ACCOUNTING UPDATE

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Mike Cheng joined Frazier & Deeter in 2019 as the Partner who oversees the firm's professional practices related to accounting and audit. As part of this role, he specializes in assisting clients with complex accounting and financial reporting issues.

Prior to joining the firm, Mike was a Senior Project Manager at the Financial Accounting Standards Board (FASB). At the FASB, he served as the Private Company Council (PCC) coordinator, where he was responsible for all PCC related matters. In addition, Mike led projects to simplify the accounting for non-employee share-based payments, help shape the future of the FASB technical agenda and improve consolidations guidance (VIE guidance). Most recently, he worked on the FASB's implementation team on revenue recognition (ASC Topic 606) and lease accounting (ASC Topic 842).

Prior to joining the FASB, Mike held various management positions with PricewaterhouseCoopers. He was an Audit Senior Manager, Private Company Services, in the firm's Stamford, CT office. From 2003-2011, he also held roles of increasing responsibility in PwC's Core Assurance divisions in Buffalo and Rochester, NY.

Agenda?

Supplier Finance Arrangements (ASU 2022-04)

Leases

- Lease Term, Leasehold Improvements & Leases under Common Control
- Accounting Owner and Start date?

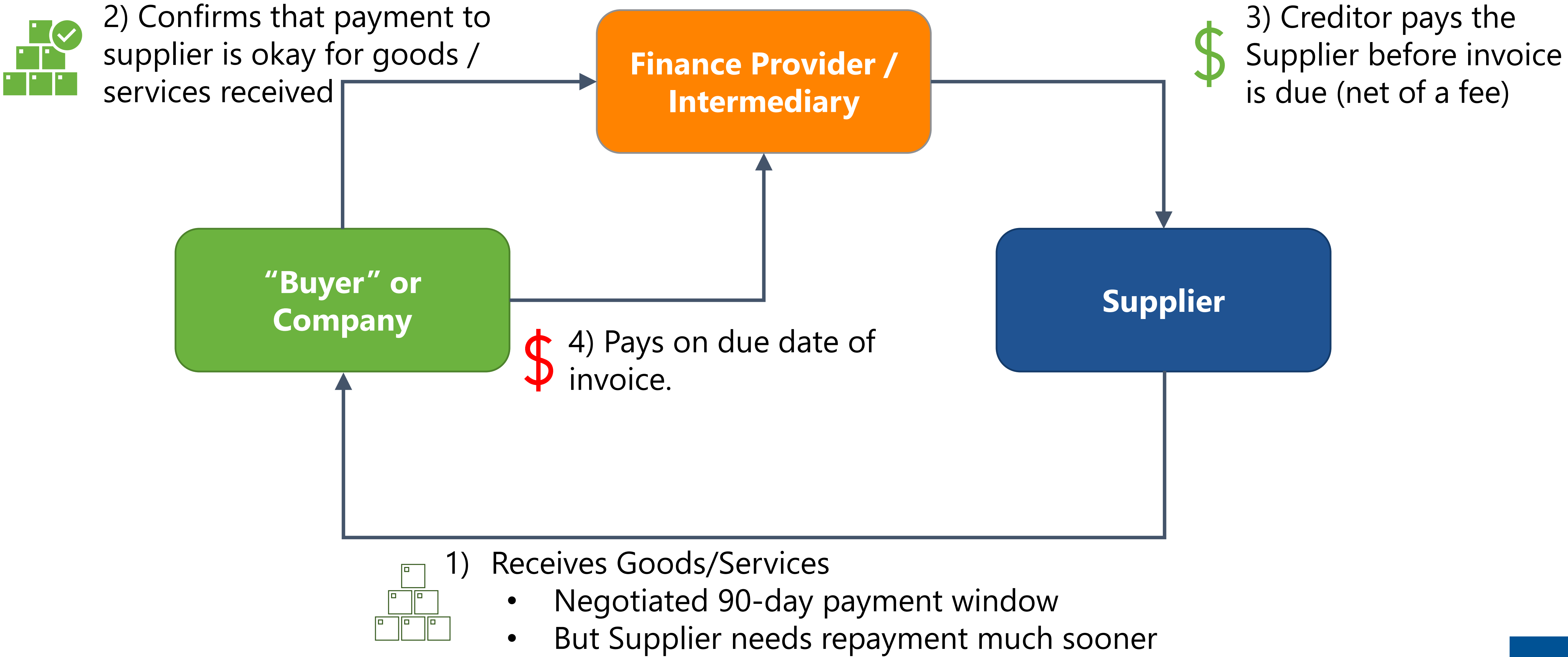
Supply Chain Impact?

Impairment Models

- Long-Lived Asset Impairment
- Can't tell you (Sorry for being cryptic about this)

Supplier Finance Arrangements (ASU 2022-04)

Example Supplier Finance Arrangement



ASU 2022-04 – Scope

All entities with obligations in connection to supplier finance programs that has all the following characteristics:

(405-50-15-2)

- Entity enters into an agreement with finance provider or intermediary
- Entity confirms supplier invoices as valid to finance provider or intermediary
- Entity's supplier has the option to request early payment for invoices that the entity has confirmed as valid

ASU 2022-04 – If in Scope then DISCLOSE

Annual Disclosures (405-50-50-3)

1. The key terms of the program, including a description of the payment terms (including payment timing and basis for its determination) and assets pledged as security or other forms of guarantees provided for the committed payment to the finance provider or intermediary

2. For the obligations that the buyer has confirmed as valid to the finance provider or intermediary:
   - a. The amount outstanding that remains unpaid by the buyer as of the end of the annual period (the outstanding confirmed amount)
   - b. A description of where those obligations are presented in the balance sheet
   - c. A rollforward of those obligations during the annual period, including the amount of obligations confirmed and the amount of obligations subsequently paid.

