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Updates to the Accounting Landscape

May 10, 2023

Lease Accounting

New Disclosures for Lessee

- Information about leases that have not yet commenced but create significant rights & obligations for the lessee
- Significant judgments, including
  - The determination of whether a contract contains a lease
  - The allocation of the consideration in a contract between lease & nonlease components
  - The determination of the discount rate for the lease
- Short-term lease accounting policy election
- Election of the practical expedient on not separating lease components from nonlease components

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New Disclosures for Lessee

- Amounts segregated between those for finance & operating leases for the following items
  - Cash paid for amounts included in the measurement of lease liabilities, segregated between operating & financing cash flows
  - Supplemental noncash information on lease liabilities arising from obtaining Right-of-Use (ROU) assets
  - Weighted-average remaining lease term
  - Weighted-average discount rate

Determining Whether a Lease Exists

Identified Asset

- Explicitly or implicitly specified
- Not able to substitute

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Right of Control

- Decision-making authority
- Substantially all the economic benefits

Lease

Finance Lease Criteria (Similar to Capital Lease)

1. Ownership of asset transfers to lessee by end of lease term
2. Lessee has purchase option that it is reasonably certain to be exercised
3. Lease term is for major part of economic life of asset (N/A for leases that commence "at or near the end" of the underlying asset's economic life, *e.g.*, in the final 25% of an asset's economic life)
4. PV of minimum lease payments amounts to at least substantially all of fair value of leased asset
5. **NEW:** Underlying asset is of such a specialized nature that it is expected to have no alternative use to the lessor at the end of the lease term

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Inception Date vs. Commencement Date

- Lease commencement is the date a lessor makes an underlying asset available for use to a lessee & is the date for classification, recognition, & measurement
  - The determination of whether a contract is a lease or contains a lease is performed at the inception date
  - Lease classification, recognition, & measurement are determined at the lease commencement date

Lease Classification & Terms

- 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 & lease liabilities on the balance sheet
- Lease term is the noncancelable period in which the lessee has the right to use an underlying asset, plus optional periods for which, after considering all relevant factors that may give lessee economic incentive to renew or terminate, it is reasonably certain the lessee will
  - Exercise the renewal option, or
  - Not exercise the termination option, or
  - The exercise of those options is controlled by the lessor

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Lease Accounting Concepts

- Lease liability (obligation to make lease payments) = measured at the present value of the future lease payments
- ROU asset = lease liability + direct cost + lease prepayments – lease incentives received
- Discount rate
  - Use the rate charged by the lessor if known
  - The incremental borrowing rate
  - All private companies & nonprofits may elect to use the risk-free rate
  - Can use the rate as of implementation date (no need to go back to the lease inception date)

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Lease Accounting Concepts

Annual expense recognition & subsequent amortization of ROU asset depends on lease classification

- **Finance lease**
  - Unwind liability using the effective interest method
  - Front-loaded expense pattern similar to today's capital leases with interest & amortization recognized separately
  - Interest determined on the lease liability in each period during the lease term as the amount that produces a constant periodic discount rate
  - ROU asset generally amortized on a straight-line basis
- **Operating lease**
  - Unwind liability using the effective interest method
  - Straight-line expense over term
  - ROU asset: Reduced by the difference between the annual straight-line lease expense & the annual interest cost on the lease liability, *i.e.*, amortize the asset to achieve straight-line total lease expense

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Lease Accounting

- Lessee Balance Sheet Presentation
  - Finance & operating lease ROU assets must be presented separately on the balance sheet or disclosed in notes (separate line items if entity has both finance & operating lease ROU assets)
  - Liabilities – same separate presentation requirements as ROU assets (separate line items if entity has both finance & operating leases)
  - ROU assets & liabilities are subject to the same considerations as other nonfinancial assets & financial liabilities in classifying them as current & noncurrent in classified balance sheets. An entity should classify a portion of its lease liabilities that is expected to be paid within one year as a current liability

Comparison of Lessee Accounting Models

Finance Lease

Balance Sheet

- ROU asset* lease liability

Income Statement

- Interest expense (on lease liability)
- Amortization expense (on ROU asset)

