A Counting Update

WITH YOUR HOST – JIM PURSLEY, CPA

Developments in Private Company Reporting

- Financial Accounting Foundation (FAF) – Governing body over FASB created the Public Company Council (PCC) in 2012 to determine if GAAP standards should be modified for privately-held companies.
- SEE EXHIBIT A - FLOW CHART IN HANDOUT – Standard setting process for the PCC.

Definition of a "Public Company"

- Developed and defined under:

  Accounting Standards Update (ASU) 2013-13.

- SEE EXHIBIT B - CRITERIA IN HANDOUT

- FASB says Not-for-Profits and Employee Benefit Plans are not eligible for the guidance.

Facts and Circumstances:

- GAAP has created disparity amongst users and preparers due to complex reporting and disclosure issues.

- Significant differences exist between users of financial statements for public and private entities.

- SEE EXHIBIT C - ON DIFFERENCES IN HANDOUT

PCC Rules are <u>Elective</u> vs. <u>Required</u>

- Provides a "mix and match" approach – pick and choose
- However, still considered GAAP

TO DATE: 3 New Standards 2 PCC "Issues"

- **<u>Standards:</u>**
- ASU 2014-07 – Applying VIE Guidance to Common Control Leasing Arrangements
- ASU 2014-02 – Intangibles, Goodwill, and Other
- ASU 2014-03 – Accounting for Interest Rate Swaps
- **<u>PCC Issues:</u>**
- PCC Issue 13-01A – Accounting for Intangible Assets
- PCC Issue 14-01 – Definition of a public business entity (Phase II)

ASU 2014-07: Applying VIE Guidance to Common Control Leasing Arrangements

- FIN 46 – Standard that came out of the Enron scandal because of investors not knowing what assets and liabilities existed at the company – "Off balance sheet accounting."
- Standard generally says if company has >50% controlling interest in other entities; must be consolidated.

ASU 2014-07: Applying VIE Guidance to Common Control Leasing Arrangements

- Exercise of identifying and consolidating entities turned out to be a costly and wasteful exercise for private companies and their auditors.
- Leasing arrangements usually set up for other reasons than "off-balance sheet" purposes – tax, estate planning, legal liability.

ASU 2014-07: Applying VIE Guidance to Common Control Leasing Arrangements

- Leasing arrangements usually set up for other reasons than "off-balance sheet" financing – tax, estate planning, legal liability.
- Lenders already familiar with leasing arrangements with business owners and their real estate business. Often-times lenders have to back out the real estate assets because they can not be seized in bankruptcy.

ASU 2014-07: Applying VIE Guidance to Common Control Leasing Arrangements

- Four Criteria:
  - 1) Common control exists between entities
  - 2) Leasing agreement in place between entities
  - 3) Substantially a "lease" activity
  - 4) No collateral > the property being leased

ASU 2014-07: Applying VIE Guidance to Common Control Leasing Arrangements

- Additional disclosures needed IF:
  - Other liabilities, commitments, or contingencies exist between the entities.

ASU 2014-07: Applying VIE Guidance to Common Control Leasing Arrangements

- SEE EXHIBIT D - LEASING ARRANGEMENT EXHIBIT IN HANDOUT – typical to many small business clients
- SEE EXHIBIT E - EXAMPLES IN HANDOUT

ASU 2014-07: Applying VIE Guidance to Common Control Leasing Arrangements

- Effective for periods beginning after December 15, 2014
  - (Essentially 12/31/15 Year-ends)

ASU 2014-02: Intangibles, Goodwill, and Other

- Coming full circle in regards to accounting for goodwill
  - (amortization –> impairment –> amortization)
- ASC 350 (Quantitative Method) – Testing Goodwill for impairment on annual basis.
  - Requires determination of fair value by appraisal
- ASU 2011-08 (Qualitative Method Option) – Current approach to Goodwill

ASU 2014-02: Intangibles, Goodwill, and Other

- ASU 2011-08 (Qualitative Method Option)
  - Uses "facts and circumstances" approach to determine whether "more likely than not" there has been impairment of Goodwill.
  - Fair Value of asset < Carrying Value = Impairment
  - If no impairment; No further action needed
  - SEE EXHIBIT F - LIST OF IMPAIRMENT INDICATORS, ASSESSMENT TABLE, AND FLOWCHART IN HANDOUT

ASU 2014-02: Intangibles, Goodwill, and Other

- ASU 2014-02 Provides alternative for private companies to elect to amortize current and future Goodwill over maximum of ten years.
- No requirement for annual impairment evaluation, unless a "triggering event" occurs. Then continue to amortize new basis over remaining years.
- Prospective application only and must apply to all business segments.

