

# SEC and Accounting Hot Topics

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# Agenda

- SEC Hot Topics
- FAS 141R
- Other new guidance
- FASB Codification
- IFRS
- Questions

# SEC Hot Topics

- Fair Value
  - Debrief on FAS 157 implementation
  - New FSP's
- Liquidity disclosures and going concern
- Impairments

# FAS 157 – Refresher

- Part of the convergence roadmap between US GAAP and IFRS
- Amended definition of Fair Value throughout GAAP with limited exceptions
- Definition of FV as the price that would be received to sell an asset in an orderly transaction between market participants at the measurement date
  - Exit price concept – the price an entity would receive to sell an asset or pay to transfer a liability

# FAS 157 – Fair value hierarchy

Distinguishes between observable and unobservable inputs in 3 levels

- **Level 1** – Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets
- **Level 2** – Include other inputs that are directly or indirectly observable in the marketplace
- **Level 3** – Unobservable inputs (e.g., internal projections)

# Impact of Credit Market Events

- Credit market conditions deteriorated from the first quarter of 2008 into the “credit crisis”
- Instances of failed auction rate securities expanded into complete failures of major lending institutions.
- Many businesses experienced significant financial distress.
- Almost complete seizure of the credit markets with limited borrowing

# FAS 157 – Implementation Challenges

- Fair value in inactive markets
  - Significant challenges valuing debt securities – eg prices obtained from brokers or pricing services
    - Consideration of underlying models
- Other Than Temporary Impairment (OTTI) - when does a loss need to be recognized in the income statement
  - Ability and intent to hold until a recovery of fair value
  - Probable that debt would be collected according to its terms

# FAS 157 – Implementation Challenges

- Intense pressure on the FASB and SEC to “fix” mark-to-market accounting
  - Severely depressed asset values
  - Negative impact on banks’ capital
- House subcommittee hearing on March 12
  - “If FASB and SEC don’t take immediate action, Congress will legislate”
  - FASB committed to a “fast track” three-week rulemaking timetable
- SEC commitment to do whatever necessary to support FASB rulemaking

# FAS 157 – Implementation Challenges

- Result of pressure on the FASB and SEC was three new standards
  - FSP FAS 115-2 – Other than temporary impairments
  - FSP FAS 157-4 – Fair value in illiquid markets
  - FSP FAS 107-1 – Interim disclosures about the fair value of financial instruments

# FAS 157 – FSP 115-2

- FSP FAS 115-2 – Other than temporary impairments
  - Only applies to debt securities
  - Impairment is an OTTI if entity:
    - intends to sell
    - will be required to sell
    - does not expect to recover amortized cost basis from PV of cash flows
  - Loss to be recognized in earnings
    - if intent to sell or required to sell – entire difference between FV and amortized cost
    - no intent to sell - only recognize credit loss portion of fair value less than amortized cost.

# FAS 157 – FSP 157-4

- FSP FAS 157-4 – Determining fair value when the volume and level of activity have significantly decreased and identifying transactions that are not orderly:
  - Provides a number of indicators to consider - activity
    - Few recent transactions
    - Price quotations vary significantly and are not current
    - Wide bid/ask spread
    - Decline in market for new issuances
  - Indicators of disorderly market:
    - Not usual marketing period or audience
    - Seller is distressed
    - Sales price is outlier to other transactions
  - Impacts
    - No prescribed methodology
    - Change in valuation technique or use of multiple techniques may be appropriate

# FAS 157 – FSP 107-1

- FSP FAS 107-1 – Interim disclosures about the fair value of financial instruments.
  - Increases the frequency of disclosures from annual to quarterly
  - Effective only for public companies
  - Scope is all financial instruments, not just those subject to FAS 157.
    - Debt fair value disclosures
  - Disclosures
    - Fair value of all financial instruments
    - Methods and significant assumptions used
    - Changes in methods or significant assumptions

# Liquidity and Going Concern Considerations

- SEC has always focused on the adequacy of management's disclosures surrounding liquidity
  - Current events have only heightened this focus
  - Particular attention to:
    - Debt repayment obligations
    - Debt covenants, especially if default possible
    - Other significant commitments or contingencies
    - Significant changes to previous disclosures.
    - Material judgments and estimates.
    - Exposure of assets and impact on financial statements.

