Volatile Accounting amid a Volatile Economy

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The Association of
Accountants and
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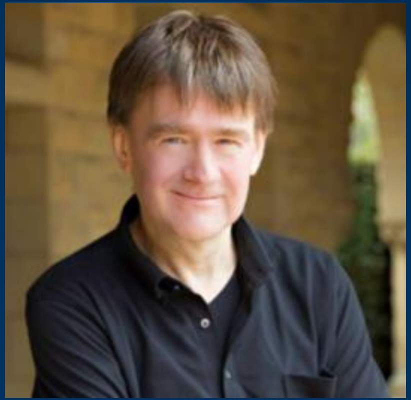
Featured Presenters



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About Connor Group

Connor Group is a specialized professional services firm of Big 4 alumni and industry executives. Our team of highly experienced professionals helps financial and operation executives with their most complex and significant matters, including digital solutions, financial accounting and operations, IPO and M&A services, and managed services.

Agenda

1. Introduction
2. Update on FASB standard-setting activities
3. Effective date reminders
4. SEC hot topics
5. Impairment of long-lived assets
6. Conclusion
7. Key take away

Poll Question 1:

I am working at (or for)

a. A private company
b. A public company
c. An audit or consulting firm
d. An investment company or similar
e. No one. Work is unusual and cruel punishment

Poll Question 1 Results: (Placeholder)

FASB Update

FASB Update

Selected FASB projects

Project	Key Provision
Segment reporting Final ASU expected Q4 2023 Effective from YE 2024, interim in 2025 Applied retrospectively unless impracticable	• Disclose significant expenses • Disclose “other segment items” • Require interim segment disclosures • Permit multiple measures of segment P&L • Require all segment disclosures for single segment entities • Define “significance”
Cryptocurrencies Final ASU expected Q4 2023 Effective 2025	• Fair value accounting required for crypto • Excludes assets with rights to or claims on goods, services, or other assets
Profits interest awards Final ASU expected Q1 2024	• Examples of when profit interests are or are not in scope of ASC 718 • May result in some awards => to ASC 718
Income tax disclosures Final ASU expected Q4 2023 Effective from YE 2025, interim in 2026 Prospective (retrospective optional)	• Major enhancements to rate reconciliation • Disaggregate by country (except UTB), cross-border effects, tax credits and unusual items • Qualitative discussion only for non-public entities

FASB Update

Selected FASB projects

Project	Key Provision
Acquired financial assets Final ASU expected Q1 2024	• Gross-up (no upfront loss) approach extended to financial assets (1) acquired in a business combination and (2) seasoned financial assets acquired in assets acquisitions • Seasoned = >90 days since origination and no involvement of acquirer
Disaggregation of income statement expenses Comment letters on proposed ASU due 10/30	• Applicable to public business entities • Disclose components of all reported expenses: inventory and manufacturing, employee compensation, depreciation, intangible amortization • Disaggregate inventory and manufacturing into inventory purchases, employee compensation, depreciation, amortization, other • Disclose total selling expenses

Select ASUs
Effective Dates Reminders

Select ASUs

Effective Dates Reminders

Select ASUs – Effective in 2023

	Public Entities Effective Date	Private Entities Effective Date
ASU 2016-13, Credit Losses	adopted in 2020	**2023**
ASU 2017-04, Goodwill Impairment Test	adopted in 2020	**2023**
ASU 2021-08, Acquired Contract Assets and Liabilities	**2023**	2024
ASU 2022-02, TDR and Vintage Disclosures	**2023**	**2023**
ASU 2022-04, Supplier Finance Programs	**2023***	**2023***

** Except for the rollforward information, which is not effective until 2024*

Select ASUs Effective Dates Reminders

Select ASUs – Recently Issued and Effective after 2023

	Public Entities Effective Date	Private Entities Effective Date
ASU 2020-06, Debt with Conversion Options	adopted in 2022	2024
ASU 2023-01, Common Control Leases	2024	2024
ASU 2023-02, Investment in Tax Credit Structures	2024	2025
ASU 2023-05, Joint-Venture Formations	2025	2025

