Don Mobley

NOT Revenue Recognition and Leases Accounting Update

June 22, 2017

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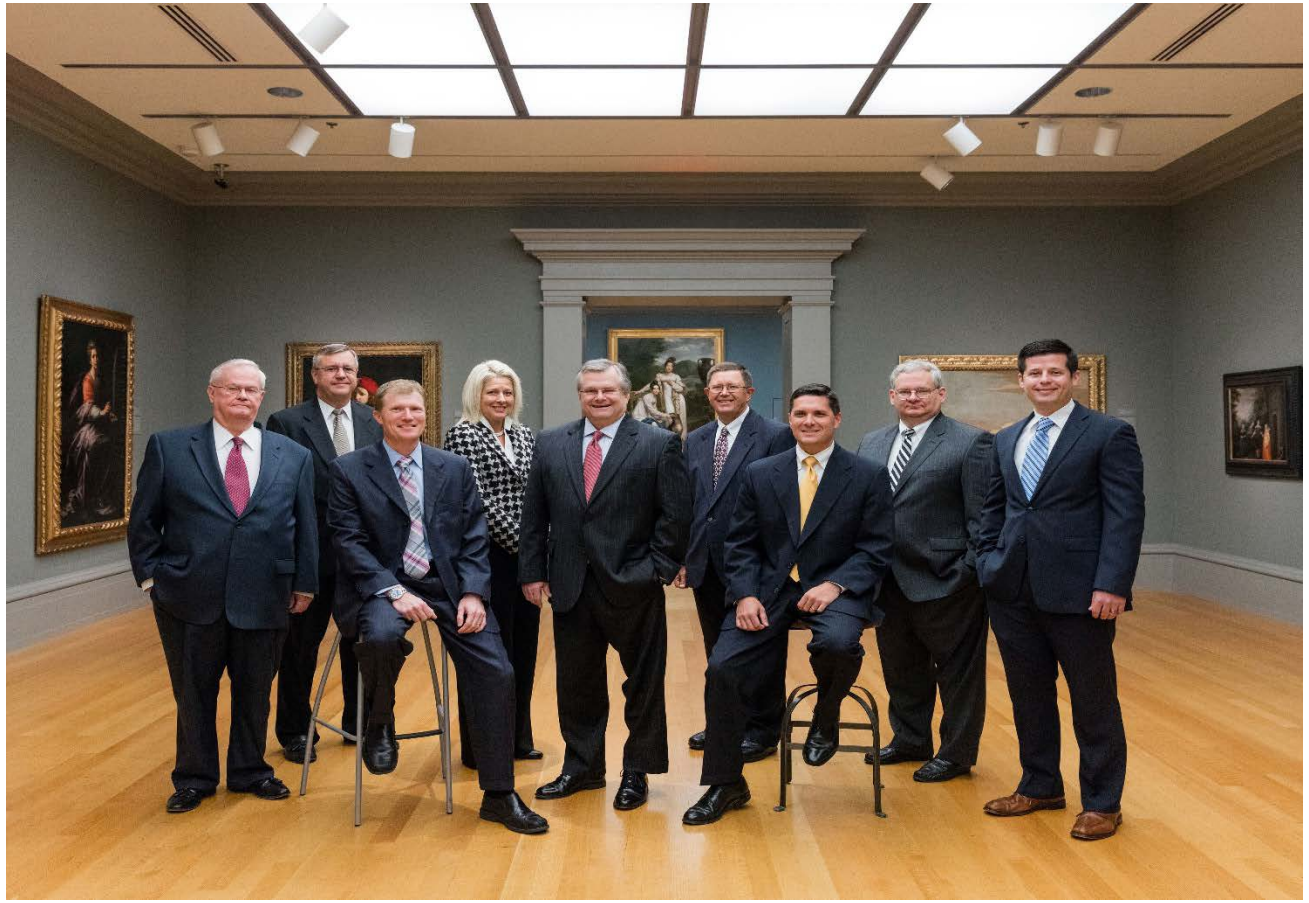
- Founded in 1995 by the late Randy Scott, CPA
- Progressive accounting, tax and consulting firm for over 20 years
- Extraordinary service
- Meeting future challenges together
- Voted one of best places to work in South Carolina



