

The quarter close

A look at this quarter's
financial reporting issues

Directors edition

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Front and center

A new chapter for SEC and FASB leadership

Against the backdrop of active regulatory and standard-setting agendas, both the SEC and FASB are facing key leadership changes this year.

President Obama nominates Mary Jo White to lead SEC

In January, President Obama announced Mary Jo White as his nominee for SEC chairman. White is a former U.S. Attorney for the Southern District of New York. Since leaving that post, she's been a partner at the law firm of Debevoise & Plimpton LLP. If confirmed, White will assume the SEC chairman position from Elisse Walter, who has been in place since Mary Schapiro stepped down in December. Another commission seat could open when current SEC Commissioner Troy Paredes' term ends in June.

White would take over the SEC at a time when pressure is mounting to complete the rulemaking mandated by the Dodd-Frank Act and JOBS Act. Two recent rules—conflict minerals and payments by resource extraction issuers—face legal challenges amid calls for a more rigorous cost-benefit assessment process. White has pledged her commitment to satisfying the remaining rulemaking mandates. She has also stated that, if confirmed, she will make it a high priority to further strengthen the SEC's enforcement function.

The envelope please...awaiting news on FASB chairman

Suspense builds as we get closer to June, the end of Leslie Seidman's term as FASB chairman. The Financial Accounting Foundation hasn't yet tipped its hand regarding Seidman's successor, but we expect word soon.

The FASB is also about to start a new chapter in its relationship with the IASB. Joint board meetings are not likely to continue after the boards complete their current projects. However, both Seidman and IASB Chairman Hans Hoogervorst have expressed their support for continued coordination on important standard-setting matters.

Revenue recognition standard—in the home stretch

After reaching key decisions on transition, effective date, and disclosures, the FASB and IASB are ready to put the finishing touches on a final revenue recognition standard.

In a change of approach, the final standard will no longer require restating prior periods for all revenue transactions. A company can elect to apply the standard to all existing contracts as of the effective date. Using this method, a company will record the cumulative effect of applying the standard in the opening balance of retained earnings.

In addition, the boards agreed to make the standards effective in 2017 (for calendar year-end companies) to allow time for companies to implement the new requirements.

What's next?

The boards' joint February meeting marked the end of their substantive discussions on revenue. They aim to release the final standard in the second quarter, although any issues arising during the drafting process could potentially push out that timing.

► **Not a financial institution? Click here to watch our experts discuss how the FASB's proposal on impairment could affect you.**

FASB delivers two proposals on financial instruments

The FASB issued two new proposals that outline revised models for impairment, and classification and measurement.

Impairment—searching for the right balance

The FASB and IASB have been searching for an impairment model that strikes the right balance. As of yet, they aren't in agreement on the best approach.

Although the FASB and IASB aren't currently aligned, both are proposing models based on “expected” as opposed to “incurred” losses. A key difference in the FASB's approach is that it does not require a threshold to be met before recording losses expected over an asset's lifetime. The IASB's proposal—released in March—requires companies to record a “lifetime” of losses once an asset experiences a significant deterioration in credit quality. Before then, expected losses are based on the probability of default in the next twelve months.

Classification and measurement—the devil's in the details

The FASB's latest proposal calls for a “mixed” measurement approach for financial assets and financial liabilities: either fair value or amortized cost. This may sound similar to today's model, but there are differences that could significantly affect the accounting for certain instruments.

The FASB's model is substantially converged with the IASB's proposed model for debt investments and financial liabilities. However, some differences remain, such as the accounting for equity investments.

What's next?

Comments on the FASB's impairment proposal are due April 30. Comments on classification and measurement are due May 15.

Accounting hot topics

Share repurchase programs—from the simple to the complex

Excess cash has prompted many companies to buy back their own shares—a trend that is expected to continue. There are various ways to repurchase shares. Some companies simply purchase shares in the open market, while others privately negotiate a repurchase with individual shareholders. Arrangements can also be complex, involving derivatives and other structured products.

Types of share repurchases

While many share repurchases are relatively straightforward, some may include terms that affect the accounting treatment. Features such as price guarantees could mean more complexity for the company. The following table summarizes some of the more common types of contracts used in share repurchase strategies.

