QUARTERLY ACCOUNTING UPDATE WEBCAST – FALL 2021

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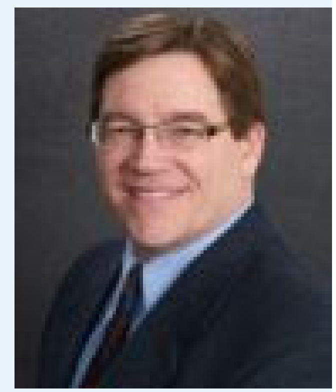

Agenda

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Recent FASB Activity

Recently issued FASB guidance

No.	Final ASU Title
2021-05	Lessors—Certain Leases with Variable Lease Payments
2021-06	Amendments to Financial Disclosures about Acquired and Disposed Businesses and Update of Statistical Disclosures for Bank and Savings and Loan Registrants (SEC Update)

Background: Lease with significant variable lease payments

Background on sales-type or direct financing leases

Derecognize the underlying asset

Recognize a net investment in the lease

- Measure the net investment in the lease based on the present value of the lease payments not yet received from the lessee
- Lease payments exclude variable lease payments that are not based on an index or rate

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Background: Lease with significant variable lease payments

Example:

- 8-year lease of CT scanner
- Monthly payments based on a fixed rate per scan
- No residual value guarantee, expected to be $50,000
- 10 year remaining useful life
- Net carrying amount = fair value of $500,000
- $5,000 in initial direct costs.

Net investment in the lease

$55,000 ($50,000 residual value + $5,000 initial direct costs)

Initial journal entry

DR Net investment	$ 55,000	
DR Loss	$ 450,000	
CR PP&E		$ 500,000
CR Cash		$ 5,000

Lessors—Certain Leases with Variable Lease Payments

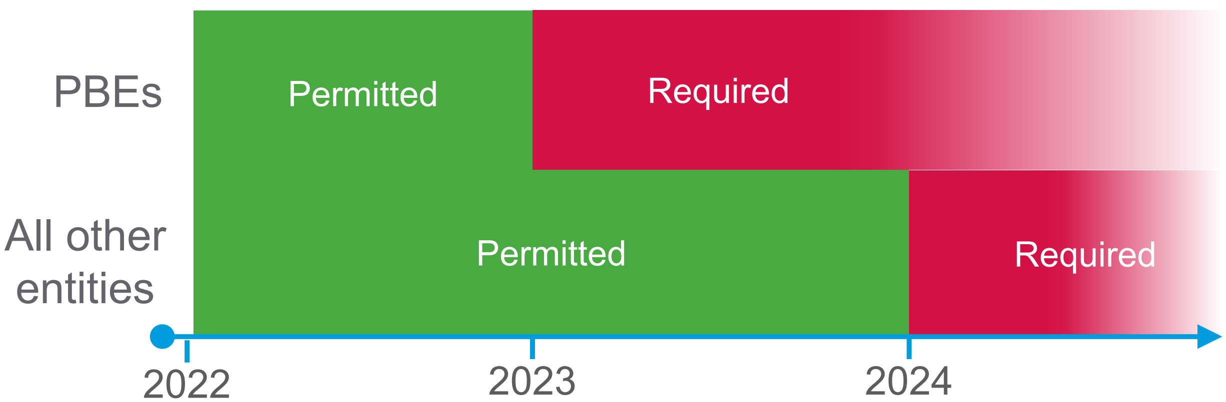
Classify and account for a lease with variable lease payments that do not depend on a reference index or a rate as an operating lease if both:

- Lease would have been classified as a sales-type lease or a direct financing lease
- Lessor would have otherwise recognized a day-one loss

ASU 2021-05

Effective date

Effective date for calendar year-ends



Transition

If ASC 842 has been adopted as of July 19, 2021:

- Retrospectively to leases that commenced or were modified on or after the adoption of ASC 842, OR
- Prospectively to leases that commence or are modified on or after the date on which the entity first applies ASU 2021-05.

