Navigating Recent Accounting Standards

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September 27, 2023

Learning objectives

As a result of this training, attendees will be able to:

- Understand accounting changes taking effect in 2023 and in the future.
- Assess the impact Current Expected Credit Loss (CECL) model on their company's financial reporting and loss estimation process.
- Evaluate the various options when accounting for Employee Retention Tax Credits (ERTC) and understand the impact on financial reporting.
- Apply lessons learned from the implementation of ASC 842, Leases to enhance your company's financial reporting process.

Present and Future

Happening Now

1

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.

2

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

Effective for annual periods beginning after December 15, 2021.

3

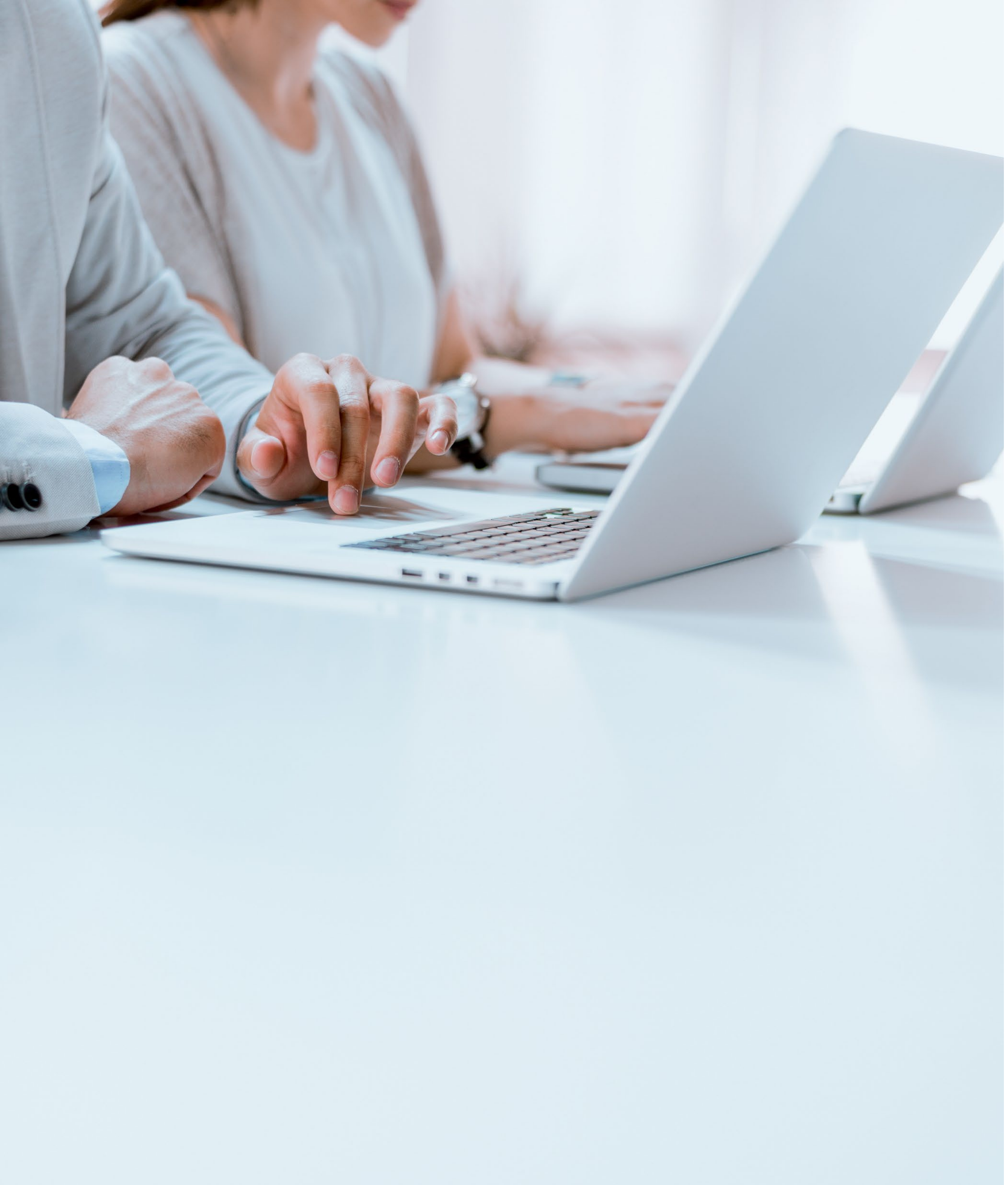
FASB ASU No. 2022-04, *Liabilities – Supplier Finance Programs* (Subtopic 405-50)