Contract	Summary of terms
Forward repurchase	Company agrees to purchase shares on a specified date in the future.
Written put option	Company agrees to purchase shares at a fixed price if its stock falls below a specified price.
Prepaid written put option	Company pays cash at inception. At maturity: <ul style="list-style-type: none"> • if the stock is above a specified price, company receives a fixed amount of cash (or a variable number of shares equal to the fixed cash amount), or • if the stock is below the specified price, company receives a fixed number of shares.
Accelerated stock repurchase	Company pays cash at inception and receives shares. The final purchase price is determined by an average market price over the life of the contract. The difference between the initial and final price can be settled in cash or shares.

Assessing the accounting implications

A key assessment for these arrangements is whether to record them as equity or a liability. Equity classification does not require subsequent remeasurement. Liabilities, on the other hand, are remeasured through earnings to their current fair value each reporting period.

For more information

We've only scratched the surface on this challenging topic. For help navigating the accounting implications of share repurchase contracts, see Chapter 10 of our [*Guide to Accounting for Financing Transactions: What You Need to Know about Debt, Equity, and the Instruments in Between*](#).

“Fiscal cliff” legislation extends popular tax incentives

Early in 2013, President Obama signed The American Taxpayer Relief Act of 2012 into law. Among other provisions, this legislation retroactively reinstated, to January 1, 2012, several corporate tax provisions that had expired. These include, for example, the research and development tax credit and certain renewable energy incentives. This change in tax law has a first quarter impact for any company taking advantage of these tax incentives.

Impact of the tax law change

Income tax accounting is based on the tax laws enacted as of the balance sheet date. Even when retroactive, a change in tax law is accounted for in the period of enactment. In the United States, enactment occurs when the President signs legislation into law, which in this case was January 2, 2013. As a result, calendar year-end companies will record the impact in the first quarter of 2013.

The prior year impact (that is, the 2012 catch-up) represents a discrete item in the period of enactment. That means it's excluded from the annual effective tax rate and recorded in the current quarter. On the other hand, the impact for the current year is reflected in the annual effective tax rate calculation.

Hot off the press

In the nick of time, the FASB finalized two standards that companies need to implement this quarter. And, in addition to the financial instruments proposals featured in “Front and center,” the FASB proposed changes to “repo” accounting and released two EITF issues for comment.

OCI—FASB finalizes new reporting requirements

The FASB issued final reporting requirements for other comprehensive income just in time for the new guidance to take effect in 2013. While the guidance provides flexibility in how companies present the information, it’s worth noting that these disclosures are required in both interim and annual financial statements of public companies.

The standard is aimed at improving the reporting of reclassifications out of accumulated other comprehensive income. New requirements include presenting information about significant reclassifications, the source of the item reclassified, and the income statement line items affected. Companies can choose between reporting this information in the notes or parenthetically on the face of their financial statements. However, they must report all of the required information in one centralized location.

Balance sheet offsetting—scope clarification provides relief

Responding to concerns raised about new balance sheet offsetting disclosures, the FASB narrowed the scope through an amendment finalized in January. The amendment limits the disclosures to derivatives and other specified arrangements.

As a refresher, disclosures are required beginning this quarter (for calendar year-end companies) that provide gross and net information about transactions that are: (a) offset in the balance sheet or (b) subject to an enforceable master-netting arrangement or similar agreement (irrespective of whether they are offset in the balance sheet).

The FASB amended the guidance to specify that the requirements apply only to derivatives accounted for under the derivatives guidance (including bifurcated embedded derivatives), repurchase/reverse repurchase agreements, and securities lending/borrowing transactions.

“Repo” accounting—proposed amendments and disclosures

The FASB issued a proposal in January that addresses when repurchase transactions should be viewed as secured borrowings as opposed to sales.

In a repurchase transaction (aka “repo”), an entity transfers a financial asset in exchange for cash and concurrently agrees to reacquire the asset (or a similar asset) at a future date. In some instances, the determination of whether a repo should be accounted for as a sale or a secured borrowing hinges on whether or not the transferor maintains effective control of the transferred asset. The proposal suggests changes to the guidance on agreements that maintain effective control.

The proposal also includes new disclosure requirements for both transactions treated as sales and secured borrowings.

EITF proposes new guidance on hedging and taxes

The EITF's latest consensus-for-exposure address two topics that could have broad applicability: hedging and unrecognized tax benefits.