Interim Disclosures (405-50-50-4)

- Amount of obligations outstanding that the entity has confirmed as valid to the finance provider or intermediary under the supplier finance program at the end of the reporting period.

Rollfoward Example (405-50-55-5)

The rollforwards of Entity A's outstanding obligations confirmed as valid under its supplier finance program for years ended December 31, 20X2, and 20X1, are as follows (in thousands):

	20X2	20X1
Confirmed obligations outstanding at the beginning of the year	$ 733	$ 712
Invoices confirmed during the year	2,435	2,278
Confirmed invoices paid during the year	(2,315)	(2,257)
Confirmed obligations outstanding at the end of the year	$ 853	$ 733

ASU 2022-04 – Transition

Disclosures ***except for Rollforward*** are effective for ***fiscal years beginning after December 15, 2022***, including interim periods within those fiscal years

- During the fiscal year of adoption, the information on the key terms of the programs and the balance sheet presentation of the program obligations, which are annual disclosure requirements, should be disclosed in each interim period.

Rollforward is effective for ***fiscal years beginning after December 15, 2023***

Topic 842 (Leases)

Lease Term, Leasehold Improvements, Leases under Common Control

Lease Term

Lease Term

(842-10-30-1)

Non-cancellable Period	**Option to extend the lease if the lessee is reasonably certain to exercise that option**	Option to terminate the lease if the lessee is reasonably certain not to exercise that option	Option to extend (or not to terminate) the lease in which exercise of the option is controlled by the lessor.

Lease Term - The Reasonably Certain Game…

Is renewal reasonably certain?

- Example 1 – Initial 5-year office lease
  - 5-year renewal option
  - Many locations and minimal cost to relocate
  - Renewed historically and CEO is pretty certain renewal is going to happy

- Example 2 – Same as Example 1 BUT:
  - There's an expensive leasehold improvement that will last 10 years

- Example 3 – Same as Example 1 BUT:
  - 5-year Renewal option will have rent payments that are below market rates

- Example 4 – Same as Example 1 BUT:
  - 5-year renewal option will have payment reset to market rates at point of renewal

- Example 5 – Same as Example 1 BUT:
  - 5-year renewal option will have payment reset to market rates at point of renewal
  - There's an expensive leasehold improvement that will last 10 years

Leasehold Improvements

842-20-35-12 (Leasehold Improvement Amortization)

- Leasehold improvements shall be amortized over the shorter of the useful life of those leasehold improvements and the remaining lease term, unless the lease transfers ownership of the underlying asset to the lessee or the lessee is reasonably certain to exercise an option to purchase the underlying asset, in which case the lessee shall amortize the leasehold improvements to the end of their useful life.

Assume the leasehold improvement will last **10 years**.

Questions:

- Q1 - If my lease term is 10 years what is the amortization period of the leasehold improvement?
- Q2 - If my lease term is 5 years what is the amortization period of the leasehold improvement?
- Q3 – If my lease term is 5 years but the entity keeps the underlying asset due to a bargain purchase option what is the amortization period?

Related Party Lease

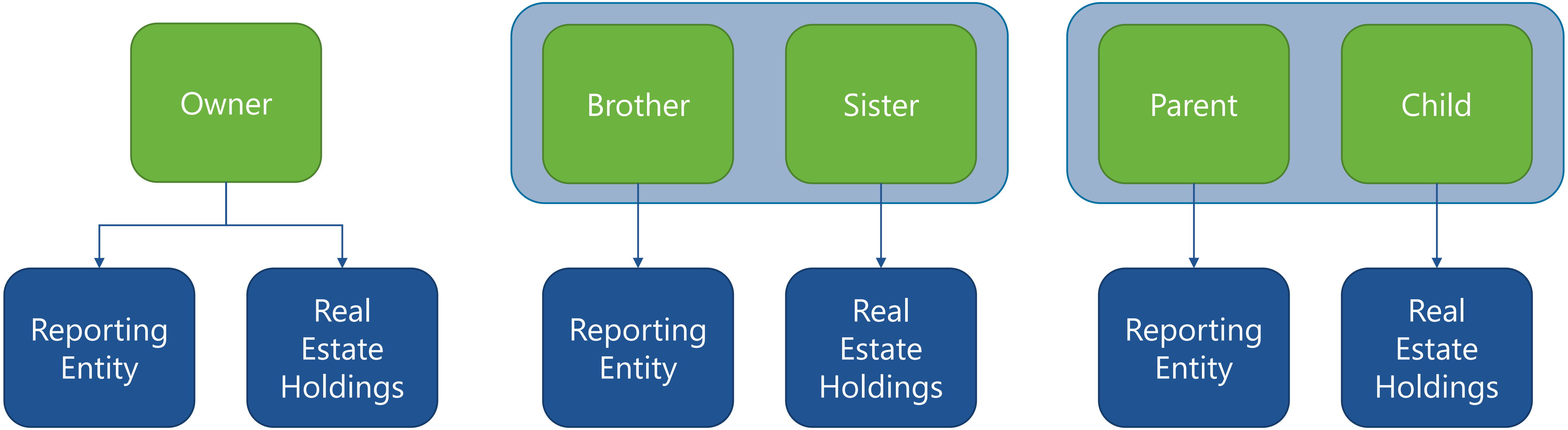
842-10-55-12 (Related Party Guidance)

- Leases between related parties should be classified in accordance with the lease classification criteria applicable to all other leases on the basis of the legally enforceable terms and conditions of the lease. In the separate financial statements of the related parties, the classification and accounting for the leases should be the same as for leases between unrelated parties.

