CPE

Not-for-Profit Accounting and Auditing Supplement No. 1—2016

Chapter 1

Not-for-Profit Accounting and Auditing Supplement No. 1–2016

Introduction

This update includes the more significant accounting and auditing developments affecting the not-for-profit industry from January through March 2016. Included in this update are standard-setting and project activities of the Auditing Standards Board, Accounting and Review Services Committee, Assurance Services Executive Committee, Professional Ethics Executive Committee, and FASB.

These developments, although believed to be complete at the date at which they were prepared for this course material, may not cover all areas within accounting and auditing relevant to all users of this material.

This update may refer you to other sources of information, in which case you are strongly encouraged to review that information if relevant to your needs.

After completing this course, you should be able to identify some of the more significant accounting and auditing developments affecting the not-for-profit industry from January through March 2016.

Audit and Accounting Final and Proposed Standards

Final Standards and Interpretations

AICPA

Auditing Standards Board

Auditing Standards

The Auditing Standards Board did not issue any new auditing standards affecting the not-for-profit industry this period.

Auditing Interpretations

The Auditing Standards Board did not issue any new auditing interpretations in this period.

Attestation Standards and Interpretations

The Auditing Standards Board did not issue any new attestation standards or interpretations in this period.

Accounting and Review Services Standards and Interpretations

The Auditing Standards Board did not issue any new accounting and review services standards or interpretations affecting the not-for-profit industry this period.

FASB

Accounting Standards Updates

Accounting Standards Update (ASU) No. 2016-01, *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*

Issue Date

January 2016

Background

The FASB and the International Accounting Standards Board (IASB) have an ongoing joint project to improve and converge their respective standards on the accounting for financial instruments. This ASU seeks to enhance the reporting model for financial instruments to provide users of financial statements with more decision-useful information. The amendments address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments.

ASU No. 2016-01 is the first of three standards under this topic that the Auditing Standards Board expects to release in the near future. The Auditing Standards Board is addressing recognition and measurement of impairment losses on financial assets in a separate project; final guidance is projected for the second quarter of 2016. An exposure draft on recognition and measurement of hedging instruments is also expected in the second quarter of 2016.

This ASU significantly affects a company's accounting for equity investments and the accounting for changes in fair value of financial liabilities under the fair value method of accounting.

Who Is Affected

This ASU broadly affects all entities that hold financial assets or owe financial liabilities. Banks and insurance companies may be particularly affected.

Main Provisions

Several important improvements are included in this ASU:

- Equity investments should be measured at fair value with changes in fair value recognized in net income. Note: Excludes equity method and consolidated investees.
    - An entity may choose to measure equity investments that do not have readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer.

- The portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments are presented separately in other comprehensive income.
- Financial assets and financial liabilities are presented separately by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements.
- For equity investments that lack readily determinable fair values, the cost method is eliminated. Instead, value the investment at fair value with changes reflected in net income, or elect a practical expedient. Under the practical expedient, report equity investments as cost adjusted for observable price changes and impairment (also reflected in income). Note: this option is not available to entities such as broker-dealers that follow "specialized" accounting models.
    - Perform a qualitative assessment at each reporting period to identify impairment. If impairment exists, measure the investment at fair value and recognize the impairment in net income.

- The need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets should be evaluated.

  For nonpublic business entities only:

    - Eliminate the requirement to disclose
        - the fair value of financial instruments measured at amortized cost, and
        - the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet.

  For public business entities only:

    - Use the exit price notion when measuring the fair value of financial instruments for disclosure purposes.

Discussion of Significant Changes and Impact on Entities

Recognition and Measurement of Equity Investments. One significant change from existing GAAP is that equity investments (within scope) that have readily determinable fair values will no longer be classified into different categories (such as trading or available for sale) and accounted for according to those categories. Rather, entities will measure such securities (and others, such as partnerships, unincorporated joint ventures, and limited liability companies) at fair value with changes in fair value recognized in income.

An entity has two options for measuring an equity security that does not have a readily determinable fair value: either

- at fair value with price changes recognized in net income, or
- at cost minus impairment, adjusted for changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer. (An "orderly transaction" means, for example, the price change did not result from a forced sale.) This option is considered a "practical expedient" under this ASU.

Therefore, entities should remeasure equity investments that lack readily determinable fair values accounted for under either method at fair value when

- a price change is observed, or
- a qualitative assessment indicates impairment.

Entities should make an election for each investment to measure an equity security in this manner and will need to consider whether it makes sense to elect the practical expedient (when available) including creating policies and procedures to identify, track, and record observable price changes.

FASB's objective was to simplify the impairment assessment for equity securities that are difficult to value quantitatively by replacing the current two-step process for assessing impairment with a one-step qualitative assessment at each reporting period. That assessment is similar to the qualitative assessment for long-lived assets, goodwill, and indefinite-lived intangible assets. If impairment exists, an entity should calculate the fair value of that investment and recognize the impairment (that is, the amount by which the carrying value exceeds the fair value of the investment) in net income. This impairment assessment reduces the complexity of the other-than-temporary impairment guidance companies were required to follow before the issuance of this ASU.

Recognition and Measurement of Financial Liabilities. According to FASB, that presentation addresses financial statement users' feedback that presenting the total change in fair value of a liability in net income reduced the decision usefulness of an entity's net income when it had a deterioration in its credit worthiness. Therefore, gains or losses that an entity may not realize (because those financial liabilities are not usually transferred or settled at their fair values before maturity) are now excluded from net income and recognized instead in other comprehensive income. However, any accumulated gains and losses due to these changes will be reclassified from accumulated other comprehensive income to earnings if the financial liability is settled before maturity.

Enhanced Disclosures. This ASU requires enhanced disclosures about the investments. For example, if the practical expedient is used to account for equity investments lacking readily determinable fair values, the company must disclose the investments' carrying amounts, annual and cumulative adjustments to carrying value, and information used to calculate carrying value adjustments resulting from observable price changes.

