

8:10 – 9:10 a.m.

Economic & Financial Market Outlook: 2022-2028

Clare Zempel, CFA, CBE, *Principal, Zempel Strategic*



WICPA Accounting and Auditing Conference

The Economic and Market Outlook 2022 – 2028

Why So Much Confusion?
What Do “Best Indicators” Predict?
Has Recession Started?
Can Recession Be Averted? Limited?
How Will Sectors Perform?

Clare Zempel

Economist and Investment Strategist

Brookfield, Wisconsin

November 16, 2022

Charts Updated October 18, 2022

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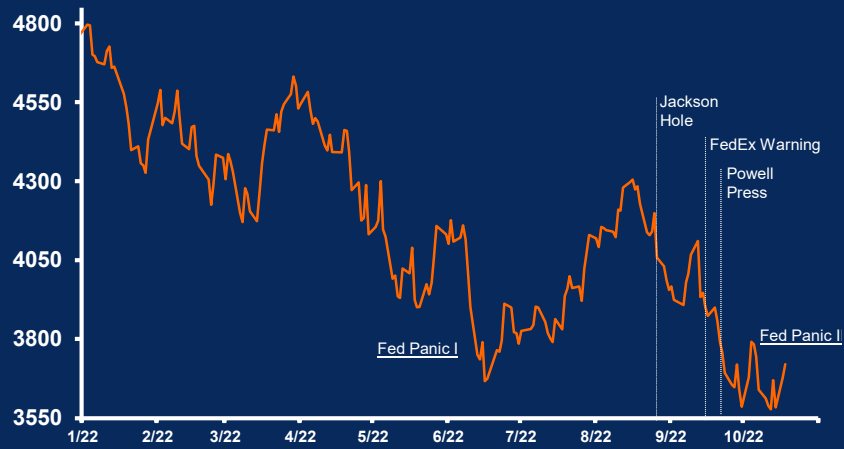
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Why So Much Confusion?

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S&P 500 Common Stock Index (Days)



Selected Interest Rates (Daily)



Breakeven CPI Inflation Rate

(T-Note - TIPS Spreads) (Daily Actual) (PCE Runs 0.45% Lower Than CPI)



New York Fed's Weekly Economic Index

"Fail-Safe" Real Growth Indicator





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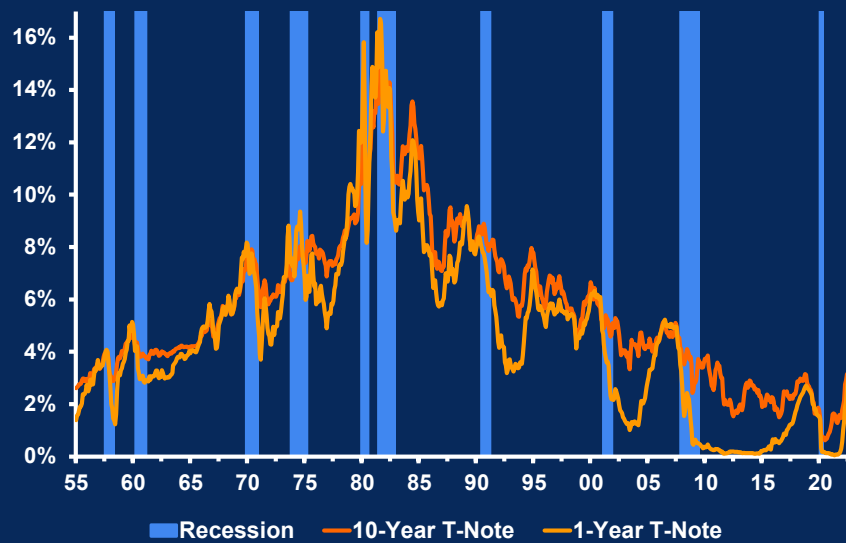
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What Do “Best Indicators” Predict?

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Interest Rates and Recessions

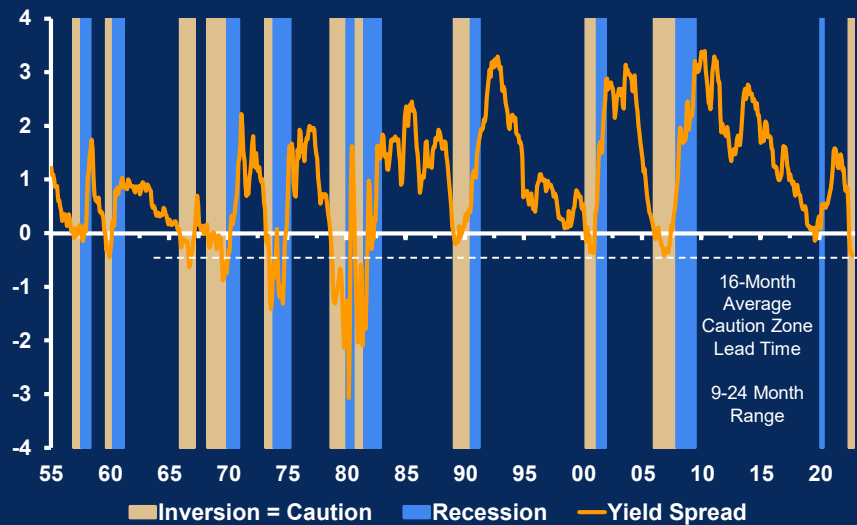
10 Recessions
Since 1955



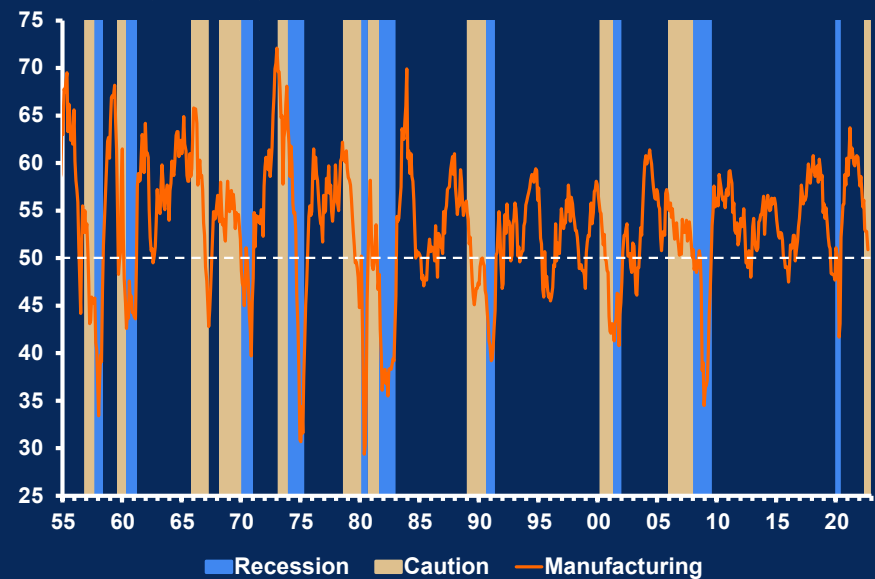
Yield Spread and Caution Zones ©

(10-Year T-Note Yield Minus 1-Year T-Note Yield) (Percentage Points)

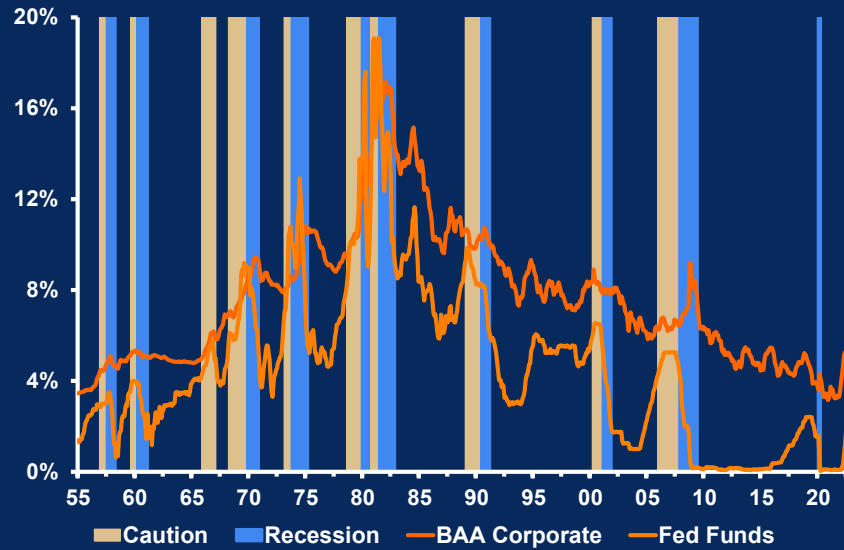
(Inversion = Caution Zone When Fed Funds Rate Is Rising)



ISM (PMI) Index (PMI = Purchasing Managers Index)

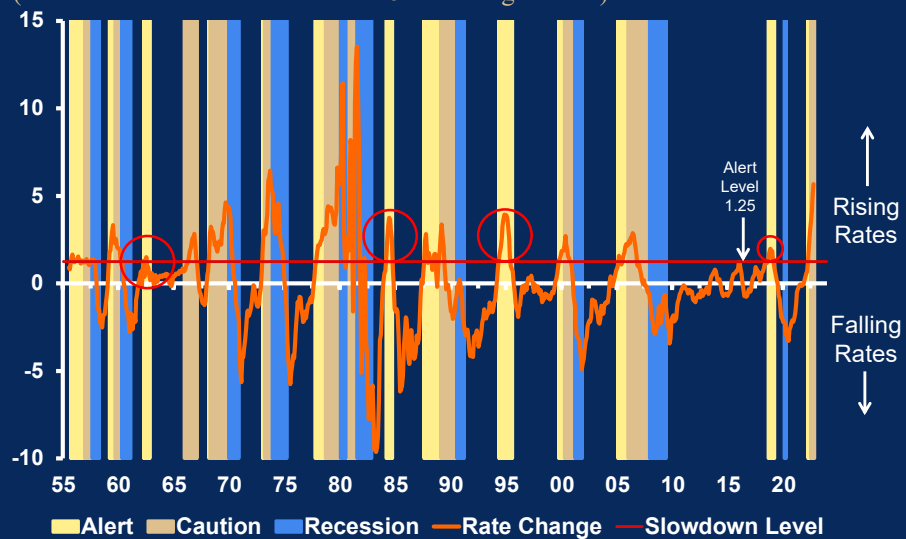


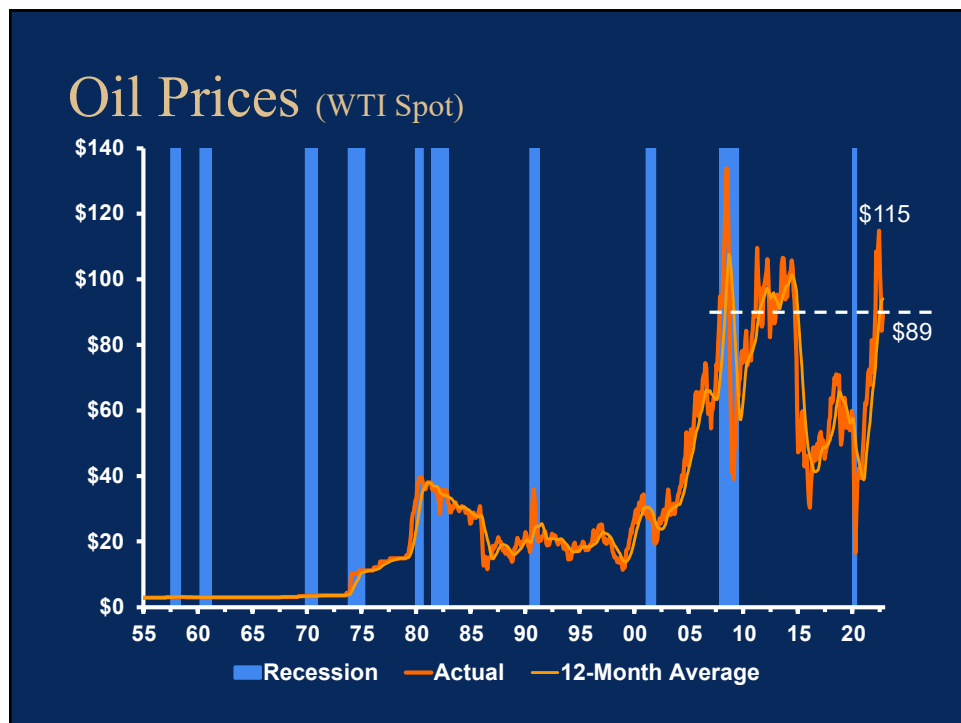
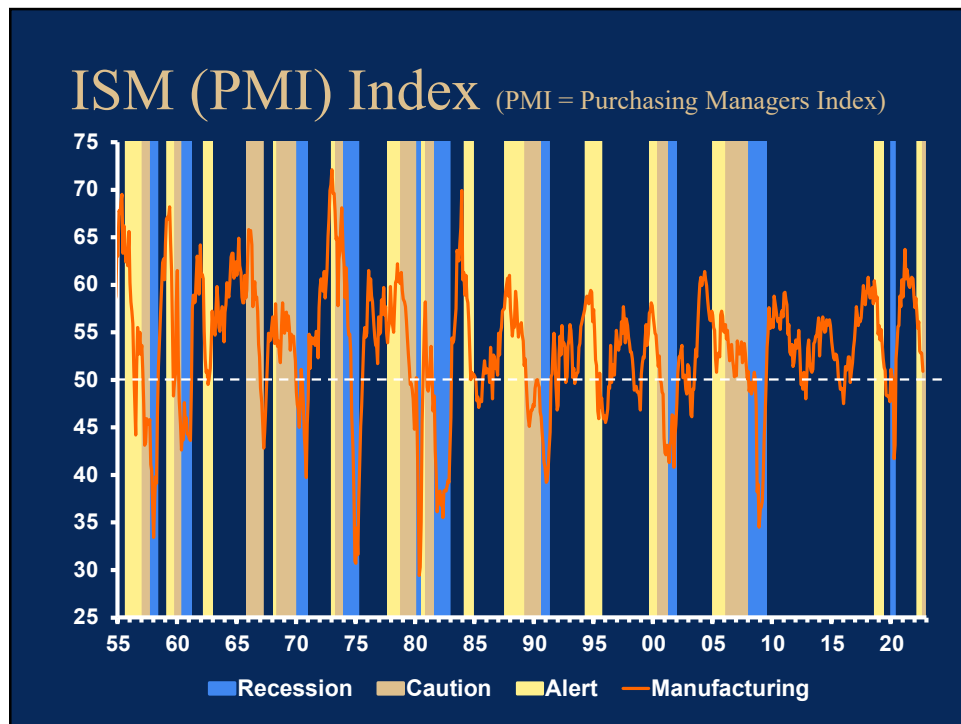
Interest Rates and Recessions