Effective for fiscal years beginning after December 15, 2022, except for amendment on rollforward information, which is effective for fiscal years beginning after December 15, 2023.

4

FASB ASU No. 2022-06, *Reference Rate Reform* (Topic 848)

Effective upon issuance of this ASU in December 2022.



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. 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.

ASU No. 2022-04, *Supplier Finance Programs* (Subtopic 405-50)

- Effective for years beginning after December 15, 2022, except for the amendment on rollforward information, which is effective for years beginning after December 15, 2023
  - Early adoption is permitted
  - Retrospective transition method
- Provides for new disclosures for supplier finance programs (SFPs)
- The amendments in this update do not affect recognition, measurement, or financial statement presentation of obligations covered under SFPs
- Disclosures include:
  - Key terms of the program
  - For obligations the buyer has confirmed as valid:
    - Amounts outstanding and unpaid
    - Description of where the obligations are in the balance sheet
    - Rollforward of those obligations during the annual reporting period

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

*As extended by ASU No. 2022-06

- Effective March 12, 2020 through December 31, 2024*
- Contract modification relief
  - Receivables and debt should be accounted for by prospectively adjusting the effective interest rate.
  - Leases should be accounted for as a continuation of the existing contracts with no reassessments of the lease classification and discount rate.
- Hedging relief
  - If specified criteria are met, entities may change certain critical terms of existing hedging relationships that are affected or expected to be affected by reference rate reform.
  - These changes would not, in and of themselves, cause an entity to de-designate the hedging relationship.

* ASU No. 2022-06 extended this date to December 31, 2024 from December 31, 2022.

Upcoming

1

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

2

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

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

3

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

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

4

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

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

5

FASB ASU No. 2023-01, *Leases* (Topic 842)

Effective for fiscal years beginning after December 15, 2023

6

FASB ASU No. 2023-02, *Investments – Equity Method and Joint Ventures* (Topic 323)

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

7

FASB ASU No. 2023-05, *Business Combinations - Joint Venture Formations* (Subtopic 805-60)

Effective prospectively for all joint venture formations with a formation date on or after January 1, 2025

