

“Our take from the trenches on the latest FASB updates and what you need to know”

June 15, 2017





Presented By:

Diana Gilbert, Senior Consultant

Diana has 30 years of corporate and operational finance experience focusing on technical accounting, process improvement and financial systems, SEC reporting, Sarbanes-Oxley, and revenue recognition.

She is the Director of RoseRyan's Technical Accounting Group and a member of the Corporate Governance team. As a RoseRyan senior consultant she has advised such clients as AcelRx, Aradigm, Quotient (Coupons.com), DNAnexus, Electric Imp, Ekso Bionics, Mera Software Services, Mimosa Networks, Nemus Biosciences, NovaBay, Outset Medical, Primus Power, and Vivus. Prior to RoseRyan, she was Corporate Controller at VNUS Medical Devices, Electroglas and Digital Interiors, Assistant Controller at HearMe, and was a Senior Manager at KPMG.

Diana is a CPA (inactive), and holds a BS in Business-Accounting from San Jose State University.

Housekeeping

- 90 minute program
- To see full screen – click on double arrows
- Slides - downloadable

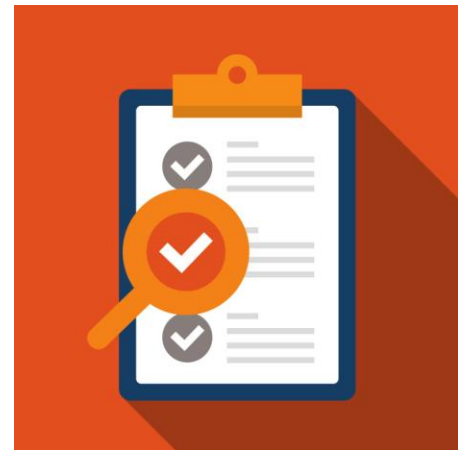
Objectives

- Provide a summary of new FASB standards and current projects
- Update you on SEC rulemaking
- Provide a summary of SEC Comment Letter Trends



Agenda

- FASB Accounting Standards updates
 - Revenue from Contracts with Customers
 - Leases
 - Everything else
- FASB proposals & projects
- SEC update



FASB Accounting Standards Update



Revenue from contracts with customers (Topic 606)

Effective 2018, including interim periods

Early Adoption Examples:

Alphabet
Modified

General Dynamics
Full Retrospective

**Ultragenyx
Pharmaceuticals**
Full Retrospective

Aradigm
Modified

Microsoft
Full Retrospective
(Planned July 2017)

United Health Group
Modified

First Solar
Full Retrospective

Raytheon
Modified

Workday
Full Retrospective

Ford
Modified

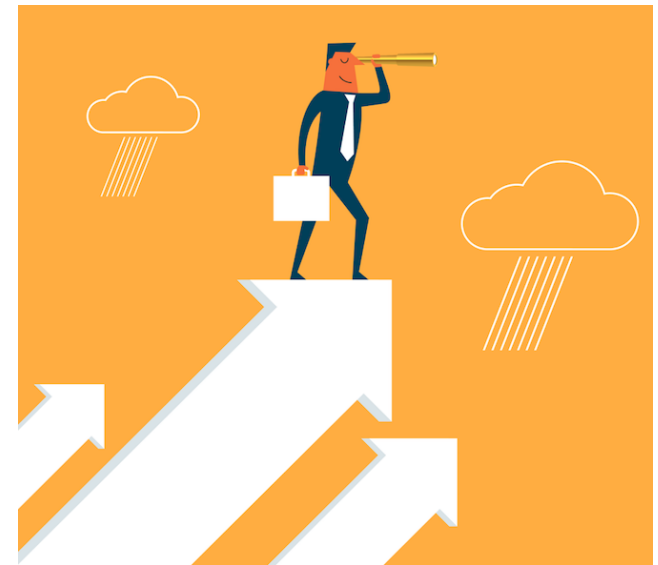
Revenue – *What we're seeing*

Most recent SAB 74 Disclosures:

Key Disclosure:	Majority of survey said
Transition Method:	Modified Retrospective
Impact:	<p>49% immaterial, 2% material, 15% impact expected but unknown, and 34% still evaluating.</p> <p>16% immaterial, 24% material, 60% still evaluating.</p>
Directional guidance:	> 50% providing some kind of directional guidance
Other:	<p>35% discussing implementation process.</p> <p>Only 10% discussing capitalization of contract costs.</p>