Eliminated Requirements. This ASU also eliminates certain requirements for public and nonpublic entities and requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset—that is, securities or loans, and receivables. Overall, FASB believes this ASU improves the relevancy of the information provided and reduces the number of items recognized in other comprehensive income.

Effective Date and Transition Requirements

Public Business Entities

Effective for financial statements issued for annual periods beginning after December 15, 2017, and interim periods within those annual periods.

All Other Entities

Effective for financial statements issued for annual periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019.

Early Application

Early application to financial statements of fiscal years or interim periods that have not yet been issued or, by all other entities, that have not yet been made available for issuance of the following amendments are permitted as of the beginning of the fiscal year of adoption:

- An entity should present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk if the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments.
- Nonpublic business entities are not required to apply the fair value of financial instruments disclosure guidance in the general subsection of FASB Accounting Standards Codification (ASC) 825-10-50.

Implementation

An entity should apply the amendments by means of a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. Apply the amendments related to equity securities without readily determinable fair values (including disclosure requirements) prospectively to equity investments that exist as of the date of adoption of this ASU.

Accounting Standards Update (ASU) No. 2016-02, *Leases (Topic 842) Section A—Leases: Amendments to the FASB Accounting Standards Codification®*

Issue Date

February 2016

Background

FASB's stated objective is to increase transparency and comparability among organizations by recognizing leased assets and associated liabilities on companies' balance sheets and to disclose important facts about lease arrangements. Because leasing is so widely used, FASB believes it is important for company stakeholders to have a clear and comprehensive picture of a company's leasing activities.

Leasing was part of FASB's joint agenda with the IASB. It was added to the two boards' agenda in response to concerns from investors, other financial statement users, and the SEC regarding the lack of transparency relating to lease obligations that have been reported off-balance sheet for many years. In addition, the SEC staff in 2005 identified leasing as a form of off-balance sheet accounting that FASB should address.

The lease accounting initiative took substantial effort spanning several years. FASB issued a discussion paper in 2009 and exposure drafts in 2010 and 2013. Over the years, FASB

- participated in more than 200 meetings with financial statement preparers and users; and
- hosted 15 public roundtables, 15 preparer workshops, and 14 meetings with practitioners, standard setters, and other interested parties.

FASB and the IASB also met with more than 500 users of financial statements.

This ASU updates and supersedes FASB ASC 840, *Leases*.

Who Is Affected

This ASU broadly affects all entities that enter into lease agreements included in the scope of this ASU. The impact on lessee financial statements is considerably greater than the impact on lessor companies' accounting. Guidance related to lessor companies is generally limited to conforming changes; to guidance applicable to lessees and other areas of GAAP, specifically, Topic 606, *Revenue From Contracts With Customers.*

Companies in the leasing business (lessors) were reportedly generally satisfied with the final standard, which was not as disruptive as the changes that FASB initially proposed.

Main Provisions

The new accounting standard generally requires entities to include lease obligations on their balance sheets. As stated in FASB's summary:

> The core principle of Topic 842 is that a lessee should recognize the assets and liabilities that arise from leases. All leases create an asset and a liability for the lessee in accordance with FASB Concepts Statement No. 6, *Elements of Financial Statements*, and therefore, recognition of those lease assets and lease liabilities represents an improvement over previous GAAP, which did not require lease assets and lease liabilities to be recognized for most leases.

This ASU retains the distinction between finance leases and operating leases as FASB believes the different economics for each type of lease should be reflected in the company's financial statements. The distinction is similar to the difference between capital leases and operating leases in the previous leases guidance. Lessees will classify their leases based on criteria that are similar to those applied in current lease accounting, without the explicit bright lines that drew substantial criticism of the existing standard. Operating leases will require straight-line expensing over the lease term and finance leases will be expensed more in the earlier than later periods (not unlike the accounting for operating and capital leases, respectively, today).

A lease is defined as 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.

Upon executing a lease agreement, a lessee recognizes a liability to make lease payments *and* a "right to use" asset for the term of the lease. In addition,

- when measuring assets and liabilities arising from a lease, a lessee (and a lessor) should include payments to be made in optional periods only if the lessee is reasonably certain to exercise an option to extend the lease or not to exercise an option to terminate the lease;
- a lessee should include optional payments to purchase the underlying asset in the measurement of lease assets and lease liabilities only if the lessee is reasonably certain to exercise that purchase option.
- (also consistent with the previous leases guidance) a lessee, and a lessor, should exclude most variable lease payments in measuring lease assets and lease liabilities, other than those that depend on an index or a rate or are in substance fixed payments; and
- for leases with a *term of 12 months or less*, a lessee is permitted to make an accounting policy election by class of underlying asset not to recognize lease assets and lease liabilities. If a lessee makes this election, it should recognize lease expense for such leases generally on a straight-line basis over the lease term.

Finance Versus Operating Lease Guidance for Lessees

For *finance* leases, a lessee should

1. recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, in the statement of financial position;

2. recognize interest on the lease liability separately from amortization of the right-of-use asset in the statement of comprehensive income; and

3. classify repayments of the principal portion of the lease liability within financing activities and payments of interest on the lease liability and variable lease payments within operating activities in the statement of cash flows.

For *operating* leases, a lessee should

1. recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, in the statement of financial position;

2. recognize a single lease cost, calculated so that the cost of the lease is allocated over the lease term on a generally straight-line basis; and

3. classify all cash payments within operating activities in the statement of cash flows.

Discussion of Significant Changes and Impact on Entities

Lessee Accounting. The principal difference from previous GAAP is that lessees should recognize lease assets and lease liabilities arising from operating leases in the statement of financial position. Some estimate that the rule change, once adopted, could add trillions of dollars of lease assets and liabilities to corporate balance sheets.