Opposite guidance from ASC Topic 840

Consider ASC Topic 850 (Related Party Disclosures)

What are Related Party Leases under Common Control?



How do we account for related-party leases?

Questions:

- Q1 – How do I account for leases without an agreement?
- Q2 – What about month-to-month leases?
- Q3 – What about leasehold improvements? What issue does this cause now?
- Q4 – Any way to structure around this?

ASU 2023-01
Common Control Leasing Arrangements

Issued in ***March 2023***

What issue(s) is the ASU addressing?

- *Issue 1 - Concerns over cost and complexity in determining legally enforceable rights and obligations for leasing arrangements under common control*
- *Issue 2 - Leasehold improvement amortization period for month-to-month leases under common control*

ASU 2023-01
Common Control Leasing Arrangements

Issue 1 – Written Contracts

Scope

- Nonpublic entities under ***common control***

Summary of Issue 1 Provisions:

- Expedient to use what is written to assess ASC Topic 842 if lease is under ***common control***
  - If there is no written agreement then the expedient cannot be applied

ASU 2023-01
Common Control Leasing Arrangements

Issue 2 - Leasehold Improvements

Scope

- All entities under ***common control***

Summary of Issue 2 Provisions:

- *Relief 2*: Leasehold improvements under ***common control***:
  - Amortize the leasehold improvement over its **<u>useful</u>** life (regardless of lease term)
  - Account for transfer of leasehold improvement through an adjustment to equity when lessee no longer controls the underlying asset

Accounting Owner – What about the following example?

Leasing Example

- *Sign a 5-year Office Lease on January 1, 2022*
- Lessee and Lessor agree on **$1,000,000 generic construction upgrades** (e.g., drywall, HVAC, nicer bathrooms, lighting and fixtures, etc.) expected to last 20 years
- Lessor will construct the upgrades with cost being split:
  - Lessor to spot **$750K** "tenant improvement allowance"
  - Lessee to pay **$250K** for construction costs
- Lease commencement (and payments start) per the contract is May 1, 2022 and ends 5 years from this date
- Lessor starts construction on January 1, 2022 and promises completion no later than April 30, 2022
- Full access is granted when construction is completed on April 1, 2022

Question

As a lessee, the $250K payment for construction is:

A. A leasehold improvement (LHI) that will be amortized over 5 years (shorter of lease term or useful life of LHI)

B. Is prepaid rent or an adjustment to Initial ROU Asset

Question

The Lessee starts recording lease expense on:

A. January 1, 2022 when the lease is signed

B. May 1, 2022 lease commencement per the lease contract

C. April 1, 2022 when construction was completed and access was access granted

Accounting Owner – No Alternative Use What about the following example?

Leasing Example (Accounting Owner)

- *Sign a* ***20-year*** *Office Lease on January 1, 2022*
- Lessee requests $1,000,000 **construction upgrades that is specific to the lessee expected to last 20 years (no alternative use after the lease is over)**
- Lessor will construct the upgrades with cost being split:
  - Lessor to spot **$750K** "tenant improvement allowance"
  - Lessee to pay **$250K** for construction costs
- Lease commencement (and payments start) per the contract is May 1, 2022
- **Lessor begins construction on January 1, 2022** and promises that construction will be completed no later than April 30, 2022
- **Lessor states that lessee may begin its operations as soon as construction is completed which was April 1, 2022**

Question

The Lessee starts recording lease expense on:

A. January 1, 2022 when construction commences

B. May 1, 2022 lease commencement per the lease contract

C. April 1, 2022 when construction was completed and access was access granted

Questions

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A. A leasehold improvement (LHI) that will be amortized over 5 years (shorter of lease term or useful life of LHI)

B. Is prepaid rent or an adjustment to Initial ROU Asset

Supply Chain Impact?

What are some of the accounting issues resulting from Supply Chain Issues or the Great Resignation?

- Variable Consideration (Step 3 of Topic 606)
- Bill and Hold? (Step 5 of Topic 606)
- Revenue – Loss Contract?
- Inventory Costing Issues?

Overview of Revenue Recognition Model

Core Principle

Recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services

Steps to apply the core principle

1. Identify the contract(s) with the customer
2. Identify the performance obligations
3. Determine the transaction price
4. Allocate the transaction price
5. Recognize revenue when (or as) a performance obligation is satisfied

Portfolio Approach

Example 20 – Variable Consideration Penalty

> > > Example 20—Penalty Gives Rise to Variable Consideration

- 606-10-55-194 An entity enters into a contract with a customer to build an asset for $1 million. In addition, the terms of the contract include a penalty of $100,000 if the construction is not completed within 3 months of a date specified in the contract.
- 606-10-55-195 The entity concludes that the consideration promised in the contract includes a fixed amount of $900,000 and a variable amount of $100,000 (arising from the penalty).

What are some of the accounting issues resulting from Supply Chain Issues or the Great Resignation?

- Variable Consideration (Step 3 of Topic 606)
- Bill and Hold? (Step 5 of Topic 606)
- Revenue – Loss Contract?
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Portfolio Approach

What is a Bill and Hold Arrangement?

> > Bill-and-Hold Arrangements

- 606-10-55-81 A bill-and-hold arrangement is a contract under which an entity bills a customer for a product but the entity retains physical possession of the product until it is transferred to the customer at a point in time in the future. For example, a customer may request an entity to enter into such a contract because of the customer's lack of available space for the product or because of delays in the customer's production schedules.