Looking beyond the 5 steps

- Operational considerations
 - Internal Controls
 - Sales Processes
 - Commissions
- Reporting & disclosures
 - At adoption – specific to transition
 - Ongoing – significant changes



Revenue – Data sources

■ Changes in timing

- Sell Through to Sell In
- No More Cash Basis
- Contract Costs



■ Support for new estimates

- Fee not fixed and determinable
- Variable consideration
- Down-stream items: e.g., gross to net adjustments

■ New disclosures

- More on this later

Revenue – Processes and controls

■ Business Processes

- Changes in contract terms
- Changes to transaction processing
- Capturing contract costs
- Accruals, estimates, and reserves

■ Internal Control Design

- SAB 74 Disclosures
 - (2017 10-Qs and 10-Ks)
- Cumulative Effect & Transition Disclosures
- Ongoing Accounting & New Disclosure Requirements



Revenue – Expectations of others

- Auditor checklists and templates
- Audit Committee monitoring
- Investor and analyst questions



Auditors

Analysts

**Audit
Committees**

Investors

SAB 74 new standard disclosures

- Adoption Date and Transition Method
- Expected Impact
- Qualitative, Directional Guidance
 - e.g. “Under this new standard, the requirement to have vendor specific objective evidence (VSOE) for undelivered elements is eliminated. As such, we may be required to recognize as revenue a portion of the sales price upon delivery of the software instead of ratably over an estimated subscription period due to the lack of VSOE.”
- Progress of Implementation
- By Q3 or Q4, should include Quantitative Disclosures

Example SAB 74 directional guidance

■ Directional Guidance examples:

- “Under this new standard, the requirement to have vendor specific objective evidence (VSOE) for undelivered elements is eliminated. As such, we may be required to recognize as revenue a portion of the sales price upon delivery of the software instead of ratably over an estimated subscription period due to the lack of VSOE.”
- “We expect changes in our revenue recognition policy relating to royalty revenues and certain other revenues that are currently recognized on a cash basis or sell through method.”
- “Under the new accounting standard, it is possible to start to recognize contingent payments before the payment-triggering event is completely achieved.”
- “Approximately 82% of the Company’s revenues may be recognized at an earlier date than in the period of actual cash receipt.”

Revenue – Disclosures at transition

- Different depending on method of adoption

	Full	Modified
Effect of adoption on each financial statement line <ul style="list-style-type: none"> • Income Statement • Balance Sheet 	Recast financial statements	In Notes
Nature and reason for change in accounting principal	√	√
Practical expedients elected	√	√

- Selected Financial Data and Ratio of Earnings to Fixed Charges - SEC FRM March 2016
- Acquisitions prior to adoption

Revenue – Financial statements

■ Balance Sheet Presentation

- Accounts Receivable are presented, net of allowances for doubtful accounts
- Contract Assets relate to Unbilled amounts or Capitalized contract costs
- Contract Liabilities relate to:
 - Prepayments for which goods or services are not yet delivered
 - Estimates made to reduce the transaction price, such as refunds, rebates, price adjustments
- Contract Assets and Liabilities are presented net for each contract
 - Groups of similar contracts may be combined on a portfolio basis
 - Refund liabilities for amounts paid would not have an offsetting contract asset and would be presented separately

Revenue - Disclosures

- Revenue from Contracts with Customers separately from other revenue sources, if not separate in Income Statement
- Disaggregate into relevant categories
- Contract Balances Reconciliation - Contract Assets and Liabilities
 - Opening and Closing Balances (if not separately presented) for receivables, contract assets, contract liabilities
 - Changes during period - Quantitative & Qualitative
 - Revenue recognized from performance obligations satisfied in prior period (e.g., changes in transaction price due to variable consideration)

Revenue - Disclosures

- Performance Obligations - in general
 - When typically satisfied
 - Typical payment terms & if financing component
 - Nature of goods or services
 - Obligations for returns, refunds, warranties
- Performance Obligations – not yet satisfied *
- Amounts for obligations not yet satisfied
- When expect to recognize
- Practical expedient
- Significant Judgments
- Costs to Obtain of Fulfill contracts

Leases (Topic 842)

