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NEWMAN
NOYES

2021 Accounting & Business Update

October 26, 2021

Accounting & Audit Update

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What you'll hear today.

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1. About the New Statements on Auditing Standards (SAS)
2. SAS 136 Impacting New Employee Benefit Plans
3. Topic 842: Leases Refresher
4. Various New Accounting Standards Updates (ASU)

New Statements on Auditing Standards

BAKER NEWMAN NOYES

- SAS 134, Auditor Reporting and Amendments, Including Amendments Addressing Disclosures in the Audit of Financial Statements
- SAS 135, Omnibus Statement on Auditing Standards
- SAS 136, Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA
- SAS 137, The Auditors' Responsibilities Relating to Other Information Included in Annual Reports

New Statements on Auditing Standards (cont.)

BAKER NEWMAN NOYES

- SAS 138, Amendments to the Description of the Concept of Materiality
- SAS 139, Amendments to AU-C Sections 800, 805, and 810 to Incorporate Auditor Reporting Changes from SAS No. 134
- SAS 140, Amendments to AU-C Sections 725, 730, 930, 935 and 940 to Incorporate Auditor Reporting Changes from SAS Nos. 134-137

New Statements on Auditing Standards (cont.)

BAKER NEWMAN NOYES

- SAS 134, Changes to the Auditors' Report
  - Issued to be responsive to the needs of the financial statement user
  - The "opinion" section is required to be presented first
  - Enhanced auditor reporting relating to going concern
  - Expand auditors' responsibilities
  - Introduces the concept of a Key Audit Matter ("KAM")

Audit Opinion Example

BAKER NEWMAN NOYES

Independent Auditor's Report

[Board of Directors] [Audit Committee] [General Partner] [Board of Trustees]
[Client Name]

Opinion

We have audited the [consolidated] financial statements of [Client Name] [and its subsidiaries] (the Company), which comprise the [consolidated] balance sheets as of December 31, 20X2 and 20X1, the related [consolidated] statements of income, [comprehensive income,] changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the [consolidated] financial statements [(collectively, the financial statements)].

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 20X2 and 20X1, and the results of [its] [their] operations and [its] [their] cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. **We are required to be independent of the Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits.** We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Key Audit Matters [NOT MANDATORY – INCLUDED IF AGREED TO IN TERMS OF ENGAGEMENT]

Key audit matters are those matters that were communicated with those charged with governance and, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

[Description of each key audit matter]

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Company's ability to continue as a going concern for [Insert the time period set by the applicable financial reporting framework].

Audit Opinion Example (cont.)

BAKER NEWMAN NOYES

Auditor's Responsibilities for the Audit of the Financial Statements
Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

Exercise professional judgment and maintain professional skepticism throughout the audit.
Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, no such opinion is expressed.
Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the Company's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control–related matters that we identified during the audit.

[Firm Signature]

[City, State]
[Date of the Auditor's Report]

New Statements on Auditing Standards (cont.)

BAKER NEWMAN NOYES

- SAS 135, aligns GAAS with PCAOB standards and primarily addresses guidance related to:
  - Communications with those charged with governance (TCWG)
  - Consideration of fraud when there are significant unusual transactions
  - Evaluation of transactions with related parties
- SAS 136, relates to Employee Benefit Plans subject to ERISA
- SAS 137, clarifies the auditors' responsibilities relating to Other Information included in "annual reports" and helps to define this reporting

New Statements on Auditing Standards (cont.)

BAKER NEWMAN NOYES

- SAS 138, aligns the description of the concept of materiality with other entity standards:
  - **Legacy Description**
    Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users made on the basis of the financial statements.
  - **Revised Description**
    Misstatements, including omissions, are considered to be material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

New Statements on Auditing Standards (cont.)

- SAS 139, adopts the provisions of SAS 134 for any reporting using a special purpose accounting framework (such as cash basis, income tax basis, etc.)
- SAS 140, further aligns reporting under SAS 134 in regards to supplementary information in relation to the financial statements as a whole, required supplementary information, interim financial information, compliance audits and audits of internal control over financial reporting (ICFR)
- SAS 141, extended the effective dates of all of these standards to reporting periods ending on or after December 15, 2021

SAS 136 Background

- Issued by Auditing Standards Board in July of 2019
- A response to DOL examination of audits which found lack of understanding about what EB audits entail
- Effective for audits of period ends December 15, 2021 and later, after a 1 year COVID related delay

Intent of the New Standard

- Strengthen understanding and communication between auditors and plan management
- Make significant updates and changes to the auditors' reports
- Requires management to acknowledge certain responsibilities as a precondition for audits
- Changes terminology for "limited scope" plan audits to refer to them as ERISA Section 103(a)(3)(C) audits
- Codifies certain audit procedures which now must be performed

“Limited Scope” Audits

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- Audits formerly known as “Limited Scope” will be referred to as ERISA Section 103(a)(3)(C) audits in reports going forward
- Goal is to differentiate this type of limitation from other scope limitations resulting in a disclaimer of opinion
- Audit opinions will have two parts, and will not have a “disclaimer opinion”
  - A typical audit opinion related to any uncertified information
  - An opinion on whether certified information agrees to certified investment reports

Auditor Report

- Report will contain more detail on the auditors' responsibilities
- Report will contain a detailed section on management's responsibilities
- Reports will not have a "disclaimer of opinion" but rather a two part opinion on both certified and uncertified information

Opinion Example – ERISA Section 103(a)(3)(C)

BAKER NEWMAN NOYES

Independent Auditor's Report

[Appropriate Addressee]

Scope and Nature of the ERISA Section 103(a)(3)(C) Audit

We have performed an audit of the financial statements of ABC 401(k) Plan, an employee benefit plan subject to the Employee Retirement Income Security Act of 1974 (ERISA), as permitted by ERISA Section 103(a)(3)(C) (ERISA Section 103(a)(3)(C) audit). The financial statements comprise the statement of net assets available for benefits as of December 31, 2021, and the related statement of changes in net assets available for benefits for the year then ended, and the related notes to the financial statements.

