

GAAP Update in Sixty Minutes:

Charting the Course

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Reviewed: MAY 15, 2017



GAAP – On a Road of Change

BY THE END OF THE PRESENTATION, YOU WILL:

- Have an understanding of highlights of recent and upcoming changes in GAAP
- Identify recent accounting updates that may impact your company's accounting procedures, policies and financial statements

GAAP Updates

– Breaking it Down



Current ASU's
– A Select Few

Leases

Revenue
Recognition

Top 6 from 2016
+ Highlights of
2017 and Beyond



What Rules the Changes?

The Financial Accounting Standards Board (FASB)

issues

Accounting Standards Updates (ASU)

and those update...

FASB Accounting Standards Codification (ASC) Topics

Effective dates noted are for calendar-year nonpublic entities.



ASU No. 2015-11

Inventory (Topic 330)

Simplifying the Measurement of Inventory

Now:

- Inventory is stated at the lower of cost or market
- FASB saw diversity in how “market” was determined
- Market could be replacement cost, net realizable value (NRV) or NRV less estimated profit margin

Simplification:

- Value inventory at lower of cost or NRV

Effective Calendar 2017

Early application permitted (EAP)



ASU No. 2016-15

Statement of Cash Flows (Topic 230) *Classification of Certain Cash Receipts and Cash Payments*

Now:

- Diversity in presentation of the 8 cash flow issues addressed

Simplification (Consistency):

- Reduce diversity in treatment as operating, investing, financing or noncash transactions
- Debt prepayment and extinguishment costs (primarily in financing section)
- Accreted interest on certain debt instruments (if insignificant, in operating , otherwise into financing)
- Payments of contingent consideration payments after an acquisition (can fall into all 3 categories)
- Proceeds from settlement of insurance claims (classify same as loss incurred)
- Proceeds from life insurance policies (primarily investing, premiums might be operating)
- Transfer of a beneficial interest in a securitization of financial assets (noncash or investing if cash received)
- Guidance on how to treat cash flows when they might fall into more than one class of cash flows
- Also covers distributions from equity method investees, including JVs
 - Cumulative earnings approach
 - Nature of distribution approach

Effective Calendar 2019, *EAP*



ASU No. 2015-17
Income Taxes (Topic 740)
*Balance Sheet Classification of
Deferred Taxes*

Now:

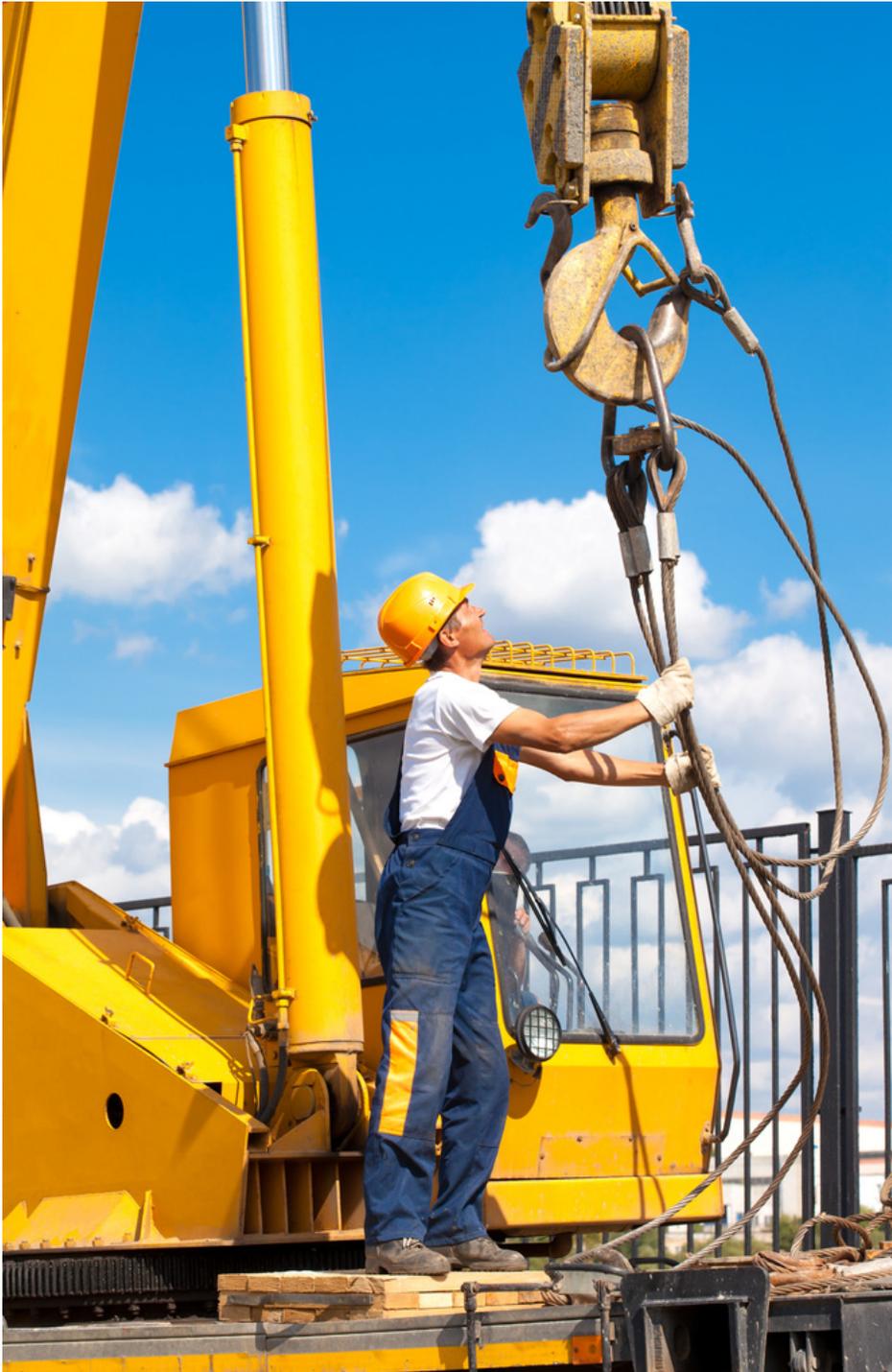
- Required to separate deferred income tax assets and liabilities into current and noncurrent classifications