Additional changes include the following:

- A requirement to re-assess and potentially revise assumptions associated with their lease accounting, such as for example, lease term, classification and purchase options, in certain circumstances other than when the lease is modified.
- Qualitative and quantitative disclosure requirements that will be extensive and require significant judgment by management. The intent is to provide greater insight into the extent of revenue and expense recognized and expected to be recognized from existing leases.
- New requirements for sales-leaseback transactions (applies to both lessees *and* lessors). Under this ASU, a sale-leaseback transaction will qualify as a sale only if
    - it meets the sale guidance in the new revenue recognition standard,
    - the leaseback is not a finance lease or a sales-type lease, and
    - a repurchase option, if any, is priced at the asset's fair value at the time of exercise and the asset is not specialized.

  If the transaction does not meet this criteria, the buyer and seller account for the lease as a financing lease.

- "Built-to-suit" asset prior to the lease commencement date. A lessee is considered the owner if it controls the asset during construction.

Lessor Accounting. Lessor accounting is largely unchanged from that applied under previous GAAP. For example, the vast majority of operating leases should remain classified as operating leases, and lessors should continue to recognize lease income for those leases on a generally straight-line basis over the lease term. However, some changes to the lessor accounting guidance were made to align both of the following:

1. The lessor accounting guidance with specific changes made to the lessee accounting guidance. For example, certain glossary terms that are applied by lessees and lessors and that will affect a lessee applying the lessor guidance as a sublessor were updated so that lessees and lessors apply the same terms.

2. Key aspects of the lessor accounting model with the revenue recognition guidance in FASB ASC 606. Leasing is fundamentally a revenue-generating activity for lessors, and many aspects of the previous lessor accounting guidance aligned with, or were derived from, the revenue recognition guidance that preceded FASB ASC 606 (for example, specific aspects of the lessor accounting guidance for real estate assets were designed to conform with the revenue recognition guidance specific to sales of real estate, and both the previous leasing and certain revenue recognition guidance in GAAP used a risk-and-rewards principle for determining when the sale of an asset occurred). Topic 842 retains alignment in key respects between the lessor accounting guidance and the revenue recognition guidance in FASB ASC 606. For example, whether a lease is similar to a sale of the underlying asset depends on whether the lessee, in effect, obtains control of the underlying asset as a result of the lease (consistent with the transfer of control principle for a sale in FASB ASC 606), and a lessor is precluded from recognizing selling profit or sales revenue at lease commencement for a lease that does not transfer control of the underlying asset to the lessee. Also consistent with the guidance in FASB ASC 606, the lessor accounting model in FASB ASC 842 does not differentiate between leases of real estate and leases of other assets.

Effective Date and Transition Requirements

Public companies. Effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018.

Private companies. Effective for annual periods beginning after December 15, 2019.

Early adoption is permitted for all companies and organizations upon issuance of the standard.

Early application to financial statements of fiscal years or interim periods that have not yet been issued or, by all other entities, that have not yet been made available for issuance of the following amendments are permitted as of the beginning of the fiscal year of adoption:

- An entity should present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk if the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments.
- Nonpublic business entities are not required to apply the fair value of financial instruments disclosure guidance in the general subsection of section 825-10-50.

Implementation

The changes that this ASU will bring have the ability to significantly affect lessees' balance sheet measures and ratios, potentially affecting their compliance with loan covenants and other agreements. For lessees, the new model likely will prompt many entities to re-evaluate and make necessary changes to their accounting and other protocols, IT systems, and related internal controls to ensure their ability to gather and report complete and comprehensive data about existing and future leases, including those embedded in services arrangements or provided along with the entities' goods or services.

Accounting Standards Update (ASU) No. 2016-03, *Intangibles—Goodwill and Other (Topic 350), Business Combinations (Topic 805), Consolidation (Topic 810), Derivatives and Hedging (Topic 815): Effective Date and Transition Guidance (a Consensus of the Private Company Council)*

Issue Date

March 2016

Background

FASB's Private Company Council heard from private company stakeholders that companies were experiencing issues related to the effective date for electing certain private company accounting alternatives due to their particular facts and circumstances or because the company was not aware of the effective date.

Who Is Affected

This ASU affects private companies eligible to elect alternative accounting options under

- ASU No. 2014-02, *Intangibles—Goodwill and Other;*
- ASU No. 2014-03, *Derivatives and Hedging (Simplified Hedging Approach);*
- ASU No. 2014-07, *Consolidation (Topic 810): Applying Variable Interest Entities Guidance to Common Control Leasing Arrangements;* and
- ASU No. 2014-18, *Business Combinations (Topic 805): Accounting for Identifiable Intangible Assets in a Business Combination.*

Main Provisions

The guidance in the aforementioned updates was made effective immediately by removing their effective dates.

Private companies may elect any of the accounting alternatives within the scope of the preceding ASUs at the start of any annual reporting period without assessing preferability the first time they elect. Subsequent changes to accounting policy require the company to justify the change in accordance with Topic 250, *Accounting Changes and Error Corrections.*

Effective Date

Effective upon issuance, March 7, 2016.

Accounting Standards Update (ASU) No. 2016-04*, Liabilities—Extinguishments of Liabilities (Subtopic 405-20): Recognition of Breakage for Certain Prepaid Stored-Value Products*

Issue Date

March 2016

Who Is Affected

This ASU affects entities that issue certain prepaid stored-value products, whether in physical or digital form, such as gift cards that customers may redeem with merchants accepting such products within a certain network, prepaid telecommunication (phone) cards, and travelers' checks.

Background

This ASU seeks to minimize current and future diversity in practice when an entity derecognizes prepaid stored-value product liability.

