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A&A Update

NSAC – Far West Chapter 62nd Annual Conference

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Overview of the Presentation

- Recently Effective ASUs
- ASU's Effective for December 31, 2018 Year-end
- Other ASUs for Current Consideration
- FASB's Pipeline Projects
- Other Standard-Setter Activities

(Effective Dates for Nonpublic Companies)

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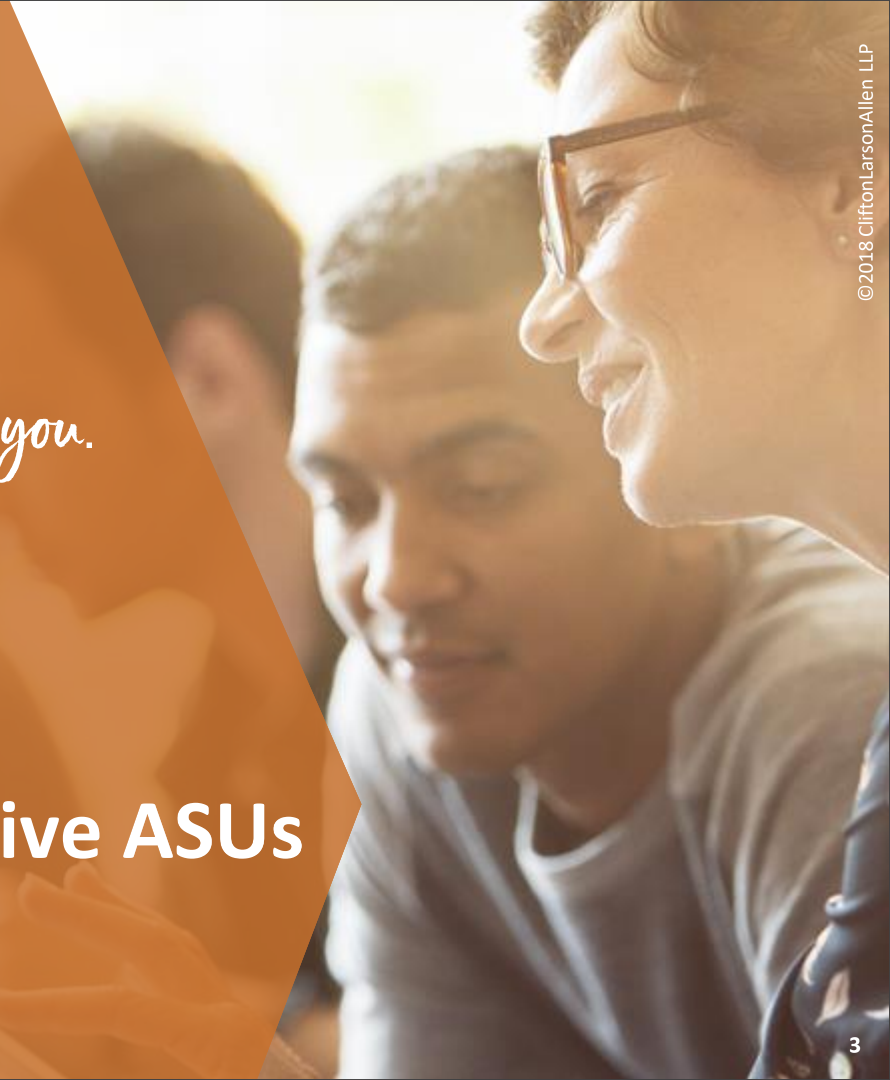
Recently Effective ASUs



ASU 2015-02: Consolidation

- Addresses targeted areas of consolidation guidance for legal entities such as limited partnerships, limited liability corporations, and securitization structures
  - Modifies the evaluation of whether limited partnerships and similar legal entities are variable interest entities (VIEs) or voting interest entities
  - Eliminates the presumption that general partner should consolidate a limited partnership (**NFP entities – see ASU 2017-02 for clarification**)
  - Affects the consolidation analysis of reporting entities that are involved with VIEs, particularly those that have fee arrangements and related party relationships (**also see ASU 2016-17 for related party guidance**)
  - Provide a scope exception for reporting entities with interests in legal entities that are required to comply with or operate in accordance with requirements that are similar to those for registered money market funds
  - Applied using retrospective or modified retrospective approach