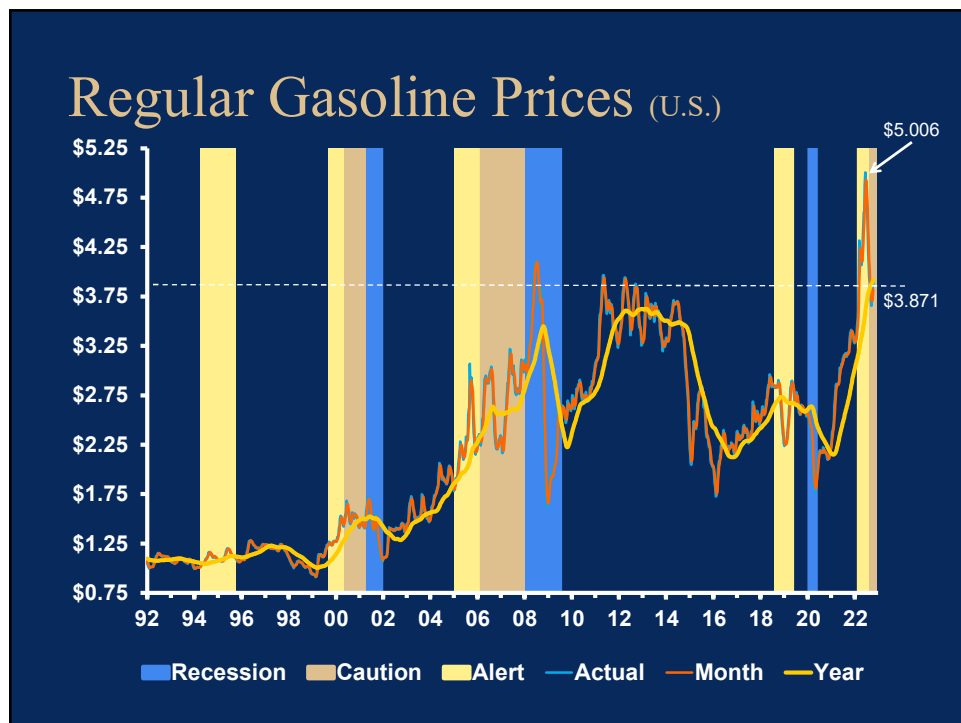
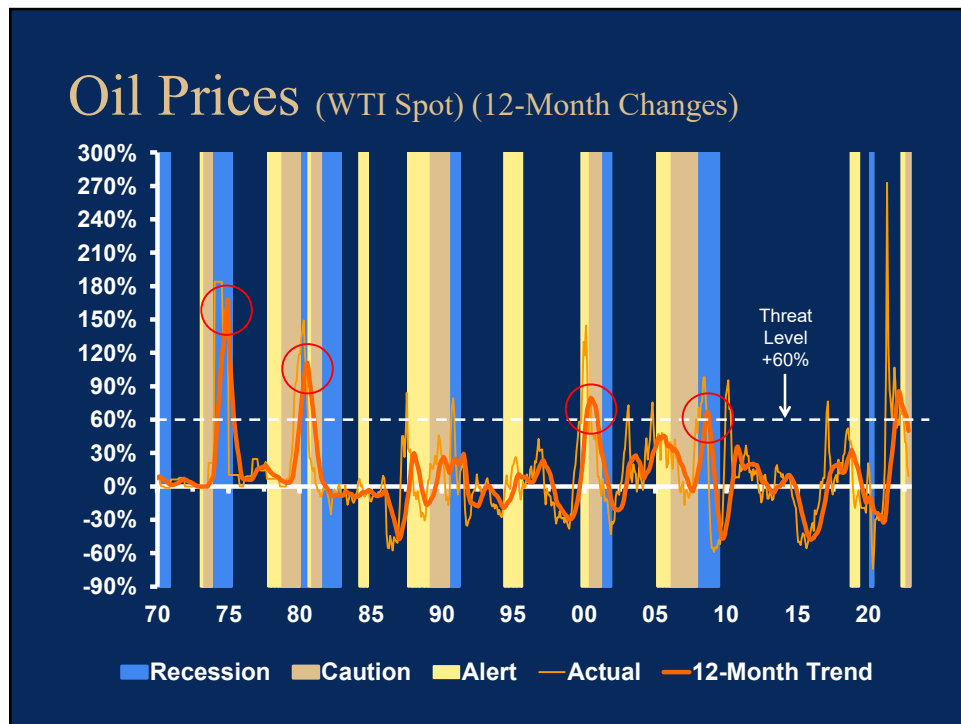


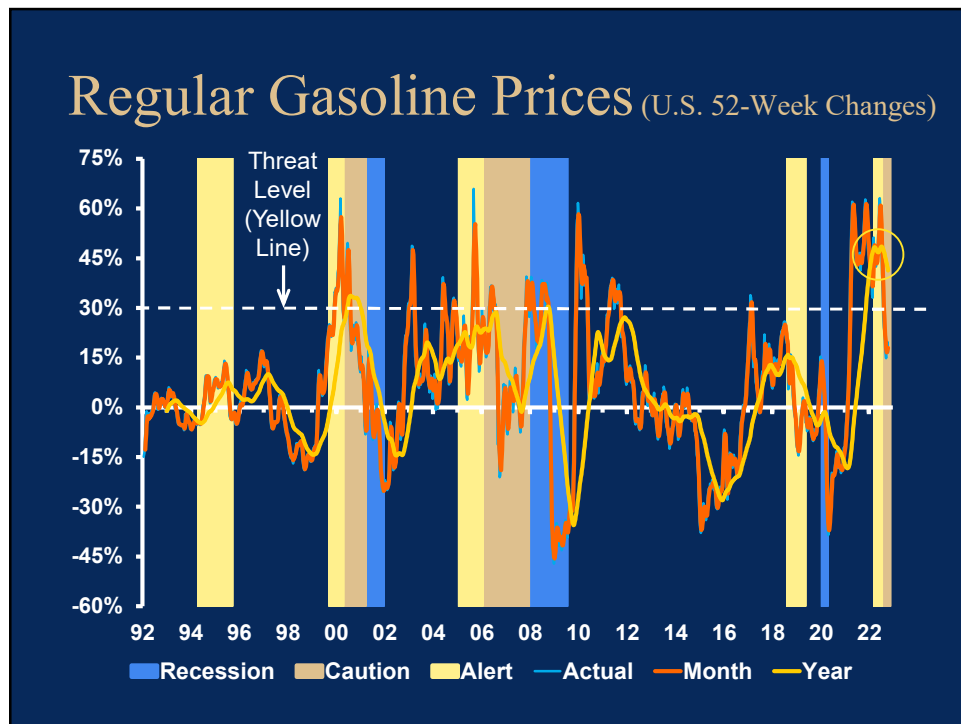
Rate Changes and Zempel Zones ©


(BAA and Fed Funds) (Total 12-Month Change in Percentage Points)
 (Alert Zone = When Rates Rise 1.25 Percentage Points)











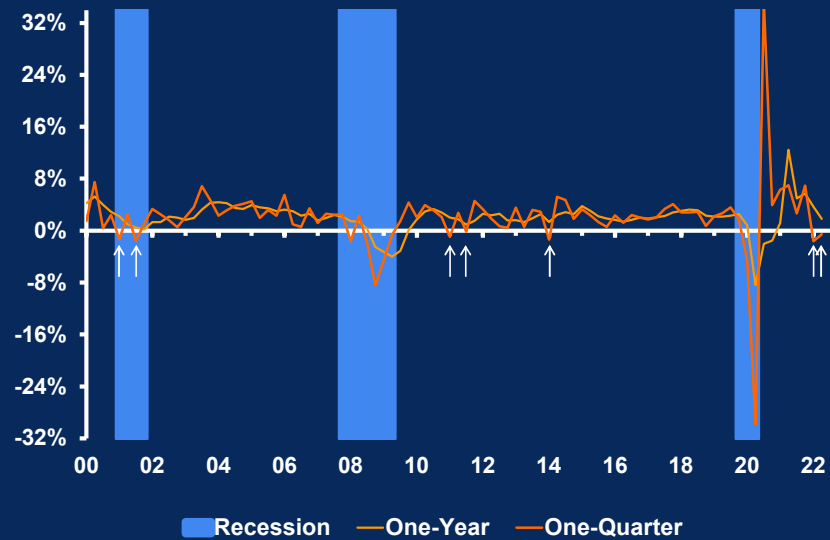
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Has Recession Started?

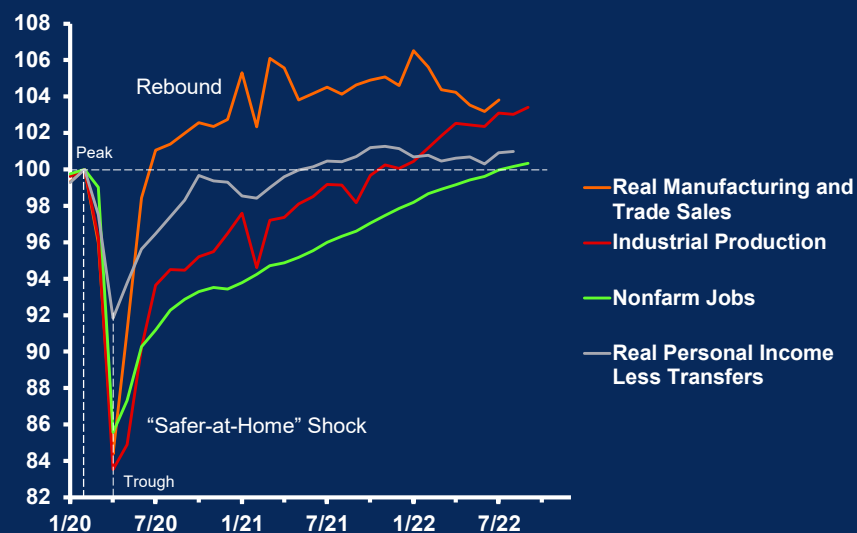
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Real GDP Growth Rates



NBER Recession Watch –The Four Key Numbers

(February 2020 = 100)



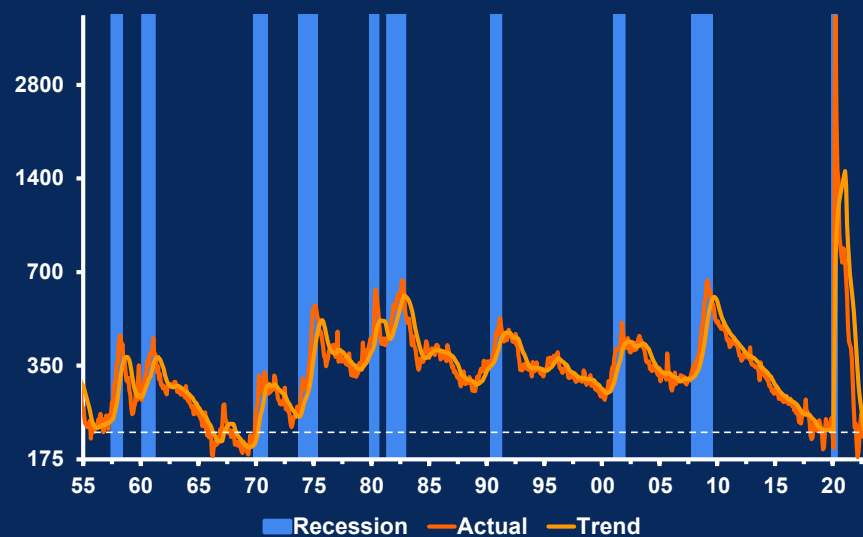
Unemployment Rate Levels

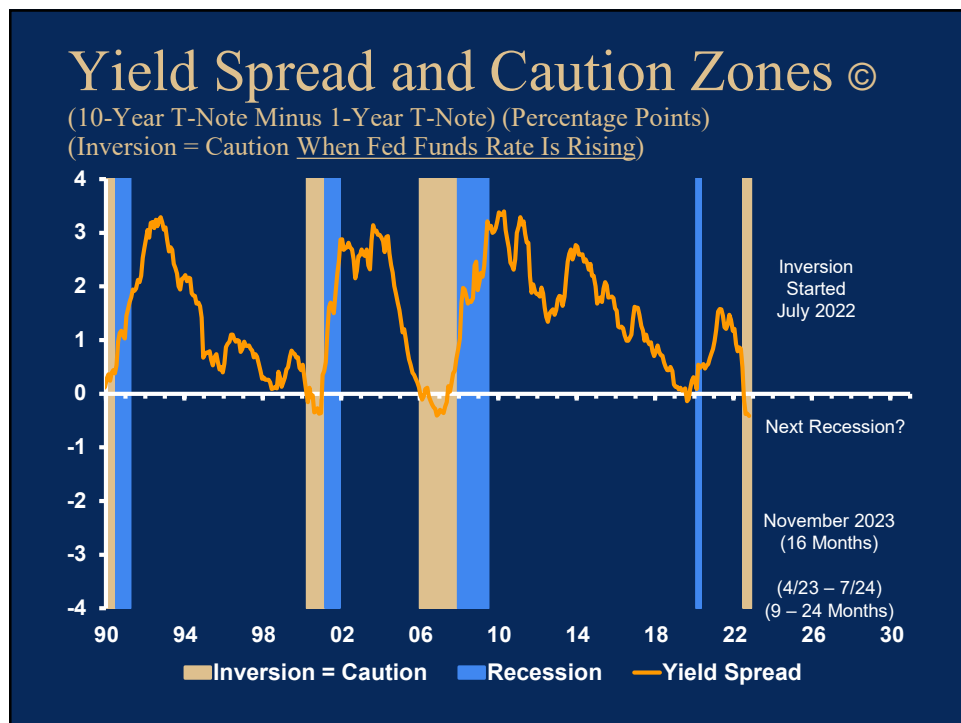
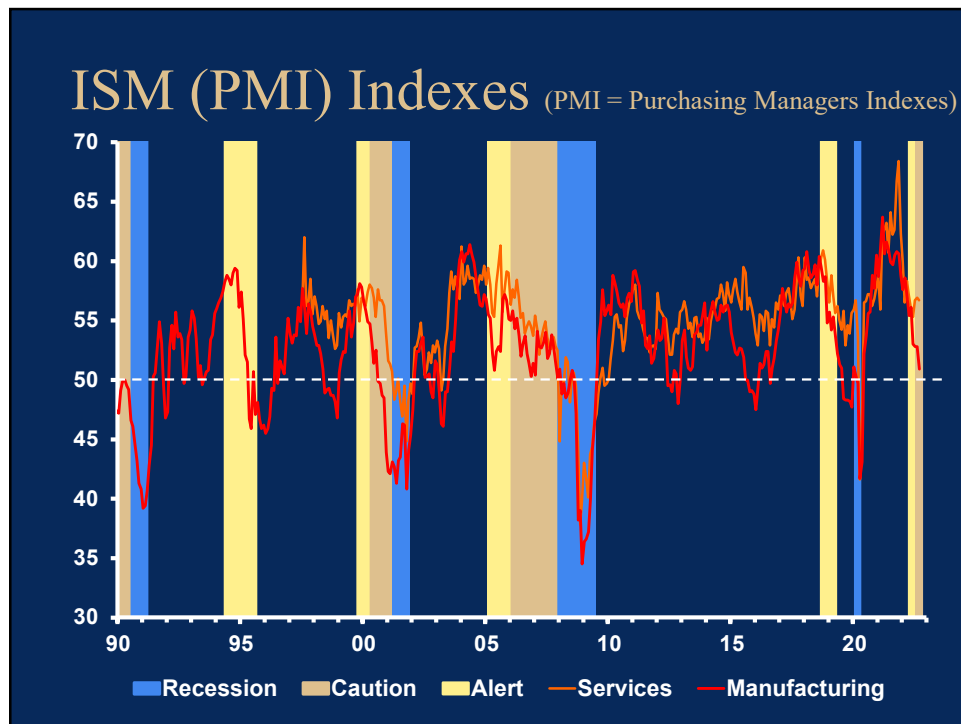
Actual and CBO's Full-Employment Estimate (Quarterly)



Initial Unemployment Claims and Zempel Zones ©

(Log Scale) (Monthly) (Thousands)







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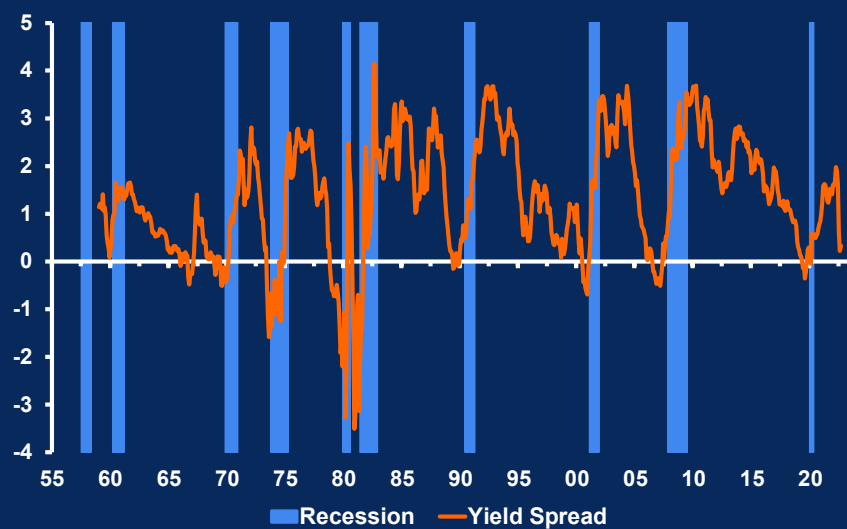
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Can Recession Be Averted? Limited?

