

The Quarter Close

A look at this quarter's financial reporting issues



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What you need to know—first quarter 2009

Welcome to our inaugural edition of **The Quarter Close**. This quarterly publication is designed to keep you informed about the latest accounting and financial reporting issues. This new publication highlights certain accounting hot topics and newly effective standards along with other areas of interest.

In this edition, we highlight the results of the latest debate on fair value accounting and impairments, and discuss the new standards for business combinations and non-controlling interests, including recent amendments to the guidance on acquired contingencies.

Accounting hot topics

The debate continues—FASB fast-tracks three new standards

As the debate about the economy continues in Washington, Congress has turned its attention to accounting standards. With some believing that fair value accounting is in part the cause of our economic woes, the FASB was told to “do more” and expeditiously deal with the guidance on fair value measurements. Amid the mounting pressure, the FASB responded with record-breaking speed and approved three FSPs, which will be effective for the second quarter for calendar year-end companies. Early adoption will be permitted.

Fair value measurements in inactive markets

This FSP will amend FAS 157, *Fair Value Measurements*, to provide additional guidance on fair value measurements in inactive markets. The new approach is designed to address whether a market is inactive, and if so, whether a transaction in that market should be considered distressed. The objective of the proposal is to remain consistent with the principles of FAS 157, yet provide additional guidance on how fair value measurements might be determined in an inactive market.

Other-Than-Temporary Impairment (OTTI) for debt securities

This FSP will amend the impairment guidance for certain debt securities and will require an investor to assess the likelihood of selling the security prior to recovering its cost basis. If an investor is able to meet the criteria to assert that it will not have to sell the security before recovery, impairment charges related to credit losses would be recognized in earnings, while impairment charges related to non-credit losses (for example, liquidity risk) would be reflected in other comprehensive income. The FSP will require adoption through a cumulative effect adjustment, which is a change from the original proposal.

Interim disclosures of fair value

This FSP will require that the fair value disclosures required by FAS 107, *Disclosures about the Fair Value of Financial Instruments*, be included in interim financial statements. This FSP was originally proposed to be effective for the first quarter for calendar year-end companies. In its deliberations, the Board acknowledged the time and effort associated with developing the interim disclosures and opted for a required effective date for the second quarter.

Next steps

The Board plans to issue these FSPs in early April, in time for companies that choose early adoption to apply them for first quarter reporting. If a company is planning to early adopt for the first quarter, it is important to note that both the FSP on FAS 157 and the FSP on OTTI for debt securities must be early-adopted together. Also, it will be important to carefully review the final FSPs to assess their implications, including the significantly expanded disclosure requirements. Coming soon will be a DataLine that will provide additional guidance.

Goodwill and long-lived asset impairment—a continuing focus

It's no surprise with current market conditions that impairment considerations for goodwill and other long-lived assets remain a pressing issue for many companies. Companies continue to deal with issues such as determination of triggering events, measurement of the fair value of reporting units and other long-lived assets, reconciliations to market cap and the determination of levels of control premiums. In this environment it's not unusual to have yet another triggering event even when triggering events may have occurred in previous quarters. While the event is not automatically a trigger (for example, a continued downward slide in market capitalization), it does require analysis. These issues, and others, are explored in newly-updated [DataLine 2008-35](#), *Nonfinancial Asset Impairment Considerations*.

Another key reminder—don't forget that newly effective standards FAS 141(R), *Business Combinations (revised 2007)*, and FAS 157 for non-financial assets and liabilities may impact the calculation of impairment for both goodwill and long-lived assets.

The following publications continue to provide relevant guidance on impairment and valuation issues:

- [DataLine 2009-09](#), *FASB's Valuation Resource Group: Highlights of February 2009 Meeting*
- [DataLine 2008-35](#), *Nonfinancial Asset Impairment Considerations*
- [DataLine 2008-34](#), *Highlights of the 2008 AICPA National Conference on Current SEC and PCAOB Developments*
- Mergers & Acquisitions—A snapshot, [vol. 2](#)

The impact of the economic downturn on financial reporting

Many accounting issues this quarter relate to some aspect of the continuing economic downturn. These conditions, combined with the legislative response to the current economic environment, may affect company's financial reporting. For example, many companies, experiencing sustained declines in the value of their debt and equity securities (some of which may be "other than temporary"), may be considering restructuring their operations, refinancing short-term debt, and evaluating whether they will be able to maintain compliance with their existing debt covenants. A DataLine will be issued shortly to provide additional guidance regarding the impact of the global economic slowdown on accounting and financial reporting in these challenging economic times.

