

# The Quarter Close

A look at this quarter's financial reporting issues



## What's inside

Accounting hot topics .....	2
Hot off the press .....	5
SEC matters .....	7
Corporate governance.....	7
IFRS .....	8
Update on selected major projects.....	8
On the horizon.....	10

## What you need to know—Q3—2009

Welcome to this edition of *The Quarter Close*, our quarterly publication designed to keep you informed about the latest accounting and financial reporting issues.

In this edition of *The Quarter Close*, we highlight a wide range of topics, some which have near-term impact, while others have the potential for significant changes in the future. Newly-approved guidance from the EITF on two revenue recognition projects could impact companies in the near-term—read all about it in "Hot off the press." Another project that is garnering considerable attention is the re-examination of the accounting for financial instruments. It's a "hot topic" that may be a "hot potato" later this year. Read about these topics and much more in this edition of *The Quarter Close*.

## Accounting hot topics

### Financial instruments—Full court press

The FASB is on a fast track again with a comprehensive re-examination of financial instruments. You may feel fatigued by all the activity surrounding the accounting for financial instruments, but this project is the “real deal” if all goes according to plan. The three joint roundtables held this month alone are an indication that the FASB and the IASB mean business. This project has the potential to have a significant impact on the accounting for financial instruments, hedge accounting, and impairment.

The objective of the project seems easy enough—simplify and harmonize the accounting for all financial instruments—but the path to simplicity is paved with a number of complexities. Take a look at the project plan on the FASB’s website and you’ll quickly see the massive task that lies ahead—all with an expected exposure date in early 2010.

#### Will amortized cost be gone?

So far, the tentative decisions reached by the FASB on the recognition and measurement of financial instruments are expected to have a significant impact on many companies. For example, one of the FASB’s tentative decisions is that almost all types of financial instruments (including loans held by banks and held-to-maturity securities) will be recognized at fair value on the balance sheet. Subsequent changes in fair value would be recognized in net income unless a company qualifies and elects to recognize the changes in other comprehensive income. In addition, interest, dividends, and changes in the credit component of fair value would be recognized in net income.

The FASB may consider allowing an exception to this treatment for certain companies (perhaps non-public entities) or for certain types of financial instruments. Stay tuned, as this project is evolving virtually on a weekly basis.

#### Will this be a converged standard?

The FASB and the IASB originally planned to work jointly on this project, but responding to political pressure, their project plans now differ. The IASB is working through the issues in three separate phases (classification and measurement, impairment, and hedging), issuing exposure drafts following each significant phase. In fact, the IASB issued their first exposure draft on financial instrument classification and measurement that it hopes to finalize in time for companies to early adopt in 2009. The FASB intends to issue one comprehensive exposure draft in early 2010. It remains to be seen whether the Boards will be able to agree on all significant aspects of the project in such a short period of time.

As the debate continues to heat up, we plan to keep you informed of important decisions and their implications.

### Impairment of debt securities—A few reminders

By the end of the second quarter, most public companies adopted the new impairment guidance issued earlier this year by the FASB that changed the impairment recognition and presentation model for debt securities. While some companies experienced improvements in earnings from a reduction in other-than-temporary impairment (OTTI) charges, there were some challenges in measuring the credit component of an impairment loss.

As companies gain experience with these new requirements, they are becoming more comfortable with identifying and measuring credit losses. However, certain other aspects of the impairment model may warrant some additional reminders as companies prepare for the third quarter:

- First, don't forget to consider the two accounting alternatives for debt securities in periods after recognizing an other-than-temporary impairment. While the two accounting models are similar, differences exist that may impact the recognition of post-OTTI interest income and subsequent impairments.
- Second, guidance continues to develop in this area as companies deal with the practical issues associated with implementation (e.g., the SEC staff recently indicated that there are several acceptable alternatives to presenting total OTTI in the income statement).
- Finally, disclosures are important. One lesson learned from early adopters of the new guidance is that companies should focus on disclosures related to the significant inputs and assumptions for measuring credit losses on debt securities. Some early adopters have received SEC staff comments on these disclosures.

The following publications will help to navigate the new guidance, including the necessary considerations in periods following an impairment loss:

- [DataLine 2009-39](#), *FASB's New Model for the Impairment of Debt Securities—Additional Questions and Interpretive Responses*
- [DataLine 2009-23](#), *FASB's New Model for the Impairment of Debt Securities—Questions and Interpretive Responses*
- [DataLine 2009-20](#), *FASB's New Guidance for Other-Than-Temporary Impairments*

## Variable interest entities—Countdown to effective date

In the [last edition](#) of *The Quarter Close*, the FASB's new guidance on the consolidation of variable interest entities (VIEs) was "hot off the press." Well, it's still hot. The activity around interpreting and implementing the new standard is in high gear.