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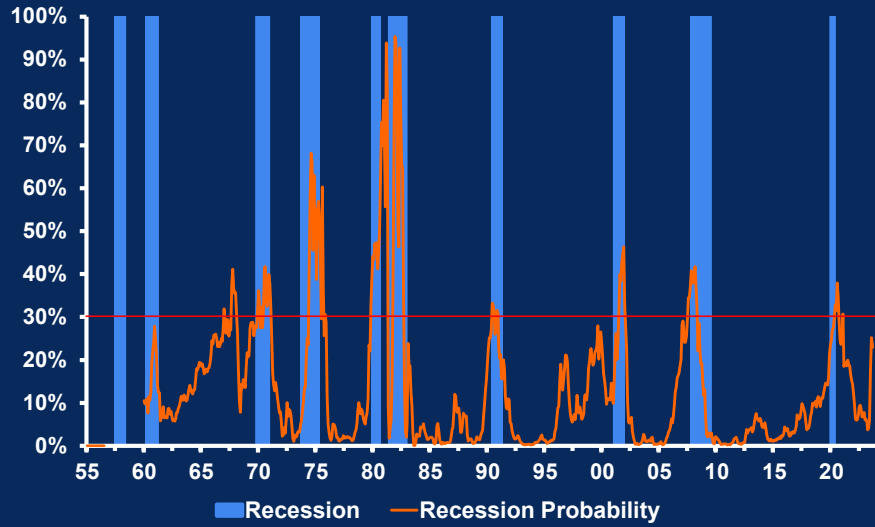
Yield Spread and Caution Zones ©

(10-Year T-Note Yield Minus 3-Month T-Bill Yield) (Percentage Points)

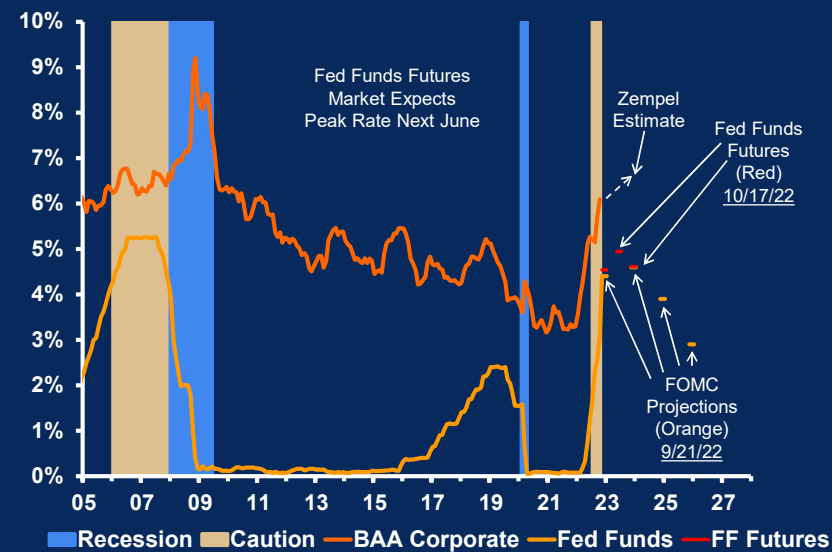


Year-Ahead Recession Probability

(Based on 10-Year T-Note Yield Minus 3-Month T-Bill Yield) (NY Fed)

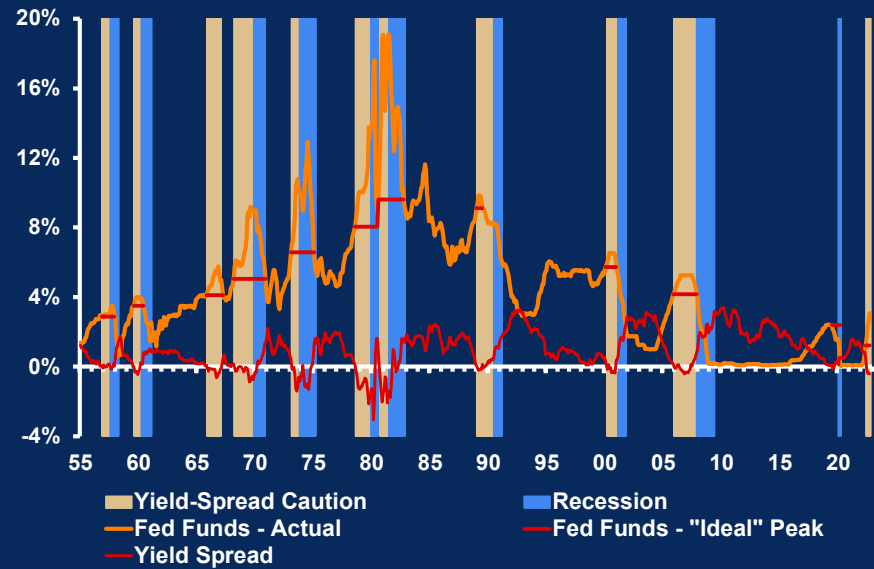


Interest Rate Prospects



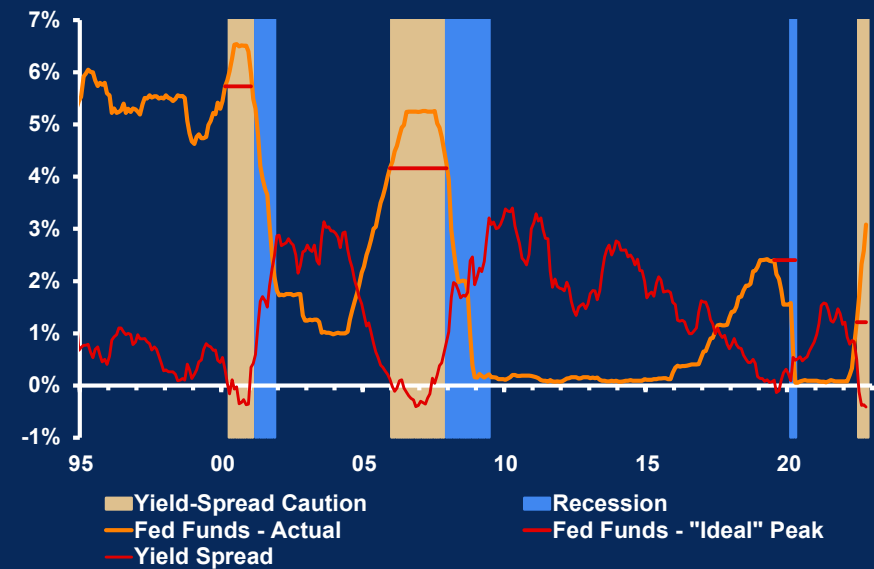
Fed Funds, Yield Spread and Caution Zones ©

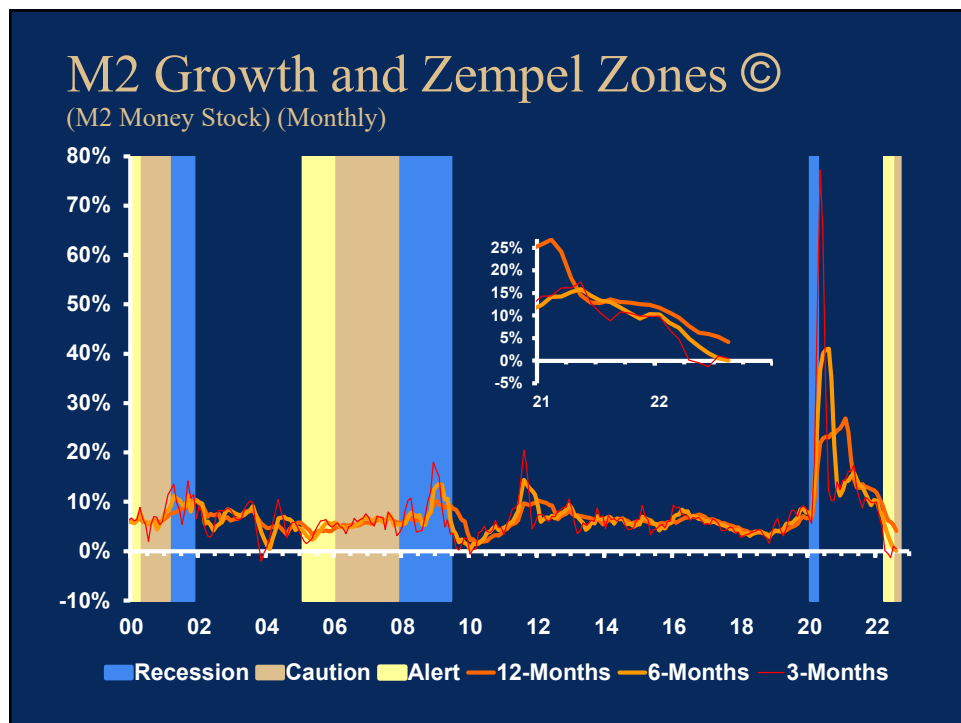
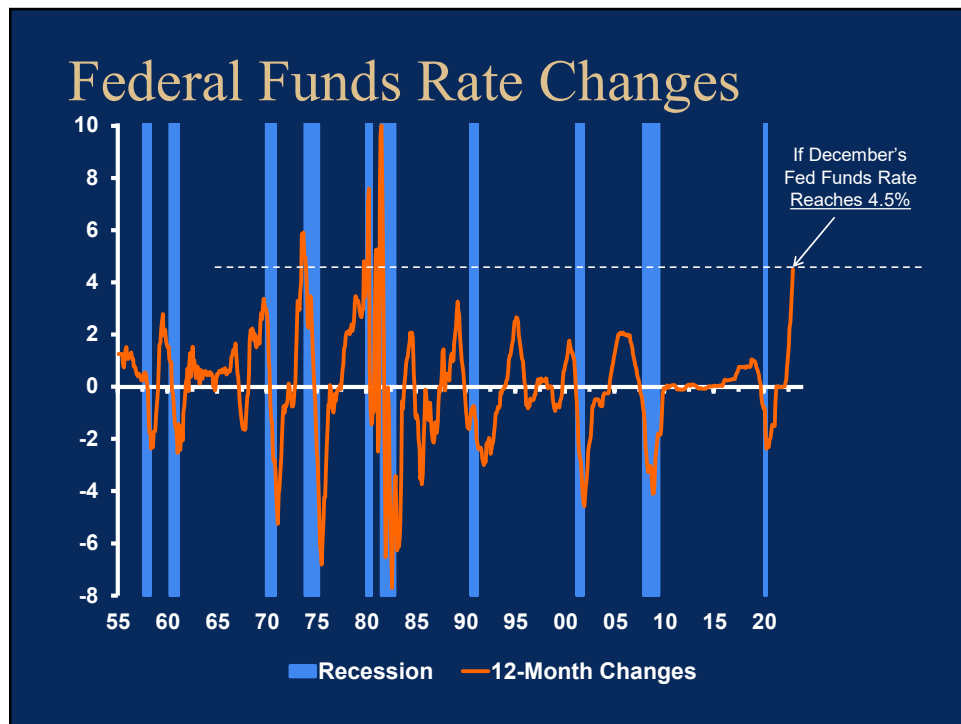
Ideal Fed Funds Limit = Level One Month Prior to Yield-Spread Inversion

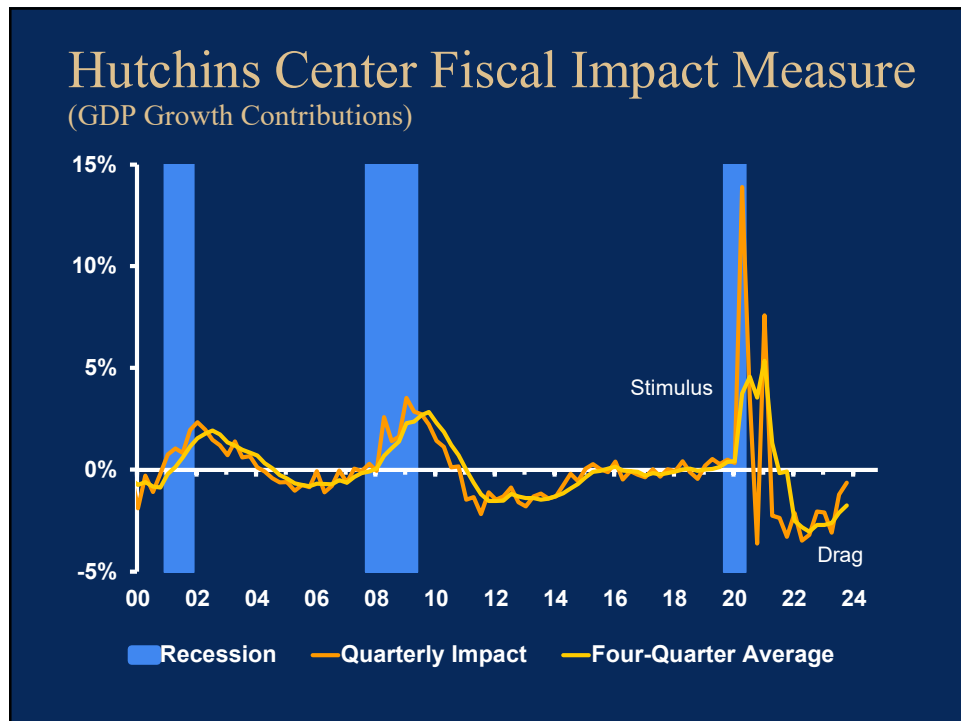
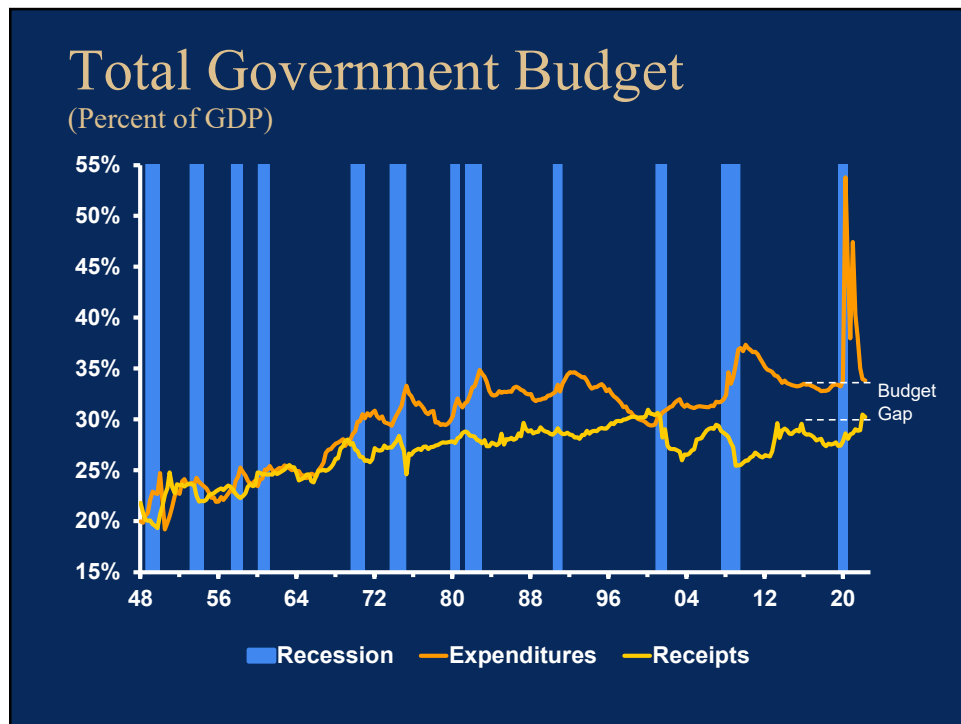


Fed Funds, Yield Spread and Caution Zones ©

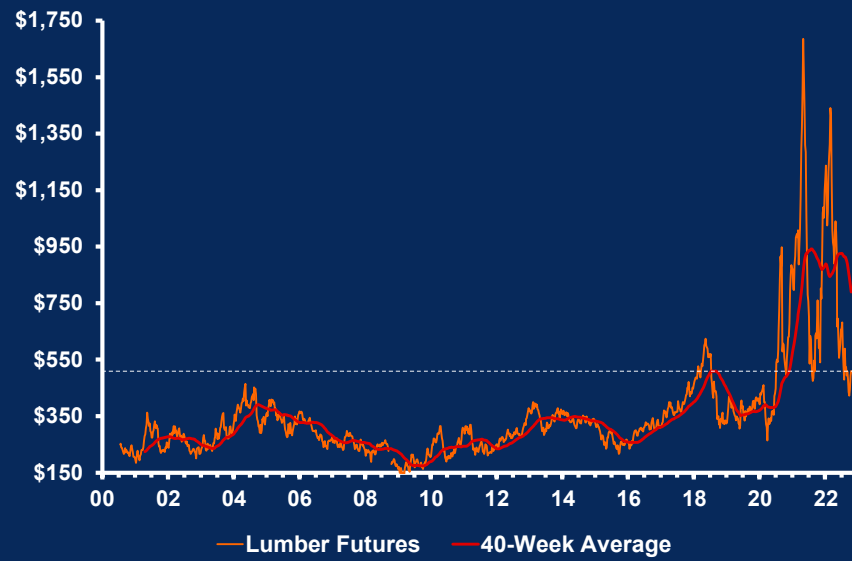
Ideal Fed Funds Limit = Level One Month Prior to Yield-Spread Inversion