SEC Reporting Considerations

IPO Landscape

Cautious optimism for successful IPOs

- Improving conditions for companies considering IPOs – but profits/strong performance are key
- Limited appetite for risk/promises of future performance/technology
- Several IPOs complete in September/October
  - Birkenstock $1.5 billion (N/A)
  - Klaviyo $570 million (16% up)
  - Instacart $660 million (10% down)
  - Neumora Therapeutics $250 million (34% down)
  - Rayze Bio $310 million (11% up)
  - ARM Holdings $4.9 billion (9% up)
- Many companies want to see the window open
- Stock market is volatile but outlook cautiously optimistic

SEC Reporting Considerations: Cheap Stock

SEC Reporting Considerations

Cheap Stock

IPO – Cheap Stock

- “Cheap stock” concept
- 409(A) date vs. grant date
- Secondary sales of options
- “Cheap stock letters”:
    - Summary of granted awards
    - Fair value methodology
    - Key factors driving changes
    - Bridging to the IPO price range

SEC Reporting Considerations

Cheap Stock

Bridging to the IPO Price

Example factors:

- Elimination of “stay-private” scenarios, conversion of preferred stock into common upon IPO, improved access to capital markets
- Completion of milestones and other events
  - Operating results
  - Development successes
  - New product launches
  - Key customer acquisitions
  - Hiring of key personnel
  - Additional financing raised
- Changes in general market conditions

SEC Reporting Considerations: Hot Topics in Reporting

SEC Reporting Considerations

SEC Comment Letter Trends

SEC Comment Letter Trends

- Nearly 60% YoY increase in the number of letters over 6 months
- More than 70% YoY increase in the number of receiving companies
- Increased focus on smaller companies (<$700 million market cap)
- Most frequent comment areas:
  - MD&A – results of operations (39%)
  - Non-GAAP measures

Source: EY SEC Reporting Update: Highlights of trends in 2023 SEC staff comment letters, dated September 14, 2023

SEC Reporting Considerations

MD&A

Key Points – Results of Operations

- Significant components of revenue and expense to understand the results of operations
- Impact of significant events/transactions
- Quantitative and/or qualitative for each significant factor
- Expectations for the future – known trends or uncertainties

SEC Reporting Considerations

Non-GAAP Measures

Key Points

- Filings, websites, investor presentations, earnings call transcripts
- No full non-GAAP income statement
- Equal or greater prominence
  - Reconcile from GAAP to non-GAAP
- Misleading or prohibited
  - Normal, recurring cash operating expenses necessary for business operations
  - Individually tailored (custom) GAAP rules
- Non-recurring
- Tax effects
- Non-GAAP Compliance and Disclosure Interpretations (C&DIs)

Poll Question 2:

I am mostly excited to see the upcoming accounting rules on…

a. Enhanced segment disclosures
b. New tax disclosures
c. Presentation of disaggregated expense information
d. Fair value accounting for crypto
e. Nothing. I vote to make 2024 a Zero-New-Rule Year

Poll Question 2 Results: (Placeholder)

Impairment of non-financial assets

Hot Topics

Impairment of non-financial assets

Order of impairment testing

Order of impairment testing

Guidance

360-10-35-27

Other than goodwill, the carrying amounts of any assets (such as accounts receivable and inventory) and liabilities (such as accounts payable, long-term debt, and asset retirement obligations) not covered by this Subtopic that are included in an asset group shall be adjusted in accordance with other applicable generally accepted accounting principles (GAAP) before testing the asset group for recoverability. Paragraph 350-20-35-31 requires that goodwill be tested for impairment only after the carrying amounts of the other assets of the reporting unit, including the long-lived assets covered by this Subtopic, have been tested for impairment under other applicable accounting guidance.

350-20-35-31

If goodwill and another asset (or asset group) of a reporting unit are tested for impairment at the same time, the other asset (or asset group) shall be tested for impairment before goodwill. For example, if a significant asset group is to be tested for impairment under the Impairment or Disposal of Long-Lived Assets Subsections of Subtopic 360-10 (thus potentially requiring a goodwill impairment test), the impairment test for the significant asset group would be performed before the goodwill impairment test. If the asset group was impaired, the impairment loss would be recognized prior to goodwill being tested for impairment.

Impairment of non-financial assets

Order of impairment testing

Order of impairment testing

Practical application

1. Indefinite-lived intangible assets (ASC 350-30)*
   - Annually, and more frequently if impairment indicators exist
2. Long-lived assets to be held and used (ASC 360-10)
   - When impairment indicators exist
3. Goodwill (ASC 350-20)
   - Annually, and more frequently if impairment indicators exist

* Other assets subject to impairment testing are tested at the same time (e.g., capitalized contract costs, inventory, equity method investments).

