

The Quarter Close

A look at this quarter's financial reporting issues
PricewaterhouseCoopers



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What you need to know—Q3—2010

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

As summer draws to a close, it's time for companies to turn their attention to third quarter reporting and the upcoming year-end reporting season. In this edition of *The Quarter Close*, we explore a number of hot topics that companies will need to consider this quarter, including an update on the impact of market conditions in Venezuela, some reminders on goodwill impairment testing, and the latest on tax legislative changes. We also will discuss the latest exposure drafts from the standard setters on selected projects, including financial instruments, revenue recognition, leases, and loss contingencies. We begin, though, by exploring what the recently-announced changes at the FASB mean for the future of convergence, and then look at the impact of the regulatory reform bill.

Hot off the press

Convergence agenda—Boards shuffle the deck on priorities and revise timeline

In the last edition of *The Quarter Close*, we briefed you on the latest announcement from the standard setters on their intent to modify their joint strategy and work plan. Since then, in late June, the FASB and IASB finalized the details of that plan. The latest plan is designed to balance the need for continued progress on the Boards' agenda, while still allowing additional time for constituent input and additional stakeholder outreach.

While the project timeline has been stretched out a bit, several high priority projects are still slated for completion by mid-2011 (such as Financial Instruments, Revenue Recognition, and Leases). For a look at the exposure drafts that are currently out for comment, refer to the "Exposure drafts on selected projects" section in this edition of *The Quarter Close*.

FASB makes headlines with Board changes

In August, the Chairman of the FASB, Robert Herz, announced his intent to retire from the FASB following more than eight years of leading the FASB's standard-setting efforts. At one of the most challenging times in the FASB's history, Herz has continued to be a strong advocate for convergence and instrumental in driving forward the Board's technical agenda. His departure raises questions on what impact the change will have on: convergence efforts, previous decisions on projects already out for exposure, and the overall timing of the FASB's work plan. At the same time, the Financial Accounting Foundation (the Foundation), the organization that oversees the FASB, announced that the five member FASB would be increased back to a seven member Board by early 2011. It was just two years ago that the Board's size was decreased from seven to five. Why the reversal? The Foundation's rationale is that the increase will enhance the FASB's investment in the convergence agenda.

Who will replace Herz ... and is convergence in jeopardy?

During the Foundation's search for a replacement for Herz, Leslie Seidman, a two-term Board member, will serve as the acting Chairman. We expect the FASB to continue with "business as usual" until the search for new board members is complete. However, since the current projects were deliberated during the tenure of the current five member Board, the road ahead is uncertain. Add three new Board members into the mix, and one might wonder whether existing decisions are at risk of being overturned.

The elephant in the room is the impact the upcoming Board changes may have on the future of convergence. Will the expanded Board be a positive step towards convergence? The Foundation believes so. While the list of potential candidates is unknown at this point, the Foundation plans to complete the search for new Board members as soon as possible. It remains to be seen how the changes will impact the future landscape of accounting and whether, collectively, the FASB and IASB will again need to modify their strategy and timeline. View the Foundation's [press announcement](#) for further details.

Financial regulatory reform—A work-in-progress

On July 21, 2010 President Obama signed into law the Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act or the Act), and in doing so ushered in a new era of financial regulation. The Dodd-Frank Act creates new regulatory bodies, establishes and increases oversight of varying market functions and market participants, and gives regulators new rulemaking and enforcement powers. The Act will significantly affect the way Corporate America and, more specifically, financial institutions conduct business,

particularly large, diversified financial holding companies and institutions considered to be of systemic importance.

Designed to address risk both at the financial system level and at individual institutions, the Dodd-Frank Act's focus on financial stability is built upon four main provisions: (1) identify at an early stage any issues of systemic concern at large institutions in the financial system, (2) require more stringent regulation of large firms so they do not find themselves in situations where capital or liquidity are threatened, (3) provide regulators the ability to break up large firms when they pose a grave danger to the financial system, and (4) have in place the means for an orderly resolution of large nonbank financial companies in ways that should not expose the taxpayer to loss.

Although some provisions of the law were effective on passage, the more than 500 rules, 60 studies, and 90 reports necessary to fully implement the Act will occur over the next four years. Banks and nonbank financial companies will need time to assess the impact of the Dodd-Frank Act on their operations, including legal entity structures and business lines, risk management, IT systems, regulatory reporting, tax planning, regulatory and public disclosures, corporate governance, internal control frameworks, and compliance. For example, the Dodd-Frank Act:

- Replaces the existing regulatory framework—a patchwork of agencies and rules—with a more centralized approach. Oversight of bank, financial, and savings and loan holding companies, and systemically important nonbank financial companies will be centralized within the Federal Reserve. Regulation of federally chartered banking institutions will be consolidated into the Office of the Comptroller of the Currency.
- Includes expanded regulation targeted at advisers to hedge funds and private equity funds, as well as increased transparency regarding derivatives.
- Encourages prudent risk-taking, requiring banks and other originators of assets for securitization to keep at least 5 percent of the credit risk associated with securitized assets on their balance sheets, except for low-risk mortgages.
- Requires that all U.S. public companies adopt clawback provisions in their incentive compensation plans for executive officers. Companies will want to take note of key provisions and plan accordingly. To help you think through some of the implications, we recently issued [DataLine 2010-36](#), *Stock Compensation Arrangements — Accounting for Clawbacks*.

Throughout the upcoming weeks, months, and years, regulators will be seeking comments from those companies directly affected by these new rules as well as the investing public.

To follow the latest updates on financial reform, including our *A Closer Look* series and an archived version of our September 8 webcast: *Financial Regulatory Reform*, visit: www.pwc.com/us/finregreform where we will continue to analyze the new law, the numerous mandated studies, and the resulting regulations. Also, stay tuned for our upcoming edition of *To the Point*, which will examine corporate governance issues associated with the Dodd-Frank Act.

Exposure drafts on selected projects

Keep those letters coming...

Standard setters have been busy to say the least. In the second and third quarters, a number of exposure drafts were issued, with comment deadlines fast approaching. We highlight some of the proposals here, as many companies have expressed a keen interest in staying abreast of the changes and weighing in with comment letters. If you have a desire to comment on the proposals, you will want to check out our DataLines on each of these exposure drafts.

