

*Views on, analysis of and news about US GAAP and SEC reporting
A Canadian perspective*

US GAAP Today



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Issue 2013-1

Issues to consider for your 2012 year-end

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More timely recognition of credit losses

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Assessing Going Concern

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US GAAP Today

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Common abbreviations

ASC	Accounting Standards Codification
ASU	Accountings Standards Update
ED	Exposure Draft or Proposed Accounting Standards Update
EITF	Emerging Issues Task Force of the Financial Accounting Standards Board
FASB	The Financial Accounting Standards Board
FinREC	The Financial Reporting Executive Committee of the American Institute of Certified Public Accountants
IASB	The International Accounting Standards Board
IFRS	International Financial Reporting Standards
SEC	Securities and Exchange Commission

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Issues to consider for your 2012 year-end

Some timely reminders about key financial reporting issues and leading practices that you should consider as you complete your year-end financial reporting process. Mark Platt and Shannon Ryhorchuk highlight ten financial reporting areas that you may want to focus on.

This year-end, companies continue to face many complex financial reporting issues such as providing new fair value disclosures, accounting for debt modifications and impairment of assets. Further, economic challenges around the world continue to have broad financial reporting implications. As many of you prepare your company's year-end financial statements, we would like to remind you of some leading practices and lessons learned on key issues that you should consider in this year's annual financial reporting process.



Mark Platt

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We have compiled ten topics for you to consider while preparing your company's financial statements for 2012. These topics have been compiled from a variety of sources including the Securities and Exchange Commission (SEC) staff speeches at the 2012 AICPA Conference on Current SEC and PCAOB Developments, comment letters, restatements, and our own observations.



Shannon Ryhorchuk

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Financial statements

1. Fair value measurement

ASU 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in US GAAP and IFRS*, is applicable for 2012 calendar year-end public companies.

When finalizing your fair value disclosures for your annual filings, you should consider:

- Qualitative descriptions of the ranges for unobservable input disclosures for Level 3 measurements. For example, if a range was 20 to 100 basis points, the company could include a statement such as “95% of the portfolio is between 80 and 100 basis points.”
- Providing the context of ranges of unobservable inputs for Level 3 measurements, quantification of weighted average amounts, particularly for non-derivative products. It would be helpful to disclose how the weighted averages are calculated.
- Expanding your disclosures about valuation techniques for Level 2 measurements as required by the amendments. This includes the sources used for Level 2 measurements.
- More detailed discussion about how changes in one unobservable input affects another unobservable input used in the measurement of a given instrument. This is one area where the disclosures so far have been fairly generic.

Fair value measurements are often determined using valuation techniques. You should consider whether your valuation methods and assumptions are appropriate. Changes in valuation methods and assumptions can occur as market practices continue to evolve. You should have well documented, consistently applied processes and controls to capture information about changes in market participant assumptions, even if third-party valuation services are used.

2. Debt restructuring

The volume of loan restructurings in 2012 was significant. Debt restructurings involve changes in cash flows resulting from changes in contractual interest rates, principal amounts, maturity dates and/or fees exchanged between the debtor and creditor. The nature of the debt restructuring determines the relevant accounting. You will need to determine whether your restructuring is 1) a troubled debt restructuring, 2) modification and continuation of an existing debt, or 3) an extinguishment of a debt and origination of a new debt. The determination of the nature of the change can be complex and may involve judgment.

The SEC staff expects companies to “tell the complete story.”

3. Segments

Identification of operating segments continues to be an area of focus of the SEC staff. The SEC staff uses information from various sources (e.g., press releases, analyst’s calls, entity’s website) to understand how a company is managed. This could include a discussion on the determination of the chief operating decision maker

(CODM) and how the CODM assesses performance and allocates resources.

The aggregation of operating segments into reportable segments has also been a concern. The criteria for aggregation should be closely considered and the reasons for aggregating segments documented.

4. Impairment of assets

The new simplified impairment test for goodwill is effective for 2012 calendar year-ends. Also the new initial assessment for impairment of indefinite-life intangible assets may be applied for 2012 calendar year-ends. Our Fall 2012 edition of *US GAAP Today* covered certain aspects of these ASUs. We remind you that you should contemporaneously and thoroughly document the factors considered and conclusions reached as part of these assessments.

