



Wichita State University Accounting & Auditing Conference

Accounting & Auditing Update

May 2009

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Agenda

- ▶ FASB Pronouncements
- ▶ FASB Projects
- ▶ EITF Consensuses for Exposure
- ▶ Key SEC Issues
- ▶ PCAOB Pronouncements and Proposals

FASB Pronouncements

FASB Pronouncements

- ▶ FAS 141(R)
- ▶ FAS 160
- ▶ FAS 157 and related guidance
- ▶ FAS 132(R)-1
- ▶ FSP FIN 48-3
- ▶ Other FASB Pronouncements

FASB Statement 141(R) Business Combinations (FAS 141R) – Key Changes

- ▶ Change in “purchase price allocation” period to “measurement” period
 - ▶ Change in values from deal date to close date are reflected in purchase price allocation retroactively
 - ▶ Final purchase price to be determined when control is obtained
- ▶ Transaction costs expensed, except debt and equity issuance costs which may be capitalized
- ▶ Liabilities recognized in business combination only if liabilities of the acquired company
 - ▶ No restructuring obligations except those assumed, actions taken by the acquirer are NOT including in purchase accounting
 - ▶ More expense for share-based payment awards if service period of replacement awards is shorter than original award

FAS 141R – Key Changes (continued)

- ▶ Recognize pre-acquisition contingencies at the acquisition date fair value for:
 - ▶ (1) all contractual pre-acquisition contingencies and
 - ▶ (2) non-contractual pre-acquisition contingencies that are determined to be “more-likely-than-not” of materializing
 - ▶ FSP 141(R)-1 clarifies recognition of fair value is required only if determinable during the measurement period (closer to FAS 5 approach)
 - ▶ Information available before end of measurement period indicates that it is probable an asset existed or a liability had been incurred at the acquisition date and
 - ▶ The amount can be reasonably estimated
 - ▶ Subsequent adjustments made only when “new information” about the possible outcome is obtained

FAS 141R – Key Changes (continued)

- ▶ Capitalize acquired IPR&D assets
 - ▶ Subject to periodic impairment reviews pursuant to Statement 142
 - ▶ Upon completion – assign a useful life and amortize
- ▶ Assets the acquirer does not intend to use or use to the extent of highest and best use (defensive assets)
 - ▶ Measured and recognized at fair value based on the highest and best use by a market participant
 - ▶ Subsequent accounting being addressed by EITF Issue No. 08-7

FAS 141R – Key Changes (continued)

- ▶ Income Taxes
 - ▶ Reduction in target's valuation allowance after the acquisition date is recognized as a reduction of income tax expense
 - ▶ All adjustments to liabilities for income tax uncertainties that pre-date or result from the acquisition are recognized as an element of the income tax provision
 - ▶ A deferred tax asset is recognized for the excess of tax deductible goodwill over financial reporting goodwill
- ▶ Identification of reporting units and assessment of goodwill impairment
 - ▶ Expanded definition of a business could increase the number of reporting units

FAS 141R – Key Changes (continued)

- ▶ The standard is effective for fiscal years beginning after 15 December 2008
 - ▶ Transition provisions included for transaction costs capitalized under Statement 141 for deals closing after effective date of FAS 141(R)
- ▶ No effect on prior transactions
 - ▶ Except, changes to deferred tax asset valuation allowances and income tax uncertainties after effective date of FAS 141(R) will affect acquirer's earnings
 - ▶ Restructuring liabilities recognized pursuant to EITF 95-3 continue to follow that guidance (adjustments to goodwill)
 - ▶ Contingent consideration continues under Statement 141
 - ▶ Purchase price adjustments continue to be based on Statement 141 (even if purchase price allocation period is after effective date)

FASB Statement 160 on Noncontrolling Interests in Consolidated Financial Statements (FAS 160) - Overview

- ▶ Significantly affects consolidation accounting for all entities, except for NFPs
- ▶ Addresses how to account for noncontrolling interests in a consolidation and changes:
 - ▶ Classification and presentation of noncontrolling interests
 - ▶ Allocation of earnings between controlling and noncontrolling interests
 - ▶ Recognition of purchases and sales of shares of subsidiary
- ▶ No net EPS impact to parent (except for loss allocation) under Statement 160

FAS 160 - Reporting noncontrolling interests

Current rules

- ▶ Typically “minority interest” reported as a mezzanine item between liabilities and equity
- ▶ Consolidated net earnings exclude minority interest component
- ▶ Rule 5-04 of Reg S-X requires presentation of minority interest after income tax as a component of income from continuing operations