Simplification:

- Classify all as noncurrent

Effective Calendar 2018

Early application permitted



ASU No. 2016-02 Leases (Topic 842)

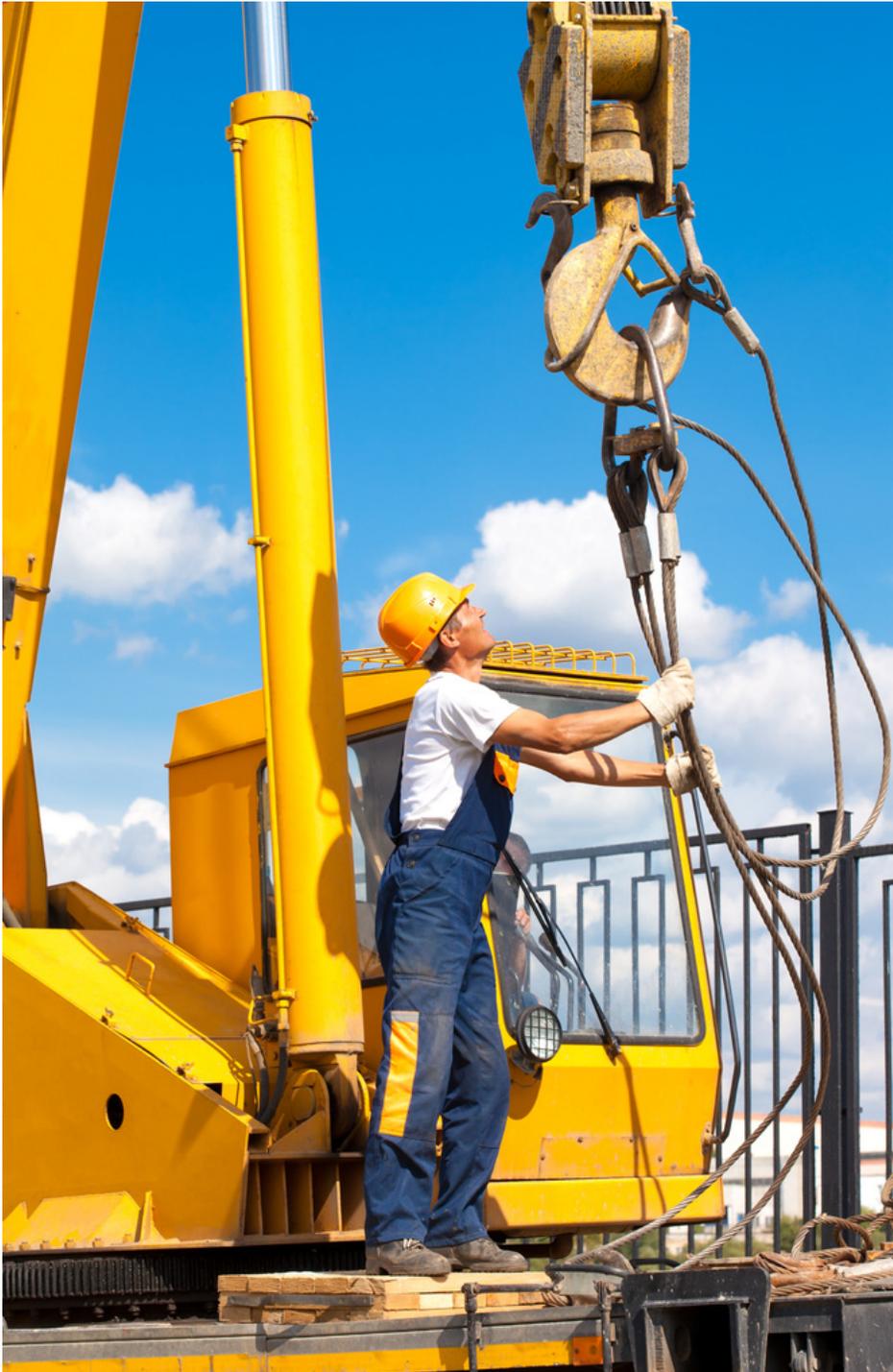
Now:

- Rules based
- Lessees determine if operating or capital based on whether or not the lease meets one of four capitalization criteria

Align with International Financial Reporting Standards (IFRS):

- Increase transparency and comparability
- Applies to all existing and new leases 12 months or longer. Assuming...
- ... your company makes an **accounting policy election** to exclude leases less than 12 months (simply expense them as paid)
- Term includes probable renewal periods,
- Record new right-of-use (ROU) asset and related lease obligation at present value of lease payments + initial direct costs

Effective Calendar 2020, *EAP*



ASU No. 2016-02 Leases (Topic 842) *(Continued)*

Classification: Finance Lease

- Ownership transfers by end of lease
- Can and probably will purchase asset
- Probable lease term is for majority of the asset's useful life
- PV of lease payments (including guaranteed residual payments) \geq substantially all fair value of leased asset
- Leased asset is so specialized in nature, not leasable to others

Expense Recognition:

- Broken down into amortization and interest components
- Acts like a loan with more expense in the initial years (interest component is higher when the lease liability is higher)
- Monthly entries would look like:

Cash	(xx,xxx)
ROU asset	(xx,xxx)
Lease liability	xx,xxx
Amortization	xx,xxx
Interest	xx,xxx



ASU No. 2016-02 Leases (Topic 842) *(Concluded)*

Classification: Operating Lease

- Not a finance lease

Expense Recognition:

- Straight-line
- All as lease expense within results from operations
- Monthly entries would look like:

Cash	(xx,xxx)
ROU asset	(xx,xxx)
Lease obligation	xx,xxx
Lease expense	xx,xxx



Polling question:

WHICH CELEBRETY DOES NOT HAVE A STAR ON THE HOLLYWOOD WALK OF FAME?