Held for use assets are tested for impairment when events or changes in circumstances indicate the assets may not be recoverable. Some items to think about include:

- Thorough documentation should be in place of processes for identifying triggering events and performing the recoverability test including determining the primary assets, significant assumptions in undiscounted cash flows, projections and the estimate of residual value.
- The recoverability test (undiscounted cash flows) is based on the entity’s specific use and eventual disposition of the assets.
- The “primary asset” is the principal long-lived asset being depreciated or amortized that is the most significant asset from which the asset group derives its cash-flow generating capacity.

When your company recognizes a significant impairment charge, you should document your conclusions about the timing of the impairment charge; the assumptions and valuation techniques used, weights assigned and any changes during the current period compared to prior periods; the events and circumstances that caused the impairment; and the adequacy of “early warning” disclosures made in prior periods.

The standards also require reassessments of the lives of intangible assets, both indefinite-life and amortizable, as well as tangible assets. You should have processes and controls in place to identify circumstances and events that would indicate a need to change the useful lives of these assets.

The SEC staff has also focused on the nature and extent of impairment disclosures in the financial statements and management’s discussion and analysis (MD&A), particularly when there are significant exposures to impairment. Your disclosures should be compared to the

requirements when there is a significant impairment charge recorded.

5. Revenue recognition

Gross versus net presentation of revenue remains a hot topic. Changes in business models and go-to-market strategies may result in a change of presentation. Processes and controls should be in place to make these evaluations as the business changes and evolves.

The changes to the multiple elements guidance in 2011 emphasized the concept of standalone value of the delivered items. The SEC staff has been focusing on the standalone value criterion for entities in the pharmaceutical industry, particularly when the vendor has ongoing involvement. The SEC staff has also been focusing on how companies determine the selling price using vendor specific objective evidence, third party evidence and best estimate of selling price. Controls and processes should be in place for the thorough evaluation and documentation of revenue streams involving multiple elements.

The SEC staff has reminded companies that revenue should not be recognized if collectability is not reasonably assured.

Some items to consider are level of days' sales outstanding, processes and experiences related to past due collections, write-off history and economic conditions of customers.

6. Income taxes

There has been an increased focus on effective tax rates by the SEC staff. Given the increased scrutiny, companies should ensure their disclosures are appropriate and transparent. Items greater than five percent in the effective rate reconciliation should be appropriately disaggregated and disclosed and the effects of tax holidays should be disclosed. Disclosures are also required of any material changes expected in the next twelve months to the effective rate.

Uncertain tax positions (UTPs) continue to be an area of focus. Each reporting period, companies should reassess unresolved UTPs and revisit disclosures, particularly related to reasonably possible changes.

The SEC staff continues to enquire about assertions that foreign subsidiary earnings will be indefinitely reinvested. The assessment of this assertion should be ongoing and requires cross-functional coordination among different management groups within the company. The unrecorded tax liability on unremitted foreign earnings

should be disclosed. If this is not practicable, adequate support for this assertion should be documented.

Valuation allowances for deferred income taxes require significant judgment. The timing of establishing or releasing a valuation allowance may be questioned. The SEC staff has emphasized this should be a "continual evaluation of all positive and negative evidence," including the magnitude and duration of past losses, the magnitude and duration of current probability, the sustainability of current profitability, management's forecast and management's forecast history compared to actual.

7. Loss contingencies

The SEC staff has been seeking improvements to disclosures about loss contingencies for several years. The FASB's decision to remove the loss contingencies project from its agenda has had no impact on the SEC's focus on compliance with the existing US GAAP requirements. Their comments have primarily been focused on early warning disclosures about how loss contingencies could possibly be settled and the amount of the possible range of loss. In the SEC staff's view, these disclosures should evolve as the company obtains more information about a potential loss.

8. Business combinations

Two frequent areas where questions arise on accounting for business combinations are about the nature of the acquisition – a business or a group of assets – and the nature of the consideration paid – for the business or other items.

The determination of whether a business or a group of assets has been acquired is important because of the potentially different accounting. For business combinations, assets and liabilities are generally recognized at fair value and the difference between the consideration and the fair value of the net assets acquired is recognized as goodwill. For an asset purchase, the consideration is allocated to the assets acquired and liabilities assumed on a relative fair value basis and goodwill cannot be recognized.

Identifying whether consideration is a business combination is purchase consideration or post-combination expense can be challenging.