Criteria for Bill-and-Hold

> > Bill-and-Hold Arrangements

- 606-10-55-83 In addition to applying the guidance in paragraph 606-10-25-30, for a customer to have obtained control of a product in a bill-and-hold arrangement, all of the following criteria must be met:
  - a. The reason for the bill-and-hold arrangement must be substantive (for example, the customer has requested the arrangement).
  - b. The product must be identified separately as belonging to the customer.
  - c. The product currently must be ready for physical transfer to the customer.
  - d. The entity cannot have the ability to use the product or to direct it to another customer.
- 606-10-55-84 If an entity recognizes revenue for the sale of a product on a bill-and-hold basis, the entity should consider whether it has remaining performance obligations (for example, for custodial services) in accordance with paragraphs 606-10-25-14 through 25-22 to which the entity should allocate a portion of the transaction price in accordance with paragraphs 606-10-32-28 through 32-41.

Bill-and-Hold Disclosures

> > Performance Obligations

- 606-10-50-12 An entity shall disclose information about its performance obligations in contracts with customers, including a description of all of the following:
  - a. When the entity typically satisfies its performance obligations (for example, upon shipment, upon delivery, as services are rendered, or upon completion of service) including when performance obligations are satisfied in a bill-and-hold arrangement
  - b. The significant payment terms (for example, when payment typically is due, whether the contract has a significant financing component, whether the consideration amount is variable, and whether the estimate of variable consideration is typically constrained in accordance with paragraphs 606-10-32-11 through 32-13)
  - c. The nature of the goods or services that the entity has promised to transfer, highlighting any performance obligations to arrange for another party to transfer goods or services (that is, if the entity is acting as an agent)
  - d. Obligations for returns, refunds, and other similar obligations
  - e. Types of warranties and related obligations.

What are some of the accounting issues resulting from Supply Chain Issues or the Great Resignation?

- Variable Consideration (Step 3 of Topic 606)
- Bill and Hold? (Step 5 of Topic 606)
- Revenue – Loss Contract?
- Inventory Costing Issues?

Question

True of False: Your company is subject to onerous contract guidance (i.e., booking a loss when a contract is not profitable).

A. True

B. False

Revenue – Contract Losses

Is there a Loss Contract?

Is it in scope of legacy guidance?

If not, don't book a LOSS

Index to Existing Contract Loss Guidance

Scope of Loss Contracts

Subtopic 605-20	Subtopic 605-35	Subtopic 985-605	Section 954-440-35	Section 954-450-30	Subtopic 980-350-35	Subtopic 912-20-45
▪ Separately Priced Extended Warranty and Product Maintenance Contracts	▪ Construction-Type and Production-Type Contracts	▪ Software requiring significant production or modification	▪ Continuing Care Retirement Community	▪ Prepaid Health Care Services	▪ Long-Term Power Sales Contracts	▪ Federal Gov't Contracts

605-35 (Construction-Type and Production-Type Contracts) What IS IN Scope?

> > Contracts Covered

- Contracts covered by this Subtopic include, but are not limited to, the following:
  - a. Contracts in the construction industry, such as those of general building, heavy earth moving, dredging, demolition, design-build contractors, and specialty contractors (for example, mechanical, electrical, or paving). In general the type of contract here under consideration is for construction of a specific project. While such contracts are generally carried on at the job site, this Subtopic also would be applicable in appropriate cases to the manufacturing or building of special items on a contract basis in a contractor's own plant.
  - b. Contracts to design and build ships and transport vessels.
  - c. Contracts to design, develop, manufacture, or modify complex aerospace or electronic equipment to a buyer's specification or to provide services related to the performance of such contracts.
  - d. Contracts for construction consulting service, such as under agency contracts or construction management agreements.
  - e. Contracts for services performed by architects, engineers, or architectural or engineering design firms.
  - f. Arrangements to deliver software or a software system, either alone or together with other products or services, requiring significant production, modification, or customization of software.

605-35 (Construction-Type and Production-Type Contracts) What is NOT IN Scope?

> > Types of Contracts Not Covered

- 605-35-15-6 Contracts not covered by this Subtopic include, but are not limited to, the following:
  - a. Sales by a manufacturer of goods produced in a standard manufacturing operation, even if produced to buyers' specifications, and sold in the ordinary course of business through the manufacturer's regular marketing channels, if such sales are normally recognized as the sale of goods and if their costs are accounted for in accordance with generally accepted principles of inventory costing.
  - b. Sales or supply contracts to provide goods from inventory or from homogeneous continuing production over a period of time.
  - c. Contracts included in a program and accounted for under the program method of accounting. For accounting purposes, a program consists of a specified number of units of a basic product expected to be produced over a long period in a continuing production effort under a series of existing and anticipated contracts.
  - d. Service contracts of health clubs, correspondence schools, and similar consumer-oriented entities that provide their services to their clients over an extended period.
  - e. Magazine subscriptions.
  - f. Contracts of not-for-profit entities (NFPs) to provide benefits to their members over a period of time in return for membership dues.
  - g. Contracts for which other Topics in the Codification provide special methods of accounting, such as leases.
  - h. Cost-plus-fixed-fee government contracts, which are discussed in Topic 912, other types of cost-plus-fee contracts, or contracts such as those for products or services customarily billed as shipped or rendered.
  - i. Federal government contracts within the scope of that Topic.
  - j. Service transactions between a seller and a purchaser in which, for a mutually agreed price, the seller performs, agrees to perform at a later date, or agrees to maintain readiness to perform an act or acts, including permitting others to use entity resources that do not alone produce a tangible commodity or product as the principal intended result (for example, services, not plans, are usually the principal intended result in a transaction between an architect and the customer of an architect).

