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Current Accounting and Reporting Developments

June 9, 2009

Current Accounting and Reporting Developments June 9, 2009



Vin Colman

**Assurance Managing Partner and
National Professional Services Group Leader**

Financial Crisis Developments

- Final FASB FSPs on fair value and other than temporary impairments (OTTI) released
- Financial Crisis Advisory Group meetings held
 - Interaction with the G-20
 - Report expected in July
- Rapid standard-setting in response to financial crisis appears to be over
 - Temporary solutions (FSPs, changes to FAS 140 and FIN 46(R), etc.)
 - Focus has returned to longer-term standard setting

Financial Instrument Standard

- Joint project between FASB and IASB
- Timing varies depending on standard-setter
 - FASB – Exposure draft by end of 2009
 - IASB – Final by end of 2009
- Approach also varies
 - FASB – entire standard at once
 - IASB – piecemeal exposure drafts

FASB Activity on OTTI and Fair Value Measurements



Marc Anderson
Partner

Overview

- Intense pressure on FASB and SEC in 1Q to “fix” mark-to-market accounting
 - Procyclicality
 - Severely depressed asset values
 - Negative impact on banks’ capital
- House Subcommittee hearing on March 12, 2009
 - Pressure on FASB to act rapidly
 - FASB committed to a “fast track” three-week rulemaking timetable

Overview (cont'd)

- On April 9, FASB released 3 FSP's:
 - FSP FAS 115-2 and FAS 124-2, “Recognition and Presentation of Other-Than-Temporary Impairments”
 - FSP 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”
 - FSP FAS 107-1 and APB 28-1, “Interim Disclosures about Fair Value of Financial Instruments”
- Effective for periods ending after June 15, 2009, earlier adoption allowed
 - Cumulative catch-up adjustment for OTTI FSP

OTTI changes overview

- New triggers for OTTI recognition:
 - Intent to sell
 - More likely than not (MLTN) will be required to sell before recovery of cost basis
 - Non-recovery of entire amortized cost basis of security (credit loss)
- OTTI still consists of entire difference between fair value and cost basis, however, the FSP introduces a new presentation of OTTI components:
 - If no intent to sell and not MLTN will be required to sell, recognize only credit loss in earnings with noncredit component in OCI
 - If intent to sell or MLTN will sell, recognize entire OTTI in earnings

Implications of OTTI changes

- Better aligns impairment models for financial instruments with similar economics (debt securities and loans)
- Recognizing only incurred credit losses in earnings in certain cases better reflects expectations of future cash flows
- New triggers are considered more operational than prior “ability and intent to hold to recovery”
- May positively effect certain financial institutions’ regulatory capital
- Previously recognized non-credit OTTI may be recycled through the income statement

Observations from early adopters

- Don't underestimate effort to comply
 - While retroactive restatement is not allowed, a cumulative catch-up adjustment is required
- Disclosure requirements are significant
- Consider impact on systems, processes and controls needed to accumulate required information
- Practices for determining credit loss (expected cash flows) are evolving
- Don't forget post-OTTI accounting (Day 2)
- Status quo for equity securities
- Implementation guidance found in PwC DataLine 2009-23

New Fair Value Guidance

- Response to difficulties in applying FAS 157 in current market environment:
 - When should observable inputs (transaction or quoted price) be significantly adjusted?
 - Concerns that fair value hierarchy may encourage undue weighting of “last transaction price”
- Response to recommendations in SEC’s recent study on market to market accounting
- Reaffirms fair value objective in FAS 157: transfer in an orderly transaction between market participants under market conditions at the measurement date

New Fair Value Guidance (cont'd)

- FSP 157-4 requires a two-step approach
 - Step 1: Assess factors to determine if the market has become inactive (i.e., there has been a significant decline in volume/activity compared to normal levels)
 - Do not presume transactions are not orderly
 - Step 2: If market is inactive, perform additional analysis as the transaction price may not represent FV
 - Preparer must use judgment in determining valuation based on facts and circumstances

New Fair Value Guidance (cont'd)

- Identifying transactions that are not orderly
 - Even when a market is considered inactive, it is not appropriate to conclude that all transactions in that market are not orderly
 - Observable transactions must be evaluated based on the weight of evidence to determine whether they represent orderly transactions
 - Entities are not required to undertake all efforts to determine whether transactions are orderly, but cannot ignore information that is available without undue cost and effort
 - Transaction prices may have to be weighed (vs. disregarded) in determining fair value

New Fair Value Disclosures

■ FSP 157-4

- Inputs and valuation techniques used in interim and annual periods
- Include changes in valuation techniques or inputs made during the interim period
- Disclose fair value of debt and equity securities by major security type