The effective date is just around the corner—January 1, 2010 for calendar year-end companies—and the amount of effort that will be necessary to adopt this new guidance should not be underestimated. As a reminder, the FASB's new guidance significantly changes the consolidation rules for VIEs and has broad applicability across all industries. Affected areas include the consolidation of common structures, such as joint ventures, equity method investments, collaboration arrangements, and co-manufacturing and power purchase arrangements. Also, remember, there is no grandfathering—the new model is applicable to all new and existing VIEs. This new guidance involves a considerable amount of judgment. Companies should be assessing the impact on their existing structures now, to avoid any unpleasant surprises.

Several common features are interpreted differently under the new guidance. For example, kick-out rights in many limited partnership arrangements may now result in these entities becoming VIEs. Likewise, the qualitative approach of assessing power and economics for determining the primary beneficiary (PB) may also lead to changes in who consolidates. Companies that are assessing the impact of this new standard have observed that identifying the significant activities that drive the economics of the VIE and who has the power to direct those activities often requires considerable judgment.

While the new standard is biased towards increasing the number of entities that are consolidated, joint ventures may be one structure that could be deconsolidated when power is truly shared between venture parties. Don't forget—this isn't a one-time-only assessment. Companies will need to embed in their systems and processes the ongoing reconsideration requirement of assessing who consolidates a VIE.

Resources are available and others are expected soon to help you work through the assessment, including an Action Plan designed to help companies implement a project plan and consider the more far reaching implications of the new standard.

- Coming Soon—Company Action Plan
- [DataLine 2009-30, FAS 167—New Consolidation Guidance for Variable Interest Entities](#)
- [Archived Webcast—Consolidation of VIEs](#)

## Short-cut versus long-haul ...which should you use?

With the credit markets starting to thaw, debt activity is heating up once again. Companies are looking to take advantage of current market conditions by issuing new debt or refinancing old debt arrangements. New debt transactions are frequently accompanied by interest rate swaps to hedge interest rate risk.

The question frequently asked is: "Can I use the short-cut method to assess hedge effectiveness?" The short answer is... "It depends." The short-cut method is an accommodation to simplify hedge accounting. However, complying with the criteria to use the short-cut method may not be so simple, as companies must strictly comply with all of the technical requirements to be able to assume "no ineffectiveness" at the inception and throughout the hedging relationship. While this may appear to be a "check the box" exercise, making the assumption that there are no terms in the debt or interest rate swap that validate the assumption of "no ineffectiveness" is, in fact, subjective. History has shown that it may be subject to different interpretations. The SEC has challenged registrants to support why they believe certain terms validate the assumption of "no ineffectiveness," even in situations where a particular feature may not have significant value.

The stakes are high. In situations where the SEC concludes that a company has inappropriately applied the short-cut method, hedge accounting may not be permitted—thus, opening up the risk of restatement. This may be the case even despite the fact that the hedges, in fact, provide an economic offset.

When companies choose to apply the short-cut method, they should be prepared to clearly demonstrate how this conclusion was reached and have robust contemporaneous documentation, including evidence on how all of the criteria were met and quantitative evidence to demonstrate "no ineffectiveness."

Considering the consequence of interpretive differences in evaluating the assumption of "no ineffectiveness," the "long-haul method" may be the best accounting path.

## Taxing matters—Earnings and liquidity impact assertions

The current economic conditions continue to have ramifications on the assessment of the realizability of deferred tax assets (DTA) and the assertions regarding indefinite reinvestment of foreign earnings. In assessing your DTA, it's important to remember that the model to assess whether a valuation allowance is needed differs from other impairment models because it is not entirely forward-looking, expectations-, or fair value-based. Rather, the evidence is "weighted" placing greater emphasis on recent performance. Recent or near-term expected losses will typically have a greater impact on the assessment than prior historic profitability or longer-term projected profitability.

Don't forget to consider the assertions regarding the remittance of foreign earnings, which many have previously asserted will be indefinitely reinvested. Conditions such as changing liquidity needs resulting from declining investment values or the trigger of a debt covenant coupled with the tightened global credit markets have compromised some companies' ability to control the remittance of foreign earnings.

Whether or not assertions regarding the realizability of your DTAs or the remittance of foreign earnings change, companies should continue to ensure that they are including transparent disclosures and, in certain circumstances, early warning disclosures, if it is possible that these assessments may change in the near term. For more information, refer to:

- *Tip of the Week 09/30, Recent or Expected Cumulative Losses May Prevent Consideration of Future Income to Support Deferred Tax Assets*<sup>1</sup>
- *Tip of the Week 09/43, A Company's Plans for Reinvestment of Foreign Earnings Must Be Reassessed at Each Reporting Date*<sup>1</sup>

## Codification—Best practices emerge

By now you are probably becoming familiar with the new FASB *Accounting Standards Codification* (the Codification), effective this quarter. So how are companies approaching the adoption of the Codification in their financial statements? While there is no right or wrong answer, a best practice that is starting to emerge is to make the disclosures plain-English when describing or referencing accounting standards. US GAAP does not require a company's financial statement disclosures to refer to particular accounting standards by name, standard number, or Codification reference number. Companies will need to use judgment in determining whether numerical references to the Codification would contribute to a financial statement users' understanding of a particular disclosure.