Today there is diversity in practice in how entities account for prepaid stored-value product liabilities, with some entities viewing them as financial liabilities and others viewing them as nonfinancial liabilities. FASB ASC 405-20, *Liabilities—Extinguishments of Liabilities,* includes derecognition guidance for both financial and nonfinancial liabilities. But entities use diverse methodologies for recognizing "breakage" (that is, the portion of the dollar value of prepaid stored-value products that goes unredeemed); and no such guidance currently exists in the subtopic.

Discussion of Significant Changes

This ASU aligns FASB ASC 405 with the authoritative breakage guidance in FASB ASC 606, *Revenue From Contracts With Customers*, by allowing entities to follow the guidance in FASB ASC 606 to recognize breakage on prepaid stored-value products. An excerpt from the pending guidance in FASB ASC 405 follows:

> If an entity expects to be entitled to a breakage amount for a liability resulting from the sale of a prepaid stored-value product in the scope of paragraph 405-20-40-3, the entity shall derecognize the amount related to the expected breakage in proportion to the pattern of rights expected to be exercised by the product holder only to the extent that it is probable that a significant reversal of the recognized breakage amount will not subsequently occur. If an entity does not expect to be entitled to a breakage amount for prepaid stored-value products in the scope of paragraph 405-20-40-3, the entity shall derecognize the amount related to breakage when the likelihood of the product holder exercising its remaining rights becomes remote. At the end of each period, an entity shall update the estimated breakage amount to represent faithfully the circumstances present at the end of the period and the changes in circumstances during the period. Changes to an entity's estimated breakage amount shall be accounted for as a change in accounting estimate in accordance with paragraphs 250-10-45-17 through 45-20.

This ASU provides a narrow scope exception per the preceding, but does not apply to the following:

- Products that can be redeemed only for cash
- Products subject to escheatment laws
- Products associated with customer loyalty programs
- Products attached to a segregated bank account

Effective Date and Transition Requirements

Public Business Entities, Certain Not-for-Profit Entities, and Certain Employee Benefit Plans

Effective for financial statements issued for annual periods beginning after December 15, 2017, and interim periods within those annual periods.

All Other Entities

Effective for financial statements issued for annual periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019.

Early Application

Early application is permitted, including adoption in an interim period.

KNOWLEDGE CHECK

1. Which statement best describes an aspect of lease accounting that was NOT changed under ASU No. 2016-02, *Leases*?

   a. Lessees will continue to report the majority of their leases that are more than 12 months in duration in other comprehensive income.
   b. Finance and operating leases (similar to capital leases and operating leases, respectively, in the extant standard) will continue to be differentiated.
   c. Lessors will continue to use the same guidance, including the terminology existing in the current leasing standard.
   d. Lessees should report most operating leases as a liability and corresponding right-to-use asset in the statement of financial position.

Accounting Standards Update (ASU) No. 2016-05*, Derivatives and Hedging (Topic 815): Effect of Derivative Contract Novations on Existing Hedge Accounting Relationships*

Issue Date
March 2016

Background
Parties to a derivative investment may change over time for various reasons, including mergers or regulatory requirements, through "novation" (meaning, to replace one party to a derivative instrument with another party). This ASU clarifies whether novation in a derivative instrument that has been designated a hedging instrument under Topic 815 terminates the hedging relationship, requiring the entity to de-designate the hedging relationship and cease hedge accounting. This ASU seeks to mitigate diversity in practice.

Who Is Affected
This ASU affects entities that experience a change in a counterparty to a derivative instrument that has been designated as a hedging instrument under Topic 815.

Main Provisions
If the only change to a hedging instrument is novation, this ASU provides that de-designation of that hedging relationship is not required, provided that all other hedge accounting criteria continue to be met. This would include criteria in ASU No. 815-20-35-14 through 35-18.

Discussion of Changes
Current GAAP is limited and not sufficiently clear as to whether novation affects the ongoing hedging instrument status. This ASU clarifies that novation does not terminate the hedge relationship and that de-designation is not required.

Effective Date and Transition Requirements

Public Business Entities

Effective for financial statements issued for annual periods beginning after December 15, 2016, and interim periods within those annual periods.

All Other Entities

Effective for financial statements issued for annual periods beginning after December 15, 2017, and interim periods within annual periods beginning after December 15, 2018.

Early Application

An entity may apply this ASU on either a prospective basis or a modified retrospective basis subject to certain requirements.

ASU No. 2016-06, *Derivatives and Hedging (Topic 815): Contingent Put and Call Options in Debt Instruments*

Issue Date
March 2016

Background
This ASU seeks to address certain questions about the "four-step decision sequence" provided as implementation guidance by the Derivatives Implementation Group (DIG), and how the implementation guidance interacts with the original guidance in FASB ASC 815, *Derivatives and Hedging*, for assessing embedded contingent call (or put) options in debt instruments. Currently, entities use two different approaches, which may lead to different conclusions about whether the embedded call (or put) option is "clearly and closely related" to its debt host, and, therefore, should be bifurcated and accounted for separately as derivatives. This ASU seeks to resolve the diversity in practice.

Who Is Affected
This ASU affects issuers of, or investors in, debt instruments (or hybrid financial instruments that are determined to have a debt host) with embedded call (or put) options.

Main Provisions
This ASU clarifies that entities should apply the four-step decision sequence in determining whether contingent call (or put) options are clearly and closely related to their debt hosts. Guidance requiring the contingent call (or put) options to be indexed to interest rates or credit risks has been removed and will no longer preclude those instruments from meeting the clearly and closely related criterion.

Effective Date and Transition Requirements

Public Business Entities

Effective for financial statements issued for annual periods beginning after December 15, 2016, and interim periods within those annual periods.

All Other Entities

Effective for financial statements issued for annual periods beginning after December 15, 2017, and interim periods within annual periods beginning after December 15, 2018.

Early Application

Early application is permitted, including adoption in an interim period. If an entity early adopts this ASU in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period.

