Accounting and Audit Updates: Past, Present, and Future

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Learning objectives

- To provide information about recent accounting pronouncements to allow organizations to plan for changes in accounting which have not yet been implemented and be aware of those which took effect in 2020

Agenda

1 Recent accounting and reporting pronouncements that may impact your company

2 Q&A

Update

1

FASB ASU No. 2014-09, *Revenue from Contracts with Customers* (Topic 606)

Effective for annual periods beginning after December 15, 2019 for non-public business entities

2

FASB ASU No. 2021-03, *Intangibles – Goodwill and Other* (Topic 350)

Effective for annual periods beginning after December 15, 2019

ASU No. 2014 -09, Revenue from Contracts with Customers (Topic 606)

Following up on performance obligations…

Performance obligations are distinct if *both* the following conditions exist

- Customer can benefit from the good or service either on its own or with other resources that are readily available.
- Promise to transfer the good or service can be identified separately from other promises in the contract.

Indicators that 2 or more promises are not separately identifiable

- Entity performs significant integration services in which multiple goods and services are combined into a bundle that is the output for which the customer has contracted.
- At least one of the goods or services is significantly customized or modified by, or significantly modifies or customizes, other goods or services promised under the contract.
- The promised goods or services are significantly affected by other goods or services in the contract (they are highly interdependent or interrelated).

ASU No. 2014 -09, Revenue from Contracts with Customers (Topic 606)

- Subsequent accounting in the next year:
  - Revisiting estimates – for example, changes in variable transaction price
  - Contract modifications
  - Contract assets evaluated for impairment

- Resources available from the AICPA to review:
  - Audit and Accounting Guides – including for Construction Contractors and Investment Companies
  - Revenue Recognition Implementation Guide – includes guidance for Engineering and Construction Contractors, Software Entities, Telecommunications Entities, and Power and Utility Entities among other industries

Polling question

Did the transition to ASC 606 have a significant impact on your company's accounting policies?

ASU No. 2021-03, Goodwill (Topic 350), Accounting Alternative for Evaluating Triggering Events

The ASU “provides an accounting alternative expected to reduce the complexity for private companies and not-for-profit organizations when performing the goodwill triggering event evaluation.” Specifically, the ASU “allows private companies and not-for-profit organizations to perform a goodwill triggering event assessment, and any resulting test for goodwill impairment, as of the end of the reporting period, whether the reporting period is an interim or annual period.”

Happening now

1. FASB ASU No. 2018-15, *Intangibles—Goodwill and Other—Internal-Use Software* (Subtopic 350-40)
   Effective for annual periods beginning after December 15, 2020 for non-public business entities

2. FASB ASU No. 2018-17, *Consolidation* (Topic 810)
   Effective for annual periods beginning after December 15, 2020 for non-public business entities

3. SAS 134 – Auditor's reports
   Effective for annual periods ending on or after December 15, 2021

ASU No. 2018-15
Customer’s accounting for implementation costs incurred in a cloud computing arrangement that is a service contract

- ASU No. 2015-05, Customer’s Accounting for Fees Paid in a Cloud Computing Arrangement, provided guidance on accounting for the cost of a cloud computing arrangement…
  - If a software license is provided, capitalize the cost and amortize over the term
  - If the arrangement is a service contract, expense the cost
- Confusion arose over accounting for ancillary costs like internal labor, external contractors assisting with implementation and/or customization, data conversion, etc.

ASU No. 2018-15
Customer's accounting for implementation costs incurred in a cloud computing arrangement that is a service contract

- ASU 2018-15 requires use of ASC Subtopic 350-40, Internal-Use Software, which classifies ancillary costs into three categories based on project stages:
  - Costs in the preliminary project stage (prior to implementation) are expensed
  - Costs in the development stage are capitalized
  - Costs in the post-implementation stage are expensed

ASU No. 2018-17
Targeted improvements to related party guidance for variable interest entities

- Non-public business entities can elect to not apply rules for variable interest entities (VIEs), provided the VIE isn’t also a public business entity (PBE)
  - Prior to this rule being effective, there was another private company alternative that allowed an entity to not evaluate a lessor for consolidation under VIE rules as long as certain conditions were met.
- If elected, ASU 2018-17 must be applied to all commonly controlled non-PBE VIEs
- Certain disclosures required regarding the reporting entity’s involvement with the entity under common control and the associated financial risks.

SAS 134 – Auditor's Report

INDEPENDENT AUDITOR'S REPORT

Board of Directors
Sample Company, Inc.