■ FSP 107-1

- Requires disclosures for financial assets and liabilities in all interim periods (previously annual only)
- Requires disclosure of methods and significant assumptions used to estimate fair value

Fair Value and Liabilities

- In May, FASB issued proposed FSP 157-f, *Measuring Liabilities under FASB Statement No. 157*
- Objective is to address difficulties associated with determining fair value of liabilities, including:
 - Lack of observable inputs (few transfer transactions)
 - Treatment of transfer restrictions in valuation

Fair Value and Liabilities (cont'd)

- Proposed FSP 157-f:
 - Reaffirms that the fair value objective remains transfer in an orderly market
 - Clarifies that fair value is not adjusted for contractual restrictions that prevent transfer
 - Reiterates that “own credit risk” must be considered in determining fair value
 - Discusses appropriate valuation approaches, including market approach based on amount an entity would receive to enter into the identical liability at the balance sheet date
- Comment period ended June 1, 2009; proposed effective date is periods beginning after issuance (possibly 3Q 2009)

FASB Developments



Sue Cospers
Partner

Proposed Statement, *Accounting for Transfers of Financial Assets* – an amendment of FASB Statement No. 140

- Amends FAS 140 for transfers of financial assets
- Key Changes:
 - Elimination of QSPE concept
 - No exemption of QSPEs from FIN 46(R)
 - Participating interest definition for sale of portions of financial assets
 - Enhanced disclosures

Proposed Statement amending FAS No. 140 (cont'd)

- Not only financial services companies impacted
 - Could change whether transfers of financial assets are accounted for as sales or secured borrowings
- Effective Date and Transition
 - Prospective for new transfers of financial assets occurring in fiscal years beginning after Nov 15, 2009
- Expected to be issued on or around June 15, 2009

Proposed Statement, *Amendments to FASB Interpretation No. 46(R)*

- Amends FIN 46(R) for consolidation of variable interest entities
- Key Changes:
 - Elimination of the scope exception for QSPEs
 - Methodology for determining the Primary Beneficiary
 - Shift towards a “qualitative analysis” focusing on
 - (1) Power to direct activities that most significantly impact the VIE, and
 - (2) Right to receive benefits or obligation to absorb losses that could potentially be significant to the VIE
 - Continuous reassessment of Primary Beneficiary
 - Enhanced disclosures

Proposed Standard amending FIN 46(R) (cont'd)

- Practical Implications
 - More consolidations with elimination of QSPE scope exception
 - May change who consolidates
- Effective Date and Transition
 - Option of Retrospective or Cumulative Effect adoption
 - Effective for fiscal years beginning after November 15, 2009
- Expected to be issued on or around June 15, 2009

FASB Statement No. 165, *Subsequent Events*

- Standard incorporates auditing literature into the accounting literature with some modification
 - Refers to subsequent events as recognized and unrecognized
 - Revises the definition of subsequent events to include concept of financial statements "being available to be issued"
 - Requires disclosure of the date through which management has evaluated subsequent events
- Effective Date
 - Interim or annual periods ending after June 15, 2009
- Refer to PwC DataLine 2009 - 27

FASB Accounting Standards Codification - Update

- FASB Board approved Codification as the single official source of authoritative, nongovernmental U.S. generally accepted accounting principles (GAAP)
- Will launch Codification on July 1, 2009
- Effective for interim and annual periods ending after September 15, 2009
- Refer to PwC DataLine 2009 - 12
- Refer to CFOdirect for archived May 19, 2009 Codification webcast

SEC Developments



Mark Herndon
Partner

SEC update

- Commissioner & Staff positions
- Vision of the new Chairman
 - Modernization of the regulatory system
 - Transparency and accountability
 - Enforcement
- Corporate governance proposals

SEC comment letter trends

- Areas potentially impacted by economic downturn
 - Restructuring and impairments
 - Management's Discussion and Analysis
 - Liquidity and capital resources
 - Debt covenant compliance
 - Income taxes
 - Executive compensation
 - Segment reporting
 - Fair value determinations

SEC comment letter trends (cont'd)

Impairments

- Robust disclosure, including “early-warning” indicators
- Consider potential interim impairment indicators:

Impairment charges to other assets	Consistently not meeting analyst expectations
Cash flow or operating losses	Planned restructurings
Negative long-term outlooks	Market cap below book value

SEC comment letter trends (cont'd)

Impairments (cont'd)

- Enhanced Disclosures
 - Reason for impairment and triggering events
 - Whether forecasts have changed
 - Events that may result in future impairment
 - Provide the assumptions used in impairment tests

- Define reporting unit levels

- Disclose reporting units whose carrying value is close to fair value

SEC Update

- Other reminders
 - XBRL
 - Codification
- Financial Reporting Manual updated
- Retrospective accounting changes