Proposal adds new benchmark rate for hedge accounting

When applying hedge accounting, companies can designate the benchmark interest rate as the risk being hedged for financial assets and liabilities. In the United States, only two rates qualify as a benchmark interest rate: the interest rate on direct treasury obligations of the U.S. government and the London Interbank Offered Rate (LIBOR) swap rate.

The EITF decided that the Fed Funds Effective swap rate should also be an allowable benchmark interest rate. With the inclusion of the Fed Funds Effective swap rate as a benchmark interest rate, we expect derivative products that are indexed to this rate to become more prevalent.

EITF addresses diversity in presenting unrecognized tax benefits

Income tax accounting guidance today does not explicitly address how to present unrecognized tax benefits when a company also has net operating losses or tax credit carryforwards. Most companies present these unrecognized benefits as a liability (gross presentation), but some present the liability as a reduction of their net operating losses or tax credit carryforwards (net presentation).

The EITF addressed this diversity in practice by proposing all companies apply a "net" presentation. In other words, a company will net its liability for unrecognized tax benefits against all same-jurisdiction net operating losses or tax credit carryforwards that are available for offset. This approach will likely be a change from current practice for many companies.

SEC matters

Dodd-Frank tops SEC's "to-do" list in 2013

Look for the SEC to make headway on the remaining Dodd-Frank Act mandates during 2013. Mary Jo White, nominee for SEC chairman, has made it clear she will prioritize completion of the rules, if confirmed.

Derivatives reform—beyond the banks

Financial institutions have been hit with increased requirements and compliance costs as a result of the derivatives reform mandated by Dodd-Frank (a joint effort by the SEC and other regulators). However, that doesn't mean they are the only ones affected. Any company that holds derivatives should expect to see changes in the new regulated environment. Management, treasurers, and boards of directors should all be tuned in to the potential implications.

► *Click here to watch our experts explain how the impact of derivatives reform goes beyond the banks.*

Derivatives reform: implications to non-financial services companies

- **Business strategy:** Not all derivatives will cost the same or have the same hedging power as they did before. Increased costs will lead companies to consider alternatives to manage their risk.
- **Funding:** Financial institutions are expected to pass along increased costs to end-users, and companies could be asked to post more collateral.
- **Operations:** Processes must be updated to accommodate new types of derivative transactions and comply with recordkeeping requirements.
- **Accounting:** It may become more difficult to obtain and manage hedge accounting, which could result in increased earnings volatility.

Key actions for companies to take now include taking an inventory of derivatives used today to manage risk and assessing the impact of the regulations. End-users of derivatives might also be required to comply with new recordkeeping and reporting requirements. For more discussion, see [*10 Minutes on derivatives reform for non-financial services companies*](#).

Conflict minerals—deadlines on the horizon

The first compliance date for new disclosures of conflict mineral use is rapidly approaching. The initial filing—due by May 31, 2014—will cover the 2013 calendar year. That means companies need to be prepared to report on activities taking place now in their supply chains.

To meet this deadline, companies should be well on their way toward developing a game plan for complying with the rule. While the rule currently faces legal challenges, a court decision isn't likely until the second or third quarter. Absent a court ruling, there are no indications that the SEC is planning any changes to the requirements or effective date.

At a high level, the rule requires new reporting by companies that use conflict minerals—tantalum, tin, gold, or tungsten—in their products. We expect a significant number of companies to be affected given the pervasive use of these minerals today.

Executive compensation—mandated rules still pending

Stay tuned for highly anticipated proposals still pending from the SEC in this area. These include executive compensation clawbacks and the so-called CEO pay-ratio disclosure.

SEC weighs in on the disclosure debate

Addressing the “dividing line”

The SEC plans to issue a staff paper in the upcoming months that will address the “dividing line” between financial statement footnote disclosures and the broader financial reporting package (for example, MD&A). Concerns about the “dividing line” have arisen in connection with recent FASB projects, including the FASB's disclosure framework discussion paper issued last July. Disclosures will also be the subject of an SEC roundtable later this year.

► ***Click here to watch our experts discuss the SEC's conflict minerals rule.***

FASB considers path forward on its disclosure project

At the same time, the FASB is considering how to proceed on its disclosure effectiveness project. Board members have emphasized the importance of staying connected with international efforts, including an IASB roundtable held in January. The IASB plans to release highlights from the roundtable and its planned response shortly.