ASU 2015-07: Fair Value Measurement

Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)

- Removes the requirement to categorize within the FV hierarchy all investments for which FV is measured using the net asset value (NAV) per share practical expedient (ASC 820-10-35-59)
  - Continue to disclose information on investments for which FV is measured at NAV (or its equivalent) as a practical expedient to help users understand the nature and risks of the investments and whether the investments, if sold, are probable of being sold at amounts different from net asset value
  - Refer to ASC 820-10-15-4 and the ASC Glossary definition of "readily determinable fair value" to be sure the investment qualifies for the NAV practical expedient

ASU 2015-11: Measurement of Inventory

- Requires an entity to measure inventory at the lower of cost and net realizable value
  - Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation
  - Does away with considerations of “market value”
  - Does not apply to inventory that is measured using last-in, first-out (LIFO) or the retail inventory method
  - Applied prospectively

ASU 2015-16: Business Combinations

Simplifying the Accounting for Measurement-Period Adjustments

- Requires an acquirer in a business combination to recognize adjustments to estimated amounts identified during the measurement period in the reporting period in which the adjustment amounts are determined
  - Record, in the same period, the effect on earnings of changes in depreciation, amortization, or other income effects, if any, as a result of the change to the estimated amounts, calculated as if the accounting had been completed at the acquisition date
- Certain additional disclosures about the adjustments are required

ASU 2016-07: Equity Method of Accounting

- Upon qualifying for the equity method of accounting, no retroactive adjustment of the investment is required
  - Applicable when an investment becomes qualified for the equity method due to an increase in the level of ownership or degree of influence
  - Requires that the equity method investor add the cost of acquiring the additional interest in the investee to the current basis of the investor's previously held interest and adopt the equity method of accounting as of the date the investment becomes qualified for equity method accounting
  - Applied prospectively

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ASU’s Effective for December 31, 2018 Year-end

ASU 2015-17: Classification of Deferred Taxes

- Requires the classification of all deferred income tax assets and liabilities as noncurrent
  - Required for annual periods beginning after Dec. 15, 2017
    - ◊ Early adoption is permitted
    - ◊ May be applied prospectively or retrospectively

ASU 2016-09: Stock Compensation

- Simplifies several aspects of accounting for share-based payment award transactions, including:
  - Income tax consequences
  - Classification as either equity or liabilities
  - Statement of cash flows classification
  - Private companies can apply a practical expedient to estimate the expected term
  - Private companies can also make a one-time election to switch from measuring all liability-classified awards at FV to intrinsic value
  - Early adoption permitted

ASU 2016-14: Presentation of NFP Financial Statements

- Issued to improve the information presented in financial statements and notes about a not-for-profit entity's liquidity, financial performance, and cash flows
  - Changes the net asset classification scheme and related disclosures
  - Eliminates the requirement of the indirect reconciliation of operating cash flows if the direct method is used
  - Requires the disclosure of expenses by nature classification and analysis of expenses by function in one location

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Other ASUs for Current Consideration
(excluding Leases)

ASU 2016-15: Statement of Cash Flows

- Addresses areas of cash flow statement presentation where there is diversity in practice, including:
  - Certain debt prepayment and extinguishment costs and settlement of zero-coupon and similar debt instruments
  - Proceeds from certain insurance settlements
  - Distributions from equity method investees
  - Contingent consideration paid after a business combination
  - Application of the “predominance principle”
  - Early adoption permitted
    - ◊ Required for annual periods beginning after Dec. 15, 2018

ASU 2016-18: Restricted Cash

- Amounts described as restricted cash should be included with cash and cash equivalents when reconciling the beginning and end-of-period total amounts shown on the statement of cash flows
  - Early adoption permitted
    - ◊ Required for annual periods beginning after Dec. 15, 2018

ASU 2017-01: Clarifying the Definition of a Business

Clarifies the definition of a business to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses

- Provides an initial screen to determine if the inputs and processes constitute a business
- Early adoption permitted in certain circumstances
  - ◊ Required for annual periods beginning after Dec. 15, 2018

