Accounting Changes: What Choices Are Best for Your Business

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BerryDunn

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Present and Future

Presenter: Robert Leonard, Principal

Learning Objectives and Agenda

After completing this session, you will be able to identify accounting and reporting standard changes impacting your calendar year 2022 financial statements, and plan for upcoming accounting and reporting standard changes.

1. Accounting and reporting pronouncements that are taking effect for calendar 2022 year-ends.
2. Accounting and reporting pronouncements that are taking effect in calendar year 2023 and beyond.

Happening Now

01

FASB ASU No. 2016-02, 2021-05, and 2021-09 *Leases* (Topic 842)

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

02

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

03

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

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

04

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

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

05

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

06

FASB ASU No. 2021-07, *Stock Compensation* (Topic 718)

Effective for all qualifying awards granted or modified during fiscal years beginning after December 15, 2021

07

FASB ASU No. 2021-10, *Government Assistance* (Topic 832)

Effective for annual periods beginning after December 15, 2021

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 roll-forward has been deleted and replaced with a 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, banks 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.
  - One-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. 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) and only applies to equity classified warrants.
- The accounting for the modification or exchange will be based on the economic substance of the modification or exchange:
  - Equity issuance
  - Debt origination
  - Modification of existing debt
  - Debt extinguishment
  - Substance of modification could be expense
  - If none of above apply – reduction of retained earnings
  - If more than one apply, allocate to respective elements

ASU No. 2021-07, Stock Compensation (Topic 718)

- Allows nonpublic entities to determine the current price input of a share option using the "reasonable application of a reasonable valuation method," taking into consideration:
  - Value of entity's tangible and intangible assets
  - Present value of entity's anticipated future cash flows
  - Market value of stock or equity interests in similar entities in similar trades or businesses
  - Recent arm's-length transactions involving the sale or transfer of the entity's stock or equity interests
  - Other relevant factors, such as control premiums or discounts for lack of marketability
  - The entity's consistent use of a particular valuation method to determine the value of its stock or assets for other purposes
- Can only be used for equity classified awards and cannot utilize a value calculated more than 12 months earlier than measurement date.

ASU No. 2021-10, Government Assistance (Topic 832)

- This was issued to increase transparency of transactions with a government accounted for by a grant or a contribution model of accounting.
- The following needs to be disclosed for such transactions:
  - Information about the nature of the transactions and the related accounting policy to account for the transactions
  - Line items on the balance sheet and income statement that are affected by the transactions, and the amounts applicable to each.
  - Significant terms and conditions of the transactions, including commitments and contingencies.
- If legally prohibited from disclosing these items, the entity should disclose a description of the general nature of the transaction and indicate the omitted disclosures are legally prohibited.

Upcoming

01 **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

02 **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

03 **FASB ASU No. 2021-08, Business Combinations (Topic 805)**

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

04 **FASB ASU No. 2022-01, Derivatives and Hedging (Topic 815)**

Effective for fiscal years beginning after December 15, 2023 for non-public business entities

05 **FASB ASU No. 2022-02, Financial Instruments – Credit Losses (Topic 326)**

Effective for fiscal years beginning after December 15, 2022 for entities that have adopted the amendments in Update 2016-13, and for entities that have not yet adopted those amendments, this guidance is effective using the same dates as in Update 2016-13.

05 **FASB ASU No. 2022-03, Fair Value Measurement (Topic 820)**

Effective for fiscal years beginning after December 15, 2024 for non-public business entities

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, 2022, early adoption is permitted.

