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Accounting and Auditing Update

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Today's Objectives

- Explain soon-to-be-effective Accounting Standards Updates
- Discuss common impacts of the current economic environment
- Discuss emerging standards
- Describe changes in auditing standards that may impact your audit



ASU 2016-13 Financial Instruments – Credit Losses

- The ASU is relevant for all organizations
- Financial Instruments include:
 - Trade receivables
 - Financing receivables
 - Held to maturity debt securities
 - Available for sale debt securities
 - Loans
 - Net investment in leases
 - Any right to receive settlement in the form of cash
 - Contract Assets



ASU 2016-13 Financial Instruments – Credit Losses

- What is excluded?
 - Financial assets measured at fair value
 - Available for sale debt securities
 - Loans to participants of DC benefit plans
 - Insurance entity policy loans receivable
 - Pledges receivable (NFP's)
 - Operating lease receivables
 - Loans and A/R between entities under common control



ASU 2016-13 Financial Instruments Credit Losses

- Why did the FASB issue this update?
- In the wake of the 2008/2009 financial crisis the Financial Crisis Advisory Group was formed
- Mission to advise FASB and IASB on improvements to financial reporting in the wake of the financial crisis



ASU 2016-13 Financial Instruments Credit Losses

- Many users of financial statements understood heightened credit risk before the financial statements reflected those risks
 - Existing GAAP restricts the ability to record credit losses until it is probable that a loss has been incurred
 - Ability to recognize expected losses is restricted
 - Users were utilizing forward looking financial models and assessing credit losses for their own purposes before issuers were recognizing losses



ASU 2016-13 Financial Instruments Credit Losses

- Objective is to provide more decision-useful information about expected credit losses by replacing the incurred loss methodology with a methodology that incorporates a broader range of reasonable, supportable information to inform credit loss estimates.



ASU 2016-13 Financial Instruments Credit Losses

- Assets measured at amortized cost
 - Present net of a valuation allowance at net amount expected to be collected.
 - Allowance should incorporate relevant information about past events, historical experience, current conditions and reasonable and supportable forecasts that affect the collectability of the reported amount.
 - The standard does not specify a method for measuring expected credit losses and allows an entity to apply methods that reasonably reflect its expectations.



ASU 2016-13 Financial Instruments Credit Losses

- Effective date:
 - Fiscal years beginning after December 15, 2022
 - Record a cumulative effect adjustment as of the beginning of the first reporting period in which the guidance is effective



ASU 2016-13 Financial Instruments Credit Losses

- Potential Impacts
 - It depends on current reserving methodologies
 - There is diversity in practice in application of “incurred loss” models
 - The more that reasonably supportable future expectations may have been incorporated, the less impact there will be
 - The more that the reserve methodology was based on backward looking data and excluded future expectations, the more impact there may be
 - Understand rationale for changes – beware unsupportable changes in methodologies that may indicate bias...



Current Economic Environment – Hot Topics

- Employee Retention Tax Credits (ERTC)
 - Eligibility based on:
 - Decline in gross receipts compared to same pre-pandemic quarter
 - >50% in 2020; >20% for Q1-3 of 2021
 - Subject to full or partial suspension due to government orders
 - What was the impact on operations?
 - IRS is concerned about widespread abuse
 - Double dipping with PPP loan proceeds
 - Existence and impact of government shutdowns
 - Devoting resources to audit ERC recipients



Employee Retention Credits

- Accounting for ERC
 - ERC is fundamentally a government grant
 - Recognize as revenue rather than as a reduction in payroll taxes
 - Analogize to NFP grant accounting – recognize when the barriers are overcome
 - Analogize to IAS 20 – provides some additional flexibility since the concept of uncertainty can factor in
 - Discuss with your auditor!