Contingent consideration arrangements with selling shareholders or transactions that are for the benefit of the acquirer need to be analyzed to determine if the consideration is purchase consideration or consideration for a transaction separate and apart from the business

combination or a combination of both. Contingent payments made to employees that are forfeited if employment terminates should be recorded as compensation expense. When there is no requirement for continuing employment, the other indicators listed in the standard should be considered.

Employee-related transactions entered into during the negotiation process should be assessed to determine whether they are purchase consideration or post-combination compensation expense. This would include settlement or acceleration of vesting of share based payments, bonuses to employees or severance arrangements. Other arrangements entered into during the negotiations should also be assessed to determine whether they were for the benefit of the acquirer and should be accounted for separately from the business combination.

9. Pensions

Some companies have been changing methods for accounting for actuarial gains and losses as well as determining the market related value of plan assets. These are changes in accounting principles under US GAAP. Such changes will have to be justified as being preferable and may require a preferability letter from the company's auditor. Any such change in method must be applied retrospectively to all prior periods presented. This can often be challenging.

Companies are also looking at ways to reduce their employee benefit obligations, including entering into settlements. Not all actions taken qualify as settlements. Companies should carefully evaluate both the legal form and substance of these arrangements to determine if a settlement has occurred.

10. Share based payments

The current guidance for share based payments has been in place since 2006; however, there continues to be certain challenging areas.

Evaluation of when a grant date occurs often requires judgment. Management or board discretion in adjusting targets or actual results for unusual items can raise questions about whether employees really understand the terms that will allow the award to vest. A grant date only occurs when there is a mutual understanding of the terms and conditions. Companies should contemporaneously document their evaluation of and conclusion on grant dates.

A share award plan with repurchase features may have to be classified as a liability with "market-to-market" accounting. Repurchase features should be carefully considered to determine the appropriate classification.

Also, subsequent repurchases of immature shares (held for less than six months) or at amounts other fair value may raise questions as to whether there is an in-substance repurchase feature or an expectation by employees that they will receive cash for their shares or an amount that is not potentially fair value. This area requires judgment and companies should have processes and controls in place to evaluate the terms of a stock award plan, as well as subsequent repurchases.

Equity restructuring may often involve modification to stock options and other stock awards. These transactions are often complex. Plans with anti-dilution provisions to keep employees whole that are at the discretion of management or the board of directors will likely result in incremental value and increased compensation cost. The determination of any incremental value is not straightforward and may require the assistance of the company's investment bankers or market making specialists.

Management's discussion and analysis (MD&A)

MD&A was the most frequent area of SEC staff comment in 2012, with the majority of comments addressing the "results of operations" section.

The SEC staff has asked for both quantitative and qualitative information about significant fluctuations and the underlying causes of those changes. The SEC also emphasized that segment level information and key business metrics can provide useful information to investors about the results of operations.

The SEC staff has also asked companies to focus on disclosures that provide the reader with additional insight into the company's liquidity and cash flows. Requests have been made for disclosures about stranded foreign cash, sources and uses of cash, drivers of changes in cash flows from operations and trends in cash flow.

One leading practice for MD&A is to provide an executive summary. The highlights for the quarter or year including current trends specific to the company and operational events at the beginning of the MD&A often sets the tone for the MD&A. The SEC staff continues to encourage companies to include a robust executive summary in their MD&A.

The SEC staff continues to suggest in comment letters that companies should provide foreshadowing disclosures which may include information on pending significant events such as a balloon loan payment, pending lawsuit or

potential impairment. We expect the SEC staff will continue to focus on MD&A with an emphasis on having management explain the “why” behind changes in financial position, operating results, cash flows and the implications.

More information

If you would like to discuss any of these leading practices, please contact your local engagement teams, Mark Platt at mark.r.platt@ca.pwc.com or Shannon Ryhorchuk at shannon.g.ryhorchuk@ca.pwc.com.

News on other proposed ASUs

Scope of disclosure about offsetting assets and liabilities

FASB

Issued November 26, 2012

Comments were due on December 21, 2012

The proposed ASU would clarify that the disclosure about offsetting assets and liabilities required under ASU 2011-11, *Disclosures about Offsetting Assets and Liabilities*, would apply to derivatives, repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions that are offset or subject to a master netting arrangement or similar arrangement. At the January 9,

2013 meeting, the FASB decided to refine the scope of disclosures to derivative instruments, including separated bifurcated derivatives. The FASB also decided the amendments will be applicable for annual periods (including interims) for years beginning on or after January 1, 2013.