Exception: Disposal groups held for sale – adjust goodwill before measuring the fair value of the disposal group

Graph source: EY Long-lived assets impairment FRD, 2.3.1.4, 4.2.3.2

Impairment of non-financial assets

Indefinite life intangibles – IPR&D

Frequency of testing

Guidance

350-30-35-18

An intangible asset that is not subject to amortization shall be tested for impairment annually and more frequently if events or changes in circumstances indicate that it is more likely than not that the asset is impaired.

Practical application

"…more frequently if events or changes and circumstances indicate…"

…should be considered at any point throughout the period

Impairment of non-financial assets

Indefinite life intangibles – IPR&D

Qualitative assessment

Guidance

350-30-35-18A

An entity may first perform a qualitative assessment, as described in this paragraph and paragraphs 350-30-35-18B through 35-18F, to determine whether it is necessary to perform the quantitative impairment test as described in paragraph 350-30-35-19. An entity has an unconditional option to bypass the qualitative assessment for any indefinite-lived intangible asset in any period and proceed

Practical application

The fair value of IPR&D can be affected by various factors, including

- Progress of research and development (timing, ongoing success)
- Changes in projected sales or costs of development and commercialization
- Changes in entity strategy, management, etc.
- Emerging competition
- Industry and market considerations and macroeconomic conditions

Threshold: More likely than not (>50%)

See 350-30-35-18B through 18F.

Impairment of non-financial assets

Example – IPR&D

Biotech entity W has a single recorded IPR&D asset acquired in 2019 (carrying value of $55 million). The development has continued as anticipated. There are no changes in the forecasts, company strategy or other factors. No impairment has been recognized to date.

In 2023, W's market capitalization has declined 40% due to both general market and industry factors and termination of a collaboration unrelated to the IPR&D asset.

How would company assess whether IPR&D is impaired?

A. A qualitative assessment (that it is more likely than not that the IPR&D asset is not impaired) should be sufficient.

B. A qualitative assessment is likely insufficient.

Poll Question 3:

If the company temporarily changes the period the volume weighted average stock price is calculated from 20 to 5 days on its convertible notes to incentivize holders to convert, this is…

a. An inducement
b. An extinguishment
c. A modification
d. Something I will ask my auditor
e. An unfair question to ask when the presentation did not cover this material at all

Poll Question 3 Results: (Placeholder)

Impairment of non-financial assets

Long-lived Assets – Defining Asset Groups

Timing of Changes in Asset Groups

Practical application

Asset groups are reassessed when there are changes in facts and circumstances such as operating structure, how long-lived assets are deployed, and how the entity expects to recover their costs.

When lease ROU assets are involved, typical indicators of change are

- A sublease agreement is signed
- Cease use of the leased facility
- Change use of the facility (into another asset group)
- Significant costs to vacate the facility are incurred
- Hired a broker/actively marketing the facility

See EY Long-lived Assets Impairment FRD 2.7, KPMG Impairment Handbook Q&A 3.3.110 and KPMG Leases Handbook Q&A 6.5.60 for interpretative guidance.

Impairment of non-financial assets

Case study – Defining asset groups

Background information

Biotech public company ABC operates out of three leased facilities, San Andres, Santa Barbara and Santa Claus. There is a single asset group for all long-lived assets, which is the entire Company.

In April 2023, the Board approved a RIF and a restructuring intended to focus on three key R&D programs. The Company announced it expects to significantly reduce its manufacturing footprint. Although not announced, this will lead to closure of the San Andres facility, making it available for sublease after the currently planned manufacturing batches are completed. This is expected after December 31, 2023. A significant loss will likely result.

Various equipment in the San Andres facility will be sold once manufacturing is completed. A significant loss is expected.

In May 2023, another tenant in the Santa Claus facility approached the Company inquiring if the Company may be willing to cede its offices. A term sheet binding the parties to negotiate a sublease in good faith was signed on June 25, with the tentative sublease date of October 1. The Board authorized management to negotiate and enter into a sublease consistent with the terms in the term sheet, during its offsite meeting in Taipei on July 1 (June 30 after close of business in the Santa Barbara time zone).

Impairment of non-financial assets

Case study – Question 1

Should company ABC classify equipment in the San Andres facility that will be sold after the manufacturing is completed in December 2023, as assets held for sale, and the estimated loss recognized, as of June 30, 2023?