If ASC 842 has not been adopted as of July 19, 2021:

- Apply 842 transition requirements

ASU 2021-05

Discount Rate for Lessees That Are Not Public Business Entities

Scope

- Lessees that are not public business entities

Current guidance

- Practical expedient allows accounting policy election to use a risk-free rate as the discount rate for ***all*** leases

Proposed guidance:

- Risk-free rate election can be made by class of underlying asset, rather than at the entity-wide level
- When the rate implicit in the lease is readily determinable for any individual lease, the lessee would use that rate

Proposed disclosure requirement

- Which asset classes apply a risk-free rate

Forthcoming ASU

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Discount Rate for Lessees That Are Not Public Business Entities

ASC 842 has not been adopted	• Apply transition and effective date provisions for ASC 842 adoption
ASC 842 has been adopted	• Effective for annual reporting periods beginning after December 15, 2021 • Modified retrospective transition method

Forthcoming ASU

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Discount Rate for Lessees That Are Not Public Business Entities

Modified Retrospective Transition Method

1. Remeasure affected lease liabilities for existing leases at the beginning of the period of adoption as an adjustment to ROU assets
2. Calculate the transition adjustment using the discount rate and remaining lease term as of the adoption date
3. Do not otherwise remeasure or reclassify leases as a result of transition
4. Disclose the fact that the amendments have been adopted and the amount of the transition adjustment

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Recently proposed FASB guidance

Date	Proposed ASU Title
9/15/2021	Fair Value Measurement (Topic 820): Fair Value Measurement of Equity Securities Subject to Contractual Sale Restrictions

Fair Value Measurement of Equity Securities Subject to Contractual Sale Restrictions

Practice Issue: Diversity in practice on whether the effects of a contractual restriction that prohibits the sale of an equity security should be considered in measuring that equity security's fair value

Some stakeholders apply a discount to the price of an identical equity security that is not subject to a contractual sale restriction.	Other stakeholders consider the application of a discount to be inappropriate under the principles of Topic 820.

Proposed Solution: Clarify that a contractual restriction on the sale of an equity security is not considered part of the unit of account of the equity security and is not considered in measuring fair value

Guidance coming into effect

Guidance coming into effect>

Targeted Improvements to Accounting for Hedging Activities (ASU 2017-12)

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ASU 2017-12, Targeted Improvements to Accounting for Hedging Activities

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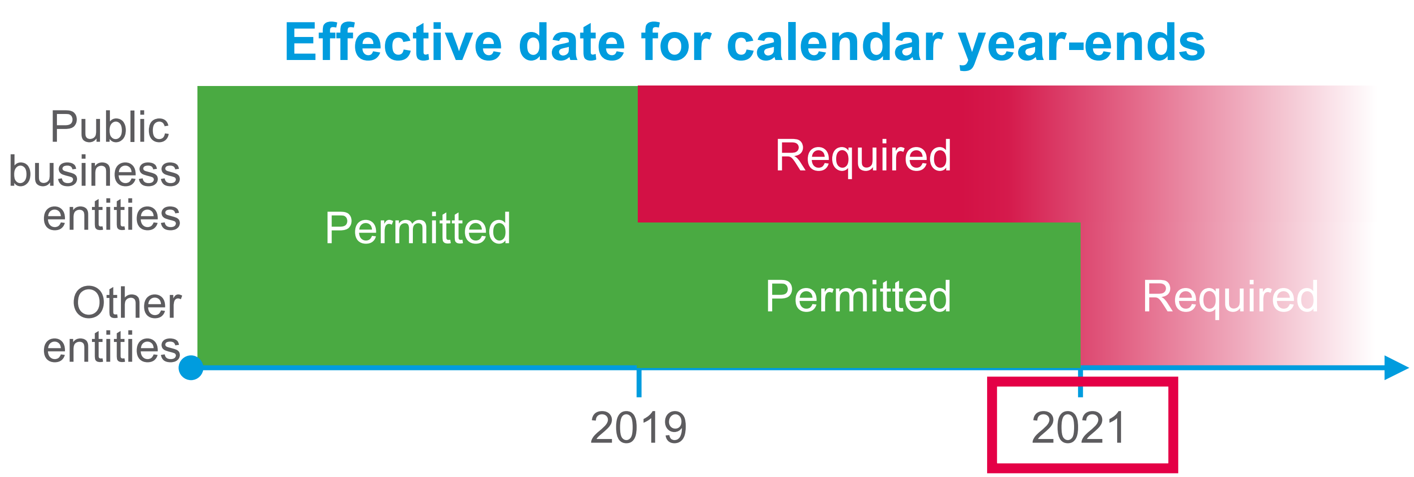