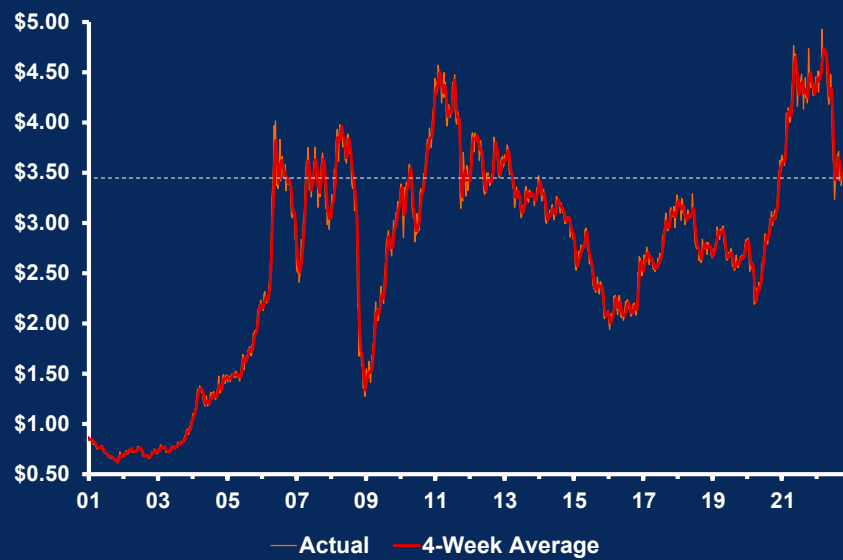


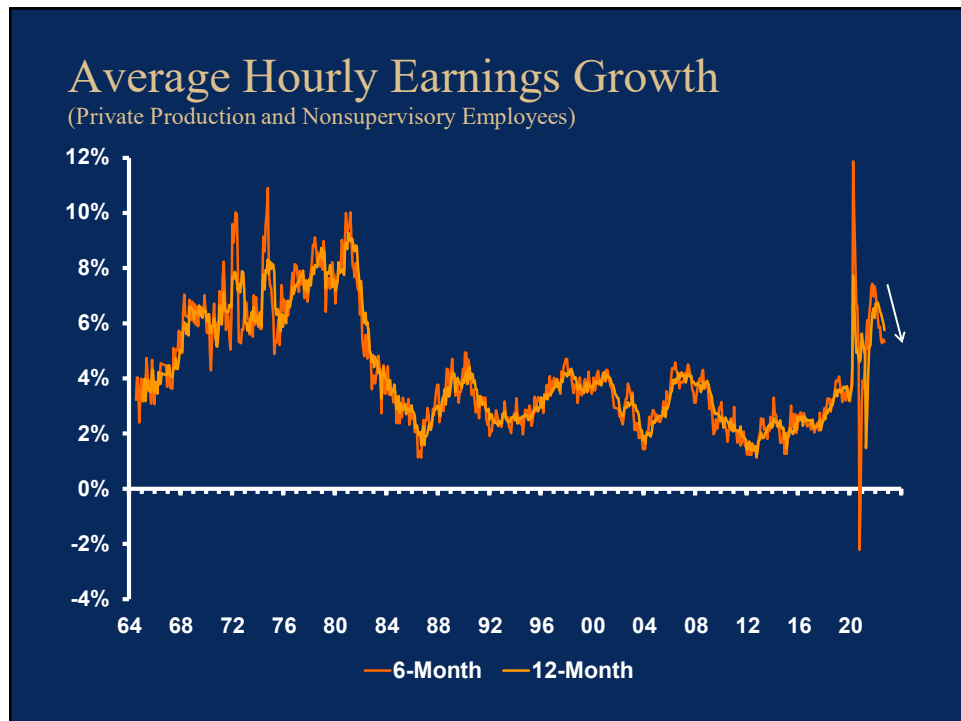
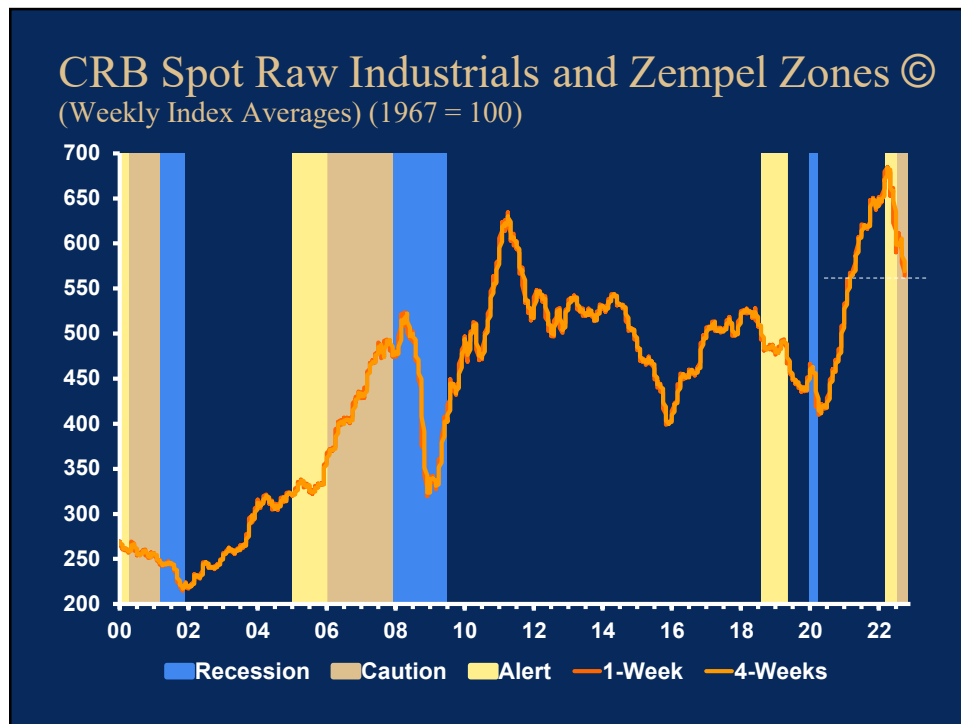


Lumber Futures (Random Lengths) (Weeks)



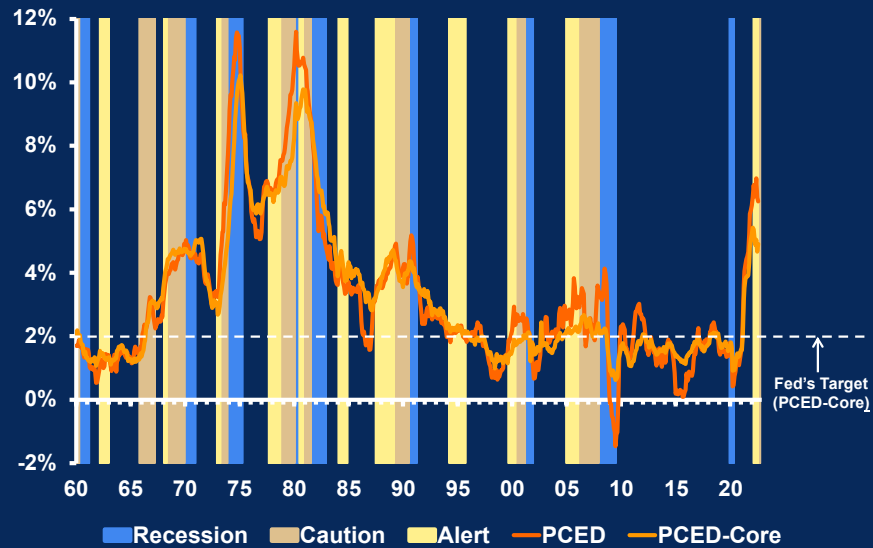
Copper Futures Price (Weekly)





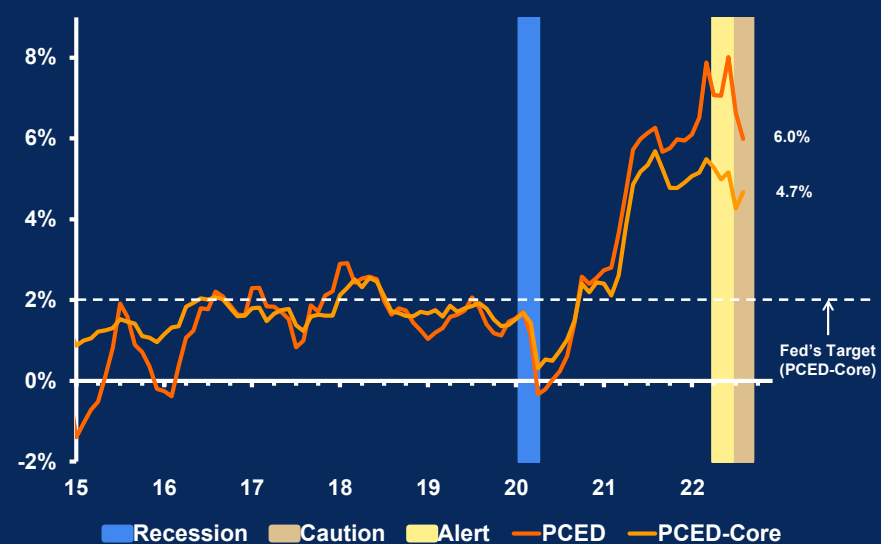
PCED Inflation and Zempel Zones ©

(PCED = Personal Consumption Expenditure Deflator) (12-Month Changes)



PCED Inflation and Zempel Zones ©

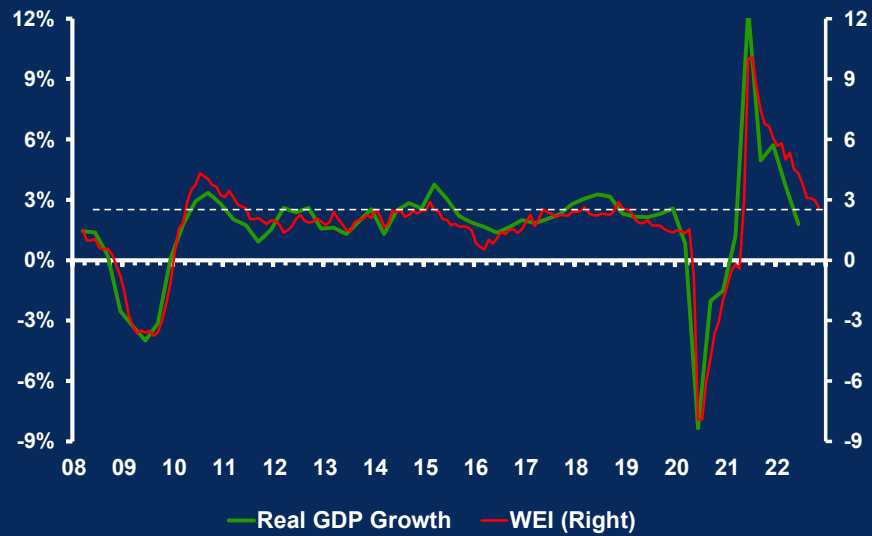
(PCED = Personal Consumption Expenditure Deflator) (6-Month Changes)



Real GDP Growth and WEI

(Real GDP's Four-quarter Growth Rate)

(WEI = NY Fed's Weekly Economic Index's Monthly Average)



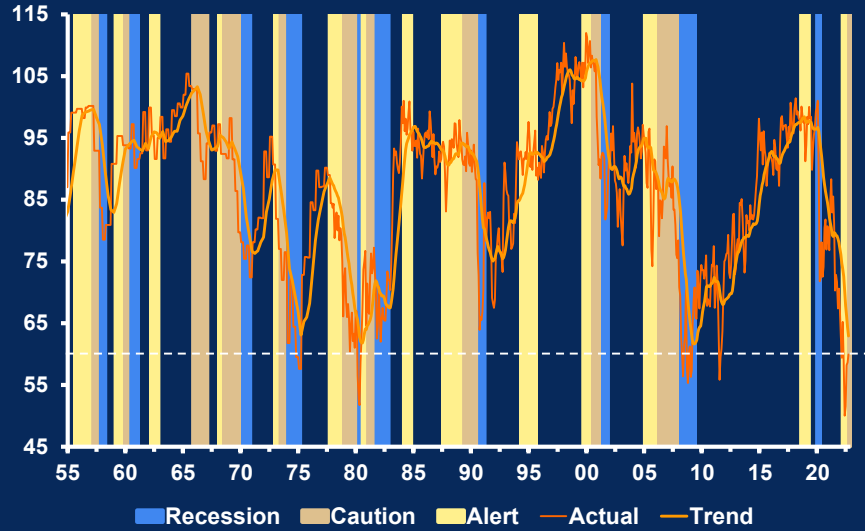
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How Will Sectors Perform?

Consumer Sentiment and Zempel Zones ©

(Consumer Sentiment Index) (University of Michigan) (Monthly)

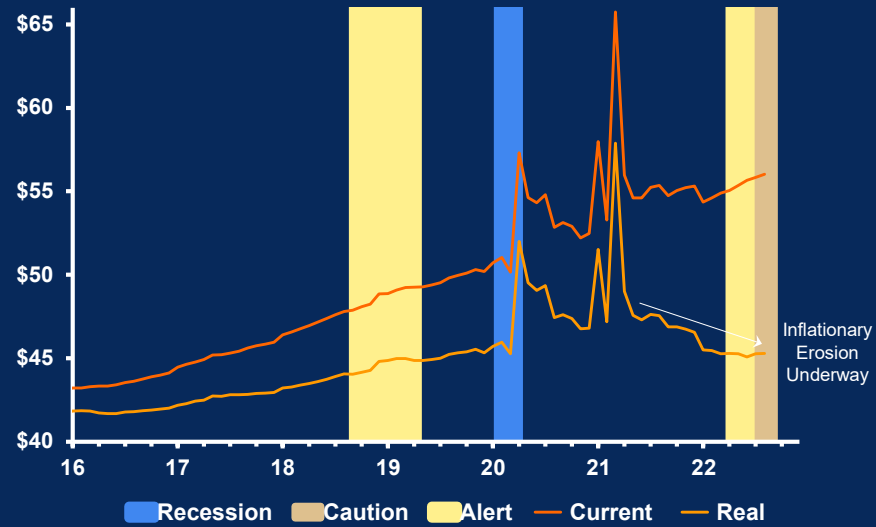


Consumer Sentiment and Zempel Zones ©

(Consumer Sentiment Index) (University of Michigan) (Monthly)

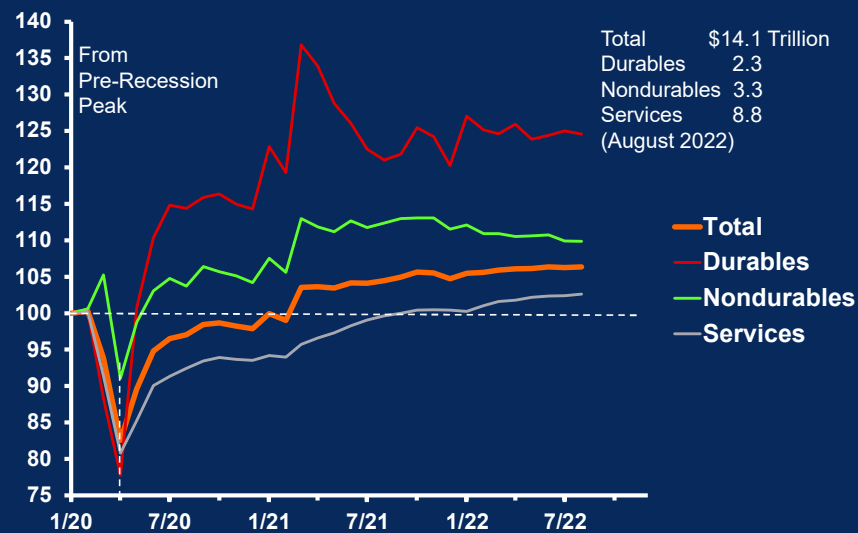


Disposable Personal Income and Zempel Zones © (Per Capita) (Thousand Dollars)



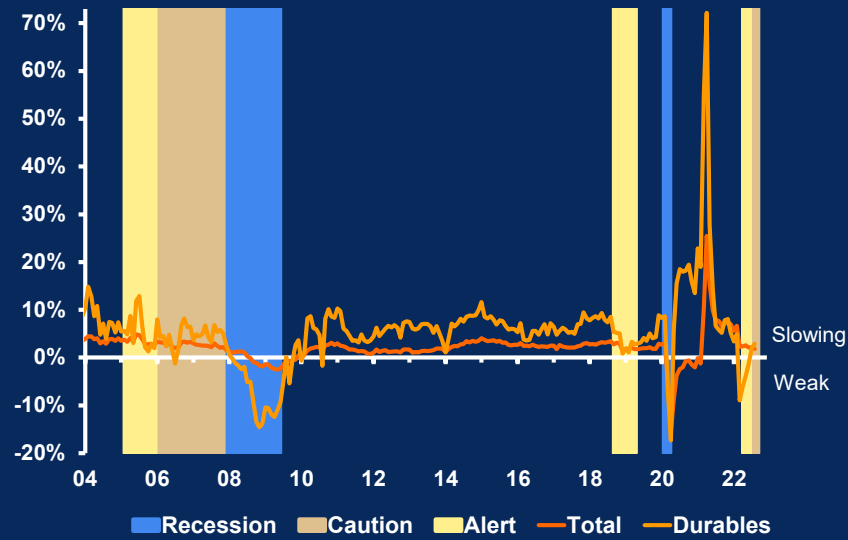
Real Personal Consumption Indexes

(January 2020 = 100)



