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What Does FASB Have in Store for Contractors Next?

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Areas of Interest

- Not-for-Profit Services
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Today's Roadmap

- Lessons learned from implementing the revenue recognition standard (ASC 606)
- Going concern: what do auditors look for?
- Leases are happening right now. Are you ready?
- Financial Instruments—Credit Losses (Topic 326): Everyone needs an allowance
- Accounting potpourri: What's on the horizon?

Lessons Learned from Implementing Revenue Recognition (ASC 606)

This may be used as a main section divider

Lessons Learned with Revenue Recognition

- Performance obligations not properly identified
  - Two criteria for recognizing revenue: 1) can the customer benefit from the good or service on its own or with other readily available resources and 2) is that good or service distinguishable separately from the other promises in the contract.
    - The key concept is “control” of the assets and the owners right to use that asset for profit
    - Consider a building from excavation to punch list vs private residence restoration
    - **Key Takeaway:** Accurately determining performance obligations is a common problem when implementing ASC 606. Improperly identified performance obligations can be difficult to change and restatement of financial statements may be required.

Lessons Learned with Revenue Recognition

- Incorrect Treatment of Modifications
  - The total contract price should be allocated to each of the separate and distinct performance obligations using the standalone selling price (SSP)
  - SSP is either taken from fair market value of comparable services or estimated
  - Modifications create changes to existing performance obligations and are handled one of three ways:
    - Separate contract, termination of existing contract and creation of a new contract, or added to existing contract if the remaining performance obligations are not distinct
  - **Key Takeaways:** Contract modifications are fairly common. Make sure to assess the modification of changes in performance obligations. Ensure that contract modification is properly accounted for as either a separate contract, a termination of the existing contract and creation of a new contract, or as part of the existing contract.

Going Concern: What do Auditors Look for?

Going Concern

Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern

- Effective for all organizations for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter.
- The amendments require **management** to assess an entity's ability to continue as a going concern by incorporating and expanding upon certain principles that are currently in U.S. auditing standards.
- Early application is permitted.

Going Concern

- The amendments require management to assess an entity's ability to continue as a going concern by incorporating and expanding upon certain principles that are currently in U.S. auditing standards.
  - Provides a definition of the term substantial doubt,
  - Requires an evaluation every reporting period including interim periods,
  - Provides principles for considering the mitigating effect of management's plans,
  - Requires certain disclosures when substantial doubt is alleviated as a result of consideration of management's plans,
  - Requires an express statement and other disclosures when substantial doubt is not alleviated, and
  - Requires an assessment for a period of one year after the date that the financial statements are issued (or available to be issued).

Going Concern

- Management should evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued when applicable).
- <u>The reporting entity management will not need to perform a detailed analysis if, for example, the reporting entity has a history of profitable operations, ready access to financial resources, and no significant near-term obligations in excess of available liquid funds.</u> On the other hand, when potentially negative events or conditions exist, a more detailed analysis may be required, including development of forecasts and projections.

Going Concern

- Management's evaluation should be based on relevant conditions and events that are known and reasonably knowable at the date that the *financial statements are issued* (or at the date that the *financial statements are available to be issued* when applicable).
  - Substantial doubt about an entity's ability to continue as a going concern exists when relevant conditions and events, considered in the aggregate, indicate that it is **probable that the entity will be unable to meet its obligations** as they become due within one year after the date that the financial statements are issued (or available to be issued).

Going Concern

Some items that management may want to consider in their analysis of the entity's ability to continue as a going concern include the following:

- The reporting entity's current financial condition, including the availability of liquid funds and access to credit (available borrowings on a Line of Credit)
- Obligations of the reporting entity due or new obligations anticipated within one year
- Backlog for contracts in process or starting in the next year
- The funds necessary to maintain operations considering the reporting entity's current financial condition, obligations, and other expected cash flows
- Other adverse conditions or events such as the following:
  - Recurring operating losses, working capital deficiencies, or negative cash flows
  - Defaults on loans or similar agreements, denial of usual trade credit from suppliers, or a need to restructure debt to avoid default
  - External matters, such as legal proceedings, legislation, or similar matters that might jeopardize the organization's ability to operate; loss of a key franchise, license, or patent; loss of a principal customer or supplier; or an uninsured or underinsured catastrophe such as a hurricane, tornado, earthquake, or flood

Going Concern

- The term ***probable*** is when management identifies conditions or events that raise substantial doubt about an entity's ability to continue as a going concern,
- **Management** should consider whether its plans that are intended to mitigate those relevant conditions or events will alleviate the substantial doubt.