Scope and applicability of a particular fair value disclosure to non-public entities

FASB

Issued January 7, 2013

Comments were due on January 22, 2013

Amendments are being proposed to Topic 825, *Financial Instruments*, to clarify that disclosures about the level of the fair value hierarchy do not apply to non-public companies for items that are not measured at fair value in the statement of financial position. The amendment would be effective when the ASU is issued.



More timely recognition of credit losses

The FASB's proposed ASU overhauls the credit impairment model to ensure credit losses are recognized earlier. Philippe Thieren and Ryan Leopold explain the significant provisions of the new model.

In December 2012, the FASB issued a proposal that introduces a new model for accounting for credit losses on financial assets. The proposed ASU is in response to a weakness in current US GAAP identified during the most recent economic crisis. Current US GAAP requires credit losses to be recognized when a loss is probable or has been incurred. This model is often referred to as the “incurred loss” model. Many were concerned that the recognition of credit losses were “too little, too late” under the existing model.

The objective of the proposed ASU is to provide more timely recognition of credit losses by requiring companies to recognize an allowance for expected credit losses and provide users of financial statements with information about expected credit losses. The model, referred to as the “current expected credit loss” (CECL), bases credit losses on the current estimate of contractual cash flows not expected to be collected.



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The FASB and the IASB had been working jointly on a credit impairment project which involved a model often referred to as the three bucket approach. This approach recognized credit losses as credit deteriorated. FASB's outreach indicated that the three bucket approach was difficult to understand and make operational. As a result of the feedback, the FASB decided to develop an alternative CECL model. The IASB is continuing to develop its proposals for a credit impairment model and expects to issue its proposals in the first quarter of 2013. At this point it is unclear whether there will be convergence.

The FASB has requested comments on the CECL model with a comment period ending April 30, 2013.

Which financial assets are covered by the proposed ASU?

The CECL model would apply to all financial assets subject to credit losses and not recorded at fair value through net income (FVNI). The scope of the model includes loans,

debt securities, loan commitments, reinsurance recoverable, lease receivable, trade receivables and similar receivables. The model would also apply to modified financial assets including troubled debt restructurings. The CECL model would replace the five current impairment models for financial assets with a single model. The model would not apply to equity instruments.

When are credit losses recognized?

The proposals calls for an allowance for expected credit losses to be recognized at each period end. An expected credit loss is defined as “an estimate of all contractual cash flows not expected to be collected from a recognized financial asset (or group of financial assets) or commitment to extend credit.”

The CECL model eliminates the “probable” threshold currently required under US GAAP to record a credit loss.

The model considers credit impairment to be a measurement issue as opposed to a recognition issue.

Financial assets accounted for at fair value through other comprehensive income (FVOCI) will be allowed a practical expedient. The practical expedient allows a company not to recognize expected credit losses if the fair value of the asset is at or above amortized cost and the expected credit losses on the individual asset are insignificant.

The CECL model also does not prescribe a unit of account for measuring credit impairment. Estimates may be made on an individual asset or groups of assets basis.

All or a portion of a financial asset would be written off when there is no reasonable expectation of future recovery. Both the amortized cost and the allowance for credit losses would be reduced by the amount written off. Any recovery of an amount written off would reduce the allowance for credit losses when the consideration is actually received.

How are expected credit losses measured?

The estimate of expected credit losses would reflect all relevant internally and externally available information – past, present and future. The information set to be considered has been broadened and includes:

- past events, including historical loss experience for similar assets and historical loss statistics,
- current conditions including the current point in the economic cycle, and

- reasonable and supportable forecasts including the forecasted direction of the economic cycle.

Qualitative and quantitative information specific to the borrower and the economic environment in which the company operates are to be considered. This includes such items as the borrower’s creditworthiness and company-specific and industry-wide credit standards.

Companies would apply judgment and use techniques that are practical and relevant in the circumstances.

The CECL model does not specify any estimation techniques that should be used. Judgments will be required in developing default based statistics, loss-rate statistics, methods of weighing historical experience, methods of adjusting loss statistics for recoveries and how expected prepayment will affect credit losses. Any estimation techniques and approaches used should be applied consistently over time and be consistent with the key principles of the proposed ASU. Under the proposed ASU, companies would be expected to use data from their existing internal credit risk management systems as a starting point for their estimates of expected credit losses.

