

Accounting Update

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Learning objectives



- ▲ **To provide detailed guidance** on the upcoming lease accounting changes
- ▲ **To provide an update** of recent audit and accounting standards in order to help you prepare for your financial statement audits

Relevant FASB and AICPA Pronouncements

| Pronouncement | | Conduit Debt Obligors | NFP without Public Debt |
|--------------------|--|-----------------------|-------------------------|
| ASU 2016-02 | Leases | Already Adopted | 12/31/2022 |
| ASU 2016-13 | Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments | 12/31/2023 | 12/31/2023 |
| ASU 2018-15 | Internal Use Software: Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Service Arrangement that is a Service Contract | Already Adopted | 12/31/2021 |
| ASU 2020-07 | Presentation and Disclosures by Not-for-Profit Entities for Contributed Nonfinancial Assets | 6/30/2022 | 6/30/2022 |
| ASU 2021-10 | Disclosures by Business Entities about Government Assistance | 12/31/2022 | 12/31/2022 |
| SAS 134 | Auditor Reporting and Amendments | 12/31/2021 | 12/31/2021 |
| SAS 135 | Communications with Those Charged with Governance | 12/31/2021 | 12/31/2021 |
| SAS 136 | Forming an Opinion and Reporting on Financial Statements of Employee Benefit Subject to ERISA | 12/31/2021 | 12/31/2021 |





Lease Accounting

Polling question





ASU 2016-02 Leases – Practical Considerations

- ▲ Ensure the lease population is complete and the data is accurate
- ▲ Consider whether you have any contracts that have imbedded leases
- ▲ Determine and maintain discount rates – they may be different depending on when the lease started
- ▲ Consider the materiality of the impact of existing leases on the entity's financial statements
- ▲ Consider implementing a lease accounting software package

Lease Classification

Classify all leases as finance or operating

- ▲ Similar initial balance sheet impact
- ▲ Separate balance sheet presentation (or disclosure)
 - Separate finance lease and operating lease right of use (ROU) assets in the balance sheet
 - Separate finance lease and operating lease liabilities in the balance sheet
- ▲ Different statement of activities and cash flow results





ASU 2016-02 – Leases – Classification of Leases

Finance Lease if one of the following is met:

- ▲ Ownership transfers at the end of the lease term
- ▲ Purchase option that is reasonably certain of being exercised
- ▲ Lease term is a major part of the remaining economic life (e.g., 75%)
- ▲ Present value of lease payments and lessee residual value guarantee is substantially all of the fair value of the underlying asset (e.g., 90%)
- ▲ Specialized asset with no alternative use

If none of these are true,
the lease will be an **Operating Lease**

Journal Entries

- ▲ Financing Lease – initial recognition
 - Initial ROU asset and lease liability = PV of lease payments
- ▲ Financing Lease – monthly entries
 - DR amortization expense = initial ROU asset divided by lease term
 - DR lease liability = cash payment, net of interest expense
 - DR interest expense = based on discount rate
 - CR cash = actual payment
 - CR ROU asset = lease expense

Note: monthly difference between decrease in ROU asset and liability equals the difference between cash payments and amortization expense plus interest expense



Journal Entries

- ▲ Operating Lease – initial recognition
 - Initial ROU asset and lease liability = PV of lease payments
- ▲ Operating Lease – monthly entries
 - DR lease expense = total lease payments divided by lease term
 - DR lease liability = cash payment, net of imputed interest
 - CR cash = actual payment
 - CR ROU asset = lease expense

Note: monthly difference between decrease in ROU asset and liability equals the difference between cash payments and straight-line expense



Lease Classification

Summary



Balance Sheet



Statement of Activities



Cash Flow

Financing

ROU asset
Financing lease liability



Amortization expense (straight-line)
Interest expense



Operating section
Interest payments Financing
Cash paid for principal

Operating

ROU asset
Operating lease liability



Single lease expense on a straight-line basis



Operating section
Cash paid for lease payments



Lease Classification

Distinguishing from contributions

Under the new ASU, **a lease is defined as 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*.

An unconditional promise to give the use of long-lived assets (such as a building or other facilities) conveys the right to control the use of identified property for a specified number of periods in which the donor retains legal title. However, an unconditional promise to give has *no lease payments*.



