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# *Current Accounting and Reporting Developments Webcast Series – Q4*

*December 1, 2011*

*Welcome*

Steve Meisel

SEC Services Leader

## *Today's agenda*

*Key reminders for year-end financial reporting*

*An update on recent FASB and IASB activity*

*SEC update*

*On the horizon*

*Q&A*

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You must respond to the multiple choice questions.

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Today's program will be worth approximately 1.5 CPE credits.

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## ***Polling Question #1***

Which of the following best describes your role or responsibilities within your organization?

- A. CFO or Controller / Assistant Controller
- B. SEC or Financial Reporting Director/Manager
- C. Accounting/Finance Manager
- D. Tax Director/Manager
- E. Other

## ***Key reminders for year-end financial reporting***

- Revenue – gross versus net considerations
- Inventory – lower of cost or market considerations
- Hierarchy of investment accounting models
- Deferred taxes – indefinite reinvestment assertion
- Impairment
  - Goodwill
  - Long-lived Assets
  - Debt securities
- Equity-linked instrument classification

Jay Seliber, Partner  
and  
Ralph Weinberger, Partner

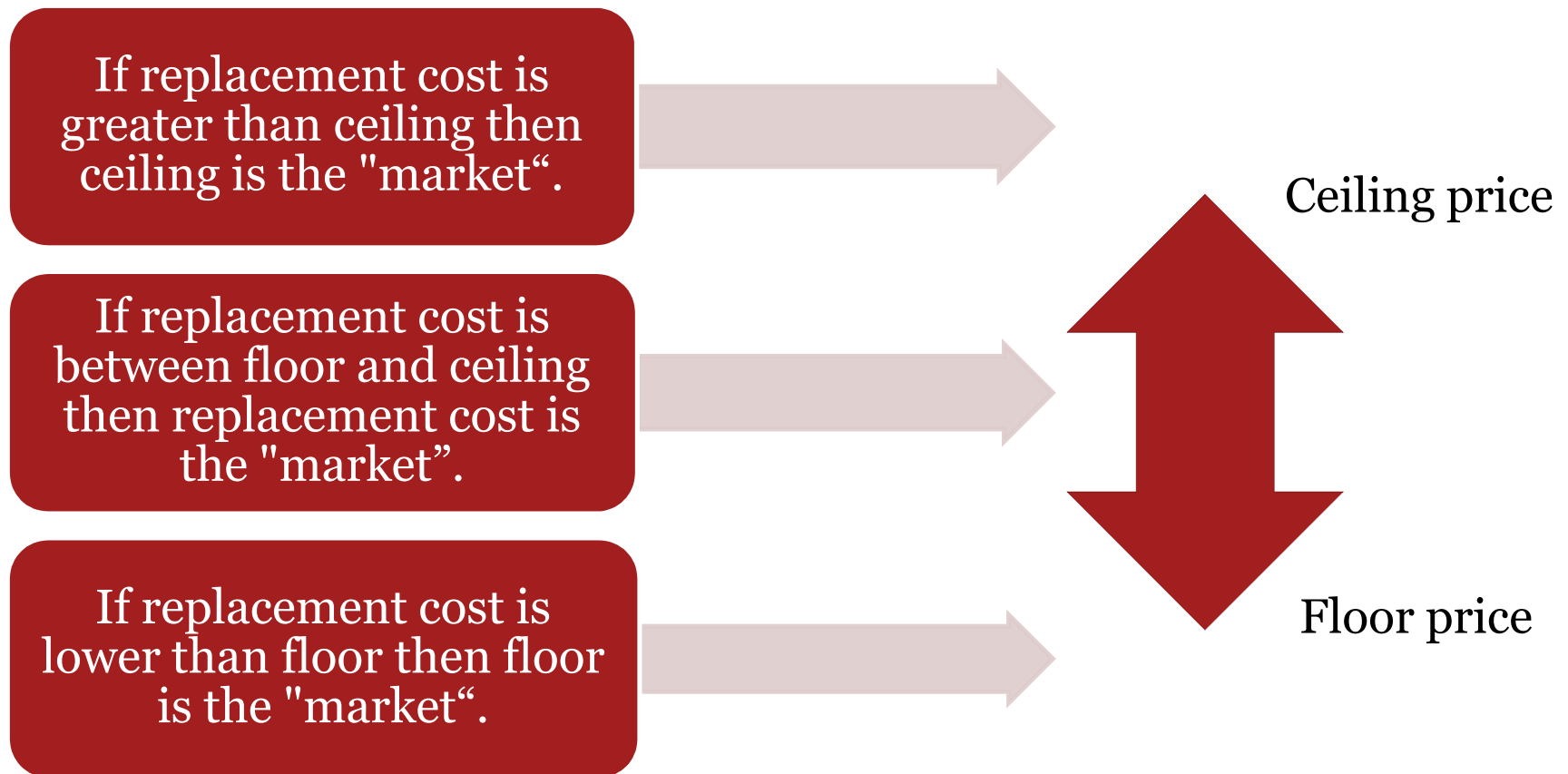
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## ***Revenue – gross versus net considerations***