New rules

- ▶ Mezzanine accounting is not permitted and “noncontrolling” interest is reported as a separate component of shareholders’ equity
- ▶ Consolidated net earnings include noncontrolling interest component
 - ▶ Income attributable to noncontrolling interests shown separate as an allocation of consolidated net earnings

FAS 160 - Reporting noncontrolling interests - allocation of losses

Current rules

- ▶ Losses attributed to both the controlling and minority on the basis of their ownership interests and contractual rights and obligations, but generally only to minority interest to the extent of the minority interest investment (minority interest can't go negative)

New rules

- ▶ Allocated losses can exceed the noncontrolling interest investment (i.e., it can go negative)
 - ▶ Could have beneficial impact to income attributable to controlling (i.e. Parent) interest and EPS
 - ▶ Pro forma disclosure required in year of adoption
 - ▶ Prospective adoption precludes recouping losses previously absorbed by parent

FAS 160 - Loss of control of subsidiary

Current rules

- ▶ Loss of control results in deconsolidation and gain or loss recognition
- ▶ Gain or loss is the difference between the FV of any consideration received and the carrying value of the interest sold
- ▶ Any remaining noncontrolling interest is recorded based on historical carrying value

New rules

- ▶ Similar to current, except that any retained shares are revalued to FV and a gain/loss recorded (new basis recognition event)
- ▶ “Full” gain or loss recognition, including revaluation of the retained interest

FAS 160 - Effective date and transition

- ▶ Statement 160 is effective for fiscal years beginning after 15 December 2008
- ▶ Early adoption prohibited
- ▶ Prospective, except for presentation and display

FASB Statement 157 Fair Value (FAS 157) - Overview

- ▶ Measuring fair value of certain financial assets is very challenging as a result of credit crisis and illiquid markets
 - ▶ Challenges for both preparers and auditors
 - ▶ Judgment needs to be applied in estimating fair value
- ▶ Ability to obtain and rely on market observable data is more difficult as transaction volumes decrease or “dry-up”
 - ▶ Auction rate securities
 - ▶ Mortgage-backed or other asset-backed securities
 - ▶ Collateralized debt obligations

FAS 157 - Application Challenges

- ▶ Many preparers believe too much emphasis placed on broker quotes and pricing service data that they believe are not representative of fair value
- ▶ Concern that Statement 157 did not provide sufficient guidance on how to determine the fair value of financial assets in an inactive market
- ▶ Differing views on what constitutes a “distressed sale”
 - ▶ Determination requires judgment and needs to be made at the individual transaction level (not broadly for an entire asset class)
 - ▶ Need a reasonable basis to conclude that an observable price can be ignored

FAS 157 – A Moving Target

- ▶ Activities and amendments
 - ▶ FSP FAS 157-1 – *Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements that Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13*
 - ▶ FSP FAS 157-2 – *Effective Date of FASB Statement No. 157*
 - ▶ FSP FAS 157-3 – *Determining the Fair Value of a Financial Asset when the Market for that Asset is Not Active (Superceded by FSP FAS 157-4)*
 - ▶ FSP FAS 157-4 – *Determining Fair Value when the Volume and Level of Activity for the Asset or Liability have Significantly Decreased and Identifying Transactions that are Not Orderly*
 - ▶ Proposed FSP FAS 157-c, now 157-f, *Measuring Liabilities under FASB Statement No. 157* – Clarifies how the price of a traded debt security should be considered in estimating the fair value of the issuer's liability

FAS 157 - Fair Value in an Inactive Market

- ▶ **Highlights of the clarifying guidance:**
 - ▶ Reiterates the need for professional judgment in estimating fair value.
 - ▶ Reemphasizes that fair value is a current exit value - measurement must include appropriate risk adjustments (nonperformance and liquidity).
 - ▶ Highlights the need to consider the relevance of market data
 - ▶ Adjustments to prices (data) from inactive markets may be required due to:
 - ▶ timing differences
 - ▶ differences in characteristics of the instruments
 - ▶ volume and level of activity.
 - ▶ Clarifies the ability to use internal assumptions about future cash flows and required rates of return when observable data does not exist.
 - ▶ Assumptions need to be consistent with market participant assumptions.
 - ▶ Maximize the use of observable inputs

FAS 157 - Fair Value in an Inactive Market

- ▶ **Highlights of the clarifying guidance (continued):**
 - ▶ Underscores the need for entities to gain an appropriate understanding of information received from third parties (e.g., brokers or pricing services).
 - ▶ Understand the valuation method and inputs used.
 - ▶ Assess relevance to appropriately weight information in the measurement
 - ▶ Considers assets and liabilities that have experienced significant reductions in volume and activity in relation to normal activity
 - ▶ Clarifies when this is indicative of a market that is not orderly
 - ▶ Provides considerations as to when alternative valuation techniques should be considered.

