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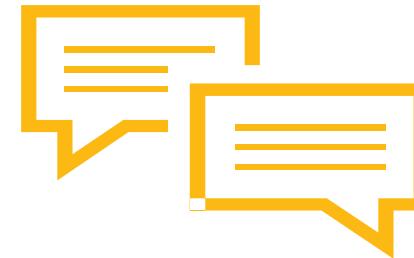
Year-End Audit and Accounting Update

Presented by: Stephen Bucker
and Sean Prince

November 28, 2018

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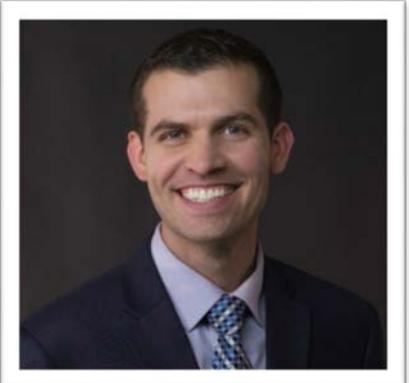
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Today's presenters



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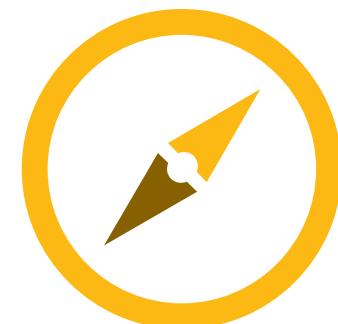
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Objectives

This webcast will provide an update on recent and upcoming changes to accounting standards that impact both public and private entities.

As a result of participating in this session, you should be able to:

- Describe the provisions of recently issued accounting guidance, and summarize the potential impacts of that guidance on financial statements and disclosures
- Summarize the major projects on the FASB's current standard-setting agenda, including their potential impacts on financial statements and disclosures



Agenda

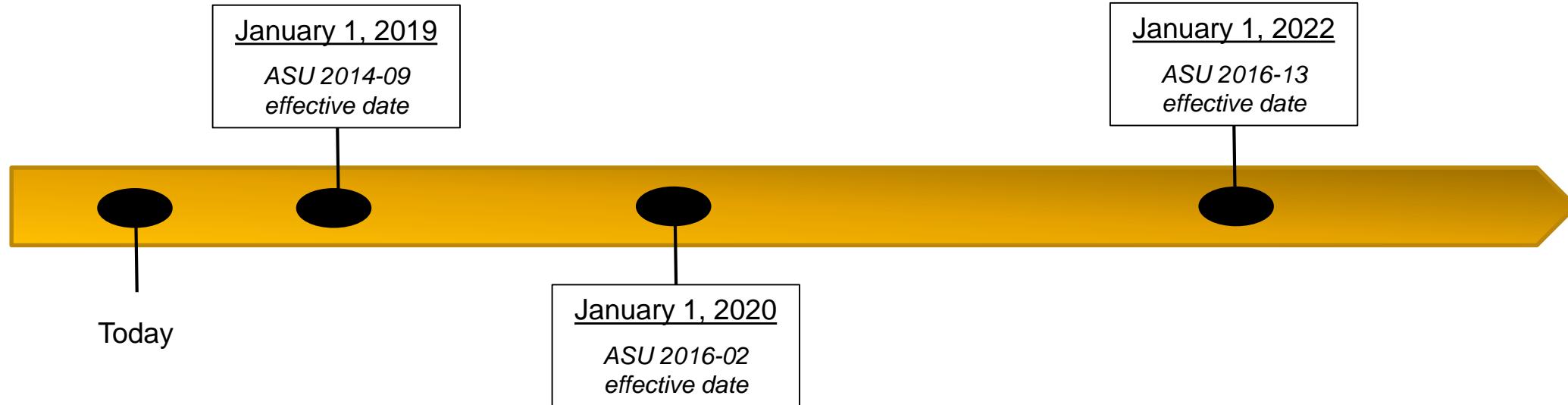
- Standards with fast-approaching effective dates
- Issued, not-yet-effective standards
- Noteworthy standard-setting projects



Standards with fast-approaching effective dates

The “Big 3” standards – Revenue, leases, CECL

Effective Date Timeline for Private Companies



Polling Question #1

Which of the following best describes your organization's adoption of the new revenue recognition standard:

- A. Signed, sealed, delivered!
- B. Finalizing contract reviews
- C. Beginning impact assessment
- D. Wait, there's a new revenue recognition standard?!