A number of resources are available to help you navigate the transition. For more information, refer to the following:

- [FASB Accounting Standards Codification Quick Reference Guide](#)
- [DataLine 2009-12, Preparing for the Transition](#)
- *Alert 09/36, Referencing the FASB Codification in Financial Statements and Other Frequently Asked Questions*<sup>1</sup>
- *Alert 09/27, What You Need to Do to Prepare for the Launch of the FASB Codification and the New Version of Comperio*<sup>1</sup>
- [Codification FAQ Series](#)<sup>1</sup>
- [Archived Codification Webcast](#)
- [SEC Regulations Committee Minutes — June 23, 2009](#)
- [CAQ Alert 2009-76, SEC Shares Views on Codification](#)

## Hot off the press

### EITF finalizes two new revenue recognition standards

The EITF completed its work on two revenue recognition standards at its September 2009 meeting. All that remains before the final release of this guidance is the official FASB ratification, which is slated to occur at the September 23, 2009 Board meeting. There are planning opportunities that companies may want to consider, as both proposals allow for early adoption. The models remain largely intact from what was proposed. However, the elimination of the residual method and the new requirements for expanded disclosures may cause some companies to pause given the amount of effort needed to early adopt.

### Multiple element arrangements—Less separation anxiety

The final consensus reached by the EITF will now allow companies to allocate arrangement consideration in a multiple element arrangement in a way that better reflects the transaction

---

<sup>1</sup> This publication is available only to PwC Partners and staff.

economics. Issue 08-1, *Revenue Arrangements with Multiple Deliverables*, will supersede the guidance in Issue 00-21, *Revenue Arrangements with Multiple Deliverables*, (now codified in ASC 605) and now provides another alternative for establishing fair value for a deliverable. When vendor specific objective evidence or third party evidence for deliverables in an arrangement can't be determined, companies will be required to develop a best estimate of the selling price to separate deliverables and allocate arrangement consideration using the relative selling price method. Additionally, some companies will be impacted by the EITF's decision to eliminate the residual method from the model.

We expect that many companies will be affected by the new guidance, even if they were able to separate deliverables under the prior guidance. For those not previously able to separate, the requirement to determine the best estimate of selling price of a deliverable may be significant in terms of the effort required to modify systems, implement internal controls, and develop new methodologies. At a minimum, the new guidance will require more expansive disclosures, particularly in the year of adoption. While the work ahead may be considerable, the feedback from the comment letter process clearly supported the change.

The new guidance allows for prospective adoption, and is not required until January 1, 2011 for calendar year-end companies. However, many companies and users requested that early adoption be allowed, as the model will better reflect the economics of these multiple element revenue arrangements. The EITF responded and provided various options for early or retrospective adoption.

### Software-enabled products—Scoped out of software accounting

The EITF also completed its work on re-scoping the existing software revenue recognition model in Issue 09-3, *Certain Revenue Arrangements That Include Software Elements*. Previously, companies that sold tangible products with "more than incidental" software were required to apply the software revenue recognition guidance. This guidance often delayed revenue recognition for the delivery of the tangible product. Under the new standard, tangible products that have software components that are "essential to the functionality" of the tangible product will be scoped out of the software revenue recognition guidance. The new guidance will include factors to help companies determine what is "essential to the functionality." Software-enabled products will now be subject to other revenue guidance and likely will follow the other new guidance for multiple deliverable arrangements (Issue 08-1).

There was broad-based support for this scope change. Once again, the expectation is that financial statements will better reflect the economics of these arrangements once removed from the scope of the software guidance. These amendments follow the same disclosure and transition provisions under Issue 08-1 for revenue arrangements with multiple deliverables, including the provisions for early or retroactive adoption.

A DataLine will be issued soon that will discuss these new changes. In the meantime, refer to the [EITF Observer](#) for more information on the new guidance.

### Liabilities—New fair value guidance for Q4

After a couple of attempts, the FASB has amended ASC 820 (formerly FAS 157), providing additional guidance on measuring the fair value of liabilities. The guidance will be effective in the fourth quarter for calendar year-end companies. Since the guidance is broadly consistent with current practice in measuring the fair value of liabilities, we don't anticipate major changes. However, it does provide some helpful clarification in an area that has perplexed many companies.