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

Convertible debt and convertible preferred stock were previously accounted for under five potential models

There are now three 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

1. Eliminates the beneficial conversion feature and cash conversion models.
2. Updates the analysis as to whether a contract qualifies for a scope exception from derivative accounting.
3. Scope exception is simplified by, among other things, removing three 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 2021-08, Business Combinations

- Current U.S. GAAP requires that assets and liabilities acquired in a business combination be recognized at fair value on the acquisition date.
- This modifies this to require that an entity recognize all contract assets and contract liabilities acquired in a business combination be recognized in accordance with Topic 606 *(Revenue from Contracts with Customers)*, as if the acquirer had originated the contracts.
- There are two practical expedients available within this guidance:

  1. Relief for contracts that have been previously modified before the acquisition date – allows acquirer to reflect aggregate effect of all modifications as of the acquisition date.
  2. Relief for situations in which the acquirer does not have appropriate data or expertise to analyze historical periods in which contract was entered into – allows acquirer to determine stand-alone selling price as of the acquisition date.

ASU 2022-01, Derivatives and Hedging, and ASU 2022-02, Financial Instruments – Credit Losses

Both of these accounting standards updates apply to unique situations which may not be applicable to many commercial entities.

1

ASU 2022-01 allows non-prepayable financial assets also to be included in a closed portfolio that is hedged using the portfolio layer method. This expanded scope permits an entity to apply the same portfolio hedging method to both prepayable and non-prepayable financial assets, thereby allowing consistent accounting for similar hedges.

2

ASU 2022-02 is associated with the new expected credit loss accounting standard issued in June 2016 (ASU 2016-13, Financial Instruments – Credit Losses, Topic 326) relating to the current expected credit loss methodology (CECL) for estimating allowances for credit losses. This guidance would only apply if a business was extending credit or holding significant financial assets.

ASU 2022-03, Fair Value Measurements

- This ASU clarifies the guidance when measuring the fair value of an equity security subject to contractual restrictions that prohibit the sale of an equity security and introduces new disclosure requirements for equity securities subject to contractual sale restrictions.
- A contractual restriction on the sale of an equity security is not considered part of the unit of account of the equity security and therefore is not considered in measuring fair value. An entity cannot, as a separate unit of account, recognize and measure a contractual sale restriction.
- The below disclosures will also be required for equity securities subject to contractual sale restrictions:
    1. The fair value of equity securities subject to contractual sale restrictions
    2. The nature and remaining duration of the restriction(s)
    3. The circumstances that could cause a lapse in the restriction(s)

Note that there are unique transition requirements for entities that qualify as investment companies

ASC Topic 842 – Leases

Presenters: Dawn Patterson, Senior Manager
Estera Ciparyte-McDonald, Senior Manager

Learning objectives

After completing this lease session, you will be able to:

- Understand the basic concepts and terminology in ASC Topic 842 – Leases
- Apply and implement the new lease standard for your Company's leases
- Prepare disclosures compliant with the new lease standard
- Have an understanding of BerryDunn lease implementation tools

Topic 842 – Leases

- Effective for fiscal years beginning after December 15, 2021 for private companies and private not-for-profits (calendar year 2022)
- Does not need to be adopted for interim periods
- Resources:
  - BerryDunn’s lease implementation guide and calculation templates
  - Podcasts

Polling question #1

Topic 842 – Leases

Example – Real estate lease

- Beginning 7/1/2021 for 36 months with two one-year extensions
- Monthly rent year one $10,000, year two $11,000, and year three $12,000
- Monthly rent includes CAM charges
- Improvement allowance of $15,000 paid prior to start of the lease

Topic 842 – Leases

Determining the Payment Amount

- Included in lease payments
  - Payment amount indicated in the lease agreement, less any lease incentives paid or payable to lessee
  - Exercise price to purchase the underlying asset by the lessee
  - Payments for penalties for terminating the lease if the lease term reflects the lessee exercising an option to terminate the lease
  - Amounts being owed under a residual value guarantee

Topic 842 – Leases

Determining the Payment Amount

- Not included in lease payments:
  - Certain other variable lease payments
    - Real estate taxes
    - Building insurance
    - Increase in payments as a result of increases in index or rate since commencement date
    - Lease payments determined based on a percentage of sales
  - Guarantee by the lessee of the lessor's debt
  - Amounts allocated to non-lease components, such as:
    - Common area charges
    - Service agreements