Going Concern

- The mitigating effect of management's plans should be considered ***only to the extent*** that:
  - (1) it is **probable** that the **plans will be** effectively implemented and, if so,
  - (2) it is **probable** that the plans **will mitigate** the conditions or events that raise substantial doubt about the entity's ability to continue as a going concern.

Going Concern

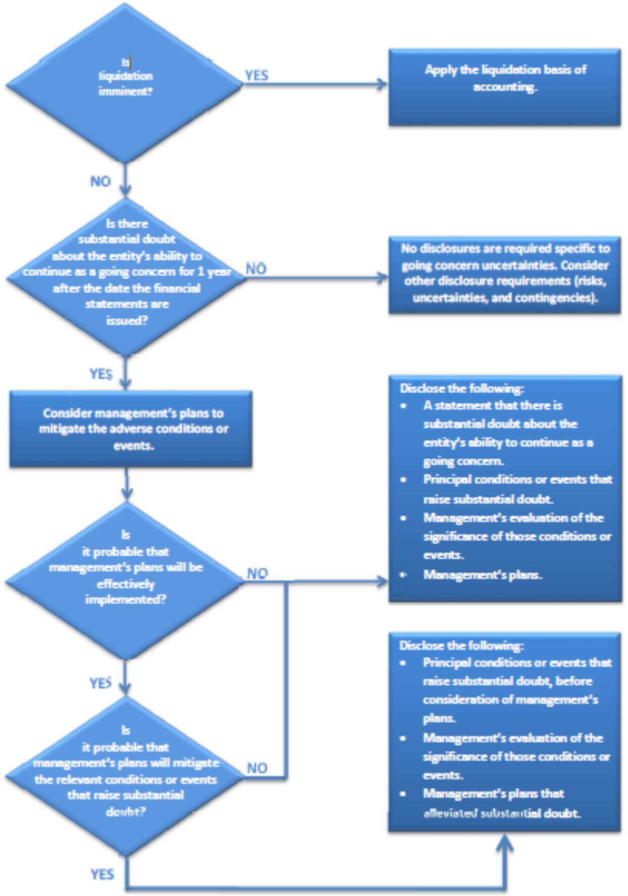
- If going concern is mitigated, the entity should disclose information that enables users of the financial statements to understand all of the following (or refer to similar information disclosed elsewhere in the footnotes):
  - Principal conditions or events that raised substantial doubt about the entity's ability to continue as a going concern (before consideration of management's plans).
  - Management's evaluation of the significance of those conditions or events in relation to the entity's ability to meet its obligations
  - Management's plans that alleviated substantial doubt about the entity's ability to continue as a going concern.

Going Concern

If conditions or events raise substantial doubt about an entity's ability to continue as a going concern, and substantial doubt is **not** alleviated after consideration of management's plans:

- an entity should include a statement in the footnotes indicating that there is *substantial doubt about the entity's ability to continue as a going concern* within one year after the date that the financial statements are issued (or available to be issued).

Going Concern



Leases: Are You Ready?