- George Clooney
- Julia Roberts
- Brad Pitt
- Donald Trump

ASUs on Revenue Recognition

ASU Nos. 2014-09, 2015-14, 2016-08 and 2016-10...

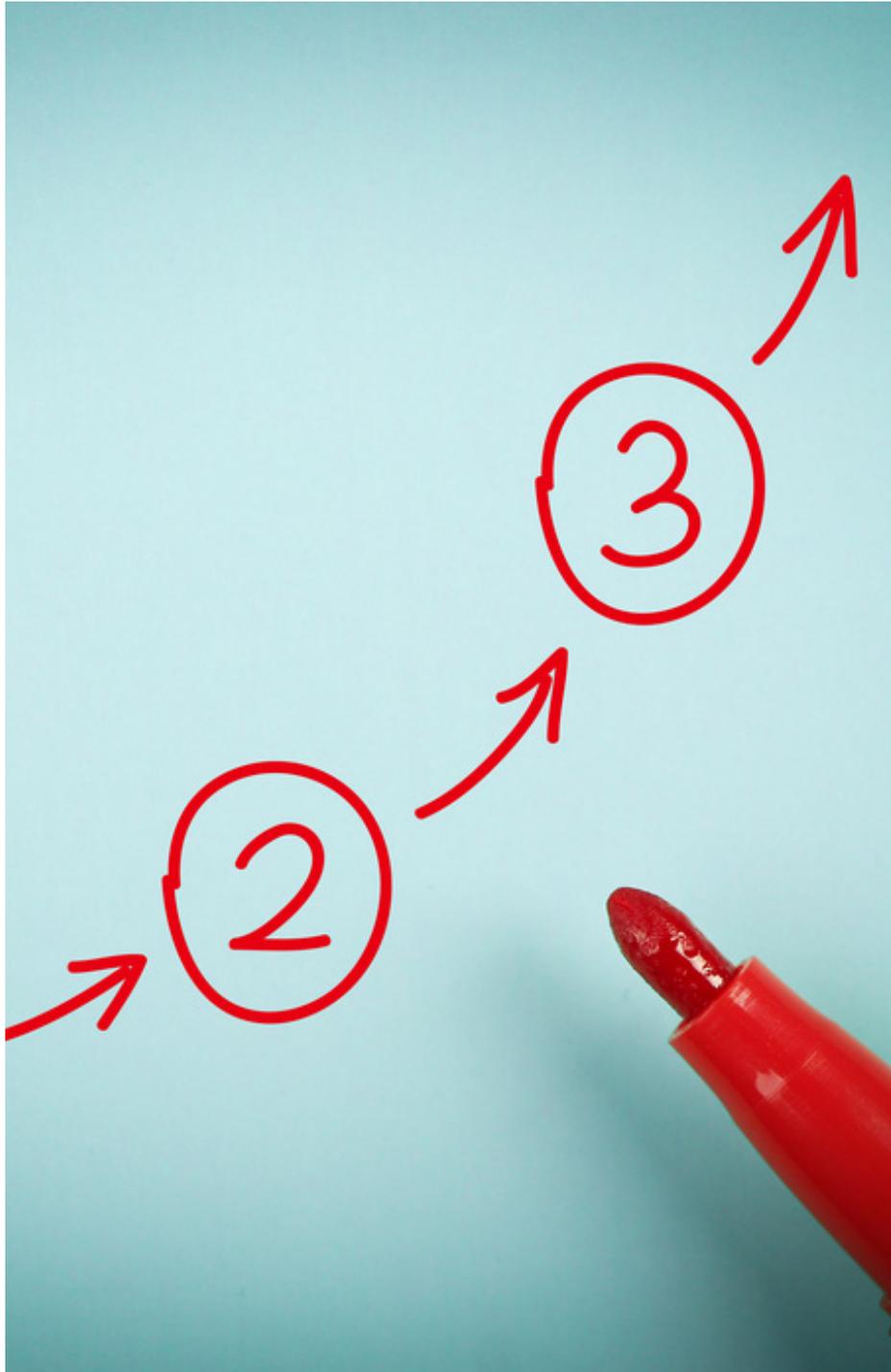
WHY IS FASB DOING THIS?

- Align with IFRS
- Moves away from transaction- and industry-specific revenue recognition standards
- Moves to a principles- based approach applicable to any entity that enters into contracts with customers to deliver goods or services.

WHAT'S THE CORE PRINCIPAL?

An entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration earned.

SIMPLE, RIGHT?



