FASB Update

Presented by

Edward J. Knauf, CPA/ABV

Chair, AICPA PCPS Technical Issues Committee

- ***The views expressed in this presentation are my own and do not represent positions of the American Institute of Certified Public Accountants or of the Partners of DeJoy, Knauf & Blood, LLP***

- ***The views and comments of the PCPS Technical Issues Committee of the AICPA are arrived at after extensive deliberation***

Agenda

- TIC Background
- FASB Rules effective this year
- FASB post-mortem from this past busy season
- FASB’s Future – What’s in store for you and your clients
- Other FASB activities
- EITF

What is TIC?

- Committee of PCPS (Private Companies Practice Section)
- Fifteen members – Partners of Small/Regional Firms
- Geographically balanced
- 3 Sub-committees:
  - Accounting Standards (Zone 1)
  - Auditing Standards/Accounting and Review Services/Professional Ethics (Zone 2)
  - Government Accounting Standards (Zone 3)

Purpose of TIC?

- To represent small/regional firm practitioners, their clients, and their financial statement users to the standards setter
- To act as the Voice of the Practitioner in the technical standards setting process
- TIC proactively identifies issues and developments requiring consideration by standards setters, monitors developing standards, and brings suggestions to the attention of the appropriate technical bodies
- To educate practitioners as to current events that will impact their practice

TIC Monitors and Comments to:

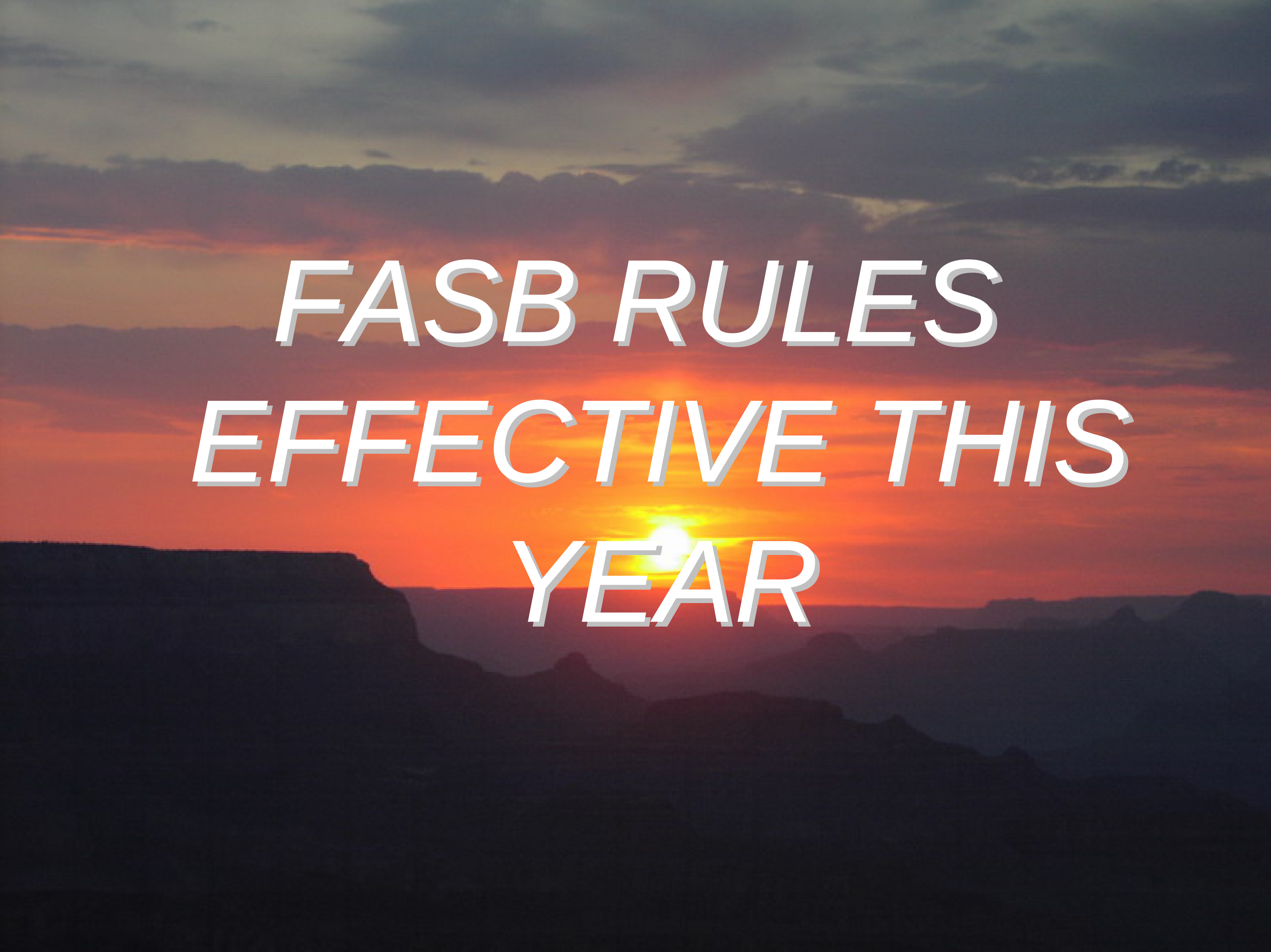
- Financial Accounting Standards Board (FASB)
- Government Accounting Standards Board (GASB)
- Emerging Issues Task Force (EITF)
- Auditing Standards Board (ASB)
- Accounting and Review Services Committee (ARSC)
- Accounting Standards Executive Committee (AcSEC)
- Professional Ethics Executive Committee (PEEC)
- Also Monitors:
  - IASB (International Accounting Standards)
  - IAASB (International Auditing Standards)
  - GAO (Government Auditing Standards)
  - DOL (Plan audits)
  - PCAOB (Public Company audits)