Opinion **[Now at the beginning of the report.]**

We have audited the accompanying financial statements of Sample Company, Inc., which comprise the balance sheets as of December 31, 2021 and 2020, and the related statements of income, changes in stockholders' equity and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Sample Company, Inc. as of December 31, 2021 and 2020, and the results of its operations and its cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

Basis for Opinion **[Points out an auditor's ethical responsibilities.]**

We conducted our audits in accordance with U.S. generally accepted auditing standards. Our responsibility under those standards are further described in the Auditor's Responsibilities for the Audit of Financial Statements section of our report. We are required to be independent of Sample Company, Inc. and to meet our other ethical responsibilities in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements **["Going concern" responsibilities.]**

Management is responsible for the preparation and fair presentation of the financial statements in accordance with U.S. generally accepted accounting principles, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about Sample Company, Inc.'s ability to continue as a going concern within one year after the date that the financial statements are available to be issued.

Auditor's Responsibilities for the Audit of the Financial Statements **[Emphasis on professional judgment and professional skepticism, communications with the board.]**

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with generally accepted auditing standards (GAAS) will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of Sample Company, Inc.,'s internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about Sample Company, Inc.'s ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control related matters that we identified during the audit.

SAS No. 134 – Auditor's Report

Key Audit Matters [This optional segment is based upon the clients request to include, is new and is reported after the Basis for Opinion.]

Key audit matters are those matters that were communicated with those charged with governance and that, in our professional judgment, were of most significance in our audit of the financial statements for the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Add description of each key audit matter

Polling question

If your company issues audited financial statements – will you want the auditor to report on key audit matters?

Upcoming

1

FASB ASU No. 2016-02 and 2021-05, *Leases* (Topic 842)

Effective for annual periods beginning after December 15, 2021 for non-public business entities

2

FASB ASU No. 2017-04, *Intangibles – Goodwill and Other* (Topic 350)

Effective for annual or interim goodwill impairment tests in fiscal years beginning after December 15, 2022 for non-public business entities

3

FASB ASU No. 2018-14, *Compensation—Retirement Benefits—Defined Benefit Plans—General* (Subtopic 715-20)

Effective for annual periods beginning after December 15, 2021 for non-public business entities

4

FASB ASU No. 2019-12, *Income Taxes* (Topic 740)

Effective for annual periods beginning after December 15, 2021 for non-public business entities

5

FASB ASU No. 2020-04, *Reference Rate Reform* (Topic 848)

Effective as of March 12, 2020 through December 31, 2022

6

FASB ASU No. 2020-06, *Debt – Debt with Conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging – Contracts in Entity's Own Equity* (Subtopic 815-40)

Effective for annual periods beginning after December 15, 2023 for non-public business entities

7

FASB ASU No. 2021-04, *Issuer's Accounting for Certain Modifications or Exchanges of Freestanding Equity-Classified Written Call Options*

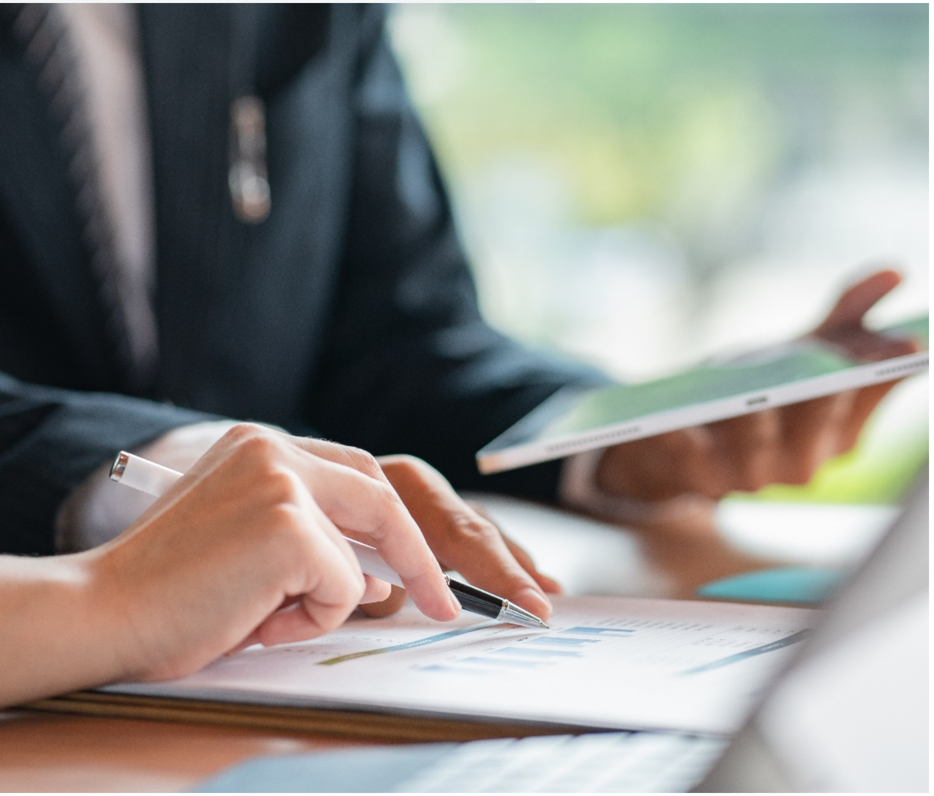
Effective for annual periods beginning after December 15, 2021

