Duquesne University 6th Annual Accounting CPE Conference

Accounting Standards Update

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November 16, 2017

The views expressed in this presentation are those of the presenter.
Official positions of the FASB are reached only after extensive due process and deliberations.
Agenda

Implementation for Significant Accounting Standards

- ASC 606: Revenue from Contracts with Customers
- ASC 842: Leases
- ASC 326-20: Current Expected Credit Loss Model

Recently Issued Accounting Standards

- ASU 2016-04: Presentation of Financial Statements of NFP Entities
- ASU 2017-04: Simplifying the Test for Goodwill Impairment
- ASU 2017-12: Hedge Accounting

What’s Next for the FASB
ASC 606: Revenue from Contracts with Customers
Five Steps to Apply the Standard

Core principle

Recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services

Steps to apply the core principle

1. Identify the contract with the customer
2. Identify the performance obligations
3. Determine the transaction price
4. Allocate the transaction price
5. Recognize revenue when (or as) a performance obligation is satisfied
Implementation Timeline

Converged standards issued
May 2014

Key clarification amendments issued
Mar–May 2016

Mandatory effective date
Jan 2018

SAB 74 disclosures on possible impact of application

Joint IASB/FASB Transition Resource Group

FASB-only TRG (IASB observer)

IASB/FASB available for implementation questions
Resources to Help with Implementation

- Technical inquiry service
- Transition resource group
- Regular agenda item for formal and informal advisory groups
- Public Board meetings about implementation status and issues
- Education (FASB webcasts, external conferences)
Transition Resource Group

- A majority of the TRG issues were educational
- Input from TRG led to amendments to clarify the Boards’ intent for a handful of issues
- No future meetings scheduled as of now
Where Are the Issues?

Identify the performance obligations (Step 2) 16
Determine the transaction price (Step 3) 14
Recognize revenue (Step 5) 13
Scope 11
Presentation and disclosure 10
Identify the contract(s) with a customer (Step 1) 10
Contract costs 16
Principal vs. Agent 5
Licensing 6
Allocate the transaction price (Step 4) 4
Transition 3
Improvements to the Standard

- Targeted amendments to clarify how the principles of the new revenue standard should be applied

<table>
<thead>
<tr>
<th>Performance obligations</th>
<th>Clarify the application of ‘separately identifiable’ notion</th>
</tr>
</thead>
<tbody>
<tr>
<td>Licensing</td>
<td>Clarify the criteria for determining the nature of license of IP and application of royalty exception</td>
</tr>
<tr>
<td>Principal versus agent</td>
<td>Clarify that the determination is based on the ‘control’ principle and how that principle is applied</td>
</tr>
</tbody>
</table>

- New practical expedients and transition relief to reduce cost and complexity
## Early Adopters

<table>
<thead>
<tr>
<th>Company name</th>
<th>Year end</th>
<th>Document reviewed for disclosure</th>
<th>Method of adoption</th>
<th>Auditor</th>
<th>Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>Raytheon</td>
<td>31-Dec</td>
<td>10-K</td>
<td>Full Retro</td>
<td>PwC</td>
<td>Not material</td>
</tr>
<tr>
<td>Ford</td>
<td>31-Dec</td>
<td>10-K</td>
<td>Modified Retro</td>
<td>PwC</td>
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</tr>
<tr>
<td>General Dynamics</td>
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<td>KPMG</td>
<td>Material</td>
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<td>10-K</td>
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<td>D&amp;T</td>
<td>Not material</td>
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<tr>
<td>First Solar</td>
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<td>10-K</td>
<td>Full Retro</td>
<td>PwC</td>
<td>Assessing</td>
</tr>
<tr>
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<td>10-K</td>
<td>Modified Retro</td>
<td>EY</td>
<td>Not material</td>
</tr>
<tr>
<td>Microsoft</td>
<td>30-Jun</td>
<td>10-Q</td>
<td>Full Retro</td>
<td>D&amp;T</td>
<td>Material</td>
</tr>
<tr>
<td>Apple</td>
<td>Last Saturday of September</td>
<td>10-Q</td>
<td>Full Retro</td>
<td>EY</td>
<td>Not material</td>
</tr>
<tr>
<td>Analog Devices, Inc.</td>
<td>Saturday closest to the last day in October</td>
<td>10-Q</td>
<td>Modified Retro</td>
<td>EY</td>
<td>Assessing</td>
</tr>
<tr>
<td>Workday, Inc.</td>
<td>31-Jan</td>
<td>10-K</td>
<td>Full Retro</td>
<td>EY</td>
<td>Not material</td>
</tr>
</tbody>
</table>