Broadly speaking, the new guidance addresses the impact of transfer restrictions on the fair value of a liability and the ability to use the fair value of a liability that is traded as an asset as an input to the valuation of the underlying liability. The standard also clarifies the application of certain valuation techniques. Those clarifications include when to make adjustments to fair value, and in addition, the amendments provide helpful examples to illustrate the guidance. Early adoption is allowed for financial statements not yet issued. For more information on this final guidance, refer to [DataLine 2009-40, Measuring Liabilities at Fair Value—Accounting Standards Update No. 2009-05](#).

## SEC matters

### SEC issues "Dear CFO" letter on loan loss disclosures

In August 2009, a number of financial institutions received a "[Dear CFO](#)" letter from the SEC's Division of Corporation Finance about the need for clear and transparent disclosures in MD&A about loans and loan losses. Specifically, the SEC staff identified several disclosures for financial institutions to consider when preparing MD&A, including:

- information about higher-risk loans, including the associated risks, trends, and uncertainties,
- changes in practices used to determine loan loss allowances, and
- the impact on the ability to collect loans, especially if there has been a decline in collateral asset values.

The SEC staff indicated that providing such disclosures may be useful to an understanding of the associated risks, uncertainties, and key accounting judgments surrounding a company's loan portfolio. Even though this most recent "Dear CFO" letter is focused on financial institutions, there may be take-aways for non-financial services companies as well, since the "Dear CFO" letter could be an indication that the SEC may provide similar comments to companies on receivables that have similar risks, uncertainties, and judgments. For instance, companies with significant customer accounts receivables might consider providing additional disclosure about concentrations, collection trends, provisioning methodologies, and risks and uncertainties. In addition, the FASB has a project on its agenda to enhance loan loss disclosures. See the "On the horizon" section for more information.

### Business combinations—Measurement period adjustments

As a reminder, the standard on *Business Combinations* requires that a company retrospectively apply measurement period adjustments. However, such retrospective application is applied to prior financial statements only when reissued. At the [June 23, 2009 SEC Regulations Committee Joint Meeting](#) with the SEC staff, the SEC staff confirmed that when a company is preparing a new or amended registration statement (other than Form S-8), the company must also provide revised financial statements to reflect any material retrospective adjustment made during the measurement period.

## Corporate governance

### *To the Point*

The next issue of *To the Point*, PwC's quarterly newsletter for directors, will be released in early October. That issue will discuss fraud scenarios directors should be aware of, the implications of changes to consolidation rules for off-balance sheet entities, and some high-level results of the recent *What Directors Think* survey conducted by PwC and *Corporate Board Member* magazine, a publication that covers corporate governance matters for directors and senior executives. Previous issues of *To the Point* are archived and available for download at [www.pwc.com/uscorporategovernance](http://www.pwc.com/uscorporategovernance).

## Board Governance Series—Volume 13

PwC continues to be a partner in *Corporate Board Member's Board Governance Series*, which discusses critical governance issues with some of today's most highly respected advisors to boards of directors. PwC contributed articles on the planning for emerging risks, how audit committees are coping with today's challenges, and what boards should be doing to help their companies in these troubled economic times. This edition also focuses on how to engage with Wall Street during a crisis of confidence, managing risk in compensation, and setting the tone for corporations to effectively manage legal and regulatory matters.

This report is one of many communications available for companies and engagement teams to use as a resource for corporate governance knowledge. This report and many of the other corporate governance reports can be obtained at [www.pwc.com/uscorporategovernance](http://www.pwc.com/uscorporategovernance).

### *This Week in the Boardroom*

PwC is participating in a new on-demand webcast series called *This Week in the Boardroom*, hosted by *Corporate Board Member* magazine. The webcasts include a discussion of boardroom developments of the preceding week, and an education segment on a board-level topic. A link to the webcasts is available at [www.pwc.com/uscorporategovernance](http://www.pwc.com/uscorporategovernance) and [www.boardmember.com](http://www.boardmember.com).

## IFRS

### IFRS developments—Useful resources

The international business community is in a period of unprecedented change from the global convergence of accounting standards and the adoption of IFRS by many countries around the world. Determining the impact IFRS has on entities with multinational subsidiaries continues to be on the radar of many companies.

In July, the IASB issued IFRS for Small and Medium-sized Entities (SMEs), designed to meet the financial reporting needs of certain smaller privately held businesses. To provide practical perspective, we have added an IFRS for SMEs Pocket Guide as a resource to summarize the basic requirements and key areas covered by IFRS for SMEs. We have also added a publication that takes a closer look at recent developments in the UK, where a proposal has been released to transition from local GAAP to IFRS for statutory reporting purposes. This publication will help identify the implications the UK proposal has on US companies. These resources are available at the IFRS home page at [www.pwc.com/usifrs](http://www.pwc.com/usifrs).