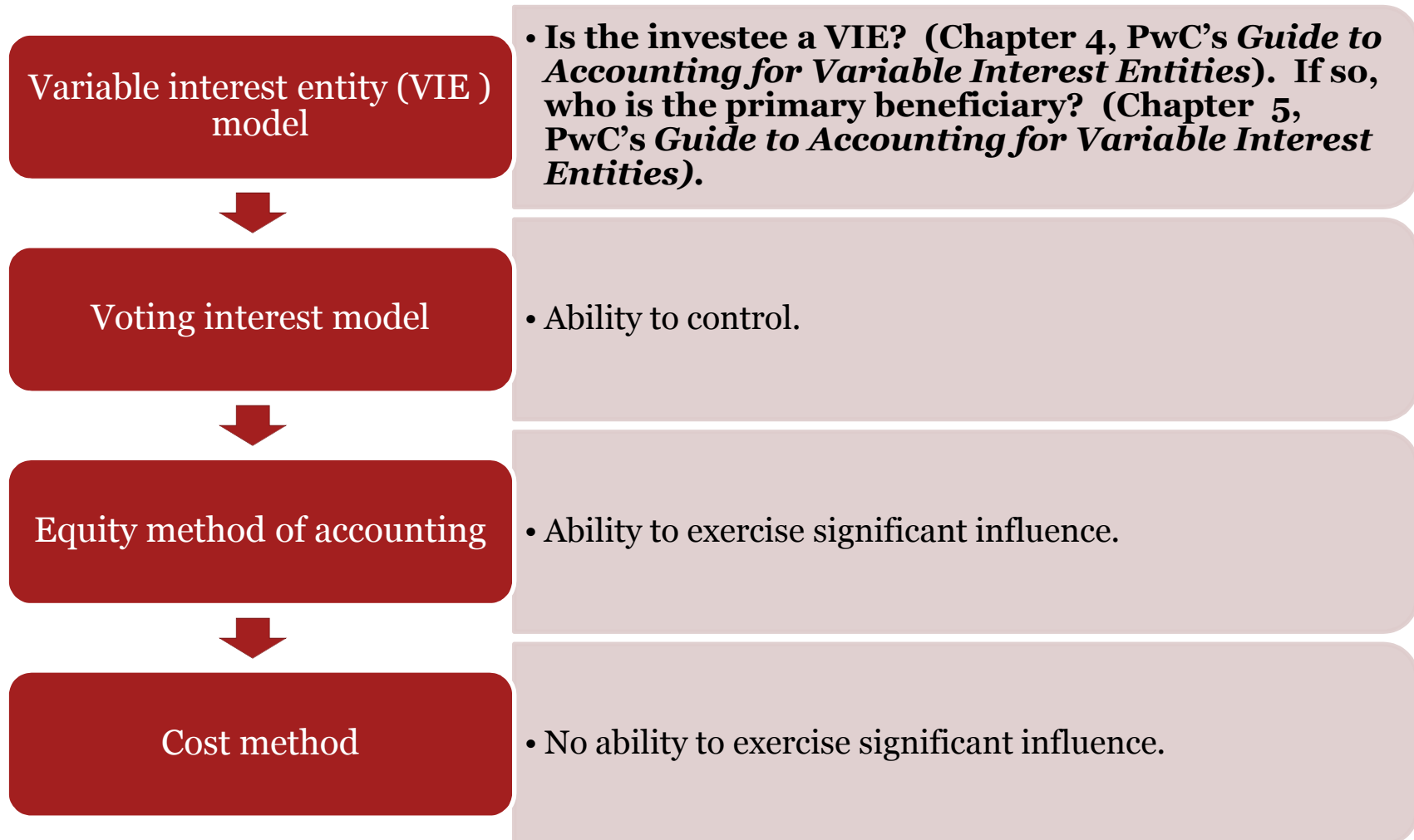
- ASC 605-45, *Principal Agent Considerations*, provides indicators that should be analyzed and weighted. These indicators include:
  - ***primary obligor,***
  - ***inventory risk,***
  - ***latitude in establishing pricing,***
  - modification of product or service, and
  - credit risk.