Management, having determined it is permissible in the circumstances, has elected to have the audit of ABC 401(k) Plan's financial statements performed in accordance with ERISA Section 103(a)(3)(C) pursuant to 29 CFR 2520.103-8 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA. As permitted by ERISA Section 103(a)(3)(C), our audit need not extend to any statements or information related to assets held for investment of the plan (investment information) by a bank or similar institution or insurance carrier that is regulated, supervised, and subject to periodic examination by a state or federal agency, provided that the statements or information regarding assets so held are prepared and certified to by the bank or similar institution or insurance carrier in accordance with 29 CFR 2520.103-5 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA (qualified institution).

Management has obtained a certification from a qualified institution as of and for the year ended December 31, 2021, stating that the certified investment information, as described in Note X to the financial statements, is complete and accurate.

Opinion

In our opinion, based on our audit and on the procedures performed as described in the Auditor's Responsibilities for the Audit of the Financial Statements section

- the amounts and disclosures in the financial statements, other than those agreed to or derived from the certified investment information, are presented fairly, in all material respects, in accordance with accounting principles generally accepted in the United States of America.
- the information in the financial statements related to assets held by and certified to by a qualified institution agrees to, or is derived from, in all material respects, the information prepared and certified by an institution that management determined meets the requirements of ERISA Section 103(a)(3)(C).

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC 401(k) Plan and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our ERISA Section 103(a)(3)(C) audit opinion.

Opinion Example (cont.)

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error. Management's election of the ERISA Section 103(a)(3)(C) audit does not affect management's responsibility for the financial statements.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC 401(k) Plan's ability to continue as a going concern for [insert the time period set by the applicable financial reporting framework].

Management is also responsible for maintaining a current plan instrument, including all plan amendments, administering the plan, and determining that the plan's transactions that are presented and disclosed in the financial statements are in conformity with the plan's provisions, including maintaining sufficient records with respect to each of the participants, to determine the benefits due or which may become due to such participants.

Opinion Example (cont.)

BAKER NEWMAN NOYES

Auditor's Responsibilities for the Audit of the Financial Statements

Except as described in the Scope and Nature of the ERISA Section 103(a)(3)(C) Audit section of our report, our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users made on the basis of these financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the AU-C §703.A155 ©2021, AICPA Forming an Opinion and Reporting on Financial Statements 967 circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC 401(k) Plan's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC 401(k) Plan's ability to continue as a going concern for a reasonable period of time.

Our audit did not extend to the certified investment information, except for obtaining and reading the certification, comparing the certified investment information with the related information presented and disclosed in the financial statements, and reading the disclosures relating to the certified investment information to assess whether they are in accordance with the presentation and disclosure requirements of accounting principles generally accepted in the United States of America.

Accordingly, the objective of an ERISA Section 103(a)(3)(C) audit is not to express an opinion about whether the financial statements as a whole are presented fairly, in all material respects, in accordance with accounting principles generally accepted in the United States of America.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the audit.

Opinion Example (cont.)

Other Matter — Supplemental Schedules Required by ERISA

The supplemental schedules of [identify the title of supplemental schedules and periods covered] are presented for purposes of additional analysis and are not a required part of the financial statements but are supplementary information required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information included in the supplemental schedules, other than that agreed to or derived from the certified investment information, has been subjected to auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with GAAS. For information included in the supplemental schedules that agreed to or is derived from the certified investment information, we compared such information to the related certified investment information.

In forming our opinion on the supplemental schedules, we evaluated whether the supplemental schedules, other than the information agreed to or derived from the certified investment information, including their form and content, are presented in conformity with the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA.

In our opinion

- the form and content of the supplemental schedules, other than the information in the supplemental schedules that agreed to or is derived from the certified investment information, are presented, in all material respects, in conformity with the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA.
- the information in the supplemental schedules related to assets held by and certified to by a qualified institution agrees to, or is derived from, in all material respects, the information prepared and certified by an institution that management determined meets the requirements of ERISA Section 103(a)(3)(C).

[Firm Signature]

[City, State]

[Date of the Auditor’s Report]

Management's Responsibilities

- Must now more clearly acknowledge certain responsibilities as a precondition for the audit
- If electing an ERISA 103(a)(3)(C) audit, must acknowledge they are responsible for determining that it is permissible to do so
- Be prepared to support their conclusion that the certification is proper, and the certifying institution qualifies to issue the certification
- Understand that while service providers can help in carrying out responsibilities, ultimately plan compliance falls on plan sponsors.