5 Steps to follow to comply with the Core Principal

1. Identify the contract(s) with the customer
2. Identify the performance obligations within each contract
3. Determine the transaction price
4. Allocate the transaction price to the performance obligations in the contract
5. Recognize revenue when (or as) the entity satisfies a performance obligation



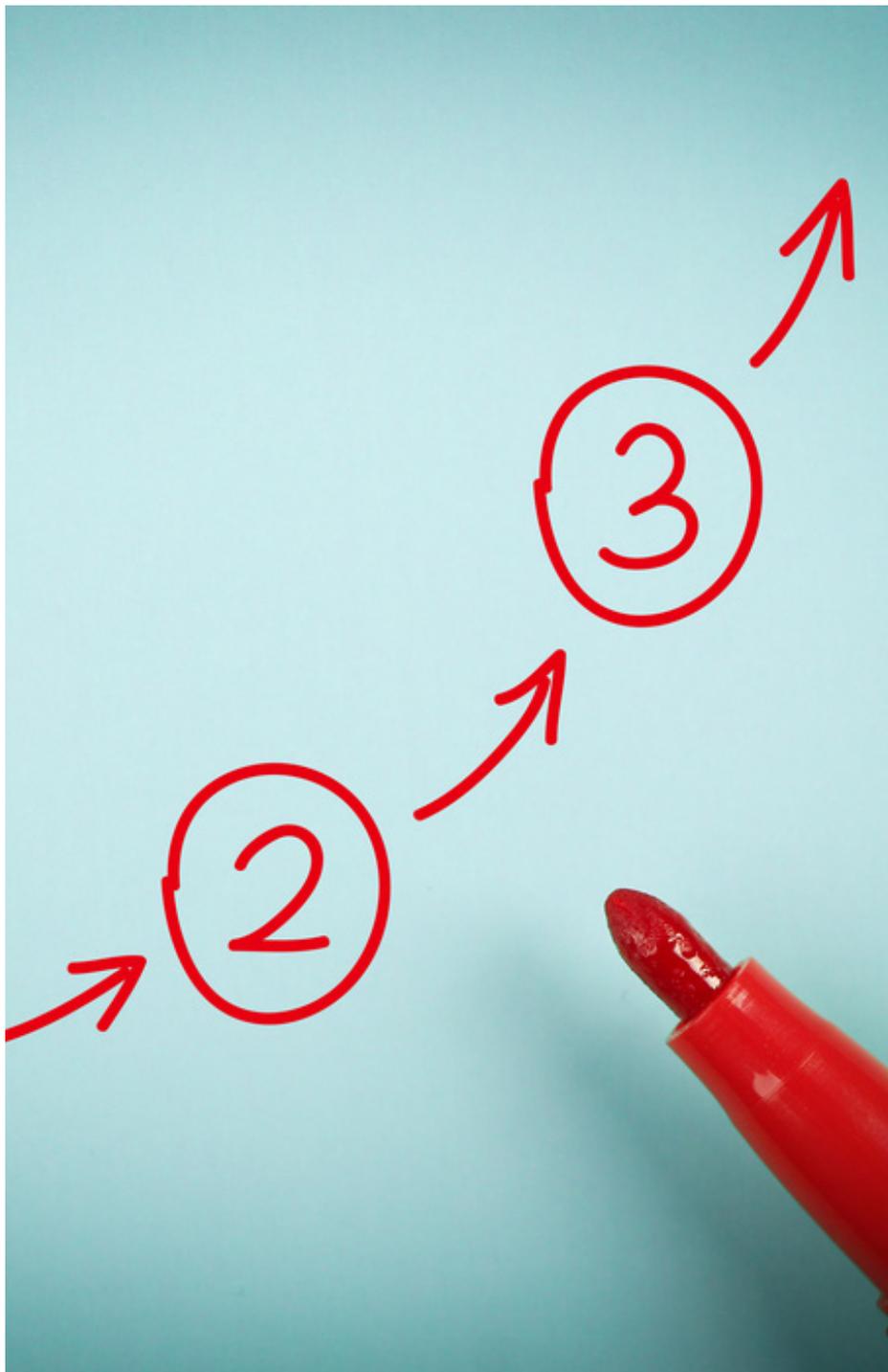
Step 1 – Identify the Contract with the Customer

What's a contract?

An agreement between two or more parties that creates enforceable rights and obligations.

Contracts should:

1. Be approved and show commitment
2. Identify rights of the parties
3. Identify payment and terms
4. Have commercial substance
5. Be probable that the company will collect the consideration (payments) for the goods or services



Step 2 – Identify the Performance Obligations in the Contract

What's a performance obligation?

