Miles CPA Review: FAR - 2018 Updates

Summary of updates:

- **"New version" CPA exam structure (w.e.f. April 2017)** – Time management on the exam
- **FAR-1.10 – Revenue Recognition** [ASU 2014-09, 2015-14, 2016-08, 2016-10, 2016-12, 2017-05, 2017-10] – New Revenue Recognition standards, refer separate hand-out for entire portion
- **FAR-3.1 – Investments in Equity & Debt Securities** [ASU 2016-01]
- **FAR-4.5 - Pensions & Post-employment benefits** [ASU 2017-07]
- **FAR-5.1 – Deferred Taxes** [ASU 2016-16]
- **FAR-5.4 – Statement of Cash Flows** [ASU 2016-15; ASU-2016-18]
- **FAR-6.1– Business Combinations & Consolidation** [ASU 2017-01]
- **FAR-6.5 – Not-for-profit Accounting** [ASU 2016-14]

Miles
CPA Review

“New version” CPA exam structure (w.e.f. April 2017):

MCQ testlets

50% weightage
Recommended time:

- **Testlet #1: 50 mins**
- **Testlet #2: 50 mins**

TBS/WCT testlets

50% weightage
Recommended time:

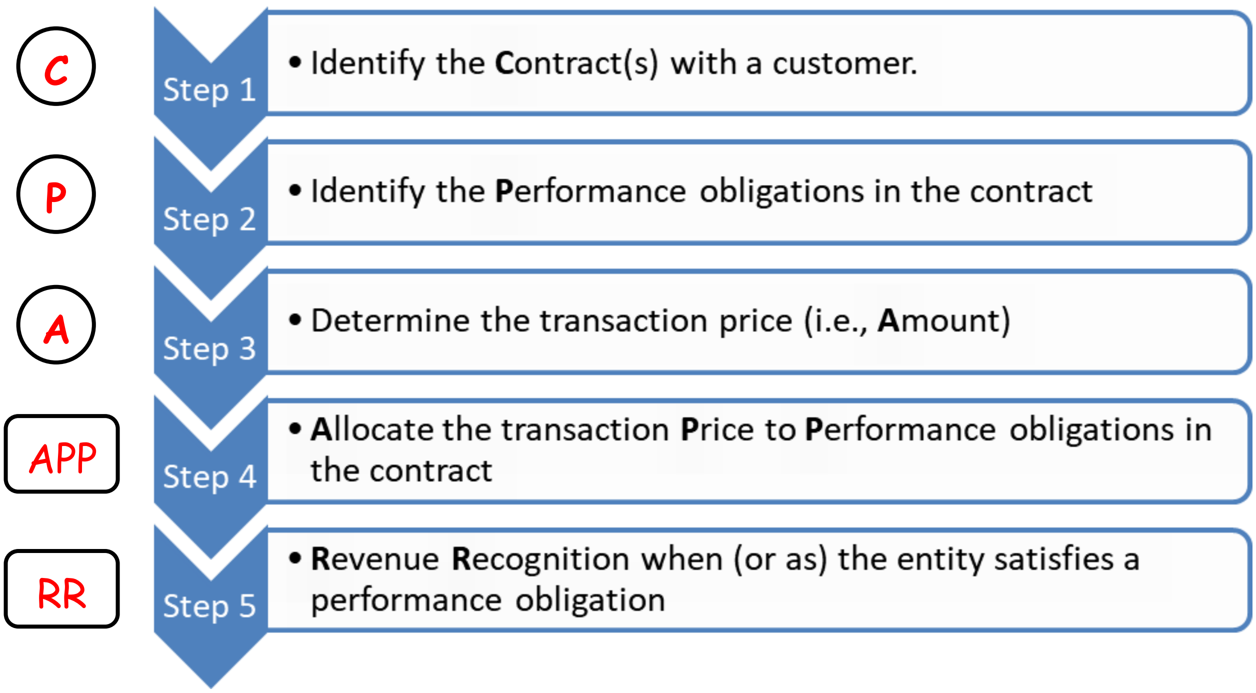
- **Testlet #3: 35 mins**
- **Testlet #4: 50 mins**
- **Testlet #5: 55 mins**