Cash Flows

- Cash paid for principal payments (financing activities) & interest payments (operating activities)

**Periodically reduced by the straight-line amortization*

Operating Lease

Balance Sheet

- ROU asset** lease liability

Income Statement

- Lease/rent expense (straight-line)

Cash Flows

- Cash paid for lease payments (operating)

***Periodically reduced by the difference between straight-line lease expense & interest cost on lease liability, i.e., “plug figure”*

****ROU asset is always long-term & lease liability is split between current & long-term*

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Lessons Learned

- Ensure that you know what is the commencement date vs inception date; termination date; renewal options
- How do you account for leases when one entity has a signed lease and the other entity is making payments?
- Inaccurate information carried forward from prior standard leads to inaccurate input for new standard
- Internal controls-who keeps and reviews all lease agreements for terms and renewals (legal/fiscal); how is communication made from program to fiscal?
- Who enters and reviews the information?
- What software are you using?
- What discount rate is being used?
- Proper calculation-fixed payments, variable payments, operating vs finance

Safeguarding of Assets

- Definition
  - Controls in this category are policies and procedures designed to provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company’s assets that could have a material effect on the financial statements
    - Under the new lease accounting standards, leases and software agreements are intangible assets.
- Technology can handle any lease type or contract structure tracking details like asset usage and location as well as dates to renew

Reconciliation

- Definition
  - Reconciliations ensure that balances in your accounting system are accurate by comparing them with balances in accounts held by other entities like banks, suppliers and credit customers. Differences between these types of complementary accounts can reversal errors or discrepancies either your accounts or those controlled by other entities
- Technology can roll-forward reports outline lease-related changes in your balance sheet over time. Integrations allow you to send these reports to your reconciliation tools automatically.

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Audit Trail

- Definition
  - A sequential record detailing the history and events related to a specific transaction or ledger history. It provides a step-by-step record to trace accounting, trade details or other financial data back to their source.
- Technology can show you change log report, help you with disclosures

How to Help Ease the CFR Preparation Process

How to Help Ease the CFR Preparation Process

- Make sure you have access to the CFR platform
- Understand changes to CFR reporting
- Set expectations of the preparation timeline
- Assign sections of the CFR to your staff
- Understand your programs and how they need to reported
- Understand your allocations and make sure that they are done early
- Make sure you have back up for all numbers and lead sheets
- Analytically review CFR data for unreasonable fluctuations

Year-Round Preparation Process

- Accumulation of statistics and other non-financial data throughout the year
- Make sure your report writer is up to date
- Review coding of accounts to CFR lines to make sure they conform to the manual

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Common Errors Found in CFR Examination

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Common Errors in CFR Examination

- **Question:** How do you report the **Paycheck Protection Program (PPP) loan forgiveness** on the Consolidated Fiscal Report (CFR)?
- **Answer:** The amount of the loan forgiveness of the PPP is reported on the CFR in the Revenue section of the following CFR schedules (as applicable):
  - Schedule CFR-1, line 79
  - Schedule CFR-2, column 9, line 10
  - Schedule DMH-1, line 25
  - Schedule DMH-2, line 24

Common Errors in CFR Examination

- CFR-2A not reconciling with financial statements
- Reconciliation page-start with financial statements
- CFR-6 properly identifying allocated employees
- Reviewing your program vs. m&g costs to reconcile with financial statements and CFR
- Reviewing transportation line 68a and 68b
- Reporting correct census

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Reference Rate Reform

Reference Rate Reform

- Reference rates such as USD LIBOR & other inter-bank offered rates are planned to be phased out & replaced by new rates that are tied to observable arms-length transactions. The original phase-out date was December 31, 2021
- ASU 2020-04, *Reference Rate Reform* (Topic 848): *Facilitation of the Effects of Reference Rate Reform on Financial Reporting*, and ASU 2021-01, *Reference Rate Reform* (Topic 848): *Scope*, were issued to provide optional accounting relief related to hedge accounting & contract modifications. That relief is set to expire on December 31, 2022 (sunset date). See next slide for extension of sunset date