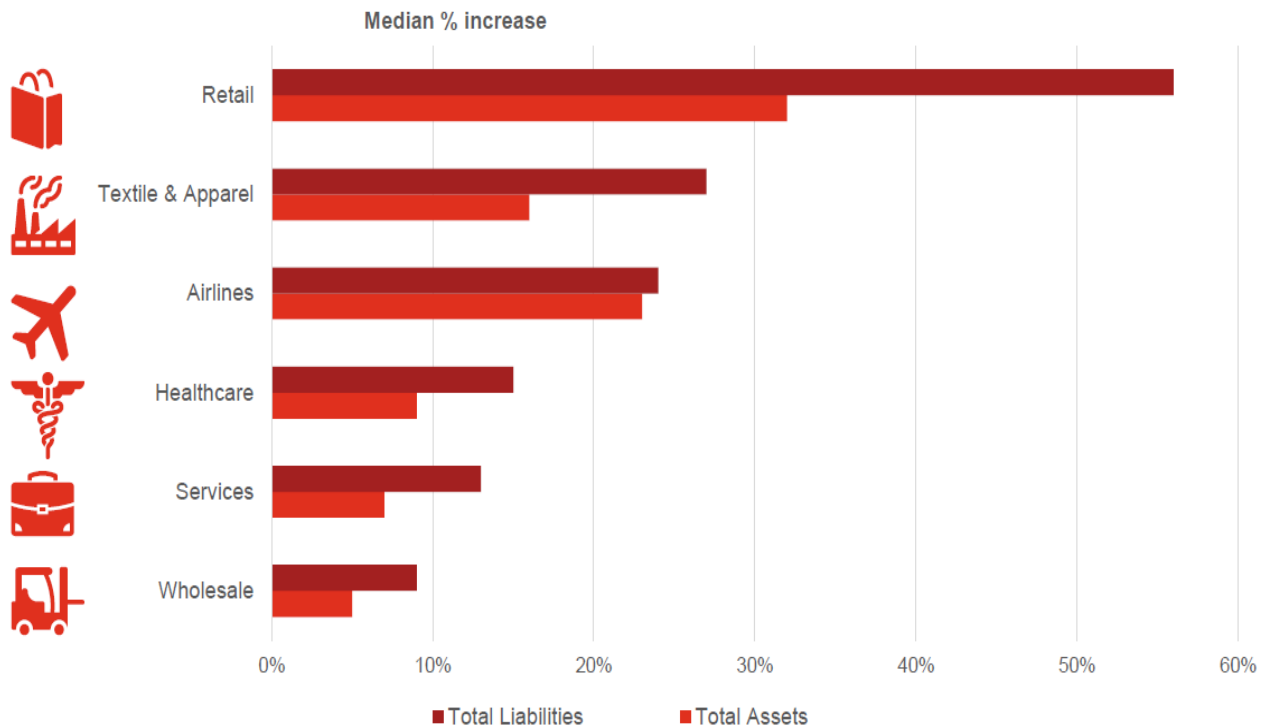


Leases in place as of the beginning of 2017 and any leases entered into thereafter will be subject to the new leases guidance.

Leases – Who is affected

Who is affected

All industries will be impacted...



Leases – Public co.s - 2019

■ Where is your company in the implementation?

- 70% planned to start implementation process last year
- 60% of technology companies have decentralized lease agreement management and accounting

(source: PwC-CBRE survey 2016)

A reminder: effective dates and transition

	Public business and certain other entities ⁵	All other entities
Annual periods – Fiscal years beginning after	December 15, 2018	December 15, 2019
Interim periods – In fiscal years beginning after	December 15, 2018	December 15, 2020
Early adoption allowed?	Yes, immediately.	

Leases – Key changes

■ Most Leases:

- Most Leases will be on the Balance Sheet
 - All leases > 1 year
- New Judgments required to Identify a Lease
 - Lease and non lease components
- New Processes and Controls
- Accounting for Executory Costs
- Fewer Lease Origination Costs will be Capitalizable
- Expanded Quantitative and Qualitative Disclosures

Leases - What should you be doing now:

- Educating stake holders – finance and operations
- Inventory of current and expected leases & renewals
 - Watch for embedded leases
- Preliminary assessment
 - Electing transition expedients
 - Identify sensitivity to financial metrics, including covenants, non-GAAP measures, analysts expectations
 - Consider Systems solutions
 - What to disclose regarding new standard's effect on financial statements (SAB 74 – update quarterly)
 - Develop Monitoring processes – identify triggers for reassessments or modifications
 - Design of internal controls