TIC Liaison with:

- Financial Accounting Standards Board (FASB)
  - Once per year with Entire Board
  - Each TIC meeting with one Board member
- Government Accounting Standards Board (GASB)
  - Annually
- Auditing Standards Board (ASB)
  - Liaison sessions the past two years
- Accounting and Review Services Committee (ARSC)

TIC Successes – past 3 years

– Had impact (with others) on FAS 150 deferral
– Halted FASB proposal regarding liability classification in default/waiver situations
– Significant change to measurement threshold in Uncertain Tax Positions proposal
– More appropriate examples and recognition exception in FIN47
– Concessions to non-publics in Share-Based Payment standard
– Frequently achieved additional implementation time for non-publics


FASB RULES EFFECTIVE THIS YEAR

FIN 48 – Uncertainty in Income Taxes

- Issued June 2006
- Effective for years beginning after December 15, 2006

FIN 48 – Accounting for Uncertainty in Income Taxes

Definition of a Tax Position:

A position taken in a past return or expected to be taken in a future return that is reflected in measuring current or deferred income tax assets or liabilities for interim or annual periods

FIN 48 – Accounting for Uncertainty in Income Taxes

A tax position –

- can result in a permanent reduction of income taxes payable
- can be a deferral of income taxes payable to future years
- can be a change in the expected realizability of deferred tax assets

FIN 48 – Accounting for Uncertainty in Income Taxes

A tax position may encompass –

- A decision not to file a tax return
- An allocation or shift of income between/among jurisdictions
- The characterization of income
- The decision to exclude reporting taxable income in a return
- The decision to classify a transaction, entity or other position as tax exempt

FIN 48 – Accounting for Uncertainty in Income Taxes

Steps for applying FIN48 -

- Identify all tax positions
- Evaluate the likelihood of each position being sustained upon settlement
- Threshold for measurement = “more likely than not”
- Must assume that each position is examined

FIN 48 – Accounting for Uncertainty in Income Taxes

- Differences in book and tax treatment of tax positions will result in increases in taxes payable or reductions in taxes receivable, or
- Reductions in deferred tax assets or increases in deferred tax liabilities,
- Or both

FIN 48 – Accounting for Uncertainty in Income Taxes

- An enterprise must de-recognize a tax position in the period in which it is determined to be no longer more likely than not that the position will be sustained
- A position is recognized when it becomes more likely than not that it will be sustained

FIN 48 – Accounting for Uncertainty in Income Taxes

- FIN48 requires the accrual of interest on tax positions that do not meet the More likely than not test
- Calculated at the statutory rate
- Classified as either interest expense or tax expense at the election of the entity

FIN 48 – Accounting for Uncertainty in Income Taxes

DISCLOSURES:

- Accounting policy regarding classification of interest accrued
- For each period presented-
  - – A tabular reconciliation of total amounts of unrecognized tax benefits at beginning and end of period, including:
    - Gross amounts of increases and decreases in unrecognized tax benefits of positions taken in a prior period
    - Gross amounts relating to positions taken in the current period

FIN 48 – Accounting for Uncertainty in Income Taxes

DISCLOSURES:

- Tabular reconciliation (continued) –
  - Amounts of decreases in unrecognized tax benefits as a result of settlements with taxing authorities
  - Amounts of decreases in unrecognized tax benefits as a result of lapse of the applicable Statute of Limitations

FIN 48 – Accounting for Uncertainty in Income Taxes

DISCLOSURES:

- The total amount of unrecognized tax benefits that, if recognized, would significantly affect the entity’s blended tax rate
- Total amounts of interest and penalties recognized in the statements of operations and balance sheets
- For positions for which it is reasonably possible that the total amounts of unrecognized tax benefits will significantly increase or decrease within 12 months of the reporting date, disclose –
  - The nature of the uncertainty
  - The nature of the event that would cause the change
  - The estimated range of possible change