FAR	Testlet #1 33 MCQs	Testlet #2 33 MCQs	Testlet #3 2 TBSs	Break: 15 min	Testlet #4 3 TBSs	Testlet #5 3 TBSs
AUD	Testlet #1 36 MCQs	Testlet #2 36 MCQs	Testlet #3 2 TBSs	Break: 15 min	Testlet #4 3 TBSs	Testlet #5 3 TBSs
REG	Testlet #1 38 MCQs	Testlet #2 38 MCQs	Testlet #3 2 TBSs	Break: 15 min	Testlet #4 3 TBSs	Testlet #5 3 TBSs
BEC	Testlet #1 31 MCQs	Testlet #2 31 MCQs	Testlet #3 2 TBSs	Break: 15 min	Testlet #4 2 TBSs	Testlet #5 3 WCTs

*** MCQ - Multiple Choice Question | TBS - Task Based Simulation | WCT - Written Communication Task**

FAR-1.10 – Revenue Recognition [ASU 2014-09, 2015-14, 2016-08, 2016-10, 2016-12, 2017-05, 2017-10] – New Revenue Recognition standards, refer separate hand-out for entire portion

- **Revenue from Contracts with Customers -** Entity should recognize revenue to depict the transfer of promised goods/services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods/services
  - 5-step approach: {Complicated? Don't you worry - Miles has a **CPA APP** for **Revenue Recognition** just for you!}



FAR-3.1 – Investments in Equity & Debt Securities [ASU 2016-01]

FASB issued Accounting Standards Update 2016-01 effective Dec 15, 2017, for public companies, and Dec 15, 2018, for non-public companies. Key provisions:

- **Investments in Equity securities to accounted for under:**
  - ✓ **MARKETABLE SECURITIES** - If no influence over investee (e.g., 0-20% ownership) and securities with readily determinable market value
    - Earlier: ~~Investments in equity marketable securities were classified as:~~
      - ~~**Trading (HFT)** - All gains/losses whether unrealized or realized were recognized on the I/S~~
      - ~~**Available-for-Sale (AFS)** - Only realized gains/losses were recognized on I/S and any unrealized gains/losses on AFS were recognized as OCI~~
    - **Update:** Investments in equity marketable securities to be classified as **Fair Value Through Net Income (FVTNI)** - i.e., measured at fair value with changes in the fair value recognized through net income (AFS classification no longer applicable where unrealized gains/losses were recognized as OCI)
  - ✓ **COST METHOD** - If no influence over investee (e.g., 0-20% ownership) and securities that do not have readily determinable market value
    - **Update:** Equity investments that do not have readily determinable fair market values to be remeasured at fair value either upon the occurrence of an observable price or upon identification of an impairment
      - Simplifies impairment assessment by requiring a qualitative assessment to identify impairment. When a qualitative assessment indicates that impairment exists, an entity is required to measure the investment at FV (i.e., cost minus any impairment). Note that this impairment assessment is similar to the qualitative assessment for long-lived assets, goodwill, and indefinite-life intangible assets
  - ✓ **EQUITY METHOD** - If significant influence over investee (e.g., 20-50% ownership)
  - ✓ **CONSOLIDATION** - If control over investee (e.g., 50%+ ownership)

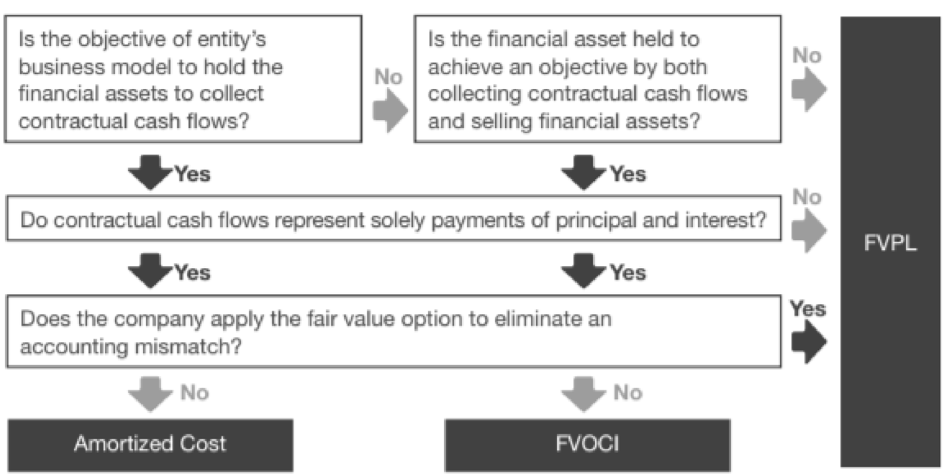
- **Investments in Debt securities may be categorized as [same as earlier]:**
  - ✓ **Trading (HFT)**
  - ✓ **Available-for-Sale (AFS)**
  - ✓ **Held-to-Maturity (HTM)**