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Introduction

- FASB Update, not including revenue recognition and leases
- 20 Accounting Standards Updates (ASU) issued
- Discussion of effects of the updates
- Some of them simplify the process
- Some issued to be in line with IFRS
- All improve current standards

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Disclosure of Uncertainties About an Entities Ability to Continue as a Going Concern

- Effective 2016, early adoption permitted
- Puts the burden on management – “management goes first”
- Provides specific disclosures that management has to make in FS
- Auditors have to audit it and report accordingly
- New audit standard relating to this also
    1. Have to get written confirmation if management/owners plan to contribute more capital
    2. One year after report date, not balance sheet date
- Emphasis paragraph only when substantial doubt has not been eliminated

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Simplifying the Presentation of Debt Issuance Costs

- Public Business Entities effective 2016, and interim periods within
- Other Entities effective 2017, with interim periods thereafter, retrospective, change in accounting principle
- "Simplification Initiative" – FASB trying to make accounting for certain things easier
- Debt issuance costs now netted with the debt, not presented separately
- Can still defer and amortize debt issuance costs
- Accounting for discounts and premiums the same

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Disclosures About Short Duration Contracts

- Public Business Entities effective 2016
- Other Entities effective 2017
- Early application permitted, retrospective
- Insurance companies will be required to make additional disclosures about short-duration contracts (a year or less)
- The disclosures focus on the liability for unpaid claims and claim adjustment expenses.

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Disclosures About Short Duration Contracts - Continued

- Insurers will have to provide tables showing incurred and paid claims development information by accident year for the number of years claims typically remain outstanding
- Insurers also will have to provide a reconciliation of this information to the statement of financial position.
- Several additional disclosures similar to current required disclosures for long-term contracts
- Start looking at it now to make sure you have the information required

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Simplifying the Measurement of Inventories

- All Entities effective 2017
- Should be applied prospectively, with earlier application permitted as of the beginning of an interim or annual reporting period
- An entity should measure inventory within the scope of this Update at the lower of cost or net realizable value.
- Net realizable value is the estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation
- Old rule was lower of cost or market
- Does not apply to LIFO

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Simplifying the Accounting for Measurement Period Adjustments

- Public Business Entities effective 2016
- Other Entities effective 2017
- Applied prospectively to adjustments to provisional amounts that occur after the effective date of the ASU
- Requires that an acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined

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Simplifying the Accounting for Measurement Period Adjustments - continued

- Requires that the acquirer record, in the same period's financial statements, the effect on earnings of changes in depreciation, amortization, or other income effects
- Requires an entity to present separately on the face of the income statement or disclose in the notes the portion of the amount recorded in current-period earnings

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Simplifying the Transition to the Equity Method

- All entities effective 2017, prospective, early adoption permitted
- Eliminates the requirement that when an investment qualifies for use of the equity method as a result of an increase in the level of ownership interest or degree of influence, an investor must adjust the investment, results of operations, and retained earnings retroactively
- 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

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Interests Held Through Related Parties that are Under Common Control

- All entities effective 2017, early adoption permitted for all entities as of the beginning of an interim or annual reporting period
- Does not change the characteristics of a primary beneficiary in current generally accepted accounting principles (GAAP)
- A primary beneficiary of a Variable Interest Entity ("VIE") has both of the following characteristics: (1) the power to direct the activities of a VIE that most significantly impact the VIE's economic performance and (2) the obligation to absorb losses of the VIE that could potentially be significant to the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE

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Interests Held Through Related Parties that are Under Common Control – continued

- Update requires that the reporting entity, in determining whether it satisfies the second characteristic of a primary beneficiary, to include all of its direct variable interests in a VIE, and, on a proportionate basis, its indirect variable interests in a VIE held through related parties, including related parties that are under common control with the reporting entity.
- A single decision maker is not required to consider indirect interests held through related parties that are under common control with the single decision maker to be the equivalent of direct interests in their entirety.

