GAAP Issues and Update

Jagruti Solanki
Rachid Zahir
Overview

- Revenue from contracts with customers
- Goodwill amortization
- VIE exemption of a real estate entity for private companies
- Debt issuance costs
- Development stage entities
- Going concern assessment
- Pending rules on compilations
- *Customer’s Accounting for Fees Paid in a Cloud Computing Arrangement*
Revenue from Contracts with Customers – Accounting Standards Codification Topic 606

- Known as:
  - Accounting Standards Update 2014-09 (ASU 2014-09), issued in May 2014
  - Accounting Standards Codification Topic 606 (ASC 606)

- Deliberations began in 2002
- First exposure draft was issued in 2008
- Second exposure draft was issued in 2011
- Converges revenue recognition standards under U.S. GAAP and International Financial Reporting Standards
- Replaces previous rules-based (over 200 pcs. of literature), industry-specific guidance with a single, principles-based standard
### Transition – Two Methods (Private)

#### Full Retrospective Method

<table>
<thead>
<tr>
<th>Year</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017*</th>
<th>2018</th>
</tr>
</thead>
</table>

Current GAAP

**ASC 606**

*Comparatives published in 2017

#### Modified Retrospective Method

<table>
<thead>
<tr>
<th>Year</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017*</th>
<th>2018</th>
</tr>
</thead>
</table>

Current GAAP

**ASC 606**

*Comparatives published in 2017
New Model – Five Step Process

Step 1: Identify the contract(s) with a customer.

Step 2: Identify the separate performance obligations in the contract(s).

Step 3: Determine the transaction price.

Step 4: Allocate the transaction price to the separate performance obligations.

Step 5: Recognize revenue when a performance obligation is satisfied.
Key Takeaways

- New standard could result in **accelerated revenue recognition**.
- Revenue is **no longer deferred until the amount is fixed and determined**.
- **Variable considerations**
  - Discounts, rebates, performance bonus
  - If the consideration promised in a contract includes a variable amount, an entity shall estimate the amount of consideration to which the entity will be entitled in exchange for transferring the promised goods or services to a customer
  - Constraining estimates of variable consideration – recognized only to the extent a significant reversal in cumulative revenue recognized will not occur when the uncertainty of variable consideration is resolved
- **No more VSOE**
- **Cost to obtain or fulfill a contract**
  - Capitalize costs to acquire a contract
  - Capitalize cost to fulfill a contract if selected criteria are met
- **Additional disclosure requirements**
Estimating Variable Consideration

**Volume Discounts (Tier Pricing Example)**

Facts Pattern – On Jan. 1, 20XX, ABC entered into a contract with XYZ company to sell pens over the year. The agreement stipulates that the price per file shall decrease as sales volume increases during the calendar year. The following schedule summarizes the tire pricing:

<table>
<thead>
<tr>
<th>Price per Pen</th>
<th>Sales Volume</th>
</tr>
</thead>
<tbody>
<tr>
<td>$5</td>
<td>0 to 50 pens purchased</td>
</tr>
<tr>
<td>$3</td>
<td>51 to 100 pens purchased</td>
</tr>
<tr>
<td>$2</td>
<td>101 and above pens purchased</td>
</tr>
</tbody>
</table>
Estimating Variable Consideration

Volume Discounts (Tier Pricing Example – Cont.)

ABC estimates the XYZ Company will purchase 80 pens during the calendar year based on two years of sales history. ABC should calculate the transaction price as follows:

<table>
<thead>
<tr>
<th>Transaction Consideration</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>$5 * 50 pens</td>
<td>$250</td>
</tr>
<tr>
<td>$3 * 30 pens</td>
<td>$90</td>
</tr>
<tr>
<td>Total:</td>
<td>$340</td>
</tr>
</tbody>
</table>

Total sales volume: 80 pens

Average price per pen: 4.25
Estimating Variable Consideration

**Volume Discounts (Tier Pricing Example – Cont.)**

- ABC will recognize revenue at the average selling price of $4.25 per pen as pens are purchased. In addition, ABC will recognize a contract liability for cash received in excess of the transaction price for each of the first 50 pens sold at the Tier One price of $5 per pen. The contract liability will accrete until the sales volume reaches the Tier Two price of $3 per pen at which point the contract liability will begin to be relieved.