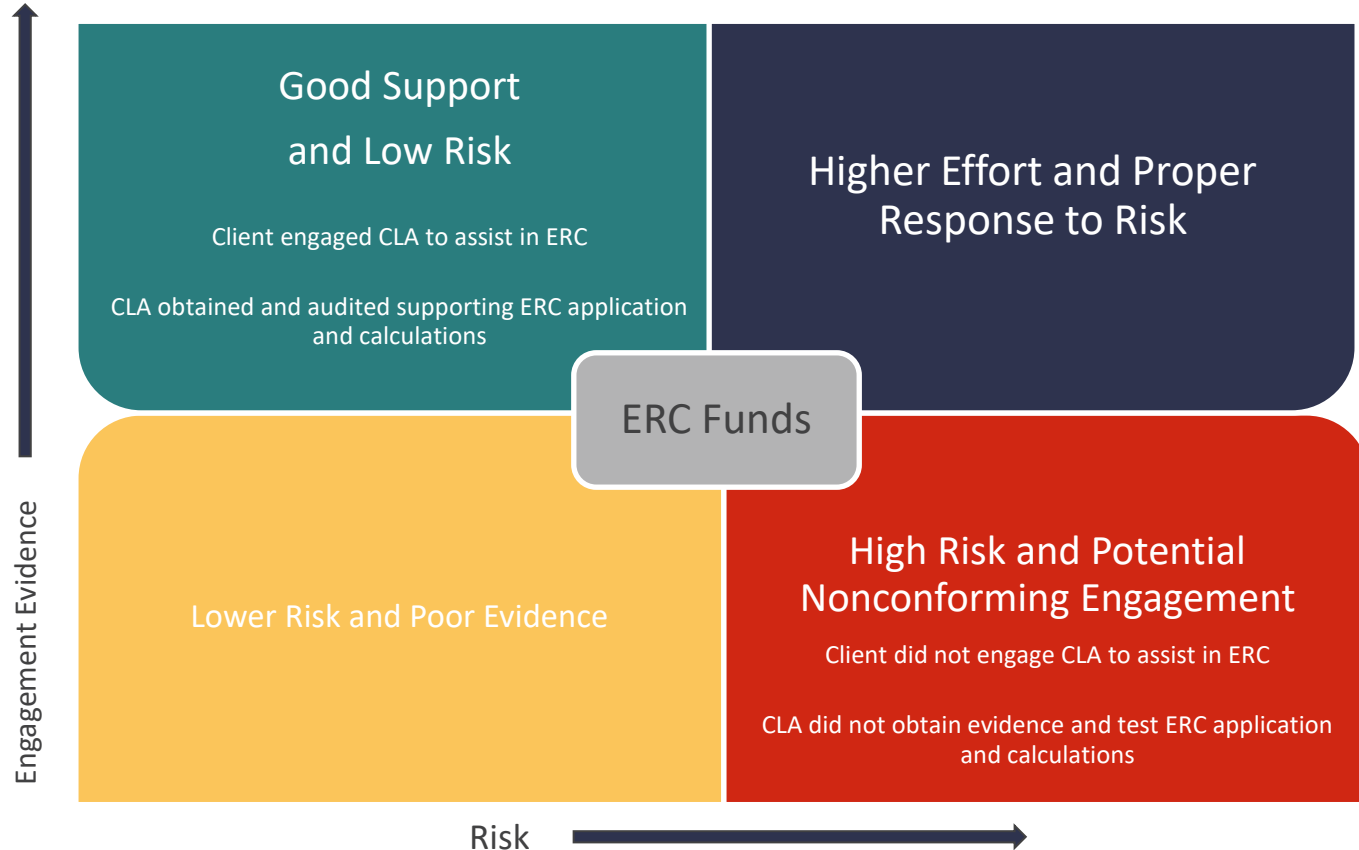


Employee Retention Credits

- Subsequent monitoring – evaluation of loss contingency
- Reserve if it is probable that a loss has been incurred
- Disclose (but do not reserve) if it is reasonably possible
- No recording or disclosure if likelihood deemed remote
- Evaluation may change in subsequent years if patterns emerge through enforcement action



ERC – The Auditor's Perspective



Going Concern Considerations

- We are seeing changes including:
 - Supply chain
 - Consumer habits
 - Cost of financing
 - Wind-down of COVID relief funding
- Uptick in “Going Concern” discussions



Going Concern Considerations

- Is liquidation imminent?
- Do conditions exist that in the aggregate give rise to substantial doubt about ability to continue as a going concern within **1 year after** financial statement issuance?
 - Consider management's plans to mitigate adverse conditions
 - Is it probable that plans will be implemented?
 - Is it probable that plans will mitigate relevant conditions?
- If conditions exist, disclosure required
- Unless the answer to both questions above is Yes, EOM paragraph in opinion



Emerging Issues

- Accounting for crypto assets
 - What are crypto assets?
- Current guidance – crypto assets are intangible assets
 - Account for as cost less impairment
 - Recognize impairment for declines in value
 - Do not recognize subsequent recoveries in value
- Exposure Draft would require fair value
 - Consider volatility and impact on earnings



Emerging Issues – Stock-Based Compensation

- Profits interests – what are they??
 - Commonly used as element of compensation by private and some public companies
 - Generally, a right to participate in future earnings and/or appreciation
 - Diversity exists – are these share-based payments or not?
- It depends! – if you have Profits interests refer to 4 scenarios articulated in 2023-ED300
 - Generally – if value is based on participation as an equity owner – it is stock-based comp
 - If on a formula (ie x% of earnings) it is not stock-based comp.



Income Statement Reporting 2023 ED500

- Would impact Public Business Entities only
- Would require more detailed reporting of expenses
 - Inventory and manufacturing expense
 - Employee Compensation
 - Depreciation
 - Selling expenses, including definition of selling expenses



Income Taxes 2023-ED100

- Enhance the transparency and usefulness of income tax disclosures
- More robust disclosures of certain details and impact of jurisdictions and cross-border and foreign tax effects (Public Business Entities Only)
- Qualitative disclosure about categories of items and individual jurisdictions that result in differences between statutory and effective tax rates
- Information regarding taxes paid by jurisdiction



Leases – 2022 ED 500 (Common Control Leases)

- Emphasis of new standard is on Legally enforceable rights rather than economic substance – challenging in common control situations
 - Practical expedient – may rely on written terms if they exist, if not sitck with legally enforceable rights
- Amortization of leasehold improvements in common control leases
 - Amortize by lessee over economic life of LHI (regardless of lease term) provided that life does not exceed term of lease with third party (if relevant)



Leases (Continued)

- If lessee no longer controls the use of the underlying asset, account for as transfer of equity



SAS 143 – Auditing Estimates and Related Disclosures

- Provides additional guidance regarding the nature of estimates and uncertainty
- Requires separate assessment of inherent risk and control risk at the assertion level
- Emphasis on performing additional audit procedures that are responsive to identified risks



SAS 145 Risk Assessment

- Updates and enhances guidance regarding risk assessment
- Consideration of economic, regulatory, technological aspects of the makes in which entities operate
- Emphasis on evaluation of risks and controls associated with IT
- Be Pro-active – ask your auditor whether they anticipate any changes? What will they need from you?

