

# FASB Update

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## Presentation Agenda

- FAS 141(R), *Business Combinations*
- FAS 160, *Noncontrolling Interests in Consolidated Financial Statements*
- FAS 157 & 159, *Fair Value Measurements*
- Other recently issued accounting standards
  - FAS 158 (the measurement date component)
  - FAS 161
- FASB codification and structural changes
- Proposed FIN 48 Deferral Update (new)



## **FAS 141(R) and FAS 160**

- Joint project with International Accounting Standards Board (IASB)
  - First joint standard, but some differences remain
- FASB - two standards:
  - FAS 141(R), *Business Combinations*, which replaces existing FAS 141
  - FAS 160, *Noncontrolling Interests in Consolidated Financial Statements*

## **FAS 141(R) and FAS 160**

- IASB - two standards:
  - IFRS 3 (Revised), *Business Combinations*
  - IAS 27 (Revised), *Consolidated and Separate Financial Statements*

## Effective Date and Transition

### Effective Date:

- U.S. - Annual periods beginning after December 15, 2008
  - January 1, 2009 for calendar year-end entities
  - Early adoption prohibited
- IFRS - Annual periods beginning after July 1, 2009

### Transition:

- Transactions are prospective – do not remeasure previous transactions
- FAS 160's presentation and disclosure requirements are retrospective

## FAS 141(R): Fundamental Principle

### Current practice:

- Cost-accumulation approach
- Focused primarily on total costs incurred by acquirer to purchase the target

### New standard:

- Fair value approach
  - The acquirer measures the assets acquired, the liabilities assumed, and any noncontrolling interests at fair value
  - Definition of fair value is from FAS 157 - focus on market participant and exit price
  - Buyer-specific uses for target would not be considered by marketplace participants in valuing assets and liabilities

## Contingencies

### Current practice:

- Generally recognized if *probable and reasonably estimable* (FAS 5) at the time of acquisition

### New standard:

- If **contractual**, measured at FV as of the acquisition date
- If **noncontractual**, measured at FV as of the acquisition date if it is **more-likely-than-not** that the acquirer has an asset or liability
  - **MLTN > 50%**
- If *noncontractual* and *less-likely-than-not*, apply other GAAP, including FAS 5

## Contingencies

### New standard:

#### *Subsequent measurement:*

- Liabilities:
  - When new information becomes available, measure at the **higher** of:
    - Acquisition-date FV
    - FAS 5 amount
- Assets:
  - When new information becomes available, measure at the **lower** of:
    - Acquisition-date FV
    - The best estimate of a future settlement amount

## Restructuring Costs

**Current practice:**

- Recognize liabilities in opening balance sheet for certain target-related restructuring activities (e.g., exit costs, relocation, plant shut-down, employee termination)
- Restructuring activities may occur over several years, but generally costs do not affect earnings

**New standard:**

- Restructuring costs generally will not be recorded as assumed liabilities
- Expense acquisition-related restructuring costs incurred post-combination that do not meet the recognition criteria of FAS 146 at the acquisition date
- Nullifies EITF 95-3
- After acquisition, follow current GAAP including FAS 146



## Income Taxes

**Current practice:**

- Reflect any changes in the acquirer's preexisting tax balances as part of the business combination accounting
- Reductions of acquisition date valuation allowances recognized first against goodwill, then intangible assets, then in the income statement

**New standard:**

- Reflect any changes in the acquirer's preexisting tax balances separate from the business combination accounting
- Changes in acquired tax uncertainties and the release of valuation allowances recorded to income tax expense, even for acquisitions accounted for under previous standards
  - Amends FAS 109 and FIN 48 with regard to the release of valuation allowances and changes in acquired tax uncertainties and nullifies EITF 93-7



## Contingent Consideration

**Current practice:**

- Earn-outs generally not recognized until contingency is resolved and then recorded as part of the purchase price

**New standard:**

- Measured at fair value at the acquisition date
  - Generally does not represent the amount that will ultimately be paid
  - Probability-weighted DCF or other complex valuation techniques may be required
  - Classify as an asset, liability, or equity
  - Expense earn-outs tied to future services as compensation (no change to current practice)
- Subsequently measure at FV if classified outside of equity and not a derivative