ASU 2017-04: Simplifying the Test for Goodwill Impairment

Impacts companies having goodwill on their balance sheet and have not adopted the private company alternative

- Eliminates Step 2 of the goodwill impairment model
- Goodwill impairment will be the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill allocated to that reporting unit
- Early adoption permitted
  - ◊ Required for annual periods beginning after Dec. 15, 2021

ASU 2017-07: Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost

To increase transparency and provide disaggregated information, the amendments require:

- The service cost component to be included on the same income statement line as other compensation costs arising from services rendered during the period
- The other (non-service) components of net benefit cost to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented
- Only the service cost component is eligible for capitalization in assets
- Early adoption permitted
  - ◊ Required for annual periods beginning after Dec. 15, 2018

ASU 2014-09:
Revenue from Contracts with Customers

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

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

Revenue Recognition - Scope of the Guidance

The standard will apply to all contracts with **customers** except:

- Lease contracts
- Insurance contracts
- Certain contractual rights or obligations within the scope of other standards
  - Some examples include financial instruments, derivatives and hedging, transfers and servicing, debt and equity securities
- Certain guarantees, other than product or service warranties
- Nonmonetary exchanges between entities in the same line of business to facilitate sales to customers, other than parties to the exchange

New guidance also address sales/transfers of nonfinancial assets outside of the entity's ordinary activities (Subtopic 610-20)

Revenue Recognition: Subsequent Developments

- ASU 2015-14 – Deferral of Effective Date (FYE after 12/15/2018)
- ASU 2016-08 – Principal versus Agent Considerations
- ASU 2016-10 – Identifying Performance Obligatons and Licensing
- ASU 2016-11 – Rescission of SEC Guidance
- ASU 2016-12 – Narrow-Scope Improvements and Practical Expedients
- ASU 2016-20 – Technical Corrections
- ASU 2017-05 – Other Income – Gains and Losses from the Derecognition of Nonfinancial Assets
- ASU 2017-13 – Amendments to SEC Paragraphs

ASU 2016-01: Financial Instruments: Recognition and Measurement

New guidance doesn’t change most classification and measurement decisions for financial instruments such as the initial and subsequent measurement of loans, debt securities, and financial liabilities

- Most of the changes that are required just revise the geography of where the information appears in the financial statements
  - Same information presented differently
  - Effective FY beginning after December 15, 2018
    - ◊ Early application available for certain provisions

Accounting for Equity Investments

Equity Investments – New ASC Topic 321

Most equity investments are required to be measured each reporting period at fair value (FV) with changes in FV recognized in net income, except for

- Equity method investments, including those that result in consolidation of the investee
- Equity investments without a readily determinable FV
  - ◊ An entity may **elect** to measure at cost minus impairment, plus or minus changes resulting from observable price changes in orderly transactions for identical or a similar investment of the same issuer
    - Election not available to investments that qualify for the NAV practical expedient

Accounting for Equity Investments

The term *equity security* includes any security representing an ownership interest in an entity (e.g., common, preferred, or other capital stock) or the right to acquire (e.g., warrants, rights, or call options) or dispose of (e.g., put options) in an entity at fixed or determinable prices

- Includes other ownership interests such as partnerships, unincorporated joint ventures, and limited liability companies
- Excludes convertible debt or preferred stock that by its terms either must be redeemed by the issuing entity or is redeemable at the option of the investor

Accounting for Equity Investments

- An equity investment without a readily determinable FV may be remeasured at FV when there is either:
  - The occurrence of an observable price change
    - ◊ Relevant transactions that occurred on or before the balance sheet date that are known or <u>can reasonably be known</u> should be considered
    - ◊ Price determined in an *orderly transaction* between *market participants*
      - Be cautious of related party transactions!
  - Identification of impairment
    - ◊ A qualitative assessment to be made each reporting period
    - ◊ Similar to the qualitative assessment done for goodwill, long-lived assets, and indefinite-lived intangibles

Financial Liabilities

<u>"Own-Credit" Provisions</u>

- Fair value change resulting from changes in own credit for financial liabilities measured under the fair value option will be recognized through other comprehensive income (OCI)