A. Yes

B. No

Impairment of non-financial assets

Case study – Question 1 Debrief

A long-lived asset or disposal group to be sold shall be classified as held for sale in the period in which all of the following criteria are met:

- Management, having the authority to approve the action, commits to a plan to sell the asset.
- The asset is available for immediate sale in its present condition, subject only to terms that are usual and customary for sales of such assets.
- An active program to locate a buyer and other actions required to complete the plan to sell the asset have been initiated.
- The sale of the asset is probable, and transfer of the asset is expected to qualify for recognition as a completed sale, typically within one year. The term probable refers to a future sale that is likely to occur.
- The asset is being actively marketed for sale at a price that is reasonable in relation to its current fair value. The price at which a long-lived asset is being marketed is indicative of whether the entity currently has the intent and ability to sell the asset.
- Actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.

Impairment of non-financial assets

Case study – Question 2

Should company ABC separate San Andres and Santa Claus facilities ROU assets and leasehold improvements into separate asset groups for impairment purposes as of June 30, 2023?

A. Only the San Andres facility assets

B. Only the San Cornelio facility assets

C. Both facilities' assets (two separate groups)

D. Neither facility's assets

Impairment of non-financial assets

Case study – Question 2 Debrief

KPMG Lease Handbook Q&A 6.5.60

"The triggering event for reassessing asset groupings is generally the change in facts or circumstances, not the commitment to a plan to make the change. This means that committing to a plan to abandon an ROU asset or to sublease an underlying asset generally will not, in isolation, trigger a reassessment of asset grouping if the lessee is continuing to use the underlying asset in substantially the same manner as before committing to the plan. Until the lessee has undertaken substantive actions directly relevant to effecting that plan, the independence of cash flows likely has not changed for the original asset group; however, all facts and circumstances should be considered."

EY Long-lived asset impairment FRD 2.7

"…a lessee needs to determine whether there has been a fundamental change in the use of the leased asset… A plan to change how the leased asset will be used by the business or to sublease the leased asset, by itself, generally does not indicate that the ROU asset's group has changed, since the lowest level of identifiable cash flows has not yet changed. For example, a lessee may decide that in one year it will sublease a leased asset that is part of an enterprise-wide asset group but it will continue to use the leased asset until then. The ROU asset would still be part of the enterprise-wide asset group because the lessee continues to use the leased asset."

Advanced topics in impairment of non-financial assets

Long-lived assets impairment

Testing recoverability – Key reminders

Estimation period – life of the primary asset (360-10-35-31)

Cash flows include proceeds from disposal of the asset group (360-10-35-29)

Likelihood of outcomes should be considered (360-10-35-30)

For assets in use, cash flows based on existing service potential (360-10-35-33)

For assets in development, cash flows based on expected service potential

- Include remaining development costs (360-10-35-34)

Lease (and debt) payments (principal) – align with the asset group (EY FRD 2.7.1)

Include variable lease payments (KPMG Leases 6.5.30)

Negative value asset groups should also be tested (KPMG Leases 6.5.32)

Impairment of non-financial assets

Case study – Question 3

Biotech company ABC tests its assets for recoverability at June 30, 2023. The testing period is through the end of the Santa Barbara lease in 2030 (the related ROU is the primary asset). ABC is currently operating at a loss, all its products are in development, and undiscounted cash flows projected through 2030 are a negative $600 million. Book value of the asset group is $550 million. Market cap of company F is $520 million.

Starting in 2031, company ABC expects to start generating profits, with combined undiscounted cash flows of $12 billion through 2050.

Are long-lived assets recoverable at June 30, 2023?

A. Yes

B. No

C. I don’t know…

Impairment of non-financial assets

Case study – Question 3 Debrief

360-10-35-32

Factors that an entity generally shall consider in determining whether a long-lived asset is the primary asset of an asset group include the following:

… c. The remaining useful life of the asset relative to other assets of the group. If the primary asset is not the asset of the group with the longest remaining useful life, estimates of future cash flows for the group shall assume the sale of the group at the end of the remaining useful life of the primary asset.

KPMG Impairment Handbook, Q&A 7.5.20

Question 7.5.20 **How are future cash flows from disposition estimated?**

Interpretive response: The assumed disposition of the asset group at the end of the useful life of the primary asset is often the assumed sale of those assets. The assumed sale proceeds should be an exit value from a market participant perspective based on the assets and liabilities of the asset group and its service potential existing at the assumed disposition date… If the asset group is a business, often the valuation method used is to estimate the sale price of the asset group assuming its continued operation as a viable business (see Question 7.5.40).