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## ***Inventory – lower of cost or market considerations***



## ***Hierarchy of investment accounting models – considering the VIE model***



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## ***Deferred taxes – indefinite reinvestment assertions***

Some questions to consider with respect to the indefinite reinvestment assertion given the state of the global economy:

- Is there significant expansion planned outside the home country?
- Is the Company pursuing major acquisitions outside the US or is it in fact more domestically focused?
- Have there been recent remittances?
- Have short and long-term budgets, funding needs and cash flows been appropriately considered?
- Are there any significant payments due domestically in the near term, such as debt and pension?
- Is there substantial doubt about the Company's ability to continue as a going concern?

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## ***Polling Question #2***

Has your company decided recently to repatriate cash from a foreign subsidiary to the U.S?

- A. Yes
- B. No
- C. N/A, do not have foreign subsidiaries

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## ***Revised goodwill impairment standard***

- The valuation of goodwill is inherently quantitative.
  - Most assessment will include robust consideration of company and market-specific influences that could impact the valuation model prepared during the most recent step 1 impairment assessment.
- To the extent that the fair value and carrying value of a reporting unit in a prior step 1 test are close, assessing impairment qualitatively could be more challenging.

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## ***Long-lived asset impairment assessment – two examples of events triggering a recoverability test (ASC 360-10-35-21)***

- A current period operating or cash flow loss combined with a history of operating or cash flow losses or a projection or forecast that demonstrates continuing losses associated with the use of a long-lived asset (asset group).
- A current expectation that, more likely than not, a long-lived asset (asset group) will be sold or otherwise disposed of significantly before the end of its previously estimated useful life.

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## ***Debt security impairment model***

- When the fair value is less than the amortized cost for the initial impairment of debt securities
    - Credit-related losses – recognize in earnings
    - Other changes in fair value – reflect in OCI
  - Accounting for subsequent changes in estimated cash flows (after the initial impairment)
    - Evaluate expected cash flows
      - If there is a further decrease – recognize further credit impairment if required and keep yield constant
      - If there is an increase – prospectively increase security yield
- This establishes new yield applicable for any future impairment assessment if expected cash flows decrease

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## ***Equity-linked instrument classification considerations***

- Settlement permitted in unregistered shares
- Entity has sufficient authorized and unissued shares
- Contract contains an explicit share limit

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## ***Polling Question #3***

By what name is the new qualitative assessment of goodwill unofficially referred to?

- A. The “quantitative test”
- B. “Step 0”
- C. “Step 1”
- D. The “filter test”