Topic 842 – Leases

Example – Real estate lease

- Beginning 7/1/2021 for 36 months with two one-year extensions
- Monthly rent year one $10,000, year two $11,000, and year three $12,000
- Monthly rent includes CAM charges
- Improvement allowance of $15,000 paid prior to start of the lease

Polling question #2

Topic 842 – Leases

Lease Term

- Included in lease term:
  - Noncancelable periods
  - Options that a lessee is reasonably certain to exercise
  - Options to extend or terminate controlled by lessor
- May require reassessment, if the following apply:
  - Change in circumstances affects lessee’s level of certainty about future action (e.g., exercise or not exercise an option to extend, or to purchase underlying asset)
  - An event written into the contract occurs that obliges the lessee to exercise (or not to exercise) an option to extend or terminate
  - Lessee elects to exercise an option to extend, even though they had previously determined that they were not reasonably certain to do so (and the converse)

Topic 842 – Leases

Example – Real estate lease

- Beginning 7/1/2021 for 36 months with two one-year extensions
- Monthly rent year one $10,000, year two $11,000, and year three $12,000
- Monthly rent includes CAM charges
- Improvement allowance of $15,000 paid prior to start of the lease

Polling question #3

Topic 842 – Leases

Discount Rate

- Discount rate: the rate indicated in the lease agreement or the incremental borrowing rate
- Discount rate for lessees that are not public business entities
  - Practical expedient allows to elect to use a risk-free rate as the discount rate for all leases
  - Election by class of underlying asset rather than at entity-wide level
  - Need to disclose which asset class the entity has elected to apply a risk-free rate
  - If rate implicit in the lease is readily determinable, lessee must still use that rate

Topic 842 – Leases

Example – Real estate lease

- Beginning 7/1/2021 for 36 months with two one-year extensions
- Monthly rent year one $10,000, year two $11,000, and year three $12,000
- Monthly rent includes CAM charges
- Improvement allowance of $15,000 paid prior to start of the lease
- Additional information:
  - No rate implicit in the lease
  - Incremental borrowing rate – 6%, risk-free rate – 3%

Polling question #4

Topic 842 – Leases

Lease Classification – Three types of leases for a lessee

1. Finance lease
   - The lease transfers ownership of the underlying asset to the lessee by the end of the lease term.
   - The lease contains a purchase option that the lessee is reasonably certain to exercise.
   - The lease term is for the major part of the remaining economic life of the underlying asset.
   - The present value of the lease payments and residual value guaranteed by the lessee equals or exceeds substantially all the fair value of the underlying asset.
   - The underlying asset is specialized and expected to have no alternative use to the lessor at the end of the lease term.
2. Operating lease
3. Short-term lease

Topic 842 – Leases

Example 1 – Real estate lease

- Beginning 7/1/2021 for 36 months with two one-year extensions
- Monthly rent year one $10,000, year two $11,000, and year three $12,000
- Monthly rent includes CAM charges
- Improvement allowance of $15,000 paid prior to start of the lease
- Additional information:
  - No rate implicit in the lease
  - Incremental borrowing rate – 6%, risk-free rate – 3%
  - Economic life of the asset = 30 years
  - FMV of the asset = $2.3M
  - No transfer of ownership or purchase of the asset

Topic 842 – Leases

Example 2 – Real estate lease

- Beginning 7/1/2021 for 300 months (25 years through 6/30/2046)
- Monthly rent year one $10,000, year two $11,000 and year three and after $12,000
- Monthly rent includes CAM charges
- Improvement allowance of $15,000 paid prior to start of the lease
- Additional information:
  - No rate implicit in the lease
  - Incremental borrowing rate - 6%, risk-free rate - 3%
  - Economic life of the asset = 30 years
  - FMV of the asset = $2.3M
  - No transfer of ownership or purchase of the asset