ASU No. 2016 –02 and ASU No. 2021–05
Leases (Topic 842)

> New FASB rules for reporting certain types of leases with variable payments has generated “extremely positive” response from solar and wind farms, many of which pushed for change, accounting practitioners said. The rules alleviate the burden of recording a day one loss upon lease commencement on profitable contracts.

ASU No. 2016 -02 and ASU No. 2021-05 *Leases* (Topic 842)

Take action now



- **Start** reviewing and evaluating early
- **Gather** documentation for all leases – keep in a centralized location
- **Assign** a lead person for the project
- **Take** inventory
- **Maintain** written policies on the thresholds to be used & any “reasonable” approaches to be used
- **Determine** accounting treatment for each lease
- **Start** reviewing impact to covenants and key performance indicators (KPI’s)
- **Talk** to bankers, stockholders, lenders
- **Apply** the policies consistently for all leases

ASU No. 2016 -02 and ASU No. 2021-05
Leases (Topic 842)

Balance Sheet

ASSETS

	Prior To Standard Change	Accounting Standard Impact to FS	After Standard Change
Current assets			
Cash	$ 10,000	$ -	$ 10,000
Accounts receivable	5,000	-	5,000
Inventory	5,000	-	5,000
Total current assets	20,000	$ -	20,000
Property and equipment, net	20,000	-	20,000
Right-of-use operating lease asset	-	**52,670**	**52,670**
Total assets	$ 40,000	$ 52,670	$ 92,670

LIABILITIES AND STOCKHOLDERS' EQUITY

	Prior To Standard Change	Accounting Standard Impact to FS	After Standard Change
Current liabilities			
Accounts payable	$ 7,500	$ -	$ 7,500
Current portion long-term debt	2,000	-	2,000
Current portion of right-of-use operating lease liability	-	**9,460**	**9,460**
Total current liabilities	9,500	9,460	18,960
Long-term debt, net of current portion	10,000	-	10,000
Long-term right-of-use lease obligation, net of current portion	-	**43,210**	**43,210**
Total liabilities	19,500	52,670	72,170
Shareholders' equity	20,500	-	20,500
Total liabilities and shareholders' equity	$ 40,000	$ 52,670	$ 92,670

Income Statement

	Prior To Standard Change	Accounting Standard Impact to FS	After Standard Change
Revenue	$ 120,000	$ -	$ 120,000
Cost of goods sold	70,000		70,000
Gross profit	50,000	$ -	50,000
Selling, general & administrative expenses	30,000	-	30,000
Lease expense	12,000	-	12,000
Depreciation expenses	5,000	-	5,000
Operating income	97,000	-	97,000
Interest expense	2,000	-	2,000
Net income	$ 194,000	$ -	$ 194,000

ASU No. 2016 -02 and ASU No. 2021-05 *Leases* (Topic 842)

KPI’s & Covenants

- Debt covenants may be affected materially if the operating lease liability will be considered debt
- Balance sheets will include a lease asset for operating leases
- Incentive compensation agreement
- KPI’s may have to be revised

Polling question

Has your company taken steps to either assess the impact of the new lease guidance or begin implementation?

ASU No. 2017-04, Intangibles – Goodwill and Other (Topic 350)

- The FASB issued this guidance to simplify accounting for goodwill.
- ELIMINATES Step 2 from the goodwill impairment test!
- Effective for annual or interim goodwill impairment tests in fiscal years beginning after December 15, 2021, early adoption is permitted.

ASU No. 2018-14 Compensation – Retirement Benefits – Defined Benefit Plans – General (Subtopic 715-20)

The following changes were made to disclosure requirements for non-public entities

- Disclosure requirements deleted:
  - Amounts in accumulated other comprehensive income (AOCI) that are expected to be recognized in expense next year.
- Disclosure requirements changed:
  - The Level 3 rollforward has been deleted, replaced with requirement to disclose transfers in and out of Level 3, and purchases of Level 3 assets.
  - When information for multiple plans is aggregated, the requirement to separate information for overfunded and underfunded plans has been clarified to provide that benefit obligations and plan assets should be disclosed for 1.) underfunded plans for which the projected benefit obligation exceeds plan assets, and 2.) underfunded plans for which the accumulated benefit obligation exceeds plan assets.
- Disclosure requirements added:
  - Weighted average interest crediting rates for plans that have such promised rates (i.e. cash balance plans).
  - Reasons for significant gains and losses related to the benefit obligation.