IFRS developments

IASB shapes its future agenda

Finalizing the joint projects with the FASB, addressing implementation issues, and navigating a new working relationship with national standard setters will all be key challenges for the IASB in 2013.

Recently added projects include rate-regulated activities and a post-implementation review of the business combinations guidance. And, the IASB has launched a multi-year effort to revise its conceptual framework. Expect to see a discussion paper later this year.

New IASB advisory group to debut this spring

A new advisory group to the IASB, the Accounting Standards Advisory Forum, will hold its first meeting in April. The advisory group consists of standard setters from around the world, including the FASB. It is designed to facilitate communications between the IASB and the global accounting standard-setting community.

Audit reporter

PCAOB spells out priorities for 2013

Standard setting on tap for 2013

The PCAOB's agenda outlines several projects slated for action this year. Notably, this includes a highly anticipated proposal on the auditor's reporting model. Internationally, this topic is also being explored by the International Auditing and Assurance Standards Board and the Financial Reporting Council (a U.K. regulator). The Financial Reporting Council's recent consultation paper suggests expanding the auditor's reporting requirements to include more information about the audit, such as materiality and scope.

In addition, the PCAOB plans to propose updates to the auditor's responsibilities related to going concern on the heels of the FASB's proposal on the topic (see "On the horizon"). Still on the longer-term agenda is determining the next steps for the PCAOB's project to enhance auditor independence, objectivity, and professional skepticism, including audit firm rotation. Stay tuned for developments on this and other projects during the year.

International groups continue to debate audit reforms

Outside the United States, debate continues over audit firm rotation, retendering, audit-only firms, and more. The European Commission's November 2011 proposals—which cover a range of topics, including rotation—are still being discussed.

In the United Kingdom, the Competition Commission¹ published summaries of its provisional findings regarding the market for audit services. The release suggests possible actions for consideration that include mandatory retendering and audit firm rotation, among others. As we reported last quarter, the Financial Reporting Council recently implemented retendering requirements under a “comply or explain” approach.

On the horizon

The focus is still on the FASB's priority projects. Revenue and financial instruments (featured in “Front and center”) are drawing closer to completion. And, although the timing on a lease accounting proposal has slipped, we expect to see an exposure draft soon.

Meanwhile, there are a number of other active standard-setting projects. In this section, we highlight two near-term proposals on discontinued operations and going concern. The activities of the new Private Company Council are also ramping up, with the council officially adding three projects to its agenda this quarter.

Lease proposal advances despite headwinds

Spring is coming early according to Punxsutawney Phil...but no such luck for the revised lease accounting proposal. Issues cropping up during drafting have once again delayed its release. Not surprisingly, a key challenge for the FASB and IASB has been the dividing line embedded in the “dual model” approach. The boards are working diligently to keep the proposal in queue for release in the second quarter.

The “dual model” income statement approach

As a refresher, while all leases will be recorded on the balance sheet, the dual model establishes two different patterns of income statement recognition. The proposal contains a presumption that leases of property (including land and buildings) should result in a straight-line recognition pattern and leases of non-property should result in a front-loaded recognition pattern.

What's next?

The boards plan to release their revised proposal in the second quarter. Expect further debate after feedback comes in on the proposal. Certain board members have already indicated they aren't satisfied with the model. And, it remains to be seen how the new FASB chairman will influence the redeliberations.

¹ The Competition Commission is an independent public body that conducts inquiries into mergers, markets, and regulated industries to promote healthy competition between companies in the United Kingdom.

Discontinued operations—moving toward a higher threshold

At the end of 2012, the FASB jump-started its project on discontinued operations, deciding to move forward with a proposal on the topic. Expect to see a proposal within the next few weeks.

Raising the threshold for “discontinued operations”

The proposal is expected to raise the threshold for determining whether a disposal should be presented as a discontinued operation in the financial statements. Generally, a component that an entity has disposed of, or classified as “held for sale,” will be a discontinued operation if that component is a separate major line of business or significant geographical area of operations. This definition more closely aligns with current IFRS guidance.