FAS 157 - Fair Value in an Inactive Market

- ▶ **The clarifying guidance DOES NOT:**
 - ▶ Suspend the use of fair value accounting or change any other existing U.S. GAAP requirements.
 - ▶ Change the objective of a fair value measurement away from a current exit value when active markets do not exist.
 - ▶ Allow for an “entity-specific” view in estimating fair value - even in situations where there is a lack of observable data.
 - ▶ Repeal the fair value hierarchy which prioritizes the use of observable inputs over unobservable inputs.
- ▶ FSP 157-4 is intended to clarify, not change, the existing principles in Statement 157
- ▶ Extension of disclosure requirements
- ▶ Effective for interim and annual periods ending after 15 June 2009

Other Fair Value Guidance

- ▶ **FSP FAS 115-2 and FAS 124-2 – *Recognition and Presentation of Other-Than-Temporary Impairments***
 - ▶ Replaces current requirement that holder has “positive intent and ability to hold and impaired security to recovery” with “does not intend to sell an impaired security and it is not more likely than not it will be required to sell the security before the recovery of its amortized cost basis”
 - ▶ Requires separation of other-than-temporary impairment into two categories:
 - ▶ Amount representing decrease in cash flows expected to be collected, which is recognized in earnings, and
 - ▶ Amount related to all other factors, which is recognized in OCI
 - ▶ Lowered threshold of recognizing other-than-temporary impairment from “probable” to “more likely than not”
 - ▶ Extension of disclosure requirements
 - ▶ Effective for interim and annual periods ending after 15 June 2009

Other Fair Value Guidance

- ▶ **FSP FAS 107-1 and APB 28-1, “Interim disclosures about Fair Value of Financial Instruments”**
 - ▶ Extends most of the disclosure requirements of FAS 107 to interim periods (optional for nonpublic entities with interim reporting)
 - ▶ Effective for interim and annual periods ending after 15 June 2009
 - ▶ No comparative disclosures required for periods prior to adoption

FSP FAS 132(R)-1, *Employers' Disclosures about Postretirement Benefit Plan Assets*

- ▶ Responds to issuer concerns about lack of transparency surrounding the types of assets held in benefit plans and concentrations of risk
- ▶ Requires additional disclosures about assets held in various benefit plans including:
 - ▶ Modifications/additions to categories of plan assets
 - ▶ Nature and amount of concentrations of risk within or across the categories of plan assets
 - ▶ Disclosures similar to those required by Statement 157, including level 3 reconciliation of beginning and ending balances
 - ▶ Technical amendment requiring nonpublic entities to disclose net periodic benefit costs for each annual period presented (effective immediately)
- ▶ Effective for fiscal years ending after 15 December 2009
- ▶ Same disclosure requirements for public and private companies

FSP FIN 48-3, *Effective Date of FASB Interpretation No. 48 for Certain Nonpublic Entities*

- ▶ Most private companies received another reprieve for 2008
- ▶ Effective for fiscal years ending after 15 December 2009
- ▶ Same disclosure requirements for public and private companies
 - ▶ Direction for 2009 still uncertain
 - ▶ FASB reconsidering disclosure requirements for private companies
 - ▶ Impact of IFRS convergence

Other FASB Pronouncements

- ▶ FSP EITF 99-20-1, *Amendments to the Impairment Guidance of EITF Issue No. 99-20*
- ▶ FSP FAS 140-4 and FIN 46(R)-8, *Disclosures about Transfers of Financial Assets and Interests in Variable Interest Entities*

FASB Projects

FASB Projects

- ▶ Exposure Draft on Loss Contingency Disclosures
- ▶ Conceptual Framework Project – Exposure Draft and Preliminary Views
- ▶ Other FASB Projects