Key Questions

1

Should I exclude short-term leases?

2

Which lease components do I include?

3

What terms and considerations are relevant?

4

What discount rate should I use to PV the lease?

Key Questions

Which lease components do I include?



Include the following

- Fixed payments reduced by lease incentives paid to lessee
- Variable lease payments dependent on a rate or index
- Options for which exercise is reasonably certain
- Fees paid to the lessor for structuring the transaction
- Amount lessee is probable to owe under a residual value guarantee



Exclude the following

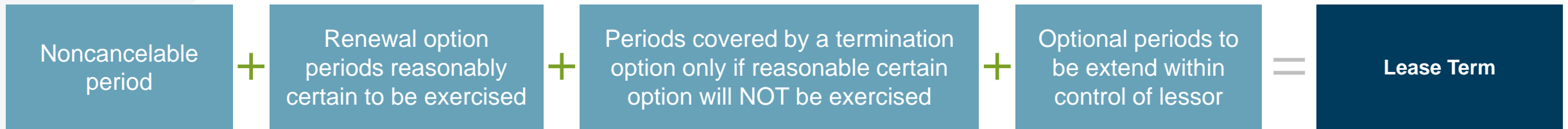
- Variable lease payments not dependent on an index or rate
- Guarantee of the lessor's debt
- Amounts allocated to nonlease components

Key Questions

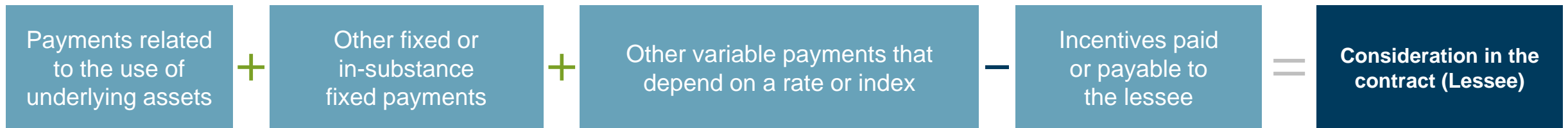
What terms and considerations are relevant? (Lessee)

Measure the consideration in the contract for **lease components** by identifying the **Lease Term** and **Consideration**.

Lease Term



Consideration



ASU 2016-02 Leases – Selecting a Discount Rate



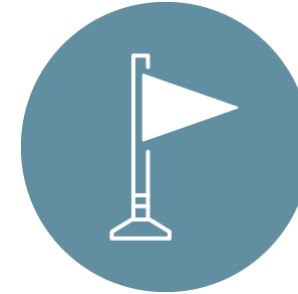
Implicit Rate

- Only use when readily determinable
- Often not known to lessee



Incremental Borrowing Rate

- Rate lessee would pay to borrow on collateralized basis
- Assume similar term/environment



Risk-free Rate

- Practical expedient for private companies
- Would likely result in larger lease liability

ASU 2016-02 Leases – Transition Methods



Cumulative Effect

- Applied retrospectively to each reporting period being presented
- Cumulative-effect adjustment recognized as of the beginning of the earliest period presented
- Prior comparative periods presented are restated to reflect Topic 842



Effective Date

- Applied retrospectively to the beginning of the period of adoption
- Cumulative-effect adjustment recognized as of the beginning of the reporting period
- Prior comparative periods presented are not restated to reflect Topic 842



Other Pronouncements

Polling question





ASU 2016-13 – Financial Instruments – Credit Losses

- ▲ Replaces current methodology for determining credit loss that is based on historical and known losses to an anticipated loss model
- ▲ Allowances could be reported on the first day credit is provided
- ▲ Applies to:
 - Loans and debt instruments not measured at fair value
 - Trade receivables and contract assets recognized under Topic 606
 - Certain lease receivables
 - Financial guarantee contracts and loan commitments
- ▲ Does not apply to contributions receivables and grants receivables (if following the contribution model)



ASU 2018-15 – Cloud Computing Arrangements

- ▲ Implementation costs for service contracts under Cloud Computing Arrangements would be accounted for in accordance with Subtopic 350-40 on internal-use software
- ▲ Include renewal options that are reasonably certain to be exercised in the amortization period
- ▲ Presentation in the financial statements would be consistent with the presentation of hosting fees