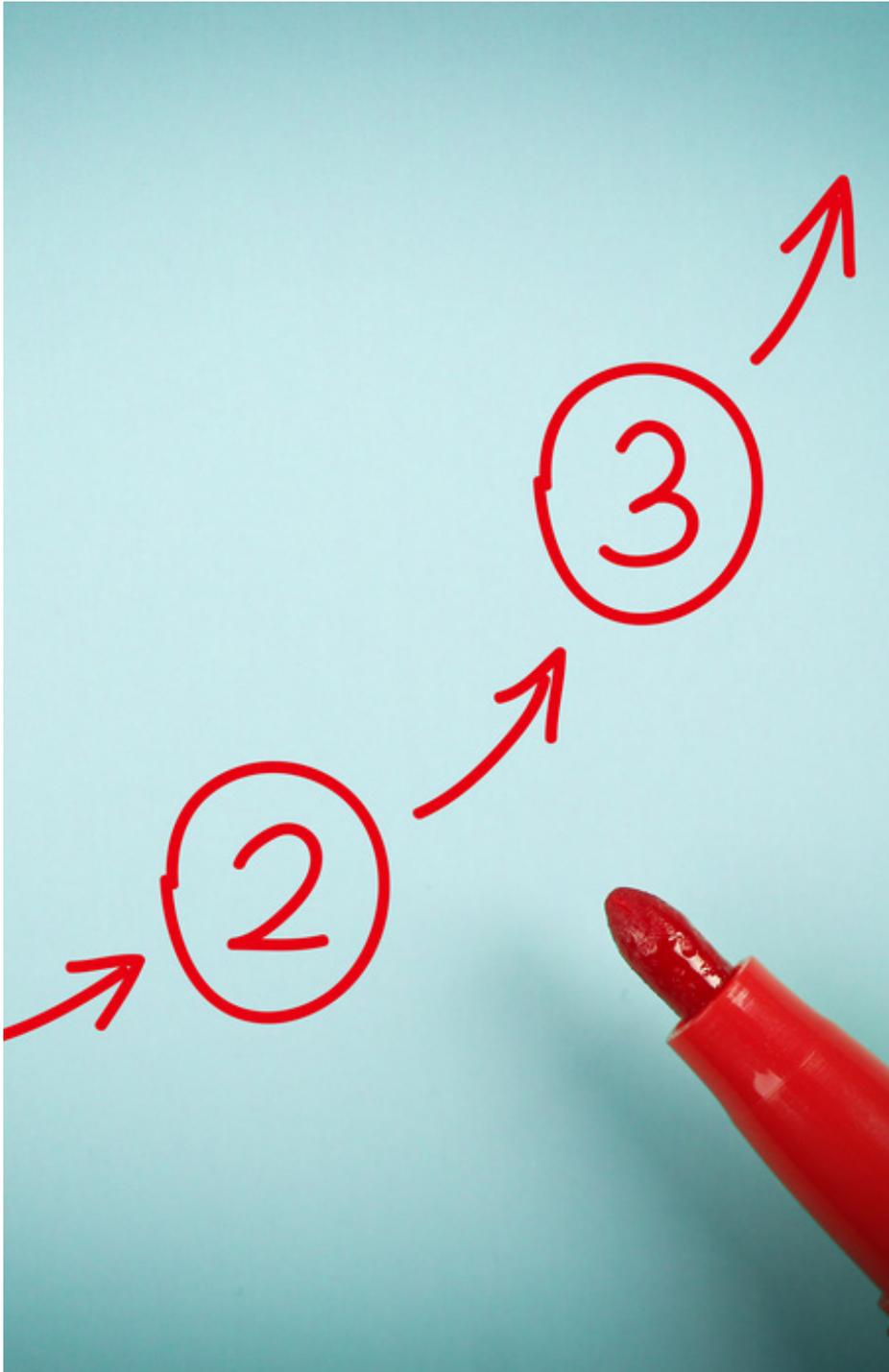
A promise in a contract to transfer a good or service to a customer that is distinct

Distinct?

1. ASU No. 2016-10 provides more in-depth guidance
2. Review the nature of the promise
3. Is it to transfer a number of items one item at a time? Or those items together in combination?

More guidance is coming from the Engineering & Construction Contractors Revenue Recognition Task Force (the Industry Task Force)

[In draft guidance] the Industry Task Force recommends considering how integrated the different services are



Step 3 – Determine the Transaction Price

Total transaction price =
fixed + variable consideration

Fixed

- Awarded fee

Variable

- Change orders
- Claims
- Penalties and incentives

Should unapproved changes be included in the transaction price?

Is it okay or required to include incentives in the transaction price?

Two methods used to measure variable consideration:

1. Expected value method
2. Most likely amount



Step 4 – Allocate the Transaction Price to the Performance Obligations within the Contract

How to Allocate?

1. In proportion to the standalone selling price, if observable
2. Estimate using a selected method if not
 - Adjusted market assessment approach
 - Expected cost plus a margin approach
 - Etc.



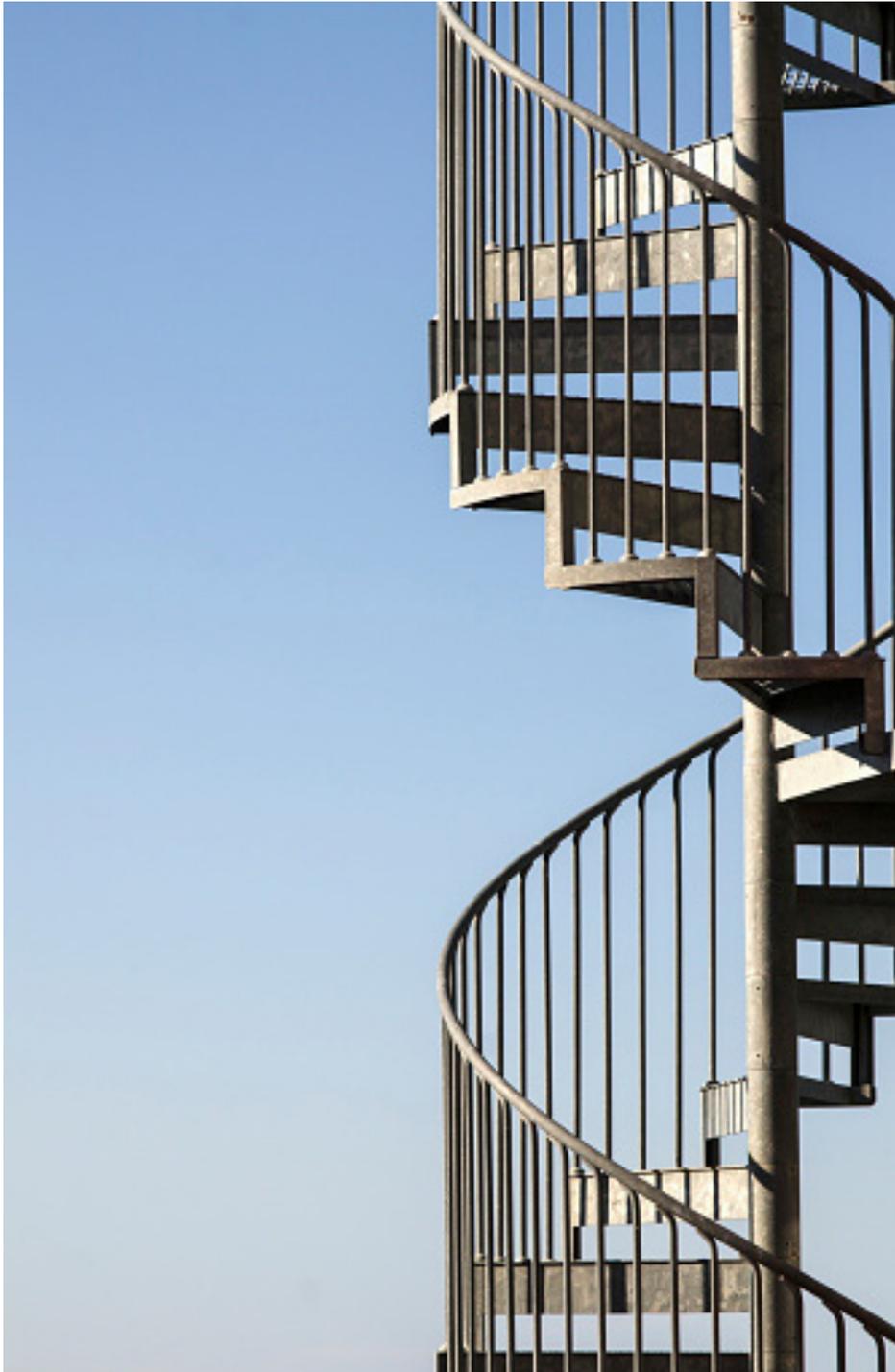
Step 5 – Recognize Revenue When the Performance Obligation is Satisfied

