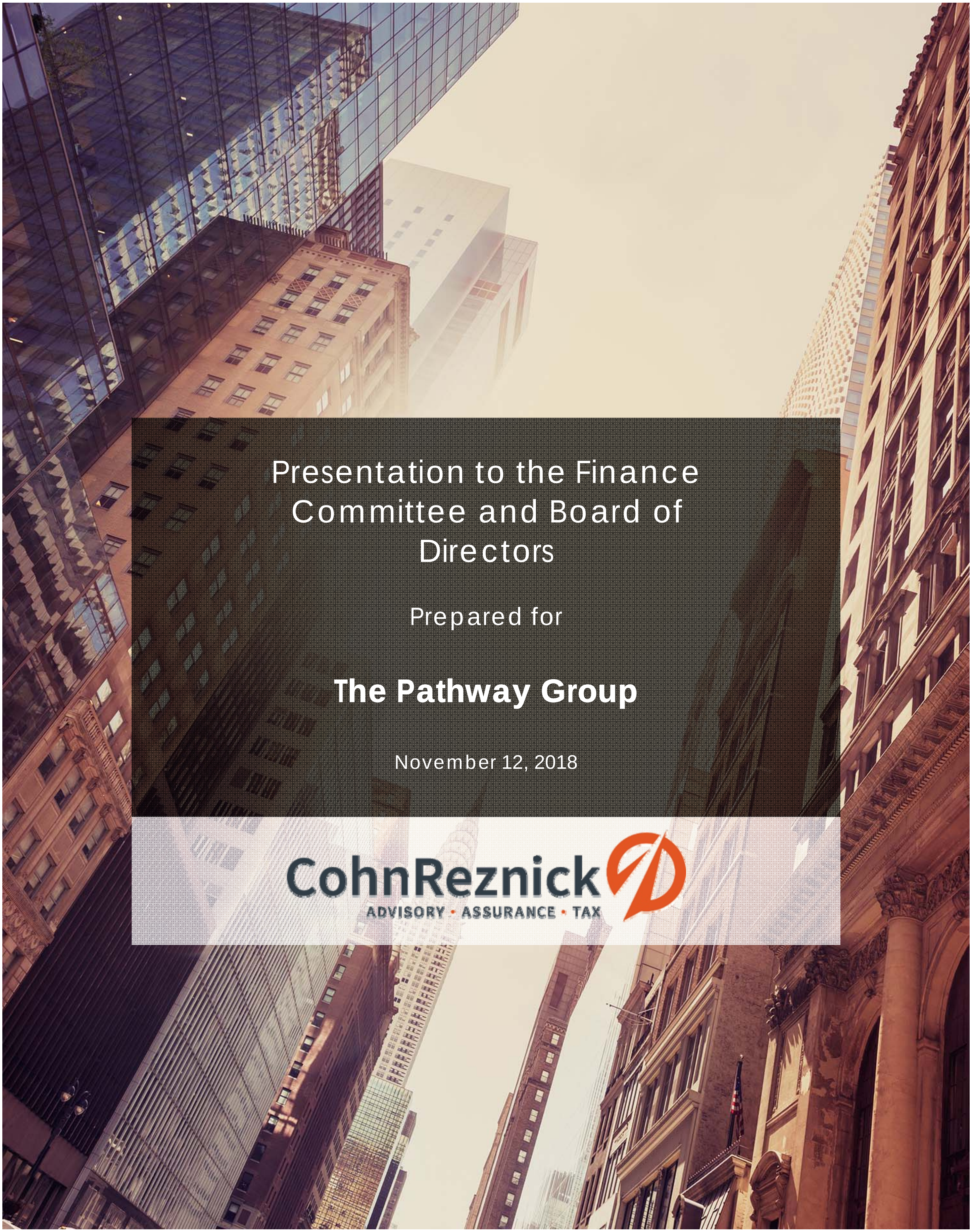

Presentation to the Finance Committee and Board of Directors

Prepared for

The Pathway Group

November 12, 2018

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November 12, 2018

Members of the Finance Committee and Board of Directors
of the Pathway Group:

As a follow-up to our audit of the Pathway Group ("Pathway Homes, Inc.", "Pathway Visions, Inc.", "Pathways Living, Inc.", "Pathway Options, Inc.", "Pathway Recovery, Inc." and "Pathway Homes of Florida, Inc.") (the "Organization") for the year ended June 30, 2018, we are pleased to provide you with a summary of our audit and communication as required by professional standards.

The goal of our engagement plan was to ensure that audit procedures were sufficient to determine that the June 30, 2018 consolidated and combined financial statements ("Financial Statements") were free of material misstatement. We determined our audit scope by performing a risk assessment that, coupled with an evaluation of materiality in relation to the Financial Statements, allowed us to determine the required level of audit effort.

Our audit procedures did not detect any material misstatements in the consolidated and combined statement of financial position of the Organization as of June 30, 2018, or the related consolidated and combined statements of activities and cash flows for the year then ended.

We appreciate and are sensitive to your interests and concerns relating to impacts on the Organization's audit process and the fulfillment of your fiduciary responsibilities as members of the Finance Committee and the Board of Directors (the "Board"). We look forward to discussing these communications and the audited Financial Statements with you.