Financial instruments—Not just for financial services companies...

So far, the overwhelming majority of respondents to the FASB's exposure draft on financial instruments have been from those in the financial services sector. However, the implications of the proposal are broad and will likely affect most companies across all industries. For nonfinancial services companies, the most common implications of the proposal (in addition to the proposed changes to hedge accounting) are:

- All investments in equity instruments, except for those qualifying for the equity method of accounting, will be required to be measured at fair value with changes in fair value reported in current period earnings. This includes investments in equity instruments currently accounted for using the cost method.
- Application of the equity method of accounting will be more limited. In order to apply equity method accounting, the operations of the investee must be "related" to the investor's consolidated operations. Otherwise, the investment must be measured at fair value. Whether an investee is "related" to the investor's operations will depend on a number of factors, including the line of business in which it operates, the level of transactions between the investor and investee, and the extent of common management.
- Investments in debt instruments will be measured at fair value with changes in fair value reported in current period earnings, unless an election is made to record changes in fair value in other comprehensive income for certain qualifying portfolios.
- Most issuances of convertible debt will be measured at fair value in their entirety, with changes in fair value reported in current period earnings.

Practically speaking, these changes will expand the use of fair value measurements and increase the need for more timely valuations since fair value measurements will be needed in each interim and annual set of financial statements. One result: greater earnings volatility.

Based on the comment letters submitted to date, there appears to be significant opposition to a number of the changes being considered. It remains to be seen whether the FASB will be swayed by these views and alter its course, and whether the final standard will bring U.S. GAAP closer to IFRS. Given that the FASB's exposure draft on financial instruments passed by only a slim margin, it will be interesting to see how the upcoming changes in the Board's composition might affect the outcome.

The public comment letter deadline of September 30, 2010 is fast approaching. Companies should evaluate the impact of the proposal on their business and consider providing their views to the FASB on this very important project. Check out our recently-issued publications and other materials that provide more insight and observations on the exposure draft and how it may affect your company:

- [DataLine 2010-34, Changes to Financial Instruments Accounting — Impacts for Nonfinancial Services Companies](#)
- [PwC Webcast — US GAAP and IFRS Convergence Series: Financial Instruments \(archived\)](#)
- [DataLine 2010-25, FASB Proposes Changes to Financial Instruments Accounting](#)
- [What investment professionals say about financial instrument reporting](#)
- [FASB Exposure Draft, Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities](#)

Now featuring...Comprehensive income

Although it was released at the same time as the financial instruments exposure draft, the proposal to require a statement of comprehensive income seems so far to have received much less attention and comment letter feedback. Don't be fooled, though. The proposed standard, which creates a new financial statement that includes both net income and other comprehensive income, likely will change the look and feel of the financial "face" companies present to investors and other users.

Under the proposal, companies no longer will have the option to use two separate statements for net income and comprehensive income, or include other comprehensive income in the statement of changes in equity. When combined with the proposed changes to financial instruments accounting, this new statement of comprehensive income will highlight the potentially greater number of fair value changes that are reflected in other comprehensive income.

The proposal will not change how individual components of net income and other comprehensive income are accounted for, nor will it change when an item of accumulated other comprehensive income must be reclassified to net income. In addition, earnings-per-share will continue to be based on net income.

The public comment letter deadline is September 30, 2010, so companies should evaluate the proposal and consider providing their views to the FASB. For more information on the proposed standard see:

- [DataLine 2010-26](#), *Statement of Comprehensive Income — The FASB has proposed to require a new primary financial statement*
- FASB Exposure Draft, [Comprehensive Income](#)

Revenue recognition joint project—Something for everyone

Now that the dust has settled on the FASB's and the IASB's recently-issued exposure drafts on revenue recognition, companies are getting a better picture of how the new proposal may affect them. One of the objectives of the proposal is to harmonize guidance for all companies — thereby eliminating most industry-specific revenue recognition standards. This means that virtually all industries are likely to be affected, but the nature and extent of the change may vary widely. The following are just a few examples of how the proposed standard is likely to impact certain industries:

- **Engineering and Construction:** Through a single contract, a contractor may promise to deliver a number of different goods or services. Companies now often account for such arrangements at the contract level. While in some cases, it still may be possible under the proposed standard to account for a single contract this way, we expect that, in other instances, contractors may have to separately recognize more obligations within each contract than they do today. This may prove challenging for many construction contracts, and likely will affect the timing of revenue and cost recognition.
- **Retail and Consumer:** Currently there is diversity in practice in the accounting for customer loyalty programs, which are common in the retail and consumer industry. Under the proposed standard, consideration will be allocated between the product and the loyalty reward performance obligation. The amount allocated to the loyalty reward will be deferred, and revenue recognized only when the reward expires or is redeemed.
- **Technology:** For software arrangements containing multiple elements (including post-contract customer support), companies will need to consider whether they can allocate revenue to separate performance obligations based on each obligation's "estimated

standalone selling price" — a lower threshold than currently required. In some cases, the separation of additional elements will impact the timing of revenue recognition.

- **Pharmaceuticals and Life Science:** Today there is mixed practice with respect to the timing of revenue recognition for intellectual property licenses in the pharmaceutical and biotech industries. Depending on the term of the license and whether it is exclusive, the proposed standard, in some situations, may result in the acceleration of revenue.
- **Industrial Products and Manufacturing:** The new standard will require companies to defer some portion of a contract's revenue at the time of sale for all product warranties. Today, companies generally recognize standard warranties in a manner similar to loss contingencies.
- **Entertainment and Media:** Under the proposal, certain exclusive intellectual property licenses that have a term shorter than the license's full economic life could result in revenue being recognized over a longer period of time (the term of the license rather than up-front as is current practice for many television, film, and music rights).

The Boards are proposing that the new guidance be adopted retrospectively, which for many companies will be a significant undertaking. The comment letter period runs until October 22, so companies should consider getting engaged now and provide their views.