Demo – BerryDunn Lease Classification Tool

Topic 842 – Leases

Lease recognition and measurement – Initial measurement

- Lease liability at present value of lease payments discounted using discount rate of lease
- Right of use asset – initial lease liability, plus any lease payments made to lessor at or before commencement date, minus any lease incentives received
- Any initial direct costs such as incentive payments and commissions

Topic 842 – Leases

Example 1 – Real estate lease operating

- Beginning 7/1/2021 for 36 months with two one-year extensions
- Monthly rent year one $10,000, year two $11,000, and year three $12,000
- Monthly rent includes CAM charges
- Improvement allowance of $15,000 paid prior to start of the lease
- Additional information:
  - No rate implicit in the lease
  - Incremental borrowing rate – 6%, risk-free rate – 3%

Topic 842 – Leases

Example 2 – Real estate lease finacing

- Beginning 7/1/2021 for 300 months (25 years through 6/30/2046)
- Monthly rent year one $10,000, year two $11,000, and year three and after $12,000
- Monthly rent includes CAM charges
- Improvement allowance of $15,000 paid prior to start of the lease
- Additional information:
  - No rate implicit in the lease
  - Incremental borrowing rate – 6%, risk-free rate – 3%

Demo- BerryDunn Operating and Finance Lease Calculation Tools

Topic 842 – Leases

Presentation – Balance Sheet

Separate Presentation Acceptable		Presentation with Other Assets and Liabilities and Disclosed Separately Acceptable		Combined Presentation Not Acceptable	
Balance Sheet Period Ended December 31, 20X1		**Balance Sheet Period Ended December 31, 20X1**		**Balance Sheet Period Ended December 31, 20X1**	
ROU assets—operating leases	25,000	ROU assets—operating leases	25,000	ROU assets	25,900
ROU assets—finance leases	900	Property, plant and equipment	2,000	Property, plant and equipment	1,100
Property, plant and equipment	1,100				
Operating lease liabilities	25,150	Operating lease liabilities	25,150	Lease liabilities	26,000
Finance lease liabilities	850				
Other liabilities	1,000	Other liabilities	1,850	Other liabilities	1,000
		Disclosure For the period ended December 31, 20X1, right-of-use assets from finance leases of $900 are included in property, plant and equipment. For the period ended December 31, 20X1, lease liabilities from finance leases of $850 are included in other liabilities			

Topic 842 – Leases

Presentation

- Statement of operations
  - Operating leases – present a single lease cost consistent with prior standards
  - Finance leases – include with depreciation/amortization and interest expense
- Statement of cash flows
  - Operating – payments from operating leases and variable and short-term lease payments not included in lease liability
  - Investing – payments to bring another asset to the condition and location necessary for its intended use
  - Financing – repayment of the principal portion of the finance lease liability

Topic 842 – Leases

Disclosures

Accounting policy

The Company determines if an arrangement is a lease or contains a lease at inception of a contract. A contract is determined to be or contain a lease if the contract conveys the right to control the use of identified property, plant, or equipment (an identified asset) in exchange for consideration. The Company determines these assets are leased because the Company has the right to obtain substantially all of the economic benefit from and the right to direct the use of the identified asset. Assets in which the supplier or lessor has the practical ability and right to substitute alternative assets for the identified asset and would benefit economically from the exercise of its right to substitute the asset are not considered to be or contain a lease because the Company determines it does not have the right to control and direct the use of the identified asset. The Company's lease agreements do not contain any material residual value guarantees or material restrictive covenants.

In evaluating its contracts, the Company separately identifies lease and non-lease components, such as common area and other maintenance costs, in calculating the ROU assets and lease liabilities for its office buildings, apartments, and vehicles. The Company has elected the practical expedient to not separate lease and non-lease components and classifies the contract as a lease if consideration in the contract allocated to the lease component is greater than the consideration allocated to the non-lease agreement.