FIN 48 – Accounting for Uncertainty in Income Taxes

DISCLOSURES:

- A description of the open tax years by major jurisdiction
- For the year of transition, the amount of cumulative effect of the change on retained earnings

FIN 48 – Accounting for Uncertainty in Income Taxes

CONSIDERATIONS:

- Applies to pass-throughs and non-profits
- Pass-through impact from state nexus issues
- Does not include sales tax
- SAS112 / possible independence considerations with respect to FIN48 calculations/controls

FSP FIN 48-1 – Definition of Settlement in FASB Interpretation No. 48

- When is a tax position effectively settled for purposes of recognizing previously unrecognized tax benefits?
- Concludes that a tax position could be effectively settled upon examination by a taxing authority
- Concludes that an examination MAY effectively settle all open tax positions for the year(s) examined

FASB Statement 158 - Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FASB Statements No. 87, 88, 106, and 132(R)

FASB Statement 158 – Pension Accounting

- Issued September 2006
- Effective already for entities with publicly traded securities
- Effective for non-publics and non-profits for years ending after June 15, 2007
- Requires balance sheet date measurement of plan assets and obligations beginning calendar 2008 year-ends

FASB Statement 158 – Pension Accounting

- Applies to defined benefit pension plans
- Requires recognition of funded status of plan (underfunded OR overfunded)
- Use the projected benefit obligation for purposes of calculating funded status (PBO includes the effect of future comp increases)

FASB Statement 158 – Pension Accounting

- Requires recognition (net of tax) of gains/losses, prior service cost or credits that arise during the period but are not a component of FAS87 net periodic benefit cost as an Other Comprehensive Income item

FASB Statement 158 – Pension Accounting

- Will require measurement of assets and benefit obligation as of balance sheet date (this requirement is not effective until calendar 2008 year-ends)
- Requires certain additional disclosures regarding the effects on net periodic benefit cost for next fiscal year that arise from delayed recognition of gains/losses, prior service costs/credits, and transition asset/obligation

FASB Statement 158 – Pension Accounting

- Represents Phase I of pension project
- Phase II will be a complete re-evaluation of all pension accounting

FASB Statement 159 – The Fair Value Option for Financial Assets and Financial Liabilities

- Issued February 2007
- Effective for years beginning after 11/15/07
- Early adoption is (was) allowed:
  - *For years the begin on or before 11/15/07*
  - *If FAS157 also adopted*
  - *If choice to adopt is made within 120 days of the beginning of fiscal year (i.e. too late now for calendar 2006 year-ends)*

FASB Statement 159 – The Fair Value Option for Financial Assets and Financial Liabilities

- Allows entities to choose to measure many financial assets and liabilities at fair value
- Why? Generally applicable to financial institutions, intended to fix “mixed attributes” problem, where assets and corresponding liabilities are measured differently
- Example – a bank’s bond portfolio securing repurchase agreement liabilities – bonds are currently market to market and liability is at cost – allowing liability to be stated at market allows the gains/losses on both the asset and liability to be reflected in earnings

FASB Statement 159 – The Fair Value Option for Financial Assets and Financial Liabilities

- Potential for abuse –
  - – Adopting early for “underwater” securities, running the loss through retained earnings at adoption, then not using FV on the replacement securities

FASB Statement 159 – The Fair Value Option for Financial Assets and Financial Liabilities

- Intended to be a “Principles-based” standard
- CPCAQ alert warns against the abuse
- Citigroup decided 5/2/07 not to follow statement 159
- TIC decided not to comment

FASB Statement 157 – *Fair Value Measurements*

- Issued 2006
- Provides a definition of *fair value* to be used whenever GAAP requires a fair value measurement
- Provides application guidance
- Provides disclosure requirements about fair value measurements that are used in the financial statements
- Effective for annual and interim periods beginning after 11-15-07

FASB Statement 157 – *Fair Value Measurements*

- Provides 3 levels of Fair Value Measurements:
  - Level 1 – quoted prices for identical assets/liabilities in active market
  - Level 2 – observable market inputs other than quoted prices for identical assets/liabilities in active market – include -
    - Quoted prices for similar assets/liabs in active markets
    - Quoted prices for identical or similar assets/liabs in non-active markets
    - Other directly observable market inputs

FASB Statement 157 – *Fair Value Measurements*

- Provides 3 levels of Fair Value Measurements:
  - Level 3 – inputs derived from extrapolation or interpolation not able to be corroborated by observable market inputs

FASB Statement 157 – *Fair Value Measurements*

- FASB is exploring whether / how much additional fair value measurement guidance is needed, and who is going to provide that