When might that be??

1. At a point in time
2. Over time

Draft guidance suggests contractors can use either input method or output method, as appropriate, to measure progress toward completion

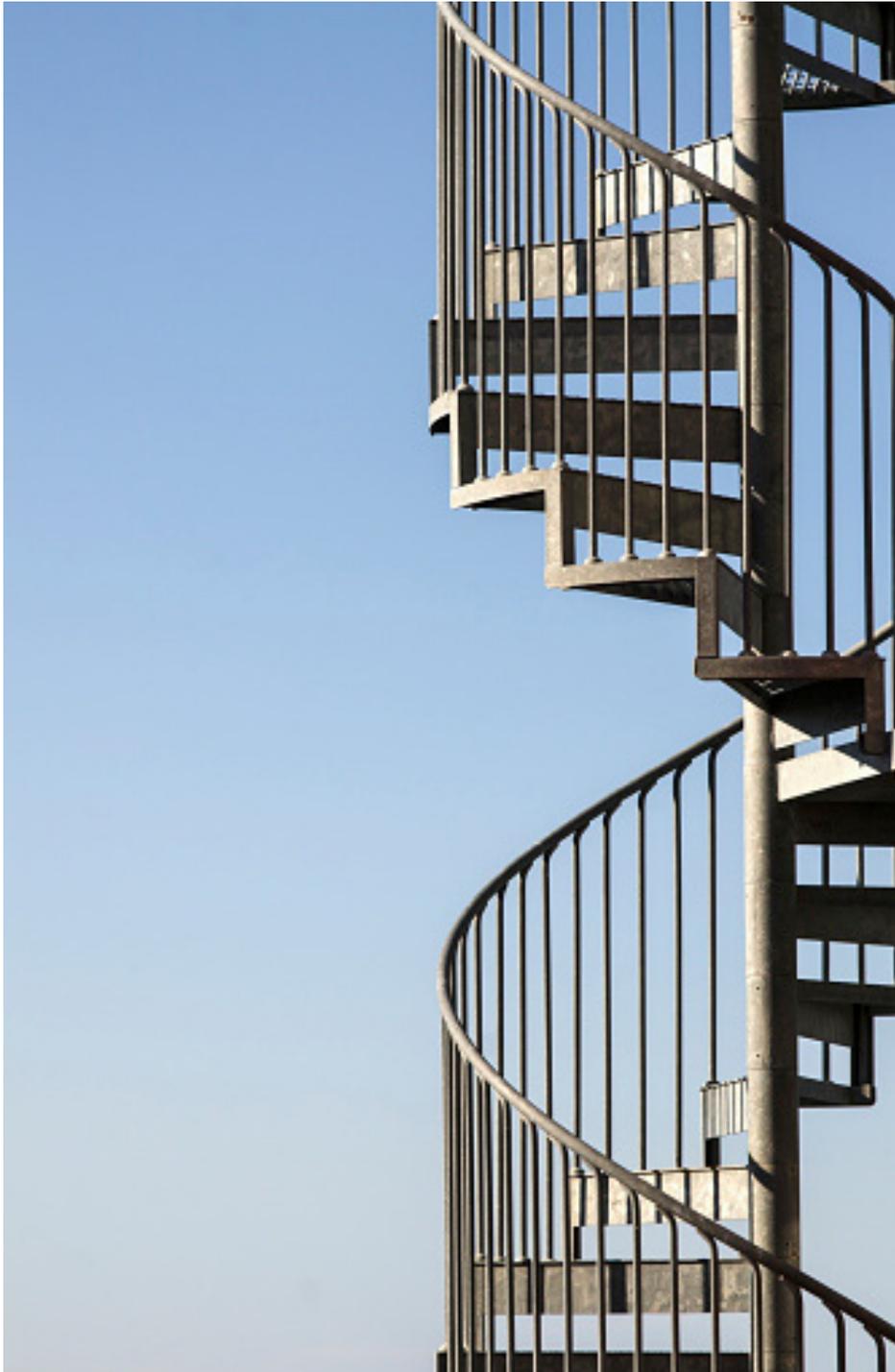
In most cases, current practice under the cost-to-cost percentage completion method will not change with revenue being recognized over time