Apply on a modified retrospective basis to existing debt instruments as of the beginning of the fiscal year for which this ASU is effective. (This ASU describes additional transition guidance.)

Accounting Standards Update (ASU) No. 2016-07, *Investments—Equity Method and Joint Ventures (Topic 323), Simplifying the Transition to the Equity Method of Accounting*

Issue Date

March 2016

Background

This ASU was adopted as a result of FASB's simplification project, the Auditing Standards Board's focused initiative to make narrow-scope simplifications and improvements to accounting standards through a series of short-term projects. The projects included in the initiative are intended to improve or maintain the usefulness of the information reported to investors, and reduce cost and complexity in financial reporting.

Who Is Affected

This ASU affects all entities that have an investment that becomes qualified for the equity method of accounting as a result of an increase in the level of ownership interest in or degree of influence over the investee.

Main Provisions

This ASU eliminates the requirement to retroactively account for an investment that becomes qualified for the equity method of accounting due to a change in ownership or influence—that is, adjust the investment, results of operations, and retained earnings retroactively as if the equity method had been in effect during all previous periods that the investment had been held.

This ASU requires that

- the entity add the cost of acquiring the additional interest in the investee to the current basis of the entity's previously held interest and adopt the equity method of accounting as of the date the investment becomes qualified for equity method accounting ("qualification date"); and
- an entity that has an available-for-sale equity security that becomes qualified for the equity method of accounting recognize through earnings the unrealized holding gain or loss in accumulated other comprehensive income at the qualification date.

Effective Date

Effective for financial statements issued for annual periods beginning after December 15, 2016, and interim periods within those annual periods. This ASU should be applied prospectively upon its effective date to increases in the level of ownership interest or degree of influence that result in the adoption of the equity method. Early application is permitted.

Accounting Standards Update (ASU) No. 2016-08, *Revenue from Contracts With Customers (Topic 606), Principal versus Agent Considerations (Reporting Revenue Gross Versus Net)*

Issue Date

March 2016

Background

This ASU clarifies the implementation of principal versus agent considerations in the new revenue recognition standard (ASU No. 2014-09, *Revenue from Contracts with Customers*). It seeks to make the guidance more understandable and help eliminate potential diversity in practice when entities begin to apply the new standard.

This issuance resulted from the formation of the FASB-IASB Joint Transition Resource Group for Revenue Recognition (TRG), whose charge is to identify implementation issues related to the new standard and enhance understandability.

Who Is Affected

This ASU broadly affects entities that will be required to apply revised FASB ASC 606, *Revenue From Contracts With Customers*, in accordance with ASU No. 2014-09 (FASB ASC 606) when the entity provides a good or service in concert with another party.

Main Provisions

This ASU does not change the core principles in FASB ASC 606, which is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

In promising a good or service to a customer with another party, FASB ASC 606 provides certain indicators to help an entity determine whether it is acting as a principal (providing the good or service to the customer directly) or as an agent (providing the good or service to the customer via an arrangement with another party). The basic rules for recognizing revenue as a principal versus as an agent is as follows:

As principal—As the performance obligation is satisfied, recognize revenue in the gross amount of consideration to which it expects to be entitled in exchange for the good or service.

As agent—As the performance obligation is satisfied, recognize revenue in the amount of any fee or commission to which it expects to be entitled in exchange for arranging for the delivery of the good or service by the other party.

Implementation

This ASU addresses the following anticipated implementation issues in connection with the critical principal versus agent evaluation:

1 – Identifying the unit of account

Clarification: A good or service is a distinct good or service or a distinct bundle of goods or services to be provided to the customer.

2 – Identifying the nature of the good or service

Clarification: Entities should determine the nature of each specified good or service (for example, whether it is a good, service, or a right to a good or service).

3 – Applying the control principle to certain types of transactions. Under FASB ASC 606, an entity controls the good or service before the good or service is transferred to the customer.

Clarification: Where uncertainty exists, the entity should evaluate three indicators in particular whether (1) the entity has primary responsibility for fulfillment; (2) the entity has inventory risks before or after transferring the good or service to the customer; and (3) the entity has discretion in setting the price for the good or service.

4 – Interaction of the control principle with the indicators in FASB ASC 606

Clarification: Entities should consider the indicators of control included in FASB ASC 606 but should not treat the indicators as a checklist. Rather, depending on the specifics, some indicators may be more (or less) relevant or persuasive than the others to the overall assessment of control.

This ASU revises certain examples and provides new ones to illustrate application of this guidance.

Entities should consider this ASU in setting policies and procedures for making these determinations under FASB ASC 606 and, in particular, anticipate that some of these evaluations may require considerable judgment.

Effective Date and Transition Requirements

Effective dates and transition requirements are identical to those in ASU No. 2014-09.

Public Business Entities

Effective for financial statements issued for annual periods beginning after December 15, 2017, and interim periods within those annual periods.

All Other Entities

Effective for financial statements issued for annual periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019.

Knowledge Check

2. Which of the following statements best describes the primary difference between a principal and an agent in ASU No. 2016-08, *Principal Versus Agent Considerations (Reporting Revenue Gross Versus Net)*?

   a. A principal directs and supervises an agent in providing goods and services to the principal's or the agent's customers.
   b. A principal usually has firsthand experience with the customer whereas an agent usually comes in contact with the customer only through the principal.
   c. A principal provides a good or service directly to the customer whereas an agent arranges for a third party to provide the good or service to the customer.
   d. A principal provides the majority of the good or service to the customer whereas an agent provides only an insignificant amount of the good or service to the customer.

Proposed Standards and Interpretations

AICPA

Auditing Standards Board

Proposed Auditing Standards

The Auditing Standards Board did not issue any proposed auditing standards or interpretations in this period.

Proposed Attestation Standards

The Auditing Standards Board did not issue any proposed attestation standards or interpretations in this period.