ASU 2020-07 – Presentation and Disclosures for Contributed Non-Financial Assets

- ▲ Improve transparency of contributed nonfinancial assets, including how those assets are used and valued
- ▲ Present contributed nonfinancial assets as a separate line item in the Statement of Activities
- ▲ Helps the reader understand the importance of gifts-in-kind on an NFP's ability to fulfill their mission and run their programs
- ▲ Effective for annual periods beginning after June 15, 2021
- ▲ Early adoption is permitted
- ▲ Retrospective basis of adoption



ASU 2020-07 – Presentation and Disclosures for Contributed Non-Financial Assets

▲ Disclosure Requirements:

- Information about whether the assets were monetized or utilized. If utilized, description of the programs where assets were used
- NFP's policy for monetizing rather than utilizing assets
- Description of any donor restrictions
- Description of the valuation techniques and inputs used to determine fair value at initial recognition
- Principal market used to arrive at a fair value measurement if it is a market in which the NFP is prohibited by donor restrictions from selling or using the asset.



ASU 2021-10 – Disclosures for Business Entities about Government Assistance

- ▲ Improve transparency of government assistance with enhanced disclosure
- ▲ Will provide comparable and transparent information to investors and other financial statement users
- ▲ Effective for annual periods beginning after December 15, 2021
- ▲ Early adoption is permitted

SAS 134 – Auditor’s Reporting and Amendments

- ▲ Effective for periods ending on or after December 15, 2021
- ▲ Changes to Independent Auditor’s Report
 - Opinion section presented first
 - Basis for opinion section follows opinion section
 - Management’s responsibilities for determining going concern issues
 - Expands description of auditor’s responsibilities
 - Allows for inclusion of Key Audit Matters
- ▲ Engagement letter will include significant risks identified in connection with the audit planning process



SAS 135 – Omnibus Statement on Auditing Standards

- ▲ Effective for periods ending on or after December 15, 2021.
 - Changes to requirements regarding communicating audit matters to those charged with governance
 - Updated requirements to include inquiries regarding related parties
 - Special considerations regarding the impact of fraud risk in financial reporting
 - Key Audit Matters



Polling question



SAS 136 – Forming and Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA

- ▲ Effective for periods ending on or after December 15, 2021
 - DOL limited-scope audit no longer allowed
 - ERISA 103(a)(3)(C) audit of financial statements
 - Management is responsible for:
 - Determining whether the certifying institution qualifies for an ERISA 103(a)(3)(C) audit
 - The certification meets the requirements of CFR 2520-103-5
 - The certified investment information is appropriately measured, presented, and disclosed in accordance with the applicable framework
 - We will issue an opinion on the ERISA plan financial statements
 - We need to review a substantially completed Form 5500
 - Reportable findings communicated to those charged with governance



Relevant GASB Pronouncements

| Pronouncement | | NFP without Public Debt |
|----------------|---|-------------------------|
| GASB 87 | Leases | 6/30/2022 |
| GASB 89 | Accounting for Interest Cost Incurred Before the end of a Construction Period | 12/31/2021 |
| GASB 92 | Omnibus 2020 (multiple effective dates) | 6/30/2022 |
| GASB 97 | Certain Component Unit Criteria, and Accounting and Financial Reporting for IRC Section 457 Deferred Compensation Plans – an amendment of GASB No. 14 and No. 84 (Supersedes GASB no. 32) | 6/30/2022 |
| GASB 98 | The Annual Comprehensive Financial Report (ACFR) | 12/31/2021 |



GASB 87 Considerations

- ▲ All leases follow the finance lease accounting model from ASU 2016-02
- ▲ AICPA Audit and Accounting Guide for State and Local Governments is a great resource
- ▲ Selecting a discount rate
 - Standards require companies to use the rate implicit in the lease, but only if readily determinable.
 - When the rate implicit in the lease is not determinable, use the lessee's incremental borrowing rate.
- ▲ Lessor Accounting
 - Continues to recognize the lease asset
 - Lease receivable = Present Value of expected lease payments over the lease term
 - Deferred Inflow = Equals lease receivable plus any cash received up front that pertains to a future period
 - Recognize revenue over the lease term in a systematic and rational manner



Questions?

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