Financial Accounting Standards Board Update

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Financial Accounting Standards Board

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The views expressed in this presentation are my own and do not represent positions of the Financial Accounting Standards Board. Positions of the FASB are arrived at only after extensive due process and deliberations.

FASB Update

- Guidance Effective in 2008/2009
- Major New Guidance in the Works
- Private Company Financial Reporting
- Codification and Retrieval Project
- Financial Accounting Foundation Decisions
- International Convergence
- SEC Advisory Committee on Improvements to Financial Reporting

Guidance Effective in 2008/2009

Major Standards

• FAS 157	Fair Value Measurements
• FAS 159	The Fair Value Option for Financial Assets and Financial Liabilities
• FAS 141R	Business Combinations
• FAS 160	Noncontrolling Interests in Consolidated Financial Statements
• FAS 161	Disclosures about Derivative Instruments and Hedging Activities

Guidance Effective in 2008

Major FASB Staff Positions

FAS 142	Determination of the Useful Life of Intangible Assets
FAS 157c	Measurement of Liabilities
FAS 133	Clarification of the Application of the Shortcut Method

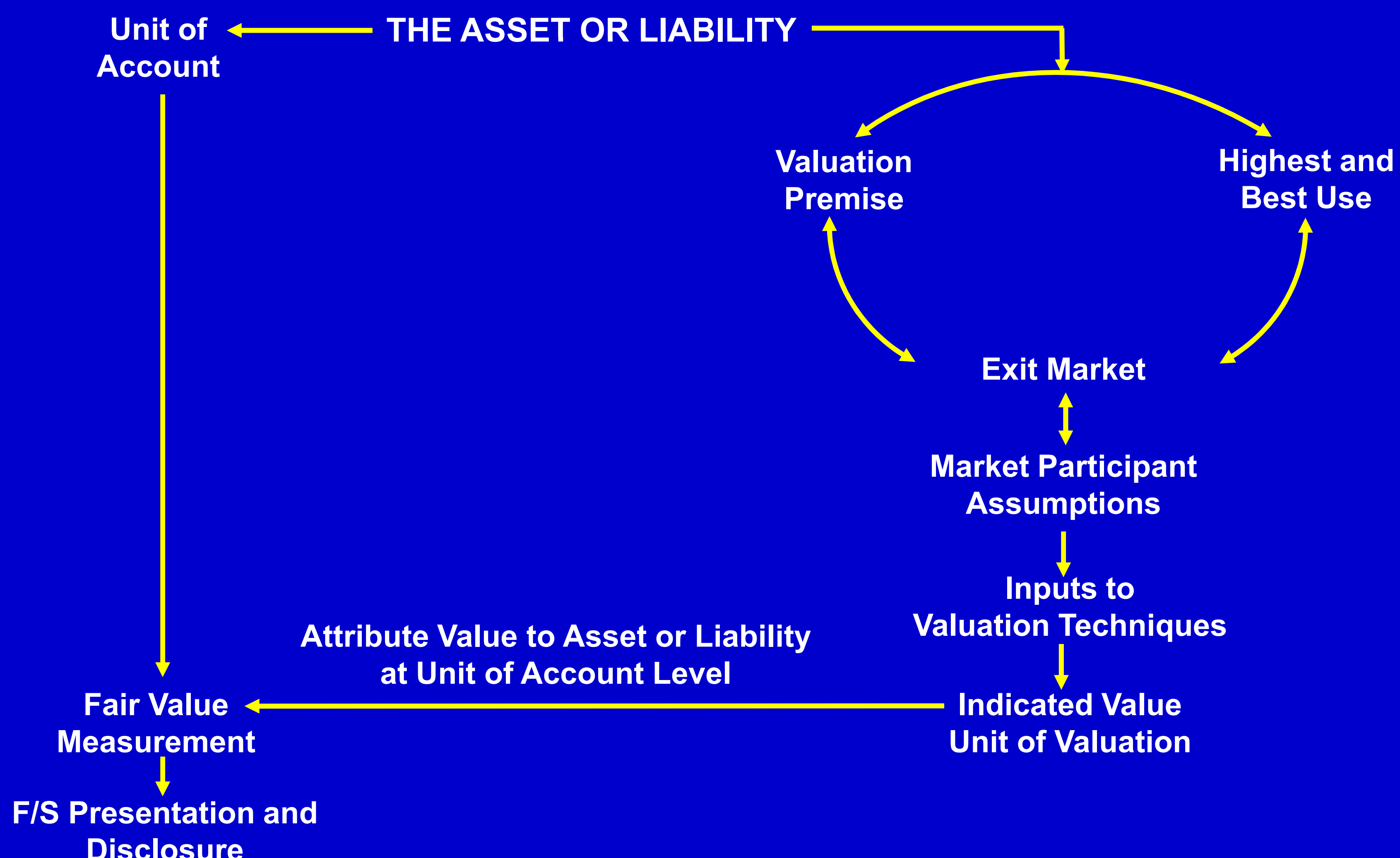
FAS 157—Fair Value Measurements

OBJECTIVE: Improve and Codify Fair Value Measurement Guidance to Improve Consistency and Comparability

MAJOR PROVISIONS:

- Defines fair value
- Establishes approach for measurement
- Enhances disclosures
- Applies when other FASB standards require fair value (no new fair value measurements)
- Effective for fiscal years beginning after November 15, 2007

Fair Value Approach



FAS 159—The Fair Value Option for Financial Assets and Financial Liabilities

OBJECTIVE: Simplify and "Improve" Accounting for Certain Financial Assets and Liabilities by Mitigating Earnings Volatility and Hedge Accounting Complexity. Expand Use of Fair Value Measurements.

MAJOR PROVISIONS:

- Report selected financial assets and liabilities at fair value
- Instrument-by-instrument basis
- Changes in fair value included in earnings
- Separate display and disclosure requirements