Source: Connor Group
ASC 842: Leases
Reminder on Issuance and Effective Dates

Issuance Date
• February 2016

Effective Date – Public Companies*
• Fiscal years beginning after December 15, 2018, including interim periods within those fiscal years

Effective Date – All Other Organizations
• Fiscal years beginning after December 15, 2019 and interim periods beginning after December 15, 2020

Early Application
• Permitted for all organizations

* “Public Companies” refers to the following: (1) public business entities, (2) a not-for-profit entity that has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market, and (3) an employee benefit plan that files or furnishes statements with or to the SEC
Transition – Practical Expedients

Package of practical expedients:

Definition | Classification | Initial Direct Costs

Also, may elect to use *hindsight* with respect to lease renewals and purchase options

Land easements (current standard-setting)
Implementation Status

- Board and staff stand ready to assist stakeholders on implementation of Topic 842

- Board meetings held to-date on Topic 842 implementation:
  - November 2016 (leases implementation update)
  - May 2017 (leases implementation update)
  - June 2017 (technical corrections)
  - August 2017 (land easements)

- Standard setting activities – Exposure Drafts:
  - Technical corrections (Comment period ended November 13)
  - Land easements (Comment period ended October 25)
Overview of Inquiries

Transition 21%
Lessee accounting and reporting 21%
Scope 18%
Lessor accounting and reporting 10%
Sale and leaseback 8%
Lease classification 7%
Lease payments 5%
Other 4%
Discount rate for the lease 3%
Lease term and purchase options 3%

Last updated Nov. 1, 2017
Specific Inquiries

- Guidance to Apply During Comparative Periods Presented
- Allocating Prior Asset Group Impairments to Operating Leases
- Built-to-suit Leases during transition
- Sales-Type Lease with Significant Variable Payments
- Impact of Sublease Renewal Options on Assessment of Head Lease Term
- Allocation to Lease and Nonlease Components When Transitioning from Topic 605 to 606
Standard Setting – Land Easements

August 2017 Board meeting (ED released Q3 2017)

- Entity should first apply Topic 842 to determine if a land easement is a lease, because the underlying asset is land
- Board decided to provide transition relief to some entities due to diversity in practice today and for cost-benefit reasons
  - As a practical expedient, optional transition guidance would permit entity not to apply Topic 842 to land easements that existed before that Topic’s effective date, provided the entity does not currently apply Topic 840 to those easements.
    - Continue to apply current accounting policy for accounting for land easements that existed before the effective date of Topic 842.
    - When Topic 842 becomes effective, an entity will apply Topic 842 to all new (or modified) land easement arrangements.
  - Proposed to amend Example 10 of Subtopic 350-30 to eliminate the perceived inconsistency between that example and Topic 842
Standard Setting – Technical Corrections

June 2017 Board meeting (ED released Q3 2017)

- Number of minor corrections and clarifications to Topic 842 have been suggested by stakeholders
- Board does not view any of the proposed changes as having a significant effect on the guidance in Topic 842, or resulting in significant administrative costs to entities.
- Separate proposed ASU within the FASB’s standing project on Technical Corrections and Improvements.
Issues Recently Raised by Stakeholders