The Three C's – three items to keep in mind when implementing the Big 3

- **Completeness:** Ensure you can evidence to management and your auditors that you have evaluated all the required areas.
- **Clarity:** Be clear in, and document how you came to your conclusions under the standard and how you controlled the implementation.
- **Control:** Beyond the controls over implementation, ensure you have developed controls that will support a sustainable process that can accommodate new aspects of your business.

ASU 2016-02 (Leases): Why was it needed?

Increase
transparency of
rights and
obligations

Reduce
opportunities for
structuring

Align lessor
accounting with
ASC 606

Improve
disclosures over
leasing activities

ASU 2016-02 (Leases): Lessee accounting model

Impact	Finance Lease	Operating Lease
Has control of the asset transferred to the lessee?	Yes	No
Balance sheet	Right-of-use asset Lease liability (debt)	Right-of-use asset Lease liability (operating liability)
Income statement (characterization)	Interest expense Amortization expense	Lease expense
Pattern of expense	Front-loaded	Straight-line
Cash flow statement	Operating - cash paid for interest Financing - cash paid for principal	Operating - cash paid for lease payments

ASU 2016-02 (Leases): Implementation challenges



Scoping

Identification of Leases

Background – Historically, many organizations did not evaluate service contracts as potential leases due to similar accounting treatment

Key Change – All leases (or lease components) now required to be recognized on the balance sheet.
Recognition of leases (or lease components) now a necessity

Practice Issues –

- Identifying leases may require significant judgment
- Consistency in application of judgment may require new controls
- May be difficult to identify all potential lease contracts in decentralized environment

Keep in mind –

- Auditors will need to get comfortable with completeness of population

ASU 2016-02 (Leases): Implementation challenges



Scoping

Financial
statement
line items



G/L
querying



Internal
rep.



Reduced risk of incomplete
lease population

ASU 2016-02 (Leases): Implementation challenges



Manual Processes

Impact to Processes, Systems

Background – Historically, many organizations used spreadsheets to manage lease accounting process – e.g., determining straight-line amount, populating disclosures

Key Change – The requirement to record leases on balance sheet necessitates entities having to capture significantly more information about each lease

Practice Issues –

- Existing systems/processes cannot perform calculations or provide necessary data
- New system solutions still a work in progress
- System changes take time, require controlled implementation, bring expense

Keep in mind –

- Auditors will need to get comfortable with controls over new systems/processes
- Auditors will be focused on accuracy of inputs, calculations, flow of information

Topic 842: Implementation challenges



Accounting Policies

Determining the appropriate discount rate

Background – To measure the lease liability, an entity must determine the appropriate discount rate to use (generally, the incremental borrowing rate)

Key Change – Topic 842 introduces two key changes to the incremental borrowing rate: 1) it must be fully collateralized; 2) it must reflect a rate available for borrowings in the amount of the lease payments

Practice Issues –

- Management needs to document judgments used in determining discount rate
- Entities that use a portfolio approach must demonstrate no material difference between portfolio approach outcome and individual discount rate approach

Keep in mind –

- Auditors will be looking for consistency between rate used for classification and rate used for measurement

Topic 842: Implementation challenges



Accounting Policies

Accounting for variable lease payments

Background – Variable lease payments are generally excluded from the measure of the lease liability; though, those based on an index or rate need to be included at the then-current spot value of the index or rate