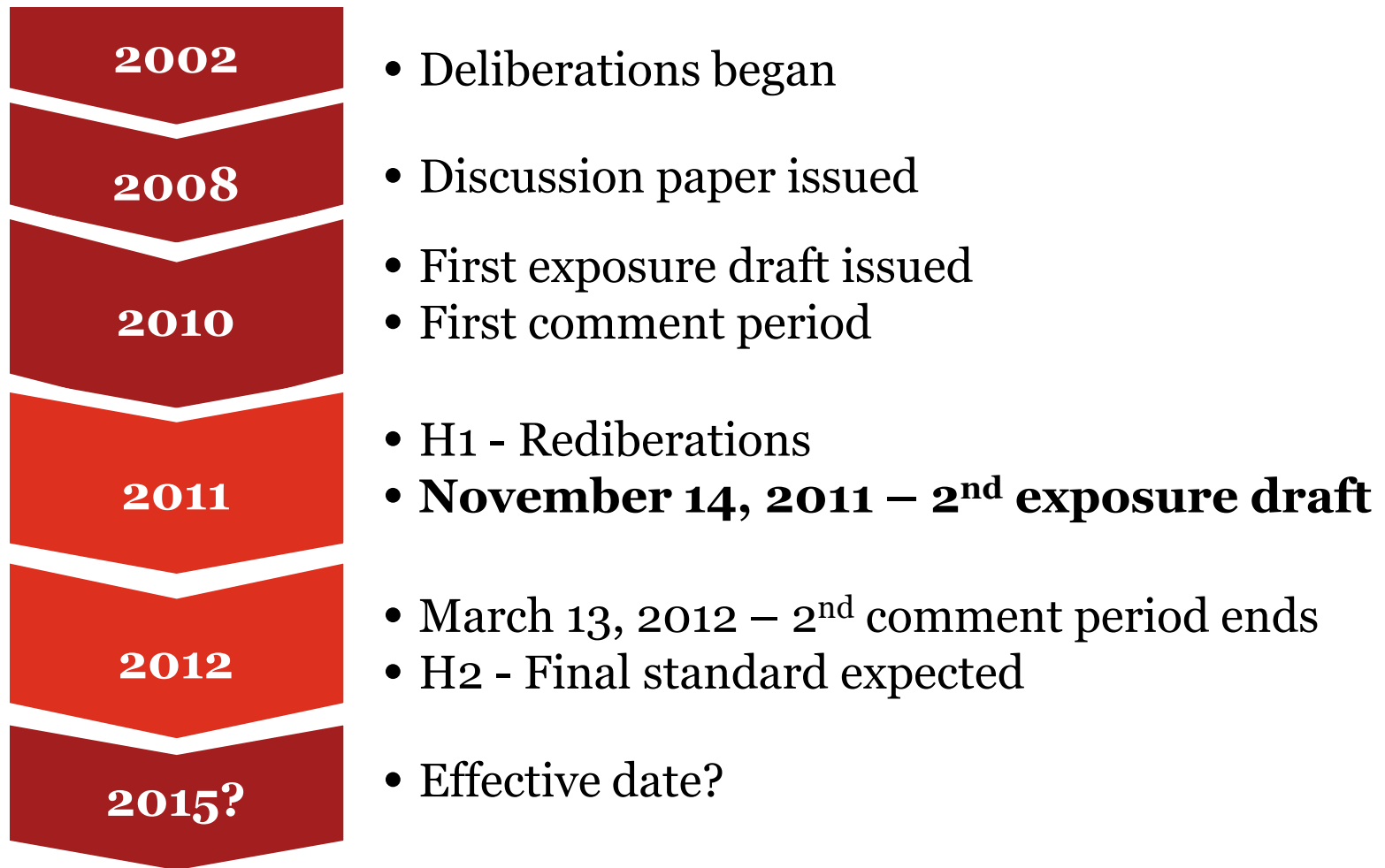
## ***An update on recent FASB and IASB activity***

- Revenue recognition
- Investment properties / investment companies
- Other comprehensive income
- Consolidation
- Codification technical corrections

David Humphreys, Partner  
and  
Craig Robichaud, Senior Manager

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## *Revenue recognition - project timeline*



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## ***Revenue recognition - background***

### **Background**

- Single comprehensive revenue recognition model
- Applicable to all entities/industries
- Applies to all contracts with customers
- Objective to improve consistency and comparability

### **Core principle**

Recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.



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## ***Revenue recognition - proposed model***

Step 1: Identify the contract with the customer

Step 2: Identify the separate performance obligations in the contract

Step 3: Determine the transaction price

Step 4: Allocate the transaction price

Step 5: Recognise revenue when a performance obligation is satisfied

## ***Revenue recognition - significant change expected?***

<b>Step 1 – Identify the contract</b>	X	<ul style="list-style-type: none"> <li>• Generally consistent with existing practice</li> </ul>
<b>Step 2 – Separate performance obligations</b>	✓	<ul style="list-style-type: none"> <li>• Results may vary</li> <li>• ‘Distinct’ criteria replaces ‘standalone value’ for multiple element arrangements</li> </ul>
<b>Step 3 – Determine the transaction price</b>	✓	<ul style="list-style-type: none"> <li>• Expected contingent consideration included</li> <li>• Collectibility no longer a hurdle for recognition and will impact gross margin</li> <li>• Consideration of time value of money</li> </ul>
<b>Step 4 – Allocate transaction price</b>	X	<ul style="list-style-type: none"> <li>• Generally consistent with existing practice</li> <li>• Residual approach permitted in limited situations</li> </ul>
<b>Step 5 – Recognize revenue</b>	✓	<ul style="list-style-type: none"> <li>• Model is now based on control</li> <li>• Introduction of ‘reasonably assured’ constraint</li> </ul>
<b>Other</b>	✓	<ul style="list-style-type: none"> <li>• Onerous losses</li> <li>• Licenses – recognition based on transfer of control</li> <li>• Disclosure – much more extensive</li> </ul>