- At each reporting date, accounting will have to obtain revised estimates from the sales group regarding total sales volume.
# Estimating Variable Consideration

### Volume Discounts (Tier Pricing Example – Cont.)

The implementation of ASC 606 will result in the deferral of revenue from tier pricing transactions as illustrated below:

<table>
<thead>
<tr>
<th></th>
<th>Under Current GAAP</th>
<th>Under New Standard</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Revenue Recognized</td>
<td>Revenue Recognized</td>
</tr>
<tr>
<td>$5 x 50 pens</td>
<td>$250</td>
<td>$212.50</td>
</tr>
<tr>
<td>$3 x 30 pens</td>
<td>$ 90</td>
<td>$127.50</td>
</tr>
<tr>
<td><strong>Total:</strong></td>
<td><strong>$340</strong></td>
<td><strong>$340</strong></td>
</tr>
</tbody>
</table>
FASB has proposed deferral of the effective date of its new revenue recognition standard by one year.
Goodwill Amortization

- Goodwill and indefinite lived intangible assets are required to be tested for impairment annually using a quantitative analysis.

- The annual impairment test required a comparison of the fair value of the reporting unit to the carrying amount of the reporting unit. This was burdensome since it required a valuation of the reporting unit.

- Public and private companies were given the option of using a qualitative test before moving on to the quantitative test.

- If management concluded that an impairment was unlikely based on a qualitative analysis, the quantitative test could be omitted.
Goodwill Amortization

- The qualitative test option wasn’t enough to alleviate the problem.
- Under ASU 2014-02, private companies can elect to amortize goodwill over the applicable life not to exceed 10 years.
- Amortization must commence at the beginning of the period of adoption.
- Once a company begins amortizing goodwill, the annual impairment test is not required.
- An impairment test is still required whenever there are indications of impairment.
VIE Exemption for Real Estate

- In March 2014, the Financial Accounting Standards Board issued a pronouncement that will give private companies the option of not consolidating a real estate leasing company that is under common ownership and qualifies as a variable interest entity (VIE).

- Effective date: Periods beginning after Dec. 15, 2014, but early adoption is permitted for any period for which the entity’s financial statements have not been issued. Retrospective application is required for all periods presented at the time of adoption.
VIE Exemption for Real Estate

The requirement for consolidation of a lessor that is under common control is eliminated if all of the following conditions are met:

- The lessee and the lessor are under common control;
- The lessee has a lease arrangement with the lessor;
- Substantially all of the activities between the lessee and the lessor are related to leasing activities between those two entities; and
- If the lessee explicitly guarantees or provides collateral for any obligation of the lessor, then the principal amount of the debt cannot exceed the value of the asset leased from the lessor at the inception of the guarantee or collateral arrangement.
Debt Issuance Costs

- ASU 2015-03 requires that debt issuance costs be presented in the balance sheet as a direct deduction from the carrying amount of the related liability.

- The recognition is effective for the calendar year ending 2016; however, early adoption is permitted.
Development Stage Entities (DSE)

A development stage entity is defined as one that is devoting substantially all of its efforts to establishing a new business and for which either of the following conditions exist:

- Planned principal operations have not commenced
- Planned principal operations have commenced, but there has been no significant revenue therefrom

What did U.S. GAAP require DSEs to disclose?

- Under current guidance, DSEs are required to present inception-to-date financial information in their annual statements (in other words, they present a P&L and cash flow statements since inception).
Development Stage Entities (DSE)

- ASU 2014-10 eliminates that requirement. Therefore, the inception-to-date information will no longer apply for a DSE.
- The new guidance applies to all entities that previously met the definition of a DSE.

What's next?

Effective for annual reporting periods beginning after Dec. 15, 2014 for public companies. For all other entities, the amendment is effective beginning after Dec. 15, 2015.
Going Concern Assessment

Before FASB issued *ASU 2014-15 Presentation of Financial Statements – Going Concern*:

- Going concern assessments were the auditor’s problem as management wasn’t required to follow auditing standards covered by AU-C 570.

- Whenever there was substantial doubt about the entity’s ability to continue as a going concern for a reasonable period of time not to exceed one year from the date of the financial statements, audit standards called for a going concern paragraph in the auditor’s report.
Going Concern Assessment

What changed?

- Going concern assessments and disclosures became management’s responsibility rather than the auditor’s sole responsibility.

- The new standard explicitly requires management to assess an entity’s ability to continue as a going concern.

