

The quarter close A look at this quarter's financial reporting issues

Directors edition

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What you need to know—Q4—2012

Welcome to the final 2012 edition of *The quarter close* — *Directors edition*. As an eventful quarter winds down, it's full speed ahead toward another year-end financial reporting season. We've got the latest updates and some timely reminders to help you navigate the path ahead. Here's a preview of the topics you'll find in this edition:

Front and center. It's the premier event for the financial reporting community: the annual AICPA National Conference on Current SEC and PCAOB Developments. Read our highlights to find out what's top-of-mind for the standard setters and regulators. Next, if you haven't been following the FASB's project on disclosure effectiveness, here's your chance to get caught up.

Accounting hot topics. We're sending you into the new year armed with insights on a number of hot topics, including fair value, asset impairments, pensions, valuation allowances, and more. And, with no resolution in sight to the Eurozone debt crisis, we explore how the uncertainty could affect you.

Hot off the press. We summarize the EITF's latest solution to a complex foreign currency issue and check in on COSO's internal control framework refresh.

Lots more. We discuss what's on the horizon for standard setting, provide timely advice on MD&A, take stock of the global audit policy debate, and more.



Front and center

Highlights from the AICPA conference

In early December, representatives from the SEC, PCAOB, FASB, and IASB gathered in Washington, D.C., for the annual AICPA National Conference on Current SEC and PCAOB Developments (AICPA conference). Speakers reflected on a busy 2012 and gave some insights into what to expect next year. Here are some key themes and highlights.

IFRS in the United States—“Stay tuned”

That was the advice coming from the SEC when addressing the timeline for a decision on whether, when, and how to incorporate IFRS into the U.S. financial reporting system. While there was plenty of discussion on the topic, SEC speakers didn’t drop any hints about the path forward, other than noting they will continue to work with the Commissioners, including new SEC Chairman Elisse Walter, on next steps.

The consideration of incorporating IFRS may be the single most important accounting determination for the Commission since ...the 1930’s.

Source: Paul A. Beswick, SEC Acting Chief Accountant, [December 3, 2012](#)

U.S. GAAP and IFRS convergence—what’s next?

With convergence efforts winding down, much of the conversation focused on the future role of the United States in international standard setting. Another issue raised was whether differences could emerge in how the converged standards (for example, revenue and leases) are implemented and interpreted in the United States and internationally.

SEC covers familiar ground

Segments, loss contingencies, income taxes, revenue recognition, goodwill, non-GAAP measures, MD&A...consistent with prior years, these topics were all highlighted by SEC speakers as frequent areas of comment. A recurring theme was that the SEC is looking for companies to provide the “full story,” not boilerplate disclosures, particularly in areas where significant judgment is applied.

PCAOB shares observations and future agenda

Auditing topics, particularly audit quality, continue to be front and center at the AICPA conference. Speakers reflected on PCAOB inspection trends, the PCAOB’s recently adopted strategic plan, and the PCAOB’s collaboration with regulators around the world. Chairman James Doty also announced that the PCAOB is undertaking a project to identify audit quality measures, with a long-term goal of tracking these measures over time.

Changing of the guard—Elisse Walter named new SEC Chairman

After months of speculation, SEC Chairman Mary Schapiro left the SEC effective December 14. This was not unexpected as she has spent nearly four years in the role. SEC Commissioner Elisse Walter was appointed the new chairman. Until another commissioner is named, Schapiro's departure leaves the SEC with two commissioners from each major political party. This dynamic could create challenges for rulemaking in the near term.

In other SEC news, Meredith Cross announced she will step down as Director of the SEC's Division of Corporation Finance at the end of the year. Lona Nallengara was named Acting Director of the division on December 17 and Craig Olinger continues to serve as Acting Chief Accountant.

Disclosure effectiveness—continuing the dialogue

Last quarter, the FASB's discussion paper kicked-off the debate on a challenging and multifaceted topic: how to make financial statement disclosures more effective.

Comment letters are supportive, but reveal diverse views

Comment letters overwhelmingly expressed support for a project on improving disclosure effectiveness. But views on the best approach varied. For example, there were mixed views on whether and how management should exercise judgment in making relevant disclosures. Some pointed out the challenges of defining "relevance" as a threshold to assess disclosures. Other feedback included requests for a clearer definition of the purpose and boundaries of the financial statements footnotes. This stemmed from concerns that certain suggestions in the discussion paper might be viewed as "blurring the line" between the footnotes and MD&A.

What's next?

