Accounting and Audit Updates: How Will They Impact You?

FASB has issued several Accounting Standards Updates (ASUs) which may have an impact on your reporting. We have identified the updates most likely to affect our clients, and they are summarized below.

ASU 2016 -02 Leases (Operating and Capital)

Effective in the year 2020 for private companies, new lease guidance requires lessees to record all leases, which are 12 months or longer, as debt on their balance sheet. The present value of any lease payment stream is recorded as a liability, and a "Right to Use" asset of equal amount is recorded in the fixed asset section. The liability and fixed asset are then amortized over the life of the lease.

The Impact: This will require significant work to document all leases, determine the present value, and maintain appropriate schedules to amortize the payments. Additionally, there is potential for a major impact on financial statement covenants (ex. debt to equity ratio).

ASU 2014-09 Revenue

Effective in the year 2019 for private companies, revenue guidance has been completely overhauled with all industry specific guidance removed and replaced with general principles for revenue recognition. The primary issue is when something is sold with multiple deliverables. The guidance requires the transaction price be allocated amongst the various performance components and revenue only recognized when each of the performance components are delivered and completed.

The Impact: Warranties are exempt from these new revenue recognition rules provided the warranty is not above and beyond industry norm (10 year warranty versus a 3 year warranty). However, revenue recognition for other add-on products may be affected.

ASU 2016-13 Financial Instruments – Credit Losses

Effective in the year 2021 for private companies, new guidance on financial instruments applies to (1) loans, accounts receivable, trade receivables, and other financial assets measured at amortized cost, (2) loan commitments and certain other off-balance sheet credit exposures, (3) debt securities and other financial assets measured at fair value through other comprehensive income, and (4) beneficial interests in securitized financial assets. This new guidance requires the allowance for credit losses be future looking rather than backwards looking, covering all expected future losses in the current portfolio.

The Impact: This new guidance will require detailed historical loss measures and sophisticated future predictive loss models. You may use historical indicators like a static pool allowance but such estimates must be adjusted to account for changes in credit quality and other factors in the portfolio that may cause future losses to differ from current losses.

ASU 2016-01 Financial Instruments

Effective in the year 2019 for private companies, this new guidance eliminates the accounting distinction between investments in equity securities that are trading investments or available for sale investments. Historically, trading investments were measured at fair market value with changes in the investments being recorded on the income statement while available for sale securities were historically adjusted through equity (other comprehensive income).

The Impact: Under this new guidance, all investments in equity securities will be recorded at fair market value with changes in their values recorded through the income statement.

ASU 2014-15 Going Concern
For entities where *some* doubt exists about the entity's ability to continue for the foreseeable future (generally one year from the date of financial statement issuance), management is now required to evaluate whether there is *substantial* doubt. This new guidance went into effect in year 2016 for private companies.
The Impact: When appropriate, management must disclose in the notes to the financial statements the conditions or events leading to substantial doubt and plans to mitigate the impact of those conditions or events.

Fraud Reminder
Additionally, we would like to remind clients of the important of an anti-fraud program. Fraud can affect all businesses in all industries. Compiled, reviewed and even audited financial statements have inherent limitations and are not specifically designed to detect fraud within a business. Management is responsible for designing, implementing and maintaining internal controls to prevent and detect fraud. An anti-fraud program should include signed employee anti-fraud disclosures, company ethics disclosures, an internal audit team, forced employee vacation and job rotation, fraud reporting hot line ect. Most fraud is discovered via employee tips and the company should have an effective means of employees anonymously reporting fraud. Additionally even the appearance of an internal audit function and anti-fraud program can be a good deterrent even if such programs are not yet fully implemented.

The back bone of a strong anti-fraud program is the tone at the top. Owners who pay personal bills through the company and use company credit cards for extravagant personal expenses are setting the wrong tone for the company and are likely to have employees who think is it okay for them to do the same. Owners should keep their personal expenses out of the company records so that employees are not aware of their personal expenditures.

Having strong written guidelines for things like use of company credit cards and travel reimbursement are important so that a silly mistake can be differentiated from actual fraud and abuse. Companies should consider purchasing employee insurance or bonds to protect the company from employee fraud.

Owners and management must be diligent in their duties to oversee employee day to day operations and implement separation of duties when and where ever possible. One employee with unlimited access to the company books and records is in a position to commit fraud and will commit fraud if they find themselves in a tough personal situation.