For more information, refer to the following:

- [DataLine 2010-28, Revenue Recognition...Full Speed Ahead](#), to see a snapshot on how certain industries will be impacted. This DataLine includes six supplements to help you dive deeper into industry-specific impacts.
- PwC Webcast — *US GAAP and IFRS Convergence Series: Revenue Recognition (archived)*
- FASB Exposure Draft, [Revenue Recognition](#)

Leases—Boards propose to bid "adieu" to operating leases

In August, the FASB and IASB issued exposure drafts proposing to fundamentally change lease accounting. The Boards are proposing that companies flip the switch from "off" to "on" balance sheet for assets and liabilities arising from lease contracts. The key objective of the Boards is to develop converged guidance for lessees that ensures assets and liabilities arising from lease contracts are recognized on-balance sheet. This has remained a consistent theme throughout the deliberations. What has been a challenge for the Boards, however, has been the accounting by lessors.

Lessor accounting

While the Boards tried for months to arrive at a single approach for lessor accounting, they concluded that a dual model was the better answer. Hmm ... sounds a bit like today's accounting. Here's the proposal that was released for public comment. Depending on the economic characteristics of the lease, a lessor would apply:

- A performance obligation approach if a lessor is exposed to significant risks or rewards of the asset either during or following the term of the lease arrangement, or
- A derecognition approach for all other leases.

Under the performance obligation approach, lessors will recognize a receivable to reflect the right to receive rental payments from the lessee. Lessors will also recognize a corresponding performance obligation for permitting the lessee to use the leased asset.

Under the derecognition approach, the lessor also recognizes a receivable that represents the right to receive rental payments from the lessee; however, under this approach, revenue

is recorded and the portion of the asset considered transferred is derecognized. This is similar to today's accounting under sales-type leases.

Lessee accounting

What's the bottom line? For lessees, the proposal effectively eliminates off-balance sheet accounting for all leases. The distinction between capital and operating leases will become a thing of the past since all leases will be subject to the same rules — giving rise to new assets and liabilities. For the income statement, expense recognition will be accelerated because straight-line rent expense would be replaced by amortization and interest expense.

Next steps

The Boards have put a wrap on their latest round of deliberations, pausing now to let constituents provide feedback during the public comment period. The stakes are high since the proposal could significantly change many companies' business models, not to mention the corresponding changes that will be necessary to their systems and operations. Companies have the opportunity to provide feedback to the FASB and IASB during the public comment letter period, which ends on December 15, 2010. A final standard is targeted to be issued in the first half of 2011. Look for a PwC DataLine coming soon that will provide valuable observations about the exposure drafts. In addition, the following continue to provide useful information related to the proposals:

- PwC webcast — US GAAP and IFRS convergence series: [Leasing](#) (archive)
- [In Brief 2010-15, FASB and IASB Propose Significant Changes to Lease Accounting](#)
- [The Overhaul of Lease Accounting: Catalyst for Change in Corporate Real Estate](#)
- [Point of View, The Future of Leasing](#)
- FASB Exposure Draft, [Leasing](#)

Financial statement presentation—Staff draft...for now

The FASB and IASB's modified strategy and work plan announced this past June has delayed the formal comment period for this major project, which is designed to overhaul the look and feel of a company's primary financial statements. The Boards' original plan to issue exposure drafts in June of 2010 has now been delayed until the first quarter of 2011, an acknowledgment that the project has fallen on the list of priorities. In the interim time period, the Boards have published a "staff draft" of the proposal with the intent of facilitating greater outreach before an exposure draft is released. The Boards' goal is to solicit input — with a particular emphasis on understanding the cost/benefit of the proposals along with the implications for financial services entities.

Some of the more controversial aspects of the staff draft released by the Boards in July include:

- Preparation of a direct method cash flow statement (with certain indirect information also presented),
- Roll-forward analysis of significant line items in the statement of financial position,
- Expanded segment disclosures, and
- New footnote disclosures for remeasurements.

While the project is focused on the presentation of financial data, the magnitude of the changes proposed are significant, and many expect that extensive operational and systems modifications will be necessary. Companies should consider using the delay to evaluate the impact of the proposed staff draft. Feedback to the Boards during this period will help facilitate a better understanding of any potential business implications. The staff draft does

not include an invitation for formal comment letters. However, the Boards will entertain input from interested parties in advance of the issuance of an exposure draft in 2011. PwC recently issued [DataLine 2010-35](#), *Financial Statement Presentation — A Look at the FASB and IASB's Staff Draft*, which provides useful information and observations on the proposal.

Loss contingencies—Revised proposal reignites debate

In July, the FASB re-exposed its controversial proposal to enhance loss contingency disclosures. More than two years have elapsed since the issuance of its original proposal. What's changed? For starters, many of the disclosures from the original proposal that were predictive in nature have been eliminated and replaced with publicly available factual information. Also, the revised proposal does not provide for an exemption from disclosing information that could be prejudicial to a company's legal matters.

Thus far, the comment letters that have been submitted on this latest proposal have not been supportive. The most commonly cited concerns raised in the comment letters include:

- **Prejudicial concerns:** Most companies want the FASB to drop from its proposal the requirement to disclose the amount accrued for a contingency and the related roll-forward. If the FASB does not drop these requirements, many companies have requested that the FASB reinstate in the final standard an exemption from disclosing information that is considered prejudicial, consistent with the 2008 version of the proposal.
- **Remote contingencies:** The latest proposal requires companies to disclose information concerning contingencies that are considered remote, but that could have a potential severe impact. A number of respondents have taken issue with the relevance of providing this information and believe that the process of evaluating such matters could be onerous.
- **Effective date:** Most believe that the proposed 2010 effective date is not practicable and that the abridged period for implementation will be a significant burden for many companies.

The ultimate effective date will depend on whether the Board is able to address the concerns raised in the comment process and redeliberate a final standard during the fourth quarter — all of which could prove challenging. A one-year deferral is proposed for non-public companies. There is still time to get engaged in the debate, as the public comment letter process has been extended to September 20. For more information, see:

- [DataLine 2010-32](#), *Disclosure of Certain Loss Contingencies*
- FASB Exposure Draft, [Contingencies](#)

Multiemployer Benefit Plans—ED poised to expand disclosures

A new exposure draft recently issued by the FASB proposes to significantly expand the disclosures about an employer's participation in a multiemployer postretirement pension or healthcare plan. The rash of underfunded multiemployer plans from recent economic conditions has continued to fuel constituent concerns that there isn't enough transparency concerning the risks associated with these plans. Currently, an employer often provides general disclosures about the amount of contributions made each period.