## ***Revenue recognition - resources***

### **Revenue Recognition**

Dataline 2011-35 and related industry supplements

#### **Released**

- Aerospace & Defense
- Asset Management
- Engineering & Construction
- Industrial Products
- Technology
- Telecom
- Transportation & Logistics

#### **Upcoming**

- Automotive
- Banking & Capital Markets
- Entertainment & Media
- Healthcare
- Pharmaceutical & Life Sciences
- Oil & Gas
- Real Estate
- Retail & Consumer
- Utilities

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## ***Investment property entities - history***

- On October 21, 2011, the FASB issued a proposed accounting standard for investment property entities
- The impetus for the proposed standard was twofold:
  - To better align U.S. GAAP with IFRS as part of the FASB and IASB's joint lease accounting project
  - To narrow the diversity in practice related to accounting and reporting by certain real estate entities (e.g. using historical cost, fair value, other basis)
- The proposed standard would require investment property within the scope of the standard to be measured at fair value with changes in value recorded in earnings
- Comments on the FASB proposal are due January 5, 2012

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## ***Investment property entities - criteria***

- Investment properties guidance would apply to an entity that meets **all** of the following five criteria:
  - 1. Nature of the Business Activities** - Substantially all activities are investing in real estate properties
  - 2. Express Business Purpose** - Investing in real estate properties for total return including an objective to realize capital appreciation. Excludes real estate properties held by an entity for the:
    - entity’s own use in the production or supply of goods or services, or for administrative purposes; or
    - development for sale in the ordinary course of business upon completion.
  - 3. Unit Ownership**
  - 4. Pooling of Funds**
  - 5. Reporting Entity**
- Interaction with revised investment companies’ definition

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## ***FASB's proposal to defer OCI reclassification requirement***

- In June 2011 the FASB issued a final ASU (2011-05) which requires:
  - Presentation of profit or loss and OCI either in a single continuous statement or in two separate, but consecutive, statements
  - Reclassification adjustments from OCI to net income to be measured and shown on the face of the financial statements by income statement line item within net income, and also within OCI
- Current U.S. GAAP only requires reclassification adjustments to be determined in total by OCI component
- FASB has proposed an indefinite deferral of this reclassification requirement

***All other requirements under ASU 2011-05 would continue to be effective beginning in 2012 for calendar year-end companies***

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## ***FASB's consolidation proposal***

- Proposal to amend the consolidation guidance for variable interest entities and partnerships that are voting interest entities
- The changes being proposed include:
  - Incorporating a new factors-based approach for determining whether a decision-maker is using its decision-making authority as an agent or a principal; an agent would not consolidate
  - Amending the kick-out rights guidance for greater consistency in consolidation literature
  - Changing the manner in which related parties are considered in the analysis
- Proposal would broadly align the VIE consolidation model with IFRS
- Comments on the proposal are due January 17, 2012.

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## ***Codification technical corrections***

- In October 2011, the FASB released an exposure draft to propose technical corrections to the Accounting Standards Codification.
- Covers a wide range of Topics and applies to all reporting entities
- The majority of the proposed amendments represent minor changes to clarify the Codification or correct unintended application of guidance.
- Use of the term *fair value* was conformed throughout the Codification
- Comments on the proposal are due on December 13, 2011.

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## ***Polling Question #4***

Do you plan on commenting on the newly released revenue recognition exposure draft?

- A. Yes
- B. No
- C. Undecided

## ***SEC Update***

- Cyber security
- Roundtable on measurement uncertainty
- Comment letter trends

Mike Smith, Partner

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## ***Cyber security risks and cyber incidents***

On October 13, the SEC issued disclosure guidance for cyber security risks and cyber incidents.