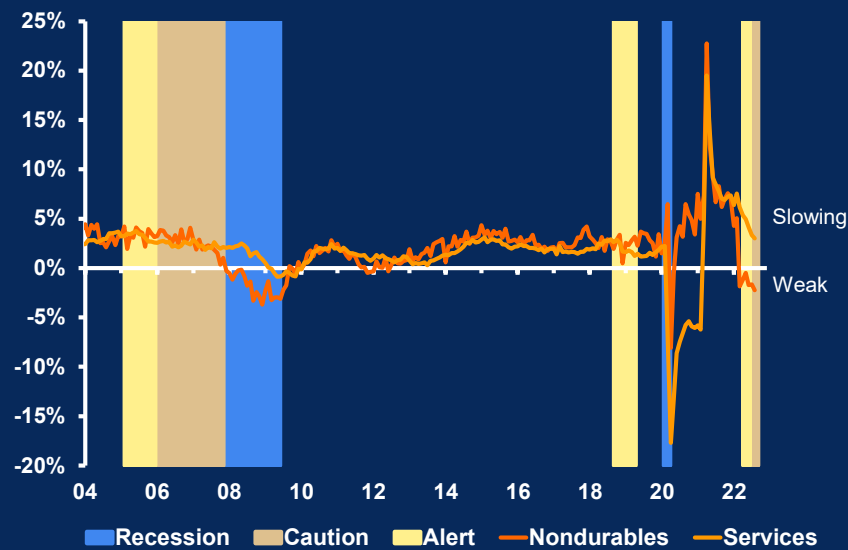
Real PCE and Zempel Zones ©

(PCE = Personal Consumption Expenditures) (12-Month Changes)



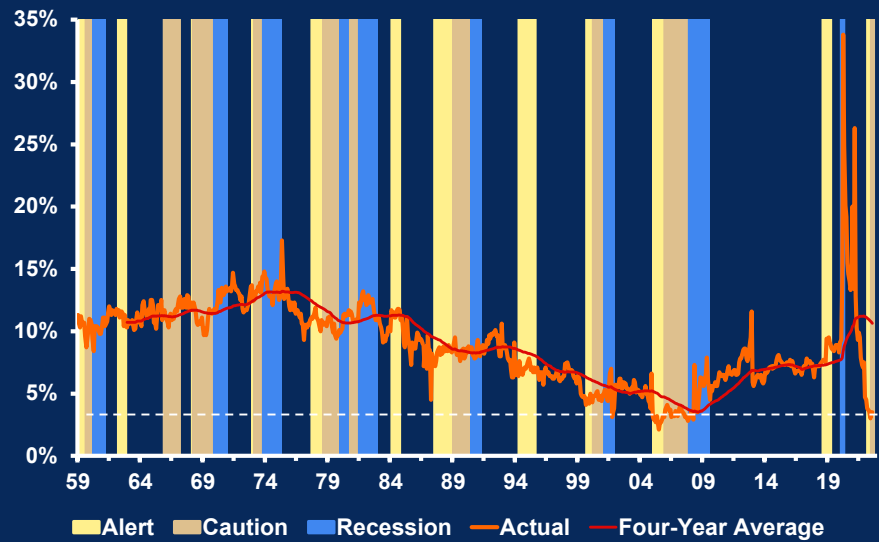
Real PCE and Zempel Zones ©

(PCE = Personal Consumption Expenditures) (12-Month Changes)



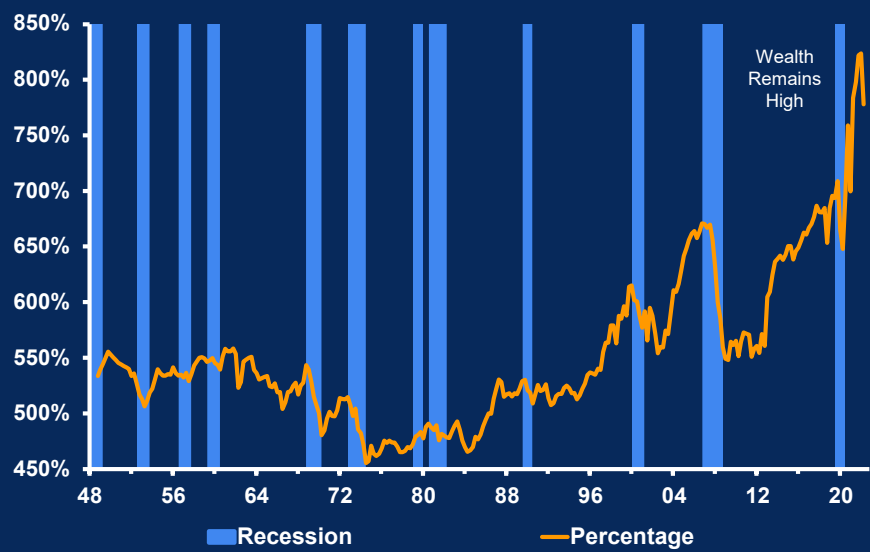
Personal Saving Rate and Zempel Zones ©

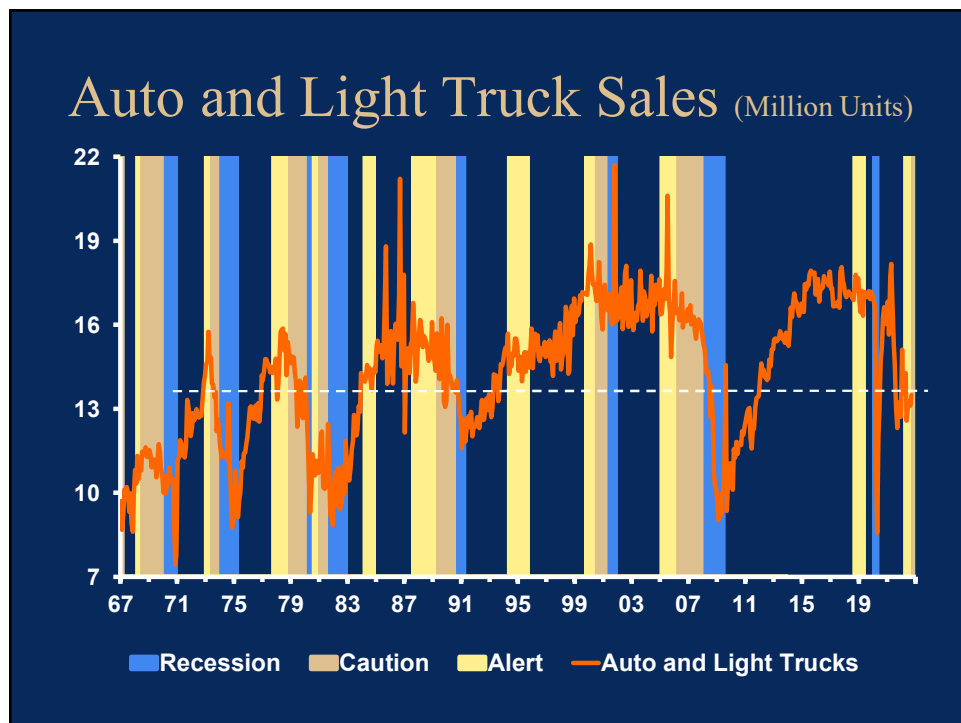
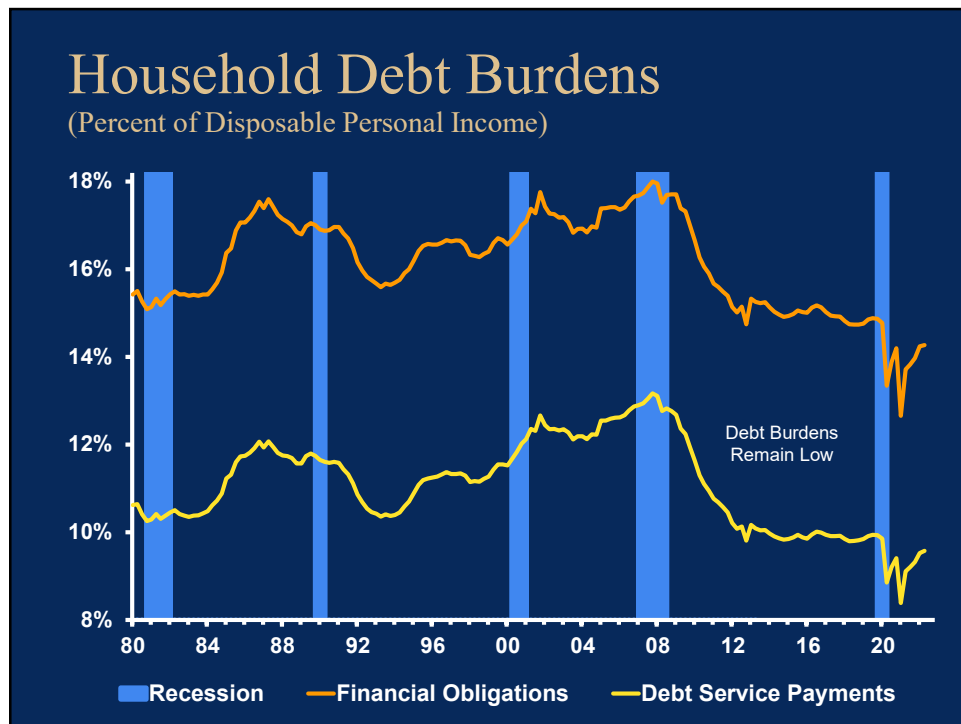
(Saving = Personal Income - Consumption)

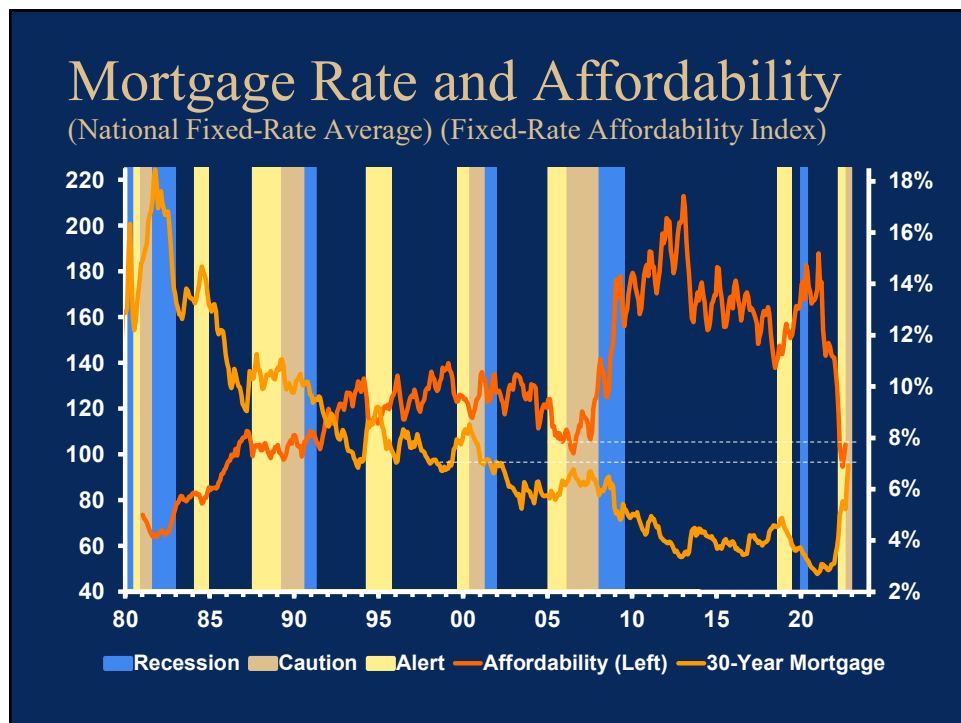
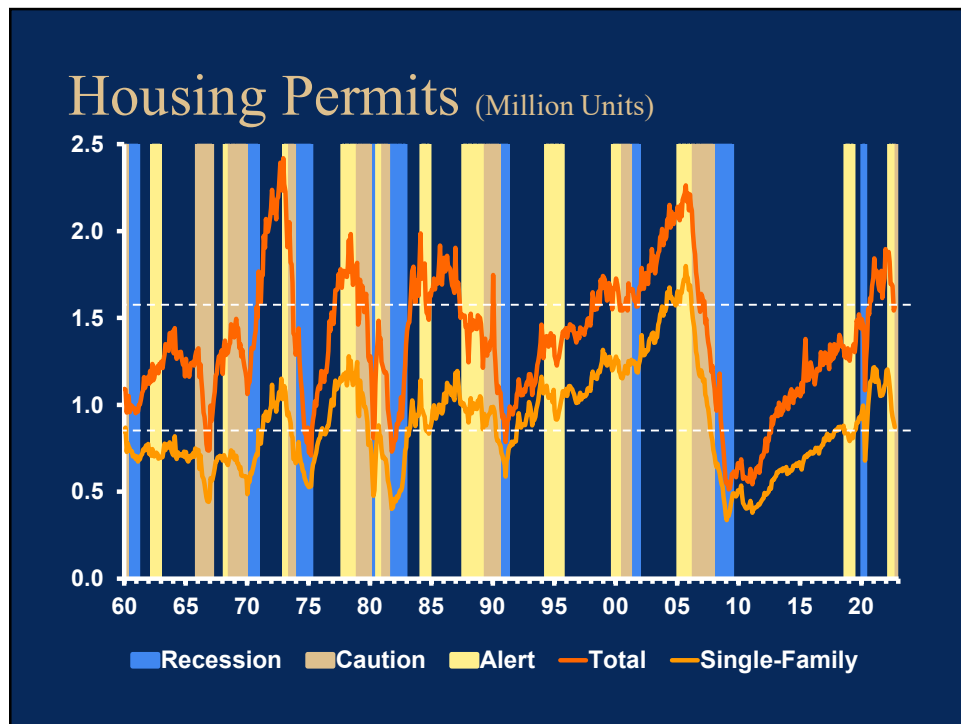


Net Worth (Percentage of DPI)

(Households and Nonprofit Organizations)

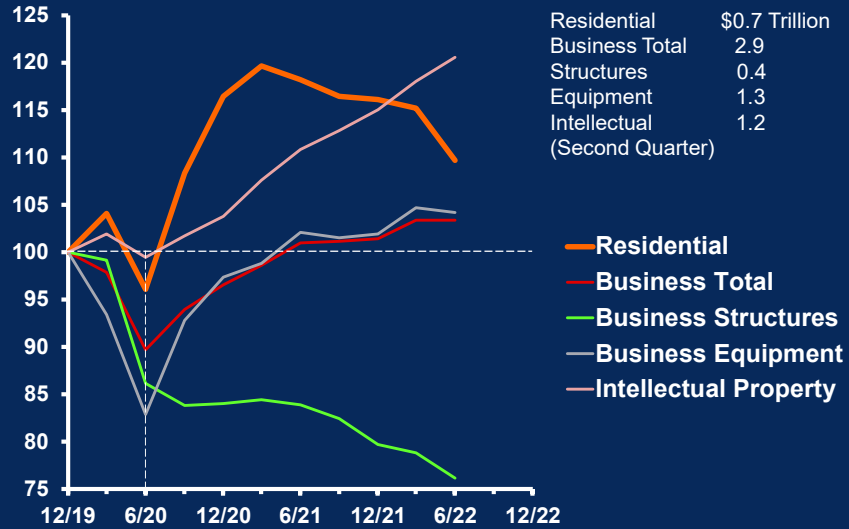






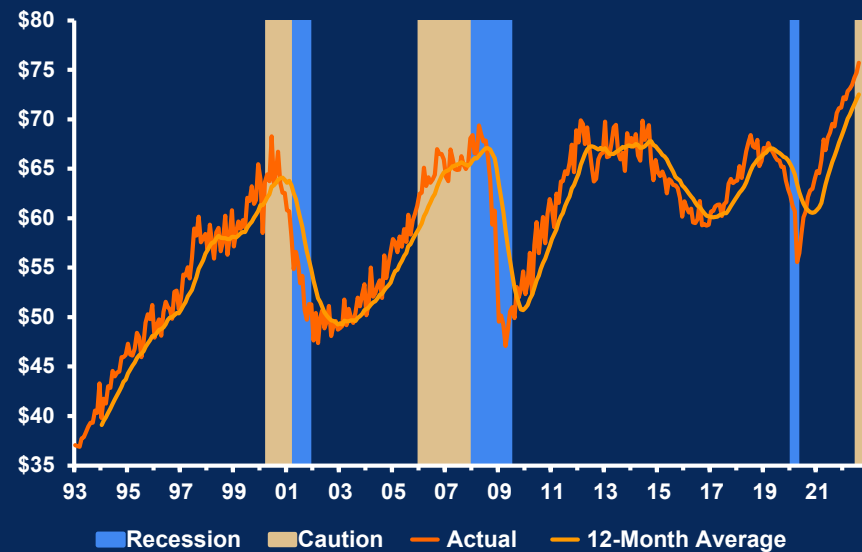
Real Investment Indexes

(Quarterly) (December 2019 = 100)