The FASB will continue to digest the feedback, and then meet to discuss next steps, including the possibility of a proposal. Stay tuned for more on this topic next year.

► *Click here to watch FASB member Marc Siegel and CAQ Executive Director Cynthia Fornelli discuss disclosure effectiveness.*

Accounting hot topics

Need to get in the right frame of mind for year end? [Click here](#) to watch our countdown of the “Top 5” themes for the 2012 financial reporting season.

We’ve brought back our popular year-end round-up of key accounting and financial reporting issues. You may want to reference [Dataline 2012-20](#), *2012 year-end accounting and reporting considerations*, before approving your annual financial statements.

As a result of Hurricane Sandy, the topic of accounting for natural disasters surfaced once again this quarter. [Dataline 2012-17](#), *Accounting and disclosure implications of Hurricane Sandy*, provides reminders of financial reporting issues that can arise because of a natural disaster. Topics include expense classification, impairments, disclosures, and more.

This quarter’s hot topics

- Eurozone uncertainty
- Fair value measurement
- Long-lived asset impairment
- Software vs. service arrangements
- Pensions: year-end reminders
- Stock-based compensation: nonrecurring large dividends
- Deferred tax asset valuation allowances



► *Click here to watch our experts share insights into the actions U.S. companies are taking in response to risks arising from the Eurozone crisis.*

Preparing for the unknown—Eurozone uncertainty continues

The Eurozone debt crisis is still making headlines, with ongoing speculation about how events will unfold. In today's global economy, most companies will likely be affected in one way or another, whether it's their operations, investments, customer or vendor relationships, or the competitive environment.

How does the crisis affect your year-end financials?

U.S. companies aren't insulated from economic difficulties in Europe. Financial statements could be affected in a number of ways. Examples include revenue recognition related to European customers, collectability of accounts receivable, asset impairments, realizability of deferred tax assets, and more. To the extent the effect is, or could be, material to operations, companies may need to enhance their MD&A disclosures as well.

Planning for the potential outcomes

While it's not possible to predict the final outcome of the Eurozone debt crisis, many companies are incorporating various scenarios into their strategic planning processes. For example, some believe the crisis could result in one or more countries exiting the Eurozone and adopting a new local currency. In addition to wide-ranging political and business implications, this scenario would also have a number of financial reporting implications. A new currency could affect, among other things, functional currency determinations, Euro-denominated contracts, and hedge accounting.

For more information

For more discussion of the crisis and how it affects U.S. companies, check out [*10Minutes on the Eurozone sovereign debt crisis*](#). For a deeper dive into the potential accounting implications should a country exit the Eurozone, see [*Dataline 2012-19, Eurozone uncertainties—Financial reporting considerations of a country's exit from the Eurozone*](#). We also highlighted several financial reporting implications earlier this year in [*In brief 2012-01, Increased focus on implications of European economic environment*](#).

Fair value measurements—don't rely on the status quo

Continued fluctuations in the economic environment, coupled with new disclosure requirements, have once again put the spotlight on fair value measurements this year end.

New disclosures in this year's annual filings

Public companies should now be familiar with the new fair value disclosure requirements effective earlier this year. However, take note of the SEC's early observations in this area as the company prepares its year-end footnotes. The feedback can also be useful for private companies adopting the guidance for the first time.

For example, the SEC has asked for additional information when registrants disclose wide ranges of significant unobservable inputs. Another recurring observation is the need for enhanced discussion about valuation methods (particularly when more than one method is disclosed) and how changes in one unobservable input could affect another input for specific instruments. We expect the SEC to continue to focus on these disclosures in future financial statement reviews.

Impairment of long-lived assets—it starts with “asset group”

Eurozone debt crisis, economic volatility, natural disasters...against this backdrop, it's no surprise we're talking about asset impairments. The guidance for assessing impairment of long-lived assets hasn't changed. However, while cash flow forecasts often receive much of the focus in an impairment analysis, it's important for management not to skip the first step: identifying the appropriate asset groups.

What is an “asset group”?

Determining the appropriate asset group is critical to ensuring impairment testing is performed at the right level. In simple terms, assets used together create an asset group. More specifically, an asset group is the unit of accounting for “held and used” assets that represents the lowest level for which identifiable cash flows are largely independent of cash flows from other groups of assets and liabilities. Yes, it's a mouthful, but if they are incorrectly grouping assets, companies could be reaching the wrong impairment conclusions.