Very truly yours,

Winell Belfonte, CPA
Partner
CohnReznick LLP

Table of Contents

Audit Results and Communication

June 30, 2018 Audit Results and Communication

As stated in our engagement letters, our audit plan represented an approach responsive to the assessment of risk of material misstatement in the consolidated and combined financial statements of the Pathway Group. We designed our audit to:

- Conduct our audit of the Financial Statements of the Pathway Group as of June 30, 2018, providing reasonable, but not absolute, assurance that the Financial Statements are free of material misstatements.
- Express an opinion on the fair presentation of the Financial Statements in conformity with accounting principles generally accepted in the United States of America.
- Conduct our audit of the consolidated financial statements of Pathway Homes, Inc. ("PHI") as of June 30, 2018, providing reasonable, but not absolute, assurance that the consolidated financial statements are free of material misstatements.

Additionally, we agreed to:

- Express an opinion on the Schedule of Expenditures of Federal Awards, Internal Controls over Financial Reporting and Compliance, required by OMB Uniform Guidance for PHI for the year ended June 30, 2018;
- Audit of the PHI. 403(b) Plan;
- Prepare IRS Form 990 for the year ended June 30, 2018 for PHI and PHF;
- Prepare IRS form 990-EZ for the year ended June 30, 2018 for PLI;
- Provide candid and timely recommendations to management and the Board; and
- Serve as a resource to management and the Board, providing timely industry-specific business and financial advice relevant to the Organization.

Communication to Those Charged with Governance

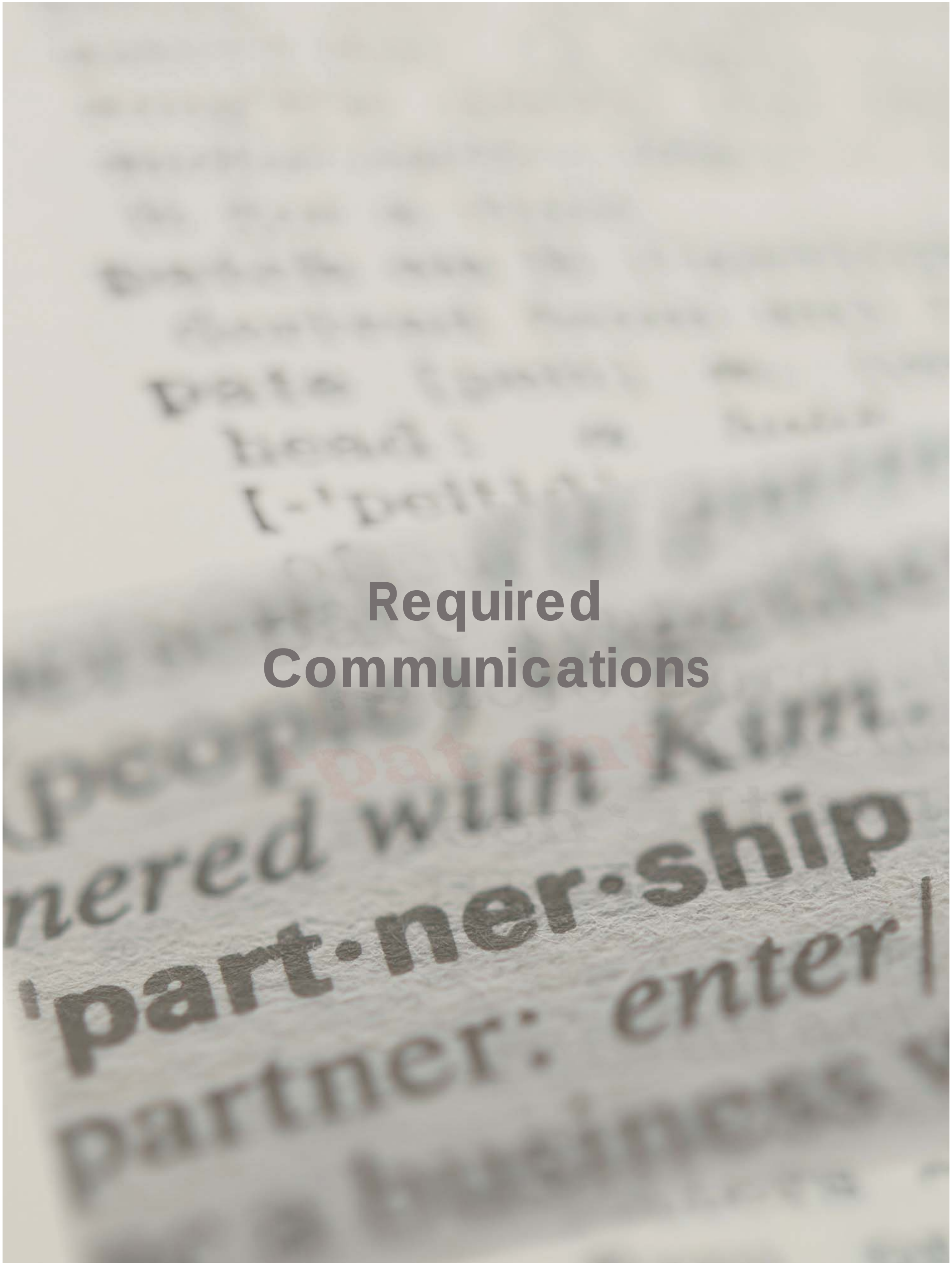
- Professional standards require the auditor to communicate certain matters to those charged with governance that may assist them in overseeing management's financial reporting and disclosure process.


Engagement
Team

CohnReznick continues to serve you with a multi-disciplinary team of professionals who offer both industry expertise and working knowledge of the Organization's business.