In addition, new this quarter, PwC has a highly-interactive IFRS adoption by country map for tracking the capital market, statutory, and tax reporting regimes in most countries around the world. The map can be found at [www.pwc.com/usifrs/countrymap](http://www.pwc.com/usifrs/countrymap).

There are many resources available to keep you up to date on all of the developments in the world of IFRS including the just released 2009 edition of the [IFRS and US GAAP: Similarities and Differences](#). For a complete listing visit the PwC IFRS homepage at [www.pwc.com/usifrs](http://www.pwc.com/usifrs) or ask your PwC engagement team for further assistance.

## Update on selected major projects

### Revenue recognition—A single recognition model?

With all of the attention focused lately on the EITF's efforts to ease the pressure on revenue recognition, some may be wondering what has happened with the comprehensive revenue recognition joint project. As a reminder, the FASB and IASB issued a joint discussion paper in December 2008 that proposed a converged, contract-based revenue recognition model. The primary goal continues to be to create one model to ensure that similar transactions

result in similar accounting, an objective echoed in several other unrelated joint projects. To recap, the discussion paper introduces a number of potentially significant changes to current practice. For example, some of the more significant changes will be in how performance obligations are defined, identified and separated for accounting purposes, how to determine the timing of revenue recognition (based on transfer of control, not risks and rewards or the activities of an entity), how to recognize contract related costs, and when to recognize contract losses.

So what did constituents think about the discussion paper? Overall, the comments were generally supportive of the Boards' objectives, but included concern about some of the specifics. For example, some voiced concerns about whether a single model could provide useful information for all types of contracts in all industries, since companies that follow percentage-of-completion accounting may be significantly impacted by the proposal. Others believed that the model is incomplete because it doesn't address several key considerations (e.g., accounting for return rights, the impact of contract modifications, and recognition and measurement of contingent consideration).

Next steps for the FASB and IASB will be to issue an exposure draft in the first half of 2010. While a final standard is not expected until 2011, companies should continue to follow the debate and provide their input through the public comment letter process. Regardless of their industry, every company could be affected by the decisions in the discussion paper. To help you stay engaged in the debate, there is a newly-issued DataLine that will update you on the public reaction to the discussion paper and the recent deliberations. For more information, refer to:

- [DataLine 2009-41](#), *FASB/IASB Revenue Recognition Project—Progress Toward Completion*
- [DataLine 2009-07](#), *The Future of Revenue Recognition—A Preliminary Peek*

## Leases—Will operating leases move on balance sheet?

While the basic lease accounting model hasn't changed in more than 30 years, it has been the subject of significant criticism for almost as long. One of the most notable criticisms is that the model, with its many "bright-line" thresholds, allows companies to structure lease transactions to result in off-balance-sheet treatment (a commonly-cited example is a commercial airline company with no airplanes on its balance sheet).

Lessee accounting is now under re-examination as the FASB and IASB work together to develop a common standard for lease accounting under both US GAAP and IFRS. The most significant impact of the discussion paper (issued in March 2009) is to bring all leases on the balance sheet (similar to today's capital lease treatment), effectively eliminating the concept of an operating lease. Under the proposal, existing leases would not be grandfathered.

What's the buzz on the street about these changes? The FASB and IASB received 290 comment letters on the discussion paper illustrating the interest and concern in the marketplace around this topic. Overall, while there is general support to bring leases on the balance sheet, there were concerns about the complexity involved in implementation and ongoing compliance. In addition, some suggested scope exceptions, for example, to exclude short-term leases. There was also broad consensus that the discussion paper was incomplete because it didn't address lessor accounting and that the Boards should not move forward with a lease accounting standard without comprehensively addressing both lessee and lessor accounting. Both Boards are currently deliberating lessor accounting and are about to begin redeliberating lessee accounting based on the comment letters received.

Although an exposure draft is not expected until 2010, companies should begin to understand the financial reporting, systems and controls, and business implications of the

changes being considered and be prepared to voice their opinions during the public comment period. For more information, refer to the following:

- [DataLine 2009-42](#), *FASB/IASB Leases Project—Progress Towards Completion*
- [DataLine 2009-14](#), *The Future of Lease Accounting*
- [DataLine 2009-10](#), *Leases—A Preview of What's to Come*

## On the horizon

## Your guide to selected issues affecting future quarters

### Fair value disclosures—Proposal may be “sensitive” topic

Regulators, standard setters, politicians and others have deliberated the impact of fair value on the credit markets. Earlier this year, the FASB added another project to its agenda related to fair value disclosures and recently issued an exposure draft proposing to improve interim and annual financial statements disclosures.

Some of the more significant proposed amendments include (1) the addition of a sensitivity analysis for level 3 measures, (2) detailed disclosures about the transfers to and from level 1 and 2 measurements, and (3) presenting "gross" the activity within the level 3 reconciliation (previously a "net" presentation). The exposure draft also includes clarifications and enhancements to existing disclosures regarding valuation techniques, inputs to fair value measures, and the level of required disaggregation.