Credit enhancements that are not separate free standing contracts should be considered when developing an estimate of credit losses. These may include guarantees or other subordinated interests that would absorb the credit losses. However, instruments such as credit default swaps would not be considered.

The estimate of expected credit losses would incorporate the time value of money either explicitly or implicitly. An explicit approach is a discounted cash flow model using the financial asset’s effective interest rate. Other methods which would implicitly reflect the time value of money include the loss-rate, roll-rate, probability of default and provision matrix methods.

For financial assets for which the repayment is expected to be provided primarily or substantially through the operation of the asset by the lender or the sale of the collateral, the proposed ASU provides a practical expedient. The estimate of expected credit losses could be based on the difference between the amortized cost of the financial asset and the fair value of the collateral, adjusted for estimated costs to sell, if applicable.

The analysis requires companies to consider multiple scenarios. The proposed ASU does not permit the use of a worst-case, best-case or most-likely scenario.

Companies will have to at least consider two possible scenarios – one where a credit loss occurs and one where a credit loss does not occur.

However, a probability weighted calculation would not be required. Methods that rely on an extensive population of actual historical data as input would satisfy this requirement if the actual loss data reflects items within the portfolio that resulted in a loss and items that resulted in no loss. Those methods may include loss-rate methods, roll-rate methods, probability of default methods and provision matrix methods using loss factors.

The accounting for financial assets purchased with evidence of credit deterioration since origination or purchased credit impaired (PCI) financial assets will change from current practice. The CECL model requires an allowance for credit losses to be established at the acquisition date that represents the buyer's assessment of the expected credit losses. The cost of the financial assets acquired would be increased by the same amount. This amount would not be recognized as interest income in the future. Any remaining purchase discount would be recognized as interest income using an effective rate calculated at the acquisition date based on expected future cash flows. This effective rate would remain unchanged over the life of the asset. Any subsequent changes in the expected credit losses, whether favourable or unfavourable, would be recognized in income and as a change to the allowance for credit losses.

How is interest income affected?

The recognition of interest income, other than for PCI assets, is not addressed in the standard. Under existing US GAAP, interest income is recognized based on contractual cash flows of the financial assets using an effective yield method.

The nonaccrual principle continues to apply under the proposed ASU. Accrual of interest would cease when it is not probable that substantially all of the principal or interest will be received. When it is not probable that substantially all of the principal will be received, cash receipts would be applied first as a reduction of the carrying amount of the financial asset until it is reduced to zero and then as a recovery of any amounts written off with any excess as interest income. When it is probable that substantially all of the principal will be recovered, but not substantially all of the interest, cash receipts are recognized as interest income to the extent of interest earned for the period with any excess used to reduce the carrying amount of the financial asset.

How are expected credit losses to be presented?

For financial assets measured at amortized cost, the statement of financial position would include the amortized cost of the financial assets as well as the allowance for credit losses. For financial assets measured at FVOCI, the statement of financial position would include the net amortized cost (amortized cost less the allowance for credit losses) and the fair value of the financial assets. For loan commitments, a liability would be included in the statement of financial position. The proposed ASU does not specify any income statement presentation.

The proposed ASU includes disclosures designed to enable users of the financial statements to understand the credit quality of the portfolio, the estimate of expected credit losses and changes to those estimates. The proposed disclosures build on the disclosures introduced in ASU 2010-20, *Disclosure about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*.

When will the proposed ASU be effective?

The FASB has not indicated an effective date as it plans to consider feedback received during the comment process. However, early adoption will not be permitted. The proposed ASU would be applied prospectively through a cumulative-effect adjustment as of the beginning of the first period the guidance is effective.

How will the proposed ASU impact us?

The proposed ASU may change the timing of the recognition of credit losses for many companies as the emphasis is on earlier recognition. The overall credit losses over an economic cycle should not change.

The application of the CECL model is expected to work with a company's existing information systems which will at least provide a history of credit losses and current information about a debtor's status. Companies may need to augment these systems to obtain current information about a debtor's creditworthiness and the implications of the current economic conditions and to incorporate future oriented information about economic conditions in the areas and industries in which the company operates. Companies that have traditionally used a single outcome model such as a most likely scenario will have to develop or adopt techniques that reflect an expected outcome consisting of at least two scenarios. Companies should be thinking about these requirements and provide their views to the FASB in the comment process.