Accounting and Review Services Committee

Proposed Statements on Standards for Accounting and Review Services: *Compilation of Prospective Financial Information, Compilation of Pro Forma Financial Information, and Omnibus Statement on Standards for Accounting and Review Services—2016*

Issue Date

December 2015

Comment Due Date

May 6, 2016

Background

The Accounting and Review Services Committee (ARSC) proposed two new statements on standards for accounting and review services (SSARS) and numerous other changes and clarifications to the SSARS.

The effective date for these proposed standards and amendments has not yet been determined. However, if adopted, they will become effective no earlier than for engagements to prepare subject matter occurring on or after May 1, 2017.

Main Provisions and Changes

Proposal—Issuance of a new SSARS, *Compilation of Prospective Financial Information*

This proposed new SSARS would incorporate the requirements and guidance currently found in the Statements on Standards for Attestation Standards (SSAE or attestation standards) AT section 301, *Financial Forecasts and Projections,* into the SSARS. This change expands the applicability of AR-C section 70 to include compilation and preparation of prospective financial statements in addition to historical financial statements. (Current standards preclude the review of prospective financial information.) The clarified attestation standards (SSAE No. 18), released in April 2016, continue to provide guidance and requirements for examinations and agreed upon procedures for engagements related to prospective financial information. An AICPA guide, *Prospective Financial Information,* provides additional authoritative guidance for preparing prospective financial information.

Proposal—Issuance of a new SSARS, *Compilation of Pro Forma Financial Information*

In this proposal, the ARSC has provided a clarified re-draft of AR section 120, *Compilation of Pro Forma Information.* No substantive changes are being proposed.

Proposed Amendments, Clarification, and Recodification—*Omnibus Statement on Standards for Accounting and Review Services—2016*

To account for the requirements and guidance moved to the SSARS from the Attestation Standards, the following amendments are also being proposed:

- Revise AR-C section 60, *General Principals for Engagements Performed in Accordance with Statements on Accounting and Review Services,* to, among other things, expand its application to information other than financial statements and incorporate definitions of *financial statements* and *prospective financial information.*
- Revise AR-C section 70, *Preparation of Financial Statements,* to, among other things,
  - clarify that a written understanding dictating the terms of the engagement is required;
  - indicate other actions that would be appropriate when the accountant is unable to state that "no assurance is provided" on each page of the financial statements (that is, perform a financial statement review or audit; issue a disclaimer to that effect; or withdraw from the engagement);
  - prohibit preparation of prospective financial information if either of the following is missing:
    - Summary of significant assumptions

        - Description of the limitations of the information's usefulness; and
    - prohibit preparation of a financial projection if the hypothetical assumptions are not identified.

- Clarify that the accountant is required to disclose known departures from the applicable financial reporting framework in the compilation report.
- Revise AR-C section 90, *Review Engagements*, to clarify that a digital signature in the report is acceptable and that a written understanding of the engagement terms is required.

The ARSC also proposed that the AT section 301 requirement to obtain a written representation from management regarding the significant assumptions underlying the information not apply to compilation and preparation ("no assurance") engagements. The ARSC noted that the requirement to have a written understanding of the engagement terms, including the responsible party's acknowledgment to disclose the assumptions is, in substance, equivalent to a written representation.

Significant Changes

If adopted as proposed, expanding the scope of the SSARS to include prospective financial information means that accountants would be able to prepare prospective financial information that is distributed to third party users provided the statements are appropriately flagged as "no assurance provided" (or one of the aforementioned alternatives is applied).

Professional Ethics Executive Committee

Transfer of Files and Return of Client Records in Sale, Transfer, or Discontinuance of Member's Practice

Issue Date

November 2015

Comment Due Date

May 16, 2016

Background

On November 25, 2015, the Professional Ethics Executive Committee (PEEC) issued an Omnibus Proposal that recommends the adoption of two new ethics interpretations in the AICPA Code of Professional Conduct (the code).

Main Provisions

Transfer of Files and Return of Client Records in Sale, Transfer, or Discontinuance of Member's Practice. The PEEC proposed a new interpretation under the "Acts Discreditable" rule in the code to address a member's obligation to his or her clients when the member sells, transfers, or discontinues a CPA practice. This interpretation would require members to take certain steps when they relinquish ownership in and control of the CPA practice, including the following:

- Notify the client of the sale, transfer, or discontinuation of all or part of the member's practice and arrange to return the client's records as required under the *Records Requests* interpretation in the code (ET section 1.400.200).
- Obtain client consent prior to disclosing confidential client information (for example, transferring client files to a successor firm).
- If the client does not respond within 90 days to the member's request for consent to transfer files or the offer to return client records, the member may presume the client consents and transfer the files.
- If the member does not transfer the files to a successor CPA or firm (for example, discontinues the practice), the member should retain the client records in a confidential manner and in accordance with his or her document retention policy and any applicable legal or regulatory requirements.

If a member acquires all or part of another's CPA practice, the member should be satisfied that the associated clients have been notified of the acquisition and consented to the member's continuation of the services and related transfer of client records. The PEEC is also proposing a revision to another interpretation in the code, "Disclosing Client Information in Connection With a Review or Acquisition of the Member's Practice" to encompass this situation.

Disclosure of a Commission and Referral Fee. The PEEC proposed a new interpretation of the "Commissions and Referral Fees" rule that would require members, when permitted to receive a commission or referral fee under the rule, to disclose receipt of the fee to the client *in writing*. Currently, the rule does not require written disclosure. The proposal would not require the member to disclose the amount of the commission or referral fee or any other details, only that the member will receive a fee. The member could disclose additional information about the fee arrangement if he or she thought it was appropriate in the circumstances.