Subtopic 605-35 Loss Contract Model

Policy Election at Contract or Performance Obligation Level

Book Entire Anticipated Loss when Evident

Estimate of **Transaction Price** (Step 3) is **LESS THAN** current estimate of **Total Cost**

Subtopic 605-35 Loss Contract Model – Compared to Old GAAP

Legacy GAAP Except for:

- Variable Consideration
- Policy Election at Contract vs Performance Obligation Level

What are some of the accounting issues resulting from Supply Chain Issues or the Great Resignation?

Variable Consideration (Step 3 of Topic 606)

Bill and Hold? (Step 5 of Topic 606)

Revenue – Loss Contract?

Inventory Costing Issues? (FIFO)

Inventory – Initial Measurement

> Cost Basis

- **330-10-30-1** The primary basis of accounting for inventories is cost, which has been defined generally as the price paid or consideration given to acquire an asset. As applied to inventories, cost means in principle the sum of the applicable expenditures and charges directly or indirectly incurred in bringing an article to its existing condition and location. It is understood to mean acquisition and production cost, and its determination involves many considerations.

- **330-10-30-3** For example, variable production overheads are allocated to each unit of production on the basis of the actual use of the production facilities. However, the allocation of fixed production overheads to the costs of conversion is based on the normal capacity of the production facilities. Normal capacity refers to a range of production levels. Normal capacity is the production expected to be achieved over a number of periods or seasons under normal circumstances, taking into account the loss of capacity resulting from planned maintenance. Some variation in production levels from period to period is expected and establishes the range of normal capacity.

Inventory – Initial Measurement

> Cost Basis

- **330-10-30-4** The range of normal capacity will vary based on business- and industry-specific factors. Judgment is required to determine when a production level is abnormally low (that is, outside the range of expected variation in production).
- **330-10-30-5** Examples of factors that might be anticipated to cause an abnormally low production level include significantly reduced demand, labor and materials shortages, and unplanned facility or equipment downtime.
- **330-10-30-6** The actual level of production may be used if it approximates normal capacity. In periods of abnormally high production, the amount of fixed overhead allocated to each unit of production shall be decreased so that inventories are not measured above cost. The amount of fixed overhead allocated to each unit of production shall not be increased as a consequence of abnormally low production or idle plant.
- **330-10-30-7** Unallocated overheads shall be recognized as an expense in the period in which they are incurred. Other items such as abnormal freight, handling costs, and amounts of wasted materials (spoilage) require treatment as current period charges rather than as a portion of the inventory cost.

Inventory – Simple Example w/ Capacity

Fact Pattern – Manufacturer:

- Plant A normally produces ~1,000,000 units per production cycle
- Direct materials cost is $10 per unit
- Total Fixed Production Overhead during the production cycle is $5,000,000.
- There are no other costs (e.g., variable overhead, etc.)
- Assume none the inventory in this cycle is sold, what should the balance of inventory be if the plant produces:
    - 1,000,000 Units?
    - 500,000 Units?

Inventory – At Normal Capacity

Units Prodcued:		
1,000,000		
	Total	**Per Unit**
Direct Cost	10,000,000.00	10.00
Overhead	5,000,000.00	5.00
Total Inventory	**15,000,000.00**	15.00
Unallocated Overhead	-	

- Because plant is operating at normal capacity all fixed production overhead is allocated
- At normal capacity expected overhead is $5 per unit
- Inventory is measured at $15,000,000 (because none have been sold)
- Cost of Sale is recognized when each unit is sold

Inventory – Below Capacity

Units Prodcued:		
500,000		
	Total	**Per Unit**
Direct Cost	5,000,000.00	10.00
Overhead	2,500,000.00	5.00
Total Inventory	**7,500,000.00**	15.00
Unallocated Overhead/COGS	**2,500,000.00**	

- Plant is significantly below capacity of 1,000,000 units
- Fixed production overhead allocation would yield $5 per unit at normal capacity ($5,000,000 divided by 1,000,000 units)
- As such inventory balance should be at $7,500,000
- Unallocated fixed production overhead of 2,500,00 is expensed

Long-Lived Asset Impairment

Question – Is this impaired?

Fact Pattern – building

- The Company purchased a building to construct a manufacturing facility for $20 million a year ago.
- Property values have crashed! Recently the building is appraised at $14 million while the carrying value is $19.5 million.

Question:

- The impairment charge on the building is likely…

Question – Building Impairment?

Question:

- The impairment charge on the building is likely…

Answer?:

a) An impairment charge of $5.5MM (Carry Value of $19.5MM LESS Fair Value of $14 MM)

b) No impairment on the building

c) More information is needed

What model are we talking about?

Various Asset Impairment Models in GAAP (for example)				
Receivables (ASC 310)	Inventory (ASC 330-10)	Long-Lived Assets (360-10)	Indefinite-lived intangibles (350-30)	Goodwill (ASC 350-20)

Long-lived Asset Impairment

Long-lived Asset

Held and Used

Assets Held for Sale

Long-lived Asset Impairment – Held and Used

Long-Lived Asset Impairment

PP& E

- Buildings
- Vehicles
- Equipment

Amortizable Intangibles

- Patents
- Internally-developed software
- Customer Relationships

Held and Used

Unit of Account:

- Asset Group

Test:

- Step 1 – Recoverability
- Step 2 – Impairment Loss

When?

- Triggering Event

Long-lived Asset Impairment – Asset Group

360-10-35-23
• For purposes of recognition and measurement of an impairment loss, a long-lived asset or assets shall be grouped with other assets and liabilities **at the lowest level for which identifiable cash flows are largely independent of the cash flows of other assets and liabilities**.