More information

If you would like to discuss these proposals, please contact your local engagement team or Philippe Thieren at philippe.thieren@ca.pwc.com or Ryan Leopold at ryan.e.leopold@ca.pwc.com.

Assessing going concern

The FASB's and PCAOB's current efforts on going concern should enhance transparency for stakeholders. John Donnelly shares our views on the collaborative efforts to help stakeholders' understanding of the going concern assessment.

During the recent economic downturn, some were surprised to learn that companies faced liquidity issues or had filed for bankruptcy. As a result, stakeholders are asking for more timely and robust disclosures of factors that could impact a company's ability to continue as a going concern.



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The current US GAAP model

Use of the “going concern” basis of accounting generally assumes that a business will continue for the foreseeable future. Unless liquidation is imminent, there is no requirement under US accounting standards for management to explain the basis under which the financial statements are prepared. Further, while all material matters are required to be disclosed in certain publicly available reports and many companies have described the basis for the use of the going concern

assumption, they are not specifically required to disclose going concern uncertainties in their financial statements by the standards.

Can we suffer this? Typically the companies do disclose issues because of the auditing standard.

This differs from IFRS. IFRS requires management to make a going concern assessment and disclose material uncertainties related to events or conditions that may cast significant doubt about the company's ability to continue as a going concern.

Auditing standards in the US require the auditor's report to highlight material going concern uncertainties when the auditor concludes that there is substantial doubt about the company's ability to continue as a going concern for a reasonable period of time. This is a high hurdle.

Auditing standards in the US require the auditor's report to highlight material going concern uncertainties. This is the case when the auditor concludes that there is substantial doubt about the company's ability to continue as a going concern for a reasonable period of time (twelve months from the balance sheet date). This is a high hurdle. Canadian Auditing Standards have a similar requirement for the auditor's report to highlight the existence of material uncertainties relating to events or conditions that may cast significant doubt on an entity's ability to continue as a going concern.

Current efforts in the US

As we reported in the Fall 2012 edition of *US GAAP Today*, the FASB expects to issue an exposure draft on going concern in early 2013. The PCAOB has also announced a project on going concern and suggested that the use of emphasis of a matter paragraph in the auditor's report should be expanded to highlight the most significant matters and uncertainties in the financial statements.

The FASB has made a number of tentative conclusions during their deliberations for the project as follows:

- At the end of each reporting period, management would assess a company's potential inability to continue as a going concern and the need for related disclosures. In doing so, management would consider the likelihood of a company's potential inability to meet its obligations as they become due for a reasonable period of time (i.e., twelve months from the period end date). In performing the assessment, management would consider existing events or conditions that may result in an entity's inability to meet its obligations within a reasonable period of time (a practical amount of time not to exceed 24 months from the period end date).
- Disclosures about a company's financial difficulties would be provided in financial statements when existing events or conditions indicate it is near more likely than not that the company may be unable to meet its obligations in the ordinary course of business, within a reasonable period of time from the balance sheet date. Any mitigating effect of management's plans would be considered unless such plans involve actions that are outside the ordinary course of business.
- A statement that there is substantial doubt about a company's ability to continue as a going concern would be required in the financial statements when the likelihood of the company's inability to meet its obligations within a reasonable period of time reaches probable.

Transparency for stakeholders

Stakeholders obtain information about companies from many sources, including press releases, ratings agency reports, the trading price of a company's securities, management presentations, regulatory reports, and

financial statements. Stakeholders typically assess all available information when making decisions.

Disclosures about management's assessment of risks and uncertainties that could impact the company's use of the going concern assumption, and its plans to address those risks and uncertainties, would give stakeholders even greater insight into management's analysis of the company's financial situation.

These disclosures should be scalable based on the risks to a company's going concern status at a point in time.

The disclosures could identify whether the financial statements are prepared on a liquidation basis or a going concern basis, and why the basis used is appropriate. Less severe going concern situations might include disclosure of the potential issue and management's anticipated actions, such as refinancing debt or raising capital. As the company's situation becomes more challenging, the disclosure could be expanded to include more specifics about the conditions and possible alternatives if management's plans are not successful.