FASB

Exposure Drafts

Proposed ASUs

Proposed Accounting Standards Update, *Statement of Cash Flows (Topic 230):*

Classification of Certain Cash Receipts and Cash Payments

Issue Date
January 29, 2016

Who Is Affected
All entities (including not-for-profit entities) that are required to present a statement of cash flows under Topic 230.

Comment Due Date
March 29, 2016

Background and Main Provisions
This proposal resulted from a consensus of the FASB Emerging Issues Task Force and addresses the diversity in practice regarding the presentation and classification of certain items in the statement of cash flows, and related items. Eight issues are addressed. All of the following items except the last one propose guidance where none currently exists in GAAP. The last item clarifies existing GAAP.

1 – Classification of cash *payments* for debt prepayment or extinguishment costs

Proposal – Classify cash payments for debt prepayment or extinguishment costs as cash outflows for financing activities.

2 – Classification of cash payment made by a bond issuer when settling a zero coupon bond

Proposal – Classify portion of cash payment attributed to accreted interest as cash outflow for operating activities; classify portion attributed to principal as financing activities.

3 - Classification of cash payments made by acquirer after a business combination for the settlement of a contingent consideration liability

Proposal – If cash payments are not made soon after the business combination, separate and classify as cash outflow for financing and operating activities. Recognize cash payments up to the amount of the contingent consideration liability at the acquisition date as financing activities, with any excess treated as operating activities.

4 – Proceeds from settling insurance claims

Proposal – Classify on the basis of the related insurance coverage—that is, the nature of the loss. If proceeds result from a lump sum settlement, consider the basis of the nature of each loss included in the settlement.

5 – Proceeds from settling corporate insurance policies (including bank-owned policies)

Proposal – Classify settlements from corporate-owned policies as financing activities. Classify cash paid for premiums as investing, operating, or a combination of investing and operating activities.

6 – Distributions received from equity method investees

Proposal – Classify as operating activities unless *the investor's cumulative distributions received in prior periods that were determined to be returns of investment exceeded the cumulative equity in earnings recognized by the investor. When this occurs, the current period distribution (up to the excess) would also be considered a return of investment or operating activity. (Note: this solution does not address investments accounted for under the fair value option.)*

7 – Beneficial interests in securitization transactions

Proposal - Disclose a transferor's beneficial interest obtained in a securitization of financial assets as a noncash activity, and classify cash receipts from payments on a transferor's beneficial interests in securitized trade receivables as cash inflows from investing activities.

8 - Separately identifiable cash flows and application of the predominance principle

Proposal - Additional guidance would clarify when an entity should separate cash receipts and cash payments and classify them into more than one class of cash flows (including when reasonable judgment is required to estimate and allocate cash flows), and when an entity should classify the aggregate of those cash receipts and payments into one class of cash flows on the basis of predominance.

Effective Date

Effective date to be determined once feedback on the proposal is considered. Otherwise, this ASU calls for entities to apply this ASU retrospectively to all prior periods presented. If impracticable to do so for some issues, entities may apply the amendments to those items prospectively at the earliest date practicable.

Proposed Accounting Standards Update, Compensation—*Retirement Benefits—Defined Benefit Plans—General (Subtopic 715-20): Changes to the Disclosure Requirements for Defined Benefit Plans*

Issue Date

January 26, 2016

Who Is Affected

All employers (including not-for-profits) that sponsor defined benefit pension or other postretirement plans.

Comment Due Date

April 25, 2016

Background

FASB is proposing this ASU as part of the disclosure framework project, which seeks to improve the effectiveness of disclosures in the notes to financial statements by facilitating clear communication of the information required by GAAP that is most important to users of an entity's financial statements.

In March 2014, the Auditing Standards Board issued a proposed FASB Concepts Statement, *Conceptual Framework for Financial Reporting—Chapter 8: Notes to Financial Statements* (proposed Concepts Statement). The proposed Concepts Statement is intended to identify a broad range of possible information for the Auditing Standards Board to consider when deciding on the disclosure requirements for a particular topic. From that intentionally broad set, the Auditing Standards Board would identify a more narrow set of disclosures about that topic to be required based on a cost versus benefit evaluation. FASB plans to use the Concepts Statement, when finalized, as a basis for establishing disclosure requirements in future accounting standards and for evaluating existing disclosure requirements.

The Auditing Standards Board decided to test the guidance in the proposed Concepts Statement and improve the effectiveness of disclosure requirements for inventory, income taxes, fair value measurements, and defined benefit pension and other postretirement plans by using those proposed concepts. This proposed ASU resulted from the Auditing Standards Board's consideration of the concepts in the proposed Concepts Statement as they relate to defined benefit pension and other postretirement plan disclosures. In general, financial statement users have indicated that current disclosures about defined benefit pension and other postretirement plans are sufficient and do not need substantial revision. However, the Auditing Standards Board believes that incremental improvements could be achieved by eliminating unimportant information and adding other pertinent information into the Accounting Standards Codification and conforming GAAP with other recently issued guidance.

Main Provisions

The following disclosure requirements would be eliminated from FASB ASC 715-20 because they are not consistent with the proposed Concepts Statement:

- Amount of pension accumulated benefit obligation
- Aggregate pension accumulated benefit obligation and aggregate fair value of plan assets for pension plans with accumulated benefit obligations in excess of plan assets
- Amount and timing of plan assets expected to be returned to the entity
- Disclosures related to the June 2001 amendments to the Japanese Welfare Pension Insurance Law
- Related party disclosures about the amount of future annual benefits covered by insurance and annuity contracts, and significant transactions between the employer or related parties and the plan
- Amounts in accumulated other comprehensive income expected to be recognized as components of net periodic benefit cost over the next fiscal year

For nonpublic entities only:

- Reconciliation of the opening balances to the closing balances of plan assets measured on a recurring basis in level 3 of the fair value hierarchy (this would require disclosure of the amounts of transfers into and out of level 3 of the fair value hierarchy and purchases of level 3 plan assets)