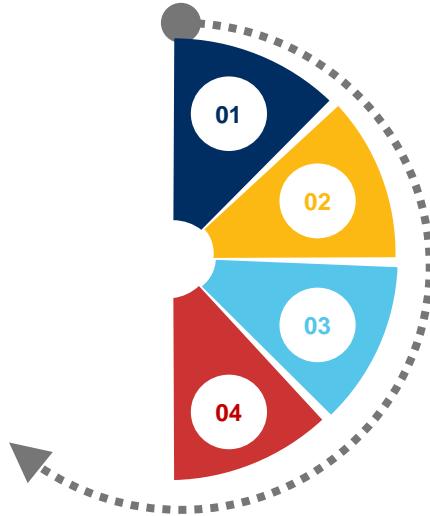
Practice Issues –

- Management will need a process to identify contracts with variable payments, and to identify which variable payments should be included in the lease liability
- Controls will likely be needed to monitor and review the separate disclosure of variable lease cost

Keep in mind –

- Auditors also need to design procedures to test management's recognition and disclosure of variable lease cost

Possible next steps



Scoping & Impact Assessment

- Scoping of leasing environment – determine population of all leases, look for unrecorded leases
- ASC 842 impact assessment report, including gaps noted, assessing ASC 842
- Technical memos and executive summaries, project plan and timeline for implementing ASC 842



People, Process & Controls

- Controls around the implementation of the standard, RCM modifications, sox and operational, etc.
- Process flow recommendations, and assistance on implementation
- Writing of policy and procedures around lease initiation, modification, and recording



Technology Enablement

- Technology Solution Implementation and Testing
- Integration into ERP backbone system, or GL package, as needed



Analysis & Impact Completion

- Creation of the required disclosures
- Evaluation and implementation of required entries for full vs. modified retrospective
- Any additional entries to bring your entity into compliance with the standard

Polling Question #2

Which of the following represents a challenge an organization may encounter in implementing the new lease accounting standard?

- A. Identifying embedded leases
- B. Determining the appropriate discount rate
- C. Capturing all necessary data (e.g., lease term) completely and accurately
- D. All of the above

Polling Question #2

Which of the following represents a challenge an organization may encounter in implementing the new lease accounting standard?

- A. Identifying embedded leases
- B. Determining the appropriate discount rate
- C. Capturing all necessary data (e.g., lease term) completely and accurately
- D. All of the above**

ASU 2016-13 (CECL) – Does it affect me?

In-Scope Items¹
Loans (employee, director, etc.) and loan commitments
Trade receivables and contract assets arising under Topic 605 and Topic 606
Financial guarantees (e.g., receivables factoring with recourse)
HTM debt securities
AFS debt securities
Reinsurance recoverables
Net investment in leases (sales-type and direct financing)

1 – Does not represent an all-inclusive listing

Notable Impacts
Replacement of “incurred loss” model with “expected loss” model Impairment no longer hinges upon the occurrence of a triggering event
Expansion of information set considered in estimating losses Entities should consider historical information, current conditions, <u>and reasonably supportable forecasts</u>
Estimate must incorporate risk of loss, even if that risk is remote Entities may not assume that the risk of nonpayment is zero.

ASU 2016-13 (CECL) – An example

Facts

At year-end, Widget Co. has on its balance sheet trade receivables with a gross carrying amount of \$50 million. The aging schedule and the historical loss rates for Widget's outstanding receivables as of year-end are as follows:

	Current balance	31 – 60 days outstanding	61 – 90 days outstanding	91 – 120 days outstanding	121+ days outstanding
Amortized cost basis	\$37 million	\$9.5 million	\$2.7 million	\$0.5 million	\$0.3 million
Loss rate	0%	3.00%	7.00%	23.00%	100%

Do I need to incorporate a risk of loss, even if current?

Do these rates need to be adjusted for forecasted future conditions (e.g., changes in unemployment rates)?