Step 5 – Some Changes to What to Include in **Costs** Used to Measure Progress

Exclude from costs and total estimated costs to complete:

1. Significant inefficiencies in performance
 - Labor strikes
 - Design or construction execution errors
2. Costs incurred that are not indicative of performance
 - Procurement of significant equipment or materials in advance of installation



More Guidance

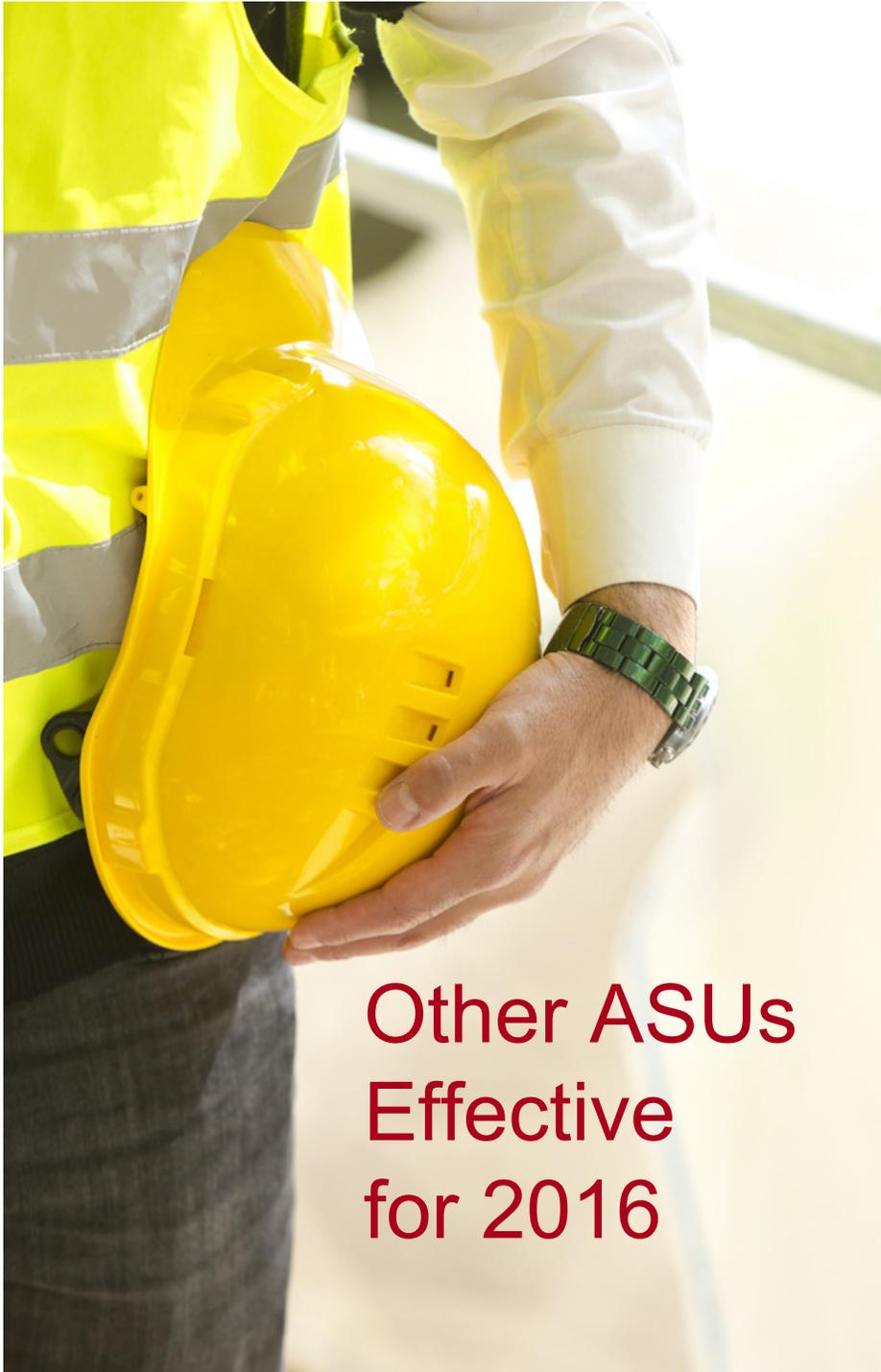
ASU 2016-08 clarified **principal vs. agent** consideration

ASU 2016-12 provided some **practical expedients for implementation**

Industry Task Force Updates and Drafts

<https://www.aicpa.org/interestareas/fr/c/accountingfinancialreporting/revenue/cognition/pages/rtrf-construction.aspx>

Stay Tuned!!