Grouping assets

For example, consider a brand name intangible asset (subject to amortization) obtained as part of a business combination. A brand name asset, itself, often does not have separately identifiable cash flows. Rather, it is used together with a broader group of assets that has identifiable cash flows largely independent of other assets. As a result, the brand name asset likely would not be individually tested for impairment, but instead would be tested as part of the larger asset group.

Management should identify asset groups even before an impairment test is triggered. It's a highly subjective assessment, based on a company's specific facts and circumstances, that requires thoughtful analysis and documentation.

Software or a service—why it matters

One noticeable trend over the past few years is a move away from a traditional shrink-wrap software sale model to a “software as a service” model. Customers now access various software solutions online, without the need to host and support the software themselves. When it comes to the accounting, the two models couldn't be more different. One is the sale (and purchase) of an asset, while the other is a service. This distinction matters for both vendors *and* customers.

Software sale vs. software as a service

It might seem obvious, but it's not always clear when a customer has purchased software or a hosted service. An important factor is whether the customer has the right to take possession of the software, without significant penalty, and can run the software on its own. If so, it's a software sale. Otherwise, the arrangement is viewed as a service. Typically, the customer's right to take possession is outlined in the contract, but judgment can be required in assessing whether that right is without “significant penalty.”

The vendor's perspective

First and foremost, the distinction between a software sale and a service arrangement will determine how and when the vendor records revenue. The vendor will either be

subject to software revenue guidance or revenue guidance for services.¹ In many cases, this could mean the difference between upfront revenue and revenue recorded over time.

The customer's perspective

This issue also affects the customer in the transaction. A software purchase typically creates a software asset. In contrast, the cost of buying a service is an operating expense, although upfront payments can create a prepaid asset that is amortized over the period of benefit. Additionally, fees paid to the vendor for professional services need to be evaluated to determine whether to record a capital asset, expense, or prepaid asset. This determination could also affect whether payments are classified as operating or investing cash flows in the cash flow statement.

Pension plan assumptions—checking them twice

This year end, there are several pension plan assumptions that warrant a closer look. Also, if your companies have made any changes to their benefit plans, they will need to pay close attention to the financial reporting implications.

Key assumptions—from discount rates to mortality

The economic landscape continues to put pressure on the assumptions used in pension plan measurements. Long-term interest rates dropped again this year, likely translating into lower discount rates. Lower discount rates, in turn, mean higher plan obligations. Also, some previously high-quality corporate bonds have been downgraded, so ensure bonds used to develop discount rate estimates are still appropriate. And, it continues to be important to revisit expected rates of return on plan assets in light of the slow economic recovery.

While it might seem grim, another key assumption is expected mortality. Companies and actuaries may be re-examining this assumption this year as a result of new mortality data (called Scale BB) recently developed by the Society of Actuaries. The good news is people are living longer, but that also means pension obligations could be increasing. Put this assumption on your list for a fresh look this year end.

A bit of relief on pension funding

Recent efforts by the Federal Reserve to stimulate the economy by keeping interest rates low have increased pension funding requirements. In response, Congress recently passed the Moving Ahead for Progress in the 21st Century Act (MAP-21), which will enable many companies to contribute less to their pension plans over the next few years. Although MAP-21 doesn't have any significant accounting implications, it could affect disclosures about expected future contributions and cash flows.

Plan amendments, curtailments, and settlements

Companies continue to explore ways to reduce operating costs, as well as the risk and volatility of their benefit plans. Actions include amending plans to reduce or eliminate benefits, buying-out plan participants in a lump-sum payment, or transferring responsibility for benefit payments to an insurance company.

These actions all have unique accounting consequences. Some may result in the recognition of gains or losses that were previously deferred. Considerations include

¹ Refer to ASC 985-605, *Software Revenue Recognition*, and ASC 605, *Revenue Recognition*.

whether actions are irrevocable, benefits are significantly reduced, and/or the risks related to the plan are significantly eliminated. Keep in mind that these types of actions usually trigger a remeasurement of the plan obligations and assets, which should be based on current assumptions as of the remeasurement date.

Nonrecurring dividends—actions that can create compensation

Amid concerns about increasing tax rates, companies may be planning to pay out larger or one-time dividends this year end. In connection with a large dividend, it's common for companies to take steps to keep employees that hold stock options or other equity awards "whole." In certain circumstances, these actions could trigger a compensation charge.

When compensation charges occur

Discretionary actions, such as modifying stock options or making cash payments to employees, are typically taken to avoid dilution of employee awards as a result of a nonrecurring large dividend. However, if these actions aren't required by the company's stock-based compensation plan, the employees received a benefit...and that means additional compensation cost.