ASU 2016-02 *Leases (Topic 842)*

- Guidance covered
  - ASU 2016-02, *Leases (Topic 842)*
  - ASU 2017-13, *Revenue Recognition (Topic 605), Revenue from Contracts with Customers (Topic 606), Leases (Topic 840), and Leases (Topic 842): Amendments to SEC Paragraphs Pursuant to the Staff Announcement at the July 20, 2017 EITF Meeting and Rescission of Prior SEC Staff Announcements and Observer Comments (SEC Update)*
  - ASU 2018-01, *Leases (Topic 842): Land Easement Practical Expedient for Transition to Topic 842*
  - ASU 2018-10, *Codification Improvements to Topic 842, Leases*
  - ASU 2018-11, *Leases (Topic 842): Targeted Improvements*
  - ASU 2018-20, *Leases (Topic 842): Narrow-scope Improvements for Lessors*
  - ASU 2019-01, *Leases (Topic 842): Codification Improvements*
  - ASU 2019-10, *Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842): Effective Dates*
  - ASU 2020-02, *Financial Instruments—Credit Losses (Topic 326) and Leases (Topic 842)—Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 119 and Update to SEC Section on Effective Date Related to Accounting Standards Update No. 2016-02, Leases (Topic 842) (SEC Update)*
  - ASU 2020-05, *Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842): Effective Dates for Certain Entities*
  - ASU 2021-05, *Leases (Topic 842): Lessors—Certain Leases with Variable Lease Payments*
  - ASU 2021-09, *Leases (Topic 842): Discount Rate for Lessees That Are Not Public Business Entities*

ASU 2016-02 *Leases (Topic 842)*

- Why the change?
  - Increase comparability and transparency among entities
  - Decade-long joint project with IASB
  - Previous guidance failed to represent fully the actual substance of leasing transactions; namely not recognizing assets and liabilities arising from operating lease transactions
  - Lessor accounting remained relatively unchanged
  - FedEx vs. UPS case study

Definition of a Lease

For each contract, at inception the company should determine whether the contract is or contains a lease.

A lease allows a lessee the right to control or use a specified asset (property, plant, or equipment) for a period of time in exchange for consideration. The lessee has a right to the economic benefit from the asset and the right to direct its use.

Previous lease accounting focused on the distinction between capital and operating leases. New guidance focuses on whether or not a contract <u>contains</u> or <u>is</u> a lease.

Definition of a Lease

- An asset is identified explicitly or implicitly
  - The asset must be physically distinct
    - A physically distinct asset may be an entire asset or a portion of an asset. For example, within a building one floor in the building may be considered physically distinct if it can be used independently
  - The supplier must not have substitution rights
    - Example if the supplier has both the <u>practical ability to substitute</u> alternative assets, and the supplier would <u>benefit economically</u> from the exercise of its right to substitution

Definition of a Lease

ASC 842 does not apply to any of the following:

- Leases of intangible assets
- Leases to explore for or use minerals, oil, natural gas, and similar non-regenerative resources, including the intangible right to explore for those natural resources and rights to use the land in which those natural resources are contained (unless those rights to use include more than the right to explore for natural resources), but not equipment used to explore for the natural resources

Definition of a Lease

ASC 842 does not apply to any of the following:

- Leases of biological assets, including timber
- Leases of inventory (i.e., assets held for sale in the ordinary course of business, assets in the process of production for sale, and assets to be currently consumed in the production of goods or services to be available for sale)
- Leases of assets under construction

Classification of Leases

- What are the changes?
  - At the core, the main difference is the recognition of leased assets and liabilities for lessees.
  - New guidance retains the distinction between <u>finance</u> leases and <u>operating</u> leases. The treatment is substantially similar to the previous guidance distinctions between <u>capital</u> and <u>operating</u> leases.
  - Under lessee accounting, the effect on the income statement and statement of cash flows remains largely unchanged.

Classification of Leases

- Lease classification and measurement occur at the lease commencement date under ASC 842

  The date on which a lessor makes an underlying asset available for use by a lessee.

- If a lease meets any of the **following five criteria**, it is a finance lease for the lessee and sales-type for the lessor:

  1. **Transfer of ownership**

     A lease is classified as a finance lease if ownership of the underlying asset transfers to the lessee by the end of the lease term.

  2. **Exercise of option to purchase the underlying asset is reasonably certain**

     If a lease contains an option to purchase and the option is reasonably certain to be exercised the lease is a finance lease. Reasonably certain to be impacted by a significant economic incentive.

Classification of Leases

3. **Lease term is for "major part" of the remaining economic life**

   ASC 842 states if the lease term is for a major part of the remaining economic life, the lessee has effectively obtained and should classify the lease as a finance lease.