### **Financial Statements**

There are broad implications, for example, accounting for:

- costs incurred to prevent cyber incidents;
- costs to mitigate damages (customer incentives, etc.);
- software costs; and,
- asserted / unasserted claims from cyber attacks.

### **MD&A**

Consider disclosing costs or other consequences of incidents or that the risk of potential incidents represent a material event, trend, or uncertainty.

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## ***Cyber security risks and cyber incidents***

### **Risk Factors**

If significant, consider disclosing risk of cyber incidents.

### **Legal Proceedings**

May need to disclose material pending legal proceedings.

### **Description of Business**

If cyber incidents materially affect products, services, relationships, or competitive conditions, consider disclosing this.

### **Disclosure Controls and Procedures**

Consider whether there are any deficiencies in disclosure controls and procedures.

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## ***SEC Financial Reporting Series Roundtable - “Measurement Uncertainty in Financial Reporting”***

- On November 8, the SEC held its first roundtable. It included investors, financial statement preparers, and auditors. The FASB and PCAOB chairs attended as observers.
- The roundtable discussion focused on:
  - **Measurement and recognition** - whether measurements that involve uncertainty provide investors with useful information.
  - **Disclosure** - the information that investors find important to understand and assess measurement uncertainties.
  - **Auditability** - the auditor's role and responsibility.
- Panelists expressed a variety of views on how best to reflect / disclose the uncertainties inherent in financial reporting.

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## *Comment letter trends*

### Loss Contingencies

- Timing of loss recognition.
- Add disclosures regarding reasonably possible losses.
- Disclose accounting policy for legal costs.
- Disclosure of indemnification and loss sharing arrangements.

### Income Taxes

- Disclose each item in the effective tax rate reconciliation that exceeds 5 % of income tax expense at the statutory rate.
- Inappropriately combining items relating to foreign jurisdictions in the tax rate reconciliation.
- Disclose allocation of pretax income between foreign and domestic and the related taxes.
- Provide quantified information about tax benefits when a material tax benefit is derived from a particular jurisdiction.
- Questioned assertion that subsidiary earnings are indefinitely reinvested when registrant may have a liquidity issue.

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## *Comment letter trends*

### Segment Reporting

- Staff may gather information by reading public communications by the company.
- Staff regularly questions segment presentation, for example, when a company aggregates operating segments, the Staff has asked the company to support how aggregation criteria were met.
- Questions on reportable segments may lead to questions on goodwill impairment testing and MD&A segment disclosures.

### Goodwill Impairment

- Given the increase in goodwill impairments, Staff comments have focused on "foreshadowing" disclosures.
- Additional disclosure for reporting units that are at risk for failing step one of impairment test. A reporting unit may be "at risk" if the reporting unit's fair value is not "substantially in excess of its carrying value."

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## *Comment letter trends*

MD&A

- Staff continues to issue comments reminding registrants that the MD&A should not be simply a repeat of information provided elsewhere in a filing; rather, it should explain the "whys" and "implications" behind the financial statements.

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## ***Polling Question #5***

Has your company ever been the victim of a cyber attack?

A. Yes

B. No

## *On the Horizon*

- Leases
- Financial instruments
- Indefinite-lived intangible assets
- Standard setting for private companies
- EITF highlights

David Humphreys, Partner  
and  
Jivka Batchvarova, Senior Manager

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## ***Lessor accounting – receivable and residual approach***

- Derecognize carrying amount of the underlying asset and allocate between a receivable and a residual asset
- Profit related to the lease receivable recognized at commencement
- Profit related to the residual asset deferred throughout the lease term
  - recognized in income at the end of the lease term (either upon the sale or re-lease of the underlying asset)

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## ***Lease accounting- investment property***

- Original ED
  - Scope exception for lessors of investment property measured at FV. This scope exception would not apply to:
    - IFRS lessors using cost model
    - US lessors that do not meet the definition of investment property entities, as proposed by FASB
  - Concerns – complexity, particularly for lessors of multi-tenant properties.
- Revised ED
  - Require current “operating lease” accounting for investment property, irrespective of whether measured at fair value
  - Lessee implications?