Many plans include "antidilution" provisions that require certain actions when an equity restructuring, such as a nonrecurring large dividend, occurs. If the company's actions are *required* by the plan and designed to keep employees "whole," generally no additional compensation cost is triggered. But this would not be the case if the antidilution provision is discretionary, giving the board of directors or compensation committee the option to take action.

Valuation allowances—don't "defer" your assessment

Like other assets, deferred tax assets require ongoing assessment for potential impairment. But that's where the similarities end. Both the trigger for impairment and the assessment itself can differ significantly from other asset impairment models.

The "more likely than not" threshold

The time to record a valuation allowance is when it is *more likely than not* (that is, a likelihood greater than 50%) deferred tax assets will not be realized. This threshold is lower than the *probable* threshold often used when assessing whether to record a loss in other circumstances. The lower threshold means it's possible the need for a valuation allowance will arise before other assets (for example, long-lived assets, investments, and accounts receivable) are impaired.

Past versus future results

While other impairment assessments rely heavily on projected cash flows, history plays a greater role in valuation allowance assessments. That's because the valuation allowance model gives more weight to results that have already been demonstrated (or "objectively verifiable" information).

Projections used for the assessment should be consistent with projections used in other areas of accounting. However, the weight given to those projections when performing the valuation allowance assessment will depend on the extent to which the major assumptions can be objectively verified or independently supported. Additionally, management must keep in mind that cumulative losses in recent years represent

significant negative evidence that can be difficult to overcome. This point was reiterated once again by the SEC during the AICPA conference in early December.

A focus on jurisdictions

The valuation allowance assessment is performed on a jurisdiction-by-jurisdiction basis. This could be different than the level at which management typically analyzes financial information. For example, management often reviews financial results at a more aggregated level instead of analyzing each individual jurisdiction. However, when assessing whether or not a jurisdiction's deferred tax assets are realizable, only the taxable income for that particular jurisdiction should be considered.

Disclosure, disclosure, disclosure

As a general rule, the more judgment required, the greater the need for transparent disclosures. The SEC frequently requests enhanced disclosures about evidence considered, including the level of reliance on projections. “Foreshadowing” type disclosures are also critical when there could be significant near-term changes.

Hot off the press

Don't risk missing an important development. Visit our newly enhanced CFOdirect website at www.cfodirect.pwc.com for the latest updates and sign-up for weekly newsletters and alerts.

New releases may have been limited so far this quarter, but the year's not over yet. Two additional proposals—financial asset impairment and repurchase transactions—are imminent. See “On the horizon” for discussion of key developments on the FASB’s standard-setting projects.

In this section, we highlight a proposal from the Emerging Issues Task Force (EITF) on a complex foreign currency issue and a new release on internal controls.



EITF offers up another solution to foreign currency challenge

Back for round two. The EITF issued a revised proposal this quarter in an attempt to find a workable solution to a complicated foreign currency issue.

Deconsolidation vs. foreign currency guidance

The issue at hand is when to release the cumulative translation adjustment, and how much, in various scenarios. Some believe existing deconsolidation guidance should be applied, requiring release of the cumulative translation adjustment when a parent loses control of a business. Others believe that the foreign currency guidance should govern, and therefore the cumulative translation adjustment should only be released upon complete or substantially complete liquidation of a foreign entity.

Searching for a compromise

After some back and forth, the EITF worked out an approach that appears to strike a compromise. It differentiates between transactions occurring *within* a foreign entity and those affecting an investment *in* a foreign entity. This distinction will significantly affect to what extent the cumulative translation adjustment, if any, is released to net income.

The EITF decided that transactions occurring *within* a foreign entity should follow existing foreign currency guidance. In other words, if a group of assets or business is sold that doesn't constitute the entire foreign entity, the cumulative translation adjustment will not be released until there is a complete or substantially complete liquidation of the foreign entity.

Transactions affecting an investment *in* a foreign entity will follow an approach more consistent with the gain and loss recognition principles in the deconsolidation guidance. That means a sale or other event resulting in loss of control of the entity will trigger release of the cumulative translation adjustment in full to earnings. The EITF also decided that acquisitions completed in stages (aka "step acquisitions") will trigger release of the cumulative translation adjustment associated with an equity method investment at the point a controlling interest in the entity is obtained.

What's next?

The comment period for the proposal ended on December 10. Look for the EITF to discuss the feedback at its January meeting.

Update on internal controls—COSO refresh coming soon

Last December, the Committee of Sponsoring Organizations of the Treadway Commission (COSO) issued a proposed update to its internal controls framework. Now, COSO has released a compendium of approaches and examples, along with an updated version of the framework and illustrative tools.