- Effective for fiscal years beginning after November 15, 2007, with early adoption permitted

FAS 141R—Business Combinations

OBJECTIVE: Revise and Improve Existing Guidance for Purchase Accounting

MAJOR PROVISIONS:

- An **acquirer** can be identified in every business combination
- A **business combination** is a transaction or other event in which an acquirer obtains control of one or more businesses
- The **acquisition date** is the date on which the acquirer obtains control of the acquiree
- A business combination is accounted for by applying the **acquisition method**
- Acquisition accounting based on three main principles (see next slide)
- Transaction and restructuring costs expensed
- 2009 effective date

Business Combinations: Key Principles

- **Recognition Principle:**
  The acquirer recognizes 100% of the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree

- **Measurement Principle:**
  The acquirer measures the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree at their acquisition-date fair values; subsequent accounting generally should be consistent with other GAAP

- **Disclosure Principle:**
  Users of the acquirer's financial statements should be able to evaluate the nature and financial effect of business combinations recognized by the acquirer

Business Combinations: Exceptions to the Key Principles

- **Recognize or Measure the Following Using Other GAAP:**
  - Assets held for sale – apply Statement 144
  - Employee benefits – apply existing standards (such as APB 12, and Statements 43, 87, 88, 106, 112, and 158)
  - Income taxes – apply Statement 109 and Interpretation 48
  - Operating leases – apply Statement 13 and Interpretation 21
  - Share-based payment awards – apply Statement 123(R)

- **Other Exceptions:**
  - Noncontractual contingencies
  - Indemnification assets
  - Reacquired rights

Major Changes to Current Practice

- Contingencies
- Research and development assets
- Restructuring reserves
- Measuring goodwill
- Transaction costs
- Contingent consideration
- Measurement date for equity securities transferred
- Bargain purchases
- Partial acquisitions
- Step acquisitions
- Noncontrolling interests
- Changes in a parent’s ownership interest in a subsidiary
- Deconsolidation of a subsidiary