Engagement Member	Title	Years of Industry Experience	Phone Number E-Mail Address
Winell Belfonte	Engagement Partner	32	301-961-5546 Winell.Belfonte@CohnReznick.com
Glenn Shelton	Senior Tax Manager	25	301-280-3077 Glenn.Shelton@CohnReznick.com
Christopher Griffin	Engagement Senior Manager – 403(b)	15	301-280-3756 Christopher.Griffin@CohnReznick.com
Micki Lin	Engagement Senior Manager	10	301-280-3624 Micki.Lin@CohnReznick.com
Greg Rogers	Engagement Senior Associate	4	301-280-3732 Greg.Rogers@CohnReznick.com

Required Communications



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October 23, 2018

To the Members of the Finance Committee and Board of Directors
The Pathway Group

We have audited the consolidated and combined financial statements of Pathway Group (Pathway Homes, Inc., Pathway Homes of Florida, Inc., Pathway Options, Inc., Pathway Visions, Inc., Pathways Living, Inc., and Pathway Recovery, Inc.), for the year ended June 30, 2018, and have issued our report thereon dated October 23, 2018. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards, *Government Auditing Standards* and the Uniform Guidance, as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our letter to you dated July 18, 2018. Professional standards also require that we communicate to you the following information related to our audit.

Significant Audit Findings

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the Pathway Group are described in Note 2 to the consolidated and combined financial statements. No new accounting policies were adopted and the application of existing policies was not changed during 2018. We noted no transactions entered into by the Organization during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the consolidated and combined financial statements in the proper period.

Accounting estimates are an integral part of the consolidated and combined financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the consolidated and combined financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimate affecting the consolidated and combined financial statements was:

> Management's estimate of the useful lives of assets is based on prior year estimates. We evaluated the key factors and assumptions used to develop the useful lives of assets in determining that it is reasonable in relation to the consolidated and combined financial statements taken as a whole.

The financial statement disclosures are neutral, consistent, and clear.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

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Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all misstatements identified during the audit, other than those that are clearly trivial, and communicate them to the appropriate level of management. The attached schedule summarizes uncorrected misstatements of the consolidated and combined financial statements. Management has determined that their effects are immaterial, both individually and in the aggregate, to the consolidated and combined financial statements taken as a whole. In addition, none of the misstatements detected as a result of audit procedures and corrected by management were material, either individually or in the aggregate, to the consolidated and combined financial statements taken as a whole.

Disagreements with Management

For purposes of this letter, a disagreement with management is a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the consolidated and combined financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated October 23, 2018.

Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the Organization's consolidated and combined financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the Organization's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Other Matters

With respect to the supplementary information accompanying the consolidated and combined financial statements, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with U.S. generally accepted accounting principles, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the consolidated and combined financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the consolidated and combined financial statements or to the consolidated and combined financial statements themselves.

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This information is intended solely for the use of the Finance Committee, Board of Directors and management of the Pathway Group and is not intended to be, and should not be, used by anyone other than these specified parties.

Very truly yours,

CohnReznick LLP

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Entity:	The Pathway Group			Balance Sheet Date:	June 30, 2018
		Entries to Record—Debit/(Credit)			
Number	Description	Total Assets	Total Liabilities	Net Assets	Change in net assets
2018 MISSTATEMENTS					
1	To fairly state temporarily restricted and unrestricted net assets for volunteer funds activity and VHDA funds	$ -	$ -	$ 27,639	$ -
1	To fairly state temporarily restricted and unrestricted net assets for volunteer funds activity and VHDA funds	$ -	$ -	(27,639)	-
Total Audit Differences		$ -	$ -	$ -	$ -
Financial Statement Caption Totals		$ 16,791,126	$ 4,530,874	$ 12,260,252	$ 1,101,133
Audit Differences as % of F/S Captions		0.00%	0.00%	0.00%	0.00%

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October 23, 2018

To the Members of the Finance Committee and the Board of Directors
of the Pathway Group

In planning and performing our audit of the consolidated and combined financial statements of the Pathway Group (Pathway Homes, Inc., Pathway Homes of Florida, Inc., Pathway Options, Inc., Pathway Visions, Inc., Pathways Living, Inc., and Pathway Recovery, Inc.) (the "Organization") as of and for the year ended June 30, 2018, in accordance with auditing standards generally accepted in the United States of America, we considered the Pathway Group's internal control over financial reporting ("internal control") as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the consolidated and combined financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Organization's internal control. Accordingly, we do not express an opinion on the effectiveness of the Organization's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the Organization's consolidated and combined financial statements will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses. In addition, because of inherent limitations in internal controls, including the possibility of management override of controls, misstatements due to error or fraud may occur and not be detected by such controls. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

This communication is intended solely for the information and use of management, Finance Committee and Board of Directors, and others within the Organization, and is not intended to be, and should not be, used by anyone other than these specified parties.

Very truly yours,

CohnReznick LLP

CohnReznick LLP
Bethesda, Maryland

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September 27, 2018

To the Audit Committee and Board of Directors
Pathway Homes, Inc.

and

To the Plan Administrator
Pathway Homes, Inc. 403(b) Plan

We have conducted a DOL limited-scope audit of the financial statements of the Pathway Homes, Inc. 403(b) Plan for the year ended December 31, 2017 and have issued our report thereon dated September 27, 2018. As permitted by 29 CFR 2520.103-8 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974, the Plan Administrator instructed us not to perform, and we did not perform, any auditing procedures with respect to the information summarized in Note 9 to those financial statements. Because of the significance of the information that we did not audit, we are unable to, and have not, expressed an opinion on those financial statements and supplemental schedule as a whole. We did, however, audit the form and content of the information included in the financial statements and supplemental schedule, other than that derived from the information certified by the trustee, in accordance with auditing standards generally accepted in the United States of America and found them to be presented in compliance with the DOL's Rules and Regulations for Reporting and Disclosure under ERISA. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards, as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our letter to you dated July 18, 2018. Professional standards also require that we communicate to you the following information related to our audit.

