DM

Dannible & McKee, LLP

Certified Public Accountants and Consultants

Delivering **Confidence**

Accounting, Financial Reporting and Employee Benefit Plan Update

Presented by:
Joseph Chemotti, CPA, CCIFP
Benjamin A. Sumner, CPA

November 9, 2023

Outline

1. Newly Issued and Effective Accounting Pronouncements
2. Looking Back (and Forward!) at ASC 842 – Leasing
3. Pension/ERISA Update

1. Newly Issued and Effective Accounting Pronouncements

Newly Issued Accounting Standards Updates

ASU 2023-01 - Leases (Topic 842): Common Control Arrangements

- Will be discussed in detail a little later!

ASU 2023-02 - Investments (Topic 323): Equity Method and Joint Ventures -Accounting for Investments in Tax Credit Structures Using the Proportional Amortization Method

- Amendments allow reporting entities to elect to consistently account for qualifying equity investments made primarily for the purpose of receiving income tax credits and other income tax benefits.
- Amortize the cost of the equity investment in proportion to the income tax benefit received, with amortization presented net of tax credits as a component of income tax expense (benefit).
- Private company effective date: Years beginning after **December 15, 2024 (2025)**

Newly Issued Accounting Standards Updates

ASU 2023-05 - Business Combinations - Joint Venture Formations (Topic 805-60): Recognition and Initial Measurements

- Requires joint ventures to recognize and initially measure assets and liabilities at fair value as of the formation date.
- Addresses historical diversity in practice due to lack of guidance.
- Required for new joint ventures with formation date after **January 1, 2025**.
- Early adoption is permitted for periods in which financial statements have not yet been issued or available to be issued.

Newly Effective Accounting Standards Updates (2023)

ASU 2016-13 - Financial Instruments - Credit Losses (Topic 326) CECL

- Introduces the current expected credit loss (CECL) model to provide more timely recognition of credit losses.
- Not just for loans receivable, also includes:
    - **Trade receivables**, contract assets, lease receivables, financial guarantees, HTM debt
- 5 measurement approaches:
    1. Discounted cash flow method
    2. Loss-rate method
    3. Roll-rate method
    4. Probability of default method
    5. **Aging schedule**

ASU 2022-04 - Liabilities - Supplier Finance Programs (Subtopic 405-50): Disclosure of Supplier Finance Program Obligations

- Requires a buyer in a supplier finance program to disclose sufficient information of the program's nature so users can understand the activity and potential magnitude
- Key terms, including a description of payments and assets pledge as security or other guarantees provided for the committed payment. Buyer also needs to confirm the amount outstanding by the buyer, a description of where the obligations are on the balance sheet, and a roll forward of those obligations during the period.

Newly Effective Accounting Standards Updates (2023)

ASU 2022-02 - Financial Instruments - Credit Losses (Topic 326): Troubled Debt Restructurings (TDR) and Vintage Disclosures

- Eliminates the TDR recognition and measurement guidance and, instead, requires that an entity evaluate whether the modification represents a new loan or a continuation of an existing loan.
- Vintage Disclosures – Public business entities are required to disclose current period gross write offs by year of origination for financing receivables and net investments.

Looking Back (and Forward!) at Leasing

Leases

ASC 842 - Leases

- Issued back in 2016.
- **Was finally required to be implemented for private companies for years beginning after December 15, 2021 (2022 calendar years)**
- Under ASC 842, all leases longer than **12 months** were required to be reflected on a company's balance sheet.
- **What was the goal**: To enhance financial transparency by giving a clear picture of an entity's future lease obligations in the balance sheet
- **What was NOT the goal:** To change the way lease expense is run through the income statement

Leases

How does the new standard differ from previous accounting under generally accepted accounting principles (GAAP)?

- **Old GAAP**
  - Capital leases were in balance sheet, operating leases were not
  - Future payments under operating leases disclosed
  - Capital leases expensed through straight-line amortization (depreciation) of assets and interest expense on liability
  - Operating leases expensed straight line through rent or lease expense

Leases

How does the new standard differ from previous accounting under generally accepted accounting principles (GAAP)?