## Transition

Full Retrospective	Modified Retrospective	
	Existing capital/finance leases	All others
Apply new rules at commencement of each lease	No adjustment to existing assets and liabilities at transition date	<u>Lessees</u> <ul style="list-style-type: none"><li>• Lease liability based on remaining lease payments.</li><li>• Use IBR at effective date (portfolio basis)</li><li>• RoU asset at transition based on proportion of total lease liability</li></ul> <u>Lessors</u> <ul style="list-style-type: none"><li>• Lease receivable based on remaining lease payments</li><li>• Derecognize underlying asset</li><li>• Recognize residual at transition based on receivable and residual approach</li></ul>
<ul style="list-style-type: none"><li>• Hindsight allowed</li><li>• No requirement to estimate IDCs</li></ul>		<ul style="list-style-type: none"><li>• Leveraged leases eliminated</li><li>• Prepaid and accrued rent adjustments</li></ul>

# ***FASB/ IASB financial instruments project***

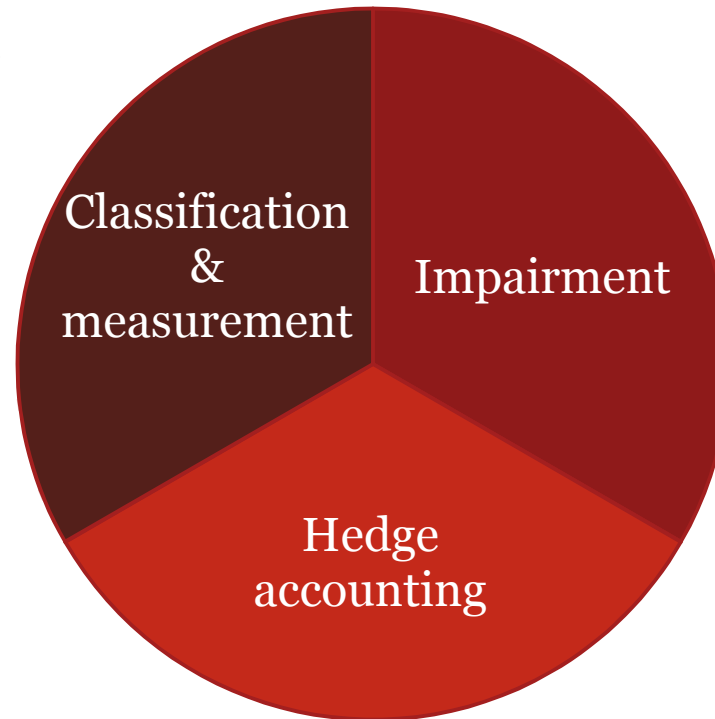
## Update on current status

### IASB

- has decided to reopen IFRS 9

### FASB

- is nearing completion of redeliberating its May 2010 proposal
- Recent FASB areas - presentations and disclosures
- Re-exposure?



### FASB & IASB

- Working together on what would be the overarching principle for impairment
- New exposure draft expected in 2012

### IASB

- to finalize its approach in Q2 2012
- to issue exposure draft on macro hedging in Q4 2011/ Q1 2012

FASB has not begun to redeliberate its May 2010 proposal

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## ***Impairment of indefinite-lived intangible assets***

- Simplification of how an entity tests indefinite-lived intangibles assets
- Improve the consistency of impairment testing guidance among long-term asset categories
- The proposed approach is similar to the revisions made to the goodwill impairment guidance
- Exposure draft expected in December 2011

## ***Standard setting for private companies***

In October 2011, Financial Accounting Foundation (FAF) laid out its plan to form a Private Company Standards Improvement Council (PCSIC or the Council)

The Council would identify, deliberate and vote on specific exceptions and modifications to US GAAP. Decisions need to be ratified by FASB.

The Council would have 11 to 15 members, plus the chair, who would be a FASB board member



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## ***EITF highlights***

### **Final Consensus**

- Derecognition of In-Substance Real Estate (10-E):
  - The scope is narrow and only addresses an investor's loss of control to a lender in a default situation.

### **Consensus-for-exposure**

- Parent's Accounting for the Cumulative Translation Adjustment (CTA) upon the Sale or Transfer of a Group of Assets within a Foreign Subsidiary That Meets the Definition of a Business (11-A):
  - The Task Force decided that the portion of the foreign entity's CTA to be allocated to the disposed business should be determined using a systematic and rational approach

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## ***Polling Question #6***

In which geographical location do you primarily work?

- A. U.S.
- B. Asia
- C. Europe
- D. Other

# *Q&A Session*

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