The exposure draft attempts to address these concerns by proposing enhanced qualitative and quantitative disclosures that provide more transparency around the risks associated with an employer's participation in a multiemployer plan and the effects the plan has on the employer's cash flows. Much of the information needed to make the disclosures will likely reside with plan sponsors and could logistically challenge the timetable for gathering this

information. Companies may want to consider this point when providing feedback to the FASB during the public comment period.

While this project has somewhat flown under the radar given all the other current standard setting activity of the Board, it will nonetheless have a significant impact on employers that participate in multiemployer plans. Companies have the opportunity to provide feedback to the FASB during the public comment letter period, which ends on November 1, 2010.

A DataLine detailing PwC's analysis of the proposed guidance is forthcoming. In the meantime, refer to the following for more information on this proposal:

- [In Brief 2010-16, FASB Proposes Enhanced Disclosure about Participation in Multiemployer Plans](#)
- FASB Exposure Draft, [Compensation-Retirement Benefits-Multiemployer Plans](#)

Boards to pose questions on transition

Many companies are asking the key question — when might they actually have to implement these new standards? The Boards are expected to issue a consultation paper sometime in September in order to solicit views on transition and effective dates for the bundle of joint projects.

For more information on each of the joint convergence projects keep an eye out for our next edition of *Setting the Standard*. In addition, see our [Point of View: Slowing down the pace of standard setting](#), which takes a deeper dive into analyzing the modified strategy and work plan.

Accounting hot topics

Venezuela—What's a company to do?

In the last edition of [The Quarter Close](#), we discussed the dilemma that many companies faced as they decided which rate to use for remeasurement of Bolivar denominated monetary assets and liabilities. The Venezuelan government suspended trading in the parallel market in late May, and then reopened a separate government-regulated market in early June. Questions continue to surface regarding whether the new regulated market (known as SITME) is a viable market exchange rate given its volume restrictions.

In July, the Emerging Issues Task Force (EITF) met to discuss the accounting for multiple foreign currency exchange rates. More specifically, the EITF discussed whether it is appropriate to use different exchange rates for the remeasurement of foreign currency transactions and the translation of a foreign subsidiary's financial statements when multiple exchange rates exist. That issue, however, is not directly relevant to the current Venezuela situation, since the country is now considered highly inflationary. The EITF suggested that a working group be formed to shed more light on the existing EITF issue and also to take the opportunity to discuss the practical issues that preparers are grappling with today related to Venezuela. The working group met in August and the EITF is convening again on September 16 to discuss further. While it is uncertain whether the EITF will issue new guidance, the discussions and the working group may help frame some of the issues that preparers need to consider. Stay tuned for further developments and look for our *EITF Observer* following the September 16 EITF meeting.

SEC Staff Comments

In addition, the SEC has also been monitoring disclosures around a company's operations in Venezuela. In particular, staff comments have focused on understanding a company's Venezuelan operations and the potential impact of further disruption in the Venezuelan economy. For example, in certain circumstances, the SEC has requested that companies make enhanced disclosure concerning their involvement in Venezuela. Suggested

disclosures include (1) summarized financial information of their Venezuelan operations, (2) the exchange rates used for remeasurement purposes and the rationale and relative significance of using various exchange rates, and (3) exchange gains or losses that resulted from changing exchange rates. Enhancements to management discussion and analysis may also be warranted to enable readers to understand the risk and accounting impact of an exchange rate change on future operations, financial position, and cash flows. This may include a discussion of material changes in business practices and operations that have or are expected to change as a result of the exchange controls and uncertainty related to accessing the foreign exchange market.

For more information, refer to [DataLine 2010-18](#), *Venezuela Highly Inflationary Accounting — An Accounting and Disclosure Update*.

Multiple element revenue recognition—The countdown begins

The effective date for the new revenue guidance for multiple element arrangements and software-enabled products is quickly approaching for calendar year-end companies. The new guidance effectively lowers the bar for allocating revenue to separate deliverables, and generally will result in earlier recognition of revenue for multiple element (bundled) transactions. This guidance will have a significant effect across many industries.

Are you ready? The new guidance is required to be adopted in January 2011 for calendar year-end companies, and many companies have already early adopted the new guidance. Not surprisingly, the judgments surrounding "best estimate of selling price" top the list of challenges faced by early adopters. Another major challenge has been the system and process changes needed to accumulate and maintain the appropriate data to support the chosen "selling price" methodology and deal with the elimination of the residual method.

In addition to the system and process changes, companies are reminded to also consider the impact on debt covenants, key performance metrics, compensation plans with financial performance based targets, and tax implications.

Refer to [DataLine 2009-54](#), *New Revenue Recognition Guidance — A More Economic Approach in Accounting for Arrangements with Multiple Deliverables*, for more information on the new guidance and insights on frequently asked questions.

Receivables and allowance for credit losses—Phased implementation begins this year

In our last edition of *The Quarter Close*, we reported that the FASB's new standard on disclosures for receivables and allowances for credit losses was imminent. Sure enough, the Board issued this new guidance in July. The new guidance likely will impact many companies across a broad range of industries, including most entities with finance receivables on their books, and has a phased implementation for certain of the disclosures. The disclosures are as follows:

- Allowance for credit losses — information should include the entity's allowance, charge-off and impairment policies and any changes from prior periods as well as a roll-forward of the allowance activities for the reporting period.
- Credit quality — disclosures should include information about management's credit assessment process, and whether that assessment is based on external or internal credit indicators.

- Modifications — disclosure should include qualitative and quantitative information about troubled debt restructurings, including quantitative information about re-default rates.
- Impaired loans, past-due and finance receivables on nonaccrual status — disclosures should include policy information and quantitative information regarding the outstanding carrying balance in each category.

For public entities, the new disclosure requirements will be effective for reporting periods ending on or after December 15, 2010. Certain disclosures related to allowance and modification activities will be effective for reporting periods beginning on or after December 15, 2010 (e.g., for the first quarter of 2011 for public companies with a calendar year-end). For nonpublic entities, the new disclosures are effective for annual reporting periods ending on or after December 15, 2011.