The proposed disclosures would be effective in the fourth quarter for calendar year-end companies with the exception of the sensitivity analysis, which will be effective for the first quarter of 2010. Considering the accelerated timetable for these amendments, companies may want to begin their assessments soon, particularly as it relates to the need to modify systems and processes. Comments on the proposal are due by October 12. The proposed requirements are discussed further in [DataLine 2009-37](#), *FASB Proposes New Fair Value Disclosures*.

### Alternative investments—New guidance imminent

We noted last quarter that more guidance was on the horizon for determining the fair value of certain alternative investments (hedge funds, real estate funds, venture capital funds, etc). The FASB's proposal was to create a practical expedient to use net asset value (NAV) without further adjustment, for estimating the fair value of investments in certain entities that don't have a readily determinable fair value.

The final guidance is expected to be issued any day and based on the FASB's recent deliberations, it will be broadly consistent with the proposed guidance. However, some key changes that will be made include:

- **Scope**—the scope will be expanded to include investments in entities that are substantially similar to investment companies.
- **Restriction on use of practical expedient**—an entity will not be permitted to use the practical expedient if at the measurement date it is probable that the entity will sell the investment for an amount less than NAV.
- **Effective date**—the guidance will be applicable for the fourth quarter for calendar year-end companies, although early application will be permitted for financial statements not yet issued. If an entity elects to early adopt the guidance, it would not be required to early adopt the disclosure provisions.

We expect the final guidance will include practical examples to assist preparers in implementing the disclosure provisions and that the final guidance will be issued before the end of the third quarter, so stay tuned for further developments. [DataLine 2009-28](#), *FASB's Proposes Guidance on Determining the Fair Value of Alternative Investments*, provides more information on the proposed guidance.

## Consolidations—Scope clarifications proposed

The accounting and reporting for noncontrolling interests and changes in ownership interests of a subsidiary (formerly in FAS 160) is included in ASC 810. A recently proposed Accounting Standard Update amends the scope of the consolidation guidance to include the sales and transfers of "businesses" rather than limiting the scope to "consolidated subsidiaries." However, the scope clarification includes a notable exception for transactions that qualify as a partial sale of in-substance real estate. Under the proposal more disposal transactions will now be subject to the full gain and loss recognition requirements in the consolidation guidance.

Expected to be finalized over the next couple months, the guidance will likely be effective in the fourth quarter for calendar year-end companies (with retrospective application required). For additional information, refer to [DataLine 2009-36](#), *Accounting for and Reporting Decreases in Ownership of a Subsidiary: A Proposed Scope Clarification*.

## Employers' pension plan/OPEB plan assets disclosures—last call

Last quarter we highlighted the significant changes that were on the horizon for the pension and OPEB plan asset disclosures. With the deadline fast approaching, time is running short. The new requirements are effective December 31, 2009 for calendar year-end companies and will significantly expand the required disclosures for pension and OPEB plan assets, including disclosures similar to the fair value measurement disclosures required by ASC 820 (formerly FAS 157). There isn't much time left to collect and evaluate the information necessary to meet the new annual reporting requirements. As a reminder, certain data will need to be accumulated as of the beginning of the year of adoption to comply with the new disclosures. Refer to [DataLine 2009-13](#), *New Disclosures Required in Employers Financial Statements about Pension/OPEB Plan Assets*, for further information.

## The FASB issues proposal to conform the oil and gas accounting standards to the new SEC rules

Since February 2009, the FASB has been hard at work amending the oil and gas accounting standards to conform to the new SEC rule on the Modernization of Oil and Gas Reporting, which was finalized in December 2008. The proposal was released by the FASB on September 15, 2009.

Certain of the proposed conforming amendments are as expected. However, other proposed amendments may attract greater attention during the public comment period. For example, the FASB took an unexpected turn and is proposing additional oil and gas reserve disclosures for a company's equity investments as well as a transition disclosure on the impact of the SEC's rules on the oil and gas roll forward schedule.

Responses on the recently issued exposure draft are due by October 15. The new guidance is expected to be effective in the fourth quarter for calendar year-end companies. Coming soon will be a DataLine that provides in-depth observations about the proposed requirements. In the meantime, companies should continue to assess the potential impact of the disclosure requirements on their year-end financial statements.

## Loans and other receivables—Proposal to expand disclosures may be effective in Q4

Continuing along the path of improving transparency in financial reporting, the FASB recently released a proposal to enhance the disclosures of a company's credit risk exposure to loans and certain other receivables. Certain accounts receivables, note receivables, loan receivables, and lease receivables all represent what the FASB calls "financing receivables" under the new proposal. While many companies have already enhanced the information they provide to investors on their potential exposure to credit losses through expanded MD&A disclosures and other supplemental materials, the FASB's proposed amendments would require incremental financial statement disclosures.