ASU 2017-12, Targeted Improvements to Accounting for Hedging Activities

ASU brings relief to the rigors of hedge accounting, including:

- Reduced upfront documentation requirements for certain private companies and ability to wait until financial statements are available to be issued to assess effectiveness
- Other entities can in some cases wait until the quarterly effectiveness testing to perform the initial assessment of effectiveness
- Can apply long-haul method if shortcut method was not or no longer is appropriate

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ASU 2017-12, Targeted Improvements to Accounting for Hedging Activities

Expanded risks eligible for hedging:

- Contractually specified component in cash flow hedge of commodities
- Contractually specified interest rate in cash flow hedge of interest rate risk
- Changes in fair value attributable to changes in SIFMA for fair value hedge of interest rate risk

Additional flexibility for fair value hedges of interest rate risk

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ASU 2017-12, Targeted Improvements to Accounting for Hedging Activities

Less quantitative analysis will be required:

- If initial quantitative effectiveness assessment indicates relationship is highly effective, can elect to perform subsequent assessments qualitatively absent a significant change in facts and circumstances
- Can assume dates match if forecasted transaction occurs, and derivative matures, within same 31-day period
- Ineffectiveness is no longer separately measured and recognized

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ASU 2017-12, Targeted Improvements to Accounting for Hedging Activities

Certain transition elections permitted including:

- Switch from quantitative assessment to qualitative
- Indicate quantitative method to be used in the event shortcut method fails
- Redesignate hedged risk as contractually specified component
- Reclassify debt security from HTM to AFS if eligible under last-of-layer method

PBEs and certain private companies had to make these elections in quarter of adoption, others have until next financial statements are available to be issued

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ASU 2017-12, Targeted Improvements to Accounting for Hedging Activities

Transition requirements for cash flow hedges and net investment hedges existing as of the date of adoption:

Cumulative-effect adjustment to accumulated other comprehensive income to eliminate recognized ineffectiveness

Corresponding adjustment to the opening balance of retained earnings as of the initial application date

ASU 2017-12, Targeted Improvements to Accounting for Hedging Activities

Presentation

Fair value and cash flow hedges	Net investment hedges
• Present in the same income statement line item as earnings effect of the hedged item: • Change in fair value of derivative included in assessment of effectiveness • Amounts excluded from assessment of effectiveness	• Present in same income statement line item as earnings effect of the hedged net investment: • Amounts reclassified from AOCI to earnings for the hedging instrument.

ASU 2017-12, Targeted Improvements to Accounting for Hedging Activities

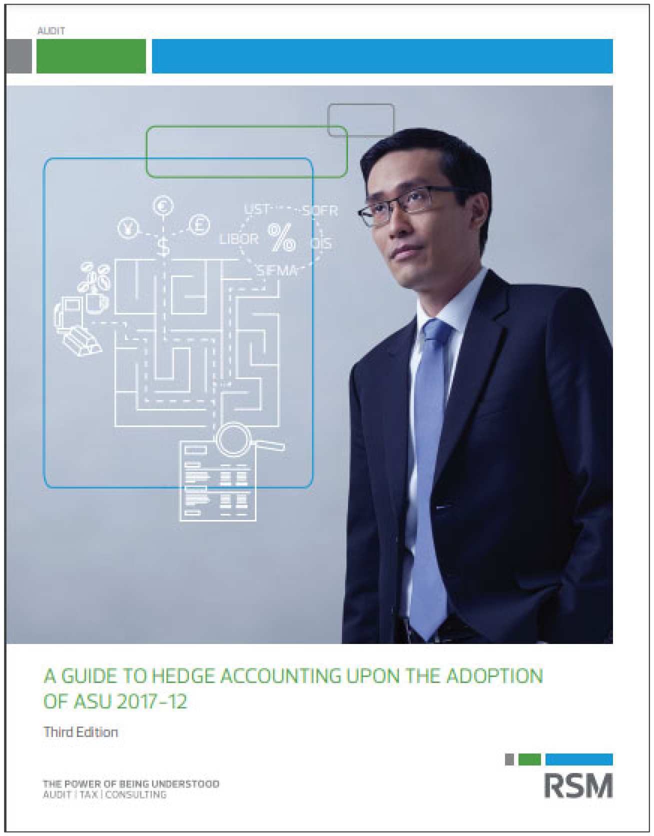
The Effect of Fair Value and Cash Flow Hedge Accounting on the Statement of Financial Performance
for the Years Ended December 31, 20X1 and 20X0

Total amount of income and expense line items should agree to the income statement for those line items that include effects of hedges.