Significant Audit Findings

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the Pathway Homes, Inc. 403(b) Plan are described in Note 2 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during 2017. We noted no transactions entered into by the Plan during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimate affecting the financial statements was:

> Management's estimate of the fair value of investments held in registered investment companies which consist of mutual funds is based on the daily closing price as reported by the fund. Mutual funds held by the Plan are open-end mutual funds that are registered with the Securities and Exchange Commission. These funds are required to publish their daily net asset value ("NAV") and to transact at that price. The mutual funds held by the Plan are deemed to be actively traded.

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The financial statement disclosures are neutral, consistent, and clear.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all misstatements identified during the audit, other than those that are clearly trivial, and communicate them to the appropriate level of management. We are pleased to report there were no such misstatements.

Disagreements with Management

For purposes of this letter, a disagreement with management is a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated September 27, 2018.

Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the Plan's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Fraud and Illegal Acts

We are not aware of any fraud or illegal acts.

Independence

CohnReznick has standard practices to ensure the independence of our partners and employees from our clients. There are annual independence certifications requirements for each employee and then additional independence certifications for each audit engagement team member before any audit work commences related to a specific event. Except for assistance with the preparation of the Plan's financial statements and 990 tax return preparation for the Plan Sponsor, there are no additional non-attestation services being provided to the Plan or the Plan Sponsor.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the Plan's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

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Other Matters

This information is intended solely for the use of the Audit Committee and Board of Directors of Pathway Homes, Inc. and the Plan Administrator and management of Pathway Homes, Inc. 403(b) Plan and is not intended to be, and should not be, used by anyone other than these specified parties.

Very truly yours,

CohnReznick LLP

Overview of Financial Statements

Consolidated and Combined Statement of Financial Position

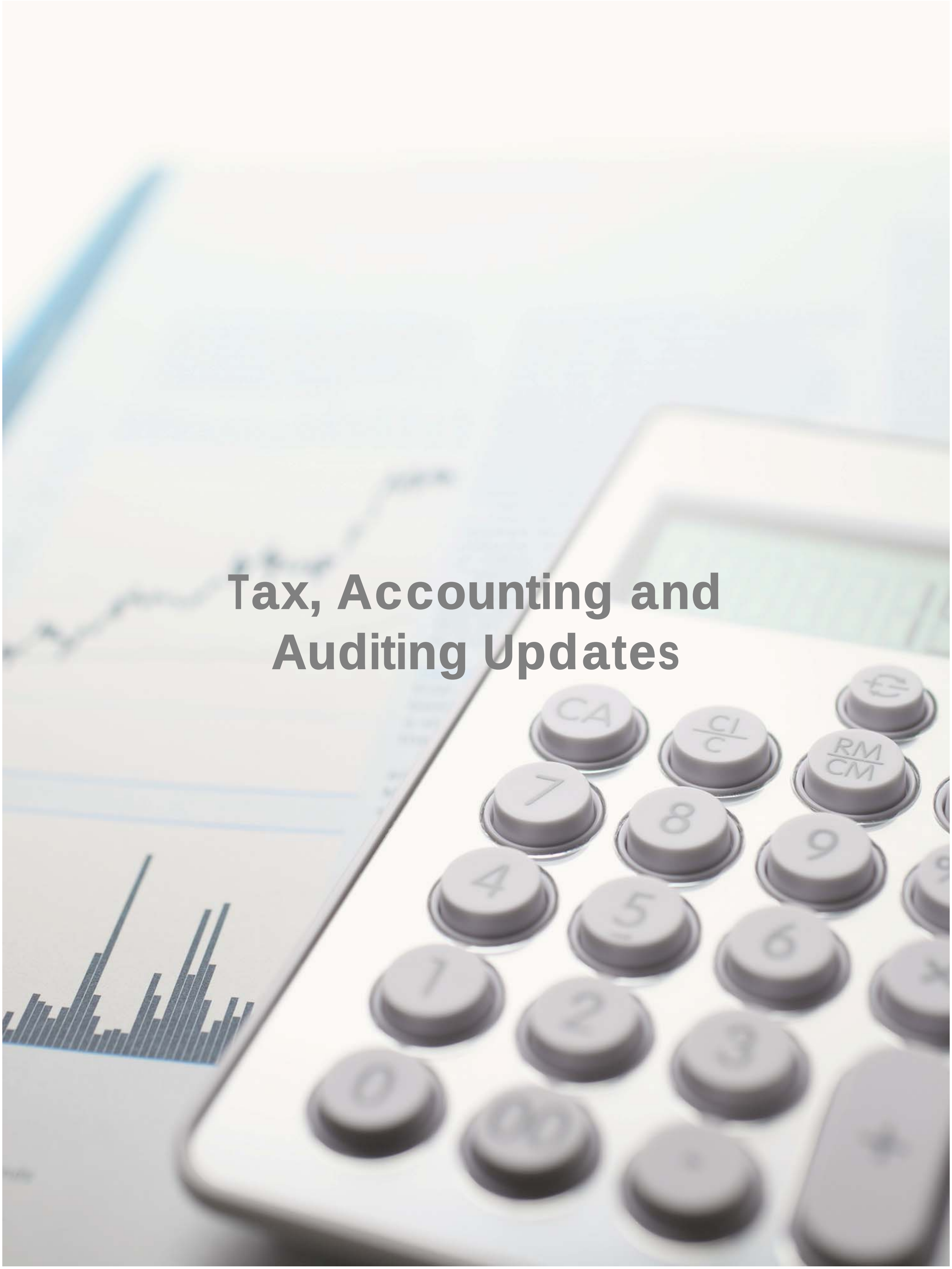
Key Account	Balance FY 18	Balance FY 17	Reason for the Change
Assets - only categories with significant changes			
Cash	$1,221,836	$1,455,291	The change is mainly due to 1) a $264K decrease in Pathway Homes, Inc.'s operating account, 2) a $152K decrease in Pathway Homes, Inc.'s McKinney Operating account and 3) a $210K increase in Pathway Homes, Inc. Capital One Bank account, used primarily for savings and reserves.
Accounts receivable	$78K	$22K	Change is due to 1) an decrease in pledge receivables in the amount of $19K generated from the Steps to Pathways Breakfast in comparison to the prior year's event and 2) an increase of $50K in receivables from HUD.
Program fees receivable	$748,106	$641,575	Change in program fees receivable is mainly due to a $33K increase in insurance receivables for Pathway Homes, Inc. and a $57K increase in Pathway Homes Inc.'s HUD program fees receivable as the programs continue to grow and expand.
Long-lived assets held for sale	$176K	$0	Change is due to the transfer of the Calamo Street property from property and equipment to long-lived assets held for sale. The property had become available for sale September 2017, the net book value of the property was $176K at this time.
Land, building and equipment, net	$13.8 Million	$12.6 Million	Change is mainly due to new purchase of 7 condo units funded by CDBG grant and Home Investment Partnership Program grant in the amount of $1.1 Million and 2 condo units funded by the Permanent Supportive Virginia Housing Trust Fund in the amount of $197K.

