ASK THE EXPERTS WEBINAR

2019 AICPA Conference Overview

January 16, 2020

PRESENTERS

Bill Maloney *EXECUTIVE MANAGING DIRECTOR*

Years of Experience: 21

Expert Areas: SEC Reporting, IFRS, Accounting for Income Taxes

Industries Served: Consumer Goods, Life Sciences, Manufacturing

Patrick Garrett *MANAGING DIRECTOR*

Years of Experience: 15

Expert Areas: Technical Accounting, SEC Reporting, Capital Markets

Industries Served: Technology, Manufacturing, Transportation, Healthcare

Drew Niehaus *MANAGING DIRECTOR*

Years of Experience: 16

Expert Areas: Technical Accounting, Financing Transactions, SEC Reporting

Industries Served: Consumer Products, Technology, Government Contracting, Manufacturing

KEY REMINDERS

- Riveron webcasts – past and upcoming
- 4 polling questions must be answered to obtain CPE
- If you have questions, feel free to ask in Q&A option in Zoom
- Webinar evaluation form & CPE certificate will be emailed to you within 1 week of today’s presentation
- On demand video is not eligible for CPE
- You will receive a follow up email including:
  - Access to this webinar recording and presentation deck
  - The ability to join our Webinar mailing list to receive future invites
  - Presenter contact info

CONFERENCE OVERVIEW

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Annual conference hosted by the AICPA focused on financial reporting and auditing with content from key standard setters and regulators.

Main themes we will cover today:

- SEC comment letter trends, particularly related to adoption of new standards
- Non-GAAP disclosures
- CECL implementation
- FASB Agenda, particularly reference rate reform

Other themes:

- Auditor independence and engaging a strong audit committee
- SEC rulemaking (changes to 3-05 and 3-10 and Article 11 pro formas)
- Adequate risk factor disclosures around Brexit, Trade war and other current events
- Critical Audit Matters

Polling Question 1

On which topic have you had the most discussion with your auditors in the past quarter:

A. Auditor Independence

B. CAM's

C. CECL

D. Reference rate reform

E. Revenue recognition

SEC COMMENT LETTERS

SEC COMMENT LETTER TRENDS

2019 vs 2018 - 12 months ended September 30, 2019

	Topic	Relative Change
1	Revenue recognition	↑
2	Non-GAAP measures	↔
3	Fair value measurement	↓
4	MD&A	↓
5	Segment reporting	↓
6	Business combinations	↔
7	Goodwill and other intangibles	↔
8	Income taxes	↔
9	Debt, quasi-debt, warrants and equity	↔
10	Disclosure controls and ICFR	↔

*This analysis was originally published by PwC: https://www.pwc.com/us/en/cfodirect/publications/sec-comment-letter-trends.html

SEC COMMENT LETTER TOPICS: REVENUE RECOGNITION

In the first year reviewing a wide range of disclosures on the adoption of the new revenue standard, the SEC staff focused on the following areas:

- **Performance obligations** – Support for conclusion that promises are or are not separately identifiable.
- **Principal vs agent** – Description of the nature of the goods or services being provided and defining the registrant's role in transferring control to the customer
- **Variable consideration** – Methodology used to determine transaction price and how the constraint was applied
- **Measure of progress** – Why the method use to recognize revenue over time is appropriate and how it depicts the transfer of control of the goods or services
- **Costs to obtain a contract** – Which costs are appropriate to classify as incurred to obtain a contract, what is the proper amortization period, and election of practical expedients
- **Disaggregated revenue** – Appropriate determination of categories for disaggregated presentation
- **General** - Questions surrounding information elsewhere in the document that appears inconsistent with other conclusions: Performance obligations; disaggregated revenue

SEC COMMENT LETTER TOPICS: MD&A

Management's discussion and analysis is a frequent topic for comments. Staff commentary related to this area focused on the following:

- Supply chain finance programs, or structured trade payables, typically used to extend the timing of payments of trade payables
- Discussion of material events including Brexit and reference rate reform in the MD&A if relevant to the company.
- Comments often focus on material trends and uncertainties and how they impact operations, both historically and prospectively

Other common comment examples include the following:

- A consistent theme over the years has been context and quantification surrounding the results of operations
- Key accounting estimates. Robust disclosure of assumptions used and uncertainties
- Discussion of liquidity matters, clearly highlighting judgments