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Interests Held Through Related Parties that are Under Common Control – continued

- Instead, a single decision maker is required to include those interests on a proportionate basis consistent with indirect interests held through other related parties.
- If, after performing that assessment, a reporting entity that is the single decision maker of a VIE concludes that it does not have the characteristics of a primary beneficiary, this update continues to require that reporting entity to evaluate whether it and one or more of its related parties under common control, as a group, have the characteristics of a primary beneficiary.

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Interests Held Through Related Parties that are Under Common Control – continued

- If the single decision maker and its related parties that are under common control, as a group, have the characteristics of a primary beneficiary, then the party within the related party group that is most closely associated with the VIE is the primary beneficiary
- Update improves GAAP because, in situations involving common control, a single decision maker focuses on the economics to which it is exposed when determining whether it is the primary beneficiary of a VIE before potentially evaluating which party is most closely associated with the VIE

Balance Sheet Classification of Deferred Taxes

- Public Business Entities effective 2017 and interim periods within
- Other Entities effective 2018 and interim periods after
- This is the first one today that is not effective this year for private companies
- Early adoption permitted for all entities as of the beginning of an interim or annual reporting period, prospective or retrospective, but disclose how it was done
- Current GAAP requires an entity to separate deferred income tax liabilities and assets into current and noncurrent amounts in a classified statement of financial position

Balance Sheet Classification of Deferred Taxes-continued

- This Update requires that deferred tax liabilities and assets be classified as noncurrent in a classified statement of financial position. The assets and liabilities can be netted as before.
- The amendments in this Update will align the presentation of deferred income tax assets and liabilities with International Financial Reporting Standards (IFRS).

Recognition and Measurement of Financial Assets and Financial Liabilities

- Public Business Entities effective 2018
- Other Entities effective 2019, implementation permitted in 2018, prospective
- Apply by means of a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption.
- Enhances the reporting model for financial instruments to provide users of FS with more decision-useful information

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Recognition and Measurement of Financial Assets and Financial Liabilities-continued

- Requires equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income.
- However, an entity may choose to measure equity investments that do not have readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer.

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Recognition and Measurement of Financial Assets and Financial Liabilities-continued

- Simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment.
- When a qualitative assessment indicates that impairment exists, an entity is required to measure the investment at fair value.
- Eliminates the requirement to disclose the fair value of financial instruments measured at amortized cost for entities that are NOT public business entities.

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Recognition and Measurement of Financial Assets and Financial Liabilities-continued

- Eliminates the requirement for PUBLIC business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet.
- Requires PUBLIC business entities to use the exit price notion (the price to sell and asset or transfer a liability) when measuring the fair value of financial instruments for disclosure purposes.

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Recognition and Measurement of Financial Assets and Financial Liabilities-continued

- Requires separate presentation of financial assets and financial liabilities by measurement category (trading or available for sale) and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements.
- Clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets.

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Classification of Certain Cash Receipts and Cash Payments

- Public Business Entities effective 2018
- Other Entities effective 2019
- Early adoption permitted, must apply guidance retrospectively to all periods presented but may apply it prospectively from the earliest date practicable if retrospective application would be impracticable
- Stakeholders indicated that there is diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows.
- This Update addresses eight specific cash flow issues with the objective of reducing the existing diversity in practice.

Classification of Certain Cash Receipts and Cash Payments-continued

- Debt Prepayment or Debt Extinguishment Costs
- Settlement of Zero-Coupon Debt Instruments or Other Debt Instruments with Coupon Interest Rates that Are Insignificant in Relation to the Effective Interest Rate of the Borrowing
- Contingent Consideration Payments Made after a Business Combination
- Cash payments made soon after the acquisition date of a business combination by an acquirer to settle a contingent consideration liability

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Classification of Certain Cash Receipts and Cash Payments-continued

- Distributions Received from Equity Method Investees
- Beneficial Interests in Securitization Transactions
- Separately Identifiable Cash Flows and Application of the Predominance Principle
- Current GAAP either is unclear or does not include specific guidance on the eight cash flow classification issues included in the amendments in this Update.