Tax law changes and related effective tax rate implications

In February, President Obama signed into law the American Recovery and Reinvestment Act of 2009 (the "Act"). Companies should account for the tax law changes created by the Act in the period of enactment (i.e., the first quarter for calendar year-end companies). While many of the tax provisions of the Act are prospective in nature, they should be taken into consideration when determining a company's annual effective tax rate. For those provisions of the Act that have a retroactive effective date, the impact should be treated as a discrete period item for interim reporting purposes. A TAS Alert will be issued soon that will provide additional information on the Act.

New accounting standards

For a complete list of effective standards refer to Appendix A

The deferral is over—FAS 157 is now effective for non-financial assets and liabilities

Despite some last minute attempts by some of the FASB's constituents to extend the deferral, FAS 157 is effective this quarter for calendar year-end companies for their non-financial assets and liabilities. Be careful not to overlook this standard—the new fair value guidance can have an impact, particularly if a triggering event requires a company to perform step-two of the goodwill or long-lived assets impairment tests. For example, in the second step of the goodwill impairment test, companies are now required to incorporate market participant assumptions in determining the fair value of non-financial assets and liabilities, which may lead to increased non-financial asset values (such as intangible assets) and, thus, higher goodwill impairment charges.

New guidance was issued this quarter to help navigate the application of FAS 157 to non-financial assets and liabilities:

- PwC's *Guide to Fair Value Measurements*, [Addendum No. 2](#)

Business combinations—broad principles bring pervasive change

The new business combinations standard, FAS 141(R), is now effective for calendar year-end companies. Although some of its provisions seem straight forward, the impacts are pervasive. The concept of fair value drives important changes to the model—including changes in the accounting for partial business combinations and step acquisitions. Other traditional concepts have also undergone fundamental change. For example, FAS 141(R):

- Expands the definitions of a business and business combination
- Requires the recognition of contingent consideration at fair value on the acquisition date
- Requires acquisition related transaction costs to be expensed as incurred
- Changes the way certain assets are valued
- Requires retrospective application of measurement period adjustments

Importantly, this new standard may have an impact regardless of whether an acquisition is planned. Even without any M&A activity, the new standard could increase the number of a company's reporting units, change the calculation of goodwill impairment, and cause tax adjustments to be recorded in earnings.

The implications of the new standard are far-reaching. Each of the publications below will help you understand the broader implications of the standard. Coming soon will be an update to the Q&As on FAS 141(R).

- [DataLine 2008-01](#), *FAS 141(R), Business Combinations*
- [DataLine 2008-30](#), *Key Considerations for Implementing FAS 141(R) and FAS 160*
- [DataLine 2008-33](#), *Frequently Asked Questions Regarding the Tax Accounting Implications of FAS 141(R) and FAS 160*
- Mergers & Acquisitions—A snapshot, [vol. 1](#), [vol. 3](#), and [vol. 4](#)
- [PwC Guide](#), *A Global Guide to Accounting for Business Combinations and Noncontrolling Interests*

Acquired contingencies—déjà vu?

After considering a number of issues associated with acquired contingencies in a business combination, the FASB has recently decided to reverse course. An FSP, issued on April 1, 2009, amends FAS 141(R) and eliminates the distinction between contractual and non-contractual contingencies. The new guidance also reinstates familiar concepts from FAS 141, yet encourages greater use of fair value when determinable.

The FSP is effective as of January 1, 2009 for calendar year-end companies. Refer to [DataLine 2009-16](#), *New Guidance for Acquired Contingencies*, for discussion of the new FSP.

Noncontrolling interests—a new paradigm

The new standard on accounting for noncontrolling interests (previously minority interests), FAS 160, *Noncontrolling Interests in Consolidated Financial Statements*, is the “companion piece” to the business combination standard and is also effective this quarter for calendar year-end companies.

The guidance creates a fundamental paradigm shift in how one thinks about noncontrolling interests. Noncontrolling interests will now be considered a component of equity. This change in classification drives a number of related accounting changes. One significant change is that transactions with noncontrolling shareholders will be reflected as equity transactions, as long as control of the subsidiary is maintained. Another significant change is that there is a new look to the income statement. Net income will now include earnings attributable to both the parent and the noncontrolling interest. EPS, on the other hand, will still be based on the earnings attributable to the parent.