Update on IFRS



Dave Kaplan
International Accounting Leader

Themes from the SEC Response Letters to the Proposed Roadmap

- Significant support for moving to a single set of global accounting standards (84%)
- Views varied on the path to IFRS.
 - Full convergence, no mandate (48%)
 - Partially converge, then mandate (24%)
 - Mandate soon (28%)
- Many preferred more time
- IASB independence and accountability is important
- Changing to IFRS will have a wider impact than expected

The Road Ahead for IFRS in the US

- Potential next steps for the SEC
 - Near-term focus on financial crisis and regulation
 - Expect increased activity later in 2009 or into 2010
 - SEC will consider
 - How much convergence is necessary before a mandatory date is established?
 - How will the transition be effected?
 - What is the final timeline?
- Other potential challenges for moving forward
 - Political pressure on the IASB
 - Declining convergence interest by countries using IFRS

Extended Period of Significant Change

- Memorandum of Understanding between the FASB and IASB will drive major standard changes
- Almost every major balance sheet caption will be affected
- Corporate oversight over converting subsidiaries will be needed as additional countries move to IFRS
- Increasing influence of IFRS on customer and vendor behavior

Strategic Planning for the Change

- Focus on the challenge ahead whether through convergence or change
- Monitor changes as they develop and perform scenario planning
- Perform an assessment. Consider impacts on business, accounting, tax, investor, controls, and systems
- Focus on what makes the most sense to tackle now

A Look Into the Future



Ray Beier

Leader – National Thought Leadership

A Look into the Future

- Standard-setting priorities
- Standard-setting activities that deserve consideration today
 - Revenue recognition
 - Classifying financial instruments as liability or equity
 - Leases
- Other matters

Standard-Setting Priorities

- Address limitations exposed by the financial crisis
- Further convergence between US GAAP and IFRS
- Increase investor involvement in standard-setting
- Reduce unnecessary complexity and inconsistent principles
- Underlying theme: Independent standard-setting and open due process

Revenue Recognition

- Background
 - Will replace the patchwork of existing guidance with a single standard
 - Moves toward a revenue recognition standard based on the principle of delivering goods or performing services
- Implications
 - Potential changes to the timing of revenue
 - Elimination of industry specific guidance
 - Recognition no longer based on transfer of risks and rewards or performing activities in a contract (e.g. percentage of completion)
 - Recognition under proposed model is based on transfer of control
 - Boards have not clearly defined when control changes

Revenue Recognition (cont'd)

- The path forward
 - Comments on the discussion paper due June 19, 2009
 - Exposure draft in 2010, final standard in 2011 (effective 2012)
 - Companies still have sufficient time to express their views and influence the Boards
- Refer to PwC DataLine 2009-07

Classifying a Financial Instrument as a Liability or Equity

▪ Background

- Intends to reduce complexity and inconsistent results
- Direction of standard-setters is a narrow definition of equity
- Classification as liability or equity drives whether and how earnings will be impacted

▪ Implications

- Instruments that are now classified as equity could become liabilities, and vice-versa, thereby impacting capital structure
- More instruments classified as liabilities could increase earnings volatility
- Financial statement metrics and debt covenants would be affected

Classifying a Financial Instrument as a Liability or Equity (cont'd)

- The path forward
 - Boards are refining the approach based on feedback received from the comment period in 2008
 - Exposure Draft is expected in Q4 2009
 - Final Standard is not expected before 2011
 - Expected effective date no earlier than 2012

Leases

- Background

- Intended to report assets and liabilities associated with leasing arrangements on the balance sheet
- Moving from a 'bright lines' model to a 'right-of-use' model

- Implications

- Current thinking would fundamentally change lease accounting by eliminating operating leases
- No grandfathering of existing leases expected
- Impact on balance sheet ratios, EBITDA, debt covenants is worth considering in the near term
- Consider impact on the lead time associated with leasing and capital planning decisions

Leases (cont'd)


- The path forward
 - Lessor accounting not yet addressed; will parallel the principles of the revised revenue recognition standard
 - Comments on the discussion paper are due in July 2009
 - Exposure draft expected in 2010, final standard expected in 2011

- Refer to PwC DataLine 2009 -14

Overview – Joint Projects of the MOU

Topic	Est. Timing	Lead
Business combinations	completed	Joint
Revenue recognition	2011	Joint
Financial instruments	2009*	Joint
Fin. stmt presentation	2011	Joint
Leases	2011	Joint
Liabilities and equity	2011	Joint
Consolidations	2009	IASB
Derecognition	2010	IASB
Fair value measurement	2007*	FASB
Post-employment benefits	2011*	IASB
Income taxes	2010*	IASB

*On these projects, one Board will (has) release(d) in advance of the other.

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