What's next?

The comment period for the new releases ended earlier this month. We expect COSO to issue the final documents in the first quarter. We also expect COSO to provide guidance at that time for transitioning to the updated framework.

SEC matters

At December's AICPA conference, representatives from the SEC recapped the many activities that kept the regulator busy in 2012, namely the continued implementation of Dodd-Frank and the JOBS Act.² Next up for Dodd-Frank includes highly anticipated proposals on executive compensation clawbacks and the so-called CEO pay-ratio disclosure.

Speaking of rulemaking, two new SEC rules mandated by Dodd-Frank stirred up plenty of controversy last quarter: disclosures about conflict minerals and payments made by resource extraction issuers. While the rules were expected, they are highly contentious with registrants. Thus, it came as no surprise that both rules have since been challenged in court. As of yet, however, the effective dates remain the same, so stay tuned for updates.

MD&A—looking for a good new year's resolution?

According to the SEC, MD&A came in first place for volume of SEC comments last year. That alone is a good reason to take a fresh look at MD&A this reporting season. We'll get you started with some high-level reminders and insight into a few areas that could warrant extra attention.

MD&A do's and don'ts

MD&A is an opportunity to provide investors a view of the company through the eyes of management. Here are a few do's and don'ts for companies to keep in mind:

Do's:

- Provide an executive overview of the period's results and follow a principles-based disclosure model
- Discuss cash flow trends and drivers of changes in cash flows from operations
- Quantify cash held overseas and discuss material future cash requirements
- Focus on trends and uncertainties that may have a material impact on future operating results and liquidity

Don'ts:

- Simply repeat information provided elsewhere; MD&A should analyze, quantify changes, and explain the "whys" and implications
- Provide generic or boilerplate disclosure; MD&A should tell the company's story

Non-GAAP measures—use them, but don't abuse them

Non-GAAP measures can be a useful way to communicate with investors, if used properly. The SEC continues to focus on these measures, particularly when they could be viewed as misleading, such as those that exclude recurring operating expenses. Other takeaways on non-GAAP measures include:

² The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) and Jumpstart Our Business Startups (JOBS) Act were signed into law in July 2010 and April 2012, respectively.

- Ensure that non-GAAP measures are not shown with undue prominence (for example, do not present a full non-GAAP income statement)
- Describe why non-GAAP measures are useful to investors and how, if at all, management uses them
- Disclose the limitations of non-GAAP measures, such as the lack of comparability (for example, the definition of “adjusted EBITDA” is not the same for all companies)

Contractual obligations—providing the full picture

One area of MD&A recently getting more attention is the contractual obligations table. Specifically, the SEC has been focusing on items *not* included in the table. Examples include interest payments, unrecognized tax benefits, and expected payments or contributions related to pension plans. Determining whether these items should be included in the table can require judgment—it depends on the level of certainty of the timing and amounts. However, if an item is excluded due to uncertainties, the footnotes to the table to describe the timing and amount of the obligation should be used to clarify what has been excluded.

Cybersecurity risks—beyond “boilerplate”

Cyber attacks are an unfortunate reality for many companies today. In comment letters and speeches (including December’s AICPA conference), the SEC continues to re-emphasize the messages in its disclosure guidance³ on cybersecurity risks issued last year. Urging registrants to go beyond generic disclosures, the SEC expects MD&A to discuss cyber attacks that have affected—or could materially affect—products, services, customer or supplier relationships, or competitive conditions. Additionally, if the threat of such attacks has prompted companies to increase cybersecurity protection, these increased expenditures may also warrant disclosure.

Is your company (or an affiliate) doing business with Iran? New law ushers in new disclosures

Last summer, President Obama signed the Iran Threat Reduction and Syrian Human Rights Act of 2012 into law. Among other things, the new law requires companies to disclose whether they *or their affiliates* engage in certain business activities related to Iran. Examples include transactions with the government of Iran that have not been specifically authorized by the United States and activities that facilitate Iran’s development, production, and exportation of petroleum.

The first disclosures under the law are required in interim and annual reports due after February 6, 2013. That means 2012 Form 10-Ks for calendar year-end companies will need to comply with the new requirements whether filed before or after February 6.

³ Refer to CF Disclosure Guidance: [Topic No. 2, Cybersecurity](#).