The following disclosure requirements would be added as they are consistent with the proposed Concepts Statement:

- Description of the nature of the benefits provided, the employee groups covered, and the type of benefit plan formula
- Weighted-average interest crediting rate for cash balance plans and other plans with a promised interest crediting rate

- Quantitative and qualitative disclosures from Topic 820, *Fair Value Measurement*, about assets measured at net asset value (NAV) using a practical expedient
- Narrative description of the reasons for significant gains and losses affecting the benefit obligation or plan assets

For Nonpublic Entities only:

- Effects of a one-percentage point change in assumed health care cost trend rates (this disclosure is currently required only for public entities)

The Auditing Standards Board also considered and incorporated the amendments in proposed ASU, *Notes to Financial Statements (Topic 235): Assessing Whether Disclosures Are Material*, in developing the amendments in this proposal. The amendments in this proposed ASU

- state that an entity shall provide required disclosures if they are material;
- exclude phrases like "an entity shall disclose at a minimum," which makes it difficult to justify omitting immaterial disclosures; and
- refer readers to Topic 235, "Notes to Financial Statements" (as would be amended by the guidance in the proposed update on that topic) for discussion of the appropriate exercise of discretion.

Note: Those specific amendments are subject to re-deliberations following the comment period for the proposed ASU on FASB ASC 235.

Effective Date

Effective date to be determined once feedback on the proposal is considered. Otherwise, this ASU proposes that entities would apply all of the provisions retrospectively to all periods presented with one exception: the qualitative disclosures about plan assets measured at NAV would be required beginning with the most recent period presented in the initial period of adoption.

Proposed Accounting Standard Update, *Compensation—Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*

Issue Date

January 26, 2016

Who Is Affected

All employers, including not-for-profits, that offer defined benefit pension plans, other postretirement benefit plans, or other types of benefits to their employees that are accounted for under Topic 715.

Comment Due Date

April 25, 2016

Background

Under current GAAP, defined benefit pension cost and postretirement benefit cost (net benefit cost) comprise several components that reflect different aspects of an employer's financial arrangements as well as the cost of benefits provided to employees. Entities aggregate those components for reporting in the financial statements. FASB ASC 715, *Compensation—Retirement Benefits*, does not prescribe where the amount of net benefit cost should be presented in an employer's income statement and does not require entities to disclose by line item the amount of net benefit cost that is presented in the income statement or capitalized in assets.

According to FASB, many stakeholders have observed that the presentation of defined benefit cost on a net basis reduces transparency and the usefulness of the information.

Main Provisions

In an effort to improve the reporting of net benefit cost in the financial statements, the Auditing Standards Board is proposing additional guidance on the presentation of net benefit cost in the income statement and on the components eligible for capitalization in assets as follows:

- Report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period.
- Present other components of net benefit cost in the income statement separately from the service cost component and if one is presented, the subtotal of income from operations.
- If a separate line item or items are used to present the other components of net benefit cost, describe that line item or items.
- When applicable, only the service cost component is eligible for capitalization.

Effective Date

Effective date to be determined once feedback on the proposal is considered.

This ASU would be applied retrospectively for

- presentation of the service cost component and other components of net periodic pension cost, and
- net periodic postretirement benefit cost in the income statement.

This ASU would be applied prospectively, on or after the effective date for

- capitalization of the service cost component of net periodic pension cost, and
- net periodic postretirement benefit in assets.

NOT-FOR-PROFIT ACCOUNTING AND AUDITING SUPPLEMENT NO. 1–2016

Solutions

The AICPA offers a free, daily, e-mailed newsletter covering the day's top business and financial articles as well as video content, research and analysis concerning CPAs and those who work with the accounting profession. Visit the CPA Letter Daily news box on the www.aicpa.org home page to sign up. You can opt out at any time, and only the AICPA can use your e-mail address or personal information.

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SOLUTIONS

CHAPTER 1

Solutions to Knowledge Check Questions

1.

a. Incorrect. For leases with a term of 12 months or less, a lessee is permitted to make an accounting policy election by class of underlying asset, not to recognize lease assets and lease liabilities. If a lessee makes this election, it should recognize lease expense for such leases generally on a straight-line basis over the lease term.

b. Correct. Lessees will classify their leases based on criteria that are similar to those applied in current lease accounting, without the explicit bright lines that drew substantial criticism of the existing standard. Operating leases will require straight-line expensing over the lease term and finance leases will be expensed more in the earlier than later periods (not unlike the accounting for operating and capital leases, respectively, today).

c. Incorrect. Lessor accounting is largely unchanged from that applied under previous GAAP. For example, the vast majority of operating leases should remain classified as operating leases, and lessors should continue to recognize lease income for those leases on a generally straight-line basis over the lease term.

d. Incorrect. Upon executing a lease agreement, a lessee recognizes a liability to make lease payments and a "right to use" asset for the term of the lease.

2.

a. Incorrect. The ASU does not indicate that the principal would be directing or supervising the agent in providing goods, but does provide guidance when applying the control principle to certain types of transactions. Under FASB ASC 606, an entity controls the good or service before the good or service is transferred to the customer.

b. Incorrect. The ASU does not indicate that a principal would have firsthand knowledge of a customer when compared to an agent, but does provide additional guidance related to anticipated implementation issues in connection with the critical principal versus agent evaluation.

c. Correct. In promising a good or service to a customer with another party, FASB ASC 606 provides certain indicators to help an entity determine whether it is acting as a principal (providing the good or service to the customer directly) or as an agent (providing the good or service to the customer via an arrangement with another party).

d. Incorrect. The ASU does not provide any indication of whether the principal provides more or less services than an agent to a customer. However, the ASU does provide clarification that entities should determine the nature of each specified food or service (for example, whether it is a good, service, or right to a good or service) when completing the principal versus agent evaluation.