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

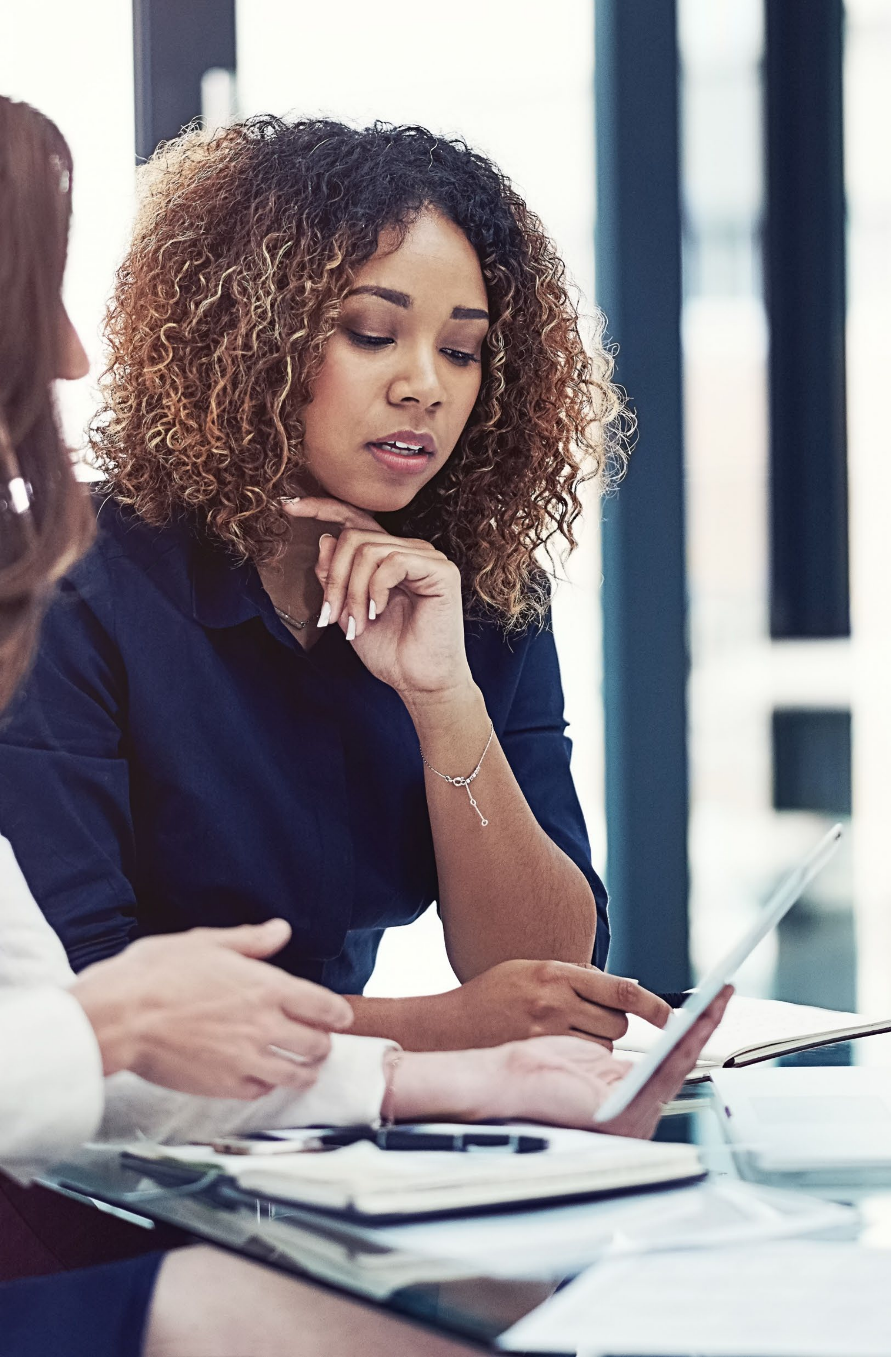
- If conversion feature is required to be separately accounted for as a derivative, would account for it as a derivative liability (at fair value).
- If the instrument is a convertible preferred share classified in equity, there would be no additional accounting.
- If the convertible instrument is issued at a substantial premium, the premium would be recorded in Additional Paid-In Capital (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 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.
- The ASU 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 standalone selling price as of the acquisition date.

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**

ASU 2023-01 – *Leases* (Topic 842)

- Effective for fiscal years beginning after December 15, 2023
- **Issue 1 –**
  - Practice expedient available to entities that are **not:**
    - Public business entities
    - Not-for-profit conduit debt obligors
    - Employee benefit plans (SEC registrants)
- Use written terms and conditions of common control agreement (CCA) to determine if a lease exists
- If no written terms and conditions exist, practical expedient not available and must use enforceable terms and conditions of Topic 842
- Adoption options

ASU 2023-01 – *Leases* (Topic 842)

- **Issue 2 – Leasehold improvements**
- Amendments affect all lessees between entities under common control regarding leasehold improvements
- Amortization of leasehold improvements in common collective group over useful life of leasehold improvement as long as the lessee controls the use of the asset
  - Current guidance under Topic 842 amortizes leasehold improvement with the shorter of remaining lease term and useful life
- Adoption options

ASU No. 2023-02 *Investments – Equity Method and Joint Ventures* (Topic 323)

Accounting for investments in tax credit structures using the proportional amortization method