## Transaction Costs

**Current practice:**

- Direct external costs (e.g., professional fees, such as banking, legal and accounting fees) are included in cost
- Indirect costs are expensed as incurred (e.g., internal M&A group)

**New standard:**

- Represent period costs – expensed as incurred
- Not considered a component of the FV of the business acquired



## Partial Acquisitions (less than 100% of voting stock)

### Current GAAP

- **Identifiable net assets acquired:**
  - Only controlling interest's pro rata share acquired is stepped up to FV (e.g. 51%)
  - Minority interest's pro rata share (49%) is recognized at carryover (historical) basis
- **Goodwill:**
  - Only stepped up to FV for controlling interest's pro rata share acquired (e.g. 51%)
  - No goodwill recognized for minority interest portion

### New GAAP

- **Identifiable net assets acquired:**
  - Recognized at 100% of FV (with limited exceptions)
    - Even if only acquire 51%
    - Limited exception to FV includes deferred taxes (FAS 109), stock options (FAS 123R), pensions (FAS 87, etc) and a few others
- **Goodwill:**
  - 100% of goodwill is recognized
    - Even if only acquire 51%



## Step Acquisitions

- What is a step acquisition?
- The buyer in a business combination may have a pre-existing ownership interest in the target
  - Buyer may already own 25% of target
  - Buyer purchases an additional 30% of target
- Acquisition occurs upon obtaining control (usually 51% of voting interests)
- Buyer obtains control as a result of purchasing the additional 30%
  - (25% + 30% = 55%)



## Step Acquisitions

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### Current GAAP

- Step acquisitions are accounted for by the purchase method

### New GAAP

- If transaction results in control being obtained, any **gain or loss** on the previously-held interest is **recognized** in the income statement and
- **100% of net assets acquired are recognized at FV** (with few exceptions)



## Step Acquisitions (Under New 141R)

***New slide***

- Two special considerations exist in step acquisitions:
  1. Buyer **must measure** the acquisition-date **FV of its *pre-existing* investment** in the target
    - Record gain (or loss) on difference between FV and carrying amount
      - May require use of complex valuation techniques
  1. Buyer must take **FV of any pre-existing NCI** into consideration when measuring goodwill (or a bargain purchase)
    - Determination of goodwill (or a bargain purchase) involves four elements
    - One of the four elements is the FV of the pre-existing NCI



**Practical Implication?  
Step Acquisitions**

***New slide***

- Purchase of additional shares to obtain control now has income statement implications

**Other significant changes in FAS 141(R)**

- Valuation of equity securities – valuation date
- Bargain purchase
- Measurement period - absolute max. of one year
- Step acquisitions
- IPR&D
- Also add:
  - Transactions considered to be business combination - expanded
  - Definition of “a business”
  - Assets not intended to be used by the acquirer

## **FAS 160, Noncontrolling Interests - Classification**

### **Current practice:**

- Unclear classification guidance. SEC requires mezzanine presentation
- Generally, reported in mezzanine or as liabilities

### **New standard:**

- Classify as equity
- Presentation and disclosure requirements consistent with classification as equity:
  - Will change the way net income and comprehensive income are presented

## **FAS 160 – If No Change in Control**

### **Current practice:**

- Increases accounted for by the purchase method
- Decreases accounted for as either equity transactions or transactions with gain or loss recognition

### **New standard:**

- Equity transactions
- No income statement effect – difference recognized in paid-in capital

## Control Lost (from greater than 50% to less than 50%)

### Current practice:

- Gain or loss recorded for the portion sold
- Retained portion (if any) at carrying value

### New standard:

- Record gain or loss for portion sold
- Revalue interest retained to fair value and record gain or loss on portion retained

## FAS 157, Fair Value Measurements

FAS 157, Paragraph 5

**Fair value** is the price that would be **received** to sell an asset or **paid** to transfer a liability in an orderly transaction between market participants at the measurement date.

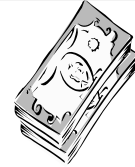
Note that FV is based on an **exit** price.