4. **Present value of the lease payments is "substantially all" of the fair value**

   The lease payments criterion is met if the present value of the sum of lease payments equals or exceeds substantially all of the fair value of the underlying asset.

5. **Underlying asset is of specialized nature**

   Specialized nature means expected to have no alternative use to the lessor at the end of the lease term

If none of the above criteria are met, the lease is classified as operating for the lessee.

Lease Terms—Lessee

- The lease term is determined on the lease commencement date and is defined as the noncancellable term. ASC 842-10-30-1 states an entity shall determine the lease term as the noncancellable period of the lease, together with all of the following (management intentions):
  - Periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option *Side note: These make your accountants cry.*

Lease Terms—Lessee

- Lease term (cont.)
  - 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
- Exclude variable lease payments, except those that are index- or rate-dependent or are, in substance, fixed payments. Practice note: think about rent as a percentage of sales (retail)
  - The new guidance in ASU 2021-05 addresses the lessor's accounting for these types of leases.

Lease Terms—Lessee

- Carve out for 12-month or less leases but not for immaterial leases
  - A short-term lease is defined as a lease that has a term 12 months or less and does not include an option to purchase (or extend) the underlying asset that the lessee is reasonably certain to exercise.
  - Short term leases are then treated as executory contracts similar to accounting for operating leases under ASC 840 (Legacy GAAP)
  - Companies will still be require to disclose aggregate short term lease costs

Recognition and Measurement—Lessee

- Operating leases
  - Right-of-use (“ROU”) asset and lease liability are both initially measured at the present value of the lease payments.
  - Single expense is recognized (lease expense) that runs through operating activities for the current year to relieve ROU. Overall cost of the lease is allocated over the lease term on a straight-line basis.
  - Consider also stair-step rentals that give rise to deferred rent.

Recognition and Measurement—Lessee

- Financing leases
  - ROU asset and lease liability are both recognized and discounted to present value.
  - Each payment has two components (interest and principal). Interest is a current period interest expense. Principal is amortized to reduce the ROU (similar to how depreciation on a capital lease is currently reported).
  - Repayment of principal portion of lease liability is a financing activity. Payments of interest and variable lease payments (think copier) are operating activities in cash flows.

Recognition and Measurement—Lessee

- The ROU asset and lease liability are measured at the present value of the lease payments to be made over the lease term.
  - Discount rate: Implicit in lease contract or incremental borrowing rate
  - Nonpublic companies can elect to use the risk free rate as a practical expedient
- Any upfront direct costs, prepayments, and lease incentives are accounted for as part of the ROU asset.
- Lease contracts may contain both lease and nonlease components. ASC 842 requires a reporting entity to allocate the contractual consideration between components of the arrangement. Components discussed later.

Recognition and Measurement—Lessor

- Lessors (primarily in real estate) lobbied harder and lessor accounting remains largely unchanged.
- Terminology updated for consistency to apply to lessees that in turn sublease an asset and become lessors.
- The classification criteria are similar to that for lessees, with an additional requirement to assess collectability to support classification as a direct financing lease. Also, in order to derecognize the asset and record revenue, collection of payments due must be probable for sales-type leases.
- Key aspects were shifted to align lessor revenue streams to new revenue recognition guidance in ASU 2014-09 *Revenue from Contracts with Customers (Topic 606)*

Lease and Nonlease Components

- Consider two distinct scenarios:
  - The lease of three individual pieces of construction equipment (a dump truck, a back hoe, and a crane)

    – VS–

  - The lease of a copier with a maintenance package
  - The consideration given for the three pieces of medical equipment can be separated out as each machine works independently. Each machine would have its own lease asset and liability whereas with the copier, the machine itself would be leased, but the maintenance contract would be a nonlease item and should not have a related asset and liability.

Lease Modifications

- ASC 842 defines a *lease modification* as a change to the terms and conditions of a contract that results in a change in the scope of or the consideration for a lease.
  - For example, a modification may occur when entities agree to expand the lease of space to include an additional floor in a medical office building or when entities agree to terminate a portion of a contract, such as a reduction in the lease term in a contract to use a medical equipment asset.