FAS 160—Noncontrolling Interests in Consolidated Financial Statements

OBJECTIVE: Improve the Relevance, Comparability, and Transparency of the Financial Information in Consolidated Financial Statements

MAJOR PROVISIONS:

- Noncontrolling interests part of equity
- Amount of consolidated net income attributable to the parent and noncontrolling interests clearly identified and presented
- 2009 effective date

FAS 161- Disclosures about Derivative Instruments and Hedging Activities

OBJECTIVE: Improve Disclosures for Derivatives Accounted for under FAS 133

MAJOR PROVISIONS:

- Disclosures will address
  - How and why an entity uses derivatives
  - How derivatives are accounted for
  - How derivatives affect balance sheet, P/L and cash flows
- Disclosures provide
  - Tabular information on amounts and location in financial statements of derivatives and hedging activities
  - Aggregate fair value of assets needed to settle derivative instruments with credit-risk contingent features
- Effective date: fiscal periods beginning after November 15, 2008

Major New Guidance in the Works

- Conceptual Framework
- Liabilities and Equity
- Financial Statement Presentation
- Accounting for Leases
- Revenue Recognition
- Accounting for Hedging Activities

Conceptual Framework

OBJECTIVE: Develop a Converged, Improved, and Complete Framework for Standard Setting focusing on private sector

MAJOR DECISIONS TO DATE:

- Objective focuses on general purpose financial reporting to present/potential equity investors, lenders and other creditors in making decisions in their capacity as capital providers, including stewardship and investment decisions
- New set of qualitative characteristics
- New definitions for assets and liabilities
- Inventory of measurement bases (as prelude to developing framework for selecting measurement bases)
- Definition of reporting entity
- Expected to be exposed in discussion papers or EDs this year

Conceptual Framework Qualitative Characteristics

Materiality Constraint

Comparability
- Consistency

Verifiability
- Direct
- Indirect

Relevance
- Predictive value
- Confirmatory value

Faithful Representation
- Completeness
- Accuracy (may change)
- Neutrality

Timeliness

Understandability

Cost Constraint

Liabilities and Equity

OBJECTIVE: To Develop a Comprehensive Standard of Accounting for Financial Instruments with Characteristics of Equity, Liabilities, or Both, and Assets

Three approaches included in a 4Q 2007 Preliminary Views, comments due by May 30, 2008.

- Basic Ownership (focus on nature of the claim)—preferred approach
  - Equity is the most residual instrument issued by an entity even if it is redeemable for fair value or an approximation
    - Entitles holder to a share of entity’s net assets after all higher priority claims are settled
- Ownership Settlement (focus on nature of claim and consideration used to settle)
- Reassessed expected outcome (reflects probability-based outcomes)

Financial Statement Presentation

OBJECTIVE: To Improve Presentation of Information in Financial Statements to Help Investors Assess Future Cash Flows

MAJOR DECISIONS TO DATE: Financial statements should

- Portray a cohesive financial picture
- Separate financing activities from business activities
- Disaggregate line items if enhances usefulness
- Help users understand:
  - Measurement bases
  - Uncertainty in measurement of assets and liabilities
  - Causes of changes in recognized assets and liabilities
  - Difference between cash-based and accrual accounting
- Target is mid-2008 discussion paper

Proposed Financial Statement Format

Statement of Financial Position	Statement of Comprehensive Income	Statement of Cash Flows
Business •Operating assets and liabilities •Investing assets and liabilities	**Business** •Operating income •Investing income	**Business** •Operating cash flows •Investing cash flows
Discontinued operations	**Discontinued operations**	**Discontinued operations**
Financing •Financing assets •Financing liabilities	**Financing** •Financing income •Financing expenses	**Financing** •Financing asset cash flows •Financing liability cash flows
Equity		**Equity**
Income taxes	**Income taxes**	**Income taxes**
	Statement of Changes in Equity	