Auditor Performance Requirements

- Must specifically consider the Plan’s unique provisions in assessing risks of material misstatement during planning
- Must communicate “reportable findings” to those charged with governance
- Must obtain and read a substantially complete draft of the Form 5500 for the plan prior to issuing an audit report

Objective of ASC 842: *Leases*

BAKER NEWMAN NOYES

- To address financial statement users' concerns of off-balance-sheet financing related to lessees' operating leases
- The new standard will require that nearly all leases are recorded on the balance sheet
- Lessor accounting has not been fundamentally changed

Scope Exceptions

- Leases of intangible assets (ASC 350)
- Leases to explore/use minerals, oil, and natural gas (ASC 930 & ASC 932)
- Leases of biological assets (animals and plants)
- Leases of inventory
- Leases of assets under construction

BAKER NEWMAN NOYES

Key Difference Between ASC 840 and ASC 842

Definition of a Lease

What is the definition of a lease?	
ASC 840	**ASC 842**
• An agreement conveying the right to use property, plant, or equipment (land and/or depreciable assets) usually for a stated period of time	• A contract, or part of a contract, that conveys the right to control the use of identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration

Definition of a Lease (cont.)

- Concept of an identified asset
  - The lease asset must be specifically identifiable either:
    - Explicitly (serial number, one floor of a building)
    - Implicitly (the only asset available to satisfy the contract)

Definition of a Lease (cont.)

BAKER NEWMAN NOYES

- Concept of substantive substitution rights
  - Substantive substitution rights preclude a contract from containing a specifically identifiable asset
  - A supplier's right to substitute an asset is substantive only if both of the following conditions exist:
    - The supplier has the practical ability to substitute alternative assets throughout the period of use
    - The supplier would benefit economically from the exercise of its right to substitute the assets

Definition of a Lease (cont.)

BAKER NEWMAN NOYES

- Concept of control:
  - Now there is consideration of both power and benefits regarding the use of the asset
  - Previously based solely on the amount of the output an entity receives from the asset
  - A lease contract conveys the right to control the use of the identified assets for a specified period of time. A customer controls an identified asset when the customer:
    - Has the right to obtain substantially all of the economic benefits from its use
    - Has the right to direct its use

Classification of Lessor Leases

BAKER NEWMAN NOYES

When is it determined?

ASC 840	ASC 842
• When the lease is executed	• At lease commencement

Classification of Lessor Leases (cont.)

BAKER NEWMAN NOYES

What are the classifications of lessor leases?

ASC 840	ASC 842
• Operating lease • Capital lease	• Operating lease • Finance lease

Classification of Lessor Leases (cont.)

BAKER NEWMAN NOYES

A lease is a capital lease (ASC 840) / finance lease (ASC 842) if any of the following criteria are met:

ASC 840	ASC 842
• Ownership transfer • Bargain purchase option • Lease term greater than or equal to 75% of useful life of the asset • Present value of minimum lease payments greater than or equal to 90% of fair value of leased property	• Ownership transfer • Option to purchase that the lessee is reasonably certain to exercise • Lease term is for a major part of the remaining economic life of the asset • Present value of minimum lease payments equals or exceeds substantially all of the fair value of the asset • Asset is of such a specialized nature that it is expected to have no alternative use to the lessor at the end of the lease term

Classification of Lessor Leases (cont.)

BAKER NEWMAN NOYES

- Criteria are generally the same aside from:
  - ASC 842 removes the bright-line thresholds of 75% and 90%. FASB has determined that a reasonable approach to assess the criteria in ASC 842 would be to continue to use the same thresholds prescribed by ASC 840.
  - There is an addition of a 5th test (specialized use) that could result in a lease being classified as a finance lease under ASC 842, which would have been an operating lease under ASC 840.

Classification of Lessor Leases (cont.)

- Short-term lease exception:
  - As an accounting policy, a lessee may elect to not apply the recognition requirements to leases with a term of 12 months or less with no purchase option. Instead, lease payments are recognized as rent expense on a straight-line basis over the lease term.

Definition of Lease Term

BAKER NEWMAN NOYES

- The noncancellable period for which a lessee has the right to use an underlying asset, together with all of the following:
  - ✓ Periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option
  - ✓ Periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option
  - ✓ Periods covered by an option to extend (or not to terminate) the lease in which exercise of the option is controlled by the lessor

Reasonably Certain is a High Threshold

BAKER NEWMAN NOYES

Consider the following:

Contract-based factors

- Bargain renewal option, contractual requirement to incur substantial costs to restore the asset before returning it to the lessor

Asset-based factors

- Installed significant leasehold improvements that would have value when the option becomes exercisable, facility is in a geographically desirable location with no vacant locations

Entity-specific factors

- Historical practices, management's intent, common industry practice

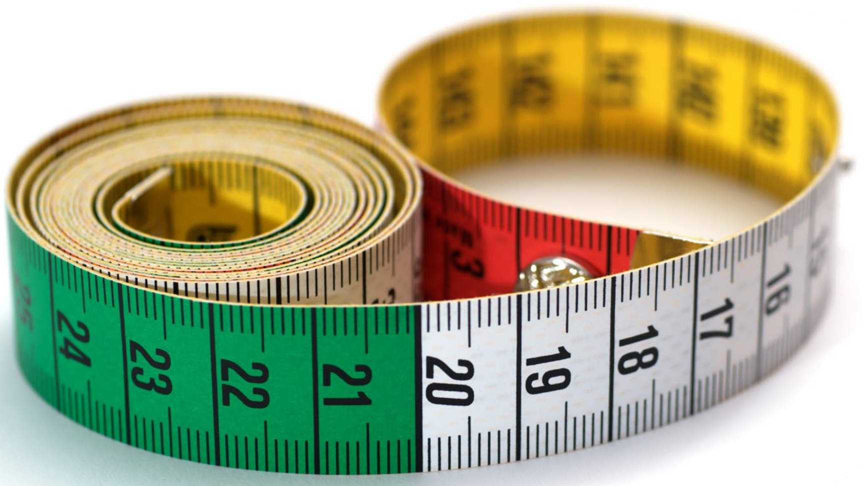
Market-based factors

- Market rentals for comparable assets

Initial Measurement: Lease Liability

BAKER NEWMAN NOYES

- The present value of the lease payments not yet paid, discounted using the discount rate for the lease at lease commencement