ASU 2014-02: Intangibles, Goodwill, and Other

- Simplifies process by permitting entities to evaluate at the overall company level vs. the reporting unit level required by ASC 350.
  - This will greatly reduce chances of impairment
  - SEE EXHIBIT G - EXAMPLE AND DISCLOSURE REQUIREMENTS IN HANDOUT

ASU 2014-02: Intangibles, Goodwill, and Other

- Effective for periods beginning after December 15, 2014
  - (Essentially 12/31/15 Year-ends)

ASU 2014-03: Accounting for Interest Rate Swaps

- Simplifies accounting for "Receive Variable, Pay Fixed" interest rate swaps
- Little effect on HBC clients – P/F/A

PCC Issue 13-01A: Accounting for Intangible Assets

- Proposal to simplify accounting for intangible assets other than goodwill.
- Approved by PCC and sent to FASB for approval in September 2014. Possible Eff. Date – 12/31/16 YE's.
- Do not recognize in a business combination: Non-compete agreements and customer-related intangibles that cannot be sold or licensed independently

Other PCC Issues:

- Definition of a public business entity, Phase 2 (PCC Issue 14-01)
- Stock-based compensation
- Accounting for certain partnership transactions

Revenue Recognition

- ASU 2014-09 – Revenue from Contracts with Customers, issued May 28, 2014.
- Effective for public companies YE 12/31/17, private companies YE 12/31/18. However, has to be retroactively applied for comparative presentation.
- New contract-based standard for revenue recognition, and designed to Streamline the revenue process.

Revenue Recognition

- Five-Step Model:
  - SEE EXHIBIT H - GRAPHIC IN HANDOUT
- Essentially revenue is recognized upon the satisfaction of contract performance obligations.
  - SEE EXHIBIT I – GRAPHIC IN HANDOUT
- Effects various industries differently:
  - SEE EXHIBIT J - INDUSTRY-IMPACT IN HANDOUT

LEASES (Topic 842) – Joint Project of the FASB and IASB

- Exposure Draft – 339 pages, 12 questions.
  - Issued May 2013 with comment period ending September 2013.
  - 641 comment letters, including from MSCPA TIG
  - Significant pushback from certain industry groups
- FASB has made preliminary decisions about certain definitions and terms, however still redeliberating the proposals as of October 2014.

LEASES (Topic 842) – Joint Project of the FASB and IASB

- Most-likely will re-exposed for comment next year (in Jim's opinion).
- Potential effective date(s): 2017 public, 2018 private.
- Basic Premise: Record all leases on the balance sheet:
  - Type A (formerly capital leases)
  - Type B (formerly operating leases)

Compilation and Reviews

- Push by the profession for 40+ years and from Professional Ethics Executive Committee (PEEC) to allow preparation of financial statements to be a "non-attest" service.
- New standards removes "triggering event" that impairs independence, and further allows "plain-paper" financial statement preparation services level.
- SEE EXHIBIT K - SSARS "triggering event" IN HANDOUT

SSARS NO. 21 – Clarification and Recodification

- Issued October 2014 and effective for periods ending after December 15, 2015 (12/31/15 Calendar YE's).
- NEW – (Section 70) Allows a new level of service for preparation of "Plain-Paper" financial statements
  - Considered a "Non-Reporting" service, as no report is provided.
  - Requires an engagement letter, signed by both parties
    - SEE EXHIBIT L - FIVE ENGAGEMENT LETTER COMPONENTS AND EXAMPLE IN HANDOUT

SSARS NO. 21 – Clarification and Recodification

- Section 70 (Cont'd):
  - Every page (including notes) should have caveat at the bottom:
    - *"No CPA provides any assurance on these financial statements. These financial statements have not been audited or reviewed, and no CPA expresses an opinion or a conclusion nor provides any assurance on them."*

SSARS NO. 21 – Clarification and Recodification

- Section 70 (Cont'd):
  - No separate evaluation of independence needed
  - CPA not required to verify the accuracy or completion of information provided by management; but do have to ask management to make corrections if they become aware of such instances.
  - Subject to peer review, per AICPA

SSARS NO. 21 – Clarification and Recodification

- Section 70 (Cont'd):
  - SEE EXHIBIT M - COMPARISON OF COMPILATION AND PREPARATION ENGAGEMENT EXHIBIT IN HANDOUT
  - PROS – Many users (namely banks) are accustomed to plain-paper statements. SSARS 8 (initial standards) not fully understood or practiced by CPAs and users.
  - CONS – Standard is inherently ambiguous; could be construed as unreliable. No restriction on use and distribution.

SSARS NO. 21 – Clarification and Recodification

- Compilations – (Section 80)
  - Largely unchanged from a practice standpoint
  - Engagement letter is required to be signed by both parties. SEE EXHIBIT N - FOUR ELEMENTS REQUIRED IN HANDOUT
  - NEW: One-paragraph report – SEE EXHIBIT O - EXAMPLE IN HANDOUT
  - Report always required, and additional paragraph needed if independence impaired.

SSARS NO. 21 – Clarification and Recodification

- Review – (Section 90)
  - No substantial changes to practice or reporting

Other FASB and GASB Projects

- SEE EXHIBIT P - HANDOUT FOR TECHNICAL AGENDA FOR FASB/GASB