Leases – How to identify a lease

An identified asset



The right to control the asset during the lease term



Is explicitly or implicitly specified



Supplier has no practical ability to substitute or would not economically benefit from substituting the asset



Decision-making authority over the use of the asset



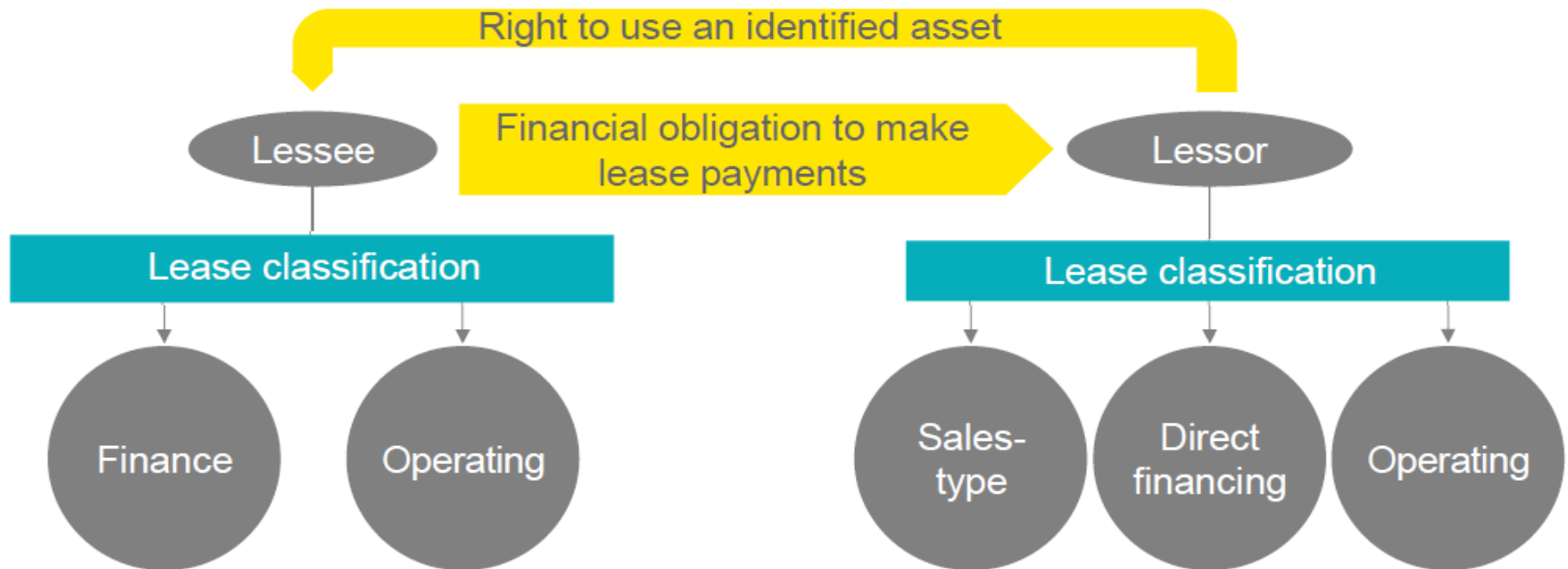
The ability to obtain substantially all economic benefits from use of the asset

Embedded leases

- Right to use embedded in an arrangement
- Evaluate using same criteria to identify if a lease
 - Asset is distinct
 - Right of use controlled by customer (lessee)
- Pharma and life science companies
- Data Center arrangements



Leases – Right of use model



- ▶ Recognize right-of-use (ROU) assets and lease liabilities for most leases
- ▶ Recognize expense similar to legacy GAAP

- ▶ Similar to legacy GAAP with some changes
- ▶ Leveraged lease accounting eliminated prospectively

Leases - Measurement

■ Measurement of Lease Liability



■ Measurement of Right of Use Asset



Leases – Subsequent measurement

■ Circumstance-Driven Reassessments

1. Change in Lease Term
2. Change in Lessee plan to exercise a purchase option
3. Change in estimate of residual value guarantee
4. Resolution of a contingency causing variable lease payments to become fixed