- Separating components of a contract and allocating consideration to components
  - Concerns raised by National Association of Real Estate Investment Trusts (NAREIT) and real estate public filers (e.g., Office REITs)
  - Question of observable standalone selling prices and use of residual method for allocation

- FEI comment letter received October 6, 2017 with requests on:
  - Comparative reporting
  - Leases with 100% variable payments
  - Short-term leases
  - Disclosures for leases in foreign currencies
ASC 326-20: Current Expected Credit Loss (CECL) Model
Key Takeaways

FASB tried to make things easy

Simplified existing impairment models in U.S. GAAP
Did not prescribe methodology

Impairment based on expected losses rather than incurred losses
No recognition threshold

Estimate represents lifetime losses
Consider the past, current, and future

Effective 2020 but don’twait to assess impact
Incremental disclosures = incremental data

Source: Deloitte & Touche LLP
ASU 2016-14: Presentation of Financial Statements of NFP Entities
NFP Financial Statements ASU—Key Objectives  (recommended by FASB’s NFP Advisory Committee (NAC))

- Update, not overhaul, the current model
- Improve net asset classification scheme
- Improve information in financial statements and notes about: financial performance, cash flows, and liquidity
- Better enable NFPs to “tell their financial story”

Issued August 18, 2016, ASU No. 2016-14
Key Provisions of ASU No. 2016-14

**Net Asset Classification**
Updates net asset scheme, changes underwater endowment accounting, removes option for implied time restrictions on capital gifts, enhances disclosures

**Liquidity & Availability**
Quantitative and qualitative disclosures about liquidity and availability of resources

**Expenses**
Requirement to report expenses by function (already required) and nature, and an analysis showing the relationship between function and nature

**Statement of Cash Flows**
“Free choice”: indirect reconciliation no longer required for direct method

**Investment Return**
Present investment return net of external and direct internal investment expenses, no longer required to disclose netted expenses
Net Assets

Current GAAP
- Unrestricted
- Temp. Restricted
- Perm. Restricted

Revised GAAP
- Without Donor Restrictions*
- With Donor Restrictions*

Disclosures
- Amount, purpose, and type of board designations **
- Nature and amount of donor restrictions

* NFPs may choose to disaggregate further
** New disclosure requirement
## Implementation – Balance Sheet

### Net assets:

<table>
<thead>
<tr>
<th></th>
<th>Without donor restrictions</th>
<th>125,056</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>With donor restrictions</td>
<td>162,268</td>
</tr>
<tr>
<td><strong>Total net assets</strong></td>
<td></td>
<td><strong>287,324</strong></td>
</tr>
</tbody>
</table>

Minimum presentation required

Alternative disaggregation allowed

### Net assets:

<table>
<thead>
<tr>
<th></th>
<th>Without donor restrictions</th>
<th>125,056</th>
</tr>
</thead>
<tbody>
<tr>
<td>Undesignated</td>
<td></td>
<td>24,931</td>
</tr>
<tr>
<td>Operating reserve</td>
<td></td>
<td>25,000</td>
</tr>
<tr>
<td>Designated by the Board for capital projects</td>
<td></td>
<td>75,125</td>
</tr>
<tr>
<td><strong>Total without donor restrictions</strong></td>
<td></td>
<td><strong>125,056</strong></td>
</tr>
</tbody>
</table>

|                          | With donor restrictions    | 162,268 |
|                          | Time restricted for future periods | 2,783   |
|                          | Purpose restricted         | 11,066  |
|                          | Endowment fund             | 148,419 |
| **Total with donor restrictions** | | **162,268** |
| **Total net assets**     |                            | **287,324** |
Liquidity and Availability of Resources

NFPs required to provide:

**Qualitative** information on how an NFP manages its liquid available resources and its liquidity risk (in the notes)

**Quantitative** information that communicates the availability of an NFP’s financial assets at the balance sheet date to meet cash needs for general expenditures within one year (on the face and/or in the notes)
Quantitative Disclosure for Financial Assets Availability Example

The following chart represents XYZ’s financial assets available to meet cash needs for general expenditures within 1 year of June 30, XX. Due to the nature of the restrictions from contributions received from donors, XYZ has omitted all restricted contributions.