FSP FAS 126-1 - Applicability of Certain Disclosure and Interim Reporting Requirements for Obligors for Conduit Debt Securities

- Issued October 2006
- Effective for years that began after 12/15/06
- Defines a “public company” for FASB differential disclosure purposes
- Pulls in many companies and NFPs that have issued conduit debt securities

FSP FAS 126-1 - Applicability of Certain Disclosure and Interim Reporting Requirements for Obligors for Conduit Debt Securities

- Applies to certain NFPs such as Museums, Hospitals, and others with conduit debt securities traded on a public market
- Also applies to For-Profits with publicly-traded Industrial Revenue Bonds

PROPOSED FSP FAS 154-a – Considering the Effects of Prior-Year Misstatements in Current Year Financial Statements

- References SEC Staff Accounting Bulletins 99 (Materiality) and 108 (the same name as above)
- Modifies FAS154 – Accounting Changes and Error Corrections
- Extends SAB108 guidance to all non-governmental entities not subject to SAB108

PROPOSED FSP FAS 154-a – Considering the Effects of Prior-Year Misstatements in Current Year Financial Statements

- Requires use of BOTH the Iron Curtain and Rollover methods for evaluating misstatements

PROPOSED FSP FAS 154-a – Considering the Effects of Prior-Year Misstatements in Current Year Financial Statements

- IRON CURTAIN METHOD –
  - Quantifying misstatement based on the effect on the Balance Sheet at the end of the period irrespective of the misstatement's year of origin

PROPOSED FSP FAS 154-a – Considering the Effects of Prior-Year Misstatements in Current Year Financial Statements

- Rollover method –
  - Quantify misstatement based on the amount of error originating in the current year statement of income

PROPOSED FSP FAS 154-a – Considering the Effects of Prior-Year Misstatements in Current Year Financial Statements

- If the misstatement using either method is material to the Current Year statements, the entity must correct its Current Year statements
- If a misstatement relating to Prior Year misstatements exists after the CY statements are corrected and the remaining difference is material to the CY statements, then the PY statements must be restated

PROPOSED FSP FAS 154-a – Considering the Effects of Prior-Year Misstatements in Current Year Financial Statements

- EXAMPLE:
  - $20 accrual understatement each year for 5 years, cumulatively $100 at end of year 5
  - $20 was not material to PY F/S in years 1-4

PROPOSED FSP FAS 154-a – Considering the Effects of Prior-Year Misstatements in Current Year Financial Statements

- Rollover approach –
  - Evaluate materiality of $20 to the current year income statement:
    - If deemed immaterial, go to Iron Current
    - If material, $20 is corrected and $80 from PYs is evaluated using Iron Curtain

PROPOSED FSP FAS 154-a – Considering the Effects of Prior-Year Misstatements in Current Year Financial Statements

- Iron Curtain:
  - – Evaluate materiality of $100 to CY balance sheet
    - If material, $100 is corrected
    - The PY effect is then evaluated and if deemed material to the CY statements, PY is restated

PROPOSED FSP FAS 154-a – Considering the Effects of Prior-Year Misstatements in Current Year Financial Statements

- Proposed to be effective for June 200y year-ends and after, with earlier application permitted
- For entities that evaluated materiality in PY using either method (but not both), the PY effect may be recorded as an adjustment to retained earnings rather than restatement

INTERMISSION – REMINDERS FROM THIS PAST BUSY SEASON

- FAS 123(R)
- FSP FAS 13-1

SFAS 123(revised 2004) – *Share-Based Payment*

- Issued December 2004
- Supersedes APB 25 and revises SFAS 123 (effectively supersedes 123)
- Effective:
  - for Non-Public Entities, for first annual reporting period beginning after 12/15/05
  - for Public Small Business Issuers, for first interim or annual reporting period beginning after 12/2005
  - For Large Public Companies, was effective 7/1/05

SFAS 123(revised 2004) – *Share-Based Payment*

- Requires recognition of expense for employee stock options
  - Debit expense, credit APIC
  - Recorded at Fair Value
  - Method of determining Fair Value not prescribed
  - Most commonly used method – Black-Scholes

SFAS 123(revised 2004) – *Share-Based Payment*

- BLACK-SCHOLES METHOD OF OPTION VALUATION –
  - Required estimated inputs:
    - Current stock price
    - Option strike price
    - Option period – days to exercise date
    - Risk-free interest rate
    - Stock price volatility (i.e. the probability the option will be "in the money")