Exposure Draft on Loss Contingency Disclosures - Overview

- ▶ Released on 5 June 2008 for comment period that ended 8 August 2008
- ▶ Resulted from financial statement user concerns regarding sudden recognition of significant losses related to previously undisclosed loss contingencies
- ▶ FASB project added to agenda in September 2007 with two phases:
 - ▶ Interim step to improve disclosures of loss contingencies so that they are sufficient to enable users of to assess the likelihood, timing, and amount of future cash flows associated with loss contingencies
 - ▶ Comprehensive reconsideration of recognition and measurement of certain nonfinancial liabilities, including contingencies
 - ▶ Potential convergence project; IASB has an active project underway

Exposure Draft on Loss Contingency Disclosures - Scope

- ▶ Loss contingencies under FAS 5 and FAS 141(R), except
 - ▶ The entity has made an assessment and determined that the likelihood of a loss is remote.
 - ▶ An unasserted claim in which there has been no manifestation by a potential claimant of an awareness of a possible claim, unless:
 - ▶ It is probable that a claim will be asserted; and
 - ▶ The likelihood of a loss, if the claim were to be asserted, is more than remote
 - ▶ However, disclosure would be required if
 - ▶ The contingency or contingencies are expected to be resolved within one year; and
 - ▶ The contingency or contingencies could have a severe impact on the entity's financial position, cash flows, or results of operations.
- ▶ Significant expansion of scope of FAS 5

Exposure Draft on Loss Contingency Disclosures - Disclosures Required

- ▶ Quantitative disclosures
 - ▶ The amount of the claim against the entity (including additional damages, such as treble or punitive damages, that are claimed) or
 - ▶ If there is no claim, the entity's best estimate of the maximum exposure to loss.
- ▶ Qualitative disclosures
 - ▶ A description of the contingency, including how it arose, legal or contractual basis, current status, anticipated timing of resolution
 - ▶ A description of factors likely to affect the ultimate outcome of the contingency along with their potential effect
 - ▶ The entity's qualitative assessment of the most likely outcome of the contingency
 - ▶ Significant assumptions made by the entity in estimating disclosed amounts and in assessing the most likely outcome.
- ▶ Tabular reconciliation of aggregate recognized loss contingencies
- ▶ Prejudicial information exemption

Exposure Draft on Loss Contingency Disclosures - Latest Status

- ▶ Controversial proposal
- ▶ Board is re-deliberating based on comments received
 - ▶ Two roundtables held in March to try and find common ground among constituents
- ▶ Effective date no sooner than fiscal years ending after December 15, 2009

Conceptual Framework Project – Overview

- ▶ Joint project of the IASB and FASB
- ▶ Objective
 - ▶ Improve common conceptual framework
 - ▶ Provide sound foundation for developing future accounting standards
 - ▶ Could have significant ramifications for future standards
- ▶ Eight phases – will take years to complete
 - ▶ First four phases are currently active
 - ▶ Phase A – Objective and Qualitative Characteristics
 - ▶ Phase B – Elements and Recognition
 - ▶ Phase C – Measurement
 - ▶ Phase D – Reporting Entity
 - ▶ Other phases deal with presentation and disclosure, framework purpose and status in GAAP hierarchy, and applicability to NFP

Conceptual Framework Project –Progress to Date

- ▶ Phase A – Objectives and Qualitative Characteristics
 - ▶ Exposure Draft issued in May 2008; comments were due in September 2008
 - ▶ As proposed, the objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to present and potential equity investors, lenders, and other creditors in making decisions in their capacity as capital providers.
 - ▶ Qualitative characteristics
 - ▶ Categorized as fundamental and enhancing
 - ▶ Two pervasive constraints
- ▶ Phase D – Reporting Entity
 - ▶ Preliminary Views document issued in May 2008; comments were due in September 2008
 - ▶ Considers issues for the purposes of developing a reporting entity concept, including the fundamental approach (parent versus entity), basis for consolidation, and issues associated with carve-out and combined financial statements

Conceptual Framework Project – Financial Statement Presentation

- ▶ PV issued in October 2008 jointly with IASB
- ▶ Comments due 14 April 2009
- ▶ If adopted, substantial change to financial statement presentation as a significant emphasis on management's view of the business
- ▶ Other major changes would include:

Statement of Financial Position

- ▶ would be grouped by major activities (operating, investing, and financing), not by assets, liabilities, and equity as it is today.
- ▶ assets and liabilities would be disaggregated into short-term and long-term subcategories within each category unless an entity believes presenting assets and liabilities in order of liquidity provides more relevant information.

Conceptual Framework Project – Financial Statement Presentation (continued)

Statement of Comprehensive Income

- ▶ a single statement of comprehensive income would be presented, with items of other comprehensive income presented in a separate section.