Lease Modifications

- In a change from today's guidance, lessees and lessors account for a lease modification as a separate contract (i.e., separate from the original lease) when certain conditions are met.
- How an entity will account for modifications that do not result in a separate contract will depend on whether the entity is a lessee or lessor, the nature of the modification, and the classification of the lease before and after the modification.

Related Party Leases

- ASC 842 requires lessees and lessors to account for related party leases (e.g., leases between a health system and its joint venture) on the basis of the legally enforceable terms and conditions of the lease.
- This eliminates the requirement in ASC 840 for lessees and lessors to evaluate the economic substance of a lease to determine the appropriate accounting.
- Lessees and lessors are required to apply the disclosure requirements for related party transactions in accordance with ASC 850, *Related Party Disclosures*.

Disclosures

- Operating and financing ROU assets should be presented separately from one another and from other assets. Same is true of lease liabilities.
- If a classified balance sheet is presented, those rules apply as well.
- No netting the assets and liabilities.
- In finance leases, interest expense and amortization of the ROU can be presented together, but only if that treatment is consistent with how interest expense and depreciation/amortization are presented for other types of assets.
- In operating leases, lease expense is included in income from continuing operations.

Disclosures

- For cash flows, principal payments of the lease liability for financing leases are financing activities. Interest expense is an operating activity consistent with *Statement of Cash Flows (Topic 230)*. Payments for operating leases are classified as operating activities, and the same holds true for variable lease payments or short-term lease payments.
- Qualitative and quantitative info including:
  - General details about leases
  - Significant judgments made
  - Amounts recognized in the financials related to those judgments

Disclosures

The disclosure requirements apply to all entities:

- A lessee that elects the practical expedient shall disclose its accounting policy election
- Short-term lease cost, excluding expenses relating to leases with a lease term of one month or less must be disclosed

Lessees need to apply judgment to determine the appropriate level to aggregate or disaggregate disclosures so that meaningful information is not obscured by insignificant details or by groupings of items with different characteristics.

	Year Ending December 31,	
	20X2	20X1
Lease cost		
Finance lease cost:	$XXX	$XXX
Amortization of right-of-use assets	XXX	XXX
Interest on lease liabilities	XXX	XXX
Operating lease cost	XXX	XXX
Short-term lease cost	XXX	XXX
Variable lease cost	XXX	XXX
Sublease income	(XXX)	(XXX)
Total lease cost	$XXX	$XXX
Other information		
(Gains) and losses on sale and leaseback transactions, net	$(XXX)	$XXX
Cash paid for amounts included in the measurement of lease liabilities	XXX	XXX
Operating cash flows from finance leases	XXX	XXX
Operating cash flows from operating leases	XXX	XXX
Financing cash flows from finance leases	XXX	XXX
Right-of-use assets obtained in exchange for new finance lease liabilities	XXX	XXX
Right-of-use assets obtained in exchange for new operating lease liabilities	XXX	XXX
Weighted-average remaining lease term—finance leases	X.X years	X.X years
Weighted-average remaining lease term—operating leases	X.X years	X.X years
Weighted-average discount rate—finance leases	X.X%	X.X%
Weighted-average discount rate—operating leases	X.X%	X.X%

Implementation

- When?
  - For public business entities: Calendar year 2019/Fiscal year 2019-20
  - For all other entities: Calendar year 2020/Fiscal year 2020-21
  - Early application is permitted
- ASU 2019-10, issued in November 2019, extended the implementation date for private companies out an additional year to calendar year 2021/Fiscal year 2021-22.
- In ASU 2020-05, issued in June 2020, the FASB, due to the effects of COVID-19, deferred implementation an additional year for private companies and certain NFPs that have not yet issued their financial statements. Calendar year 2022/Fiscal year 2022-23.