Topic 842 – Leases

Disclosures

Accounting policy (concluded)

Leases result in the recognition of ROU assets and lease liabilities on the balance sheet. ROU assets represent the right to use an underlying asset for the lease term, and lease liabilities represent the obligation to make lease payments arising from the lease, measured on a discounted basis. The Company determines lease classification as operating or finance at the lease commencement date. ROU assets for finance leases are included in property and equipment in our balance sheet.

At lease inception, the lease liability is measured at the present value of the lease payments over the lease term. The ROU asset equals the lease liability adjusted for any initial direct costs, prepaid or deferred rent, and lease incentives. The Company uses the implicit rate when readily determinable. As most of the leases do not provide an implicit rate, the Company uses its incremental borrowing rate based on the information available at the commencement date to determine the present value of lease payments. Incremental borrowing rates used to determine the present value of lease payments were derived by reference to the secured-debt yields the Company would receive to finance each lease transaction or needed to borrow the amount of the undiscounted future payments over the term of the lease.

The lease term may include options to extend or to terminate the lease that the Company is reasonably certain to exercise. Lease expense is generally recognized on a straight-line basis over the lease term.

The Company has elected not to record leases with an initial term of 12 months or less on the balance sheet. Lease expense on such leases is recognized on a straight-line basis over the lease term.

Topic 842 – Leases

Disclosures – Nature of leases

The Company has entered the following lease arrangements:

- Finance Leases
  - These leases mainly consist of equipment for the use of operations. One finance lease includes an escalating fee schedule, which range from a 25% to 33% increase for specific years. Termination of the leases generally are prohibited unless there is a violation under the lease agreement.
- Operation Leases
  - The Company has two leases for office space that expire in 2027. These leases generally contain renewal options for periods ranging from two years to five years and require the Company to pay all executory costs (property taxes, maintenance and insurance). One operating lease includes an escalating fee schedule, which range from a 25% to 33% increase for specific years. Termination of the leases is generally prohibited unless there is a violation under the lease agreement.
- Short-Term Leases
  - The Company has certain leases that are for a period of 12 months of less or contain renewals for periods of 12 months or less. The Company does not include short-term leases within the statements of financial position since it has elected the practical expedient to included these leases within the operation right of use asset and lease liabilities. The Company did not have any short-term leases during the years ending December 31, 2022 and 2021.

Topic 842 – Leases

Disclosures – Lease Cost

Finance lease		
Amortization of right-of-use asset	$	58, 957
Interest on lease liabilities		31, 837
Operating lease cost		80, 000
Total lease cost	$	170, 794

Topic 842 – Leases

Disclosures – Cash flow and other information

Cash paid for amounts included in the measurement of lease liabilities		
Operating cash flows from finance leases	$	31, 837
Financing cash flows from finance leases		38, 163
Operating cash flows from operating leases		70,000
Right-of-use assets obtained in exchanged for new finance lease liabilities		353, 743
Right-of-use assets obtained in exchange for new operating lease liabilities		353,743
Weighted-average remaining lease term		
Finance leases		5.0 years
Operating leases		5.0 years
Weighted-average discount rate		
Finance leases		6.0%
Operating leases		9.0%

Topic 842 – Leases

Disclosures – Future minimum lease payments and reconciliation to the balance sheet

	Finance Leases	Operating Leases
2023	$ 70,000	$ 70,000
2024	80,000	80,000
2025	80,000	80,000
2026	90,000	90,000
2027	90,000	90,000
Thereafter	-	-
Total future undiscounted lease payments	410,000	410,000
Less present value discount	(94,420)	(94,420)
Lease liabilities	$ 315, 580	$ 315, 580

Topic 842 – Leases

Transition Methods

- Retrospectively to each prior reporting period presented, referred to as the modified retrospective approach
- Retrospectively at the beginning of the period of adoption, referred to as the additional (and optional) transition method

Questions?

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