Long-lived Asset Impairment – Test & Measure

Step 1 – Recoverability Test

- ***Undiscounted cash flows*** generated by ***Asset Group*** and its ultimate disposal **exceeds carrying value**
- If not recoverable then proceed to Step 2

Step 2 – Measurement of Impairment

- Impairment Equals:
  - [**Carrying Value** of Asset Group] **LESS** [**Fair Value** of Asset Group]
- Difference is Allocated ***pro-rata*** based on Long-Lived Assets
- Individual asset cannot be written below its Fair Value

Long-lived Asset Impairment – When?

360-10-35-21
• Significant decrease in the market price • Significant adverse change in the extent or manner of use • Significant adverse change in legal factors or in the business climate • Accumulation of costs significantly in excess of the amount originally expected for the acquisition • Current-period operating/cash flow loss combined with a history of operating/cash flow losses or a projection or forecast that demonstrates continuing losses • Expectation that, more likely than not, a long-lived asset will be sold/disposed of significantly before the end of its estimated useful life.

Asset Group?

<u>Fact Pattern – Real Estate Company:</u>

- Owns 10 commercial properties (i.e., office buildings)
- Primarily leases out office space to earn revenue
- Each location consists of: land, parking garage, building, equipment, etc.

<u>Question:</u>

- What’s the asset group?
- What if this was a manufacturing Company with 3 different facilities each manufacturing a critical component that goes into a forklift? None of the facilities produce anything that can be individually sold.

Asset Group?

Fact Pattern – Large Multinational Company

- The Company purchased a $1 billion HQ building 1 year ago.
- The HQ building is just a cost center.

Question:

- What is the asset group?

Step 1 - Recoverability Cash Flows

- Undiscounted cash flows from the use and eventual disposal or sale of the asset group:
  - *Cash Inflows* over the remaining useful life of asset group
    - Consider output capacity
    - Do not consider future expansion
  - *Cash Outflows* necessary to operate the asset group.
    - Include costs to maintain the asset group (e.g., repairs & maintenance, roof replacement)
  - Cash flow from eventual disposition or sale
    - Value the company derive from disposal (e.g., salvage, residual, fair value)
    - Less cost to dispose or sale

Step 1 – Recoverability Test Considerations

- Duration of Cash Flows:
  - 360-10-35-31
    - [T]he primary asset is the principal long-lived tangible asset being depreciated or intangible asset being amortized that is the most significant component asset from which the asset group derives its cash-flow-generating capacity.
  - Primary asset cannot be land or indefinite-lived asset (e.g., brand)
- Generally financial obligations (e.g., debt or financing leases) not included in the asset group
  - If debt is included in the asset group then only include cash outflows from principal payments
- Generally done on pretax basis (but GAAP is silent on this)

Long-lived Asset Impairment – Measure

Step 2 – Measurement of Impairment

- Impairment Equals:
  - [**Carrying Value** of Asset Group] **LESS** [**Fair Value** of Asset Group]
- Difference is Allocated ***pro-rata*** based on Long-Lived Assets
- Individual asset cannot be written below its Fair Value

Long-lived Asset Impairment – Measure - Example

Asset Group **GAAP Value**	Asset Group **Fair Value**
Building (+750)	Building (+500)
Parking Garage (+200)	Parking Garage (+150)
Equipment (+60)	Equipment (+60)
A/R (+50)	A/R (+50)
A/P (-60)	A/P (-60)
Total GAAP NBV of 1,000	**Group Fair Value of 800**

Long-lived Asset Impairment - Measure

- What will the total impairment charge be?
- Is it an issue that the fair value of the asset group does not reconcile to the sum of FV for each asset and liability in the group?
  - What could cause this to happen?
- Which assets do I write down and how?

Long-lived Asset Impairment - Measure

Fair Value of Long-Lived Assets

Building = 500

Parking Garage = 150

Equipment = 60

Total Impairment to Allocate 200.00

Long Lived Assets		Initial NBV	Pro-Rata Allocation	Allocation of Impairment	Adj Carrying Value	Pro-Rata Reallocation	Reallocation of Excess Impairment	Final NBV
	Building	750.00	74.26%	(148.51)	601.49	78.95%	(9.38)	592.11
	Parking Garage	200.00	19.80%	(39.60)	160.40	21.05%	(2.50)	157.89
	Equipment	60.00	5.94%	-				60.00
		1,010.00	100%	11.88	761.88	100%	(11.88)	810.00

Difference Between Initial NBV and Final NBV: (200.00)

Question – Impairment

True/False:

- After an asset group is impaired, the carrying value of an individual asset within the asset group cannot exceed its fair value.

Answer?:

a) True

b) False

Long-lived Asset Impairment – Held and Used - Recap

Long-Lived Asset Impairment

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- Buildings
- Vehicles
- Equipment

Amortizable Intangibles
- Patents
- Internally-developed software
- Customer Relationships

Held and Used

Unit of Account:
- Asset Group

Test:
- Step 1 – Recoverability
- Step 2 – Impairment Loss

When?
- Triggering Event

What's our next topic? Hint Below…

Accounting for Cryptocurrencies

You'll see why I'm covering this ☺

What is Bitcoin?