# Liquidity and Going Concern Considerations

- Provide greater detail and analysis of:
  - Cash generated and used (not just a summary of the cash flow statement)
  - How cash needs will be met
  - Trends and events impacting future liquidity

# Impairment Charges - Overview

	<b>Goodwill</b>	<b>Indefinite-Lived Intangible Assets</b>	<b>Amortizable Intangible Assets and Other Long-Lived Assets</b>
<b>Accounting Standard</b>	FAS 142	FAS 142	FAS 144
<b>Frequency</b>	Annual test / Trigger-based	Annual test / Trigger-based	Trigger-based
<b>Methodology</b>	Two step	One step	Two step
<b>Focus</b>	Implied fair value of goodwill	Individual asset fair value	Recoverability of carrying amount of the assets

# Goodwill Impairment

- Comparison of fair value and market cap
  - Consider existence of control premium and overall market conditions
- Control premium
  - May cause fair value to be more than market cap
  - Requires well-reasoned and thoroughly documented assessment
  - The greater the control premium, the greater the scrutiny
- Consider market cap trends instead of a single day's value
- Focus on the right level of analysis
  - Component/Operating segment

# Impairment Charges

- Robust disclosure, including “early-warning” indicators
- Consider interim impairment indicators
  - Impairment charges to other assets
  - Cash flow or operating losses
  - Negative long-term outlooks
  - Consistently not meeting analyst expectations
  - Planned restructurings
  - Market cap below book value

# Impairment Charges – SEC Comments

- *There is a concern that investors may have been surprised by the ...impairment charge. In this regard, we note the significant impact on share price when the charge was announced... Item 303 of Regulation S-K requires M,D&A disclosure of material uncertainties unless management has concluded that the uncertainty is not reasonably likely to materially impact future operating results...*
- *Section 216 of the Financial Reporting Codification states that ‘registrants have an obligation to forewarn investors of deteriorating conditions which, unless reversed, may result in a subsequent write-off. This includes an obligation to provide information regarding the magnitude of exposure to loss’...Please clarify for us why there was apparently no specific, prior disclosure regarding a material uncertainty over the recoverability of the goodwill.*

# Impairment Charges – SEC Comments

- *We note that your goodwill impairment test in 2007 resulted in no impairment. Please provide us with the analysis performed in accordance with paragraphs 19 and 20 of SFAS 142 supporting your conclusion that goodwill was not impaired as of December 31, 2007. Please identify each of the significant assumptions used in your analysis and explain the basis for each such assumption. Also, please tell us how you concluded that no triggering events occurred that would require an interim test during either the quarter ended March 31, 2008 or the quarter ended June 30, 2008.*

# Impairment Charges – SEC Comments

- *We ask that you please revise your goodwill disclosures in future filings to address the following points, especially for reporting units whose carrying value is close to the estimated fair value:*
  - *Define the reporting unit level at which you test goodwill for impairment.*
  - *Describe each of the methodologies used, including sufficient information to enable a reader to understand how each of the methods used differ, the assumed benefits of a valuation prepared under each method, and why management selected these methods as being the most meaningful for the company in preparing the goodwill impairment analysis.*

# FAS 141R - Top 5 Changes

1. Expanded definition of a business: Definition expanded to include entities capable of providing a return to investors and removes self sustaining and output requirement (e.g., a development stage enterprise now meets the definition of a business).
2. Transaction/Restructuring Costs: generally expensed.
3. Taxes: Adjustments to income tax provisions acquired in a business combination will now follow the same measurement period principles as other assets and liabilities.

## FAS 141R - Top 5 Changes (cont'd)

4. Contingent Consideration: measured at fair value on acquisition date and adjusted to fair value in subsequent reporting periods if classified as a liability.
5. In Process Research and Development (IPR&D): Measured and recognized initially at fair value. Subsequently classified as an indefinite-lived intangible asset until the project is completed or abandoned and is tested for impairment under FAS 142.

## Other New Guidance

- EITF 08-1 – Revenue Recognition for a Single Unit of Accounting
- EITF 08-9 – Milestone Method of Revenue Recognition
- Proposed EITF 09-3 – Applicability of SOP 97-2
- FSP APB 14-1 – Accounting for Convertible Debt
- EITF 07-5 – Meaning of Indexed to Entity's Own Stock
- FAS 161 – Disclosures about Derivative Instruments

# EITF 08-1

- EITF 08-1 – Revenue Recognition for a Single Unit of Accounting
  - Revision to EITF 00-21
  - Converges US GAAP with IFRS
  - Requirement for evidence of fair value of undelivered element removed for separation:
    - Separate unit of accounting if delivered unit has standalone value and no rights of return
  - If no VSOE or TPE – use “best estimate” of selling price
  - Effective for calendar 2010 companies