- New GAAP
  - Capital leases now called finance leases
  - Operating leases now also in balance sheet
  - Finance leases expensed through amortization (depreciation) of assets and interest expense on liability (same as before)
  - Operating leases expensed straight line through rent or lease expense (same as before)

Leases

How are leases accounted for under the new guidance?

- Lessees recognize a **"right-of-use"** asset (long-term) and a liability (current and long-term portions) for their obligation to make lease payments for ***all*** leases.
- Asset and liability are initially measured using the **present value (PV)** of the lease payments over the lease term using a discount rate.
- Available discount rates to use:
  - Rate implicit in the lease (if FV or Residual Value is known)
  - Entity's incremental borrowing rate
  - Practical Expedient available to Private Companies to use risk-free rate (Treasury Rate)

Leases

Two Elements Form Basis for PV of Lease Payments:

1) Lease Term

Noncancellable period for which a lessee has the right to use an underlying asset.

+

Any periods covered by an option to:

EXTEND THE LEASE If the lessee is reasonably certain to exercise that option.

TERMINATE THE LEASE If the lessee is reasonably certain they will not exercise that option.

Leases

Two Elements Form Basis for PV of Lease Payments:

2) Lease Payments - INCLUDED

Fixed Payments
Fixed payments, including in-substance fixed payments, less any lease incentives paid or payable to the lessee.

Transaction Fees
Fees paid by the lessee to the owners of a special-purpose entity for structuring the transaction.

Amounts Owed
Amounts it's probable the lessee will owe under residual-value guarantees.

Purchase Option
The exercise price of an option to purchase the underlying asset, if the lessee is reasonably certain to exercise that option.

Penalty Payments
Penalty payments for terminating the lease, when the lessee expects to exercise an option to terminate the lease.

Some Variable Payments
Variable lease payments that depend on an index or a rate (i.e. CPI).

Leases

Two Elements Form Basis for PV of Lease Payments:

2) Lease Payments - EXCLUDED

Certain other variable lease payments

- Real estate taxes
- Building insurance
- Lease payments determined based on a percentage of sales

Amounts allocated to non-lease components

- Common area charges
- Service agreements

Practical expedient available for Private Companies to combine lease and non-lease components when calculating ROU asset and lease liability

Leases

Lease Classification for Lessees

- Two approaches based on the “lease classification test.”
  - ✓ Approach A – Financing Type (Old “Capital Lease”)
  - ✓ Approach B – Operating Type

The only difference is how you charge the lease asset and payments to operations.

Leases

Approach A **-** Financing Type (Capitalized)

- To amortize a 5-year lease at $20,000 / year with a 3% escalation ($106,183 total payments) using a 6% incremental borrowing rate.

Finance Lease						
	A	B	C	D	E - B	E
Year	Payment	Interest	Principal	Remaining	Asset Amortization	Total Expense
				$ 86,727		
1	$ 20,000	$ 6,071	$ 13,929	72,798	$ 17,345	$ 23,416
2	20,600	5,096	15,504	57,294	17,345	22,441
3	21,218	4,011	17,207	40,086	17,345	21,356
4	21,855	2,806	19,049	21,038	17,345	20,151
5	22,510	1,473	21,038	-	17,345	18,818
	106,183	19,456	86,727		86,727	106,183

- Note that the **asset amortization is static** from year to year.

Leases

Approach B **-** Operating Type, Straight-line Approach.

- To amortize a 5-year lease at $20,000 / year with a 3% escalation ($106,183 total payments) using a 6% incremental borrowing rate.

Operating Lease						
	A	B	C	D	E - B	E
Year	Payment	Interest	Principal	Remaining	Asset Amortization	Total Expense
				$ 86,727		
1	$ 20,000	$ 6,071	$ 13,929	72,798	$ 15,166	$ 21,237
2	20,600	5,096	15,504	57,294	16,141	21,237
3	21,218	4,011	17,207	40,086	17,226	21,237
4	21,855	2,806	19,049	21,038	18,431	21,237
5	22,510	1,473	21,038	-	19,764	21,237
	106,183	19,456	86,727		86,727	106,183

- Note that the **total expense is static** from year to year.