- One year from the **date of the financial statements** versus one year from the date the financial statements **are available to be issued**.

- Effective date: for public business entities for annual periods, including interim periods within those annual periods, beginning after Dec. 15, 2015. For all entities, the amendment is effective for annual periods beginning after Dec. 15, 2015, and interim periods in annual periods beginning after Dec. 15, 2016. Earlier application is permitted.
Compilations

- New rules on preparation of financial statements
- Permit issuing financial statements prepared by a public accountant without a compilation report
- Each page of the financial statements must include a disclaimer such as the following:
  - No assurance is provided on these financial statements.
  - These financial statements have not been subjected to an audit or review or compilation engagement, and no assurance is provided on them.
Compilations

- If management omits the required disclosures, an accountant in public practice may issue a disclaimer such as the following:

  The accompanying financial statements of XYZ Company as of and for the year ended December 31, 20XX, were not subjected to an audit, review or compilation engagement by us and, accordingly, we do not express an opinion, a conclusion, nor provide any assurance on them.
  
  Signature
  City and state
  Date

- Effective for years ending after Dec. 15, 2015

- Source – ARC Section 70 and SSARS No. 21
Customer’s Accounting for Fees Paid in a Cloud Computing Arrangement

Prior to the issuance of the new standard:

- U.S. GAAP only provided explicit guidance for cloud computing providers to evaluate whether the software revenue recognition guidance applied to a revenue transaction (FASB ASC Subtopic 985-605, Software – Revenue Recognition)

- At present, some entities analogize to operating lease guidance in accounting for some software licenses under the hosting agreement

- Hosting arrangement includes a software license if it meets both of the following criteria:
  - The customer has the contractual rights to take possession of the software at any time during the hosting period without significant penalty, and
  - It is feasible for the customer to either run the software on its own hardware or contract with another party unrelated to the vendor to host the software
Customer’s Accounting for Fees Paid in a Cloud Computing Arrangement

What’s new?

- The new standard provides explicit guidance to help companies evaluate the accounting for fees paid by a customer in a cloud computing arrangement.

  - If a cloud computing arrangement includes a software license, the customer should account for the license consistent with its accounting for other software licenses.
    - When a cloud computing arrangement includes a license of software, the customer will capitalize the fee attributable to the software license portion of the arrangement when the criteria for capitalization of internal-use software are met.
  
  - If the arrangement does not include a software license, the customer should account for the arrangement as a service contract.
Customer’s Accounting for Fees Paid in a Cloud Computing Arrangement

- The Board decided not to expand the updated standard to address the range of implementation and setup costs incurred by a customer in a cloud computing arrangement.

- Effective date: for public business entities, the standard is effective for annual and interim periods in fiscal years beginning after Dec. 15, 2015 for public companies and private companies. For all other entities, the amendments will be effective for annual periods beginning after Dec. 15, 2015, and interim periods in annual periods beginning after Dec. 15, 2016. Early adoption is permitted for all entities.
Our team of experts

Jagruti Solanki, CPA
Audit Manager

Jagruti is a manager in the Audit practice at HA&W, the largest Georgia-headquartered tax, accounting and consulting firm. She has worked for the firm since 2007 providing audit services for a variety of industries, including manufacturing, technology, software, construction, distribution, alternative investments and non-profits. She has assisted in various compilations, reviews and audits in a variety of areas including hedge funds, hospitality and construction companies. She is in charge of audits from planning through delivery of the financial statements.

Rachid Zahir, CPA
Audit Manager

Rachid is a manager in the Audit practice at HA&W, the largest Georgia-headquartered tax, accounting and consulting firm. He has worked for the firm since 2013 providing audit services to clients in the Atlanta area serving a variety of Commercial and Industrial Markets clients, including global manufacturers, technology, software and life sciences industries. He manages the day to day operations of annual audits and assisted with various external filings including Form 10-K, Form 10-Q and Form 8-K.
Contact us
We look forward to working with you.

<table>
<thead>
<tr>
<th>Jagruti Solanki, CPA</th>
<th>Rachid Zahir, CPA</th>
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<tbody>
<tr>
<td>Audit Manager</td>
<td>Audit Manager</td>
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<td>770.353.3094</td>
<td>617.372.4280</td>
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<td><a href="mailto:rachid.zahir@hawcpa.com">rachid.zahir@hawcpa.com</a></td>
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