Lease Payments

BAKER NEWMAN NOYES

What is included in lease payments?	
ASC 840	**ASC 842**
• Payments that a lessee is obligated to make in connection with the leased asset, excluding contingent rentals and executory costs	• Fixed payments and "in substance" fixed payments are identified as payments that will determine the amount of the liability and corresponding asset recorded on the balance sheet

Lease Payments (cont.)

BAKER NEWMAN NOYES

- Include the following amounts for lessee leases:
  - Fixed (including in-substance fixed) payments less any lease incentives payable to lessee at lease commencement
  - Variable payments based on an index or rate
  - Exercise price of a reasonably certain purchase option
  - Payments for penalties for terminating the lease if reasonably certain to exercise
  - Amounts that are probable that the lessee will owe under residual value guarantees
- Do **not** include the following:
  - All other variable payments
  - Guarantee by the lessee of the lessor's debt
  - Amounts allocated to nonlease components

Discount Rate

BAKER NEWMAN NOYES

What discount rate should I use?	
ASC 840	**ASC 842**
• Rate implicit in the lease (if known) • Incremental borrowing rate	• Rate implicit in the lease (if known) • Incremental borrowing rate • Risk-free rate (if practical expedient elected – private companies only)

Discount Rate (cont.)

BAKER NEWMAN NOYES

Definition of incremental borrowing rate:	
ASC 840	**ASC 842**
• The rate that, at lease inception, the lessee would have incurred to borrow over a similar term the funds necessary to purchase the leased asset	• The rate of interest that a lessee would have to pay to borrow on a collateralized basis over a similar lease term an amount equal to the lease payments in a similar economic environment

Discount Rate (cont.)

BAKER NEWMAN NOYES

- In the past the IBR could be obtained from treasury; however, under ASC 842 more effort will go into identifying the appropriate IBR and models can be quite complex
- The company should document the determination process including the key inputs used and judgments made

Discount Rate (cont.)

BAKER NEWMAN NOYES

Factors to consider:

- Credit quality of the company
- Secured/collateralized cost of borrowing
- Cost to borrow over an equivalent term
- Foreign subsidiaries may not default to parent company's credit standing
- Foreign currency and political risks inherent in the jurisdiction should be considered

Initial Measurement: Right-of-Use Asset

BAKER NEWMAN NOYES

Lease liability + Lease prepayments + Initial direct costs − Lease incentives received = ROU asset

Note: ASC 842 does not specifically prohibit the lessee from recognizing a right-of-use asset that exceeds the fair value of the underlying asset; however, the lessee should challenge the inputs and assumptions used to measure the right-of-use asset in such instances

Example: Lessee Lease

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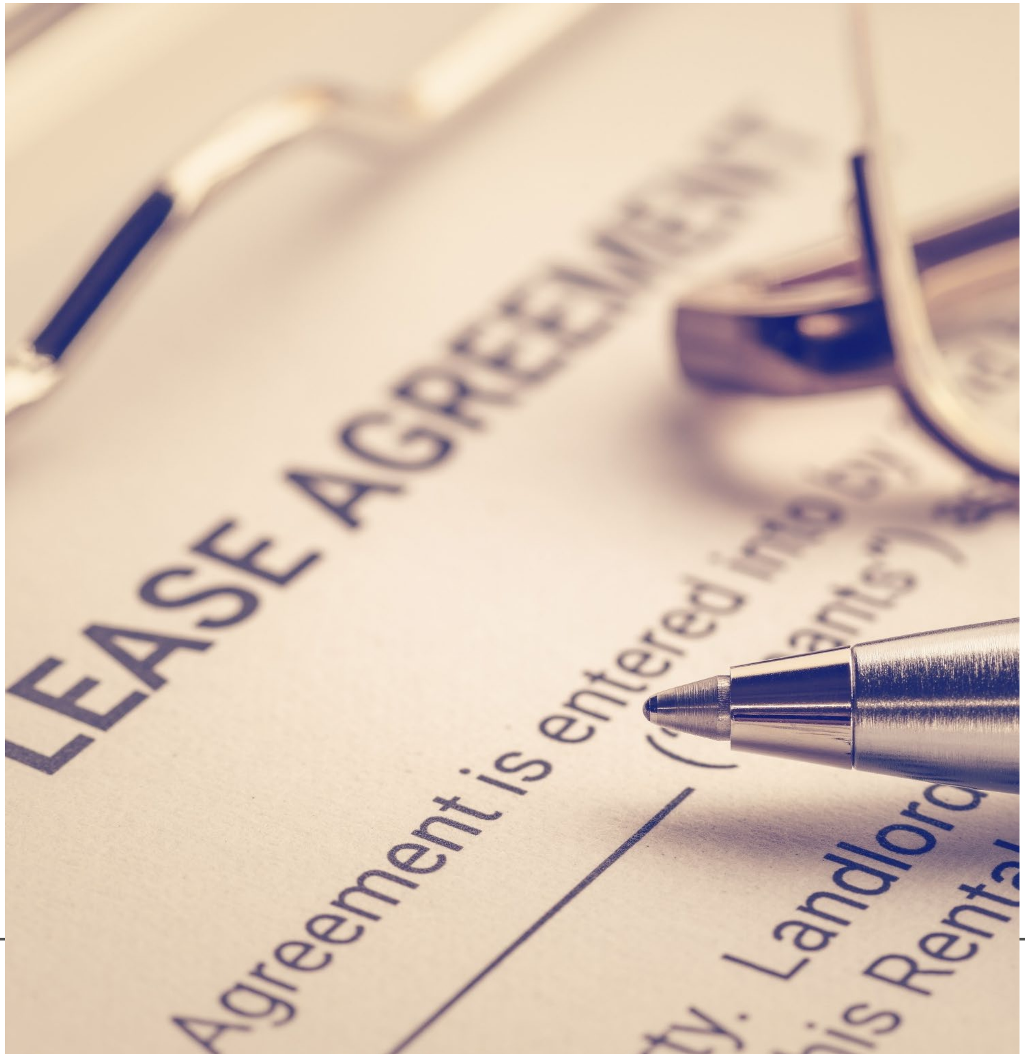