These extensive new disclosures would impact both interim and annual financial statements, and the FASB is proposing that they be effective in the fourth quarter for calendar year-end companies. The impact may be significant, as companies may need to change their systems and processes to adapt to the new requirements. Companies potentially impacted by this proposed standard should continue to monitor the FASB's redeliberations, expected to occur in September and October. Expect a DataLine once the final standard is issued. For further information refer to [FASB Loan Loss Disclosures](#), which includes the exposure draft and current project status.

## R&D in an asset acquisition—EITF proposes to capitalize

At the September EITF meeting, the Task Force agreed to release a proposal for public comment that would take a step towards aligning the accounting for acquired research and development (R&D) in an asset acquisition with that in a business combination. For affected companies, the proposal would require research and development acquired in an asset acquisition to be capitalized. Similar to R&D in a business combination, the subsequent accounting would have the R&D asset treated as an indefinite lived intangible, subject to annual impairment tests.

But the big question debated by the Task Force at the September meeting was the treatment of contingent consideration in an asset acquisition. Here, the EITF departed from the business combination model – that is, the contingent consideration would not be recorded at its fair value. Instead, companies would record the contingent consideration pursuant to other existing guidance.

While a consensus-for-exposure is expected shortly, the debate is not over since there are mixed views on whether the asset acquisition model should be modified in a piecemeal fashion. Interested parties should consider providing comments to the EITF and stay tuned for the upcoming discussion at the November meeting. In the meantime refer to the [EITF Observer](#) for more information.

## Loss contingency disclosures—Back in play

After a period of little activity, the FASB has become re-engaged in the loss contingencies project. In fact, the project is alive and kicking. The FASB recently began its redeliberations of the hotly contested project, in which it intends to amend the disclosure requirements for certain loss contingencies.

You may recall that the controversial proposals in the 2008 exposure draft got significant attention. Based on a recent meeting, it appears that the FASB has embraced constituent feedback and is moving away from some of the more onerous disclosures originally proposed in the 2008 exposure draft that would have required that companies estimate or predict certain outcomes. The FASB now seems to be moving towards developing principles that focus on disclosures of publically available information that would not

prejudice the outcome of the contingency. The direction that the FASB is heading may alleviate the many objections of constituents who were concerned that the original disclosures would have been prejudicial and could have jeopardized a company's legal strategy.

While redeliberations are expected to continue over the next few months, the verdict is still out whether the proposal will be re-exposed for public comment or possibly be effective for the 2009 year-end financial reporting season. While the FASB didn't rule out the earlier effective date, it seems unlikely as the FASB appears to be leaning towards re-exposure. Companies and engagement teams should continue to stay-tuned for further decisions from the FASB on this project.

## The milestone method—To be continued

While the EITF continued its debate on this issue at the September EITF meeting, no consensus was reached and the EITF has gone back to the drawing board as it relates to the scope of the project. As a reminder, in a milestone arrangement a vendor receives consideration contingent upon the vendor's performance or a specific outcome (such as achieving FDA approval for a new drug compound). Currently, no authoritative literature addresses the application of the milestone method, but practice has evolved to recognize revenue based upon the achievement of the milestone that meets certain criteria. The issue will be discussed again at the November EITF meeting and if a consensus is reached it will likely be re-exposed for an additional public comment period. See [DataLine 2009-35](#), *Revenue Recognition—The Milestone Method Moves Closer to Codification*, for more information on this ongoing project.

## Standards that became effective in 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) (Codified within ASC 820)
- FAS 161, *Disclosures about Derivative Instruments and Hedging Activities—An Amendment of FASB Statement No. 133* (Codified within ASC 815)
- FSP FAS 140-3, *Accounting for Transfers of Financial Assets and Repurchase Financing Transactions* (Codified within ASC 860)