IOU \$100 million



## Fair Value - How Not When!



- FAS Statement 157 – issued September 2006!
- Codified all the accounting literature on fair value
- Developed a common definition, increased disclosures
- Establishes a 3 category hierarchy for measuring fair value – market quotes are always the best! A “market participant” view!
- Effective fiscal years beginning after Nov. 15, 2007 and interim periods within those years, except for:
  - Certain nonfinancial assets and liabilities (FSP FAS 157-2)

## FAS 157 - New Terms to Learn!

- Market – principal or most advantageous market
- Fair value hierarchy (3 levels – use the highest)
  1. Observable inputs – quoted market price (like the Wall Street Journal)
  2. Observable inputs – derived from markets prices
  3. Unobservable inputs – discounted cash flows
- Types of valuations (market, income, cost approaches)

### **FSP FAS 157-1**

- Good news!
- Amends scope of FAS 157 to remove leasing transactions accounted for under FAS 13 (and related leasing guidance)
- Does not apply to assets or liabilities related to a lease that are acquired in a business combination
- Effective upon initial adoption of FAS 157

### **FSP FAS 157-2, *Effective Date of FAS 157***

- Defers effective date of FAS 157 for all nonfinancial assets and liabilities, unless measured at FV annually
  - Issued in February 2008, effective upon issuance
- What is in deferral:
  - Impairment testing for goodwill, indefinite-life intangibles, long-lived assets
  - Asset retirement obligations
- What is not in deferral:
  - FAS 159 elected items
  - FAS 107 disclosures
  - Impairment testing for loans when using an allowed practical expedient

**FSP FAS 157-2, *Effective Date of FAS 157*  
(continued)**

- FAS 157 now effective for **all nonfinancial assets and liabilities, unless measured at FV annually**, for fiscal years beginning after November 15, 2008 (and interim periods in those fiscal years)
  - If had been early adopted, no reversal
  - If still elect to early adopt – must adopt in entirety

***New slide***  
**FSP FAS 157-3, *Determining the Fair Value of a Financial Asset  
when the Market for that Asset is not Active***

- Provides guidance on determining FV in an inactive market
  - Issued October 2008
- Does not change FV measurement principles
- Key guidance issued:
  - Use of internal assumptions to estimate FV when there are no relevant market data
  - Consideration of observable market information in inactive market
  - Use of market (broker) quotes to measure FV
- Effective upon issuance, including prior periods where FS are not issued

**FAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities***

- Issued to ease the burden of hedge accounting
- Applicable to almost all financial instruments
- The election of fair value option:
  - Is made on a contract-by-contract basis
  - Is irrevocable
  - Requires that changes in fair value be recognized in earnings as those changes occur
  - Must be made on date of initial recognition or event causing new-basis accounting at FV and is irrevocable

**FAS 159**

- Debt - consider credit rating in calculation
- Prospective, cumulative catch up, beginning of FY
- Effective date as of the beginning of each reporting entity's first fiscal year that begins after November 15, 2007

**Other Recently Issued Accounting Standards**

- **FASB 158**, *Employers' Accounting for Defined benefit Pension and Other Postretirement Plans*
- **FASB 161**, *Disclosures about Derivative Instruments and Hedging Activities*

**FAS 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans***

- Requires recognition of a liability or asset for underfunded or overfunded positions
- Funded positions should be reviewed based on current market conditions
- Should also be aware of discount rate assumption and expected long-term rate of return on plan assets

## FAS 158

- Requires plan assets and benefit obligations to be **measured** as of the annual balance sheet date
  - This measurement portion of FAS 158 had a delayed effective date.
    - Effective for all entities in fiscal years ending after 12/15/08
- Two measurement approaches available for transition
  - Change in measurement date (paragraph 18)
  - “Fifteen-month” approach (paragraph 19)

## FAS 158 – Change in Measurement Date Approach

- Steps to be taken (assume calendar year end company)
- Original measurement at 9/30
- Perform a new measurement at 12/31
  - Recognize net periodic benefit cost for 10/1/07 to 12/31/07 as adjustment to the opening balance of retained earnings
  - Recognize change in FV of plan assets and benefit obligations for 10/1/07 to 12/31/07 as a separate adjustment to opening balance of accumulated OCI

### **FAS 158 – Change in Measurement Date Approach (continued)**

- Re-measure assets and benefit obligations at 12/31/08
  - For year end financials and to calculate 2009 net periodic benefit expense
- Any curtailments and settlements after 9/30/07 are recorded in income statement as they are incurred