SEC COMMENT LETTER PROCESS: PRACTICAL TIPS

1. Do not hesitate to call the staff with procedural or interpretive questions when clarity would be helpful
2. When calling, do not assume the staff has all the facts.
3. Clearly and directly address the issues raised in the comments
4. Do not assume that the staff permitted something simply because it is in a precedent filing.
5. Address any considerations regarding materiality early in the comment letter process.
6. When a comment letter is provided prior to an upcoming filing, address the comment within the existing filing timeline if possible. When the comment is more substantial, requesting more time from the staff to appropriately analyze and consider the response is acceptable.
7. When the staff provides oral comments and the question is more than a request for minor clarification, requesting a follow-up call with all key stakeholders is appropriate

Polling Question 2

Which of these disclosures do you anticipate will be the most challenging in your upcoming year-end reporting?

A) Segment reporting

B) Revenue recognition

C) Goodwill

D) Income Taxes

NON-GAAP AND SUPPLEMENTAL INFORMATION

NON-GAAP AND SUPPLEMENTAL INFORMATION

Investor and stakeholder perspective on supplemental information

- Provides insight into management's thinking, how the business is run, adjustments management uses to evaluate quality of earnings
- At times, available earlier than interim or annual financial statements
- Reconciliations to GAAP measures are reviewed
- Consistency is expected
- Examples
  - Earnings releases
  - Investor discussions and the associated presentations
  - Form 8-K filings related to material events
  - Management discussion and analysis
  - Press releases

NON-GAAP AND SUPPLEMENTAL INFORMATION

Recent trends and examples of comments around non-GAAP measures include the following:

- Measures that reflect legacy accounting for revenue
- Measure excluding the impact of ASC 326 (CECL)
- Contribution margin is often disclosed, but there is no standard definition
- Keep non-GAAP measures disclosed consistent

Other common comment examples include the following:

- Reconcile to the most comparable GAAP financial measure
- Provide context to justify that adjustments identified by non-recurring are appropriate
- Present the most comparable GAAP measure with equal or greater prominence
- Disclose why the non-GAAP measure is useful to investors