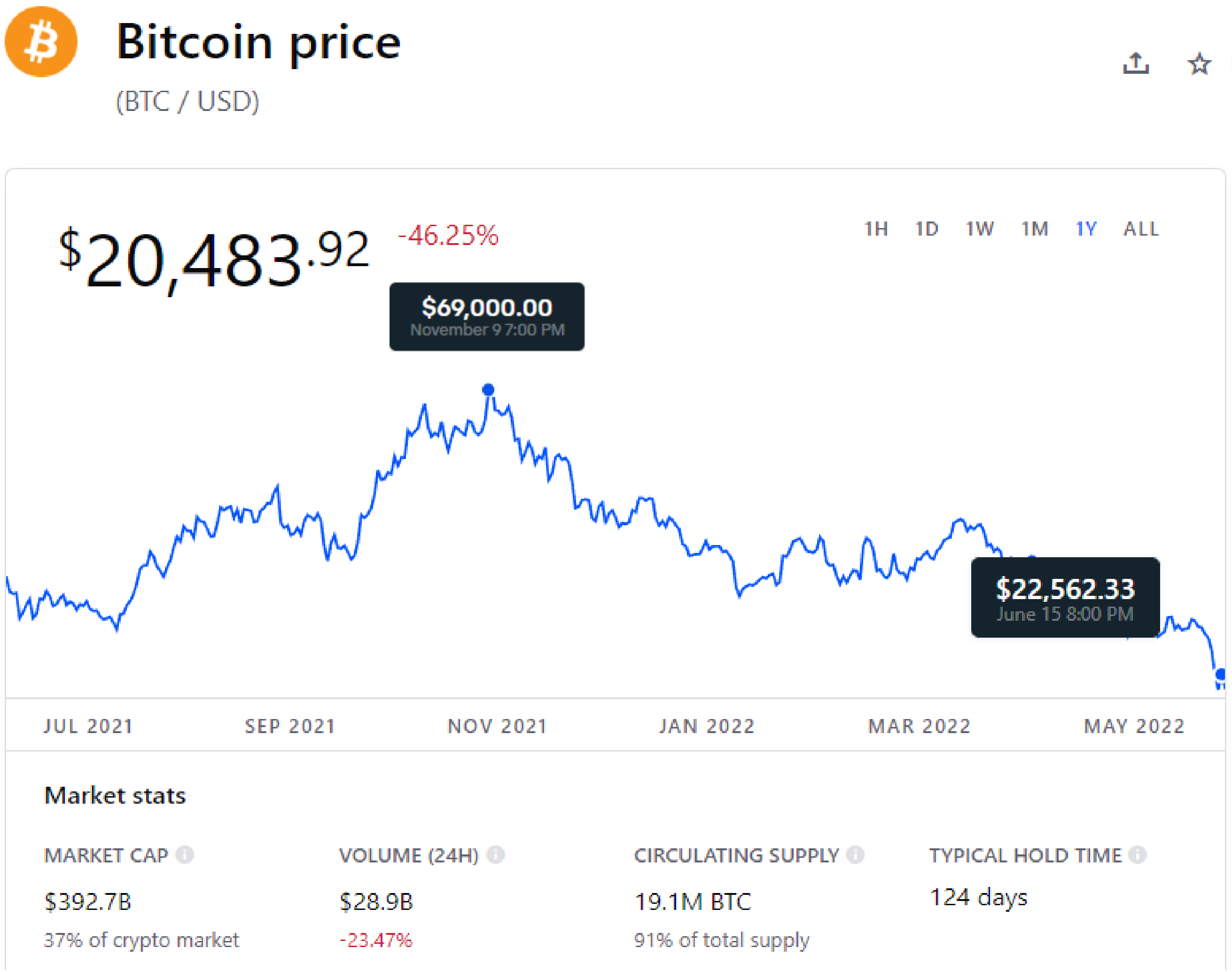
Bitcoin: A Peer-to-Peer Electronic Cash System

Satoshi Nakamoto
satoshin@gmx.com
www.bitcoin.org

Abstract. A purely peer-to-peer version of electronic cash would allow online payments to be sent directly from one party to another without going through a financial institution. Digital signatures provide part of the solution, but the main benefits are lost if a trusted third party is still required to prevent double-spending. We propose a solution to the double-spending problem using a peer-to-peer network. The network timestamps transactions by hashing them into an ongoing chain of hash-based proof-of-work, forming a record that cannot be changed without redoing the proof-of-work. The longest chain not only serves as proof of the sequence of events witnessed, but proof that it came from the largest pool of CPU power. As long as a majority of CPU power is controlled by nodes that are not cooperating to attack the network, they'll generate the longest chain and outpace attackers. The network itself requires minimal structure. Messages are broadcast on a best effort basis, and nodes can leave and rejoin the network at will, accepting the longest proof-of-work chain as proof of what happened while they were gone.

https://bitcoin.org/bitcoin.pdf

What is Bitcoin worth?



Price Points:

3/13/2020	$5,631
11/9/2021	$69,000
6/15/2022	$22,562
11/30/2022	$17,173

https://www.coinbase.com/price/bitcoin

Question

The accepted GAAP model in accounting for Bitcoin is:

A. A Financial Instrument that is marked to fair value with changes going through the income statement

B. An Intangible Asset at historical cost subject to impairment. Reversal of impairment NOT permitted!

C. Policy Election - either are acceptable

Bitcoin/Digital Currency - Where does it fit in GAAP?

Cash (as defined by GAAP)?

- Probably not…
  - "Includes not only currency on hand but demand deposits with banks or other financial institutions"
  - Not backed by a sovereign government and do not represent legal tender

Financial Instrument / Financial Asset (as defined by GAAP)?

- Probably Not…
  - Not "cash, evidence of an ownership interest in an entity, or a contract that conveys to one entity a right to do either receive cash or another financial instrument from a second entity; or exchange other financial instruments on potentially favorable terms with the second entity."

Intangible Asset?