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Intra-Entity Transfers of Assets Other than Inventory (relating to income taxes)

- Public Business Entities effective 2018 and quarters within
- Other Entities 2019 and quarters following
- Modified retrospective-cumulative effect adjustment to beginning retained earnings
- Early adoption is permitted and should be in the first interim period if an entity issues interim financial statements

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Intra-Entity Transfers of Assets Other than Inventory-continued

- No new disclosures but change in GAAP could affect existing disclosures
- The Board decided that an entity should recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. Consequently, the amendments in this Update eliminate the exception for an intra-entity transfer of an asset other than inventory.

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Restricted Cash

- Public Business Entities Effective 2018
- Other entities effective 2019
- Early adoption is permitted, including adoption in an interim period, retrospectively applied
- Update requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents

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Restricted Cash-continued

- Amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows
- The amendments in this Update do not provide a definition of restricted cash or restricted cash equivalents

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Clarifying the Definition of a Business

- Public Business Entities effective 2018
- Other Entities effective 2019
- Early implementation allowed in certain instances, applied prospectively
- Under the current guidance, there are three elements of a business—inputs, processes, and outputs
- While an integrated set of assets and activities (collectively referred to as a "set"), that is a business usually has outputs, outputs are not required to be present
- Have to have the ability to **contribute** to generating outputs, not actually **creating** outputs

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Clarifying the Definition of a Business-continued

- In addition, all the inputs and processes that a seller uses in operating a set are not required if market participants can acquire the set and continue to produce outputs, for example, by integrating the acquired set with their own inputs and processes
- This Update provides a screen to determine when a set is not a business.
- The screen requires that when substantially all of the fair value of the gross assets acquired (or disposed of) is concentrated in a single identifiable asset or a group of similar identifiable assets, the set is not a business
- This screen reduces the number of transactions that need to be further evaluated

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Clarifying the Definition of a Business-continued

- If the screen is not met, this Update

  (1) requires that to be considered a business, a set must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create output and

  (2) removes the evaluation of whether a market participant could replace missing elements. This provides a framework to assist entities in evaluating whether both an input and a substantive process are present.

Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Costs

- Public Business Entities Effective 2018
- Other Entities effective 2019
- Early adoption is permitted, retrospective implementation
- This Update requires that an employer report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period.
- The other components of net benefit cost as defined are required 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.

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Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Costs-continued

- If a separate line item or items are used to present the other components of net benefit cost, that line item or items must be appropriately described.
- If a separate line item or items are not used, the line item or items used in the income statement to present the other components of net benefit cost must be disclosed.
- This Update also allows only the service cost component to be eligible for capitalization when applicable (for example, as a cost of internally manufactured inventory or a self-constructed asset).

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Stock Compensation

- All Entities effective 2018
- Early implementation allowed, prospective implementation
- This Update provides guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in Topic 718.
- What is “substantive change” in plan? This update answers that question

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Stock Compensation-continued

- An entity should account for the effects of a modification unless all the following are met:

  1. The fair value of the modified award is the same as the fair value of the original award immediately before the original award is modified.

     If the modification does not affect any of the inputs to the valuation technique that the entity uses to value the award, the entity is not required to estimate the value immediately before and after the modification

  2. The vesting conditions of the modified award are the same as the vesting conditions of the original award immediately before the original award is modified

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Stock Compensation-continued

3. The classification of the modified award as an equity instrument or a liability instrument is the same as the classification of the original award immediately before the award is modified.

- The current disclosure requirements apply regardless of whether an entity is required to apply modification accounting under the amendments in this Update.

Service Concession Arrangements

- Public Business Entities effective 2018
- Other Entities effective 2019, applied prospectively
- The main provisions of this Update are illustrated by the following example: A public sector grantor enters into an arrangement with an operating entity under which the operating entity will provide operation services (which include operation and general maintenance of the facility) for a toll road that will be used by third-party users (drivers)
- This Update ties in to the new revenue recognition standards and clarifies that the company, rather than the third-party driver, is the customer of the operation services in all cases for service concession arrangements within the scope of this topic

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Presentation of Financial Statements of Not-for-Profit Entities

- Effective calendar year-end 2019, but June 30, 2020 if you have a June 30 year-end or September 30, 2020 if you have a September year-end
- The amendments in the ASU should be initially adopted only for an annual fiscal period or for the first interim period within the fiscal year of adoption.