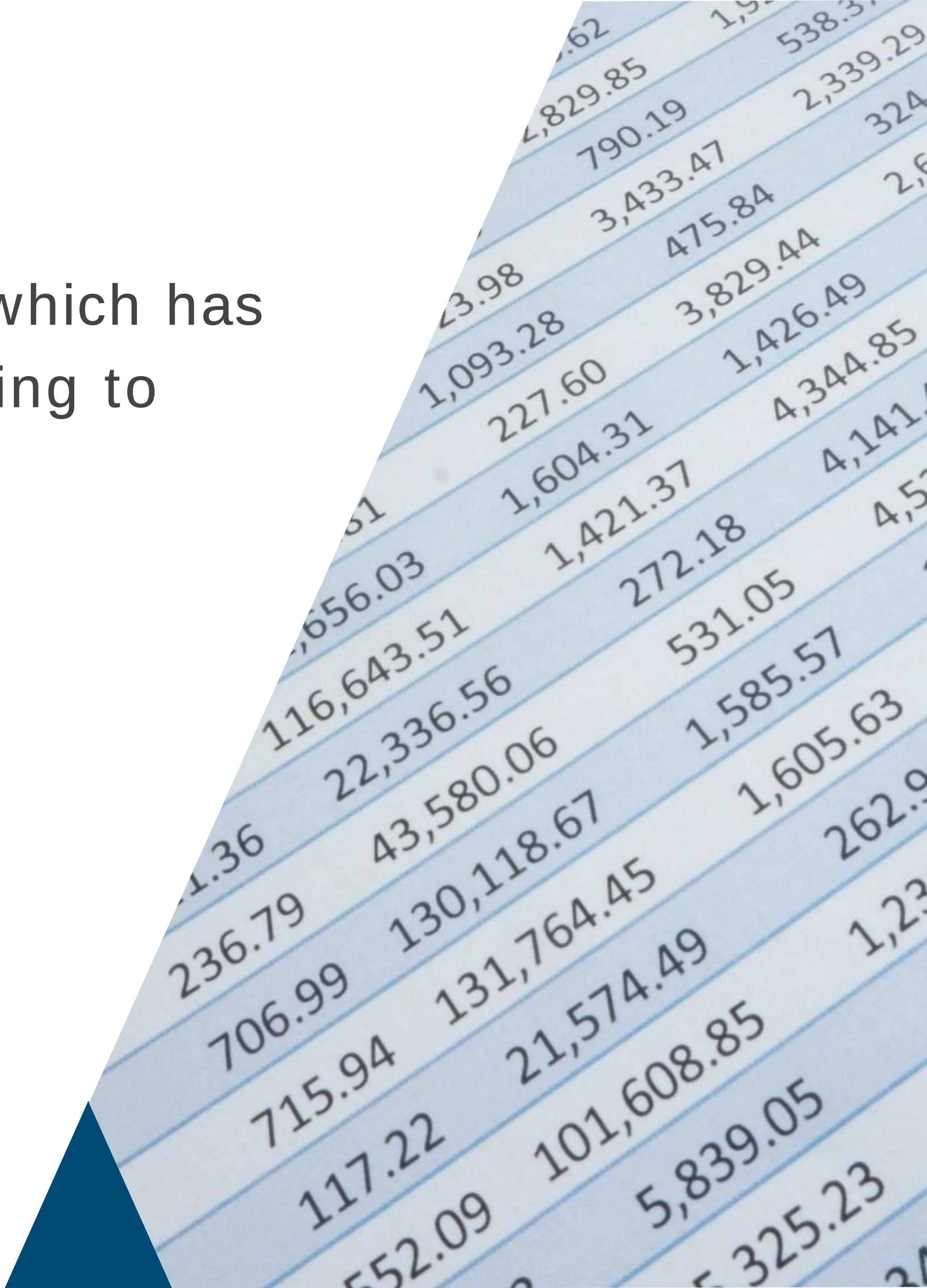
Polling Question 3

Of the new standards, which has been the most challenging to explain the impact to stakeholders?

A. Revenue recognition

B. Leases

C. CECL



CECL IMPLEMENTATION

CECL IMPLEMENTATION

- Chief Accountant Sagar Teotia noted the ongoing progress related to the adoption of ASC 326 which is effective for most public companies as of January 1, 2020.
  - Smaller reporting companies and private companies are effective beginning in 2023 for calendar year end companies.
  - SAB 74 disclosures for CECL will be required in most companies' 10-k's. Similar to ASC 842, this may include quantitative and qualitative information regarding the adoption of CECL.

- The Staff noted that, consistent with adoption of other standards, the impact should not be shown as a non-GAAP adjustment when calculating any non-GAAP measures (Adjusted EBITDA), etc.

- The FASB reiterated its commitment to assisting with implementation and providing implementation resources through the use of the ASC 326 Transition Resource Group.
  - The CECL TRG is similar to the 606 TRG in its evaluation of CECL implementation issues

CECL IMPLEMENTATION TIPS

- The SEC issued SAB 119 to help align guidance under the incurred loss model (prior guidance) and the expected loss model (new guidance).
  - SAB 119 lists several considerations for registrants from a documentation, controls, and governance perspective related to the adoption of CECL.
  - SAB 119 has a significant focus on a systematic and rationale methodology that is documented
- The Staff also noted that CECL is more than just a standard for financial institutions, but also for companies with trade receivables.
  - The Staff specifically noted ASC 326-20-55-37, which is an example of application of the standard to trade receivables using an aging schedule.
- The OCA discussed a recent consultation related to advances made by a lender on behalf of a borrower, in which it determined the advances were not subject to guidance in ASC 326 when applying the discounted cash flow model as
  - 1) the advances were not unconditional obligations
  - 2) the DCF guidance does not specify which cash flows must be included in the computation and
  - 3) such advances do not meet the definition of a cost to sell and not included in amortized basis of a loan

REFERENCE RATE REFORM AND THE FASB AGENDA

REFERENCE RATE REFORM: TIMELINE

Pre-2014
As a result of the financial crisis, LIBOR measurement transactions significantly decrease

2012 to 2014
Most significant markets establish working groups to select a new benchmark rate to replace LIBOR

2017
The ARRC (Alternative Reference Rates Committee) publishes its second report and recommends SOFR as the LIBOR alternative

April 2017
The NY Fed begins publishing the SOFR daily rate

September 2019
FASB issues an exposure draft on reference rate reform guidance

March 2020
FASB expects to issue final Reference Rate Reform guidance

December 2021
LIBOR is expected to cease being published as a reference rate

January 2023
The FASB will suspend its reference rate reform guidance and changes in interest rate will be subject to current modification guidance

LIBOR:

- LIBOR is a reference rate that is determined by a panel of reference banks based on judgment
- Process of determining LIBOR is somewhat outdated and as a result of financial crisis reforms there are no longer enough reference transactions
- Will no longer be in effect after 2021, but could be sooner if the number of panel banks publishing decreases below 4 (currently between 11 and 16)

SOFR:

- SOFR stands for “Secured Overnight Financing Rate”
- SOFR is based on transactional data from the U.S. Treasury repurchase market
- SOFR was recommended as the reference rate to replace USD LIBOR in 2017
- SOFR is not the only new reference rate being developed. Other countries developed their own local currency denominated alternative reference rates for short term lending, but SOFR is the recommended replacement for USD LIBOR.