# EITF 08-9

- EITF 08-9 – Milestone Method of Revenue Recognition
  - Prior SEC informal guidance.....
  - Accounting policy election to recognize revenue in the period in which a milestone is achieved
  - Elective policy – proposed standard acknowledges that different policies are acceptable
  - Must apply policy consistently to similar arrangements
  - Milestone must be “substantive” and must not relate to past performance
  - Expected to be effective for calendar 2010 companies

# EITF 07-5

- EITF 07-5 – Determining whether and instrument is indexed to an entity's own stock
  - FAS 133 derivative guidance scopes out those instruments both indexed to its own stock and classified in shareholders equity
  - EITF 07-5 analysis required before EITF 00-19 analysis
  - Guidance requires two-step approach
    - Contingent exercise provisions
    - Settlement provisions
  - Generally, should not change classification of existing instruments, however....
  - Price protection provisions which require a reduction in strike price if at-market issuances below original strike price would cause EITF 07-5 criteria not to be met
    - Whether remote or within issuer control not relevant....

## More to come....

- *Consolidation and derecognition:* Revised standards (FAS 140 and FIN 46R) expected in the first quarter of 2009.
- *Liabilities and equity:* Exposure draft of a standard is expected in the fourth quarter of 2009.
- *Financial statement presentation:* A discussion paper was issued on October 16, 2008; comments are due by April 14, 2009.
- *Revenue recognition:* A "preliminary views" document was released on December 19, 2008 and comments are due in June 2009.
- *Leases:* A discussion paper is scheduled to be released in the first quarter of 2009.
- *Disclosure of certain loss contingencies:* The staff plans to present the results of its field-testing to the FASB in the first quarter of 2009. The FASB agreed that if it decides to issue a final standard, the guidance would not take effect earlier than fiscal years ending after December 15, 2009.

# Codification - Overview

- Single source of reference for U.S. GAAP
- No references to prior literature (e.g., FASBs, EITFs, FSPs, SABs, etc.)
- Includes relevant authoritative content issued by the SEC
- Codification verification available to public for over 1 year, commencing January 15, 2008
- Codification available at [www.asc.fasb.org](http://www.asc.fasb.org)
- Effective on July 1, 2009

# Codification - Structure

## Areas and Topics:

- Four general areas that are presented in key “Topics”
  1. Presentation: Balance Sheet, Income Statement, etc.
  2. Financial Statement Accounts: Assets, Liabilities, etc.
  3. Broad Transactions: Revenue, Consolidation, Leases, etc.
  4. Industries: Airlines, Entertainment, Software, etc.