IFRS developments

Proposal to bring national standard setters to the IFRS table

In November, the IFRS Foundation issued a proposal for a new advisory group to the IASB that would include representatives from standard setters around the world. The proposal was prompted by recommendations that the IASB strengthen and formalize its relationships with national standard setters. With this advisory group, the IASB hopes to move from bilateral relationships (such as the FASB and IASB convergence efforts) to a more streamlined, collective relationship with national standard setters.

According to the proposal, participants would be required, among other things, to make a formal commitment to a single set of globally accepted financial reporting standards, and make their best efforts to promote the endorsement or adoption of IFRSs in full without modification over time. At December's AICPA conference, IASB Chairman Hans Hoogervorst expressed his expectation that the FASB will be an active participant in the new advisory group.

IFRS standard-setting update

Highlights of the IASB's standard-setting activities this quarter include new releases on two joint projects with the FASB: investment entities and financial instruments.

IASB finalizes definition of "investment entity"

At the end of October, the IASB issued its final guidance on the definition of an "investment entity." Entities meeting the definition are not required to consolidate certain subsidiaries and, instead, will report all investments at fair value. While the FASB and IASB have been working jointly on this project, the approaches are not identical. For example, parent entities with investment company subsidiaries will retain the "specialized accounting" of the investment company subsidiary under U.S. GAAP, but not under IFRS. Look for the FASB's final standard in the first half of 2013.

Proposal on debt investments takes steps toward convergence

Last year, the FASB and IASB agreed to jointly discuss certain aspects of the financial instruments classification and measurement guidance. This quarter, the IASB proposed limited amendments to its existing guidance that, among other things, reduce the differences between IFRS and the FASB's proposed approach. Notably, the proposal includes a third measurement category for debt investments: fair value with changes in fair value recognized in other comprehensive income. As discussed in "On the horizon," the FASB plans to issue its proposal on classification and measurement in early 2013.

PCAOB shares its 2013 resolutions

At December's AICPA conference, representatives from the PCAOB continued to drive home the importance of performing high-quality audits. They also provided a preview of what's coming down the road from the PCAOB.

Upcoming standard setting

The PCAOB's standard on audit committee communications was approved by the SEC earlier this month. The new guidance is effective for audits of fiscal years beginning on or after December 15, 2012. In the first half of 2013, expect to see a proposal on the auditor's reporting model. The PCAOB also plans to issue a proposal on the auditor's responsibility for assessing "going concern" in coordination with the FASB's efforts (see "On the horizon").

What's next for audit firm rotation?

The PCAOB has collected a significant amount of feedback on mandatory audit firm rotation, as well as other possible alternatives to increase auditor objectivity and professional skepticism. In October, the PCAOB held a third public meeting on the topic. However, the PCAOB has not yet indicated whether it intends to move forward with a proposal.

Momentum continues outside the United States

Audit policy matters also continue to be debated outside the United States. For example, in the United Kingdom, the Financial Reporting Council finalized changes that require the largest 350 companies on the London Stock Exchange to retender audits at least every ten years under a "comply or explain" approach.⁴ Meanwhile, the European Commission's proposals released last year—ranging from audit firm rotation to audit-only firms—are still under discussion. The International Auditing and Assurance Standards Board (IAASB) has been working on an auditor's reporting model project with similarities to the PCAOB's 2011 concept release. Like the PCAOB, the IAASB expects to issue a proposal in the first half of 2013.

⁴ Under this approach, companies are required to retender their audit engagements (that is, request proposals), or explain why they did not.

On the horizon

Looking for more standard-setting news? Check out our upcoming edition of Setting the standard for the latest updates on many of the FASB's and IASB's active standard-setting projects.

With only a week or so left in 2012, the FASB could still push through two additional exposure drafts before we ring in the new year. The first is the highly anticipated proposal on financial asset impairment, discussed further in this section. A proposal on repurchase transactions is also imminent.

Looking forward to 2013, expect efforts on the remaining joint FASB and IASB projects to continue. Proposals on leases and insurance contracts, as well as classification and measurement of financial instruments, are all slated for next year. The boards also plan to wrap-up discussions on revenue recognition early in 2013 and release a final standard later in the year.



Financial instruments—two proposals poised for release

With redeliberations wrapped-up, the FASB is putting the final touches on revised proposals on financial instruments. First up, the FASB could get a proposal on financial asset impairment out the door yet this year. We expect a proposal on classification and measurement of financial instruments to follow shortly thereafter.

Impairment—getting closer?

In the aftermath of the financial crisis, the current model for impairment was widely criticized as “too little, too late.” The FASB and IASB joined forces to reconsider the accounting and were jointly exploring an approach known as the “three-bucket” model earlier this year. Feedback on the “three-bucket” model, however, caused the FASB to abandon this approach in favor of a less complex model.