- Current GAAP retained for all other financial liabilities

ASU 2016-13: Financial Instruments - Credit Losses

Affect entities holding financial assets and net investment in leases that are not accounted for at fair value through net income

- Including loans, debt securities, trade receivables, net investments in leases, off-balance-sheet credit exposures, reinsurance receivables, and any other financial assets not excluded from the scope that have the contractual right to receive cash
- Effective FY beginning after Dec. 15, 2020

Financial Instruments: Credit Losses

Establishes a Current Expected Credit Loss (CECL) model

- Allowance for credit losses would reflect management's current estimate of the contractual cash flows not expected to be collected based on its assessment of credit risk at the reporting date
- Reflects more forward-looking information based on management expectations based on past events, current conditions, and reasonable and supportable forecasts
  - Neither a "worst case" or a "best case" scenario
  - Estimates would not be limited to losses expected over a specific period of time

ASU 2017-12: Financial Instruments- Hedge Accounting

- Background – originally part of the bigger Financial Instruments project
- Objective is to make targeted improvements to the hedge accounting model
  - ◊ Better alignment with an entity's risk management activities
  - ◊ Simplify the application of hedge accounting guidance
- Effective for FY beginning after Dec. 15, 2019
  - ◊ Early application permitted

Significant Changes in ASU 2017-12

Expands the risk components that are eligible for hedge accounting by:

- Eliminating the requirement to designate only the overall variability in cash flows or variability due to foreign currency risk as the hedged risk for cash flow hedges of a forecasted purchase or sale of a nonfinancial asset
- Eliminating the concept of benchmark interest rates and the requirement to designate only the overall variability in cash flows as the hedged risk for cash flow hedges of variable-rate financial instruments
- Adding the Securities Industry and Financial Markets Association (SIFMA) municipal swap rate to the allowable benchmarks for fair value hedges of interest rate risk

Significant Changes in ASU 2017-12

Ease the requirements for testing hedge effectiveness by:

- Expanding the items that can be excluded from the assessment to include the change in fair value of a current swap due to a cross-currency basis spread
- Allowing, in certain situations, qualitative subsequent effectiveness assessments to be performed after the initial quantitative assessment
- Allowing entities using the critical terms match method to assume that the hedging derivative matures at the same time as the forecasted transaction if both occur within the same 31-day (or fiscal month) period

Significant Changes in ASU 2017-12

Ease the requirements for testing hedge effectiveness by:

- Allowing the initial prospective quantitative assessment of hedge effectiveness to be performed anytime before the first quarterly effectiveness testing date.
- Allowing nonpublic entities (except financial institutions and certain nonprofit organizations) to select the method of hedge effectiveness testing and perform the initial quantitative and subsequent quarterly assessments before the date the next interim or annual financial statements are available for issuance.
- Allowing entities, in certain situations, to use the long-haul method for assessing effectiveness when it determines the short cut method was not or is no longer appropriate

Significant Changes in ASU 2017-12

- For fair value hedges of interest rate risk, remove certain limitations for designating and measuring changes in fair value
- Require the presentation of the earnings effect of the hedging instrument in the same line item in the income statement as the earnings effect of the hedged item
- Change disclosure requirements by requiring the effect of fair value and cash flow hedges on the income statement to be disclosed in a table, and eliminating the requirement to disclose the ineffective portion of the change in fair value of hedging instruments

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FASB’s Pipeline Projects

FASB's Pipeline Projects

- Balance Sheet Classification of Debt
  - Scheduled for issuance Q3 2018
  - Effective for FY beginning after Dec. 15, 2021
- Consolidation Targeted Improvements to Related Party Guidance for VIEs
  - Scheduled for issuance Q3 2018
  - May elect to apply upon issuance

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Other Standard-Setter Activities

Other Standard-Setter Activities

Auditing Standards Board

- SSAE 18 – Attestation Standards: Clarification and Recodification
  - ◊ Effective for reports issued after May 1, 2017
  - ◊ Current project explores changes to these new rules
- SAS 132 – The Auditor's Consideration of the Entity's Ability to Continue as a Going Concern
  - ◊ Effective for periods ending after Dec. 15, 2017
- Exposure Draft – Auditor Reporting Standards
  - ◊ Comment period ended May 15, 2018

Questions ???

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