Side by Side Comparison
Balance Sheet

	Old Standard	New Standard
Assets		
Cash	$ 2,000,000	$ 2,000,000
Accounting receivable	11,500,000	11,500,000
Contract asset	1,500,000	1,500,000
Prepaid expenses and other current assets	500,000	500,000
Total Current Assets	15,500,000	15,500,000
Property and Equipment	10,279,000	10,000,000
Operating Lease Right of Use Asset	--	5,805,000
Financing Lease Right of Use Asset	--	279,000
Total Assets	$ 25,779,000	$ 31,584,000
Liabilities and Stockholder's Equity		
Line of credit	$ 3,500,000	$ 3,500,000
Current portion of operating lease liability	--	510,000
Current portion of financing lease liability	--	92,000
Current portion of capital lease obligations	92,000	--
Accounts payable and accrued expenses	7,000,000	7,000,000
Contract liability	2,000,000	2,000,000
Total Current Liabilities	12,592,000	13,102,000
Operating Lease Liability, less current portion	--	5,295,000
Financing Lease Liability, less current portion	--	191,000
Capital Lease Obligations, less current portion	191,000	--
Total Liabilities	12,783,000	18,588,000
Stockholder's Equity	12,996,000	12,996,000
Total Liabilities and Stockholder's Equity	$ 25,779,000	$ 31,584,000

	Old Standard	New Standard
Debt to Equity Ratio		
Total Liabilities	$ 12,783,000	$ 18,588,000
Total Equity	12,996,000	12,996,000
Debt to Equity Ratio	0.98	1.43

	Old Standard	New Standard
Current Ratio		
Current Assets	$ 15,500,000	$ 15,500,000
Current Liabilities	12,592,000	13,102,000
Current Ratio	1.23	1.18

	Old Standard	New Standard
Working Capital		
Current Assets	$ 15,500,000	$ 15,500,000
Current Liabilities	12,592,000	13,102,000
Working Capital	$ 2,908,000	$ 2,398,000

Side by Side Comparison
Income Statement

	Old Standard	New Standard
Revenues Earned	$ 40,000,000	$ 40,000,000
Cost of Revenues Earned	35,000,000	35,000,000
Gross Profit	5,000,000	5,000,000
General and Administrative Expenses		
Office salaries, payroll taxes and benefits	3,400,000	3,400,000
Rent	595,000	--
Operating lease	--	595,000
Travel and entertainment	300,000	300,000
Depreciation and amortization	248,850	248,850
Office expense	200,000	200,000
Total General and Administrative Expenses	4,743,850	4,743,850
Income from Operations	256,150	256,150
Other Expense		
Interest expense	11,150	11,150
State Income Tax Expense	50,000	50,000
Net Income	$ 195,000	$ 195,000

	Old Standard	New Standard
Debt Coverage Ratio		
Net Income	195,000	195,000
Plus: Interest expense	11,150	11,150
Plus: Taxes	50,000	50,000
Plus: Depreciation and amortization	248,850	248,850
Plus: Operating lease expense	--	--
EBITA	505,000	505,000
Current debt and capital/financing leases	92,000	602,000
Interest expense	11,150	11,150
Debt Service	103,150	613,150
Debt Coverage Ratio	4.90	0.82

Leases

What were some observations from initial application?

1. Most private companies elected to adopt as of the beginning of the year of adoption (January 1, 2022).
   a) Using this method, only future payments from January 1, 2022, and forward were utilized.
2. The initial adjustment to bring operating leases onto the balance sheet was almost always balance sheet adjustment.
   a) ROU assets = Total lease liability = No change to equity.

Leases

What were some observations from initial application?

3. Specialized lease software was helpful, but not perfect.
   a) Input data needs to be 100% correct.
   b) Software reporting needed to be scrutinized.
4. Leases with uneven payments created P&L adjustments.
5. Ongoing accounting is not "set it and forget it."
6. *Every company* had to, and continues to have to, consider the impact.
7. Financial statement disclosures were widely enhanced.

