, 2019:** • All Other Entities	**Annual periods beginning after December 15, 2018, including interim periods:** • Public Business Entities • 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.	**Annual periods beginning after December 15, 2019, and interim periods beginning after December 15, 2020:** • All Other Entities

**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

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INTERNAL USE SOFTWARE CLOUD COMPUTING ARRANGEMENTS

(AS A SERVICE)

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Internal Use Software

- Cloud computing – As a service
- Aligns accounting with existing internal use software accounting

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Internal Use Software

- Defines implementation costs that are to be capitalized or expensed
- Three stages:
  - Preliminary Project stage
  - Application Development stage
  - Post Implementation/Operation stage

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Internal Use Software

- Preliminary Project Stage (Expensed)
  - Conceptual formation of alternatives
  - Evaluation of alternatives
  - Determination of existence of needed technology
  - Final solution of alternatives

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Internal Use Software

- Application Development Stage (Capitalize)
  - Design of chosen path, including software configuration and software interfaces
  - Coding
  - Installation to hardware
  - Testing, including parallel processing phase
- Capitalize as a prepaid **NOT** an intangible

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Internal Use Software

- Post Implementation/Operation Stage (Expensed)
  - Training
  - Application maintenance

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Internal Use Software

- Effective for years beginning after December 15, 2020
- Early adoption allowed

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