We support the FASB's current efforts to develop a standard with input from the PCAOB and others. By continuing to collaborate, the FASB and PCAOB have an opportunity to improve stakeholders' understanding of going concern assessments. Stakeholders will benefit from these new disclosure requirements.

More information

For more information on these current efforts, please contact your local engagement team or John Donnelly at john.b.donnelly@ca.pwc.com.

News on other proposed ASUs

(continued)

Transfers with forward agreements to repurchase assets and accounting for Repurchase financings

FASB

Issued January 15, 2013

Comments are due on March 29, 2013

The proposed amendments would require repurchase agreements (repos) and similar transactions to be accounted for as secured borrowing transactions if the following criteria are met:

- The agreement involves a transfer of an existing financial assets at its inception;
- The agreement involves both a right and an obligation to repurchase the financial assets;
- The initial transfer and forward repurchase agreement involve the same counterparty;
- The agreement to repurchase is entered into contemporaneously or in contemplation of the initial transfer;
- The repurchase price is fixed or readily determinable; and
- The financial assets specified under the forward purchase agreement are identical to or “substantially the same” as the financial assets transferred at inception.

Arrangements that do not meet the above criteria will be evaluated under the existing derecognition guidance for sales of financial asset conditions under Topic 860, *Transfers and Servicing*.

As a result, repo-to-maturity transactions currently accounted for as sales with an obligation to repurchase will likely be accounted for as secured borrowings. In addition, the proposed amendments would eliminate

the requirement to account for repurchase financing transactions on a linked basis (i.e., the components of the transaction are considered as a unit and generally reflected as a derivative instrument).

The proposed amendments would require additional quantitative disclosures for certain transfers of financial assets with agreements that both entitle and obligate a transferor to repurchase the transferred financial asset from the transferee.

The FASB has not yet indicated when the guidance would be effective, but has decided to prohibit early adoption.

News on FASB projects in progress

Revenue recognition

The FASB and IASB continued redeliberations of the revenue recognition exposure draft during the quarter and reached tentative decisions on several of the matters under consideration. The Boards reached decisions on allocating the transaction price to separate performance obligations, applying the proposed model to bundled arrangements, constraining the cumulative amount of revenue recognized on licenses, and accounting for contract acquisition costs. The Boards’ decisions are tentative and subject to change. Other key issues still to be redeliberated include scope, disclosures, transition and certain industry specific matters.

The Boards decided to retain the proposals in the 2011 exposure draft relating to the use of a residual approach to estimate the standalone selling price of a performance obligation. They clarified that this approach can also be used when two or more performance obligations in a contract have standalone selling prices that are highly variable or uncertain. The Boards also clarified that when two or more performance obligations have standalone selling prices that are highly variable or uncertain, the transaction price should first be allocated to the performance obligations for which standalone selling prices are determinable. The remaining (residual) transaction price should be allocated between the other performance obligations using another method of estimation.

The 2011 exposure draft includes guidance on when discounts and variable consideration in an arrangement should be allocated to specific performance obligations. The Boards clarified that discounts or variable consideration should first be allocated to one or more specific performance obligations using that guidance. The company would then use a residual approach to estimate the standalone selling price of any other performance obligations.

The Boards decided to remove the specific exception in the 2011 exposure draft that constrained revenue from licenses of intellectual property where payments vary based on the customer’s subsequent sales (for example, a sales-based royalty). They agreed that when consideration is highly susceptible to factors outside the

company's influence, the company's experience for determining the transaction price might not be predictive. Highly susceptible factors could include actions of third parties, such as sales by a company's customers. The Boards will enhance the guidance to clarify this point, and that the underlying principle applies to all contracts with customers.

The Boards' timeline indicates issuance of a final standard in the first half of 2013. They are expected to finalize their redeliberations over the next few months and perform targeted outreach on some of the more significant changes. We anticipate the final standard to have an effective date no earlier than 2015.

Discontinued operations

On December 12, 2012, the FASB met to resume redeliberations on its discontinued operations project. The project had been inactive since early 2010 while the Board focused on its higher priority projects. At this meeting, the Board reaffirmed its previous decision about the definition of a discontinued operation, modified certain disclosure requirements, and directed its staff to issue a revised exposure draft as soon as possible.