- **Other Updates:**
  - ✓ **Financial Liabilities** - If the entity elects to measure the liability at FV in accordance with the FV option for financial instruments, need to record the change in FV of a liability resulting from a change in the instrument-specific credit risk separately as OCI
  - ✓ **Presentation of Financial Assets & Financial Liabilities** - Present separately by measurement category & form of financial asset (i.e., securities or loans & receivables) on B/S or notes to F/S
  - ✓ **Disclosure of FV of financial instruments measured at amortized cost (e.g., HTM) -**
    - Non-public entities - Not needed
    - Public entities - Disclose FV, but not the method & significant assumptions used to estimate FV. Also, FV to be measured using the "exit price" notion (i.e., eliminates the entry price method previously used by some entities)
  - ✓ **Deferred taxes related to AFS securities** - Evaluate need for valuation allowance on a deferred tax asset related to AFS securities in combination with the entity's other deferred tax assets

- **US GAAP vs. IFRS:**

	US GAAP (earlier)	US GAAP (now)	IFRS (now)
Equity Securities			
No influence & readily determinable FV	**{HFT} - Trading** **OR** **{AFS} - Available-for-Sale** [may elect FV option]	**{HFT} - Fair Value Through Net Income (FVTNI)** No longer AFS for Equities! ~~{AFS} - No longer allowed AFS which was through OCI~~	**{HFT} - Fair Value Through Profit or Loss (FVTPL)** **OR** **{AFS} - Fair Value Through OCI (FVTOCI)** allowed as an irrevocable option
No influence and not readily determinable FV	Cost Method (i.e., Cost less impairment); for impairment, now use of qualitative assessment		No cost exception; but guidance on when cost may be the best estimate of FV
Significant Influence	Equity method		Equity method
Control	Consolidation		Consolidation
Debt Securities			
Based on management intent	**{HFT} - Trading** **{AFS} - Available-for-Sale** [may elect FV option] **{HTM} - Held-to-Maturity** [may elect FV option] No change for Debt Investments. AFS & HTM allowed as earlier		**{HFT} - FVTPL** **{AFS} - FVTOCI** [may elect FVTPL] **{HTM} - Amortized cost** [may elect FVTPL]

- **Note: IFRS requires a single model for classification & measurement of financial assets with 2 tests:**
  - ✓ **Business model test** - Whether objective is to hold the financial asset to collect the contractual cash flows
  - ✓ **SPPI (Solely Payments of Principal & Interest) test** - Whether contractual cash flows represent SPPI



FAR-4.5 – Pensions & Post-employment benefits [ASU 2017-07]

FASB issued Accounting Standards Update 2017-07 effective Dec 15, 2017, for public companies, and Dec 15, 2018, for non-public companies. Key provisions relate to the **reporting of the Net Pension Expense {SIP R**ejoice **DATE} on I/S**:

- **Report the Service cost component {S of S**IP Rejoice DATE**} in the same line item(s) as other compensation costs arising from services rendered by the pertinent employees during the period {first O of O**N-TID-NO-C**}**
    - ✓ E.g., COGS for factory workers, Selling (S of SG&A) for Salesmen, G&A for officers
    - ✓ If capitalization is applicable (e.g., cost of internally manufactured inventory or a self-constructed asset), only the **S**ervice cost component to be eligible for capitalization
- **Other components of net benefit cost {IP R**ejoice **DATE} are required to be presented in I/S separately from the Service cost component as Non-operating item {first N of** O**N**-TID-NO-C**}**
    - ✓ If presented as a separate line item on I/S, that line item must be appropriately described. Else, if included along with other non-operating items, must disclose these components

Earlier: Components of Net Pension Expense (SIP Rejoice DATE) used to be aggregated and presented as Operating Expenses on I/S

- **Reporting Pension Expense on the I/S:**

Combined Statement of Income & Comprehensive income

Sales

<COGS>

Gross Margin

<SG&A>

Operating Income

Non-operating items

<Taxes>

Income from continued opns.