- Why?
  - ASU No. 2014-01 introduced the proportional amortization method in accounting for Low Income Housing Tax Credit (LIHTC) investments
  - This ASU relaxed the existing guidance permitting the effective yield method of accounting for affordable housing investments meeting certain criteria
- Provides simplification
  - Supporters sought to simplify the accounting treatment for various tax credit investments and better reflect the return from investments made primarily for the purpose of receiving income tax benefits
  - Offers more consistent accounting to similar tax-incentivized investments

ASU No. 2023-02 *Investments – Equity Method and Joint Ventures* (Topic 323)

Accounting for investments in tax credit structures using the proportional amortization method

	Proportional Amortization Method	**Cost Method**	**Equity Method**
Subsequent Measurement	Investment cost basis amortized in proportion to the income tax credits and other income tax benefits received	Investment cost basis amortized in proportion to only the income tax credits received	Investment cost basis remeasured consistent with other equity method investments (that is, in proportion to allocable book gains and losses)
Presentation	Cost basis amortization and income tax credit presented net in the income tax expense (benefit) line item	Cost basis amortization presented as other expense and income tax credit presented in the income tax expense (benefit) line item	Cost basis remeasurement presented as other income or expense and income tax credit presented in the income tax expense (benefit) line item

ASU No. 2023-02 *Investments – Equity Method and Joint Ventures* (Topic 323)

Accounting for investments in tax credit structures using the proportional amortization method

- Proportional amortization method can be used if:
  - Tax credit is probable
  - Investor does not have significant influence over operating and financial policies of the underlying project
  - The investment's yield is positive
  - Substantially all of the projected benefits are from income tax credits and other income tax benefits (losses from depreciation, etc.)
  - Investor is a limited partner whose liability can't exceed its capital investment

ASU 2023-05 – *Business Combinations – Joint Venture Formations* (Subtopic 805-60)

Provides guidance on accounting for contributed assets to a joint venture.

- A joint venture is the formation of a new entity without an accounting acquirer.
- A joint venture measures its identifiable net assets and goodwill, if any, at formation date. The formation date is the date at which an entity initially meets the definition of a joint venture.
- Initial measurement of a joint venture's total net assets is equal to the fair value of 100% of the joint venture's equity.
- A joint venture provides relevant disclosures. The disclosures should help a user of the financial statements understand nature and financial effect of the joint venture formation in the period that the formation date occurs.

Polling Question #1

FASB ASU 2016-13

Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments

FASB ASU 2016-13

Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments

What is CECL?

What is the primary goal?

Effective date

Who does it impact?

Scope of CECL

Items within the scope of CECL

- Financial assets measured at amortized cost
    - Trade receivables
    - Loan receivables
    - Held-to-maturity (HTM) debt securities
- Other financial instruments

Items outside of CECL scope

- Financial assets measured at fair value through net income
- Available-for-sale (AFS) debt securities
- Participant loans in defined contribution plans
- Other financial instruments

How does CECL work?

1 | Immediate recognition

- Estimated expected credit losses
- Life of financial instrument (reduced by prepayments)

2 | Unit of Account (Pooling Requirement)

- Financial asset type
- Credit score
- Historical or expected credit loss patterns
- Size

3 | Methodology Flexibility

- Aging schedule
- Discounted cash flows
- Loss-rate methods

4 | Basis for Estimates

- Past events
- Current conditions
- Reasonable and supportable forecasted information

5 | Recording Expected Credit Loss

- Recorded as an allowance for credit losses
- Changes are treated as credit loss expense

Application of CECL to Trade Receivables

Aging	Amortized Cost Basis	Existing Loss Rate	Existing Allowance	Adjusted Loss Rate	CECL Allowance
Current	$ 19,000,000	0%	$ -	1.50%	$ 285,000
1–30 days	$ 11,000,000	6%	$ 660,000	6.09%	$ 669,900
31–60 days	$ 6,000,000	28%	$ 1,680,000	28.42%	$ 1,705,200
61–90 days	$ 3,000,000	54%	$ 1,620,000	54.81%	$ 1,644,300
>90 days	$ 1,000,000	87%	$ 870,000	88.31%	$ 883,100
Allowance	**$ 40,000,000**		**$ 4,830,000**		**$ 5,187,500**