We anticipate a number of practice issues will emerge as companies implement the new requirements. Already, the EITF has started deliberations on several issues. We will continue to update our Q&A on FAS 160 to provide you with current information on these implementation issues.

The following publications provide information on FAS 160, including some helpful implementation guidance.

- [DataLine 2008-02](#), *FAS 160, Noncontrolling Interests in Consolidated Financial Statements*
- [DataLine 2008-30](#), *Key Considerations for Implementing FAS 141(R) and FAS 160*
- [DataLine 2009-08](#), *Revisions to EITF Topic D-98, Classification and Measurement of Redeemable Securities*
- Alert 09/09¹, *Accounting for Certain Sales of Real Estate or In-Substance Real Estate Following the Effective Date of FAS 160*
- Mergers & Acquisitions—A snapshot, [vol. 1](#)
- [PwC Guide](#), *A Global Guide to Accounting for Business Combinations and Noncontrolling Interests*

¹ This publication is available only to PwC partners and staff.

New disclosures for derivative instruments and hedging activities

FAS 161, *Disclosures about Derivative Instruments and Hedging Activities—an amendment of FASB Statement No. 133*, is effective this quarter for all companies, regardless of their year-ends. FAS 161 amends and significantly expands the disclosures required by FAS 133, including (1) how and why an entity uses derivative instruments, (2) how derivative instruments and related hedged items are accounted for under FAS 133 and its related interpretations, and (3) how derivative instruments affect an entity's financial position, financial performance, and cash flows. The following DataLines provide more information and examples of these expanded disclosures.

- [DataLine 2008-07](#), *Disclosure about Derivative Instruments and Hedging Activities*
- [DataLine 2008-25](#), *FASB Issues Guidance on Credit Derivatives Disclosures and Certain Guarantees and Clarifies the Effective Date of FAS 161*

New accounting for convertible debt

FSP APB 14-1, *Accounting for Convertible Debt That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)*, requires that debt issuers separately recognize the liability and equity components of convertible instruments that may be settled in cash upon conversion. This is accomplished by first determining the fair value of the liability component (based on a similar liability without an embedded conversions option) and allocating the residual to the embedded conversion option.

Since the debt discount recognized under this approach will likely be higher, the amount of interest cost recognized each period as the debt discount is amortized may also be higher. Careful...the amortization period is based on the estimated life of a similar liability that does not have an embedded conversion option.

Effective this quarter for calendar year-end companies, the FSP is required to be applied retrospectively to convertible debt instruments outstanding during the periods presented in the financial statements, even if those instruments were amended, extinguished, or converted prior to the effective date. Refer to [DataLine 2008-11](#), *FASB Issues Guidance on Convertible Debt Instruments that may be Settled in Cash Upon Conversion*, for further information.

New approach for evaluating equity-linked instruments—is equity still equity?

Effective this quarter for calendar-year companies, EITF 07-5, *Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity's Own Stock*, provides guidance on determining whether an equity-linked financial instrument (or embedded feature) can be considered indexed to an entity's own stock—a key criterion for determining if the instrument (or embedded feature) may be classified as equity. The guidance in EITF 07-5 constitutes a partial change from how this determination has been made in practice. It employs a two-step approach that evaluates contingent exercise features similar to current guidance and settlement provisions under a new methodology. The transition provisions require companies to apply the new guidance through a cumulative effect adjustment.

For many instruments, the new guidance will not cause a change in practice. However, one notable exception is that the new guidance will have an impact on certain “antidilution” provisions that provide downside price protection to an investor. These provisions (also known as “down round” provisions) are often problematic when evaluated under step 2 and

are common in many instruments. This may result in a significant change in practice for those instruments with these protective features.

The guidance is not always intuitive. To help you navigate, a DataLine will be issued shortly. Refer also to Alert 08/55², *Issuance of EITF 07-5 May Require Reclassification of Certain Equity-linked Financial Instruments (or Equity-linked Embedded Features) Containing Certain "Antidilution" or "Price Protection" Provisions*.

EPS—have you assessed the impact of participating securities?

FSP EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities*, requires that certain unvested share-based payment awards (e.g. restricted stock) that contain nonforfeitable rights to dividends or dividend equivalents be included in the computation of EPS using the two-class method.

Unvested share-based payment awards with nonforfeitable rights to dividends have typically been included in the calculation of diluted EPS using the treasury stock method. These awards are now required to be included in the calculation of EPS using the two-class method. This change will likely reduce both basic and diluted EPS as a result of the application of the two-class method since the computation of diluted EPS under the treasury stock method is likely to be less dilutive than the computation under the two-class method.