	Location and Amount of Gain or (Loss) Recognized in Income on Fair Value and Cash Flow Hedging Relationships [a]							
	20X1				20X0			
	Revenue	Cost of Goods Sold	Interest Income (Expense)	Other Income (Expense)	Revenue	Cost of Goods Sold	Interest Income (Expense)	Other Income (Expense)
Total amounts of income and expense line items presented in the statement of financial performance in which the effects of fair value or cash flow hedges are recorded	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX
The effects of fair value and cash flow hedging:								
Gain or (loss) on fair value hedging relationships in Subtopic 815-20:								
Interest contracts:								
Hedged items	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Derivatives designated as hedging instruments	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Commodity contracts:								
Hedged items	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Derivatives designated as hedging instruments	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Amount excluded from effectiveness testing recognized in earnings based on an amortization approach	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX

The effects the hedges had on each line item is presented in the detail that follows.

Resources on Hedge Accounting



- RSM's Hedge accounting guide

Guidance coming into effect>

FASB Simplifies Accounting for Income Taxes (ASU 2019-12)

ASU 2019-12: What it does to simplify accounting for income taxes

- ASU 2019-12 **simplifies the accounting for income taxes** as part of FASB's overall initiative to reduce complexity in accounting.
- To accomplish this simplification, the ASU amends a **total of eight** areas within ASC 740, *Income Taxes:*
  - **Removes <u>three</u> exceptions to the general principals** of ASC 740
  - **Simplifies <u>five</u> other areas** within ASC 740
- Let's take a very *brief look* at each of these eight areas

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Removal of three exceptions to general principles of ASC 740

1. Intraperiod tax allocation:

- Removes the exception to the incremental approach *for intraperiod tax allocation* when financial statements have <u>both</u>:
  - i) a *loss from continuing operations,* <u>and</u>
  - ii) a gain (or loss) from *other* items (such as discontinued operations or OCI)
- **Intraperiod tax allocation** is the process of allocating *total* tax expense to various components of the income statement (such as continuing operations and discontinued operations) and to shareholders' equity (e.g. OCI)

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Removal of three exceptions to general principles of ASC 740

2. Deferred tax liabilities related to outside basis differences:

- Removes the exception to recognize a deferred tax liability (DTL) when a **foreign subsidiary becomes an equity-method investment (i.e., control is lost)**
- Removes the exception to <u>not</u> recognize a DTL when a **foreign equity-method investment becomes a subsidiary (i.e., control is obtained)**

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Removal of three exceptions to general principles of ASC 740

3. Year-to-date losses in interim periods:

- Removes the exception for *interim-period income tax allocation* when a *year-to-date loss* exceeds the *anticipated* loss for the year (e.g., there is year-to-date loss as of Q3 but company anticipates that Q4 will have a profit)
  - Previously, an exception *limited the amount of income tax benefit* that could be recognized in the *earlier* quarters.
  - The ASU removes the exception so that a company would record the *full tax benefit* of the earlier quarters' losses

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Five *other* simplifications to ASC 740

4. Franchise and other taxes *partially* based on income (*hybrid* taxes):

- Some jurisdictions have “hybrid” tax laws that are *partially* based on income and *partially* based on other factors
  - Example, company is required to pay the *greater* of an income-based tax or a capital-based tax
- The ASU now requires a company to recognize the *amount based on income* to be accounted for *in accordance with ASC 740*
- Any *incremental* amount is accounted for as a *non-income-based tax* (i.e., above the line) and is recognized entirely in the period incurred (no deferred tax on non-income-based tax)
- Prior to the ASU, this order was reversed

Five *other* simplifications to ASC 740

5. Step-up in tax basis of goodwill:

- Requires an entity to evaluate when a step-up in the *tax basis* of goodwill should be considered: i) part of a business combination (in which the goodwill was originally recognized) or ii) a *separate* transaction
  - Depending on the above determination, a DTA of differing amounts could be recognized