Assume the following

1. Six year lease with no renewal options
2. Lease payment is $50,000 paid at the end of each year
3. Lessee incremental borrowing rate is 6%

Calculation of Lease Liability and Right-of-Use Asset

Lease Liability = $245,866

PV of 6 payments of $50,000 discounted at 6%

Right-of-Use Asset = $245,866

lease liability + no initial direct costs + no prepaid lease payments – no lease incentives

Example: Lessee Lease

BAKER NEWMAN NOYES

Journal entry at commencement:

Description	Debit	Credit
Right-of-Use Asset	245,866	
Lease Liability		245,866

Example: Lessee Leases (cont.)

BAKER NEWMAN NOYES

		Finance Lease					Operating Lease		
	Cash	Asset	Liability	Amort. Expense	Interest Expense	Total Expense	Asset	Liability	Lease Expense
Commencement		245,866	245,866				245,866	245,866	
Year 1	50,000	204,889	210,618	40,978	14,752	55,730	210,618	210,618	50,000
Year 2	50,000	163,911	173,255	40,978	12,637	53,615	173,255	173,255	50,000
Year 3	50,000	122,933	133,651	40,978	10,395	51,373	133,651	133,651	50,000
Year 4	50,000	81,955	91,670	40,978	8,019	48,997	91,670	91,670	50,000
Year 5	50,000	40,978	47,170	40,978	5,500	46,478	47,170	47,170	50,000
Year 6	50,000	-	-	40,978	2,830	43,808	-	-	50,000
Total	300,000			245,866	54,134	300,000			300,000

Disclosure Requirements

BAKER NEWMAN NOYES

- ✓Noncash investing and financing activities
- ✓A general description of leases
- ✓The basis and terms and conditions on which variable lease payments are determined
- ✓The existence of terms and conditions of options to extend or terminate the lease
- ✓The existence of terms and conditions of residual value guarantees
- ✓Restrictions or covenants imposed by leases

Disclosure Requirements (cont.)

BAKER NEWMAN NOYES

- ✓ Information about leases that have not yet commenced but that create significant rights and obligations for the lessee
- ✓ Information about significant judgments made in applying the requirements of ASC 842
- ✓ Finance lease cost, segregated between amortization of the right-of-use assets and interest on the lease liabilities
- ✓ Operating lease cost

Disclosure Requirements (cont.)

BAKER NEWMAN NOYES

- ✓ Variable lease cost
- ✓ Sublease income
- ✓ Net gain or loss recognized from sale and leaseback transactions
- ✓ Amounts segregated between finance and operating leases for the following:
  - Cash paid for the amounts included in the lease liability
  - Supplemental noncash information on lease liabilities arising from obtaining right-of-use assets
  - Weighted-average remaining lease term
  - Weighted-average discount rate

10-K SEC Filing Example: CVS

Source: https://investors.cvshealth.com/investors/default.aspx

Consolidated Balance Sheets

In millions, except per share amounts	At December 31, 2019	2018
Assets:		
Cash and cash equivalents	$ 5,683	$ 4,059
Investments	2,373	2,522
Accounts receivable, net	19,617	17,631
Inventories	17,516	16,450
Other current assets	5,113	4,581
Total current assets	50,302	45,243
Long-term investments	17,314	15,732
Property and equipment, net	12,044	11,349
Operating lease right-of-use assets	20,860	—
Goodwill	79,749	78,678
Intangible assets, net	33,121	36,524
Separate accounts assets	4,459	3,884
Other assets	4,600	5,046
Total assets	$ 222,449	$ 196,456
Liabilities:		
Accounts payable	$ 10,492	$ 8,925
Pharmacy claims and discounts payable	13,601	11,365
Health care costs payable	6,879	6,147
Policyholders' funds	2,991	2,939
Accrued expenses	12,133	10,711
Other insurance liabilities	1,830	1,937
Current portion of operating lease liabilities	1,596	—
Short-term debt	—	720
Current portion of long-term debt	3,781	1,265
Total current liabilities	53,303	44,009
Long-term operating lease liabilities	18,926	—
Long-term debt	64,699	71,444
Deferred income taxes	7,294	7,677

BAKER NEWMAN NOYES

New Accounting Pronouncements Recently Adopted

Leases

In February 2016, the Financial Accounting Standards Board (the "FASB") issued ASU 2016-02, *Leases* (Topic 842). Under this accounting standard, lessees are required to recognize a right-of-use asset and a lease liability for virtually all of their leases (other than leases that meet the definition of a short-term lease). The liability is equal to the present value of lease payments. The asset is based on the liability, subject to certain adjustments, such as for initial direct costs. For income statement purposes, a dual model was retained, requiring leases to be classified as either operating or finance leases. Operating leases result in straight-line expense (similar to operating leases under the prior accounting standard), while finance leases result in a front-loaded expense pattern (similar to capital leases under the prior accounting standard). Lessor accounting is similar to the prior model, but updated to align with certain changes to the lessee model (e.g., certain definitions, such as initial direct costs, have been updated) and the new revenue recognition standard that was adopted in 2018.