Key Account	Balance FY 18	Balance FY 17	Reason for the Change
Liabilities and Net Assets - only categories with significant changes			
Accounts payable and accrued expenses	$535,122	$513,694	Change is due to increase in Pathway Homes, Inc.'s overall accounts payable.
Deferred revenue	$348,102	$691,921	Change is mainly due to 1) the decrease in Pathway Homes Inc. cash match advances for SHP and SPC programs in the amount of $422K, 2) Pathway Homes Inc.'s increase of $105K for Potomac Health Foundation Grant, 3) Pathway Homes McKinney decrease of $88K for deferred income and 4) Pathway Homes of Florida has net $55K increase in deferred revenue in relation to the CFF Homeless Impact Fund.
Liability for escrowed funds	$119,870	$78,461	Change is mainly due to change in escrowed funds Pathway Homes, Inc. holds on behalf of CRS.
Mortgages and notes payable, net of unamortized debt issuance costs	$3.25 Million	$2.85 Million	Change is due to 1) the proceeds from mortgages due to new acquisition in the amount of $496K; and 2) required mortgage payments and payments of note payable.
Net assets	$12.3 Million	$11.2 Million	Change is mainly due to temporarily restricted CDBG and Home Investment Partnerships Program grant revenue from Fairfax County in the amount of $1.1 Million.

Consolidated and Combined Statement of Activities

Key Account	Balance FY 18	Balance FY 17	Reason for the Change
Revenue - only categories with significant changes			
Fees and grants from governmental agencies	$11.3 Million	$12.2 Million	Change is mainly due to 1) a $1.9 Million decrease in Pathway Homes Inc. contract funds, 2) a $262K increases in Pathway Homes Inc. grant revenue, 3) a $277K increase in Pathway Homes Inc. HUD housing funds, and 4) a $378K increase in Pathway Homes of Florida, Inc's contract funds.
Expenses - only categories with significant changes			
Contracts	$4.4 Million	$2.2 Million	Change in contracts expense is mainly due to new grant agreements acquired by Pathway Homes, Inc. in FY2018.
Miscellaneous operating and maintenance expenses	$132,017	$256,039	Change is due to decrease in operating, furnishing, and maintenance costs.
Salaries	$4 Million	$5.1 Million	Change is due to the implementation of merit based increases, reduction in hires of new positions, and termination of employees during FY2018.
Employee benefits	$364,146	$567,737	Change was due to Pathway Homes, Inc. not recognizing contributions on behalf of it employees for FY2018.
Grant Expense	$55K	$1.8 Million	Change is due to Pathway Homes consolidating SPC contract expenses into contracts grouping.
Depreciation expense	$380,278	$336,973	Change is due to new acquisition of properties purchased by Pathway Homes, Inc.

Tax, Accounting and Auditing Updates



I. Tax Update: Tax Cuts and Job Act

On December 22, 2017, the Tax Cuts and Jobs Act (the "Tax Act") was enacted into law. The following are some of the more significant effects of the Tax Act on not-for-profit organizations:

- *Income Tax Rates* - The Tax Act modified the U.S. federal corporate tax rate structure from a graduated rate structure with a maximum rate of 35 percent to a flat rate of 21 percent.

- *Unrelated Business Taxable Income (UBTI)* - Not-for-Profits will now need to calculate net unrelated business income separately with respect to each unrelated trade or business. Each line of business needs to stand alone and income and losses from each can no longer be netted against one another. Similarly, a net operating loss ("NOL") resulting from an activity is only allowed to be utilized with respect to the trade or business from which it arose. Additionally, NOL's generated for 2018 tax years and beyond can no longer be carried back but can be carried forward indefinitely. Utilization of a NOL will be limited to 80 percent of taxable income. Special transition rules will apply for NOL's carried forward from tax years prior to 2018.

- *Excise Tax on Executive Compensation* - For years beginning after December 31, 2017, tax exempt organizations will now be required to pay a 21% excise tax on compensation that is paid to "covered employees" that exceeds $1 million. Compensation includes certain types of vested deferred compensation. The excise tax can also apply to "excess parachute payments" paid upon separation from service in some cases.