## Sub-topics, Sections and Sub-sections

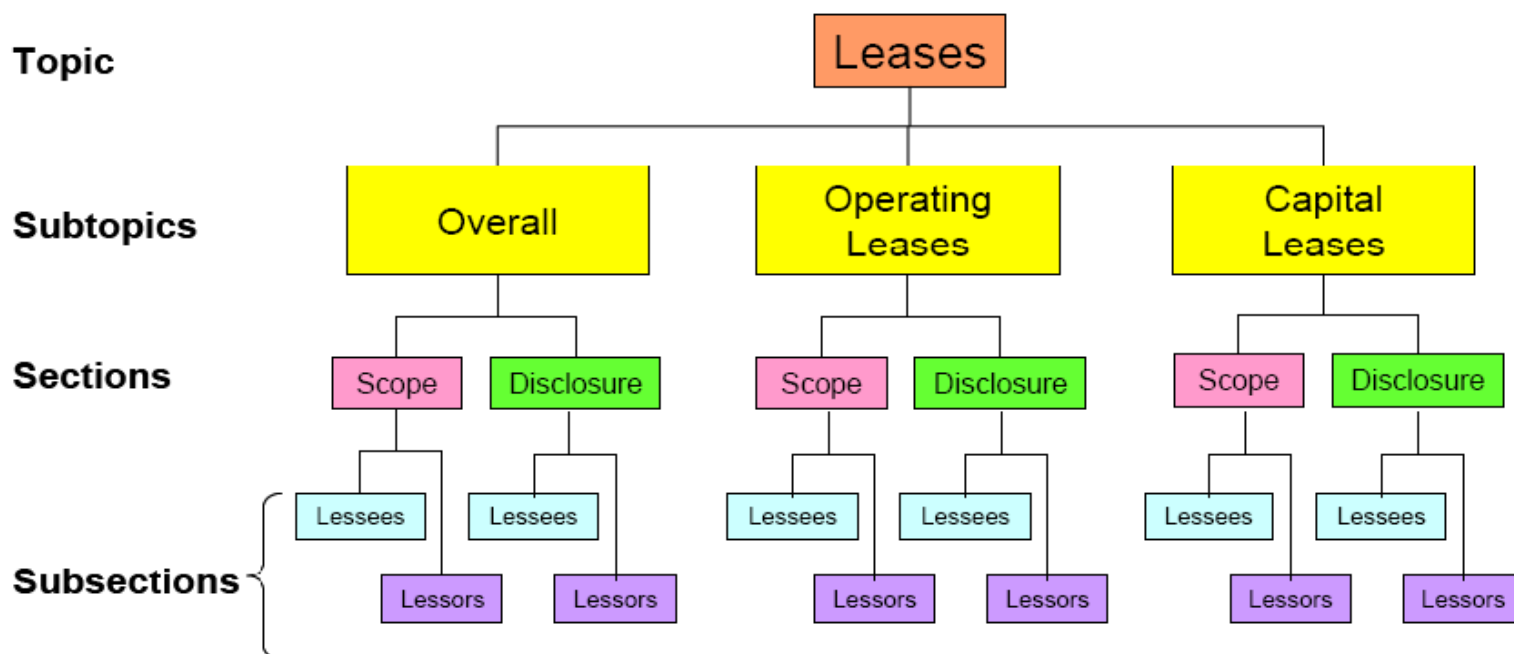
- Sub-topics dependant on topic (e.g. Overall, operating leases and capital leases are the three sub-topics under the Leasing Topic)
- Section dependant on subtopic (e.g. scope, recognition, measurement, disclosure, etc.)
- Sub-section dependent on section (e.g. lessor vs. lessee accounting)

# Codification - Structure

## Topical structure

### Illustration of the hierarchy

The following figure provides the terminology and a visual representation using a partial hierarchy of the Leases Topic.



Note: This is for illustration purposes only and does not include all Topics, Subtopics, Sections and Subsections.

# Codification - Structure

## ■ Structure of referencing:

### ■ ASC XXX-YY-ZZ-PP

- XXX = Topic,
  - YY = Subtopic,
  - ZZ = Section (an “S” preceding the Section number indicates SEC content)
  - PP = Paragraph
- For example, a sample of classification codes for Leases are as follows:
- ASC 840 = Leases (Topic)
  - ASC 840-10 = Overall (Subtopic)
  - ASC 840-10-15 = Scope (Section)
  - ASC 840-10-50 = Disclosure (Section)

# Codification - Impacts

## ■ What it means:

- Effectively adoption will be as of Q3 as at June 30 the old standards were applicable - however there is no definite guidance on this point.
  - No need to revise previously filed 10-K's
- Disclosure should be revised on a prospective basis to be in plain English which will eliminate the need to reference the standards or the codification. For instance: saying:
  - Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement

# IFRS – US Regulatory Update

- Roadmap issued in November
  - SEC will reconvene in 2011 to make a decision
  - Potential phase-in over 3 years, beginning 2014
  - Provides for early adoption in limited circumstances
- SEC staff encouraged comments on the proposal and acknowledged concerns about proposed effective date

# IFRS – US Regulatory Update

- Comments received
  - There was overwhelming support for the goal of moving toward a single set of global accounting standards.
  - The opinions varied on the approach to adopting IFRS in the US: convergence over time or adoption with a mandatory date.
  - Respondents favored one of three generalized approaches to adopting IFRS in the US; 1) full convergence (43%); 2) convergence in certain key areas coupled with establishing a mandatory date for adoption (24%), and; 3) establish a mandatory adoption date (28%).
  - There were different views and concerns on some of the other matters such as the independence of the IASB and how IFRS would interact with the US legal and regulatory system.

# IFRS – US Regulatory Update

- SEC will likely appropriately continue to prioritize its focus on the financial crisis and regulatory oversight matters.
- Expect more public SEC activity around IFRS later in 2009 and into 2010, as progress is made on their other priority matters.
- Expect accounting change to US standards through:
  - The convergence process, which will lead to standards that are much closer to IFRS;
  - Continued IFRS adoption by overseas subsidiaries; and
  - IFRS-influenced behavior of non-US customers and vendors.

# Questions