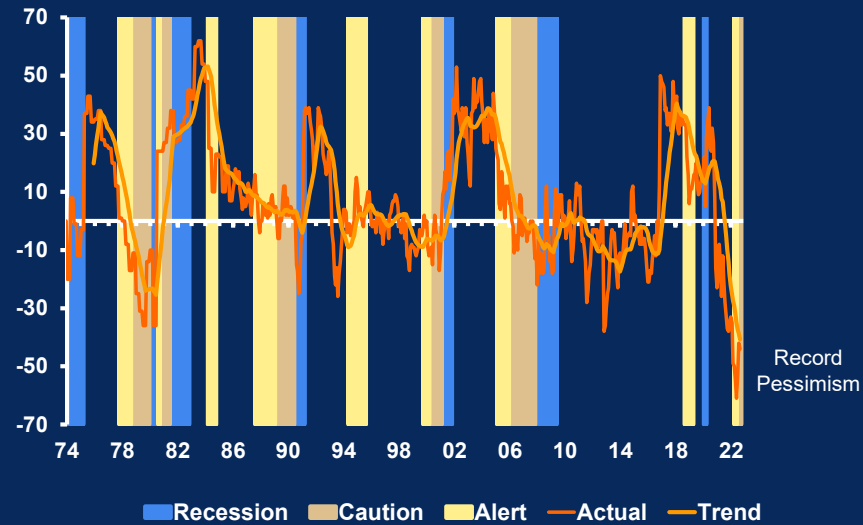
New Non-Defense Capital Goods Orders

Excluding Aircraft (Monthly) (Current Dollars) (Billions)



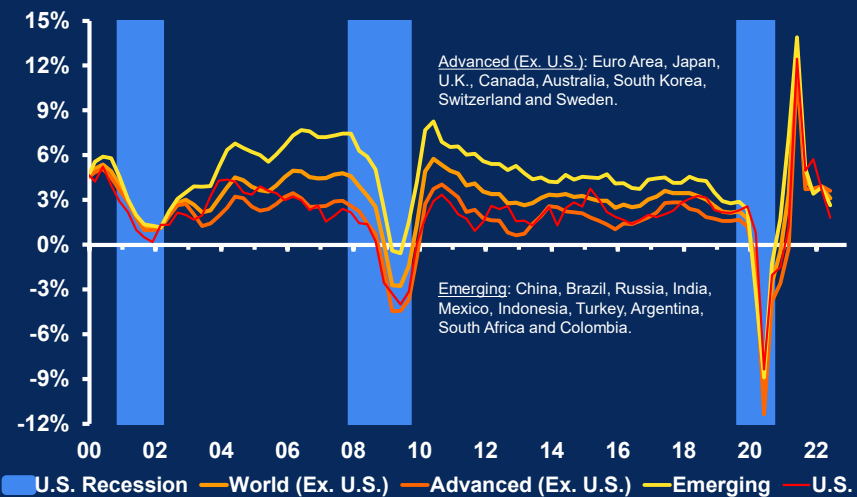
NFIB Outlook and Zempel Zones ©

(NFIB = National Federation of Independent Business) (Small Business Economic Trends)
(Net Percent "Better" Minus "Worse" Six Months from Now) (Monthly Since 1986)



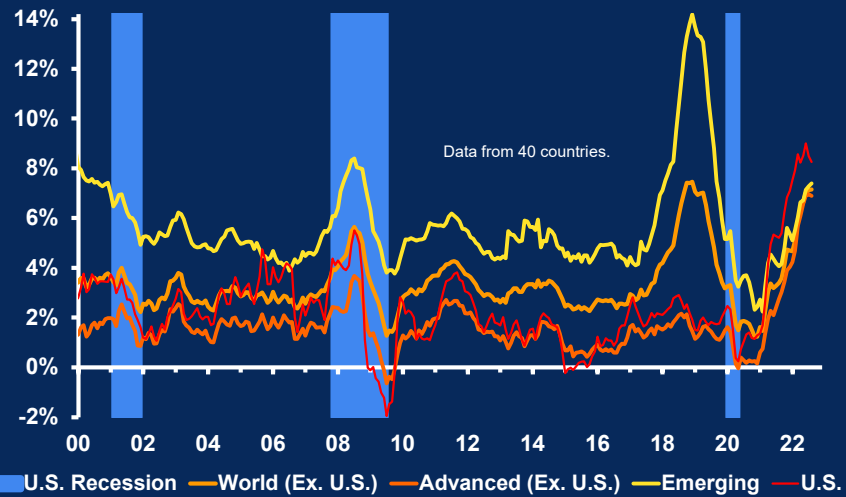
World Real GDP (Four-Quarter Growth Rates)

Dallas Fed's Globalization & Monetary Policy Institute



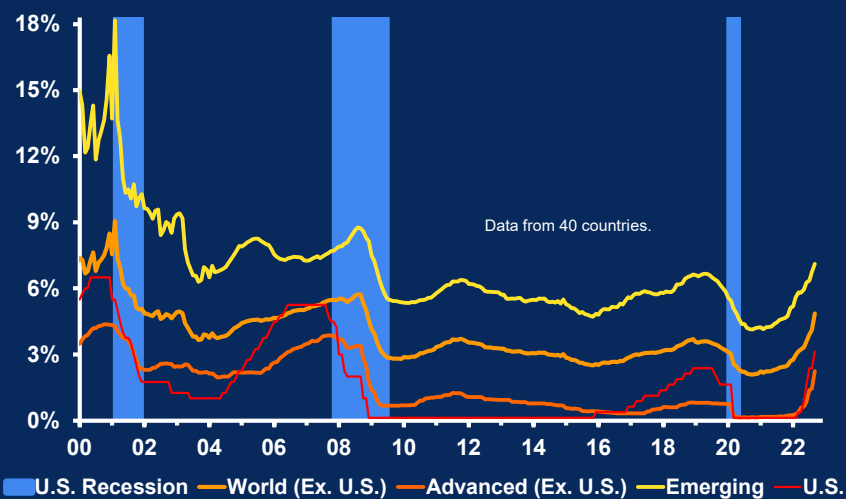
World Headline CPI Inflation Rates

Dallas Fed's Globalization & Monetary Policy Institute



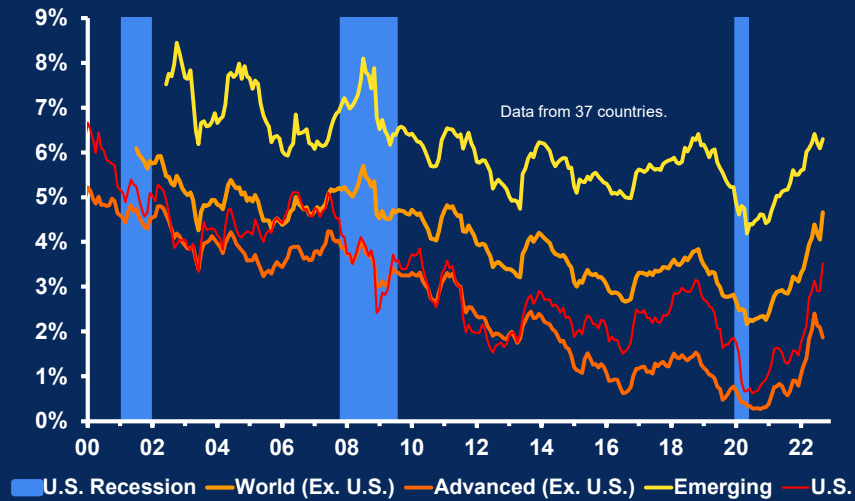
World Policy Short-Term Interest Rates

Dallas Fed's Globalization & Monetary Policy Institute



World Long-Term Interest Rates

Dallas Fed's Globalization & Monetary Policy Institute



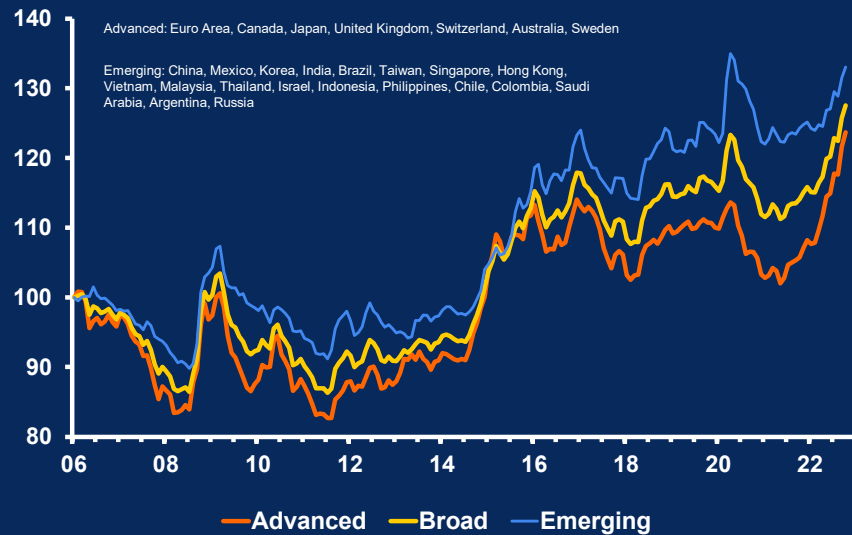
World Trade Volume Index

(CPB Netherlands Bureau for Economic Policy Analysis) (2010 = 100)

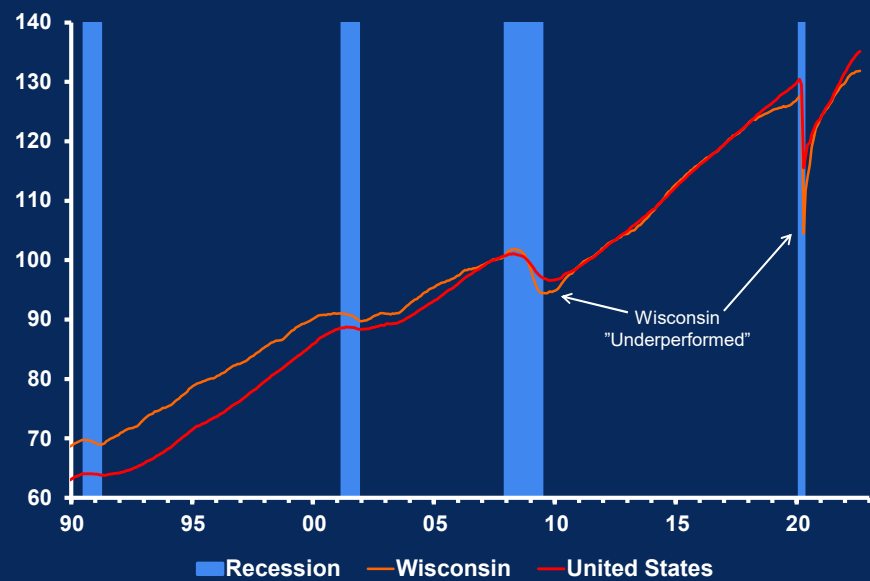


Dollar Exchange Rates

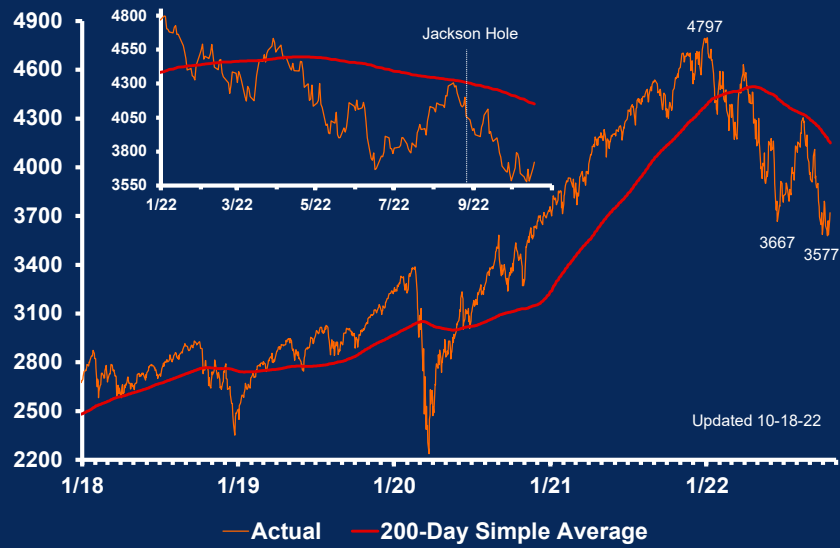
(Fed's New Trade-Weighted "Country" Indexes) (Monthly)



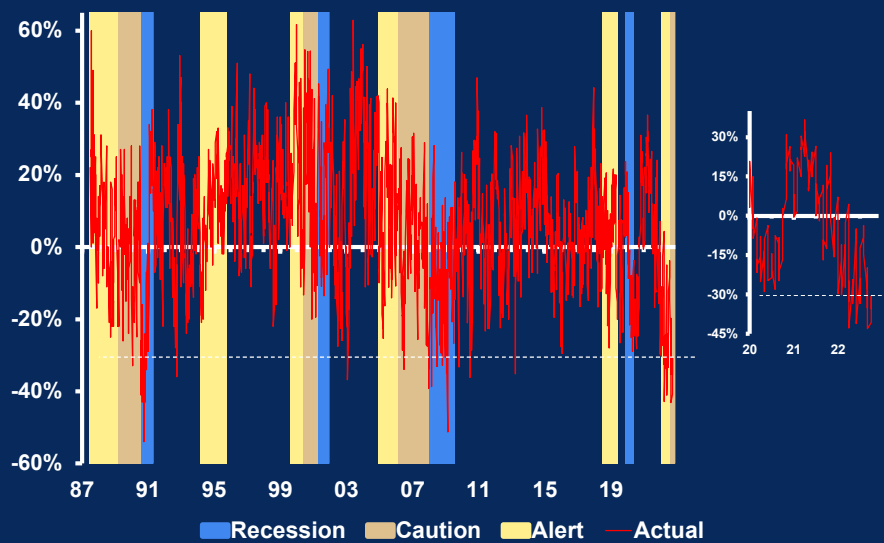
Coincident Economic Indexes (2007 = 100)