- *Fringe Benefits* - The Tax Act changes the treatment of various employer-paid fringe benefits such as qualified transportation and, potentially, parking benefits. Under the Tax Act, if a not-for-profit employer pays directly for an employee's transportation benefits, the employer will report as unrelated business taxable income the total amount of the benefits, which will then be subject to the 21 percent corporate tax rate. Similarly, if these benefits are paid by employees on a pretax basis, the not-for-profit will include these in the calculation as well.

It is important to note, that the Internal Revenue Service has not updated the Internal Revenue Code nor issued regulations on the new law. Limited guidance has been issued thus far. We will continue to monitor new developments and will provide you updates as we receive them.

More resources about The Tax Cuts and Jobs Act can be found at: https://www.cohnreznick.com/insights-and-events/insights/tax-reform-resource-center

II. Financial Statements of Not-for-Profits

In August 2016, the Financial Accounting Standards Board (the "FASB") issued Accounting Standards Update ("ASU") No. 2016-14 *Presentation of Financial Statements of Not-for-Profit Entities* ("ASU 2016-14"), an amendment to FASB Accounting Standards Codification ("ASC") Topic 958 *Not-for-Profit Entities* ("ASC 958").

The main provisions of ASU 2016-14 are as follows:

1. Present on the face of the statement of financial position amounts for two classes of net assets at the end of the period, rather than for the currently required three classes (*net assets with donor restrictions* and *net assets without donor restrictions*), as well as the currently required amount for total net assets.
2. Present on the face of the statement of activities the amount of the change in each of the two classes of net assets (noted in item 1) rather than that of the currently required three classes.
3. Continue to present on the face of the statement of cash flows the net amount for operating cash flows using either the direct or indirect method of reporting but no longer require the presentation or disclosure of the indirect method (reconciliation) if using the direct method.
4. Provide the following enhanced disclosures about:
    a. Amounts and purposes of governing board designations, appropriations, and similar actions that result in self-imposed limits on the use of resources without donor-imposed restrictions as of the end of the period.
    b. Composition of net assets with donor restrictions at the end of the period and how the restrictions affect the use of resources.
    c. Qualitative information that communicates how a not-for-profit manages its liquid resources available to meet cash needs for general expenditures within one year of the date of the statement of financial position.
    d. Quantitative information, either on the face of the statement of financial position or in the notes, and additional qualitative information in the notes as necessary, that communicates the availability of a not-for-profit's financial assets at the date of the statement of financial position to meet cash needs for general expenditures within one year of the date of the statement of financial position. Availability of a financial asset may be affected by (1) its nature, (2) external limits imposed by donors, grantors, laws, and contracts with others, and (3) internal limits imposed by governing board decisions.
    e. Amounts of expenses by both their natural classification and their functional classification. That analysis of expenses is to be provided in one location, which could be on the face of the statement of activities, as a separate statement, or in notes to financial statements.
    f. Method(s) used to allocate costs among program and support functions.
    g. Underwater endowment funds, which include required disclosures of (1) a not-for-profit's policy, and any actions taken during the period, concerning appropriation from underwater endowment funds, (2) the aggregate fair value of such funds, (3) the aggregate of the original gift amounts (or level required by donor or law) to be maintained, and (4) the aggregate amount by which funds are underwater (deficiencies), which are to be classified as part of net assets with donor restrictions.
5. Report investment return net of external and direct internal investment expenses and no longer require disclosure of those netted expenses.
6. Use, in the absence of explicit donor stipulations, the placed-in-service approach for reporting expirations of restrictions on gifts of cash or other assets to be used to acquire or construct a long-lived asset and reclassify any amounts from *net assets with donor restrictions* to *net assets without donor restrictions* for such long-lived assets that have been placed in service as of the beginning of the period of adoption (thus eliminating the current option to release the donor-imposed restriction over the estimated useful life of the acquired asset).

The amendments pursuant to ASU 2016-14 are effective for fiscal years beginning after December 15, 2017, and for interim periods within fiscal years beginning after December 15, 2018. Early application of the amendments in this Update is permitted. Retrospective application should be applied in the first year of adoption. However, not-for-profit entities presenting consolidated financial statements have the option to omit the following information for any periods presented before the year of adoption:

1. Analysis of expenses by both natural classification and functional classification for not-for-profit entities that were not previously required to present a statement of functional expenses.
2. Disclosures about liquidity and availability of resources.

III. Revenue Recognition Standard

- FASB ASU No. 2014-09 *Revenue Recognition - Revenue from Contracts with Customers* ("ASU 2014-09")
- FASB ASU No. 2015-14 *Revenue from Contracts with Customers: Deferral of the Effective Date* ("ASU 2015-14")
- FASB ASU No. 2016-08 *Revenue from Contracts with Customers: Principal versus Agent Considerations* ("ASU 2016-08")

Each are amendments to FASB ASC Topic 606 *Revenue from Contracts with Customers* ("ASC 606").

In May 2014, the IASB and FASB jointly approved ASU 2014-09 to conform GAAP and International Financial Reporting Standards ("IFRSs") revenue recognition standards, and improve both sets of standards. The guidance changes would affect any entity that enters into contracts with customers unless those contracts are in the scope of other standards (for example, insurance contracts or lease contracts).

The core principle of the guidance is that an entity should recognize revenue representing 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.

The objective of the ASU 2014-09 is to establish the principles that an entity is to adopt in order to report useful information to users of financial statements about the nature, amount, timing, and uncertainty of revenue and cash flows arising from a contract with a customer. It clarifies proper accounting treatment and disclosure requirements as they relate to the many different types and characteristics of contracts.