On the surface, the new disclosures may seem to be relatively straight forward. However, companies should not underestimate the amount of effort that will be necessary, even with the FASB delaying certain disclosures related to activities of these accounts to 2011. Refer to PwC [DataLine 2010-31](#), *New Disclosure Requirements for Finance Receivables and Allowance for Credit Losses*, for additional information.

Compensation and benefits accounting update

Winds of change continue to blow in standard setting for compensation and benefits. Recently, the FASB and the IASB have issued exposure drafts proposing new rules for employers' reporting of retirement benefit plans. An exposure draft issued by the FASB proposes significant new disclosures for employers who participate in multiemployer pension plans. The FASB's exposure draft on multiemployer benefit plans is highlighted in the "Exposure drafts on selected projects" section of this edition of *The Quarter Close*. Separately, the IASB has issued an exposure draft proposing changes to its standard on employers' accounting for defined benefit pension and other postretirement plans. For additional information about the IASB's pension proposal, refer to [DataLine 2010-23](#), *Pension/OPEB Accounting — An Analysis of the IASB's Exposure Draft*, and [DataLine 2009-31](#), *Pension/OPEB Accounting — Major Changes Coming to IFRS That Could Affect U.S. GAAP*.

PwC has also performed a study of the potential financial reporting implications of the new IASB proposal, and has compiled a survey of trends in retirement benefit plans.

PwC's IASB pension study

The IASB has proposed changes to its standard on employers' accounting for defined benefit pension and other postretirement benefits. While the proposal is not the result of joint deliberations with the FASB, both Boards hope to eventually adopt a converged standard. In the meantime, the changes proposed by the IASB will be considered by the FASB for purposes of determining the best path to achieve convergence.

The IASB's proposal would impact employers' financial statements in various ways. It would require immediate recognition of the full amount of plan amendments in determining operating income. Gains and losses, including those related to plan asset performance, would be recognized in other comprehensive income in the statement of comprehensive income when they occur, without recycling to net income. The expected return on investments set aside to pay benefits would be determined using the discount rate used to estimate the present value of the benefit obligation, instead of an expected long-term rate of return on plan assets. Benefit expense would be disaggregated and the components presented separately in reporting net income and comprehensive income.

PwC performed a study of the potential impact of the proposal, looking at 60 US and non-US companies and evaluating how their historical reported financial information would have been affected had they been applying the proposal in past years. The impact of the proposal varied widely from company to company, and for many there were significant changes in historical operating and net income from year to year. See PwC's publication, *Pension and OPEB Accounting: A Study of the IASB's Proposal*, which presents an analysis of the proposal and our study results.

PwC's retirement plan assumption survey

Interested in knowing how your company stacks up against your peers in pension assumptions? PwC recently released its *Pension/OPEB 2010 Assumption and Disclosure Survey*. In the survey, we analyzed 100 companies, comprising Fortune 100 companies and other large and established companies, with a December 31 measurement date. We reviewed the public annual reports for the companies selected, specifically financial information regarding pension and other postretirement benefit (OPEB) plans. We also included 2008 data for comparison.

Goodwill impairment—Always a hot topic

You might be wondering why we chose to include goodwill impairment as a "hot topic" in this edition of *The Quarter Close*. While there are no new developments in this area, we thought a few reminders would be helpful since many companies will soon be performing their annual goodwill impairment test. Moreover, goodwill impairment continues to be an area of focus for the SEC, especially given the current economic uncertainty.

Assessing goodwill for impairment requires significant judgment, so the following reminders and tips focus on those areas that often prove most challenging.

- Step back and take a fresh look at how you are determining the fair value of your reporting units. Current market conditions and the condition of a reporting unit's operations (and perhaps those of its competitors) may indicate a need to review how a reporting unit's fair value is measured. Consider using multiple valuation approaches in determining the fair value of a reporting unit, and when multiple approaches are used, consider whether their weighting is still appropriate. Valuation approaches may include discounted cash flow analyses and market-based approaches, and, in certain cases, a reconciliation of the aggregate fair value of a company's reporting units to that company's overall public market capitalization.
- Remember that the assignment of assets and liabilities to reporting units inherently involves judgment, and may change over time based on changes in a company's structure or the operations of a reporting unit. The objective of the assignment of identifiable assets and liabilities to a reporting unit is to achieve symmetry between the assets and liabilities that are assigned to the reporting unit and the net assets that are considered in the determination of the reporting unit's fair value.
- Always include deferred tax assets and liabilities in the carrying value of a reporting unit when performing step one of the goodwill impairment test. This is true regardless of whether measurement of the reporting unit's fair value assumes a taxable or non-taxable transaction.
- When measuring the implied fair value of goodwill in step two of the impairment test, remember that this process involves first measuring the fair value of the reporting unit's assets and liabilities — both recognized and unrecognized. When measuring implied goodwill, keep in mind that the objective is to perform a hypothetical purchase price allocation as though the unit were a newly-acquired business.
- Companies that may be at risk for failing step one of the goodwill impairment test may need to include forward looking disclosure regarding potential future impairment

charges in their risk factors for the third quarter. In addition, goodwill impairment testing is commonly a critical accounting estimate where additional disclosures should be considered.

Finally, don't forget that goodwill impairment testing is not just an annual event. Testing should be done when events suggest that the fair value of the reporting unit is below its carrying amount. In such cases, companies should consider whether an interim impairment test is necessary. Refer to the following publications for additional information regarding goodwill impairment:

- [DataLine 2008-35](#), *Nonfinancial Asset Impairment Considerations*
- [PwC Guide: A Global Guide to Accounting for Business Combinations and Noncontrolling Interests](#)
- [M&A Snapshot: Goodwill impairment testing: What's old is new again](#)

U.S. tax update—Foreign tax credits reduced

On August 10, 2010, President Obama signed into law a bill to provide education jobs funding and a six-month extension of increased federal Medicaid assistance. How might this impact your company? The costs of this new legislation are expected to be partly funded by several international tax revenue-raising provisions.