Implementation

- Available Practical Expedients
  - A lessee may elect an accounting policy, by asset class, to include both the lease and non-lease components as a single component and account for it as a lease.
  - Hindsight Practical Expedient
    - Must be applied consistently by an entity to all of its leases to use hindsight in determining the lease term (that is, when considering lessee options to extend or terminate the lease and to purchase the underlying asset) and in assessing impairment of the entity's ROU assets.

Implementation

- Available Practical Expedients
  - Packaged Practical Expedient
    1. An entity need not reassess whether any expired or existing contracts are or contain leases.
    2. An entity need not reassess the lease classification for any expired or existing leases (for example, all existing leases that were classified as operating leases in accordance with ASC 840 will be classified as operating leases, and all existing leases that were classified as capital leases in accordance with ASC 840 will be classified as finance leases).
    3. An entity need not reassess initial direct costs for any existing leases

Implementation

- Available Practical Expedients
  - An entity also may elect a practical expedient to not assess whether existing or expired land easements that were not previously accounted for as leases under ASC 840 are or contain a lease under ASC 842
  - Other practical expedients subsequently issued:
    - Easements—treat easements as currently treated upon transition
    - Removal of retrospective adoption requirement—no need to adopt as of earliest presented period, rather just the current period when adopting

ASU 2016-03, *Financial Instruments—Credit Losses (Topic 326)*

Everyone Needs an Allowance

ASU 2016-13, *Financial Instruments—Credit Losses (Topic 326)*

- Ramification from the 2008 financial crisis, the FASB was concerned that credit losses were identified far too late for effective remediation.

- Primarily affects credit lending institutions like banks and lenders, although the standard is written so broadly that essentially all entities are subject to the requirements.

ASU 2016-13, *Financial Instruments—Credit Losses (Topic 326)*

- At a high level, the new guidance addresses these key areas:
  - Current expected credit losses (CECL) impairment model for financial assets measured at amortized cost
  - Available-for-sale (AFS) debt security impairment model
  - Initial recognition of what are called purchased financial assets with noticeable credit deterioration or purchased credit-deteriorated (PCD) assets
  - Accounting for beneficial interests in securitized financial assets

ASU 2016-13, *Financial Instruments—Credit Losses (Topic 326)*

- Entities must estimate the amount expected lifetime credit losses on all manner of financial assets ranging from short-term trade accounts receivable to long-term financing.
- Gathering the information needed for the required modeling will be a substantial undertaking, requiring entities to enhance their policies, processes, and controls, particularly around the data involving historical credit losses needed to also satisfy enhanced financial statement disclosures.

ASU 2016-13, *Financial Instruments—Credit Losses (Topic 326)*

	Financial assets measured at amortized cost	Available-for-sale (AFS) debt securities	Beneficial interests in the scope of ASC 325-40
Examples of affected Instruments	Accounts receivable, held-to-maturity (HTM) debt securities, financing receivables and net investments in leases (i.e., for a sales-type lease, the lease receivable and the unguaranteed residual asset; for a direct finance lease, the lease receivable and the unguaranteed residual asset less any deferred selling profit)	AFS debt securities	Residual interests and other subordinated tranches of securitizations
Impairment model to be applied	Current estimate of expected lifetime credit losses (CECL) model in ASC 326-20	AFS debt security model in ASC 326-30	The CECL model for HTM securities (ASC 326-20) or the model for AFS debt securities (ASC 326-30)

Source: EY – *A comprehensive guide: Credit impairment under ASC 326* – June 2019