Discontinued operations

Net Income

OCI

Comprehensive Income

Service Costs [reported as Operating Expenses]

Interest Costs
\+ **P**rior Service Cost Amortization

\- **R**eturn (actual) on Plan Assets

+/- **D**eferred Gain or <Loss>
-/+ **A**mortization of excess deferred <Gain> or Loss
+/- **T**ransition Net obligation or <Net asset> Amortization

Non-operating Expense

Net Pension **E**xpense

P of PACER in Other Comprehensive Income = Pension Minimum Liability Adjustment which includes:

- Capitalization/Deferral of
- Prior service costs
- **D**eferred Gain/Loss from plan assets
- Actuarial Gain/Loss
- Transition asset/obligation

\- Amortization of
{**PAT** them once every year!}
- **P**rior Service Cost Amortization
- **A**mortization of excess deferred prior Gain or <Loss> from Plan Assets
- **T**ransition Net Obligation or <Net Asset> Amortization

- Note that components of Net Pension Expense (SIP Rejoice DATE) must be disaggregated for presentation on I/S
  - ✓ Service Cost included as Operating expense (COGS/SG&A as applicable)
  - ✓ Other components {IP Rejoice DATE} included as Non-operating items

FAR-5.1 – Deferred Taxes [ASU 2016-16]

FASB issued Accounting Standards Update 2017-07 effective Dec 15, 2017, for public companies, and Dec 15, 2018, for non-public companies. Key provision

- Update: An entity should recognize the income tax consequences of an intra-entity transfer of an asset (e.g., intellectual property, PP&E) other than inventory when the transfer occurs

- Earlier: Recognition of current and deferred income taxes for an intra-entity asset transfer was prohibited until the asset has been sold to an outside party

FAR-5.4 – Statement of Cash Flows [ASU 2016-15; ASU-2016-18]

- FASB issued Accounting Standards Update 2016-15 effective Dec 15, 2017, for public companies, and Dec 15, 2018, for non-public companies. This update comprises FASB guidance regarding the following specific cash flow issues:

Cash Flow Issue	Summary of Amendments
Debt prepayment or debt extinguishment costs	Classify as cash outflows for financing activities
Settlement of zero-coupon debt instruments (or other debt instruments with very low coupon interest rates)	• Portion of cash payment attributable to accreted interest related to the debt discount = Classify as cash outflows for operating activities, and • Portion of cash payment attributable to the principal = Classify as cash outflows for financing activities
Contingent consideration payments made after a business combination	• Cash payment made soon after the acquisition date = Classify as cash outflows for investing activities • Cash payments not made soon after the acquisition date: - Upto the amount of the contingent consideration liability recognized at the acquisition date = Classify as cash outflows for financing activities; - Any excess = Classify as cash outflows for operating activities
Proceeds from settlement of insurance claims	Classify on the basis of the related insurance coverage (i.e., nature of the loss). E.g., - Insurance proceeds received for business interruption = Classify as cash outflows for operating activities - Insurance proceeds received for damage to PP&E = Classify as cash outflows for investing activities
Proceeds from settlement of corporate-owned life insurance policies (including bank-owned life insurance policies)	Cash proceeds received from settlement = Classify as cash inflows from investing activities Cash payments for premiums = May classify as cash outflows for investing activities, operating activities, or a combination of both
Distributions received from equity method investees	• Cumulative earnings approach - Generally, distributions received are considered returns on investment; classify as cash inflows from operating activities • Nature of the distribution approach - Distributions received are classified on the basis of the nature of the activity(ies) of the investee that generated the distribution as either cash inflows from operating activities, or investing activities
Beneficial interests in securitization transactions	Disclosed as a non-cash activity, and cash receipts from payments on a transferor's beneficial interests in securitized trade receivables should be classified as cash inflows from investing activities
Separately identifiable cash flows and application of the predominance principle	Classification of cash receipts and payments that have aspects of more than one class of cash flows should be determined: - Firstly, apply specific guidance in GAAP - In the absence of specific guidance, classify each separately identifiable source or use within the cash receipts and cash payments on the basis of the nature of the underlying cash flows (financing, investing or operating) - If cash receipts and payments have aspects of more than one class of cash flows and cannot be separated by source or use, the appropriate classification should depend on the activity that is likely to be the "predominant" source or use of cash flows for the item

- FASB issued Accounting Standards Update 2016-15 effective Dec 15, 2017, for public companies, and Dec 15, 2018, for non-public companies. This update comprises FASB guidance regarding presentation of restricted cash or restricted cash equivalents on the Statement of C/F:
  - Update: Require that a Statement of C/F explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents.
    - ✓ Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the Statement of C/F

FAR-6.1– Business Combinations & Consolidation [ASU 2017-01]

FASB issued Accounting Standards Update 2017-01 effective Dec 15, 2017, for public companies, and Dec 15, 2018, for non-public companies. This update clarifies the definition of a business