- Most notably, foreign tax credit benefits are expected to be reduced, which is likely to have widespread implications for many companies. Certain provisions will apply to historical earnings and profits and tax pools of foreign subsidiaries. The new provisions could increase the U.S. tax cost for companies that repatriate foreign earnings. The provisions also may result in a change in the measurement of deferred taxes for companies that do not assert permanent reinvestment of foreign earnings. Companies may also need to assess the realizability of their deferred tax assets for foreign tax credits and whether a valuation allowance is warranted. While certain provisions are effective on the date of enactment (August 10, 2010), others will be effective after December 31, 2010.
- The new legislation also includes a technical correction to the statute of limitations provision in the HIRE Act. Enacted on March 18, 2010, the HIRE Act amended certain rules to provide an extension to the statute of limitations for the entire tax return if a company fails to provide complete information regarding certain foreign transactions. Previously, it was generally understood that the extension only applied in the context of a tax deficiency related to the specific foreign information that was not properly reported. The technical correction clarifies that the statute of limitations would be extended only for the tax deficiency related to the specific foreign information that was not properly reported. The technical correction applies as if it was originally enacted as part of the HIRE Act earlier this year. Companies will need to assess the impact the new law has on recorded tax reserves.
- What the new law does not include are certain individual tax provisions that were anticipated to extend through the end of 2010, including the research credit, controlled foreign corporation (CFC) look-through, subpart F active financing income, and 15-year depreciation for leasehold, restaurant and retail improvements. While many believe these provisions may be extended, the timing for further action on tax extender provisions is unclear at this time.

Companies will need to assess their deferred tax accounts and estimate the impact this legislation will have on their annual effective tax rate. Refer to the TAS NewsAlert, [Tax accounting implications of the international tax provisions included in the Education Jobs and Medicaid assistance Act \(H.R. 1586\)](#), for more information on the tax accounting impacts of the bill.

Tax code— No "economic substance" may cost you plenty

The health care reform legislation passed earlier this year included a provision known as the codification of economic substance (COES). This provision, incorporated into the Internal Revenue Code tax law principles, requires certain tax positions to be supported by economic substance. This concept continues to garner attention and may have significant tax implications with respect to transactions entered into on or after March 31, 2010.

Many tax planning strategies could be at risk since the provision can deny tax benefits associated with transactions challenged by the IRS if a court determines that the tax benefits were unintended by Congress and the transaction serves no economic purpose other than tax savings. Evaluating the potential impact of this law change on transactions will be critical. The legislation includes a penalty that ranges from 20% to 40% of the underpayment of tax attributable to a transaction that lacks economic substance. The penalty cannot be avoided on the basis of reasonable cause or good faith, and cannot be waived by the IRS.

Companies should evaluate their reserve for uncertain tax positions, as well as the assessment of whether this provision creates a new or revised uncertain tax position for a transaction. Refer to the Tax Accounting Services (TAS) NewsAlert, [*Tax accounting implications of the March 2010 comprehensive health care reform*](#), for more information on the tax accounting impacts of the various provisions within the health care legislation, including the COES.

U.K. corporate tax rate...declines

Companies will reap the benefit of newly-enacted U.K. legislation that, among other changes, reduces the corporate income tax rate from 28% to 27% effective April 1, 2011. Calendar year-end companies will need to evaluate the impact of this legislation on their deferred tax accounts this quarter. In addition, the UK government also announced its intent to continue reducing the corporate income tax rate, from 27% to 24%, through a series of future legislative enactments.

Companies are reminded that current accounting requires deferred tax accounts to be adjusted for the effect of a change in an enacted tax law. The effect should be recognized through an adjustment to income from continuing operations in the period that legislation is enacted — even if the deferred taxes were originally established through a component other than continuing operations. Don't forget that changes in valuation allowances associated with the adjusted deferred taxes are also recognized as an adjustment to continuing operations. When determining the impact on deferred taxes, companies should not consider the government's anticipated legislation to further reduce the corporate income tax rate until such legislation is enacted.

Refer to the Tax Accounting Services (TAS) NewsAlert, [*Tax accounting implications of the United Kingdom Finance Bill 2010*](#), for more information on the tax accounting impacts of the Act.

SEC matters

Contingencies—SEC seeks transparency

While the FASB recently proposed new guidance to enhance the disclosures for loss contingencies, the SEC is focusing its attention on whether the current disclosures companies are making about loss contingencies provide enough transparency and comply with existing disclosure requirements. For example, contingencies that are probable of occurring and that can be reasonably estimated should be accrued and the contingency

should be adequately disclosed in a company's financial statements. Moreover, the SEC has questioned whether companies have disclosed sufficient information about the nature of such contingencies and the range of possible losses. When a range cannot be estimated, companies should include disclosure that highlights that point. Even when the criteria for accrual have not been met, existing standards require that companies disclose information about contingencies if there is at least a reasonable possibility that a loss or additional loss has occurred.

When a company resolves a material loss contingency, the SEC has cautioned companies that they would typically expect to find a disclosure about the potential for the contingency in an earlier period. Companies should also be mindful that disclosures should include potential exposures greater than the amount accrued in the financial statements, if the additional loss is reasonably possible and could be materially different from what is accrued. Expectations regarding the level of disclosure likely will increase with the significance of the potential loss.

Permanent reprieve for non-accelerated filers

Non-accelerated filers are breathing a collective sigh of relief since President Obama signed the Dodd-Frank Act in July. The Act contains a provision that permanently exempts smaller companies and debt-only issuers from the Sarbanes-Oxley internal control audit requirements. The exemption applies to companies who are non-accelerated filers (generally companies with public float of less than \$75 million). However, that relief may be slightly tempered since management will still need to perform its own assessment of the effectiveness of internal control over financial reporting.

This permanent exemption was effective immediately (July 21, 2010), and the SEC plans to revise its rules and forms to conform to the [Dodd-Frank Act](#).

Consolidating a new VIE? Internal controls should be assessed

The scope exception provided by the SEC for a company that consolidates a variable interest entity (VIE) to apply the internal control reporting requirements in certain circumstances is now a thing of the past. In April, the SEC staff communicated during an AICPA SEC Regulations Committee meeting that since the new consolidation model for VIEs is based on control (power and benefits), a company can no longer assert that it lacks the ability to modify the internal controls of a VIE. Therefore, newly consolidated VIEs resulting from the adoption of the amended consolidation guidance should be included in management's report on internal control over financial reporting.