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Reference Rate Reform

- On March 5, 2021, LIBOR's administrator indicated that major tenors of USD LIBOR will cease to be published as of June 30, 2023
- FASB voted at the December 15, 2021 meeting to propose that the sunset date be extended to December 31, 2024. ASU 2022-06 was issued in December 2022
- Reminders for NFPs
  - Review contracts & agreements that may be affected by reference rate reform
  - Discuss timing with your creditor/lender
  - Consider the guidance in Topic 848

Current Expected Credit Loss (CECL)

CECL – Overview

- Effective for fiscal years that begin in 2023
- Applies to loans & trade receivables (including student receivables)
- Does not apply to contributions/grants receivable
- Need to consider historical losses plus current conditions plus/minus predictions/forecasts
- This is different than the amount expected to collect under revenue recognition (Topic 606) & the application of discounts to tuition

CECL – Disclosures

Required disclosures to enable financial statement user to understand

- The credit risk inherent in a portfolio & how management monitors the credit quality of the portfolio
- Management's estimate of expected credit losses
- Changes in the estimate of expected credit losses that have taken place during the period (this includes both qualitative descriptions of how the estimate changed & quantitative rollforward of allowance for credit loss by portfolio segment)

New York State Health Care & Mental Hygiene Worker Bonus (HWB)

HWB – Background

- Fiscal Year 2023 New York State Executive Budget legislation
- Approximately $1.2 billion for the payment of bonuses for certain frontline healthcare workers
- Allows for the payment of bonuses to "recruit, retain, & reward health care & mental hygiene workers" meeting specified eligibility requirements
- Bonus amounts will be commensurate with the number of hours worked by eligible workers covered by the HWB Program during designated vesting periods for up to a total of $3,000 per covered worker
- Qualified employers are required to claim their bonus on behalf of their eligible employees
- Both qualified employers & qualified employees are required to submit an attestation form, as dictated by the HWB Program

How Do We Account for HWB

- What is the proper accounting treatment of the Health Care & Mental Hygiene Worker Bonus?
- How would a Not-for-Profit (NFP) versus a For-Profit entity account for such transaction?

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How Do We Account for HWB – NFP Entities

Exchange Transaction

vs.

Grant/Contribution

vs.

Agency Transaction

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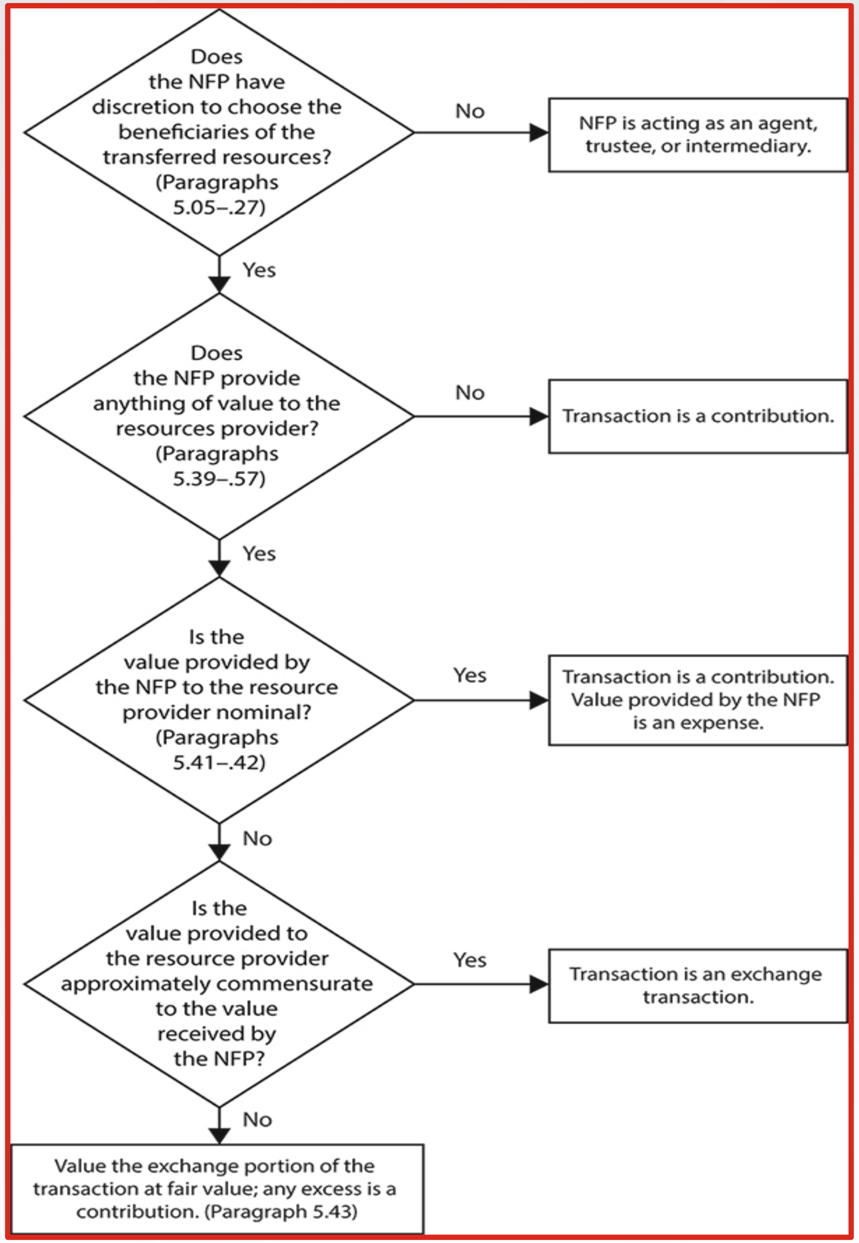
NFP Audit & Accounting Guide