Earlier: Definition of a business -

- Business defined as having an integrated set of assets & activities (collectively referred to as a "set") which usually has 3 elements - inputs, processes, and outputs
    - While a business usually has outputs, outputs not required to be present
    - In addition, all the inputs and processes that a seller uses in operating a set not required if market participants can acquire the set and continue to produce outputs (e.g., by integrating the acquired set with their own inputs and processes)
- Note: The earlier definition of a business led to broad interpretations and many transactions being recorded as business combinations rather than more appropriately as asset acquisitions
    - Accounting for a business combination significantly differs in certain respects from the accounting for an asset acquisition. E.g.,
        - Acquirer's transaction costs are expensed in a business combination but capitalized in an asset acquisition
        - In a business combination, the assets acquired are recognized at fair value and goodwill is recognized; however, in an asset acquisition, the cost of the acquisition is allocated to the assets acquired on a relative fair value basis and no goodwill is recognized

Update: Revised definition of a business -

- Now, to be considered a business, evaluate based on below steps:
    - **Step 1 (Initial "screen")** - If substantially all of fair value of assets acquired (or disposed of) is concentrated in a single identifiable asset (or group of similar identifiable assets), it is NOT a business (and no need to evaluate per Step 2)
        - This initial screening test reduces the number of transactions that an entity must evaluate to determine whether they are business combinations or asset acquisitions
    - **Step 2** - To qualify as a business, the acquired integrated set of activities need to include an input and a substantive process which together significantly contribute to the ability to create an output
        - When a set does not have outputs (e.g., early stage companies), it must include employees that form an organized workforce and an input that the workforce could develop or convert to an output
- Note: As a result of the new changes, more acquisitions may end up being accounted as an asset acquisition rather than business combination

FAR-6.5– Not-For-Profit Accounting [ASU 2016-14]

Earlier: UNA, TRNA, PRNA

FASB issued Accounting Standards Update 2016-14 effective Dec 15, 2017. Key provisions:

Now:
- **Statement of Financial Position -** Present only 2 classes of Net Assets
  - ✓ Net assets without donor restrictions (i.e., Unrestricted Net Assets) = UNA
  - ✓ Net assets with donor restrictions (i.e., Temporarily Restricted Net Assets + Permanently Restricted Net Assets) = TRNA + PRNA
- **Statement of Activities -** Present changes in only above 2 classes of Net Assets
- **Statement of Cash Flows -** Continue to present cash flows from operating activities using either the direct or indirect method of reporting; but no longer require the presentation or disclosure of the indirect method (reconciliation) if using the direct method
- **Enhanced disclosures** including:
  - ✓ Amounts and purposes of governing board designations, appropriations, and similar actions that result in self-imposed limits on the use of resources without donor-imposed restrictions as of the end of the period
  - ✓ Composition of net assets with donor restrictions at the end of the period and how the restrictions affect the use of resources
  - ✓ Qualitative information that communicates how an NFP manages its liquid resources available to meet cash needs for general expenditures within one year of B/S date
  - ✓ Quantitative information, either on the face of B/S or in the notes, and additional qualitative information in the notes as necessary, that communicates the availability of an NFP's financial assets at the B/S date to meet cash needs for general expenditures within one year of B/S date. Availability of a financial asset may be affected by:
    - its nature,
    - external limits imposed by donors, grantors, laws, and contracts with others, and
    - internal limits imposed by governing board decisions
  - ✓ Amounts of expenses by both their natural classification and their functional classification. That analysis of expenses is to be provided in one location, which could be on the face of the statement of activities, as a separate statement, or in notes to F/S
  - ✓ Method(s) used to allocate costs among program and support functions
  - ✓ For underwater endowment funds (i.e., fund value less than original funding $), disclose:
    - NFP's policy, and any actions taken during the period, concerning appropriation from underwater endowment funds,
    - Aggregate FV of such funds,
    - Aggregate of original gift $ (or level required by donor/law) to be maintained, and
    - Aggregate $ by which funds are underwater (deficiencies)
- **Report investment return net of external and direct internal investment expenses** and no longer require disclosure of those netted expenses. Regardless of whether the investment activities:
  - ✓ Are managed by internal staff, outside investment managers, volunteers, or a combination or
  - ✓ Employ the use of mutual funds, hedge funds, or other vehicles for which management fees are embedded in the investment return of the vehicle
- Use, in the absence of explicit donor stipulations, **placed-in-service approach for reporting expirations of restrictions** on gifts (of cash or other assets) to be used to acquire or construct a long-lived asset
  - ✓ Thus, eliminates the earlier option to release the donor-imposed restriction over the estimated useful life of the acquired asset
  - ✓ Also, reclassify any amounts from net assets with donor restrictions to net assets without donor restrictions for such long-lived assets that have been placed in service as of the beginning of the period of adoption