ASU 2016-13, *Financial Instruments—Credit Losses (Topic 326)*

	Financial assets measured at amortized cost	Available-for-sale (AFS) debt securities	Beneficial interests in the scope of ASC 325-40
Key changes from current US GAAP	▸ Estimate losses over the contractual life using pool-based assumptions to capture the risk of loss, even if remote ▸ Consider reasonable and supportable forecasts of economic conditions ▸ Record an allowance on all components of the instrument's amortized cost ▸ Record an allowance at acquisition (but no credit loss expense) for instruments that have experienced more-than- insignificant credit deterioration since origination (PCD assets) ▸ Make significant new disclosures	▸ No longer consider the length of time an instrument has been impaired ▸ Record an allowance for credit losses rather than a reduction of the amortized cost basis ▸ Limit credit losses to the excess of amortized cost over fair value ▸ Reduce the allowance for improvements in expected cash flows and reverse credit loss expense in the income statement ▸ Record an allowance at acquisition (but not a credit loss expense) for PCD assets	▸ Record an allowance rather than a reduction of the amortized cost basis ▸ Record an allowance at acquisition or origination (but not a credit loss expense) for PCD assets, including those for which there is a significant difference between estimated and contractual cash flows ▸ Recognize changes in expected credit losses (both positive (up to the amount of the allowance) and negative) in the allowance

Source: EY – *A comprehensive guide: Credit impairment under ASC 326* – June 2019

ASU 2016-13, *Financial Instruments—Credit Losses (Topic 326)*

	Financial assets measured at amortized cost	Available-for-sale (AFS) debt securities	Beneficial interests in the scope of ASC 325-40
Financial statement and process-related effects	▸ May recognize credit losses earlier and record on instruments that may not have had an allowance under legacy GAAP ▸ May make credit loss expense and, therefore, earnings more volatile ▸ May require additional processes and controls and financial modeling capabilities ▸ May need to collect external data to support existing data gaps	▸ Will likely require enhancements to existing systems and processes ▸ May recognize credit losses earlier because an entity may not consider the amount of time an AFS debt security is impaired when determining whether an allowance is required	▸ Same effects as for other securities classified as either HTM or AFS because they follow the CECL or AFS impairment model, respectively. ▸ Will require adjustments to yield less frequently because positive changes in expected credit losses will first be recognized in the allowance for credit losses, if any, and will be reflected immediately in the income statement

Source: EY – *A comprehensive guide: Credit impairment under ASC 326* – June 2019

ASU 2016-13, *Financial Instruments—Credit Losses (Topic 326)*

	Key differences	
	Legacy GAAP	**CECL (ASC 326-20)**
Recognition threshold	When a loss is incurred as of the balance sheet date	When lifetime credit losses are expected (i.e., in virtually all cases)
Unit of measurement	Pooling permitted but not required	Pooling required when assets share risk characteristics
Consideration of economic conditions	Consider current economic conditions	Consider current economic conditions and management's expectations of future economic conditions
Consideration of the contractual term	Not part of the calculation of incurred losses at the balance sheet date	Measure expected credit losses over the asset's contractual term

Source: EY – *A comprehensive guide: Credit impairment under ASC 326* – June 2019

ASU 2016-13, *Financial Instruments—Credit Losses (Topic 326)*

	Description	Key implementation considerations
Based on an asset's amortized cost	The components of amortized cost include unpaid principal balance (UPB), accrued interest, unamortized discounts and premiums, foreign exchange adjustments and fair value hedge accounting adjustments. The ASU requires the estimate to be based on a financial asset's amortized cost. An entity is not permitted to avoid recording an allowance because a discount exists (i.e., the ASU prohibits "accrete to impair" policies where an entity would not record an allowance if the allowance amount is less than the discount).	▸ Limited historical loss information may be readily available for components of amortized cost other than the UPB. ▸ Nonaccrual policies may affect loss history for accrued interest. ▸ Entities will need to develop processes and controls to capture the expected credit losses on those components of amortized cost that may not have historically been addressed.

Source: EY – *A comprehensive guide: Credit impairment under ASC 326* – June 2019

ASU 2016-13, *Financial Instruments—Credit Losses (Topic 326)*

	Description	Key implementation considerations
Reflect the risk of loss	Assets should be evaluated collectively based on similar risk characteristics. The risk of loss, even if remote, should be captured.	▸ Defining pools as precisely as possible will increase the precision of the estimate. ▸ Assets that historically had a zero allowance will likely require an allowance under CECL. ▸ Entities need to reconsider whether assets grouped in a pool continue to share similar risk characteristics at each measurement date.