Accounting Steps	Circumstance			
	1	2	3	4
Remeasure & reallocate consideration to remaining lease & non-lease components.	✓	✓	✓	✓
Remeasure the lease liability to reflect the revised lease payments, using new discount rate.	✓	✓	✗	✗
Remeasure lease liability to reflect revised lease payments, using original discount rate.	✗	✗	✓	✓
Adjust ROU asset by remeasurement of lease liability. Once ROU asset is zero, remaining remeasurement recorded to income statement.	✓	✓	✓	✓
Reassess lease classification at the remeasurement date (e.g., fair value and remaining economic life).	✓	✓	✗	✗
If change in classification, adjust remaining cost recognition pattern, income statement & statement of cash flows prospectively.	✓	✓	✗	✗

Leases – And more...

■ Disclosures

- Qualitative and Quantitative
- Additional data will be needed
- Systems & processes

■ ICFR

- Completeness
- Accuracy of accounting & reporting
- Timely identification and analysis new & modified leases

■ Income Taxes

- State apportionment
- Book/tax differences

■ International location leases

Update on the rest of the FASB Accounting Standards



Statement of cash flows

- 2016-15: Guidance for certain specific cash receipts and disbursements
- 2016-18: Restricted cash & equivalents are included with cash and cash equivalents
- Effective Fiscal 2018 for public companies
- Transition: Full retrospective
- Disclosures:
 - Nature of restrictions
 - Reconciliation between Cash and Equivalents in BS and Cash, Equivalents, and Restricted Cash in SCF
- Adoption Disclosures: standard for a change in accounting principle (ASC 250)

Clarifying the definition of a business

- Simplification
- Tests to determine whether business or asset
- Differences in accounting

	Acquisition is a	
Account for:	Business	Asset
Goodwill	Recognize if consideration > FV assets & liabilities	Not recognized
In-process R&D	Capitalize at FV	Expense if no alternative use
Contingencies assumed	Recognize at FV	Record only if probable
Transaction costs	Expense	Capitalize

- Effective Fiscal 2018 for Public Companies
- Transition: Prospective

Gains & losses from derecognition of nonfinancial assets

- Clarifies treatment for sales of nonfinancial assets that don't fall under Revenue or Business Combinations guidance
 - If Seller has Controlling interest in buyer: don't derecognize, equity treatment
 - If Seller has no controlling interest and control of nonfinancial asset transferred to buyer, derecognize, record full gain/loss
 - If Seller has no controlling interest and control of asset not transferred to buyer (e.g. repurchase right retained), don't derecognize. Record consideration under Revenue standard
- Aligns with new Revenue Guidance (ASC 606)
 - Evaluation of a contract
 - Estimation of variable consideration
- Eliminates carryover basis for nonmonetary exchanges
- Effective Fiscal 2018, Full Retrospective or Modified

Financial instruments

- ASU 2016-01 Financial Instruments Overall, Recognition & Measurement (Sub Topic 825-10)
 - Equity Investments
 - Changes in FV now in income (previously OCI)
 - Cost method eliminated
 - Financial Liabilities
 - Effective Fiscal 2018 for Public Companies
- ASU 2016-13 Financial Instruments- Credit Losses - Measurement (Topic 326)
 - Affects all entities - Trade receivables, loans, lessor's lease receivables, debt securities – both held to maturity and available for sale
 - Change in impairment model & recording
 - Effective Fiscal 2020 for Public Companies

Intangibles - goodwill and other impairment

- Simplifies impairment test for public companies
- Eliminates determining implied FV of goodwill at testing date
- Impairment measured based on FV of reporting unit vs. carrying amount
- Effective Fiscal 2020 for Public Companies
- Transition: Prospective
- Disclosures – Possibly additional

Share-based Payments Modifications

- Allows companies to make certain changes to awards without accounting for them as modifications.
- Modification if Changes to:
 - Value
 - Vesting Conditions
 - Classification of the Award
- Effective FY after 12/15/17, including interim periods. Early adoption permitted in any interim period.
- Prospective adoption

Recognition and measurement – narrow topics

- Nonemployee Share-Based Payment Accounting Improvements
 - Aligns to Employee SBC accounting - Comments due June 5th
- Collaborative Arrangements (Topic 808)
 - Initial deliberation
- Liabilities & Equity (Topic 480)
 - Targeted Improvements related to Down Round features & Mandatorily Redeemable Financial Instruments
 - Exposure Draft redeliberation