Leases

Financial Statement Disclosures

- Accounting change - Cumulative effect of the change on retained earnings, if any
- Accounting change - Effect on income from continuing operations, net income, or any other line item
- Lease accounting policy disclosures
- Narrative description of leasing activity including extension and termination options
- More required financial disclosures about lease assets by class (operating/finance):

    -Expense and cash flow disclosures.
- Future annual payment analysis for next 5 years by year and by class
- Weighted average lease term and discount rate by class

Leases

What were the biggest issues?

1. Unwritten leases
2. Uncertain lease terms:
   a) Month-to-month
   b) Optional renewal periods
3. Leasing activity with related parties
4. Leasehold improvements:
   a) Depreciation should be over the shorter of the useful life or the lease term.

Leases

Was there any guidance?

- Financial Accounting Standards Board (FASB) released a new accounting update ASU 2023-01 in March 2023.
  - Allows the use of written terms and conditions of a common control arrangement to determine whether a lease exists and, if so, the classification of and accounting for that lease.
  - In addition, the ASU requires all entities (i.e., including public companies) to amortize leasehold improvements associated with common control leases over the useful life to the common control group.

3. ERISA/PENSION UPDATE

2023 Pension Update

- 2024 Pension Limits
- SECURE 2.0 Act
- DOL Changes to 2023 Form 5500

2024 Pension Limits

	2024	2023	2022
401(k) Elective Deferrals (Section 402g)	$ 23,000	$ 22,500	$ 20,500
Catch-Up Contribution Limit (Section 414v)	$ 7,500	$ 7,500	$ 6,500
Annual Defined Contribution Limit (Section 415)	$ 69,000	$ 66,000	$ 61,000
Annual Compensation Limit (Sections 401, 404, 408)	$ 345,000	$ 330,000	$ 305,000
FICA Wage Limit	$ 168,600	$ 160,200	$ 147,000
SIMPLE Employee Deferrals	$ 16,000	$ 15,500	$ 14,000
SIMPLE Catch-Up Deferrals	$ 3,500	$ 3,500	$ 3,000

SECURE ACT 2.0

- On December 29, 2022, Setting Every Community Up for Retirement Enhancement Act (SECURE Act 2.0) was enacted as part of the Consolidated Appropriations Act.
- The legislation combines provisions from the Securing a Strong Retirement Act of 2022, the Enhancing American Retirement Now (EARN) Act, and the Retirement Improvement and Savings Enhancement to Supplement Health Investments for the Nest Egg (RISE & SHINE) Act.
- The Act contains ninety-two (92) new provisions to promote savings, boost incentives for businesses, and offer more flexibility to those saving for retirement.

SECURE ACT 2.0

Provisions Effective January 1, 2023

- SECURE 2.0 Act makes some enhancements to the credits:
  - 2019 SECURE Act provided certain eligible employers (generally with no more than 100 employees who received at least $5,000 of compensation) with an election to claim an income tax credit for their qualified costs associated with establishing a new retirement plan for the plan's first 3 years.
  - The 3-year small business startup credit is currently 50 percent of administrative costs and can generate an annual credit between $500 and $5,000 each year.

SECURE ACT 2.0

Provisions Effective January 1, 2023

- SECURE 2.0 Act makes some enhancements to the credits:
  - Employer plan start-up credit is increased from 50 percent to 100 percent for employers with up to 50 employees.
  - Note - Employers with greater than 50 employees, but no greater than 100, will continue to qualify for the for the existing 50 percent credit.

SECURE ACT 2.0

Provisions Effective January 1, 2023

- SECURE 2.0 Act makes some enhancements to the credits:-
  - An additional credit is also provided based upon employer contributions made:
    - The amount of the additional credit generally will be calculated by applying an “applicable percentage” to the amount contributed by the employer on behalf of employees, up to a per-employee cap of $1,000.
    - The full additional credit is limited to employers with 50 or fewer employees.
    - The credit is reduced for employers with between 51 and 100 employees.