The Company adopted this new accounting standard on January 1, 2019 on a modified retrospective basis and applied the new standard to all leases through a cumulative-effect adjustment to beginning retained earnings. As a result, comparative financial information has not been restated and continues to be reported under the accounting standards in effect for those periods. The Company elected the package of practical expedients permitted under the transition guidance within the new standard, which includes, among other things, the ability to carry forward the existing lease classification. On January 1, 2019, the Company recorded an after-tax transition adjustment to increase retained earnings by approximately $178 million ($241 million prior to tax effect). The new standard had a material impact on the Company's consolidated balance sheet, but did not materially impact the Company's consolidated operating results and had no impact on the Company's cash flows.

Right-of-Use Assets and Lease Liabilities

The Company determines if an arrangement contains a lease at the inception of a contract. Right-of-use assets represent the Company's right to use an underlying asset for the lease term and lease liabilities represent the Company's obligation to make lease payments arising from the lease. Right-of-use assets and lease liabilities are recognized at the commencement date of the lease, renewal date of the lease or significant remodeling of the lease space based on the present value of the remaining future minimum lease payments. As the interest rate implicit in the Company's leases is not readily determinable, the Company utilizes its incremental borrowing rate, determined by class of underlying asset, to discount the lease payments. The operating lease right-of-use assets also include lease payments made before commencement and are reduced by lease incentives.

The Company's real estate leases typically contain options that permit renewals for additional periods of up to five years each. For real estate leases, the options to extend are not considered reasonably certain at lease commencement because the Company reevaluates each lease on a regular basis to consider the economic and strategic incentives of exercising the renewal options and regularly opens or closes stores to align with its operating strategy. Generally, the renewal option periods are not included within the lease term and the associated payments are not included in the measurement of the right-of-use asset and lease liability. Similarly, renewal options are not included in the lease term for non-real estate leases because they are not considered reasonably certain of being exercised at lease commencement. Leases with an initial term of 12 months or less are not recorded on the balance sheets, and lease expense is recognized on a straight-line basis over the term of the short-term lease.

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6. Leases

The Company adopted ASU 2016-02, *Leases* (Topic 842) ("ASC 842") on January 1, 2019 on a modified retrospective basis. As a result, the Company's lease disclosures as of and for the year ended December 31, 2019 are reported under ASC 842. Comparative financial information for prior periods has not been restated and continues to be reported under ASC 840, the lease accounting standard in effect for those periods.

Disclosure Subsequent to the Adoption of the New Lease Accounting Standard (ASU 2016-02)

The Company leases most of its retail stores and mail order facilities and certain distribution centers and corporate offices under operating or finance leases, typically with initial terms of 15 to 25 years. The Company also leases certain equipment and other assets under operating or finance leases, typically with initial terms of 3 to 10 years.

In addition, the Company leases pharmacy space at the stores of another retail chain for which the noncancelable contractual term of the pharmacy lease arrangement exceeds the remaining estimated economic life of the buildings. For these pharmacy

lease arrangements, the Company concluded that for accounting purposes the lease term was the remaining estimated economic life of the buildings. Consequently, most of these individual pharmacy leases are finance leases.

The following table is a summary of the components of net lease cost for the year ended December 31, 2019:

In millions		2019
Operating lease cost	$	2,720
Finance lease cost:		
Amortization of right-of-use assets		38
Interest on lease liabilities		44
Total finance lease costs		82
Short-term lease costs		24
Variable lease costs		581
Less: sublease income		50
Net lease cost	$	3,357

Supplemental cash flow information related to leases for the year ended December 31, 2019 is as follows:

In millions		2019
Cash paid for amounts included in the measurement of lease liabilities:		
Operating cash flows paid for operating leases	$	2,701
Operating cash flows paid for interest portion of finance leases		44
Financing cash flows paid for principal portion of finance leases		26
Right-of-use assets obtained in exchange for lease obligations:		
Operating leases		1,824
Finance leases		283

Supplemental balance sheet information related to leases as of December 31, 2019 is as follows:

In millions, except remaining lease term and discount rate		
Operating leases:		
Operating lease right-of-use assets	$	20,860
Current portion of operating lease liabilities	$	1,596
Long-term operating lease liabilities		18,926
Total operating lease liabilities	$	20,522
Finance leases: (1)		
Property and equipment, gross	$	790
Accumulated depreciation (2)		(38)
Property and equipment, net	$	752
Current portion of long-term debt	$	27
Long-term debt		781
Total finance lease liabilities	$	808
Weighted average remaining lease term *(in years)*		
Operating leases		13.8
Finance leases		20.5
Weighted average discount rate		
Operating leases		4.6%
Finance leases		6.7%

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The following table summarizes the maturity of lease liabilities under finance and operating leases as of December 31, 2019:

In millions	Finance Leases	Operating Leases [1]	Total
2020	$ 84	$ 2,699	$ 2,783
2021	82	2,598	2,680
2022	79	2,444	2,523
2023	77	2,335	2,412
2024	76	2,103	2,179
Thereafter	1,056	15,654	16,710
Total lease payments [2]	1,454	27,833	29,287
Less: imputed interest	(646)	(7,311)	(7,957)
Total lease liabilities	$ 808	$ 20,522	$ 21,330

Effective Date and Transition

- Effective date for private companies: January 1, 2022
- Transition methods:
  - Retrospectively to each prior reporting period with the cumulative effect adjustment recognized at the beginning of the earliest year presented
  - Retrospectively at the beginning of the period of adoption through a cumulative-effect adjustment
- Full retrospective transition is prohibited

Practical Expedients

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- Transition:
  - Package (all or none):
    - Need not reassess whether any expired or existing contracts are or contain leases
    - Need not reassess lease classification for any expired or existing leases
    - Need not reassess initial direct costs for any existing leases
  - Use hindsight in determining the lease term and in assessing impairment of the entity's right-of-use assets
  - Need not assess whether there are existing or expired land easements that were not previously accounted for as leases

Practical Expedients (cont.)

- Accounting policy election by class of underlying asset to account for each separate lease and nonlease components as a single lease component
- Accounting policy election to not record a right-of-use asset and lease liability for short-term leases (12 months or less)
- Private companies can elect to use a risk-free rate to discount lease payments

COVID-19 Considerations

- Accounting for deferrals and forgiveness of lease payments related to COVID-19
  - FASB clarification on acceptable accounting that is less complex than modification guidance
- Potential impairment of right-of-use asset

Software Tools

VL VISUAL LEASE

ProLease

TANGO

CoStar Group™

simpLease

LeaseQuery®
BUILT BY ACCOUNTANTS FOR ACCOUNTANTS

Start Preparing Now

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- Identify all leases
- Organize and obtain executed copies of all contracts
- Put in place processes for accounting
- Develop the required disclosures

Join Us for More Lease Training!

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As part of the Commercial Businesses break-out session we will be doing a deeper dive into the new lease standard, including a case study related to developing an amortization schedule for a lessee operating lease.

Thursday, October 28

9:00am – 9:45am

Learn more here.

Implementation Costs in Cloud Computing Arrangements

- ASU 2018-15 attempts to clarify which costs can be capitalized in cloud computing arrangements
- Builds off of guidance provided on cloud computing arrangements in ASU 2015-05
- Effective for calendar year 2021

Software Arrangement Distinctions

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- Cloud computing arrangements do not include a software license, i.e. the customer accesses a vendor hosted software through the internet (cloud hosted)
- Other types of software arrangements are licensed by vendors to customers, and the software is actually hosted on the customers’ servers
- ASU 2015-05 made clear that cloud computing fees paid to vendors were to be expensed rather than capitalized

Why the New Guidance?

- Cloud computing arrangements are becoming more popular, and often involve high up front implementation costs
- Diversity in practice about whether implementation costs were capitalized
- New standard says that implementation costs can be capitalized, and to follow existing internal use software guidance in doing so

Project Stages

- Preliminary project stage – Expense as incurred
  - Feasibility studies
  - Vendor selection
- Application development stage – Capitalize certain costs
  - More detail on the following slide
- Post-implementation costs – Expense as incurred
  - Ongoing service contract fees (see ASU 2015-05)
  - Ongoing testing and post-implementation reconfiguration

Certain Costs Always Expensed

- Certain costs are expensed no matter the stage:
  - Training costs
  - Data conversion costs
- Any costs in preliminary planning or post-implementation stages
- As always, the actual service contract component, i.e., the fee for using the cloud software, is expensed as incurred

Costs Capitalized in Application Development

- Once the vendor is selected and work begins to get the software up and running, certain costs can be capitalized including but not limited to:
  - Customization costs
  - Configuration
  - Scripting
  - Network integration
  - Testing (prior to post implementation stage)
- Both internal and external costs are capitalized

Accounting and Reporting Considerations

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- Any capitalized implementation costs should be amortized over the term of the arrangement
  - Includes options to extend that are reasonably certain to be exercised
- Presentation should follow the balance sheet, income statement, and cash flow line items where the ongoing service contract fees are presented

ASU 2021-03 Intangibles – Goodwill and Other (Topic 350): Accounting Alternative for Evaluating Triggering Events

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- Allows for an accounting alternative to perform goodwill triggering evaluation as required by ASC 350-20 at the end of the reporting period (interim or yearend)
- Applies to private companies and all nonprofits (including not -for-profit PBEs)
- Issued in response to COVID-19
- No longer required to monitor goodwill impairment triggering during the reporting period

ASU 2021-03 Intangibles – Goodwill and Other (Topic 350): Accounting Alternative for Evaluating Triggering Events (cont.)

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- Instead evaluate facts and circumstances as of the end of each reporting period to determine if triggering event exists and if so, whether it is more likely than not goodwill is impaired
- Scope of ASU 2021-03 alternative is limited to only goodwill, not applied to impairment testing of other assets or intangibles
- Important to remember to evaluate potential impairment of goodwill and long term assets in cases where potential going concern uncertainty exists

ASU 2021-03 Intangibles – Goodwill and Other (Topic 350): Accounting Alternative for Evaluating Triggering Events (cont.)