Presentation and disclosures

■ Balance Sheet Classification of Debt

- Debt refinanced after BS date must be classified ST at BS date
 - Debt with subjective or material adverse change clauses

■ Income Taxes

- Substantial new additional disclosures
 - More disaggregation - primarily U.S. vs. international
 - Public company additional disclosures
 - ✓ Unrecognized tax benefits
 - ✓ Recognition / release of DTA valuation allowance
 - ✓ Expiry of carry forwards by date

■ Inventory Disclosures

- Additional disclosures: Changes, Composition, Segments

SEC Update



SEC Rule-Making – Final Rules

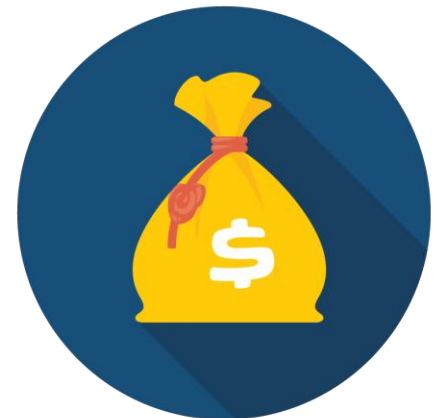
■ Pay Ratio Disclosure

2018 proxy season for 2017 compensation

- Does not apply to smaller reporting & emerging growth companies, IPOs
- Exiting EGCs have one year transition
- Median total annual compensation of all employees (excluding Principle Executive Officer)
- Annual total compensation of the PEO
- Ratio of the two amounts

SEC Rule-Making – Not yet final

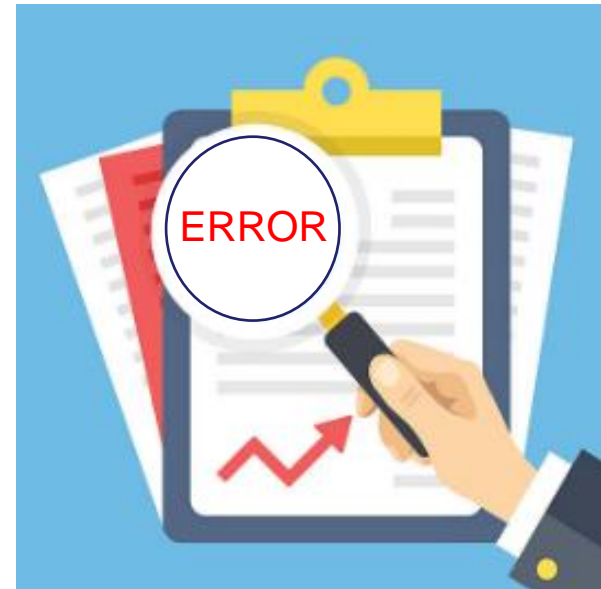
- Pay vs. Performance disclosures
- “Clawback” of executive incentive-based compensation in event of restatement
- Audit Committee Disclosure
 - Auditor oversight, appointment process, qualifications
- Changing landscape
 - Financial CHOICE Act



Reporting issues

■ Similar to last year

- Statement of Cash Flows
- Segments, Income Taxes
- Business Combinations
- Fair Value
- Revenue Recognition
- Non-GAAP