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial assets, at year-end*</td>
<td>$234,410</td>
</tr>
<tr>
<td>Less those unavailable for general expenditures within one year, due to:</td>
<td></td>
</tr>
<tr>
<td>Contractual or donor-imposed restrictions:</td>
<td></td>
</tr>
<tr>
<td>Restricted by donor with time or purpose restrictions</td>
<td>(11,940)</td>
</tr>
<tr>
<td>Subject to appropriation and satisfaction of donor restrictions**</td>
<td>(144,500)</td>
</tr>
<tr>
<td>Investments held in annuity trust</td>
<td>(4,500)</td>
</tr>
<tr>
<td>Amounts held by bond trustees</td>
<td>(30,200)</td>
</tr>
<tr>
<td>Board designations:</td>
<td></td>
</tr>
<tr>
<td>Quasi-endowment fund, primarily for long-term investing**</td>
<td>(36,600)</td>
</tr>
<tr>
<td>Amounts set aside for liquidity reserve</td>
<td>(1,300)</td>
</tr>
<tr>
<td>Financial assets available to meet cash needs for general expenditures within one year</td>
<td>$5,370</td>
</tr>
</tbody>
</table>

*Total assets, less nonfinancial assets (e.g., PP&E, inventory, prepaids)

**Excludes amounts that have been appropriated for next 12 months that do not have purpose restrictions
Effective Date, Early Adoption, and Transition

**Effective Date:** For fiscal years beginning after 12/15/2017 (e.g., CY 2018, FY 2018-19)
- Interim financials the following year

**Early Adoption:** Permitted, but must apply the regular transition provisions.

**Transition:**
- For year of adoption: apply all provisions.
- For comparative years presented: apply all provisions, except can choose not to present:
  - Analysis of expenses by nature and function*, and/or
  - Disclosures around liquidity and availability of resources
  - *unless already required to do so under current GAAP
ASU 2017-04: Simplifying the Test for Goodwill Impairment
Key Provisions

▪ Eliminates Step Two from the goodwill impairment model
  - No longer required to determine and assign the fair value of a reporting unit to its assets and liabilities
  - Impairment will be measured as the excess of a reporting unit’s carrying value over its fair value
  - Impairment is limited to the reporting unit’s recorded amount of goodwill
  - Less precise than current Step Two model

▪ New model could result in a goodwill impairment that is not attributable to a decline in the fair value of a reporting unit’s goodwill

▪ Applies to all reporting units, including those with zero or negative value
  - Eliminates qualitative assessment for reporting units with zero or negative carrying values
  - New requirement to disclose reporting units with zero or negative carrying values and the amount of goodwill allocated to them
Effective Date and Transition

SEC Filers
- Annual periods beginning after December 15, 2019, for public business entities that are SEC filers

All other entities (including private companies and NFPs)
- Annual periods beginning after December 15, 2020 and interim periods beginning after December 15, 2019

Transition
- New guidance to be applied prospectively

Early Application
- Early adoption would be allowed for all entities as of January 1, 2017
ASU 2017-12: Hedge Accounting
Key Simplifications

- Separate recognition of periodic hedge ineffectiveness
- SIFMA added as a benchmark interest rate
- Timing of initial hedge documentation
- Need for subsequent quantitative effectiveness assessments
- “Fallback” long haul method for shortcut method
- Critical terms match for CF hedge of groups of forecasted transactions
- Simplified measurement of hedged item
What’s Next for the FASB
New Projects

- Distinguishing liabilities from equity, including convertible debt
- Financial performance reporting focused on the disaggregation of performance reporting by function and nature
- Segment reporting intended to improve the aggregation criteria and segment disclosures
Thank You