### Effective for fiscal years beginning after December 15, 2008

- FAS 141 (revised 2007), *Business Combinations* (Codified within ASC 805)
- FAS 160, *Noncontrolling Interests in Consolidated Financial Statements—An Amendment of ARB No. 51* (Codified within ASC 810)
- FAS 163, *Accounting for Financial Guarantee Insurance Contracts—An Interpretation of FASB Statement No. 60* (Codified within ASC 944)
- FSP EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities* (Codified within ASC 260)
- FSP EITF 99-20-1, *Amendments to the Impairment Guidance of EITF Issue No. 99-20* (Codified within ASC 325)
- FSP APB 14-1, *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)* (Codified within ASC 470 and ASC 825)
- FSP FAS 141(R)-1, *Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies* (Codified within ASC 805)
- FSP FAS 140-4 and FIN 46(R)-8, *Disclosures by Public Entities (Enterprises) about Transfers of Financial Assets and Interests in Variable Interest Entities* (Codified within ASC 810 and ASC 860)
- FSP FAS 117-1, *Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures for All Endowment Funds* (Codified within ASC 958)
- FSP FAS 142-3, *Determination of the Useful Life of Intangible Assets* (Codified within ASC 275 and ASC 350)
- EITF 07-1, *Accounting for Collaborative Arrangements* (Codified within ASC 808)
- EITF 07-4, *Application of the Two-Class Method under FASB Statement No. 128 to Master Limited Partnerships* (Codified within ASC 260)
- EITF 07-5, *Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity's Own Stock* (Codified within ASC 815)
- EITF 08-3, *Accounting by Lessees for Nonrefundable Maintenance Deposits* (Codified within ASC 840)
- EITF 08-4, *Transition Guidance for Conforming Changes to EITF Issue No. 98-5, 'Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios'* (Codified within ASC 470)
- EITF 08-5, *Issuer's Accounting for Liabilities Measured at Fair Value with a Third-Party Credit Enhancement* (Codified within ASC 820)
- EITF 08-6, *Equity Method Investment Accounting Considerations* (Codified within ASC 323)
- EITF 08-7, *Accounting for Defensive Intangible Assets* (Codified within ASC 350 and ASC 805)
- 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* (Codified within ASC 815)

## Appendix A

### Standards that will be effective in upcoming periods

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

- FAS 165, *Subsequent Events* (Codified within ASC 855)
- FSP FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* (Codified within ASC 820)
- FSP FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments* (Codified within ASC 320)
- FSP FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments* (Codified within ASC 825)

#### Effective for periods beginning after August 26, 2009

- ASU 2009-05—*Measuring Liabilities at Fair Value*

#### Effective for interim or annual periods ending after September 15, 2009

- FAS 168, *The FASB Accounting Standards Codification<sup>TM</sup> and the Hierarchy of Generally Accepted Accounting Principles* (Codified within ASC 105)
- ASU 2009-06, *Implementation Guidance on Accounting for Uncertainty in Income Taxes and Disclosure Amendments for Nonpublic Entities*

#### Effective for fiscal years beginning after November 15, 2009

- FAS 166, *Accounting for Transfers of Financial Assets—an amendment of FASB Statement No. 140* (not yet included in the Codification)
- FAS 167, *Amendments to FASB Interpretation No. 46(R)* (not yet included in the Codification)

#### Effective for fiscal years ending after December 15, 2009

- FSP FAS 132(R)-1, *Employers' Disclosures about Postretirement Benefit Plan Assets* (Codified within ASC 715)

#### Effective for fiscal years beginning on or after December 15, 2009

- FAS 164, *Not-for-Profit Entities: Mergers and Acquisitions—including an amendment of FASB Statement No. 142* (not yet included in the Codification)
- EITF Issue No. 09-1, *Accounting for Own-Share Lending Arrangements in Contemplation of Convertible Debt Issuance or Other Financing* (not yet included in the Codification)

## Authored by:

### Jan Hauser

Partner

Phone: 1-973-236-7216

Email: [jan.hauser@us.pwc.com](mailto:jan.hauser@us.pwc.com)

### Susan Cospers

Partner

Phone: 1-973-236-5156

Email: [susan.m.cospers@us.pwc.com](mailto:susan.m.cospers@us.pwc.com)

### Saira Gilani

Senior Manager

Phone: 1-973-236-5335

Email: [saira.s.gilani@us.pwc.com](mailto:saira.s.gilani@us.pwc.com)

### Traci Hornfeck

Senior Manager

Phone: 1-973-236-5032

Email: [traci.a.hornfeck@us.pwc.com](mailto:traci.a.hornfeck@us.pwc.com)

*The Quarter Close* is prepared by the National Professional Services Group of PricewaterhouseCoopers LLP. This publication has been prepared for general information on matters of interest only, and does not constitute professional advice on facts and circumstances specific to any person or entity. You should not act upon the information contained in this publication without obtaining specific professional advice. No representation or warranty (express or implied) is given as to the accuracy or completeness of the information contained in this publication. The information contained in this material was not intended or written to be used, and cannot be used, for purposes of avoiding penalties or sanctions imposed by any government or other regulatory body. PricewaterhouseCoopers LLP, its members, employees and agents shall not be responsible for any loss sustained by any person or entity who relies on this publication.

© 2009 PricewaterhouseCoopers LLP. All rights reserved. "PricewaterhouseCoopers" refers to PricewaterhouseCoopers LLP, a Delaware limited liability partnership, or as the context requires, the PricewaterhouseCoopers global network or other member firms of the network each of which is a separate and independent legal entity.

To access additional content on accounting and reporting issues, register for CFOdirect Network (<http://www.cfodirect.pwc.com>), PricewaterhouseCoopers' online resource for senior financial executives.