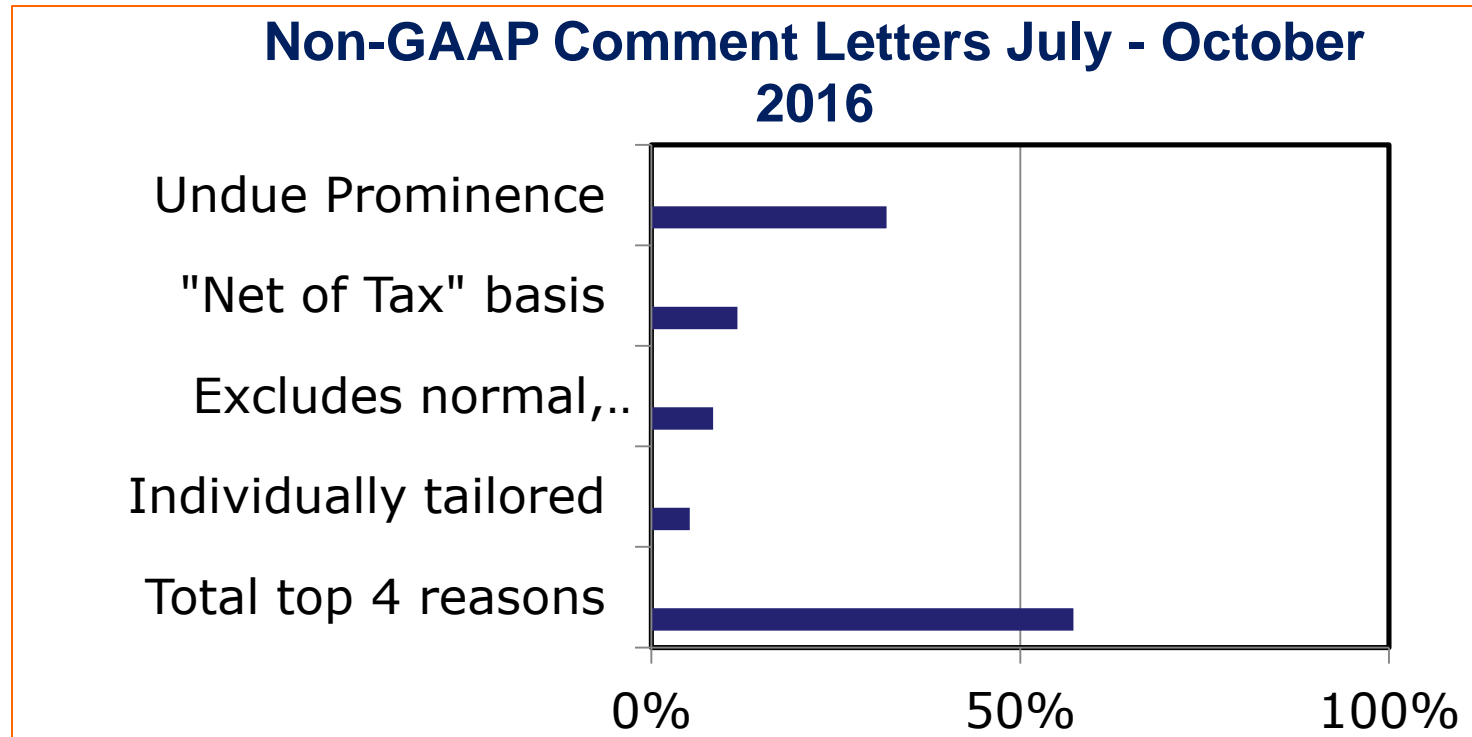
■ Addressing effect on Internal Controls over Financial Reporting (ICFR)

Comment trends & restatement issues

Comment area	Ranking		Comments as % of total registrants that received comment letters*
	12 months ended 30 June		
	2016	2015	2015 and 2016
Management's discussion and analysis**	1	1	44%
Non-GAAP financial measures	2	4	18%
Fair value measurements***	3	2	21%
Revenue recognition	4	3	16%
Segment reporting	5	7	13%
Income taxes	6	6	14%
Intangible assets and goodwill	7	8	12%
Acquisitions and business combinations	8	9	10%
Signatures, exhibits and agreements	9	5	13%
Commitments and contingencies	10	13	8%

Non-GAAP

■ Up-tick in SEC comments



■ May 2016 CD&I expands guidance:

- When a measure may be misleading and/or more prominent than comparable GAAP
- What are allowable disclosures