During August 2015, the FASB issued ASU 2015-14. The amendments in ASU 2015-14 defer the effective date of ASU 2014-09 for all entities by one year. Public business entities, certain not-for-profit entities, and certain employee benefit plans should apply the guidance in ASU 2014-09 to annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. Earlier application is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period.

All other entities should apply the guidance in ASU 2014-09 to annual reporting periods beginning after December 15, 2018, and interim reporting periods within annual reporting periods beginning after December 15, 2019. All other entities may apply the guidance in ASU 2014-09 earlier as of an annual reporting period beginning after December 15, 2016, including interim reporting periods within that reporting period. All other entities also may apply the guidance in ASU 2014-09 earlier as of an annual reporting period beginning after December 15, 2016, and interim reporting periods within annual reporting periods beginning one year after the annual reporting period in which the entity first applies the guidance in ASU 2014-09.

During March 2016, The FASB issued ASU 2016-08. The amendments within ASU 2016-08 relate to when another party, along with the entity, is involved in providing a good or service to a customer. ASC 606 requires an entity to determine whether the nature of its promise is to provide that good or service to the customer (i.e., the entity is a principal) or to arrange for the good or service to be provided to the customer by the other party (i.e., the entity is an agent).

The amendments are intended to improve the operability and understandability of the implementation guidance on principal versus agent considerations by clarifying the following:

- An entity determines whether it is a principal or an agent for each specified good or service promised to a customer.
- An entity determines the nature of each specified or service (e.g., whether it is a good, service, or a right to a good or service).
- When another entity is involved in providing goods or services to a customer, an entity that is a principal obtains control of: *(a)* a good or another asset from the other party that it then transfers to the customer; *(b)* a right to a service that will be performed by another party, which gives the entity the ability to direct that party to provide the service to the customer on the entity's behalf; or *(c)* a good or service from the other party that it combines with other goods or services to provide the specified good or service to the customer.
- The purpose of the indicators in paragraph 606-10-55-39 of ASC 606 is to support or assist in the assessment of control. The amendments in paragraph 606-10-55-39A of ASC 606 clarify that the indicators may be more or less relevant to the control assessment and that one or more indicators may be more or less persuasive to the control assessment, depending on the facts and circumstances.

The amendments pursuant to ASU 2016-08 amend certain existing illustrative examples and add additional illustrative examples to assist in the application of the guidance.

The effective date and transition of the amendments pursuant to ASU 2016-08 is the same as the effective date and transition of ASU 2014-09*.* Public entities should apply the amendments in ASU 2014-09 for annual reporting periods beginning after December 15, 2017, including interim reporting periods therein (i.e., January 1, 2018, for a calendar year entity). Private entities must apply the amendments one year later.

IV. <u>Lease Accounting</u>

In February 2016, the FASB and International Accounting Standards Board ("IASB") issued final guidance on accounting for leases. The FASB's implementation is by way of the issuance of ASU No. 2016-02 *Leases (Topic 842)* ("ASU 2016-02"). ASU 2016-02 creates an entirely new Topic within the ASC (Topic 842, Leases). ASU 2016-02 significantly changes how leases are accounted for and impacts virtually every company. The core principle of ASU 2016-02 is that an entity should recognize assets and liabilities on its balance sheet for a leasing transaction.

The key provisions of ASU 2016-02 are as follows:

- **Lease Classification -** The majority of leases for lessees and lessors will be classified as either a Type A lease or Type B lease. The lease classification would be determined based on the underlying asset and whether a lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset (essentially, classification would depend on whether the asset is considered property or not). Leases of assets other than property (e.g. equipment and vehicles) are Type A leases unless specified classification criteria are met, and leases of property (land, and/or a building) are Type B leases. If classified as a Type A lease, income and expense would be accelerated (like financing transactions). If classified as a Type B lease, income and expense would generally be recorded on a straight-line basis.
- **Short-Term Leases -** For leases with a maximum possible term (including any options to extend) of 12 months or less (short-term lease), a lessee and a lessor would be permitted to make an accounting policy election to account for leases similar to existing operating lease accounting, on a straight-line basis over the lease term.
- **Lessee Accounting -** For leases, other than short-term leases, a lessee would record assets and liabilities (under both Type A and Type B classifications). A lessee would record a right-of-use ("ROU") asset representing its right to use the leased asset (the underlying asset) for the lease term and also record a

liability to make lease payments (the lease liability). This method for lessees is essentially the same as current practice for capital leases.

- **Lessor Accounting -** For Type A leases, lessors would apply a receivable and residual ("R&R") approach where the lessor would derecognize the underlying asset and in turn record a receivable for the expected lease payments and also record a residual asset. Type B leases for lessors would be accounted for similar to current operating leases, where the lessor would retain the underlying asset on its books and record lease income over the lease term.

ASU 2016-02 is effective for fiscal years beginning after December 15, 2019.

V. Classification of Certain Cash Receipts and Cash Payments - FASB ASU No. 2016-15 (Topic 230)

In August 2016, FASB issued an Update to address diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows under Topic 230, Statement of Cash Flows, and other Topics. The amendments in this Update apply to all entities, including both business entities and not-for-profit entities that are required to present a statement of cash flows under Topic 230.

The main provisions in this Update provide guidance on the following eight specific cash flow issues:

1. <u>Debt prepayment or debt extinguishment costs</u> - Cash payments for debt prepayment or debt extinguishment costs should be classified as cash outflows for financing activities.

2. <u>Settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing</u> - At the settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing, the issuer should classify the portion of the cash payment attributable to the accreted interest related to the debt discount as cash outflows for operating activities, and the portion of the cash payment attributable to the principal as cash outflows for financing activities.