Effective this quarter for calendar-year companies, the FSP requires a retrospective adjustment for all prior-period EPS data. Refer to [DataLine 2008-16](#), *Certain Share-Based Payment Awards with Rights to Dividends May Be Considered Participating Securities*, for further information.

SEC matters

Adoption of new standards—restated financials may be required

If a company is thinking about preparing a new or amended registration statement, proxy statement, or private offering that includes or incorporates by reference interim financial statements that reflect a change in accounting principle, don't forget to ask the following question: Does the new principle require retrospective application? Since several new accounting standards require retrospective application (e.g., FSP APB 14-1 and FAS 160), a company must revise its previously filed annual financial statements included or incorporated by reference in the new or amended registration statement, proxy statement, or private offering to reflect the impact of the change in accounting principle if the change is material.

FAS 141(R)—impact on tests of significance

FAS 141(R) will impact the tests SEC registrants use to determine whether the historical financial statements of an acquired business (and associated pro-forma financial information) need to be filed with the SEC. The three tests (commonly known as the investment test, the asset test, and the income test) are described in Rule 1-02(w) of Regulation S-X. The SEC's tests have not changed; rather, FAS 141(R) impacts how the investment test is performed.

² This publication is available only to PwC partners and staff.

For example, under FAS 141(R), the investment test will include the fair value of contingent consideration but will exclude transaction costs. Additionally, if the purchase consideration includes acquirer stock, the acquisition date share price will be used to measure the fair value of consideration transferred. Additional information associated with this change can be found in:

- [SEC Financial Reporting Manual](#), Topic 2015.5
- AICPA SEC Regulations Committee April 2008 Minutes ([Discussion Document A](#), Items 1 and 2)

Corporate governance

Audit Committee Alert

What new questions will audit committee members consider asking management and the auditors? Issued in January 2009, this Alert serves to supplement the questions that audit committees routinely ask management and the auditors. The Alert covers questions related to fair value measurement, other-than-temporary impairment, goodwill impairment, disclosure, risk, going concern and M&A, among other topics. The publication is available at www.pwc.com/uscorporategovernance.

To the point—new quarterly publication for Audit Committees

Beginning in April 2009 and quarterly thereafter, a new publication for audit committees will be available. As the title suggests, *To the point*, addresses contemporary issues and is impactful, insightful, and concise. The first issue addresses going concern, fair value and counterparty risk. Upon release it will be available for download at www.pwc.com/uscorporategovernance.

IFRS

IFRS placemat

The climate around IFRS continues to change. To help you understand the most current developments, we have prepared a placemat that includes a high-level overview of the SEC's Proposed Roadmap, our thoughts on specific aspects of the proposal, and our point of view on the impact of the economic environment on the move to IFRS. The placemat also recommends action steps that companies should consider to prepare for what may be a lengthy period of significant change caused by both the economic environment and the increasing influence of IFRS. Companies can obtain a copy of the placemat from their local PwC representative. PwC partners and staff can access it through myKcurve.

Comment letter—IFRS roadmap

Comments on the SEC's Proposed Roadmap for the transition to IFRS in the U.S., released in November 2008, are due by April 20, 2009. We have released a draft of the cover letter of our planned response containing our preliminary views on the more significant aspects of the Proposed Roadmap. While we typically do not distribute comment letters in draft form, we decided to share our preliminary views in this case due to the significance of and high level of interest in this topic. The draft is subject to change as our thinking evolves, based upon listening to the views of interested parties, deliberating the issues raised in the proposal, and evaluating events that occur prior to submission of our letter. Companies can obtain a copy of our draft comment letter from their local PwC representative. PwC partners and staff can access it through Alert 09/12³, *Draft Cover Letter of PwC's Response to the SEC's Proposed IFRS Roadmap*.

³ This publication is available only to PwC partners and staff.

Your guide to those selected issues affecting future quarters

New going concern standard—effective Q2

The FASB has proposed an accounting standard related to the assessment of going concern directed specifically to management, which is expected to be effective for second-quarter reporting. Previously, guidance on assessing an entity's ability to continue as a going concern was only found in the auditing literature.

The proposed model is expected to extend the time horizon to be evaluated when making the going concern assessment from the *not to exceed one year beyond the end of the reporting period* threshold used in current auditing standards to a time frame that is *generally, but not limited to, twelve months from the end of the reporting period*.