Other fast-approaching accounting changes

Accounting Standard	Key Changes	Effective Date
ASU 2016-01	<ul style="list-style-type: none">➤ Requires virtually all equity investments to be accounted at fair value with changes through P&L➤ Requires certain fair value changes of financial liabilities to be recorded through OCI	PBEs: Fiscal periods beginning after December 15, 2017 Non-PBEs: Fiscal years beginning after December 15, 2018
ASU 2016-15	<ul style="list-style-type: none">➤ Provides cash-flow-statement classification guidance for certain cash receipts and cash payments, including equity-method investments, debt prepayment costs, zero-coupon debt, contingent consideration payments, and more	PBEs: Fiscal periods beginning after December 15, 2017 Non-PBEs: Fiscal years beginning after December 15, 2018
ASU 2017-01	<ul style="list-style-type: none">➤ Revises the definition of a business, generally resulting in fewer items meeting the definition of a business	PBEs: Fiscal periods beginning after December 15, 2017 Non-PBEs: Fiscal years beginning after December 15, 2018

Other fast-approaching accounting changes

Accounting Standard	Key Changes	Effective Date
ASU 2017-11	➤ Provides an exception for down round provisions in determining the appropriate classification for certain hybrid financial instruments	PBEs: Fiscal periods beginning after December 15, 2018 Non-PBEs: Fiscal years beginning after December 15, 2019
ASU 2017-12	➤ Significantly amends the hedge accounting model in Topic 815 to simplify the application of hedge accounting	PBEs: Fiscal periods beginning after December 15, 2018 Non-PBEs: Fiscal years beginning after December 15, 2019

ASU 2017-12: Hedging simplifications

Reasons for change

- Poor alignment between risk management practices and accounting
- Punitive documentation and “effectiveness assessment” requirements
- Hard for investors to understand hedge ineffectiveness

Key changes

- Expanded eligible hedged items
- Simplified upfront documentation and ongoing effectiveness assessment requirements
- Eliminated concept of measuring hedge ineffectiveness

Effective date

- Public companies: Fiscal years beginning after December 15, 2018
- Private companies: Fiscal years beginning after December 15, 2019
- Early adoption permitted

Polling Question #3

Which of the following does not represent a simplification made possible under the new hedge accounting standard?

- A. Ability to use qualitative hedge effectiveness assessments in certain situations
- B. Ability to assume perfect effectiveness for all interest rate risk hedges
- C. Elimination of the concept of measuring hedge ineffectiveness
- D. Expanded set of eligible hedged items

Polling Question #3

Which of the following does **not** represent a simplification made possible under the new hedge accounting standard?

- A. Ability to use qualitative hedge effectiveness assessments in certain situations
- B. Ability to assume perfect effectiveness for all interest rate risk hedges**
- C. Elimination of the concept of measuring hedge ineffectiveness
- D. Expanded set of eligible hedged items

Issued, not-yet-effective standards (that can be early adopted)

Issued, not-yet-effective standards (that can be early adopted)

Accounting Standard	Key Changes	Effective Date
ASU 2018-15	<ul style="list-style-type: none">➤ Addresses a customer's accounting for costs incurred in implementing a hosting arrangement➤ Requires customers to apply the Subtopic 350-40 model to determine if costs should be capitalized or expensed	PBEs: Fiscal periods beginning after December 15, 2019 Non-PBEs: Fiscal years beginning after December 15, 2020
ASU 2018-14	<ul style="list-style-type: none">➤ Removes, adds, and clarifies certain disclosure requirements for defined benefit plans➤ Issued in connection with FASB's disclosure framework project	PBEs: Fiscal periods beginning after December 15, 2020 Non-PBEs: Fiscal years beginning after December 15, 2021
ASU 2018-13	<ul style="list-style-type: none">➤ Removes, adds, and modifies certain disclosure requirements for fair value measurements➤ Issued in connection with FASB's disclosure framework project➤ May adopt removals/modifications early	PBEs: Fiscal periods beginning after December 15, 2019 Non-PBEs: Fiscal years beginning after December 15, 2019

Customer's accounting for implementation costs from hosting arrangements

Capitalize or expense?