The proposal is expected to raise the threshold for a disposition to qualify as a discontinued operation. These proposals are consistent with those currently contained in IFRS. The revised definition of a discontinued operation is a component that has either been disposed of, or is classified as held for sale, and:

- represents a separate major line of business or major geographical area of operations,
- is part of a single coordinated plan to dispose of a separate major line of business or geographical area of operations, or
- is a business that meets the criteria for classification as held for sale upon acquisition.

Under current guidance, the threshold is a component of a company that comprises operations and cash flows that can be clearly distinguished. A component could range from an asset group to a reportable segment.

The proposals will no longer preclude presentation as a discontinued operation if (a) there are operations and cash flows that have not been eliminated from ongoing operations or (b) there is significant continuing involvement with the component after the disposal transaction.

The proposal also includes increased disclosures, which are incremental to those required under IFRS. The incremental disclosures will focus on:

- Profit and loss and balance sheet information about disposals of individually material components that are not classified as discontinued operations; and
- Continuing ownership interests in a discontinued operation after a disposal.

The FASB has not yet deliberated an effective date. The Board plans to issue a revised exposure draft in January 2013 with a 150-day comment period.

Insurance contracts

During Q4 of 2012, the FASB and IASB continued their joint discussion on insurance contracts. The FASB also addressed scope this quarter, focusing on guarantee contracts. Guarantee contracts in scope of its existing insurance guidance will be included, while those covered under derivatives and hedging guidance will

not. The FASB will continue to discuss whether other types of guarantees should be included in the scope of the project at a future meeting.

Investment companies

At a recent meeting, the FASB has reversed its previous decision to include mortgage real estate investment trusts within its investment company guidance. FASB also indicated it will consider accounting for real estate investment companies after it completes investment company project.

News on SEC Developments

PCAOB standard on communication with audit committees approved

On December 17, 2012, the SEC approved the rules on Auditing Standard No. 16, *Communications with Audit Committees (AS16)*, and *Related Amendments to PCAOB Standards*. AS16 will be effective for public company audits of financial years beginning on or after December 15, 2012. AS16 incorporates the existing PCAOB standards and the SEC rules on communications with audit committee and adds new requirements generally linked to performance requirements.

The key enhancements include communications about:

- Certain matters regarding the company's accounting policies, practices and estimates including, but not limited to, a description of processes and assumptions managements used in critical estimates;
- The auditor's evaluation of the quality of the company's financial reporting;
- Information related to significant unusual transactions including the business rationale for such transactions; and
- The auditor's views regarding significant accounting or auditing matters when the auditor is aware that management consulted with other accountants about such matters and the auditor has identified a concern regarding these matters.

Helpful information on complying with the US Foreign Corrupt Practices Act

The SEC and the US Department of Justice have released *A Resource Guide to the US Foreign Corrupt Practices Act (FCPA)*. The 120-page guide provides a detailed analysis of the FCPA including who and what is

covered by the FCPA anti-bribery and accounting provisions, the definition of a "foreign official"; what constitutes proper and improper gifts, travel and entertainment expenses; facilitating payments; how successor liability applies in mergers and acquisitions; the hallmarks of an effective compliance program; and different types of civil and criminal resolutions.

The guide is available online at:
www.sec.gov/spotlight/fcpa.shtml or
www.justice.gov/criminal/fraud/fcpa.

Compliance guides for small entities

In our October 2012 edition of *AC Insights*, we indicated that the SEC had adopted a new rule and forms related to disclosures about the use of conflict minerals that originated in the Democratic Republic of the Congo or adjoining countries and new requirements for disclosures of payments by resource extraction issuers. The SEC staff has prepared two small entity compliance guides to summarize and explain these new requirements. These guides are not a substitute for the rules themselves, but may be helpful in considering how to comply with the requirements.

The guide on conflict minerals disclosure can be found online at:

<http://www.sec.gov/info/smallbus/secg/conflict-minerals-disclosure-small-entity-compliance-guide.htm>.

The guide on payments by resource extraction issuers can be found online at:

<http://www.sec.gov/info/smallbus/secg/resource-extraction-small-entity-compliance-guide.htm>.

Our US GAAP Reporting team

Our people are ready to help you understand US GAAP. If you have questions or want to discuss the developments in this publication or other developments, our people in the US GAAP Reporting Group will be happy answer your questions and have a discussion with you.

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