SECURE ACT 2.0

Provisions Effective January 1, 2023

- SECURE 2.0 Act makes some enhancements to the credits:-
  - An additional credit is also provided based upon employer contributions made:
    - The applicable percentage is 100 percent in the first and second years, 75 percent in the third year, 50 percent in the fourth year, 25 percent in the fifth year with no credit for tax years thereafter.
    - The applicable percentage is reduced by 2 percentage points for every employee over the 50-employee limitation.
    - Employer contributions to an employee's retirement account are only eligible to be included in the credit calculation if the employee wages for the taxable year are less than $100,000 in 2023 (indexed annually).

SECURE ACT 2.0

Provisions Effective January 1, 2023

SECURE 2.0 Act makes some enhancements to the credits:

- Certain IRS rules continue to apply:
  - Both credits are elective.
  - There is as an employer aggregation test to determine employer eligibility.

SECURE ACT 2.0

Provisions Effective January 1, 2023

- Required - Increase in age for required beginning date for mandatory distributions from age 72 to age 73 and to age 75 by year 2033.
- Required - Expansion of Employee Plans Compliance Resolution System (EPCRS). Expands EPCRS to (1) allow inadvertent errors to be self-corrected within a "reasonable time" and (2) apply to inadvertent IRA errors.

SECURE ACT 2.0

Provisions Effective January 1, 2023

- Required - Eliminating unnecessary plan requirements related to unenrolled participants. Eliminates requirement for employers to provide certain annual ERISA or code notices to unenrolled participants who have not elected to participate in a workplace retirement plan provided they receive disclosures initially and a subsequent annual reminder of the right to enroll.
- Required - Reduces the penalty for failure to take RMDs from 50% to 25%, with a further reduction to 10% if the RMD failure is corrected in a timely manner.

SECURE ACT 2.0

Provisions Effective January 1, 2023

- Optional - Employer may rely on employee certifying that deemed hardship distribution conditions are met.
- Optional - Treatment of employer matching or nonelective contributions as Roth contributions. Allows defined contribution plans to provide participants with the option of receiving matching and qualified nonelective contributions on a Roth basis.

SECURE ACT 2.0

Provisions Effective January 1, 2024

- Required - All catch-up contributions for workers with wages over $145,000 during the previous year to be deposited into a Roth (i.e., after tax) account.
  - The wage threshold will be adjusted annually for inflation beginning in 2025 (rounded down to the lowest multiple of $5,000).
  - However, on August 25, 2023, the IRS issued Notice 2023-62, which will allow a two-year transition period for this provision. Therefore, plans and plan sponsors will have until January 1, 2026, to implement this provision.

SECURE ACT 2.0

Provisions Effective January 1, 2024

- Required - Penalty-free withdrawals for certain emergency expenses. Provides an exception to the early withdrawal penalty for distributions up to $1,000 annually used for emergency expenses. A taxpayer has the option to repay the distribution within three years.

- Required - Updating dollar limit for mandatory distributions. Increases the amount that plans can require to be distributed without consent from $5,000 to $7,000.

- Required - Roth plan distribution rules. Eliminates pre-death RMDs from Roth accounts in employer plans.

SECURE ACT 2.0

Provisions Effective January 1, 2024

- Optional - Student loan matching. Permits an employer to make matching contributions under a 401(k) plan with respect to “qualified student loan payments.”
- Optional - Emergency savings accounts linked to individual account plans. Provides employers the option to offer to their non-highly compensated employees’ pension-linked emergency savings accounts. Contributions are treated as Roth and are prohibited once the account balance meets or exceeds $2,500 (indexed). Auto-enrollment and match are permitted, subject to conditions.
- Optional - Penalty-free withdrawals for victims of domestic abuse. Allows retirement plans to permit participants that self-certify that they experienced domestic abuse to withdraw up to the lesser of $10,000 indexed (or 50% of the vested balance) within one year of incident without penalty.

SECURE ACT 2.0

Provisions Effective January 1, 2025

- Required - Auto-enrollment and auto-escalation for all **NEW** 401(k) and 403(b) plans.
  - Certain exceptions for:
    - Collective bargaining plans
    - Church plans
    - Governmental plans
    - As well as plans established on or before December 29, 2022
  - The initial automatic enrollment amount is at least 3% but not more than 10%.
  - Each year thereafter, that amount is increased by 1% until it reaches at least 10%, but not more than 15%.