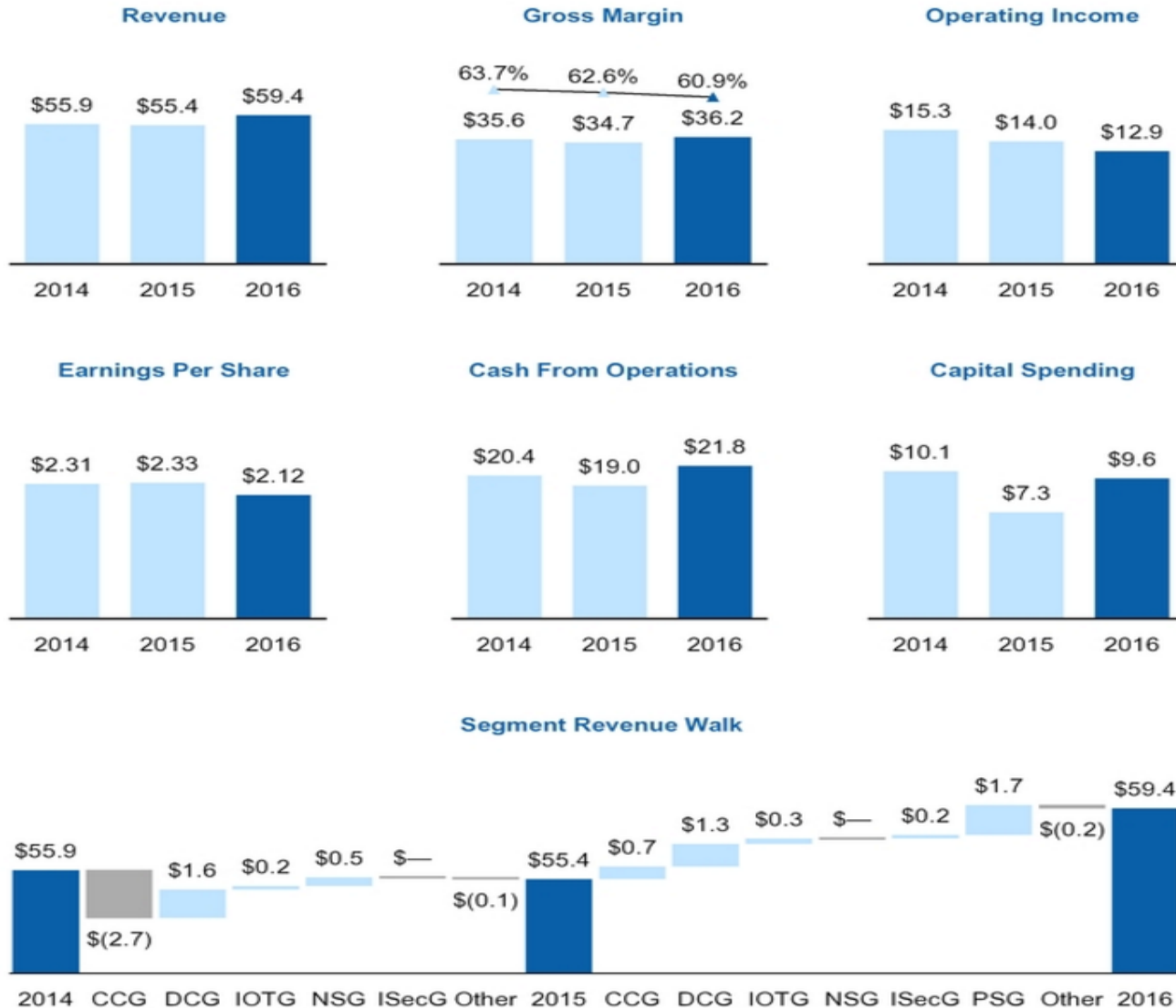
Disclosure effectiveness initiative

- SEC is evaluating comments received on its Request for Comment on disclosure effectiveness
- Yes! - Material information
- No - Immaterial, outdated
- Visuals:
 - Charts & graphs
 - Tables, bullets
- No redundancy – Use cross references
- Plain language



Charts

Management's discussion and analysis of financial condition and results of operations



Source: Intel
2016 10-K

Public Company Accounting Oversight Board

PCAOB
Public Company Accounting Oversight Board

Improving Transparency of Audits

- Disclosure of Engagement Partner and Certain Other Participants in Audits – Release 2016-001 and 2015-008 (Docket 029)
- Form AP for each audit:
 - Engagement partner - Effective: 1/31/17
 - Other accounting firms involved with audit – Effective 6/30/17
 - Due 10 days after IPO filing;
 - 35 days after other SEC filings

Improving Auditor's Reports

- Making the Auditors Reports More Relevant and Informative – Release 2017-001 and ISA 701
- Critical Audit Matters (CAMs):
 - Matters communicated to the audit committee that relate to material accounts or disclosures and involved especially challenging, subjective or complex auditor judgment.
 - Effective: annual periods ending after 6/30/19 large filers; ending on or after 12/15/20 all other filers
 - Auditor tenure information, clarifying auditor's responsibilities
 - Effective annual periods on or after 12/15/17

Thank you!

Speaker contact info:

Diana Gilbert

dgilbert@roseryan.com

www.RoseRyan.com