### **FAS 158 - “Fifteen Month” Approach**

- Steps to be taken (assume calendar year end company)
- Original measurement at 9/30
- Calculate 15 months of cost (to next 12/31)
- Recognize 3/15 of net periodic benefit cost as an adjustment of opening balance of retained earnings
- Recognize 12/15 during 2008
- At 12/31/08, recognize change in FV of plan assets and benefit obligations for 10/1/07 to 12/31/08 as a separate adjustment to OCI
- Remeasure assets and obligations as of 12/31/08

**FAS 161, *Disclosures about Derivative Instruments and Hedging Activities***

- Issued in March 2008
- Purpose: To provide greater transparency about how and why an entity uses derivatives
- Requires:
  - Expanded qualitative disclosures
  - Volume of derivative activity disclosures
  - Tabular presentation
  - Credit-risk disclosures

**FAS 161**

**Effective Date and Transition**

- Effective for financial statements issued for fiscal years (and interim periods) beginning after November 15, 2008
- Early application encouraged
- Comparative disclosures for earlier periods encouraged, but not required

## FASB Codification Project

- January 2008—commencement of one-year verification phase
- Does not change existing GAAP; simply reorganizes it
- Includes all authoritative accounting literature issued by US standard setters
  - FASB
  - AICPA
  - EITF
- Codifies that literature by topic in an online database
- April 2008—SEC content added for verification phase



## FASB Codification Project

- Goal is to simplify the organization of U.S. accounting pronouncements issued by multiple standard-setters
- FASB expects that the new structure and new system will:
  - Reduce the amount of time & effort required to solve an accounting research issue
  - Mitigate the risk of noncompliance with standards
  - Provide accurate information with real-time updates as new standards are released
  - Assist the FASB with research & convergence efforts
  - Make clear that guidance not in the Codification is not considered to be authoritative



Slide 39

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**BHM8** get rich's notes from Q2 webcast  
Brian H Marshall, 5/6/2008

## FASB Codification Project

- To encourage feedback, FASB providing free online access to the *FASB Accounting Standards Codification* research system during the one-year verification period (right now)
  - During verification period, able to review the content and provide comments using feedback feature
- FASB expects to approve the Codification as the single authoritative source of GAAP in April 2009
  - Supersedes existing FASB, AICPA, EITF literature
  - Only one level of authoritative GAAP
  - All other literature will be nonauthoritative



## FASB Codification Project

- Not authoritative until after verification phase
- Encouraged to use and familiarize yourselves with codification and send comments
- Available at <http://asc.fasb.org/home>
- Will be a major change to those who research accounting issues
- Webcast presented by FASB; moderated by Jay Hanson from McGladrey & Pullen
- Archive at [http://www.fasb.org/fasb\\_webcast\\_series/index.shtml](http://www.fasb.org/fasb_webcast_series/index.shtml)



## FASB Structural Changes

- Trustees of the FASB approved a number of changes to the organizational structure and oversight of FASB
- Effective July 1, 2008, size of FASB is reduced from 7 members to 5
- Simple voting majority requirement is retained
- “Leadership agenda process” is instituted—FASB chair has authority to set project plans, agenda, and priority of projects

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## Proposed FIN 48 Deferral for Private Entities

- Proposed FSP FIN 48-c, *Effective Date of FASB Interpretation No. 48 for Certain Nonpublic Enterprises*
  - Issued on November 3, 2008
- Defer effective date to fiscal years beginning after December 15, 2008 (i.e., calendar 2009)
- Applies to nonpublic enterprises
  - FASB originally considered limiting deferral only to pass-through entities
    - Partnerships Sub-S corps, LLCs
- Definition of nonpublic?

## **Proposed FIN 48 Deferral for Private Entities**

- Nonpublic enterprises - defined by para. 289 of FAS 109, *Accounting for Income Taxes*
  - Includes nonpublic not-for-profit organizations
- However, these do not qualify for the deferral:
  - Nonpublic consolidated entities of publicly-traded companies using U.S. GAAP.
  - Nonpublic enterprises that have already adopted FIN 48 in a full set of annual financial statements
  - **Conduit bond obligors** of publicly-traded debt securities
    - Certain not-for-profit organizations should closely study definition, including hospitals, museums and others

## **FASB Update**

Thank You!