REFERENCE RATE REFORM

How does the transition from LIBOR impact accounting?

Significant areas of LIBOR impact below:

Area	Description	Accounting impact
Hedges and Derivatives	- Interest rate derivatives tied to LIBOR will inevitably have to be modified. - Cash flow hedges will likely need to evaluate the probability of future transactions occurring based on a rate no longer in use	- Under current guidance, changes in critical terms of agreements may cause a modification and require an evaluation of whether the instrument continues to qualify for hedge accounting.
Loans	- Many loan agreements are tied to LIBOR as the reference rate and will have to be modified. - Companies will also need to assess their intercompany loans to determine if they will need to be modified.	- Under current guidance, changes to key terms of loans must be evaluated to determine if they are a modification or extinguishment of the current loan.
Discount rates	- LIBOR is commonly a basis for discount rates in some valuation models. - Leases that have a reference rate are commonly indexed to LIBOR.	- Valuations dependent on LIBOR may need to be revised.

REFERENCE RATE REFORM

The exposure draft states:

- Limited time application of guidance to ease the transition from LIBOR to a new rate (likely SOFR)
- During the effective window, modifications of contracts subject to accounting guidance would be treated as follows:
  - ASC 310 and ASC 470 – No modification and the change in rate would be accounted for prospectively.
  - ASC 842 - Accounted for as a continuation of the existing contract with no reassessments or remeasurements that otherwise would be required
  - ASC 815-15 – Modification would not require a reassessment of whether an embedded derivative should be bifurcated.
  - Additional exceptions to the guidance under ASC 815 related to hedging arrangements are included in the exposure draft that are designed to lessen the burden on preparers. The FASB clarified that preparers can continue to assess that transactions under current arrangements indexed to LIBOR are probable even after 2021.

The finalized guidance is expected to be issued in March 2020 and expire in January 2023.

THE FASB AGENDA: END OF THE (RUSS) GOLDEN ERA

The FASB Chairman, Russ Golden, who has been chairman for 12 years, will end his tenure as FASB Chair on June 30, 2020.

In the time left on Chairman Golden's watch, the FASB has prioritized the following projects:

1. **Reference rate reform** – discussed on previous slides
2. **Liabilities vs. Equity** – clarification of guidance determining the appropriate classification of complex instruments with both liability and equity characteristics. The Chairman indicated this as a top before the end of his tenure. An exposure draft was issued in July 2019 and the FASB continues to redeliberate the final version of the standard.
3. **Goodwill** - The FASB issued an invitation to comment in July 2019 and received a record outpouring of response, especially in regard to the decision-usefulness of the reporting compared to the effort to prepare it. Likely it will not be finished by the end of Golden's tenure, but will be a significant topic for discussion going forward.
4. **Performance reporting and segment disclosures** – The FASB added a project to their agenda focused on the disaggregation of performance information, but this will not be concluded during Golden's tenure.
5. **New standard implementation** – The key activity of the FASB in the near term will be monitoring the continued implementation of three large accounting standards related to revenue, leases and current expected credit losses.

Polling Question 4

Which of the topics on the future FASB Agenda are you interested in learning more about:

A. Reference rate reform

B. Goodwill

C. Debt vs Equity

D. Performance Reporting

ADDITIONAL INFORMATION ON TOPICS DISCUSSED:

- SEC Conference Recap: https://riveron.com/posts/key-takeaways-2019-aicpa/
- SEC Comment Letter Process: https://riveron.com/posts/sec-comment-letter-insights/
- Revenue Recognition: https://riveron.com/posts/rev-rec-asc-606/
- Non-GAAP Financial Measures – what constitutes an individually tailored accounting principle: https://riveron.com/posts/non-gaap-financial-measures-clarification/
- CECL's impact on short-term receivables: https://riveron.com/posts/cecl-and-short-term-receivables/
- How to prepare for the LIBOR transition: https://riveron.com/posts/libor-transition-3-ways-to-prepare/

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