Income Statement

- ▶ in addition to classifying its income and expense items into the operating, investing, and financing categories, an entity should disaggregate those items on the basis of their function

Cash Flow Statement

- ▶ an entity would present the main categories of its cash receipts and payments for operating activities (a direct method), rather than reconciling profit or loss or net income to net operating cash flows (an indirect method) as most entities do today.
- ▶ Reconciling each line on the statement of cash flows to each line in the statement of comprehensive income

Other FASB Projects

- ▶ Codification
 - ▶ Replacement of FAS 162, The Hierarchy of Generally Accepted Accounting Principles with two levels of GAAP – authoritative and nonauthoritative
 - ▶ Expected effective date 1 July 2009
- ▶ Subsequent events and going concern
 - ▶ Intent to provide authoritative accounting guidance to issues currently addressed only in audit literature
 - ▶ No significant change with subsequent events
 - ▶ Potentially extends the time horizon of a going concern from up to one year to at least one year – clarification expected
- ▶ Accounting for Transfers of Financial Assets, an Amendment of FASB Statement No. 140
 - ▶ Addresses concerns about consistency in application
 - ▶ Removes the concept of a QSPE

Other FASB Projects (continued)

- ▶ Amendments to FASB Interpretation No. 46(R)
 - ▶ Amends guidance for determining primary beneficiary to qualitative versus quantitative analysis
 - ▶ Would require continuing assessments of primary beneficiary (not just at a reconsideration event)
 - ▶ Significant expansion of disclosures
- ▶ Earnings per Share – an amendment of FASB Statement No. 128
 - ▶ Joint project with IASB
- ▶ Discontinued operations-proposed FSP issued September 2008
 - ▶ Joint project with IASB
 - ▶ Would change the definition of a discontinued operation
 - ▶ Must be an operating segment
 - ▶ Eliminates prohibition against continuing involvement

Other FASB Projects (continued)

- ▶ Accounting for Hedging Activities, an Amendment of FASB Statement No. 133
 - ▶ Intended to simplify hedge accounting
 - ▶ Received overwhelmingly negative reaction
 - ▶ Redeliberations delayed as issues to be addressed in joint project on financial instruments which will also address liabilities with the characteristics of equity
- ▶ Not-for-profit business combinations
 - ▶ Distinguishes between mergers and acquisitions, acquisitions require purchase accounting
 - ▶ Final statement pending, expected effective date fiscal years beginning after 15 December 2009
- ▶ Not-for-profit goodwill and other intangibles acquired
 - ▶ Will require application of FAS 141(R) and FAS 142
 - ▶ Final statement pending, expected effective date fiscal years beginning after 15 December 2009

Other FASB Projects (continued)

- ▶ Discussion papers – joint with IASB
 - ▶ Leases
 - ▶ Revenue Recognition in Contracts with Customers
 - ▶ Financial Statement Presentation
- ▶ Establishment of Financial Crisis Advisory Group

Other Standard Setters

EITF Consensuses for Exposure

- ▶ EITF Issue 09-1, *Accounting for Own-Share Lending Arrangements in Contemplation of Convertible Debt Issuance*
- ▶ EITF Issue 08-9, *Milestone Method of Revenue Recognition*
- ▶ EITF Issue 08-1, *Revenue Arrangements with Multiple Deliverables*

Key SEC Issues

- ▶ Amended reporting requirements for Foreign Private Issuers
- ▶ XBRL reporting
- ▶ Modernization of oil & gas reporting – requires increased transparency/clarifications regarding assumptions related to reserves
- ▶ IFRS Roadmap
- ▶ Studies/committees
 - ▶ “Mark to market accounting”
 - ▶ Advisory Committee on Improvements to Financial Reporting (CIFiR)

PCAOB Pronouncements and Proposals

▶ Recent Pronouncements

- ▶ Staff Audit Practice Alert No. 3 – Audit Considerations in the Current Economic Environment
- ▶ Staff Views – An Audit of Internal Control Over Financial Reporting That is Integrated with an Audit of Financial Statements: Guidance for Auditors of Smaller Companies
 - ▶ Guidance on application of AS 5 to smaller companies

▶ Recent Proposals

- ▶ PCAOB Release No. 2009-001 – Proposed Auditing Standard – Engagement Quality Review
- ▶ PCAOB Release No. 2008-0-6 – Proposed Auditing Standards Related to the Auditor’s Assessment of and Response to Risk; Proposed Conforming Amendments to PCAOB Standards