ASU No. 2019-12, Income Taxes

- This guidance removed the below exceptions from existing U.S. GAAP:
  - Exception to incremental approach for intra-period tax allocation
  - Exception to accounting for basis differences when there are ownership changes in foreign investments
  - Exception in interim-period income tax accounting for year-to-date losses that exceed anticipated losses
- This guidance makes the below simplifications to existing U.S. GAAP:
  - Determining how to apply income tax guidance to franchise taxes which are partially based on income
  - When a step up in the tax basis of goodwill occurs subsequent to a business combination
  - In the separate financial statements of a non-tax paying entity (i.e. a partnership or single member LLC) that files a consolidated return with a taxpaying entity, current and deferred income tax expense is not required to be allocated
  - Enacted changes in tax laws in interim periods

ASU No. 2020-04, Reference Rate Reform

Effective as of March 12, 2020 through December 31, 2022

- At the end of 2021, bank will no longer be required to report information that is used to determine London Inter-bank Offering Rate (LIBOR). As a result, LIBOR could be discontinued.
  - 1 week and two month periods will cease on December 31, 2021
  - 1, 3, 6 and 12 months will cease on June 30, 2023

ASU No. 2020-06, Debt and Derivatives and Hedging

Convertible debt and convertible preferred stock were previously accounted for under five (5) potential models.

There are now 3 models for evaluating convertible instruments

1. If conversion feature is required to be separately accounted for as a derivative, would account for it as a derivative liability (at fair value).
2. If the instrument is a convertible preferred share classified in equity, there would be no additional accounting.
3. If the convertible instrument is issued at a substantial premium, the premium would be recorded in APIC separately.

The guidance

- Eliminates the beneficial conversion feature and cash conversion models.
- Updates the analysis as to whether a contract qualifies for a scope exception from derivative accounting.
  - Scope exception is simplified by, among other things, removing 3 of the conditions required to avoid derivative accounting

ASU No. 2020-06, Debt and Derivatives and Hedging

	Convertible debt (includes preferred stock classified as a liability)	Convertible preferred stock
Conversion feature requires convertible debt to be accounted for as stock-settled debt	Accounted for as a single debt instrument, initially measured at fair value	N/A
Conversion feature requires separate accounting as a derivative instrument	Conversion feature separated out and accounted for as derivative liability (initially at fair value). Debt/preferred stock accounted for as difference between the proceeds received and the derivative liability.	
Convertible instrument issued at a substantial premium	Premium recorded to APIC and remaining proceeds recognized as debt	N/A
None of the above apply	Account for as single debt or equity instrument	

ASU No. 2021-04, Issuer's Accounting for Certain Modifications or Exchanges of Freestanding Equity – Classified Written Call Options

- The ASU applies whether the modification or exchange was made through an amendment to the existing terms of the warrant or issuance of a replacement warrant(s).
- The accounting for the modification or exchange will be based on the economic substance of the modification or exchange.
- Only applies to equity classified warrants – for example, this guidance would not apply to warrants modified to compensate for goods or services.

ASU No. 2021-04, Issuer's Accounting for Certain Modifications or Exchanges of Freestanding Equity – Classified Written Call Options

If the modification is related to:

- **Equity issuance:** increase* in warrant's fair value recorded as equity issuance cost.
- **Debt origination:** increase* in warrant's fair value recorded as debt discount or debt issuance cost.

*Disregard decrease

ASU No. 2021-04, Issuer's Accounting for Certain Modifications or Exchanges of Freestanding Equity – Classified Written Call Options (cont'd)

If the modification is related to:

- Modification of existing debt:
  - **If warrant held by creditor –** increase or decrease in fair value of warrant is recorded as debt discount.
  - **If warrant held by 3rd party –** increase* in fair value of warrant is treated as third party issue costs and expensed.
- Debt extinguishment:
  - **If warrant held by creditor** – increase or decrease in fair value of warrant is included in determining gain or loss on extinguishment.
  - **If warrant held by 3rd party** – increase* in fair value of warrant is treated as debt issuance costs.

*Disregard decrease

ASU No. 2021-04, Issuer's Accounting for Certain Modifications or Exchanges of Freestanding Equity – Classified Written Call Options (cont'd)

If the modification is related to:

- **If substance of modification is expense –** apply relevant guidance (i.e. share based compensation or payment to a customer) to increase* in the fair value of the warrants.
- **If none of above apply –** increase* in fair value of the warrants is a reduction of retained earnings.
- **If applies to multiple above elements –** allocate the total effect to the respective elements in the transaction.

*Disregard decrease

Questions?

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