Now, the FASB is poised to propose an alternative approach (known as the “current expected credit loss” model). The IASB, on the other hand, is sticking with the “three-bucket” approach (now called the “credit deterioration” model) and plans to issue a proposal early next year. At a high level, a key difference in the FASB’s approach as compared to the IASB’s model—and current practice—is that it does not require a “threshold” to be met before recording a credit loss. Companies will determine their credit impairment allowances based on expected losses over the full life of the loan at each reporting date.

Classification and measurement—moving toward convergence

For classification and measurement, the FASB and IASB have agreed on broadly consistent approaches for debt investments and financial liabilities. This includes a three-category approach for debt investments: (1) amortized cost, (2) fair value with changes in fair value recognized in other comprehensive income, and (3) fair value with changes in fair value recognized in net income. However, in other areas, the FASB’s and IASB’s guidance is expected to differ, such as accounting for certain equity instruments.

The IASB has already released for public comment proposed limited amendments to its existing guidance,⁵ while the FASB plans to issue its proposal in the first quarter.

Revenue recognition—countdown to completion

The FASB and IASB continue to check off remaining open items on the revenue project. Meeting frequently to revisit key aspects of the model, the boards are getting closer to a final standard.

Key decisions on variable consideration and collectibility

Accounting for variable consideration (that is, amounts that could change in the future) has been a challenging aspect of the standard. Reconsidering the proposed “reasonably assured” threshold, the boards decided to clarify that the overall objective is to recognize revenue at an amount that should not be subject to significant revenue reversals in the future. This will be a qualitative assessment based on the entity’s historical experience.

The boards also decided to change course on the presentation of uncollectible amounts. In the proposal, the boards had concluded these amounts should be shown in a line item

⁵ IFRS 9 (2010), *Financial instruments*

adjacent to revenue. Based on the feedback received, the boards decided uncollectable amounts should be an expense presented as a separate line item below gross margin.

A compromise on licenses?

The boards continue to struggle with opposing views on the appropriate timing of revenue from licenses. After much discussion, they concluded there may not be a “one size fits all” approach. The boards tentatively outlined two “types” of licenses: (1) a promise to provide a right, which transfers to the customer at a *point in time*, and (2) a promise to provide access to intellectual property, which transfers benefits to the customer *over time*. Acknowledging the potential complexities of a dual model, the boards agreed to provide indicators to help determine the appropriate accounting based on the nature of the license and the commercial substance of the agreement.

Going concern—FASB outlines model for upcoming proposal

After much back and forth, the FASB appears to have settled on an approach for “going concern”—and is now moving the ball forward. At its meeting in November, the FASB made a number of decisions, providing a preview of a proposal that could be issued as early as next quarter.

Where is the FASB headed?

The FASB decided management should perform a “going concern” assessment each reporting period. That assessment will focus on the company’s ability to meet its obligations in the ordinary course of business for a reasonable time period. A reasonable time period will be defined as twelve months after the balance sheet date, but management will also consider events probable of occurring beyond twelve months.

Thresholds for “going concern” disclosures

The FASB tentatively agreed on two key thresholds. First, if it’s *more likely than not* that a company can’t meet its obligations, certain early warning disclosures will be required. 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 upcoming proposal is expected to include guidance on how the thresholds should be applied.

What’s next?

The FASB plans to move quickly, targeting a proposal in the first quarter of 2013. We expect the PCAOB to begin reassessing the guidance for auditors on this topic next year.

OCI—FASB puts a bow on revised disclosures

Last quarter, the FASB proposed new disclosures of reclassifications from accumulated other comprehensive income into net income. After some fine-tuning, the FASB is now ready to move forward with a final standard, but it won’t be finalized in time for 2012.

What are the new requirements?

As a refresher, the FASB decided last year to defer the requirement to present reclassifications from accumulated other comprehensive income by line item on the face of the financial statements. Last quarter’s proposal took an alternative approach, moving disclosure of reclassifications to the footnotes.

In response to feedback on the proposal, the FASB decided not to require a prescriptive tabular footnote disclosure. Instead, the FASB will give companies the flexibility to

present the information either in the notes or parenthetically on the face of the financial statements. The key objective, however, is to present all of the required information in a single location. For public companies, the disclosures will be required both in interim and year-end financial statements. Nonpublic companies are only required to include the disclosures in year-end financial statements.

What's next?