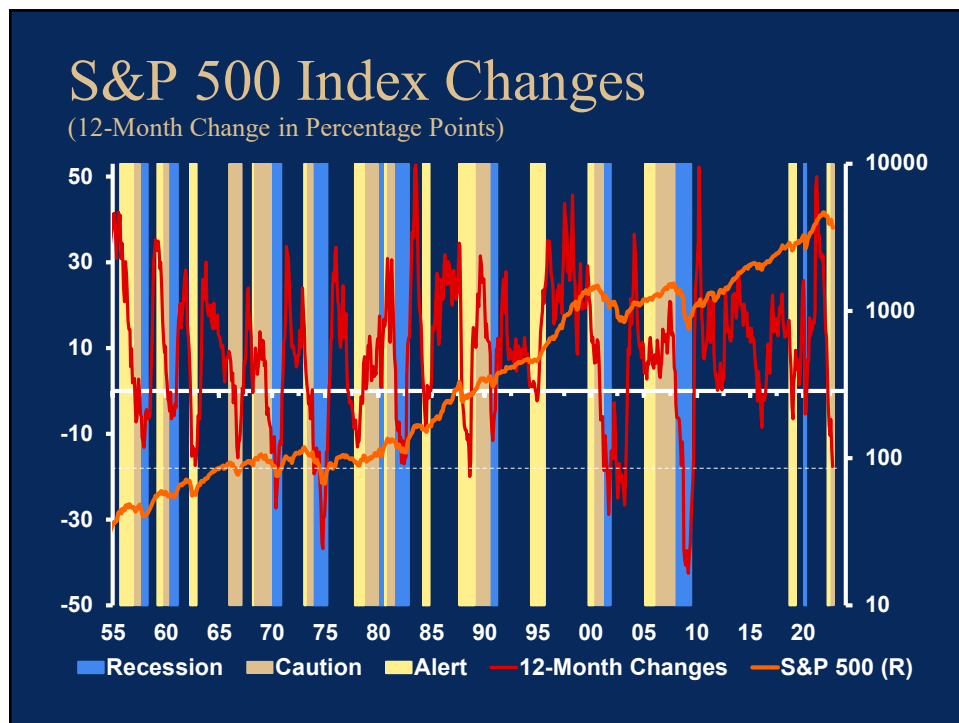
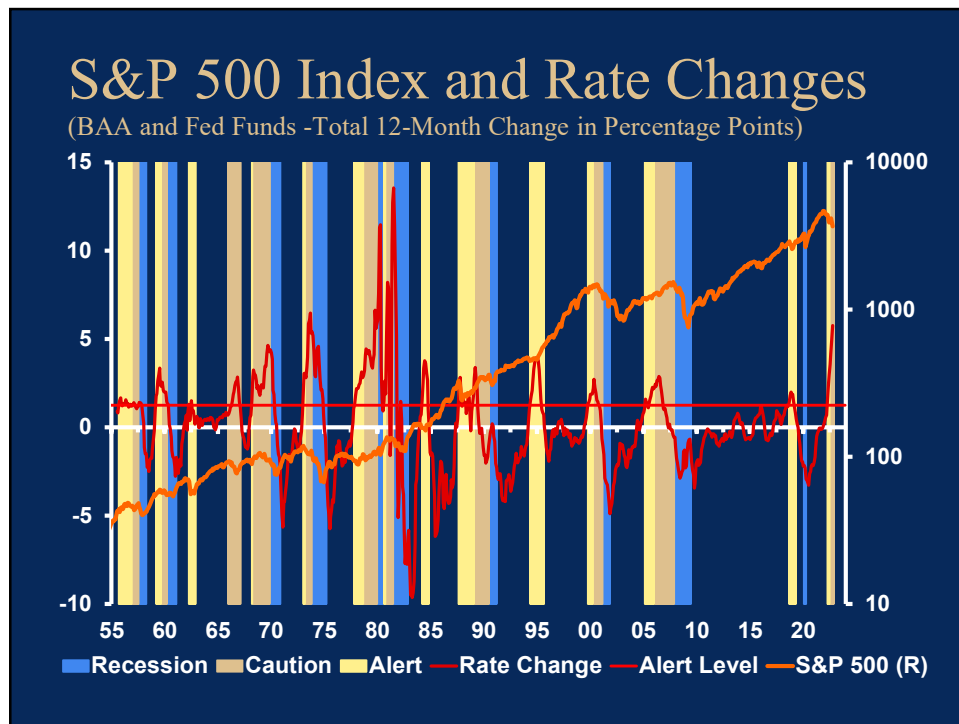


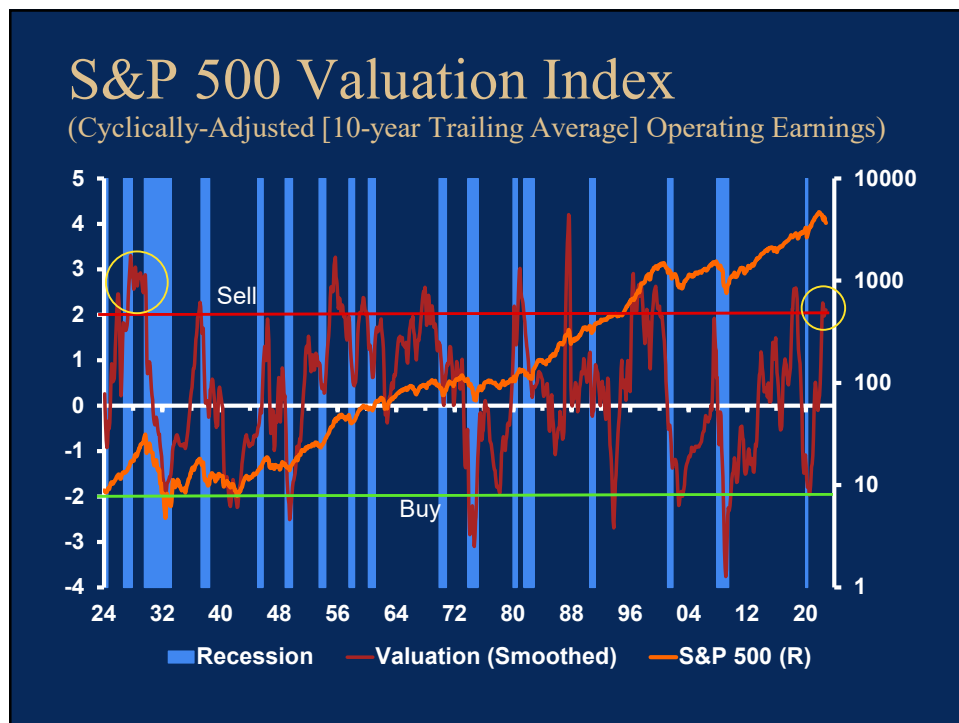
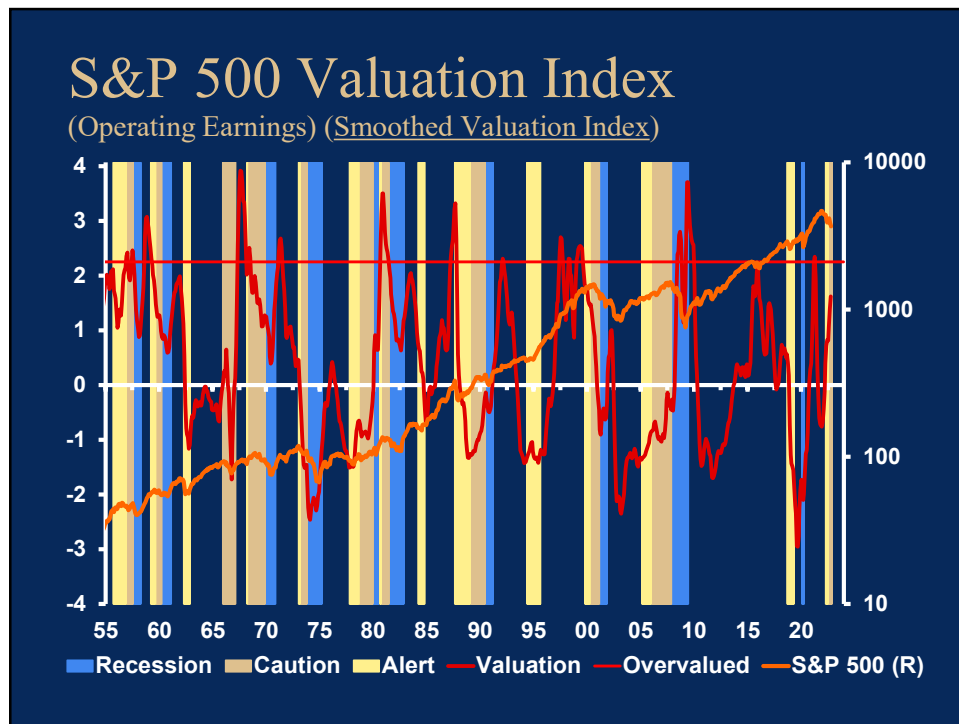
S&P 500 Common Stock Index (Days)



AAII Investor Sentiment and Zempel Zones © (Bull-Bear Spread) (Weekly)









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Questions...

Clare W. Zempel, CFA, CBE

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Applied Economics and Financial Market Analysis

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9:25 – 10:15 a.m.

Testing IT Controls in Today's Environment

Chris Semrow, CPA, CISA, *Senior Manager, BDO USA LLP*



TESTING IT CONTROLS IN TODAY'S ENVIRONMENT

November 16, 2022

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CS1

Session Agenda

- Introduction
- What are IT Controls? A Refresher
- Trends in Technology & IT Controls
- The Changing Landscape of Testing IT Controls
- Questions?



Introductions

Chris Semrow, CPA, CISA

csemrow@bdo.com

Senior Manager - BDO Digital



- ✓ 25+ Years of IT Audit & Assurance experience (Public & Private)
- ✓ 10+ Years IS/Business Consulting
- ✓ CPA & CISA Certificates
- ✓ Areas of Expertise:
 - ❖ IT Audit & IT Risk Assessments
 - ❖ ISO & Privacy
 - ❖ SOX / MAR Reporting
 - ❖ SOC Reporting (SOC 1, SOC 2)
 - ❖ Lean/Six Sigma, Business Process Improvement
 - ❖ Cybersecurity Assessments
 - ❖ Disaster Recovery / Business Continuity Process

IT Controls - A Refresher



IT Controls - A Refresher

IT General Controls (ITGCs) are the basic controls that can be applied to IT systems and infrastructure such as:

- Applications
- Operating Systems
- Databases
- IT Infrastructure (Servers, workstations, firewalls, etc)

Objective of ITGCs is to ensure the integrity of the data and processes that these systems and areas support.

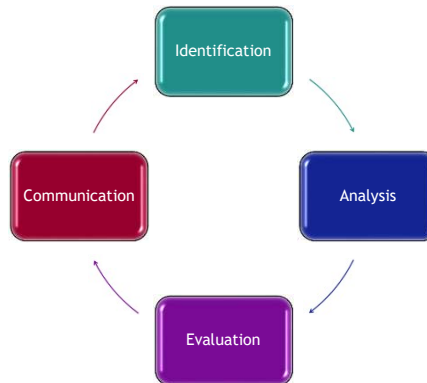
ITGCs are routinely examined by external audit firms and if these controls aren't sufficient, it could have disastrous results on your financial reporting or security controls (SOX audits)

IT Controls - A Refresher



IT Controls - A Refresher

First step: IT Risk Assessment



* Audits are performed with a focus on risk; specifically identifying potential risk, threats and vulnerabilities to IT operations, integrity of data, internal controls, automated controls and application controls are key objectives.

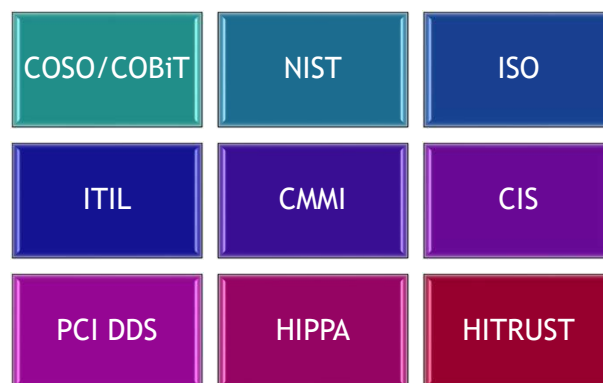
7

Testing IT Controls in Today's Environment



IT Controls - A Refresher

IT General Controls are based on a framework:



There are many frameworks for organizations to leverage and utilize in their IT controls structure. None are more "correct" than any other; the organization decides which is appropriate for their environment.

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Testing IT Controls in Today's Environment



Trends in Technology & IT Controls



9

Testing IT Controls in Today's Environment



Trends in Technology & IT Controls

Emerging Technologies:

Robotic Process Automation (RPA)	Enterprise Metaverse
Artificial Intelligence (AI)	Cloud-Native Platforms
Machine Learning Code Generation	Virtual & Augmented Reality
Data Analytics	Cybersecurity
Cryptocurrency & Bitcoin	Quantum Computing



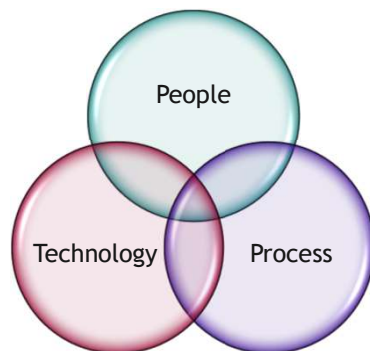
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Testing IT Controls in Today's Environment



Trends in Technology & IT Controls

Golden Triangle:



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Testing IT Controls in Today's Environment



Trends in Technology & IT Controls

Challenges for businesses today:

- Technology & Process:
 - Corraling the emerging technologies to work for an organization
 - No longer the “It will take jobs away...” mentality
 - Automation is critical to being successful in today’s environment
 - New technologies:
 - “How can we use those advanced technologies to handle the high volume, high transaction work that we have in our workflows and processes?”
- People:
 - Staffing shortages
 - Hybrid workforce
 - Becomes necessary to embrace technology as a solution

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Testing IT Controls in Today's Environment



Trends in IT Controls & IT Testing/Audit

Trends in IT Controls & IT Testing/Audit:

Cybersecurity domains, while not emerging, still represent a strong foundational area for review (more emphasis):	ITGC's and automated process controls are part of the core audit plan:	Data Privacy continues to be a prominent, high-risk area for organizations (given the rise in regulatory compliance and the evolution of the cloud):
<ul style="list-style-type: none"> Threat & Vulnerability Management assessments Identity & Access Management design and implementation IT Asset Management audits Network Configuration & Hardening review Remote, Wireless and Mobile security assessment IT Operational risk assessment 	<ul style="list-style-type: none"> Backup & Recovery effectiveness Segregation of Duties assessment IT Change Management effectiveness Continuous controls monitoring 	<ul style="list-style-type: none"> Data Governance assessment Privacy Regulation compliance Cloud Strategy & Governance Cloud Migration assessments

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Testing IT Controls in Today's Environment



Trends in IT Controls & IT Testing/Audit

- Data Analytics
- Compliance Landscape
- Understanding the Cloud & “_aaS” Model
- What's a SOC Report?
- Cyber, Cyber Cyber

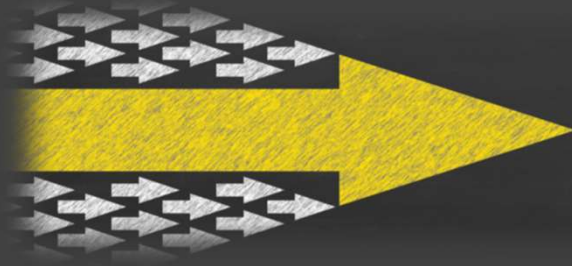


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Testing IT Controls in Today's Environment



- The Changing Landscape of Testing IT Controls



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Testing IT Controls in Today's Environment



The Changing Landscape of Testing IT Controls

Where Do We Test in 2022 & Beyond?

How Do We Test in 2022 & Beyond?

What Do We Test in 2022 & Beyond?



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Testing IT Controls in Today's Environment



Where Do We Test in 2022 & Beyond - People & Process

- Prior to 2020 vs Post 2020 - **VAST DIFFERENCE**
 - Location, Location, Location
- Pivot to a Remote Model
 - Stay-at-Home workforce
 - Flexibility to work non-traditional hours (Flex Time)
- Challenges from this:
 - How to manage this “New” workforce
 - Productivity - What’s going to happen?
 - Efficiency & Effectiveness of conducting work
 - Technical expertise & infrastructure to support
 - Mental well being of the workforce



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Testing IT Controls in Today's Environment



How Do We Test in 2022 and Beyond - People

- With a focus on Remote & Mobility:
 - Planning & Project Management
 - Effective and well practiced project management, processes and technology capabilities
 - Use the cloud
 - Be more agile
 - Emphasize Time management
 - Rely on Data Analytics
 - Enable the Future of Work
 - Digital Transformation
 - Revisit the Tools of the Trade
 - Data Strategy
 - Shift from Centralized to De-Centralized Mind Set
 - The Human Side
 - Respect & Promote the Work/Life Balance
 - Focus on Communication
 - Leadership Matters



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Testing IT Controls in Today's Environment



How Do We Test in 2022 and Beyond - Technology

Robotic Process Automation (RPA)

- A rules-based software application programmed to automate activities
- Best used with repetitive tasks that interact with multiple applications
 - Tasks occur with significant frequency with a significant effort
- Replicates human interactions with technology, mimicking common tasks
- Contributes to both cost and hours savings



How Do We Test in 2022 and Beyond - Technology

Examples of RPA:

- Configured to identify & respond to potential fraud situations (e.g. money laundering)
- Help detect suspicious logs associated IT Systems
- SOD Testing (user access testing) can automated through RPA.
- RPA can be used to perform reconciliations of data between systems
- RPA can assist with entire audit populations rather than sampling

Key Considerations for RPA:

- Testing strategies should consider data quality, upstream/downstream dependencies on systems & humans
- Governance structure needs to consider scaling and risk control management of automation
- With RPA, comes a shift in an organization's culture, working practices and overall structure
- Potential non-technical personnel develop RPA creates a need for more governance over this

How Do We Test in 2022 and Beyond - Technology



Data Analytics

- Involves analyzing complete sets of data to identifying anomalies and trends for further investigation
- Allows for a deeper understanding of an organization's data
- Many organizations are reevaluating processes and procedures to make better use of their data
- Used in many organizations in continuous auditing and monitoring of data to identify risks and anomalies

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Testing IT Controls in Today's Environment



How Do We Test in 2022 and Beyond - Technology

Advantages of Data Analytics

- Can be used to conduct better advanced planning, identifying problem areas early
- Can yield higher-quality audit evidence, using more data than audit sampling
- More likely to uncover a variety of anomalies that can provide management with more relevant results

Disadvantages of Data Analytics

- Use of Data Analytics can be restricted by using inaccessible or inaccurate data
 - Or data that cannot be converted into a format to be useful
- Requires a new set of competencies in which personnel may not have the training or experience
- Cost involved in tools to conduct Data Analytics

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Testing IT Controls in Today's Environment



What Do We Test in 2022 and Beyond



Areas of Focus:

- Cybersecurity
 - Network Controls (Firewall, VPN, Vulnerability Management, DLP, etc)
 - Mobile Computing & Handheld Devices
- Cloud
 - Ever-Changing Landscape (Hybrid, Multi-Cloud, XaaS)
 - Cloud Native Applications & Edge Computing

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Testing IT Controls in Today's Environment



What do we Test in 2022 and Beyond



Areas of Focus:

- Compliance
 - Cyber Resilience
 - Ever-Changing Landscape of Compliance (US and Abroad)
 - US - State legislation
 - Abroad - Russia, China, etc.
- Vendor / Third Party Suppliers
 - Automation & Digitalization - big focus “need to have”
 - Data Analytics is a game changer
 - Cloud & Mobility

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Testing IT Controls in Today's Environment





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Testing IT Controls in Today's Environment



Thank You!