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Presentation of Financial Statements of Not-for-Profit Entities-continued

- The main provisions of this Update, which amend the requirements for financial statements and notes in Topic 958, Not-for-Profit ("NFP") Entities, require an NFP to:

  1. Present on the face of the statement of financial position amounts for two classes of net assets at the end of the period, rather than for the currently required three classes. An NFP will report amounts for *net assets with donor restrictions* and *net assets without donor restrictions*

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Presentation of Financial Statements of Not-for-Profit Entities-continued

2. Present on the face of the statement of activities the amount of the change in each of the two classes of net assets (noted in item 1) rather than that of the currently required three classes.

3. For cash flows, no longer require the presentation or disclosure of the indirect method (reconciliation) if using the direct method.

4. Provide enhanced disclosures such as:

    a. Amounts and purposes of governing board designations and appropriations

    b. Composition of net assets with donor restrictions at the end of the period and how the restrictions affect the use of resources.

Presentation of Financial Statements of Not-for-Profit Entities-continued

c. Qualitative information that communicates how an NFP manages its liquid resources

d. Quantitative information, either on the face of the balance sheet or in the notes, and additional qualitative information in the notes as necessary, that communicates the availability of an NFP's financial assets at the balance sheet date

e. Amounts of expenses by both their natural classification and their functional classification.

f. Method(s) used to allocate costs among program and support functions.

Premium Amortization on Purchased Callable Debt Securities

- Public Business Entities effective 2019
- Other Entities effective 2020
- Early adoption permitted, modified retrospective, disclose change in accounting principal
- The amendments in this Update shorten the amortization period for certain callable debt securities held at a premium. Specifically, the amendments require the premium to be amortized to the earliest call date.
- The amendments do not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity.

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Simplifying the Test for Goodwill Impairment

- Public Business Entities effective 2020
- Public non-SEC filers 2021
- Other Entities effective 2022
- Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017, applied prospectively
- To simplify the subsequent measurement of goodwill, the Board eliminated Step 2 from the goodwill impairment test.
- In computing the implied fair value of goodwill under Step 2, an entity had to perform procedures to determine the fair value at the impairment testing date of its assets and liabilities (including unrecognized assets and liabilities) following the procedure that would be required in determining the fair value of assets acquired and liabilities assumed in a business combination.

Simplifying the Test for Goodwill Impairment-continued

- Under the amendments in this Update, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount.
- An entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit.

ASU 2017-04 – Simplifying the Test for Goodwill Impairment-continued

- The Board also eliminated the requirements for any reporting unit with a zero or negative carrying amount to perform a qualitative assessment and, if it fails that qualitative test, to perform Step 2 of the goodwill impairment test.
- Thus, the same impairment assessment applies to all reporting units
- An entity is required to disclose the amount of goodwill allocated to each reporting unit with a zero or negative carrying amount of net assets.

Measurement of Credit Losses on Financial Instruments

- Effective 2020 for SEC filers, 2021 for all other public business entities
- Effective 2022 for all other entities
- All entities may implement early in 2019, cumulative adjustment to beginning retained earnings using modified retrospective approach
- The amendments in this Update require a financial asset (or a group of financial assets) measured at amortized cost basis to be presented at the net amount expected to be collected.

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Measurement of Credit Losses on Financial Instruments-continued

- The measurement of expected credit losses is based on relevant information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount.
- The previous objectives generally delayed recognition of the full amount of credit losses until the loss was probable of occurring.
- The amendments in this Update are an improvement because they eliminate the probable initial recognition threshold in current GAAP and, instead, reflect an entity's current estimate of all expected credit losses. Previously, when credit losses were measured under GAAP, an entity generally only considered past events and current conditions in measuring the incurred loss.

Contact

Don Mobley

Scott and Company
1441 Main Street, Suite 800
Columbia, SC 29201
803.256.6021
dmobley@scottandco.com
220 N. Main Street, Suite 500
Greenville, SC 29601
864.660.2045

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