Continuing involvement no longer a hurdle

The proposal will also eliminate today’s guidance that precludes presentation as discontinued operations if the company has continuing involvement or cash flows with the disposed component. Thus, while we expect fewer disposals to meet the new definition of a discontinued operation, once it does, this change removes a significant hurdle to discontinued operation presentation.

Council picks up three private company projects

In February, the Private Company Council provided a preview of what’s to come by choosing three initial areas of focus. In addition, a revised draft of the private company decision-making framework will soon be available for public comment.

The council picked three topics for its initial agenda: variable interest entities (specifically regarding related party arrangements), “plain vanilla” interest rate swaps with a single counterparty, and intangible assets acquired in a business combination. Discussion of these topics—including potential modifications to existing guidance for private companies—will begin at the council’s May meeting.

Going concern proposal slated for second quarter

Last quarter, the FASB laid out its plans for a new standard on “going concern” assessments and disclosures. After ironing out a few final details, the FASB is poised to release its proposal in the second quarter.

The FASB decided this quarter on a key difference between the requirements for public and non-public companies. As a refresher, the going concern model includes two primary thresholds. First, if it’s *more likely than not* that a company can’t meet its obligations, early warning disclosures will be required. Second, a company will disclose there is substantial doubt about its ability to continue as a going concern when it’s *probable* it can’t meet its obligations.

The FASB tentatively concluded that non-public companies will only apply the first assessment outlined above. In other words, they will not be required to disclose when there is substantial doubt about their ability to continue as a going concern.

EITF debates scope of “pushdown accounting”

The EITF kicked-off deliberations on “pushdown accounting”—a closely watched topic—this quarter. The question at hand is when an acquired company’s standalone financial statements should reflect assets and liabilities based on what the buyer paid (that is, a “push down” of the buyer’s basis).

One possibility being debated is expanding the application of pushdown accounting to all transactions and events that result in a change in control. Another key issue is whether to require pushdown accounting for nonpublic entities. Stay tuned for more discussion of this complex topic.

Corporate governance

Early proxy activity provides preview of 2013 season

As the 2013 proxy season kicks off, many of the hot topics from last year remain in the spotlight. These include political spending disclosure, executive compensation, and board declassification (annual election for all board members).

SEC joins debate on political spending disclosures

SEC Commissioner Luis Aguilar recently offered up his support for greater transparency of political spending. He commended those companies that currently provide voluntary disclosure. The SEC updated its rulemaking agenda earlier this year to include a potential proposal on political spending disclosures; however, other SEC commissioners have already expressed their opposition to such a rule.

Investors use lawsuits to influence executive compensation

This season, some investors have turned to class action injunction lawsuits to force more disclosure of executive compensation plans. These lawsuits are filed before the shareholder vote on a company’s executive compensation proposals. They allege that disclosures about the proposals are materially deficient and ask the courts to delay the vote until the court can assess the adequacy of the disclosures.

Proxy Pulse: a new shareholder trend publication

PwC’s Center for Board Governance is working with Broadridge to produce *Proxy Pulse*, a monthly barometer of shareholder trends during the 2013 proxy season. Look for the first edition in the April *BoardroomDirect*.

For more information

For more updates on the proxy season, read the latest issue of *BoardroomDirect* on our [Center for Board Governance website](http://www.pwc.com/us/centerforboardgovernance).

Other governance publications

To find the following publications, visit our [Center for Board Governance website](#).

10Minutes on shaping the boardroom agenda

PwC's recent *10Minutes* publication outlines key points from PwC's *2012 Annual Corporate Directors Survey* that illustrate how boards are working to improve their oversight. This perspective can help executives identify priorities and tackle challenges. Survey findings may also provide insight as boards cope with regulation and compliance issues in 2013 and beyond.

2013 Key questions for board and audit committee members

This annual publication outlines questions directors should ask at year end and throughout the year. The publication addresses such areas as strategy and risk management, compliance and anti-corruption, financial reporting and audit quality, the new tax law and possible corporate tax reform, information technology, and stakeholder communications.

Governance for Companies Going Public—What Works Best™

Companies thinking about going public will want to be on the lookout for this soon-to-be-released PwC guide. The publication is designed to help companies address many of the key decisions they need to make before and after an initial public offering (IPO). It spells out the directors' roles in an IPO and covers topics such as building the board, providing proper protection for directors, and preparing for a company's first year as a public company. The full document and a companion version will be available soon.

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