6. Separate entity financial statements:

- ASU specifies that, when members of a consolidated tax filing group issue separate "stand-alone" financial statements an entity is not required (but may choose) to allocate a portion of the consolidated current and deferred tax expense to a legal entity that is both: i) <u>not</u> subject to tax and is ii) *disregarded* by the taxing authorities
  - For example, a single-member LLC would meet both of these conditions
  - However, a partnership would not meet both of these conditions

Five *other* simplifications to ASC 740

7. **Interim-period recognition of enactment of tax laws or rate changes:**
   - The ASU amends the interim-period guidance to clarify that ASC 740 requires that <u>all</u> tax effects, **both current and deferred**, should be accounted for *in the interim period that includes the date of enactment.*
8. **Minor codification improvements:**
   - Various minor improvements, primarily, to:
     - Employee stock comp plans
     - *Qualified Affordable Housing* projects using the equity-method of accounting

ASU 2019-12: Effective dates for tax simplification

- FASB issued ASU 2019-12 in December 2019
- For ***public business entities***, the amendments became (or become) effective for:
  - Fiscal years beginning *after* Dec. 15, 2020, including interim periods therein
    - For calendar-year *public business entities*, was effective as of January 1, 2021
- For all ***other entities***, the amendments become effective for:
  - Fiscal years beginning *after* December 15, 2021, and interim periods within fiscal years beginning after December 12, 2022
    - For calendar year private entities, becomes effective in calendar 2022
- Early adoption permitted

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COVID grants

Recipient accounting for SVOG and RRF grants received under COVID-19 Relief Programs

AICPA recently issued Technical Q&A 5270.01, which discusses recipient accounting for:

- Shuttered Venue Operators Grants (SVOG)
- Restaurant Revitalization Fund (RRF)

AICPA

Q & A

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Accounting models for SVOG and RRF grants

IAS 20, Accounting for Government Grants and Disclosure of Government Assistance	ASC 450-30, Gain Contingencies

• Government grants recognized in income once there is reasonable assurance that a recipient
  • Will comply with the conditions associated with the grant
  • Will receive the grant.
• Impact is recorded on a systematic basis over the periods in which the entity recognizes related costs
• May be reported either as income or as a reduction in the related expense
	• Earnings impact is recognized when
	  • All the contingencies related to receipt of the assistance have been met
	  • The gain is realized or realizable.
	• A business entity would record the payments received under the SVOG or RRF grants as a refundable advance until proceeds are realized or realizable.

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Accounting models for SVOG and RRF grants

ASC 958-605, Not-for-Profit Entities

- SVOG and RRF grants would be considered conditional contributions under ASC 958-605
- Contribution revenue would be recognized only to the extent that eligible expenses have been incurred at a given reporting date.
- Due to the linkage of the conditions with the restrictions, restrictions likely will be satisfied simultaneously with meeting the conditions
- An NFP entity that has elected one of the "simultaneous release" accounting policy options would be permitted to report the contribution revenue directly in net assets without donor restrictions

Practice Issues

Practice Issues>

A “reminder” - accounting for changes in tax law (or rates) in the appropriate period

Accounting for changes in tax law (or rates) in the appropriate period

- Congress and President Biden are in the midst of negotiating potentially significant changes in the U.S. tax code, including changes to tax law and in tax rates for corporations.
- As a reminder, ASC 740 requires that **the effect of changes** in tax law (or rates) is required to be recognized **in the period in which the new law is enacted.**
  - In the U.S., the enactment date for federal income taxes is the date that the bill becomes law, which **generally is upon signature by the president**.
- At this time, it is unclear when, or whether, any new tax legislation may pass Congress or be signed by the president.

Practice Issues>

Monitoring inflation when applying ASC 830

Monitoring inflation when applying ASC 830

- Center for Audit Quality International Practices Task Force has updated its framework, ***Monitoring Inflation in Certain Countries***
  - Categorized the countries based on their cumulative inflation rates considering the guidance in ASC 830
  - Helpful to a financial statement preparer in applying ASC 830, in conjunction with its internal controls over financial reporting, to reach a conclusion on whether a country's economy should be considered highly inflationary

QUESTIONS AND CLOSING REMARKS

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