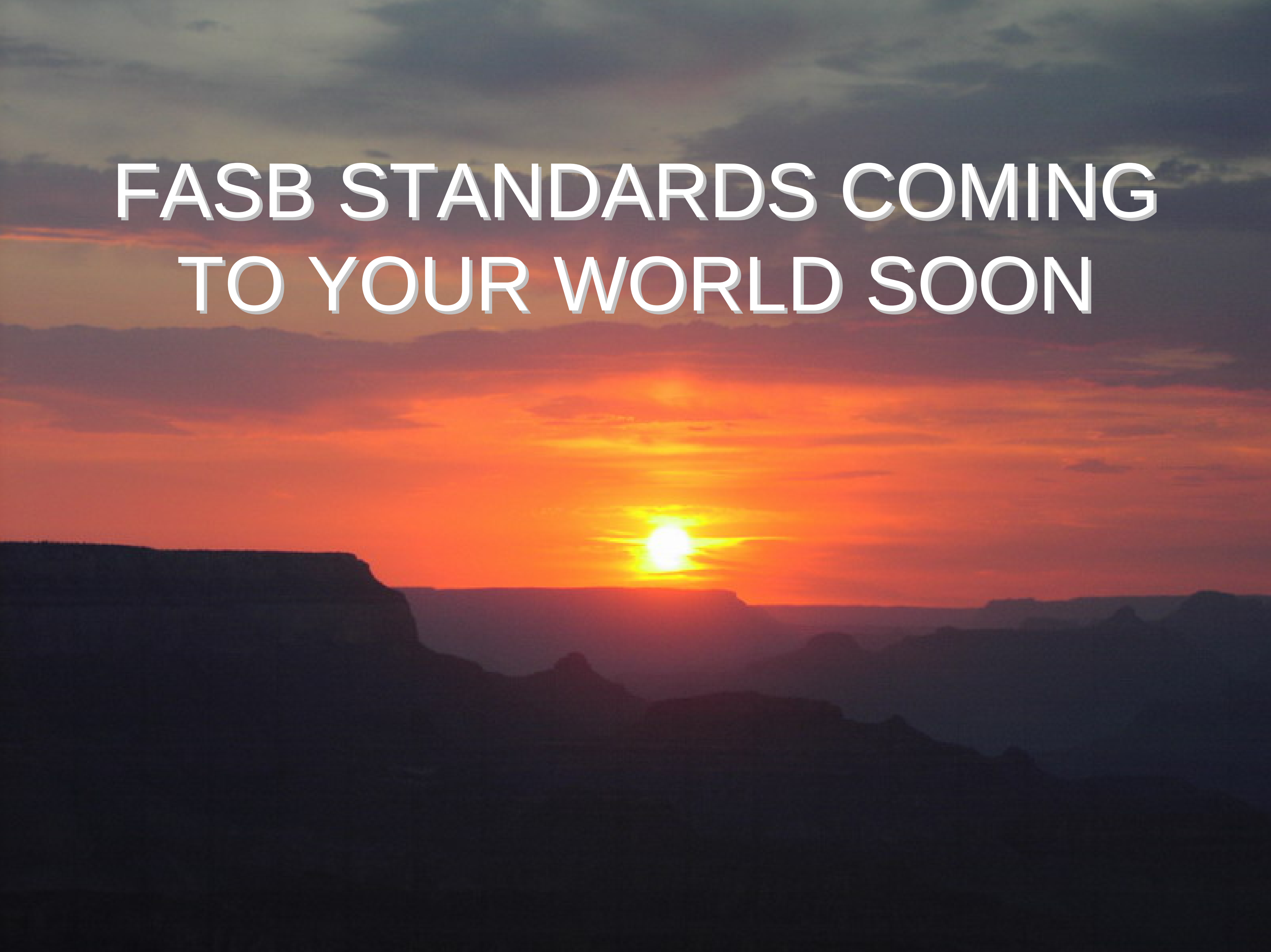
Stock price, option period and volatility are all difficult to measure!

FSP FAS 13-1 – *Accounting for Rental Costs Incurred During a Construction Period*

- Issued October 2005
- Effective for years beginning after 12/15/05
- Addressed practice inconsistencies, particularly in retail businesses
- Reiterates FAS 13 requirement to accrue and expense rent during rent holidays and reduced-rent periods

FSP FAS 13-1 – *Accounting for Rental Costs Incurred During a Construction Period*

- Clarifies that accrual and expensing of rent is required even for free-rent period during buildout
- TIC strongly opposed, citing capitalized interest analogy to support capitalization of rent during construction period *(to no avail)*


FASB STANDARDS COMING
TO YOUR WORLD SOON

FASB Statement – *Business Combinations – Applying the Acquisition Method*

- Exposed June 2005
- Amends FASB Statement No. 141
- Expected to be issued in Q3 2007
- Joint Project with IASB – objective is to achieve a single global BusCom standard
- Deliberated in tandem with Non-controlling interests proposed standard

FASB Statement – *Business Combinations – Applying the Acquisition Method*

- ED proposes to require Fair Value estimation at transaction date for any contingent consideration