However, similar to past conclusions, when a VIE is newly-consolidated, an assessment may not be possible. Therefore, in such circumstances, the SEC will provide a limited deferral for a VIE to be excluded from the internal control assessment. For more information, refer to the [AICPA SEC Regulations Committee minutes](#).

IFRS

IFRS developments—The SEC solicits feedback

In recent editions of *The Quarter Close*, we discussed the SEC's statement on its continued support for a single set of high-quality global standards. The statement also contained details of a "work plan" to analyze whether and how IFRS can be incorporated into the U.S. financial reporting system. As a result, the SEC in August issued two separate notices (Release Nos. [33-9133](#) and [33-9134](#)) soliciting comments from investors and preparers on six topics related to its ongoing consideration of incorporating IFRS into the financial reporting system for U.S. issuers. These topics focus on determining the impact of IFRS on contractual arrangements, corporate governance requirements, application of legal standards, and investor understanding and education. The comment letter deadline is October 18, 2010.

Meanwhile, the FASB and IASB continue their work converging U.S. GAAP and IFRS in certain areas. As we discussed earlier in the "Hot off the press" section, the FASB and IASB announced in late June the details of their modified convergence strategy that commits to an increase in stakeholder outreach and slows the pace of development of several standards. The SEC has said that the change should not affect its ability to decide in 2011 about whether, when and how to further incorporate IFRS into the financial reporting system for U.S. domestic issuers.

Outside the U.S., adoption of IFRS continues at a rapid pace. Transition continues in Brazil, Canada, and South Korea in 2011 and Mexico in 2012. Japan began allowing optional IFRS use for certain domestically listed companies in March 2010. Further, Indian regulators have issued a roadmap requiring a three-phased conversion to IFRS beginning in 2012. Finally, there is a current proposal to adopt IFRS for statutory purposes in the U.K. as early as 2013.

For more information, refer to:

- [Point of View: Slowing Down the Pace of Standard Setting](#), which discusses the current pace and timing of standard setting
- [MoU Status Update](#) by the FASB and IASB
- [Get Ready for Sweeping Changes in Accounting Rules](#), which focuses on the impact of the convergence agenda on many areas of a company's business
- [PwC's Convergence Website](#), containing information on the convergence projects and links to PwC publications and webcasts on the FASB and IASB projects
- [DataLine 2010-12, SEC Reaffirms Support for Single Set of High-Quality Global Accounting Standards](#), which takes a closer look at the SEC's statement and work plan

Corporate governance

To the Point

The next edition of *To the Point*, PwC's quarterly newsletter for directors, is scheduled for release in mid-September. This edition will take an overall look at the corporate governance issues included in the Dodd-Frank Act. It will also take a deeper dive on say-on-pay and proxy access. This edition of *To the Point* will be available at our [Corporate Governance website](#), along with all previously issued editions.

PwC announces: BoardroomDirect

In July 2010, PwC launched a new electronic publication for directors called *BoardroomDirect*. This new publication is distributed electronically on a quarterly basis and offers robust content on one major topic together with access to additional relevant

resources. The launch issue of *BoardroomDirect* is available at our [Corporate Governance website](#).

On the horizon

EITF—Several issues (nearly) finalized

In July, the EITF finalized new guidance on several issues, including two that will affect health care entities (presenting insurance claims and related recoveries gross, and measuring and disclosing charity care).

In addition, the EITF finalized its proposed guidance on costs associated with acquiring or renewing insurance contracts. However, the final issuance of the guidance was deferred pending additional discussion at the September EITF meeting. As part of the EITF's decision to defer its final consensus, the FASB agreed to publish a "staff draft" in the interim in order to engage in additional outreach and to solicit fatal flaw comments. This issue has been hotly debated over the past year and will significantly change the way the insurance sector accounts for these costs. One bright spot for those required to implement the new rules is that the guidance will not be effective until 2012 for calendar-year entities.

The EITF also reached decisions on several new issues, which were recently exposed for public comment. These include:

- Reporting participant loans at amortized cost in employee benefit plan financial statements,
- Recognition of certain fees associated with the recently-enacted US health care legislation as an operating expense ratably in the year it is due, and
- Accounting for legal costs associated with insurance claims for the health care industry through an accounting policy election.

The next EITF meeting is scheduled for September 16. In addition to discussing certain of the issues above, topics to be discussed at the meeting include:

- Accounting for multiple foreign exchange rates,
- Revenue recognition for health care entities,
- Deconsolidation of a subsidiary that is in-substance real estate,
- Performing step 1 of a goodwill impairment test, and
- The disclosure of supplementary pro forma information in a business combination.

Look for PwC's *EITF Observer*, which will be issued shortly after the September 16 meeting. In the meantime, the following publications are a helpful resource in assessing how these Issues may impact your company:

- July [EITF Observer](#)
- [EITF Agenda committee report](#)

Troubled debt restructuring—Clarifications on the horizon

In July 2010, the FASB began work on a project to improve the guidance used to evaluate whether a loan modification should be accounted for as a troubled debt restructuring. The FASB, responding to the increase in loan modifications now taking place in the wake of the economic downturn, believes that this project will result in a more consistent identification and measurement by creditors of loan impairments resulting from troubled debt restructurings. Overall, the proposed changes could result both in a greater number of impairments, and potentially higher amounts for those impairments.

Generally, under current U.S. GAAP, a modification of a loan that represents a concession to a borrower experiencing financial difficulty is a troubled debt restructuring. Although the project is at an early stage, recent tentative decisions made by the FASB include:

- Creditors may not use the borrower's effective interest rate on the modified loan to measure the amount of impairment.
- If a creditor modifies a loan of a borrower who is current with their payments, a creditor should still evaluate if financial difficulties for this borrower is imminent.
- A creditor should not conclude that a modification is not a troubled debt restructuring simply because a delay in payment resulting from that modification is insignificant.