SECURE ACT 2.0

Provisions Effective January 1, 2025

- Required - Higher catch-up limit to apply at ages 60, 61, 62 and 63. Increases catch-up limits to the greater of $10,000 or 50% more than the regular catch-up amount in 2025 for individuals who have attained ages 60, 61, 62 and 63.
  – The increased amounts are indexed for inflation after 2025.
- Required - Improving coverage for part-time workers.
  – Reduces to two years (from three years) the requirement to allow long-term, part-time workers to participate in employers' 401(k) plans.

SECURE ACT 2.0

Provisions Effective January 1, 2025

- Required - Retirement savings lost and found. Requires DOL to create and administer a national online searchable lost and found database for Americans' retirement plans; requires plan administrators to provide annual reporting of disposition of balances for vested terminated participants.

SECURE ACT 2.0

Provisions Effective January 1, 2026

- Required - Requirement to provide paper statements in certain cases. Amends ERISA to generally provide that, with respect to defined contribution plans, unless a participant elects otherwise, the plan is required to provide a paper benefit statement at least once annually.

SECURE ACT 2.0

- Plan amendments to conform the terms of a qualified plan to the requirements of SECURE 2.0 are not required until the end of the 2025 plan year.
- However, plans must be in operational compliance with all mandatory provisions of SECURE 2.0 (as well as the SECURE Act and other recent legislation) from the effective date of the applicable provisions to maintain tax-qualified status.

SECURE ACT 2.0

- Employers will also need to carefully coordinate with their recordkeepers and advisors to determine whether and when to implement the many optional provisions of SECURE 2.0.
- Practical constraints may come into play too, as some optional features may not be available on your plan provider’s platform until a later date.

DOL Changes to 2023 Form 5500

- In February 2023, the DOL, the IRS and the Pension Benefit Guaranty Corporation released Federal Register Notices that announce changes to the 2023 Form 5500 Annual Return/Report of Employee Benefit Plan and Form 5500-SF Short Form.

DOL Changes to 2023 Form 5500

- Participant-counting methodology for defined contribution retirement plans will be based on the number of participants with account balances:
  - Rather than the current method that counts individuals who are eligible to participate even if they have not elected to participate and do not have an account in the plan.
  - As a result, some plans could be able to claim the small plan audit exemption.
  - DOL/IRS estimates that 20,000 plans will no longer need an audit to be performed.
  - 80/120 Participant Rule still applies.

DOL Changes to 2023 Form 5500

DOL is expanding the administrative expense breakdown on the Schedule H, as follows:

- Salaries and allowances
- Contract administrator fees
- Recordkeeping fees
- IQPA audit fees
- Investment advisory and management fees
- Bank or trust company trustee or custodian fees
- Actuarial fees
- Legal fees
- Valuation or appraisal fees
- Other trustee fees or expenses
- Other expenses

DOL Changes to 2023 Form 5500

The addition of selected Internal Revenue Code compliance questions to various existing schedules to improve tax oversight and compliance of tax-qualified retirement plans.

- The IRS has stated that this data will be used for a variety of purposes, which include:
  - Performing a pre-examination analysis
  - Assisting the IRS to prepare initial audit information and document requests
  - Helping identify whether an employer adopted a preapproved plan
  - Determining whether the plan is up to date for all required law changes
- The DOL stated nondiscrimination testing **should be completed by the due date** of the Form 5500, meaning **failure to answer the questions** on the return could **raise red flags**.