The FASB plans to make the disclosures effective for public companies beginning in the first quarter of 2013.

Private company standard setting picks up steam

The Private Company Council is up and running, and comments are in on the private company decision-making framework.

Private Company Council kicks off discussions

In late September, the Financial Accounting Foundation⁶ (FAF) announced the members of the Private Company Council. The new council is charged with assessing whether U.S. GAAP should be modified for private companies. The council identified four areas for initial consideration: variable interest entities, “plain vanilla” interest rate swaps, uncertain tax positions, and intangible assets acquired in a business combination. After additional research and discussion, the council will decide which projects to add to its agenda. Stay tuned for more after the council meets again in February.

Comment period ends for decision-making framework

The response to the FASB’s proposed framework, which will help guide the Private Company Council in its deliberations, was largely positive. Many cautioned, however, that modifications to recognition and measurement requirements should be rare. One issue many will be watching closely is whether a private company will be allowed to adopt only certain changes identified under the framework, or required to apply *all* changes. Expect this issue to be debated as proposed modifications are being deliberated.

Some who commented on the framework emphasized that modifications identified by the Private Company Council should also be considered for public companies and non-profit entities. One possible solution is to make this assessment a required part of the FASB’s deliberation process.

AICPA proposes an alternative financial reporting framework

In November, the AICPA released its proposed financial reporting framework as an alternative for smaller entities that aren’t required to prepare U.S. GAAP financials. The framework is an “other comprehensive basis of accounting” that uses historical cost as a primary measurement basis. It’s not U.S. GAAP, nor is it authoritative guidance. Therefore, once the framework is finalized, there would not be an official effective date or transition. Comments on the proposal are due January 30. For more information, see [In brief 2012-51](#), *AICPA seeks feedback on its Financial Reporting Framework for Small- and Medium-Sized Entities*.

⁶ The FAF is the organization responsible for oversight of the FASB and Private Company Council.

EITF to reconvene in January

With the November EITF meeting sidelined by Hurricane Sandy, the next meeting is now scheduled for mid-January. “Push-down” accounting—a topic garnering significant interest—is among the issues on the agenda. There is limited U.S. GAAP guidance today for determining when and how 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). We expect the EITF’s initial discussions to focus on defining the scope of the issue.

Other new topics for January are: (1) accounting for service concession contracts between governmental and nongovernmental entities (for example, to operate or maintain infrastructure assets such as roads and airports), (2) whether the Fed Funds rate should be permitted as a “benchmark interest rate” for hedge accounting purposes, and (3) whether to present a liability for an unrecognized tax benefit on a gross or net basis when a net operating loss or tax credit carryforward exists. Look for our *EITF observer* shortly after the meeting for all of the highlights.

Corporate governance

FCPA resource guide: put it on your reading list

Consider it an early holiday gift. In November, the SEC and Department of Justice (DOJ) jointly issued a new [resource guide](#) to the U.S. Foreign Corrupt Practices Act (FCPA). The more than 100-page guide provides a detailed analysis of the FCPA and insight into SEC and DOJ enforcement practices. With the number of FCPA prosecutions continuing to increase, you'll want to take advantage of this new resource. Read more in the December issue of *BoardroomDirect* on our [Center for Board Governance website](#).

Looking ahead to the 2013 proxy season

Ready or not, the 2013 proxy season is right around the corner. This year, expect to see more activity in the areas that gained momentum in 2012. These include shareholder proxy access, board declassification (requiring all directors to be elected every year), and say-on-pay. We expect shareholders—particularly institutional investors—will focus on these and other related issues as they look to gain influence in the boardroom.

Other topics likely to be debated in the 2013 proxy season include environmental and social proposals. In the aftermath of the recent election, disclosure of political contributions could remain a hot topic in 2013. For more on the upcoming proxy season, read the November issue of *BoardroomDirect* on our [Center for Board Governance website](#).

Other governance publications

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

Directors and IT: What Works Best

Overseeing a company's information technology (IT) can be a challenging task for directors, especially when few directors have IT backgrounds. We developed a two-part comprehensive guide—available now—to help directors bridge the “IT confidence gap.” Part 1 outlines a structured and efficient multi-step oversight process. Part 2 provides supplemental reading, giving directors information to better understand IT topics that they consider relevant.

To the point—Winter 2013

In the upcoming edition of *To the point—Current issues for boards of directors*, we discuss Institutional Shareholder Services (ISS) policy updates for the 2013 proxy season, the recently issued guidance on FCPA, and insights about data security. *To the point* will be available in early January.

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