FASB Project – Financial Statement Presentation

- Joint project – FASB and IASB
- Goal – to provide a single, high-quality financial statement presentation globally:
    - Including classification, line item display and subtotal aggregation
- Preliminary views document projected late in 2007

FASB Project – Financial Statement Presentation

- Tentative conclusions:
  - For each period:
    - A Statement of Financial Position at the Beginning of the Period
    - A Statement of Financial Position at the End of the Period
    - A Statement of Earnings and Comprehensive Income
    - A Statement of Changes in Equity
    - A Statement of Cash Flows

FASB Project – Financial Statement Presentation

Likely will divide Statement of Earnings and Cash Flows into three sections:

Operating, Financing, Investing

FASB Project – Mergers and Acquisitions of Not-for-Profit Organizations

- Exposure draft 2006
- NFPs were excluded from Statement 141:
  - Extension of business combinations project
- Presumed that FAS141 should apply unless circumstances are different (difference-based approach)
- All acquisitions by NFPs to be accounted for using the Acquisition method (fka Purchase method)

FASB Project – Mergers and Acquisitions of Not-for-Profit Organizations

- Either Goodwill or a Contribution Received are recorded, depending on consideration <> FV of assets aquired
- Goodwill impairment similar to FAS142 for NFPs not supported primarily by contributions/return on investments
- Goodwill impairment for NFPs supported by contributions/return on investments using a "trigger-based approach"

FASB Project – Mergers and Acquisitions of Not-for-Profit Organizations

- FASB re-deliberating certain aspects, including whether pooling may be appropriate for small NFPs that do not have public debt

FASB Project – Revenue Recognition

- Project began in 2002
- Planned PV Document late in 2007
- Purpose of the Project:
  - develop coherent conceptual guidance for revenue recognition
  - develop a comprehensive Statement on revenue recognition that would be based on those concepts

FASB Project – Revenue Recognition

- Current situation –
  - No comprehensive standard
  - Much of current GAAP predates Concepts statements
  - Over 200 sources of revenue recognition guidance in various standards, some inconsistent
  - Little current guidance for service companies

FASB Project – Subsequent Events

- Project objective – to establish standards of accounting for events the occur subsequent to the balance sheet date
- Also, to reconcile differences with International standards (except for short-term obligations expected to be refinanced and cured breaches in loan covenants)
- FASB to begin deliberations later in 2007, Q3 or Q4 Exposure Draft

FASB Project – Liabilities and Equity

- Phase II (Statement 150 was phase I)
- Separately deliberating Single-component financial instruments and Multiple-component instruments
- Issued Milestone draft in Spring 2005
- Expect Preliminary Views document in Q3 2007

FASB Project – Conceptual Framework

- Goal to develop a common conceptual framework that is complete and internally consistent
- Joint project with IASB
- PV Document was issued in July 2006
- Exposure Draft concerning the objective of financial reporting and qualitative characteristics of financial information is expected to be issued late in 2007

FASB Project – Leases

- Board consensus that substantially all leases should be capital leases
- No action until PV document sometime in 2008

FASB Project – Loan Disclosures

- AcSEC draft SOP was not cleared by FASB
- This effort replaces AcSEC's project
- Provide disclosures related to the allowance for credit losses associated with financing receivables
- Projected E.D. late 2007, Final standard early 2008

Other FASB Projects

- Derivative disclosures (Final standard Q3)
- Fair Value Option Phase 2 (non-financial assets and liabilities) – E.D. Q4 2007
- Proposed FSP FIN 46(R)-7 – Application of FIN46(R) to Investment Companies (expected final later in 2007)
- Going Concern and Liquidation Basis of Accounting (late 2007)

OTHER FASB ACTIVITIES

- ***GAAP Codification*** and the ***GAAP Hierarchy***
- ***Revised format for standards (recent ED on Financial Guarantee Risk Insurance is in the new format)***
- ***Plans to do away with FSPs and FINs (just release all new standards as statements)***

OTHER FASB ACTIVITIES

- Larry Smith to replace Ed Trott effective 6/30

OTHER FASB ACTIVITIES

- Private Company Financial Reporting Committee met for the first time in May – Judy O'Dell (former TIC Chair) is PCFRC Chair
- Committee to examine new proposed standards and existing standards for possible/desirable GAAP differences based on:
  - User needs
  - Cost/benefit considerations
- Committee made up of users, preparers, practitioners

EITF Activities

- **EITF 07-1:**
  Accounting for Collaborative Arrangements Related to the Development and Commercialization of Intellectual Property

- **EITF 07-2:**
  Accounting for Convertible Debt Instruments That Require or Permit Partial Cash Settlement upon Conversion

- **EITF 07-3:**
  Accounting for Nonrefundable Advance Payments for Goods or Services to Be Used in Future Research and Development Activities