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Testing IT Controls in Today's Environment

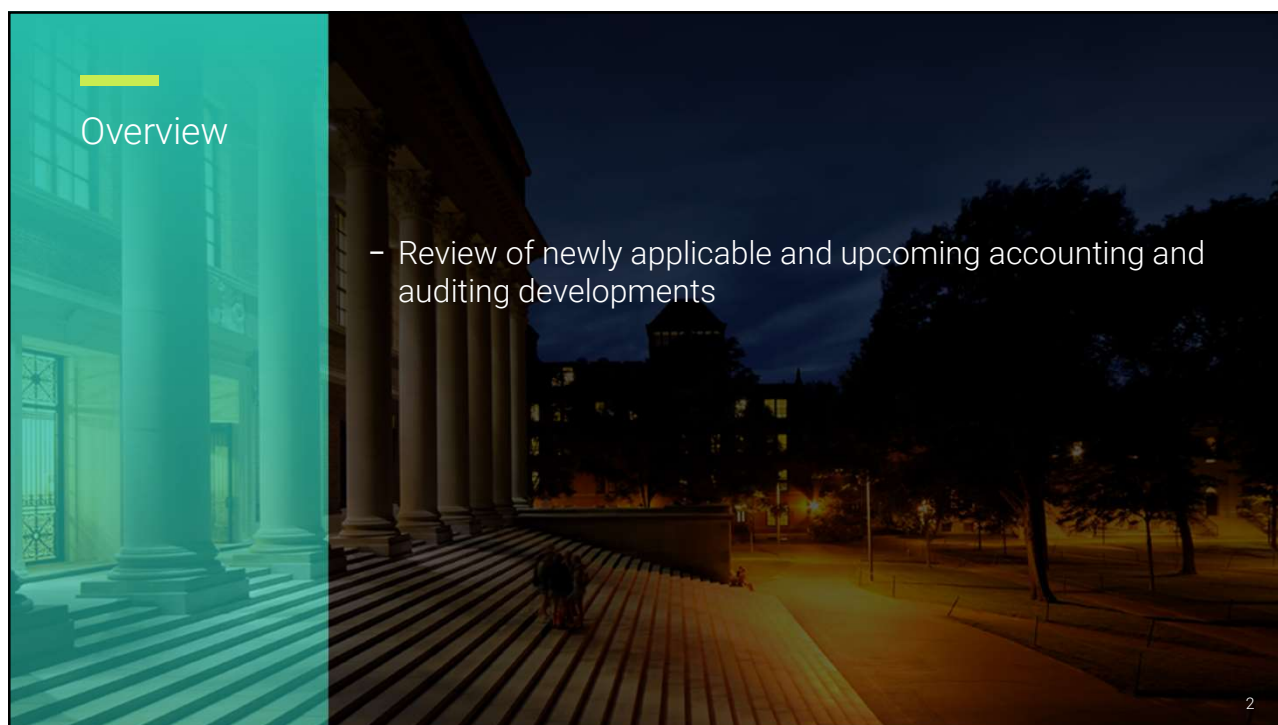


10:30 – 11:20 a.m.

GASB & FASB Update

Anthony Cervini, CPA, CFE, *Partner-in-Charge, Sikich LLP*

Ryan Lay, CPA, *Partner, Baker Tilly*



Presenter

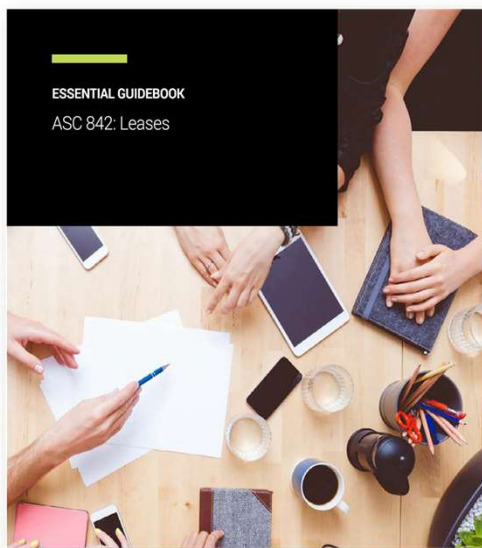


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Accounting and auditing developments



- Audit opinion revisions
- Derivatives and hedging
- Retirement benefits
- Contributed nonfinancial assets
- Reference rate reform
- Leases
- Measurement of credit losses on financial instruments
- Intangibles – goodwill and other
- 2022 issued standards

Major revisions: Audit opinion

Most significant changes

- 1 Moving the opinion to the first part of the report
- 2 Adding more titles
- 3 Disclosing management's and the auditor's responsibility for going concern issues
- 4 Introducing key audit matters (KAM)
- 5 Expanding the disclosure of auditor responsibilities.

Major changes are detailed in the following AU-C sections

- AU-C 700—Forming an Opinion and Reporting on Financial Statements
- AU-C 701—Communicating Key Audit Matters in the Independent Auditor's Report
- AU-C 705—Modifications to the Opinion in the Independent Auditor's Report
- AU-C 706—Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report

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Major revisions: Audit opinion



Exhibit Example of New Report Form Independent Auditor's Report	
[Appropriate Addressee]	
Opinion We have audited the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20X1, and the related statement of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements. In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.	
Basis for Opinion We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.	
Emphasis of Matter As discussed in Note X to the financial statements, subsequent to the date of the financial statements, there was a fire in ABC Company's production facilities. Our opinion is not modified with respect to this matter.	
Key Audit Matters Key audit matters are those matters that were communicated with those charged with governance and, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. [Description of each key audit matter in accordance with AU-C 701]	
Other Matter The financial statements of ABC Company for the year ended December 31, 20X0, were audited by another auditor, who expressed an unmodified opinion on those statements on March 31, 20X1.	

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Major revisions: Audit opinion

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error. In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [insert the time period set by the applicable financial reporting framework].

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users made on the basis of these financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the audit.

[Signature of the auditor's firm]
[City and state where the auditor's report is issued]
[Date of the auditor's report]

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Accounting and auditing developments

ASU No. 2017-12, *Derivatives and Hedging (Topic 815): Target Improvements to Accounting for Hedging Activities*

- 1 Alignment of risk management activities and financial reporting
- 2 Risk component hedging
- 3 Accounting for the hedged item in fair value hedges of interest rate risk
- 4 Recognition and presentation of the effects of hedging instruments
- 5 Amounts excluded from the assessment of hedge effectiveness
- 6 Other simplifications of hedge accounting guidance

- Objective is to improve the financial reporting of hedging relationships to better portray the economic results of an entity's risk management activities in its financial statements
- Makes certain targeted improvements to simplify the application of the hedge accounting guidance in current GAAP

Effective date: Nonpublic companies will be required for reporting periods beginning after Dec. 15, 2020 (calendar 2021, fiscal year 2022).

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Accounting and auditing developments

ASU No. 2018-14, *Compensation-Retirement Benefits-Defined Benefit Plans – General* (Subtopic 715-20):

Disclosure Framework – Changes to the Disclosure Requirements for Defined Benefit Plans

Removes current required disclosures	Requires additional disclosures
<ul style="list-style-type: none"> Amount and timing of plan assets expected to be returned to employer Reconciliation of opening to closing balances of plan assets in Level 3 (include disclosure of transfers into and out of Level 3 and purchases of Level 3 assets) 	<ul style="list-style-type: none"> Weighted average interest crediting rates for cash balance plans and other plans with promised interest crediting rates Explanation of reasons for significant gains and losses related to changes in the benefit obligation
Clarifies disclosure requirements	
<ul style="list-style-type: none"> Projected benefit obligation and fair value of plan assets for PBOs > plan assets Accumulated benefit obligation and fair value of plan assets for ABOs > plan assets 	



Effective date: Fiscal years ending after Dec. 15, 2021 (calendar 2021, fiscal year 2022).

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Accounting and auditing developments

ASU No. 2020-07, *Not-for-Profit Entities* (Topic 958)

Presentation and Disclosures by Not-for-Profit Entities for Contributed Nonfinancial Assets

Statement of activities
Requires a separate line item for contributed nonfinancial assets
Footnotes
Requires disclosure of the following for contributed nonfinancial assets recognized in the period <ul style="list-style-type: none"> Disaggregation by category Whether the assets were monetized or utilized Organization's policy for monetizing rather than utilizing the assets Associated donor-imposed restrictions, if any Valuation techniques and inputs used to arrive at fair value



Effective for annual periods beginning after June 15, 2021 (fiscal & calendar year 2022).

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Accounting and auditing developments

ASU No. 2020-04, Reference Rate Reform (Topic 848):
Facilitation of the Effects of Reference Rate Reform on Financial Reporting



- Allows organization's optional expedients and exceptions for applying generally accepted accounting principles to contracts, hedging relationships, and other transactions affected by reference rate reform if certain criteria are met
 - Contract modifications
 - Excluded components
 - Fair value hedges
 - Cash flow hedges
- Only applicable if agreements reference LIBOR or another reference rate expected to be discontinued

Effective for all entities as of Mar. 12, 2020, through Dec. 31, 2022. There is currently a proposed standard to extend the sunset date to December 31, 2023.

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Accounting and auditing developments

ASU No. 2016-02, Leases (Topic 842)



Goal is to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the statement of financial position.



The ASU will require a lessee to recognize in the statement of financial position a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term.

Effective date: Nonpublic companies will be required to apply the standard for fiscal years beginning after Dec. 15, 2021 (calendar year 2022, fiscal year 2023).

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Accounting and auditing developments

ASU No. 2016-02, Leases (Topic 842):

Considerations:

- Leases for no or de minimis consideration are not subject to the guidance in Topic 842
 - Subject to the contributions received guidance in Subtopic 958-605, *Not-for-Profit Entities – Revenue Recognition*
 - Also subject to the presentation and disclosure guidance in ASU 2020-07
- Leases for below-market consideration
 - For example, lease of office space for 50% of rent paid by other tenants for the same square footages
 - NFPs may need to consider both Topic 842 and the inherent contribution guidance under Subtopic 958-605

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Accounting and auditing developments

ASU No. 2016-02, Leases (Topic 842):

Lessee Model – Initial Measurement:

- Lease liability (obligation to make the lease payments)
 - Measured at the present value of the future minimum lease payments
- Right-of-use asset
 - Lease liability + initial 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 & NFPs may elect to use the risk-free rate rather than its borrowing rate (and can use both by class of underlying asset)
 - Rate as of the implementation date for the remaining lease term (no need to go back in time)

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Accounting and auditing developments

ASU No. 2016-02, Leases (Topic 842):

Lessee Model – Subsequent Accounting:

- Finance lease
 - Unwind liability using effective interest method
 - Front-loaded expense pattern similar to capital leases under ASC 840 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)
 - For leases with escalating lease payments, lessee recognizes only rent expense on straight-line basis. Difference in asset amortization & liability is cumulative difference of payments & expense

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Accounting and auditing developments

ASU No. 2016-02, Leases (Topic 842)

Lease Disclosures

Qualitative

- Nature of leases
- Leases that have not yet commenced but create significant rights and obligations for the lessee
- Significant assumptions and judgments made in application
- Main terms and conditions of any sale and leaseback transactions
- Whether accounting policy election was made for short-term lease exemption

Quantitative

- Finance lease expense, segregated between amortization and interest
- Operating, short-term lease, variable lease costs
- Sublease income
- Gains and losses arising from sale and leaseback transactions
- Lease payment maturity analysis (similar to that in Topic 840 disclosures)
- Separately for operating and finance leases:
 - Cash paid for amounts in lease liabilities, segregated between operating and financing
 - Lease liabilities arising from obtaining ROU assets
 - Weighted-average remaining lease term
 - Weighted-average discount rate for leases

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Accounting and auditing developments

ASU No. 2016-13, *Financial Instruments-Credit Losses Topic (326): Measurement of Credit Losses on Financial Instruments*



- Significant shift in the way credit losses are recorded – requires entities to estimate and record credit losses expected over the contractual life of an asset or liability on day one
- Goal is to improve financial statement users' access to more timely information about credit losses
- Standard does not prescribe one method for estimating expected losses but does provide examples so entities can decide what makes sense for their organization
- Dollar impact after adoption will be recorded through a cumulative effect adjustment to net assets
- Main financial instruments affected: loans, receivables, and financial guarantees

Nonpublic companies will be required to apply the standard for annual periods beginning after Dec. 15, 2022 (calendar year 2023, fiscal year 2024). Early adoption is permitted.

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Accounting and auditing developments

ASU No. 2016-13, *Financial Instruments-Credit Losses Topic (326): Measurement of Credit Losses on Financial Instruments*

CECL adoption considerations



CECL implementation

- CECL training
- Gap analysis
- Data stratification
- Model selection and validation
- Parallel runs
- Governance, compliance, and risk restructuring
- Internal controls testing



CECL outsourced modeling

- Staffing augmentation
- Fully outsourced modeling
- Model back testing



CECL model validation

- Review of processes, documentation, and policies
- Partial or full replication of CECL model
- Back-testing of estimates
- Stress-testing and sensitivity analyses



Data analytics and model risk management

- Leveraging data collected for models to inform broader business processes and decision making
- Loan portfolio analytics
 - Stress testing and scenario analysis
 - Capital adequacy analysis
 - Data quality

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Accounting and auditing developments

ASU No. 2017-04, *Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment*



Simplifies the subsequent measurement of goodwill

- Eliminates step #2 of the goodwill impairment test
- Annual (or interim) goodwill impairment test still required
 - Compare the fair value of the reporting unit with the carrying amount
 - Impairment charge if carrying value exceeds fair value of the reporting units
- Eliminates the requirement for qualitative assessment and step #2 calculation for zero or negative carrying value items

Effective date: Fiscal years beginning after Dec. 15, 2022 (calendar year 2023, fiscal year 2024).

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Accounting and auditing developments

2022 Issued Standards

- ASU No. 2022-01 – *Derivatives and Hedging (Topic 815): Fair Value Hedging – Portfolio Layer Method*
 - Allow multiple hedged layers to be designated for a single closed portfolio of financial assets
 - Effective date: Fiscal years beginning after December 15, 2023 (calendar year 2024, fiscal year 2025). Early adoption is permitted.
- ASU No. 2022-02 – *Financial Instruments – Credit Losses (Topic 326): Troubled Debt Restructurings and Vintage Disclosures*
 - Eliminate accounting guidance for Troubled Debt Restructurings by creditors in Subtopic 310-40 while enhancing disclosure requirements for certain loan refinancings and restructurings
 - For public business entities, required to disclose current period gross write-offs by year of origination for financing receivables and net investments in leases
 - Effective date: Fiscal years beginning after December 15, 2022 (calendar year 2023, fiscal year 2024). Early adoption is permitted.

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Accounting and auditing developments

2022 Issued Standards

- ASU No. 2022-03 – *Fair Value Measurement (Topic 820): Fair Value Measurement of Equity Securities Subject to Contractual Sale Restrictions*
 - Clarify contractual restriction on sale of an equity security is not considered in measuring fair value
 - Effective date: Fiscal years beginning after December 15, 2024 (calendar year 2025, fiscal year 2026). Early adoption is permitted.
- ASU No. 2022-04 – *Liabilities – Supplier Finance Programs (Subtopic 405-50): Disclosure of Supplier Finance Program Obligations*
 - Require buyer in supplier finance program disclose sufficient information about the program to allow a user of the financial statements to understand the program's nature, activity during the period, changes from period to period, and potential magnitude
 - Effective date: Fiscal years beginning after December 15, 2022 (calendar year 2023, fiscal year 2024), except for the amendment for rollforward information, which is effective for fiscal years beginning after December 15, 2023 (calendar year 2024, fiscal year 2025). Early adoption is permitted.

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Let's connect.



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