Question 7.5.50 **If an asset group includes all of the entity's long-lived assets, do estimated future cash flows from disposition assume disposal of the entire business?**

Interpretive response: Yes. When an asset group contains all of the entity's long-lived assets, its disposal represents the sale of the business. This means that disposition value includes all value associated with the entity, even if not recorded on the balance sheet…

Poll Question 4:

I would happily have bitcoins...

a. Paid to our company by customers
b. Paid to me as salary
c. Accumulating in my cryptowallet so I can retire next year
d. Mined - I can solve for the hash value in my mind and in no time
e. Go up in smoke and disappear from this world

Poll Question 4 Results: (Placeholder)

Impairment of non-financial assets

Entity-level asset group fair value

Fair Value Approaches

Guidance

350-20-35-23

Substantial value may arise from the ability to take advantage of synergies and other benefits that flow from control over another entity. Consequently, measuring the fair value of a collection of assets and liabilities that operate together in a controlled entity is different from measuring the fair value of that entity's individual equity securities. An acquiring entity often is willing to pay more for equity securities that give it a controlling interest than an investor would pay for a number of equity securities representing less than a controlling interest. That control premium may cause the fair value of a reporting unit to exceed its market capitalization. The quoted market price of an individual equity security, therefore, need not be the sole measurement basis of the fair value of a reporting unit.

Practical application

If asset group = entity level, consider control premium over market cap

- No control premium on cash/marketable securities

Control premiums normally range 0-40%

Impairment of non-financial assets

Long-lived assets impairment

Valuation premises

Guidance

820-10-35-10E

The highest and best use of a nonfinancial asset establishes the valuation premise used to measure the fair value of the asset, as follows:

a. The highest and best use of a nonfinancial asset might provide maximum value to market participants through its use in combination with other assets as a group (as installed or otherwise configured for use) or in combination with other assets and liabilities (for example, a business).

> …3. Assumptions about the highest and best use of a nonfinancial asset shall be consistent for all of the assets (for which highest and best use is relevant) of the group of assets or the group of assets and liabilities within which the asset would be used.

b. The highest and best use of a nonfinancial asset might provide maximum value to market participants on a standalone basis. If the highest and best use of the asset is to use it on a standalone basis, the fair value of the asset is the price that would be received in a current transaction to sell the asset to market participants that would use the asset on a standalone basis.

820-10-35-11A

The fair value measurement of a nonfinancial asset assumes that the asset is sold consistent with the unit of account specified in other Topics (which may be an individual asset). That is the case even when that fair value measurement assumes that the highest and best use of the asset is to use it in combination with other assets or with other assets and liabilities because a fair value measurement assumes that the market participant already holds the complementary assets and associated liabilities.

Impairment of non-financial assets

Long-lived assets impairment

Valuation premises

Practical application
Fair value is always exit price (sale price)

In combination with other assets: Sale price as an asset group or as a business

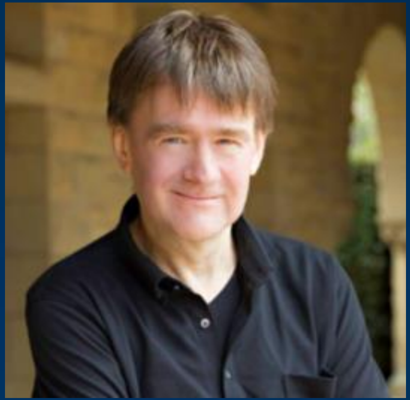
Standalone basis: Sale price on a standalone basis (as is, used or new)

ROU assets
In combination with other assets = continuing lease by the business
- Current market lease rates + annual increase (e.g. 2-3% per year)
- Discounted at the applicable rate (e.g. IBR)

Standalone basis = sublease to a third party
- The same as above, minus
- Lost value for time to find subtenant and lease incentives to subtenant
    - Current market = 1-2 months free for each remaining year of lease

Equipment
Standalone basis = price in the secondary market (used or new as applicable)
Current market = values substantially below typical net book values
In combination with other assets = adjust for installation, transportation etc. costs
(value as part of the existing factory, lab, etc.)

Questions and Answers



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