3. <u>Contingent consideration payments made after a business combination</u> - Cash payments not made soon after the acquisition date of a business combination by an acquirer to settle a contingent consideration liability should be separated and classified as cash outflows for financing activities and operating activities. Cash payments up to the amount of the contingent consideration liability recognized at the acquisition date (including measurement-period adjustments) should be classified as financing activities; any excess should be classified as operating activities. Cash payments made soon after the acquisition date of a business combination by an acquirer to settle a contingent consideration liability should be classified as cash outflows for investing activities.

4. <u>Proceeds from the settlement of insurance claims</u> - Cash proceeds received from the settlement of insurance claims should be classified on the basis of the related insurance coverage (that is, the nature of the loss). For insurance proceeds that are received in a lumpsum settlement, an entity should determine the classification on the basis of the nature of each loss included in the settlement.

5. <u>Proceeds from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies</u> - Cash proceeds received from the settlement of corporate-owned life insurance policies should be classified as cash inflows from investing activities. The cash payments for premiums on corporate-owned policies may be classified as cash outflows for investing activities, operating activities, or a combination of investing and operating activities.

6. Distributions received from equity method investees - When a reporting entity applies the equity method, it should make an accounting policy election to classify distributions received from equity method investees using either of the following approaches:

    - Cumulative earnings approach: Distributions received are considered returns on investment and classified as cash inflows from operating activities, unless the investor's cumulative distributions received less distributions received in prior periods that were determined to be returns of investment exceed cumulative equity in earnings recognized by the investor. When such an excess occurs, the current-period distribution up to this excess should be considered a return of investment and classified as cash inflows from investing activities.

    - Nature of the distribution approach: Distributions received should be classified on the basis of the nature of the activity or activities of the investee that generated the distribution as either a return on investment (classified as cash inflows from operating activities) or a return of investment (classified as cash inflows from investing activities) when such information is available to the investor.

7. Beneficial interests in securitization transactions – A transferor's beneficial interest obtained in a securitization of financial assets should be disclosed as a noncash activity, and cash receipts from payments on a transferor's beneficial interests in securitized trade receivables should be classified as cash inflows from investing activities.

8. Separately identifiable cash flows and application of the predominance principle – The classification of cash receipts and payments that have aspects of more than one class of cash flows should be determined first by applying specific guidance in generally accepted accounting principles ("GAAP"). In the absence of specific guidance, an entity should determine each separately identifiable source or use within the cash receipts and cash payments on the basis of the nature of the underlying cash flows. An entity should then classify each separately identifiable source ruse within the cash receipts and payments on the basis of their nature in financing, investing, or operating activities. In situations in which cash receipts and payments have aspects of more than one class of cash flows and cannot be separated by source or use, the appropriate classification should depend on the activity that it is likely to be the predominant source or use of cash flows for the item.

The amendments in this Update are effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. Early adoption is permitted.

VI. Restricted Cash - FASB ASU No. 2016-18 Statement of Cash Flows (Topic 230)

In November 2016, FASB issued an Update to address the diversity that exists in the classification and presentation of changes in restricted cash on the statement of cash flows under Topic 230, Statement of Cash Flows. The amendments in this Update apply to all entities that have restricted cash or restricted cash equivalents are required to present a statement of cash flows under Topic 230.

The main provisions in this Update require that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows.

The amendments in this Update are effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. Early adoption is permitted.

VII. Compensation - FASB ASU No. 2017-07 Retirement benefits (Topic 715)

In March 2017, FASB issued this ASU primarily to improve the presentation of net periodic pension cost and net periodic postretirement benefit cost.

The amendments in this ASU apply to all employers, including not-for-profit entities that offer to their employees defined benefit pension plans, other postretirement benefit plans, or other types of benefits accounted for under Topic 715.

The main provisions of this ASU require that an employer report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost as defined in paragraphs 715-30-35-4 and 715-60-35-9 are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented. If a separate line item or items are used to present the other components of net benefit cost, that line item or items must be appropriately described. If a separate line item or items are not used, the line item or items used in the income statement to present the other components of net benefit cost must be disclosed.

The amendments in this ASU also allow only the service cost component to be eligible for capitalization when applicable (for example, as a cost of internally manufactured inventory or a self- constructed asset). This is effective for annual periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019. Early adoption is permitted as of the beginning of an annual period for which financial statements (interim or annual) have not been issued or made available for issuance. Disclosures of the nature of and reason for the change in accounting principle are required in the first period of adoption.

VIII. Contributions Received and Contributions Made by Not-for-profit Entities – FASB ASU No. 2018-08

On June 21, 2018, FASB issued an ASU (ASU 2018-08) intended to clarify and improve the scope and the accounting guidance for contributions received and made, primarily by not-for-profit organizations.

The ASU improves financial reporting by reducing diversity in practice among not-for-profits and other businesses and organizations that make or receive contributions, particularly for grants and similar contracts received by not-for-profits from governments.

Additionally, the ASU improves current guidance about whether a transfer of assets is a contribution or an exchange transaction. It also provides criteria for determining whether the resource provider is receiving commensurate value in return for the resources transferred which, depending on the outcome, determines whether the organization follows contribution guidance or exchange transaction guidance in the revenue recognition and other applicable standards.

The ASU also provides guidance for determining whether a contribution is conditional or unconditional, and for distinguishing a donor-imposed condition from a donor-imposed restriction. This is important because such classification affects the timing of contribution revenue and expense recognition.

FASB believes these provisions will be an improvement to current guidance. These amendments should be applied on a modified prospective basis. They are effective for annual periods beginning after June 15, 2018.