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Variance Power

- The FASB ASC Master Glossary defines variance power as
  - the unilateral power to redirect the use of the transferred assets to another beneficiary. A donor explicitly grants variance power if the recipient entity's unilateral power to redirect the use of the assets is explicitly referred to in the instrument transferring the assets. Unilateral power means that the recipient entity can override the donor's instructions without approval from the donor, specified beneficiary, or any other interested party

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Discretion to Choose a Beneficiary

- ASC 958-605-55-76 – Discretion to Choose the Beneficiary – states that
  - "A recipient entity has discretion sufficient to recognize a contribution received if it can choose the beneficiaries of the assets.
  - For example, if a recipient receives cash that it must disburse to any who meet guidelines specified by a resource provider or return the cash, those receipts may be deposits held by the recipient as an agent rather than contributions received as a donee.
  - *Similarly, if a recipient receives cash that it must disburse to individuals identified by a resource provider or return the cash, neither the receipt nor the disbursement is a contribution for the agent, trustee, or intermediary.*
  - In contrast, if a resource provider allows the recipient to establish, define, & carry out the programs that disburse the cash, products, or services to the recipient's beneficiaries, the recipient generally is involved in receiving & making contributions."

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How Do We Account for HWB – For-Profit Entities

- Guidance from TQA Section 6400.71 – Accounting by a Recipient Entity for Vaccines or Other Pharmaceuticals, Medical Supplies, or Equipment Received for Distribution to Specified Patients
  - This TQA discusses the receipt of vaccines from the pandemic & notes that occasionally healthcare entities receive pharmaceuticals or other items from resource providers to distribute to patients participating in right-to-try programs, clinical trials, prescription assistance programs, or other programs designed to distribute pharmaceuticals to patients free of charge
  - Generally, those items are required to be dispensed by a licensed healthcare entity only to the specified patient or patients & free of charge to the specified patients. Typically, the arrangements between the provider of the items & the dispensing healthcare entity do not allow the healthcare entity to dispense the items to anyone other than the specified patients & also require that if the items cannot be dispensed to the specified patients, they must be either returned to the resource provider or destroyed

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How Do We Account for the HWB – For-Profit Entities