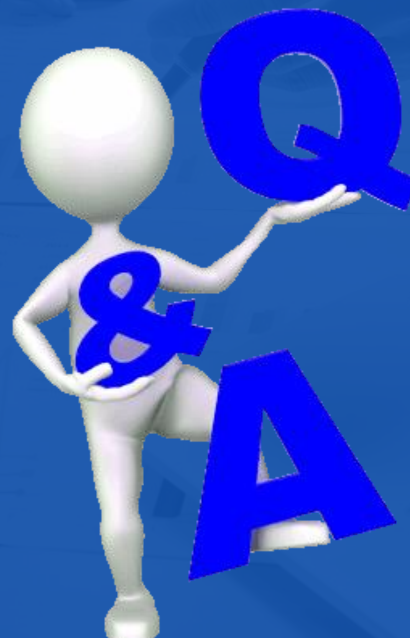
DOL Changes to 2023 Form 5500

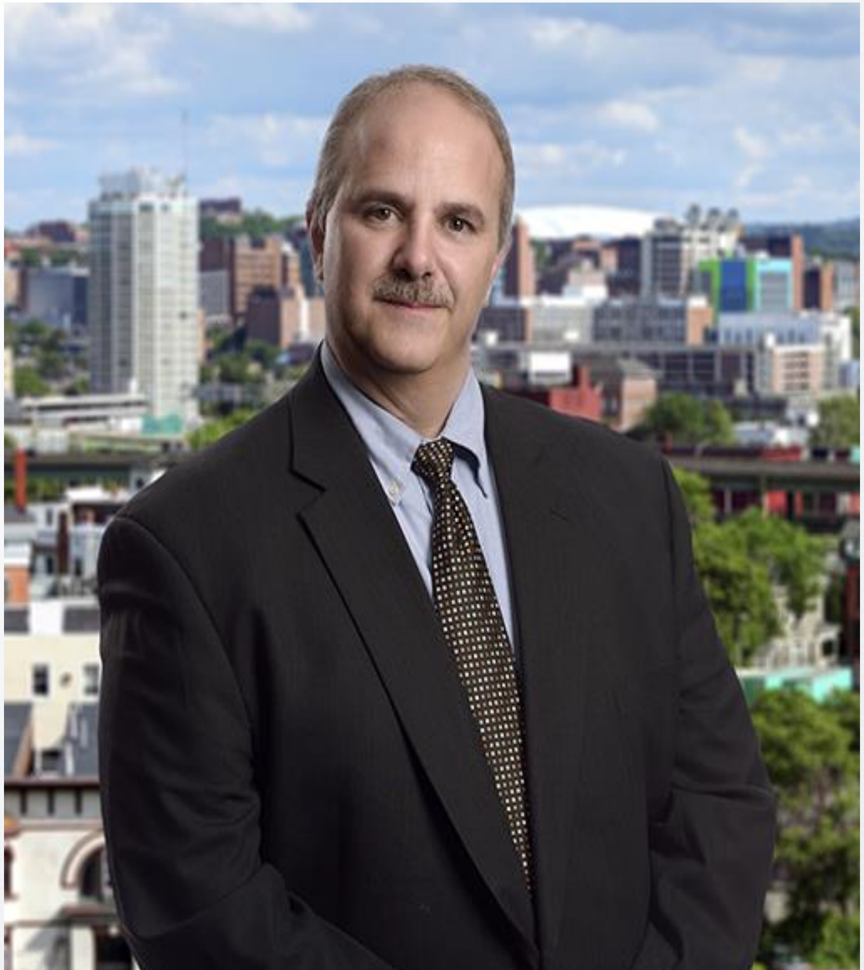
- Further improvements in financial and funding reporting by PBGC-covered defined benefit plans:
  - Those with 1,000 or more participants at the beginning of the plan year.
  - Enabling the PBGC to better model important characteristics of plan portfolios.

DOL Changes to 2023 Form 5500

- A consolidated Form 5500 reporting option for certain groups of defined contribution retirement plans, improved reporting by pooled employer plans and other multiple employer plans.
  - New Schedule MEP that will consolidate and standardize information that was previously reported as an attachment to the Form 5500. The new schedule will report the same information that was previously required to be reported in an attachment to the Form 5500.
- Technical and conforming changes as part of the annual rollover of forms and instructions.