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- Effective date- prospective basis for fiscal years beginning after December 31, 2019
- Early adoption permitted for financial statements not yet issued as of March 30, 2021.

Accounting for Convertible Debt Agreements

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Common terms & conditions to consider:

- ✓ Automatic Conversion Upon an Equity Financing
- ✓ Automatic Redemption Upon Change in Control
- ✓ Automatic Redemption Upon Event of Default
- ✓ Beneficial Conversion Feature (BCF)
- ✓ Debt issuance costs
- ✓ Warrants
- ✓ Determining fair value of the features and allocation to those features
- ✓ Equity vs liability treatment of bifurcated features

Convertible Debt Agreements can contain many terms & conditions that can require complex US GAAP considerations.

CECL for Non-Financial Institutions

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- CECL (Current Expected Credit Losses) applies to all financial assets carried at amortized cost
- Examples are loans, trade receivables, held to maturity debt securities, etc
- Switches from recognizing losses on these assets as incurred, to recognizing lifetime expected losses over the contractual term at inception

CECL Impacts

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- Impacts are likely not significant for non-financial institutions, however, there are items to consider:
  - Reasonable and supportable forecasts should be included in calculating allowances for credit losses
  - Requires pooling of assets with similar credit risks
  - Requires recognizing losses on certain assets even when they have not yet been incurred, i.e., on receivables that are current at the report date, if any losses are expected over the contractual life for that pool of assets

ASU 2021-01 Reference Rate Reform (Topic 848): Scope

- Current global efforts are underway to transition from using or referencing LIBOR and other interbank offered rates to using or referencing alternative reference rates
- The FASB previously issued ASU 2020-04 under ASC Topic 848 to assist with this transition, but this new ASU expands on some of the accounting relief associated with this type of change
- Includes the ability to apply certain aspects of contract modification and hedge accounting expedients to derivative contracts affected by changes in reference rates even when the referenced rate is not intended to be discontinued in the future
- Generally available for changes made through December 31, 2022

ASU 2019-12 Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes

- ASU 2019-12 issued to simplify certain areas of income tax accounting and to bring more consistency in some cases.
- Eliminates certain exceptions in ASC 740 relating to:
  - Approach for intraperiod tax allocation
  - Methodology for calculating income taxes in an interim period
  - Recognition of deferred taxes for outside basis differences
- Simplifies accounting for franchise and other non - income based taxes as well as enacted changes in tax laws and rates

ASU 2019-12 Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes (cont.)

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- Single member LLC and other disregarded entities not subject to income tax- not required to recognize allocation of consolidated income tax expense, but elect to do so.
- Clarifies Accounting for transactions that result in step up in tax basis of goodwill
- Guidance is effective for calendar year PBEs in 2021 and interim periods in that year
- For other calendar entities (non PBEs) effective for annual periods beginning in 2022.
- Early adoption is permitted

Questions?

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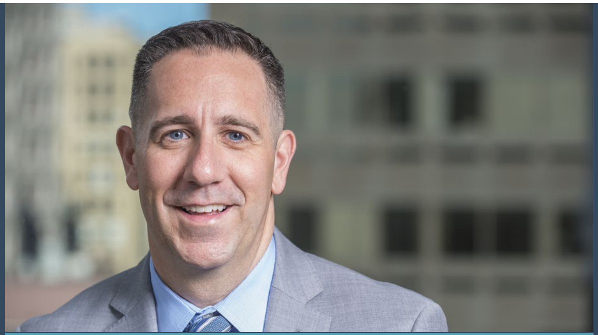
Contact Us



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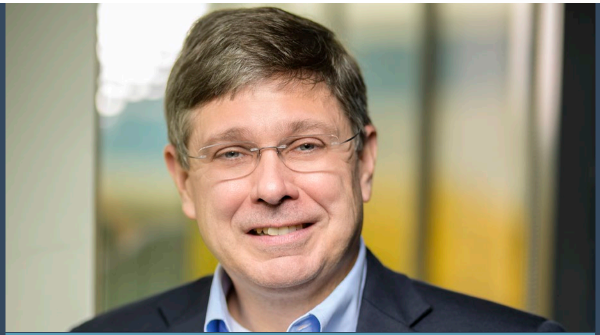

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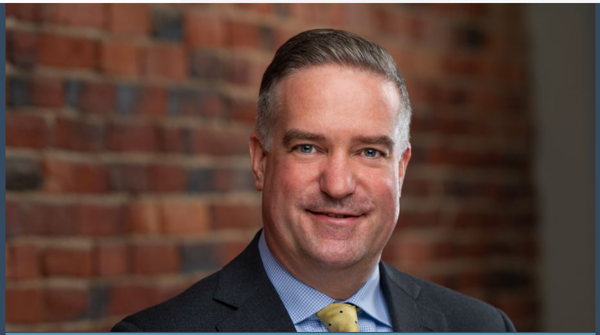

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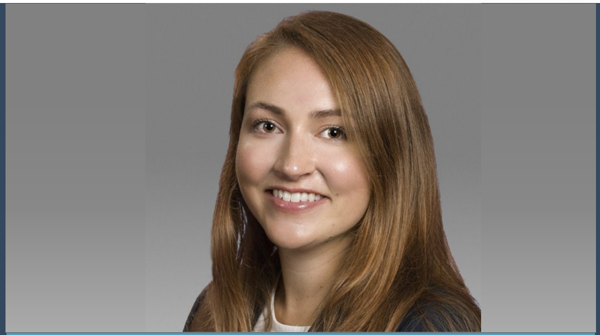

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