ASU 2016-13, *Financial Instruments—Credit Losses (Topic 326)*

	Description	Key implementation considerations
Reflect losses over an asset's contractual life	Contractual life should consider expected prepayments but should not consider expected extensions, renewals and modifications unless there is a reasonable expectation that a troubled debt restructuring (TDR) will be executed with the borrower or the lender has no control over whether a contractual extension option will be exercised by the borrower (i.e., the option is not unconditionally cancelable by the lender).	▸ Entities may find it challenging to: ▸ Determine the life of instruments with no stated maturity date (e.g., accounts receivable, credit card receivables) ▸ Evaluate whether loans refinanced with the same lender are prepayments ▸ Obtain sufficient support for prepayment adjustments ▸ Entities may find the modeling of contractual extension and renewal options challenging.

Source: EY – *A comprehensive guide: Credit impairment under ASC 326* – June 2019

ASU 2016-13, *Financial Instruments—Credit Losses (Topic 326)*

	Description	Key implementation considerations
Consider available relevant information	Historical loss data should provide the basis for determining the allowance for credit losses. This data should be adjusted for asset-specific considerations, current economic conditions and reasonable and supportable forecasts.	▸ Significant judgment will be required to: ▸ Select key economic variable(s) ▸ Develop the reasonable and supportable forecast period and model the effect on loss rates ▸ Determine whether to use a single best estimate or probability-weighted scenarios ▸ Support adjustments to historical loss information and the reversion methodology ▸ Entities need to evaluate data availability and integrity and consider the use of external data to address incomplete or insufficient internal data.

Source: EY – *A comprehensive guide: Credit impairment under ASC 326* – June 2019

Accounting Potpourri: The FASB Horizon

FASB Horizon

- ASU 2020-04, *Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting*. Effective for private companies from March 12, 2020-December 31, 2022
  - ASU 2021-01, *Reference Rate Reform (Topic 848): Scope*. Effective for private companies immediately (January 2021)
- ASU 2019-12, *Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes*. Effective for private companies after 12/15/21
- ASU 2017-04, *Intangibles—Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment*. Effective for private companies after 12/15/22
  - ASU 2021-03, *Intangibles—Goodwill and Other (Topic 350): Accounting Alternative for Evaluating Triggering Events*. Effective for private companies for years after 12/15/2019 that have not issued financial statements as of 3/30/2021

Reference Rate Reform

- Regulators in several jurisdictions around the world have undertaken reference rate reform initiatives to identify alternative reference rates that are more observable or transaction-based and less susceptible to manipulation than LIBOR and others. The upshot:
  - LIBOR folks were naughty
  - Modification to receivable and debt contracts to substitute LIBOR for another rate should be accounted for prospectively
  - Modifications to leases under 840 and 842 should experience no change and have no reassessment to discount rate

Income Taxes

- Part of the Simplification Initiative. It took FASB 49 pages to simplify the 25,500 page tax code.☺
- Main provisions:
  - Removed four exceptions to accounting for taxes including applying the incremental approach to intraperiod tax allocations when there is a loss from ops and gain from other items; recognizing a deferred tax liability for equity method investments on a foreign sub; and calculating income taxes in an interim period when YTD losses exceed anticipated losses.

Income Taxes

- Main provisions (cont.)
  - Added four expedients/clarifications including recognizing a tax based on income (even partially) as a income tax and incremental increases as non-income taxes; evaluating whether a step up in goodwill should be considered part of the business combination in which book goodwill was originally recognized or if it is a separate transaction; clarifying that an entity does not need to allocate the consolidated amount of current and deferred taxes to a entity that is not subject to taxes in its own financials; requiring that entites reflect the effect of a change in tax rate during interim periods

Intangibles—Goodwill and Other

- ASU 2021-03: This ASU affords a policy election that management may opt to consider goodwill impairment triggering events at the end of a financial reporting period rather than during a financial reporting period. Volatility due to COVID made evaluating impairment during the reporting costly and often erroneous.
- ASU 2017-04: This ASU removes the requirement for the two-step goodwill impairment test and instead only requires private companies to evaluate whether the carrying value is below the fair market value of goodwill and book the reduction at the time of evaluation.

Thank you

QUESTIONS?

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