We expect the final standard to contain language that clarifies that while certain events beyond one year should be considered, the FASB's intent is not to create an indefinite look-forward period.

New subsequent events standard—effective Q2

The FASB has proposed a new standard to include guidance on subsequent events in accounting literature directed specifically to company management. Although the familiar terminology of Type I and Type II would be eliminated, the FASB incorporated the existing auditing guidance with minimal changes. The FASB expects a final standard to be effective for second-quarter reporting.

XBRL—effective Q2

It's finally required. The SEC's final rule requiring public companies to provide financial information in interactive data format using XBRL is effective for large accelerated filers⁴ that prepare U.S. GAAP financial statements that have fiscal periods ending after June 15, 2009. Many companies are now stepping-up their readiness efforts. While initially many companies are likely to take a compliance-oriented view, there are important financial reporting process implications for the concurrent submission of the supplemental XBRL format that is required by the SEC's rule. Companies should build sufficient time into their period end financial reporting process for the preparation and review of the XBRL-formatted financial statements.

For a summary of the final rule and additional information and resources, refer to:

- [DataLine 2009-06](#), *SEC Issues Final Rules Mandating Phased-In Use of Interactive Data*
- [PwC Archived Webcast](#): *The SEC has mandated XBRL—what should you do next?*

The FASB Codification—effective Q3

Are you ready to get rid of your Original Pronouncements? Effective July 1, 2009, the FASB will declare the Codification as the sole source of authoritative non-governmental U.S. GAAP. Although the Codification is not intended to change GAAP, it will represent a significant change in the way we reference U.S. GAAP in our workpapers and how preparers will use references in financial statements and their accounting policies.

⁴ Foreign and domestic registrants with world-wide public float above \$5 billion as of the end of the second quarter of their most recently completed fiscal year.

Try the new FASB codification and become familiar with its search features. The FASB codification can be accessed via the FASB website, <http://asc.fasb.org/home>. Registration is required. For more information refer to the following DataLines:

- [DataLine 2009-12](#), *Preparing for the Transition*
- [DataLine 2008-04](#), *FASB Codification of U.S. GAAP*

Appendix A

Standards that became effective in the recent periods

Effective for fiscal years beginning after November 15, 2008

- FAS 157, *Fair Value Measurements* (for the delayed application of this Statement for nonfinancial assets and nonfinancial liabilities)
- FAS 161, *Disclosures about Derivative Instruments and Hedging Activities—an amendment of FASB Statement No. 133*
- FSP FAS 140-3, *Accounting for Transfers of Financial Assets and Repurchase Financing Transactions*

Effective for fiscal years beginning after December 15, 2008

- FAS 141 (revised 2007), *Business Combinations*
- FAS 160, *Noncontrolling Interests in Consolidated Financial Statements—an amendment of ARB No. 51*
- FAS 163, *Accounting for Financial Guarantee Insurance Contracts—an interpretation of FASB Statement No. 60*
- FSP EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities*
- FSP APB 14-1, *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)*
- FSP FAS 141(R)-1, *Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies*
- FSP FAS 142-3, *Determination of the Useful Life of Intangible Assets*
- EITF 07-1, *Accounting for Collaborative Arrangements*
- EITF 07-4, *Application of the Two-Class Method under FASB Statement No. 128 to Master Limited Partnerships*
- EITF 07-5, *Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity's Own Stock*
- EITF 08-3, *Accounting by Lessees for Nonrefundable Maintenance Deposits*
- EITF 08-5, *Issuer's Accounting for Liabilities Measured at Fair Value with a Third-Party Credit Enhancement*
- EITF 08-6, *Equity Method Investment Accounting Considerations*
- EITF 08-7, *Accounting for Defensive Intangible Assets*
- EITF 08-8, *Accounting for an Instrument (or an Embedded Feature) with a Settlement Amount That Is Based on the Stock of an Entity's Consolidated Subsidiary*

Effective for periods ending after June 15, 2009, early adoption permitted

- FSP FASB 107-b and APB 28-a, *Interim Disclosures about Fair Value of Financial Instruments*
- FSP FAS 115-a, FAS 124-a, and EITF 99-20-b, *Recognition and Presentation of Other-Than-Temporary Impairments*
- FSP 157-e, *Determining Whether a Market is Not Active and a Transaction is Not Distressed*

Effective for fiscal years ending after December 15, 2009

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

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