EITF Activities

- **EITF 06-1:**
  Accounting for Consideration Given by a Service Provider to Manufacturers or Resellers of Equipment Necessary for an End-Customer to Receive Service from the Service Provider

- **EITF 06-2:**
  Accounting for Sabbatical Leave and Other Similar Benefits Pursuant to FASB Statement No. 43

- **EITF 06-3:**
  How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation)

- **EITF 06-4:**
  Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements

- **EITF 06-5:**
  Accounting for Purchases of Life Insurance—Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4

EITF Activities

- **EITF 06-6:**
  Application of Issue No. 05-7

- **EITF 06-7:**
  Issuer's Accounting for a Previously Bifurcated Conversion Option in a Convertible Debt Instrument When the Conversion Option No Longer Meets the Bifurcation Criteria in FASB Statement No. 133

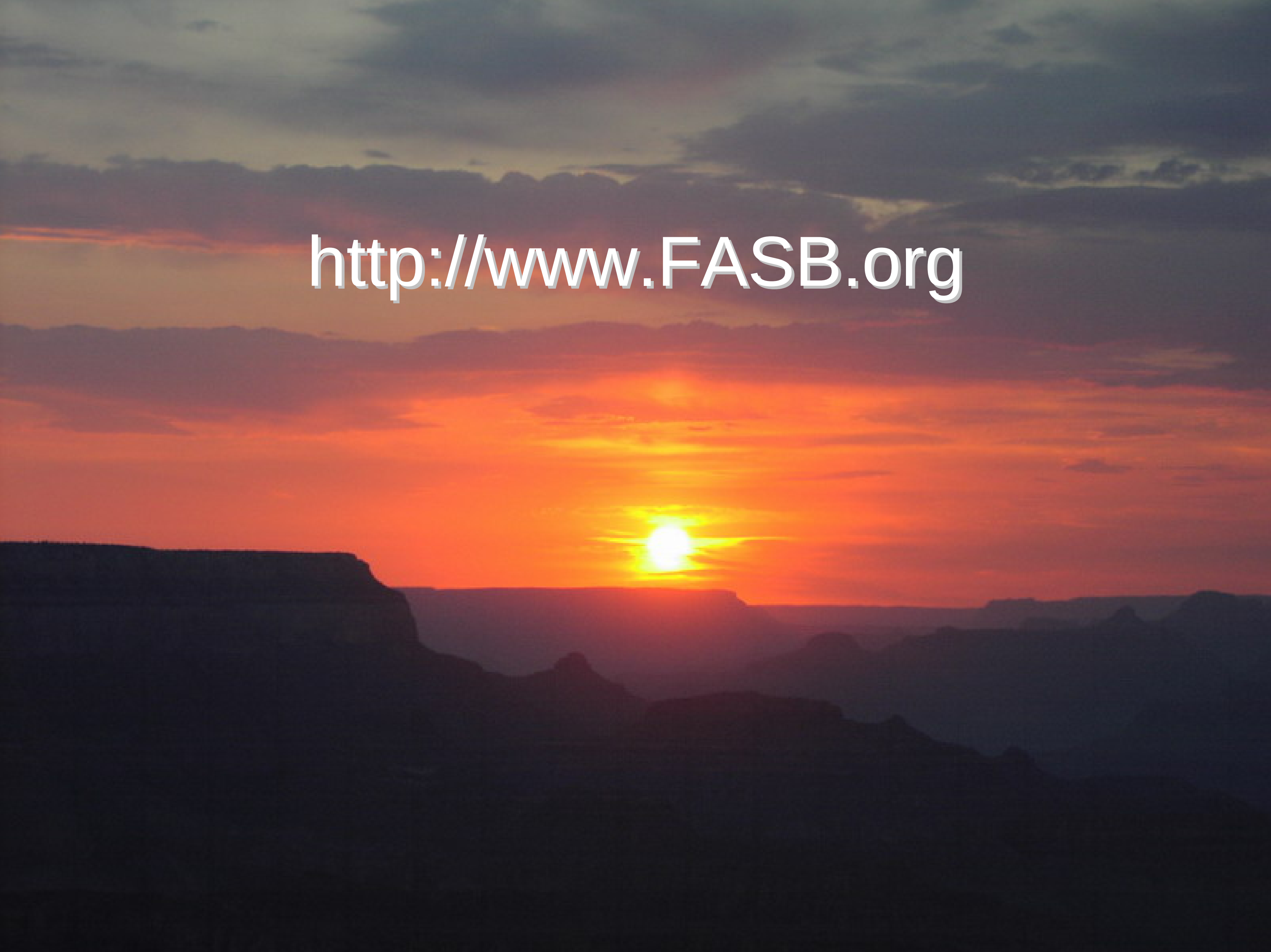
- **EITF 06-8:**
  Applicability of the Assessment of a Buyer's Continuing Investment under FASB Statement No. 66 for Sales of Condominiums