- Assets (not including financial assets) that lack physical substance.
- Most likely indefinite

Indefinite-Lived Asset Impairment

Indefinite-Lived Asset

Held and Used

Assets Held for Sale

Indefinite-Lived Asset Impairment

Indefinite-Lived Asset Impairment

- Brands
- Tradenames
- Certain Licensing Rights
- Certain Digital Currencies

Held and Used

Unit of Account:
- Indefinite-Life Asset

How?
- Amount ABOVE Fair Value
- Optional Qualitative Assessment

When?
- Annual
- Triggering Event

Reversal?
- Never

MicroStrategy (MSTR) – Bitcoin Accounting

	Source of Capital Used to Purchase Bitcoin	Digital Asset Original Cost Basis (in thousands)	Digital Asset Impairment Losses (in thousands)	Digital Asset Carrying Value (in thousands)	Approximate Number of Bitcoins Held	Approximate Average Purchase Price Per Bitcoin
Balance at June 30, 2020		**$ 0**	**$ 0**	**$ 0**	**0**	**n/a**
Digital asset purchases	(a)	425,000		425,000	38,250	11,111
Digital asset impairment losses			(44,242)	(44,242)		
Balance at September 30, 2020		**$ 425,000**	**$ (44,242)**	**$ 380,758**	**38,250**	**$ 11,111**
Digital asset purchases	(b)	700,000		700,000	32,219	21,726
Digital asset impairment losses			(26,456)	(26,456)		
Balance at December 31, 2020		**$ 1,125,000**	**$ (70,698)**	**$ 1,054,302**	**70,469**	**$ 15,964**
Digital asset purchases	(c)	1,086,375		1,086,375	20,857	52,087
Digital asset impairment losses			(194,095)	(194,095)		
Balance at March 31, 2021		**$ 2,211,375**	**$ (264,793)**	**$ 1,946,582**	**91,326**	**$ 24,214**
Digital asset purchases	(d)	529,231		529,231	13,759	38,464
Digital asset impairment losses			(424,774)	(424,774)		
Balance at June 30, 2021		**$ 2,740,606**	**$ (689,567)**	**$ 2,051,039**	**105,085**	**$ 26,080**
Digital asset purchases	(e)	419,865		419,865	8,957	46,876
Digital asset impairment losses			(65,165)	(65,165)		
Balance at September 30, 2021		**$ 3,160,471**	**$ (754,732)**	**$ 2,405,739**	**114,042**	**$ 27,713**

	Approximate Number of Bitcoins Held at End of Quarter	Lowest Market Price Per Bitcoin During Quarter (f)	Market Value of Bitcoin Held at End of Quarter Using Lowest Market Price (in thousands) (g)	Highest Market Price Per Bitcoin During Quarter (h)	Market Value of Bitcoin Held at End of Quarter Using Highest Market Price (in thousands) (i)	Market Price Per Bitcoin at End of Quarter (j)	Market Value of Bitcoin Held at End of Quarter Using Ending Market Price (in thousands) (k)
June 30, 2020	0	n/a	n/a	n/a	n/a	n/a	n/a
September 30, 2020	38,250	$ 8,905.84	$ 340,648	$ 12,486.61	$ 477,613	$ 10,706.00	$ 409,505
December 31, 2020	70,469	$ 10,363.76	$ 730,324	$ 29,321.90	$ 2,066,285	$ 29,181.00	$ 2,056,356
March 31, 2021	91,326	$ 27,678.00	$ 2,527,721	$ 61,788.45	$ 5,642,892	$ 58,601.28	$ 5,351,820
June 30, 2021	105,085	$ 28,800.00	$ 3,026,448	$ 64,899.00	$ 6,819,911	$ 34,763.47	$ 3,653,119
September 30, 2021	114,042	$ 29,301.56	$ 3,341,609	$ 52,944.96	$ 6,037,949	$ 43,534.56	$ 4,964,768

https://www.microstrategy.com/content/dam/website-assets/collateral/financial-documents/financial-document-archive/form-10-q_10-28-2021.pdf

MicroStrategy (MSTR) – Bitcoin Accounting

	Three Months Ended September 30, 2021	Three Months Ended September 30, 2020	Nine Months Ended September 30, 2021	Nine Months Ended September 30, 2020
Reconciliation of non-GAAP income from operations:				
Loss from operations	$ (49,661)	$ (20,271)	$ (647,060)	$ (14,015)
Share-based compensation expense	12,166	2,560	30,973	7,897
Digital asset impairment losses	65,165	44,242	684,034	44,242
Non-GAAP income from operations	$ 27,670	$ 26,531	$ 67,947	$ 38,124

- https://www.microstrategy.com/content/dam/website-assets/collateral/financial-documents/financial-document-archive/form-10-q_10-28-2021.pdf

Recent Articles

- https://www.forbes.com/sites/shehanchandrasekera/2022/01/31/sec-objects-to-microstrategy-accurately-valuing-its-billion-dollar-bitcoin-stash/?sh=13409272158e
- https://www.bloomberg.com/news/articles/2022-01-21/microstrategy-plummets-as-sec-rejects-its-bitcoin-accounting

MicroStrategy (MSTR) – What did the SEC Say?

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

DIVISION OF
CORPORATION FINANCE

December 3, 2021

Phong Le
President & Chief Financial Officer
Microstrategy Incorporated
1850 Towers Crescent Plaza
Tysons Corner, VA 22182

Re: Microstrategy Incorporated
Form 10-K for Fiscal Year Ended December 31, 2020
Filed February 12, 2021
Form 10-Q for the Quarter Ended September 30, 2021
Filed October 22, 2021
File No. 000-24435

Form 10-Q for the Quarterly Period Ended September 30, 2021

Non-GAAP Financial Measures, page 29

1. We note your response to prior comment 5 and we object to your adjustment for bitcoin impairment charges in your non-GAAP measures. Please revise to remove this adjustment in future filings. Refer to Rule 100 of Regulation G.

We remind you that the company and its management are responsible for the accuracy and adequacy of their disclosures, notwithstanding any review, comments, action or absence of action by the staff.

https://www.sec.gov/Archives/edgar/data/1050446/000000000021014605/filename1.pdf

Questions?