- If, after reviewing the facts & circumstances of the arrangement between the resource provider of the items & the dispensing healthcare entity, it is determined that the arrangement is a non-exchange transaction
- The not-for-profit healthcare entities receiving transfers from governmental or nongovernmental entities **& for-profit healthcare business entities** with transfers from nongovernmental entities **should apply the guidance within FASB ASC 958-605**
- Although there is no specific guidance in U.S. GAAP applicable to for-profit healthcare business entities for transfers from governmental entities, FASB ASC 105 describes the decision-making framework for determining the guidance to apply when guidance for a transaction or event is not specified within U.S. GAAP
- The AICPA staff has observed that guidance in FASB ASC 958-605 is one method that might be considered for application by analogy by for-profit healthcare business entities in which the resource provider is a governmental entity

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Employee Retention Tax Credit (ERC)

Employee Retention Tax Credit

- The Employee Retention Credit (ERC) is a refundable tax credit for businesses that continued to pay employees while shut down due to the COVID-19 pandemic or had significant declines in gross receipts from March 13, 2020 to December 31, 2021. Eligible employers can claim the ERC on an original or adjusted employment tax return for a period within those dates. Only recovery startup businesses are eligible for the ERC in the fourth quarter of 2021

How to Account for Employee Retention Tax Credit

- Employee Retention Credit (ERC) part 1
  - If you don’t file the 941x do you have a barrier?
- ERC part 2
  - Is the filing of the 941x administrative in nature?

How to Account for Employee Retention Tax Credit

Conditional contribution – Entities can record the ERC revenue as follows:

1. After determination has been made that the organization is eligible for the quarter

OR

2. As a conditional contribution after the funds are ultimately received

However, at a minimum the application & conditional funding should be disclosed in the financial statements.

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Employee Retention Tax Credit – FRAUD

IRS issues renewed warning on Employee Retention Credit claims; false claims generate compliance risk for people & businesses claiming credit improperly

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FEMA Funding

FEMA Recognition

From the PRF FAQs

- If a provider has submitted an application to FEMA but has not yet received the FEMA funds, the provider should not report the requested FEMA amounts in the Provider Relief Fund &/or ARP Rural report
- If FEMA funds are received during the same Payment Received Period in which provider is reporting on use of Provider Relief Fund &/or ARP Rural payments, the receipt & application of each payment type is required in the Provider Relief Fund &/or ARP Rural reporting process
- If an entity receives a retroactive payment from FEMA that overlaps with the period of availability, the entity must not use the FEMA payment on expenses or lost revenues already reimbursed by Provider Relief Fund or ARP Rural payments
- Revenue is recognized only after approval from FEMA of the funds applied for

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The Future of Accounts Payable

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Accounts Payable in 2023

- Invoice images are securely stored electronically & are regularly backed up
- No need to keep paper invoices
- Important vendor information is stored in the AP system
- Vendors can email invoices directly to the accounting software
- Automated AP software also recognizes duplicate invoice numbers

Accounts Payable in 2023

- Approval policies can be automated, reducing paper being delegated & passed around throughout an organization
- In a teleworking environment the need to remove the manual invoice approval is critical
- Accounts payable software has built-in approval policy workflows that can be managed from a mobile device, tablet, or computer to align with this ever-changing need
- Payment processing is performed electronically & payments are sent directly from the AP software
- Copies of check images, invoices, & payments are available to your vendors
- Vendors can even decide if they would prefer paper checks or ACH payments

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Accounts Payable in 2023

- Integration with the general ledger software avoids requiring double entry of bills from one system to another
- AP software syncs automatically daily or you can manually sync as you need, providing real-time updates
- The risk of fraud is reduced by segregating duties between processing, approving, & paying bills
- Performed in the cloud, reducing or eliminating the need to keep check stock on hand reducing the risk of check theft

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Accounts Payable – Fraud

- Fake invoices being submitted more than once, perhaps first under a legitimate vendor ID & a second time under a fictitious vendor ID
- This could be uncovered by looking for potential duplicate invoices
- As a result of increased confidence & greed over time, fictitious vendors often display an acceleration pattern, which is an increase in payments over time
- Examining payments over time by vendor can help identify unusual patterns that can be indicative of fraud

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Q&A

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Thank you!

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