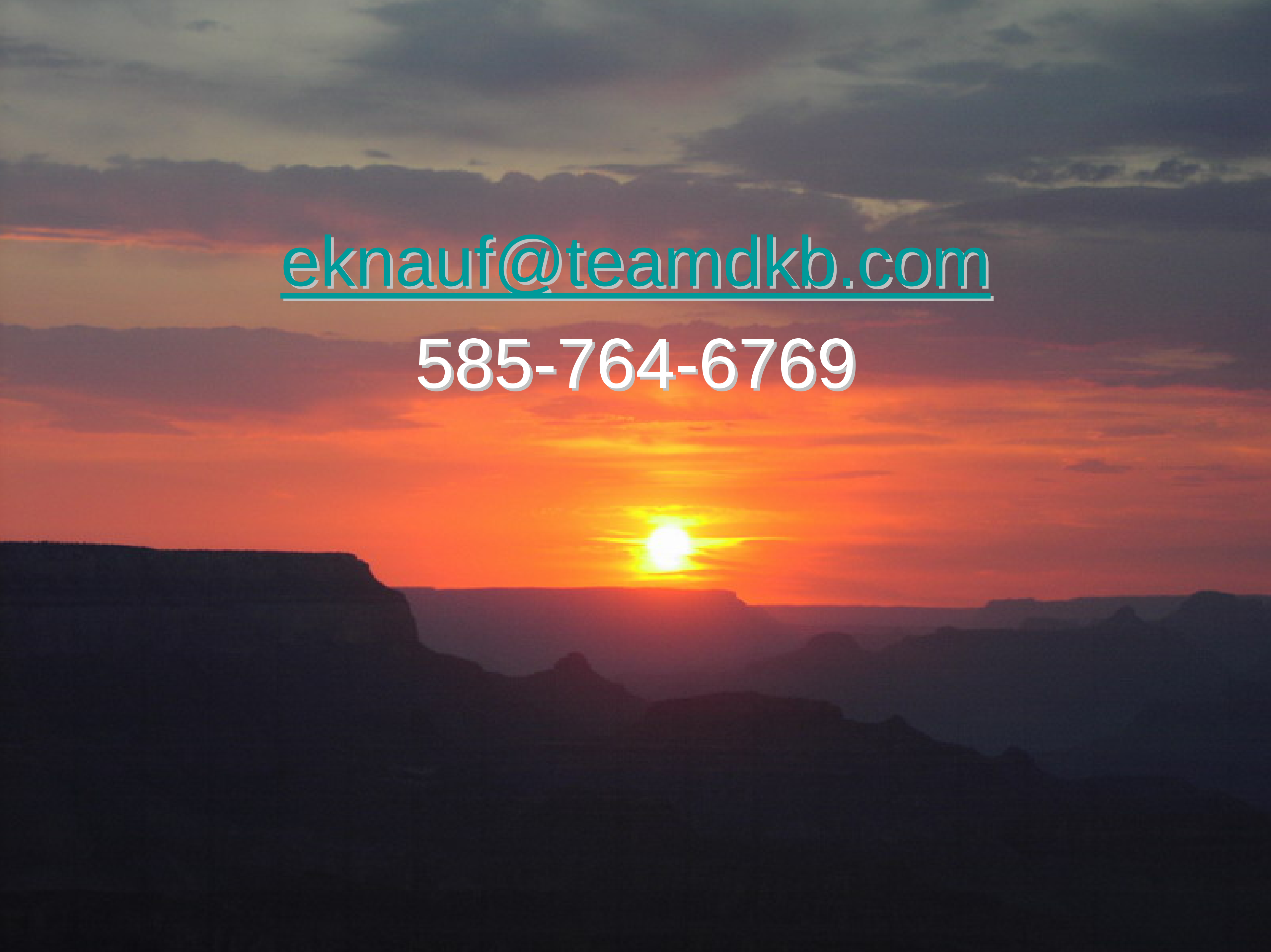
- **EITF 06-9:**
  Reporting a Change in (or the Elimination of) a Previously Existing Difference between the Fiscal Year-End of a Parent Company and That of a Consolidated Entity or between the Reporting Period of an Investor and That of an Equity Method Investee

- **EITF 06-10:**
  Accounting for Deferred Compensation and Postretirement Benefit Aspects of Collateral Assignment Split-Dollar Life Insurance Arrangements

- **EITF 06-11:**
  Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards

- **EITF 06-12:**
  Accounting for Physical Commodity Inventories for Entities within the Scope of the AICPA Audit and Accounting Guide, **Brokers and Dealers in Securities**


http://www.FASB.org


eknauf@teamdkb.com
585-764-6769