Questions





Joseph Chemotti, CPA, CCIFP
Audit Partner

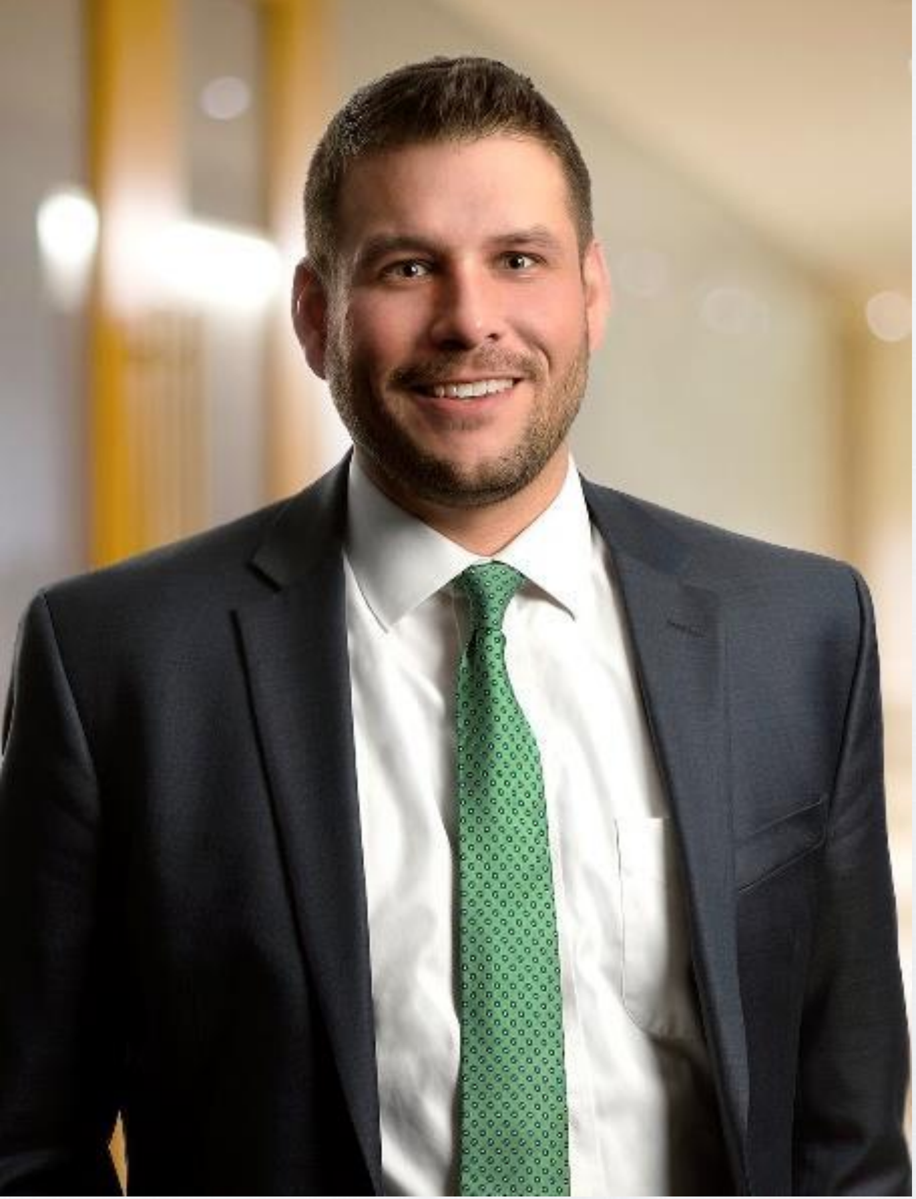
Email: jchemotti@dmcpas.com

Web: www.dmcpas.com

Address:

DM Financial Plaza
221 S. Warren St.
Syracuse, New York 13202-1628

Phone: (315) 472-9127, ext. 121



Benjamin Sumner, CPA
Audit Partner

Email: bsumner@dmcpas.com

Web: www.dmcpas.com

Address:

DM Financial Plaza
221 S. Warren St.
Syracuse, New York 13202-1628

Phone: (315) 472-9127, ext. 221

Circular 230

Any tax advice contained herein was not intended or written to be used, and cannot be used, for the purpose of avoiding penalties that may be imposed under the Internal Revenue Code or applicable state or local tax law provisions.

Copyright / Disclaimer