Other ASUs Effective for 2016

ASU No. 2016-03 Intangibles – Various Topics

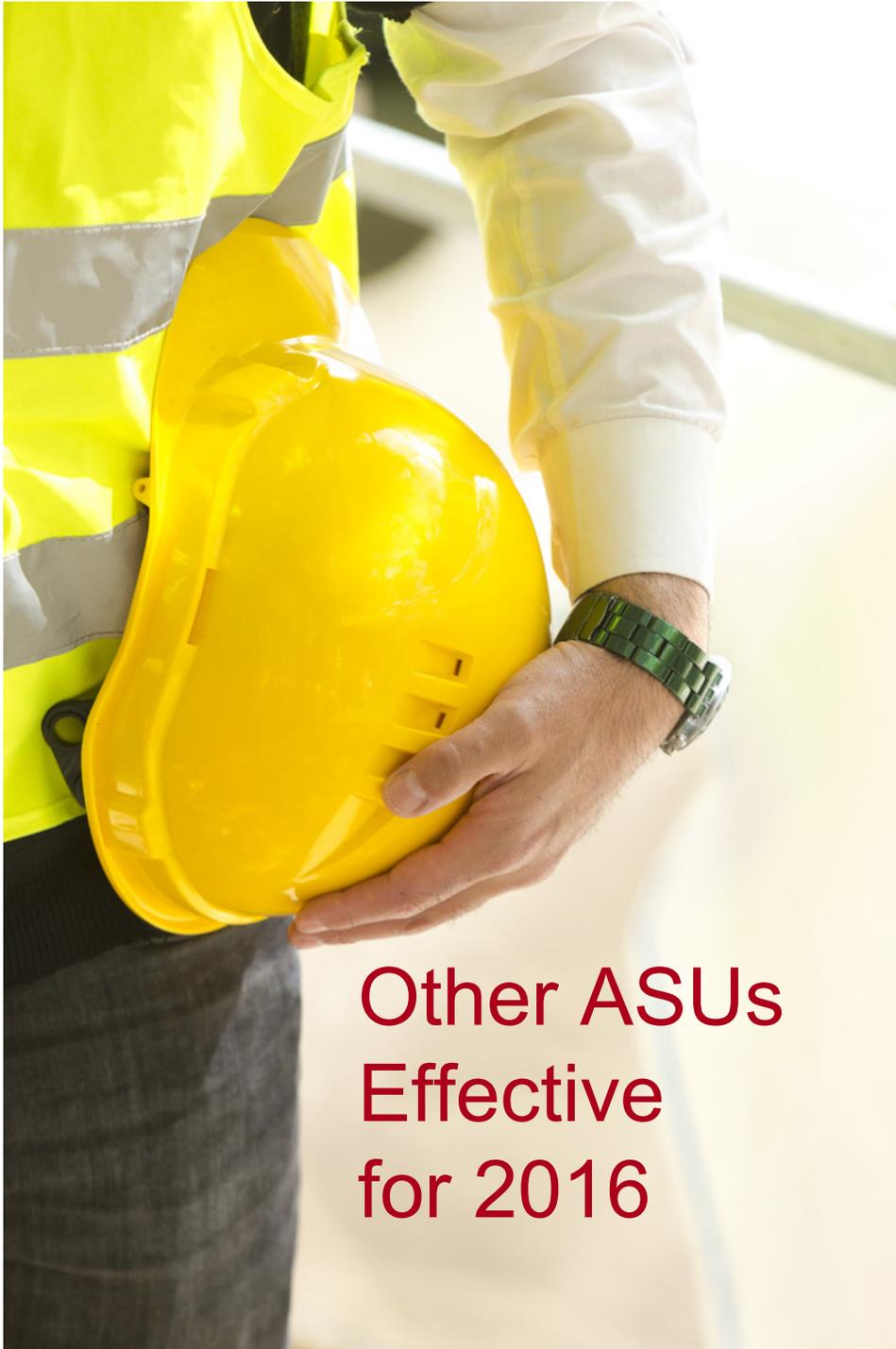
- Removes the effective dates for all Private Company Council (PCC) alternatives to GAAP
- Made them effective immediately and indefinitely

ASU No. 2014-15 Presentation of Financial Statements – Going Concern *Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern*

- Clarifies management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern at least one year from the financial statement report date and to provide related footnote disclosures
- That evaluation should be based on relevant conditions and events known or reasonably knowable at the financial statement report date

ASU No. 2015-01 Income Statement – Extraordinary and Unusual Items *Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items*

- Simply said – no more extraordinary items



Other ASUs Effective for 2016

ASU No. 2015-03 Interest- Imputation of Interest *Simplifying the Presentation of Debt Issuance Costs*

- Treatment of debt issuance costs is a contra-debt balance vs. as other assets
- Amortization is reported within interest expense

ASU No. 2015-05 Intangibles – Goodwill and Other – Internal-Use Software *Customer’s Accounting for Fees Paid in a Cloud Computing Arrangement*

- Guidance on discerning whether there are software licenses to capitalize or a service contract to expense within a cloud-computing arrangement

ASU No. 2015-12 Plan Accounting – Various Topics

- Simplification of benefit and pension plan disclosures related to investments

Other ASUs Effective 2017 or After



ASU Nos. 2015-02 and 2016-17 Consolidation *(Effective 2017, EAP)*

- Refine guidance on consolidation of commonly controlled entities and identifying the primary beneficiary of a VIE

ASU No. 2015-07 Fair Value Measurement *Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (Effective 2017, EAP)*

- Simplification to exclude assets valued at net asset value from the fair value hierarchy

ASU No. 2015-16 Business Combinations *Simplifying the Accounting for Measurement-Period Adjustments (Effective 2017, EAP)*

- Effect of measurement-period adjustment is recorded and reported when identified; no retroactive restatement

ASU No. 2016-07 Investments *Simplifying the Transition to the Equity Method of Accounting (Effective 2017, EAP)*

- Simplification of accounting for change from cost to equity method when increase level of ownership or influence



Other ASUs Effective 2017 or After

ASU No. 2016-18 Statement of Cash Flows *Restricted Cash* (Effective 2019, EAP)

- Guidance to lend uniformity in reporting on cash flows from restricted cash and cash equivalents
- To be included in cash and cash equivalents with the statement of cash flows

ASU No. 2017-04 Intangibles – Goodwill and Other *Simplifying the Test for Goodwill Impairment* (Effective 2022, EAP)

- Simplification is elimination of Step 2 in a test for goodwill impairment (measured impairment loss by comparing implied fair value (as if in a business combination) to the carrying amount for the unit)
- Moves to just compare fair value of the unit to the carrying value
- Does not apply to entities that elect to amortize goodwill under private company GAAP



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