Polling Question #2

CECL Disclosure Requirements

- Flexible, but disclosures should enable readers to understand:
  - Credit risk inherent in an entity's portfolio and how management monitors this risk
  - Management's estimate of expected credit losses
  - Changes in the estimate of expected credit losses that have taken place during the period
- To achieve this, the standards prescribe quantitative and qualitative disclosures around:
  - Credit quality information
  - Allowance for credit losses
    - Including a rollforward of the allowance for credit losses (new requirement)
  - Past-due and nonaccrual status
  - Purchased financial assets with credit deterioration
  - Collateral-dependent financial assets
  - Off-balance-sheet credit exposures

Employee Retention Tax Credit

Accounting considerations

Accounting for the Employee Retention Tax Credit (ERTC)

There is no authoritative guidance on the accounting for government grants to business entities. Below are some resources to consider:

1

ASC *105 Generally Accepted Accounting Principles*

Provides framework for when there is no guidance in U.S. GAAP for a transaction or event.

2

ASC 832
Government Assistance

Provides disclosure requirements for entities (except not-for-profit entities and employee benefit plans) that receive government assistance.

3

Center for Plain English Accounting

Has released several articles on accounting and auditing considerations around the ERTC (see the Special Report dated April 5, 2022).

Accounting for the ERTC

- For 2020 claims only, a retroactive application could be used, analogized to a recovery of a loss. The guidance referenced is ASC 410, *Asset Retirement and Environmental Obligations.*
  - This is because the 2020 claims were not allowed for companies that received PPP funds until a law change in December 2020.
- Conditional contribution model—recognize when conditions are substantially met and barriers substantially overcome. Guidance referenced in ASC 958-605, *Not-for-Profit Entities, Revenue Recognition.*
- Reasonable assurance model—recognize when reasonable assurance that (1) conditions attached to program will be met, and (2) revenue (credits) will be received. Guidance referenced in international standards – IAS 20, *Accounting for Government Grants and Disclosure of Government Assistance*.

Accounting for the ERTC

The accounting for the ERTC should also address any uncertainties related to compliance with the program.

- Particularly in cases where there is significant judgment involved, if there are questions about compliance, that may impact whether or not the credit is recognized.
  - If the credit was already received, a liability may need to be recognized.
  - This should be re-evaluated each reporting period if there are any regulatory updates that could impact recognition.
- The likelihood of government enforcement should not factor into this determination.

ASC Topic 842, Leases

Lessons Learned

Sale and Leaseback Transactions

Recognition of gains and losses

ASC 840	ASC 842
Deferred recognition	Immediate recognition

Lease Classification Criteria

Changes between ASC 840 and ASC 842

ASC 840		ASC 842
Lease term is greater than or equal to **75%** of estimated economic life of the asset.	→	Lease term is for a **major part** of the remaining economic life of the asset.
Present value of minimum lease payments greater than or equal to **90%** of the fair value of the leased property.	→	Present value of the sum of the lease payments and any guaranteed residual value is **substantially all** of the fair value of the underlying asset.
N/A – New with ASC 842	→	The asset is so specialized it is likely to have no future use to the lessor at the end of the lease term.

Lease Payment Test

Six items to include when calculating present value of lease payments

1	Fixed payments, including in substance fixed payments, less any lease incentives paid or payable to the lessee.
2	Variable lease payments that depend on an index or a rate, initially measured using the index or rate at the commencement date.
3	The exercise price of an option to purchase the underlying asset if the lessee is reasonably certain to exercise that option.
4	Payments for penalties for terminating the lease if the lease term reflects the lessee exercising an option to terminate the lease.
5	Fees paid by the lessee to the owners of a special-purpose entity for structuring the transaction.
6	For a lessee only, amounts probable of being owed by the lessee under residual value guarantees.

What is “substantially all” of the fair value of the underlying asset?

Lease Payment Test

Items to exclude when calculating present value of 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

Other lessons learned

Short-term leases

- Lease term of 12 months or less
- No purchase options on underlying assets
- Renewal and termination options (reasonably certain to exercise)

Discount rates

- Implicit vs other options
- Rates to use for subsequent leases
- Discount rate remeasurement on existing leases under ASC 842

Polling Question #3

Questions?

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