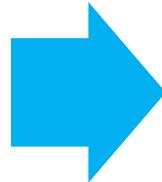
Apply model in Subtopic 350-40;
consider phase and nature of cost

Amortization period



Contractual term + reasonably
certain options to renew (terminate)
+ periods under control of vendor

Presentation



Same line item/classification as
hosting arrangement fee

Other items: Impairment (module/component level), disclosures

Issued, not-yet-effective standards (that can be early adopted)

Accounting Standard	Key Changes	Effective Date
ASU 2018-07	<ul style="list-style-type: none">➤ Expands scope of Topic 718 to include share-based payment to nonemployees➤ Provides expedients for private companies related to measurement of share-based awards	PBEs: Fiscal periods beginning after December 15, 2018 Non-PBEs: Fiscal years beginning after December 15, 2019
ASU 2017-04	<ul style="list-style-type: none">➤ Removes Step 2 of the goodwill impairment test➤ Retains Step 0 – i.e., qualitative impairment assessment	PBEs: Fiscal periods beginning after December 15, 2019 Non-PBEs: Fiscal years beginning after December 15, 2020

Standard-setting projects of interest

Standard-setting projects of interest

Topic	Key Proposal(s)	Current Status
VIEs	<ul style="list-style-type: none">➤ <u>PCC Alternative</u> – would allow a private company to elect to not apply VIE guidance to entities under common control➤ <u>Reorganization</u> – would reorganize Topic 810 guidance to improve readability	<ul style="list-style-type: none">➤ <u>PCC Alternative</u> – final ASU issued in Q4 '18➤ <u>Reorganization</u> – work in progress
Classification of debt	<ul style="list-style-type: none">➤ Would require debt to be classified as noncurrent if either of the following criteria is met:<ol style="list-style-type: none">1. Liability is contractually due more than one year after the balance sheet date2. Entity has contractual right to defer settlement for at least a year after the balance sheet date➤ Exception for certain waivers	<ul style="list-style-type: none">➤ Board redeliberations➤ Tentative effective date – Fiscal years beginning after 12/15/2021 (for private companies)
Goodwill	<ul style="list-style-type: none">➤ Board to propose expanding PCC Alternative for amortizing goodwill to NFPs➤ Board to separately consider possibility of amortizing goodwill for all entities	<ul style="list-style-type: none">➤ Just now starting

New PCC Alternative – Common control entities

Accounting policy election to not apply VIE guidance to certain entities under common control

Criteria:

- 1) The reporting entity and legal entity are under common control
- 2) The reporting entity and legal entity are not under common control of a public business entity
- 3) The legal entity under common control is not a public business entity
- 4) The reporting entity does not have a controlling financial interest in the legal entity under General consolidation guidance

Other Considerations:

- 1) Accounting policy election. Applies to all entities meeting the criteria listed
- 2) Only apply General subsections when determining if common control exists
- 3) Requires retrospective adoption
- 4) New disclosure requirements applicable

Polling Question #4

Do you think your organization will take advantage of the new PCC Alternative to VIE Guidance?

- A. Yes
- B. No
- C. Does not apply

Standard-setting projects of interest

Topic	Key Proposal(s)	Current Status
Hedging	<ul style="list-style-type: none">➤ In September 2018, the FASB added a new pre-agenda research project to consider further changes to hedge accounting model	<ul style="list-style-type: none">➤ Just now starting
Disclosures	<ul style="list-style-type: none">➤ FASB continues to examine existing disclosure requirements for simplifications➤ Current focus areas include disclosure on:<ol style="list-style-type: none">1. Inventory2. Income taxes3. Interim reporting4. Segment reporting	<ul style="list-style-type: none">➤ Work in progress
Others	<ul style="list-style-type: none">➤ EITF Issues (deferred revenue, accounting for episodic film series)➤ Distinguishing Liabilities from Equity	<ul style="list-style-type: none">➤ Various

Thank you

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Upcoming Webinar:

ASC 606 Implementation: Lessons From Companies That Have Adopted the New Revenue Recognition Rules

Date: Tuesday, Dec. 11, 2018

Time: 2-3 p.m. Eastern

Location: Webinar

The Financial Accounting Standards Board (FASB) has issued new guidance under topic 606 in the Accounting Standards Codification (ASC) that significantly changes rules for recognizing revenue under U.S. generally accepted accounting principles (U.S. GAAP). These rules went into effect on Jan. 1, 2018, for many public companies, and many nonpublic entities will adopt these new rules on Jan. 1, 2019. This webinar will describe aspects of the new rules that have been challenging for some of the public company adopters and will include practical examples of how public companies resolved some of these challenges.

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