We expect the FASB to issue an exposure draft in the coming months with a 60-day comment period. Lending institutions and other creditors should not underestimate the amount of effort required to evaluate all modifications executed during the periods presented. We plan to issue a DataLine to help companies understand the significant aspects of the proposal.

Emissions trading schemes—Finally off the back-burner?

Although dropped to the bottom of the priority list as a result of the Boards' modified strategy, the emissions trading schemes joint project seems to be coming back to life. At their upcoming joint meeting on September 15, 2010, the FASB and IASB plan to pick up where they left off – deliberating on the basic principles – whether assets and liabilities exist and should be recognized for allowances received under an emissions trading program.

Emissions trading programs have expanded in recent years, helping to drive growth in the trading of emission allowances – and this activity is expected to grow further in the years to come. Emission allowances are issued by a government or regulator to participating entities under certain types of programs (e.g., cap and trade programs) and provide those entities the "right" to emit substances such as carbon or sulfur. Entities that participate in these programs may (and often do) buy and sell these allowances when they have shortfalls or excess, but ultimately are required to submit to the government or regulator allowances sufficient to cover their actual emissions, or pay a fine.

Numerous accounting issues stem from these programs and the standard setters have at various times attempted to address the issues, but with little success. As a result, neither U.S. GAAP nor IFRS currently provide specific guidance. The project aims to comprehensively address several issues related to emissions trading schemes, including asset and liability recognition and measurement, asset impairment, profit and loss recognition, presentation, and disclosure. Because of the growing use of emission allowances by companies in a wide array of industries (including industrial manufacturing, power utilities, and energy and mining to name a few), any resulting standard could have a significant impact to many. Companies should therefore begin to tune in. For more information, refer to PwC's [10 Minutes on Monetizing Carbon](#).

Appendix

Effective dates for recently issued standards

Effective for fiscal years beginning after November 15, 2009

- ASU 2009-16, *Transfers and Servicing (Topic 860): Accounting for Transfers of Financial Assets*
- ASU 2009-17, *Consolidations (Topic 810): Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities*

Effective for interim or annual periods ending after December 15, 2009

- ASU 2009-12, *Fair Value Measurements and Disclosures (Topic 820): Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*
- ASU 2010-01, *Equity (Topic 505): Accounting for Distributions to Shareholders with Components of Stock and Cash (A consensus of the FASB Emerging Issues Task Force)*
- ASU 2010-02, *Consolidation (Topic 810): Accounting and Reporting for Decreases in Ownership of a Subsidiary—a Scope Clarification*
- ASU 2010-06, *Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements (the disclosures about purchases, sales, issuances, and settlements in the roll-forward of activity in Level 3 fair value measurements is deferred until fiscal years beginning after December 15, 2010)*

Effective for fiscal years ending after December 15, 2009

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

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

- ASU 2010-07, *Not-for-Profit Entities (Topic 958): Not-for-Profit Entities: Mergers and Acquisitions*
- ASU 2009-15, *Accounting for Own-Share Lending Arrangements in Contemplation of Convertible Debt Issuance or Other Financing*

Effective for annual reporting periods ending on or after December 31, 2009

- ASU 2010-03, *Extractive Activities—Oil and Gas (Topic 932): Oil and Gas Reserve Estimation and Disclosures*

Effective as of February 24, 2010

- ASU 2010-09, *Subsequent Events (Topic 855): Amendments to Certain Recognition and Disclosure Requirement (the recognition of subsequent events through issuance date of conduit debt obligors is deferred until interim or annual periods ending after June 15, 2010)*

Effective as of March 18, 2010

- ASU 2010-19, *Foreign Currency (Topic 830): Foreign Currency Issues: Multiple Foreign Currency Exchange Rates (An announcement made by the staff of the SEC)*

Effective for fiscal years beginning after June 15, 2010

- ASU 2009-14, *Software (Topic 985): Certain Revenue Arrangements That Include Software Elements (A consensus of the FASB Emerging Issues Task Force)*
- ASU 2009-13, *Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements (A consensus of the FASB Emerging Issues Task Force)*

Appendix

Effective for fiscal quarters beginning after June 15, 2010

- ASU 2010-11, *Derivatives and Hedging (Topic 815): Scope Exception Related to Embedded Credit Derivatives*

Effective for fiscal years beginning on or after June 15, 2010

- ASU 2010-17, *Revenue Recognition—Milestone Method (Topic 605): Milestone Method of Revenue Recognition (A consensus of the FASB Emerging Issues Task Force)*

Effective for interim or annual periods ending on or after July 15, 2010

- ASU 2010-18, *Receivables (Topic 310): Effect of a Loan Modification When the Loan Is Part of a Pool That Is Accounted for as a Single Asset (A consensus of the FASB Emerging Issues Task Force)*

Effective for interim and fiscal years beginning on or after December 15, 2010

- ASU 2010-24, *Health Care Entities (Topic 954): Presentation of Insurance Claims and Related Insurance Recoveries (a consensus of the FASB Emerging Issues Task Force)*
- ASU 2010-23, *Health Care Entities (Topic 954): Measuring Charity Care for Disclosure (a consensus of the FASB Emerging Issues Task Force)*
- ASU 2010-13, *Compensation—Stock Compensation (Topic 718): Effect of Denominating the Exercise Price of a Share-Based Payment Award in the Currency of the Market in Which the Underlying Equity Security Trades (A consensus of the FASB Emerging Issues Task Force)*
- ASU 2010-16, *Entertainment—Casinos (Topic 924): Accruals for Casino Jackpot Liabilities (A consensus of the FASB Emerging Issues Task Force)*
- ASU 2010-20, *Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses (for public entities, disclosures about activity that occurs during the reporting period)*

Effective for interim and fiscal years beginning after December 15, 2010

- ASU 2010-15, *Financial Services—Insurance (Topic 944): How Investments Held through Separate Accounts Affect an Insurer's Consolidation Analysis of Those Investments (A consensus of the FASB Emerging Issues Task Force)*

Effective for interim and fiscal years ending on or after December 15, 2010

- ASU 2010-20, *Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses (for public entities, disclosure as of the end of the reporting period)*

Effective for annual reporting periods ending on or after December 15, 2011

- ASU 2010-20, *Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses (for non public entities only)*

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