Proposed Reconciliation Schedule

Statement of Cash Flows	Several Reconciling Columns*			Statement of Comp. Income
Business •Operating cash flows •Investing cash flows				**Business** •Operating income •Investing income
Discontinued operations				Discontinued operations
Financing •Financing asset cash flows •Financing liability cash flows				**Financing** •Financing income •Financing expenses
				Translation adjustments
Income taxes				Income taxes

* Cash affecting income, cash not affecting current income, accrual/deferrals, fair value changes

Accounting for Leases

OBJECTIVE: To Comprehensively Reconsider Lease Accounting to Insure that Financial Statement Users are Provided Useful and Complete Information

MAJOR DECISIONS TO DATE:

- Scope is both lessee and lessor accounting within the scope of existing lease accounting literature
- Joint international working group established
- Concentrating so far on developing right to use accounting model for lessee
  - Many scope, measurement, recognition/derecognition issues to be addressed
- Lessor accounting model to follow
- Target is 2008 discussion paper

Revenue Recognition

OBJECTIVES: Converge, Eliminate Inconsistencies in Conceptual Guidance and Standards, and Establish a Single Comprehensive Standard on Revenue Recognition

PREMISE: Rights and performance obligations in a revenue arrangement give rise to assets and liabilities for the seller

- Identify all rights and performance obligations
- Determine when performance obligations are satisfied
- Decide if pre-arrangement activities produce revenue
- Determine measurement basis for rights and obligations

Two models under development that differ in terms of last two items only

Revenue Recognition

Customer Consideration Approach

- No pre-arrangement revenue
- Performance obligations measured by transaction price
  - Allocation over estimated sales price of individual items sold
- No remeasurement

Measurement Approach

- Performance obligations measured by lay-off/exit price of individual items sold
- Pre-arrangement revenue
- Remeasurement at every reporting date

Accounting for 133 Hedging Activities

OBJECTIVES: Resolve Practice Issues, Simplify Accounting, Make Accounting and Disclosures Easier to Understand

MAJOR DECISIONS TO DATE:

- Fair value approach for both fair value and cash flow hedges
  - Generally eliminates bifurcation-by-risk, shortcut method, critical terms match, and most quantitative effectiveness testing
  - For fair value hedges, measure 100% of hedging instrument and hedged item at fair value and reporting changes in fair value in income; late hedging permitted; de-designation not permitted
  - For cash flow hedging, report effective (ineffective) portion of changes in derivative fair value in OCI (income); effectiveness based on hypothetical derivative; recycle from OCI as before
- One exception: By-risk model for hedging the benchmark interest rate in own debt still permitted
- ED in 2Q 2008

Private Company Financial Reporting

- AICPA Task Force Report in 2006 recommends separate GAAP for private companies
- Joint FASB and AICPA recommendations to improve private company's reporting received overwhelming support
  - Differences approach vs. separate GAAP
  - Criteria = different user needs and/or cost benefit considerations based on private company attributes e.g., user access to information
  - Increased staffing and process changes at FASB
- Formed Private Company Financial Reporting Committee in 2007 to make recommendations relating to proposed and existing GAAP

Codification and Retrieval Project

OBJECTIVES:

- Develop a single, authoritative, timely, comprehensive, integrated codification of all relevant U.S. accounting and financial reporting literature
- Develop a single, fully functional, online, real-time database with easy retrievability

PROGRESS TO DATE:

- Software developed and master index of topics complete
- Mapping of existing literature/authoring completed
- Released in January 2008 for verification for one year
- Over 13,000 registered users
- Operational in 2009

Codification and Retrieval Project

Topic Structure

340 Inventory
.10 Overall

340.10.00	Status (References to standards affecting the subtopic)
340.10.05	Overview and Background
340.10.10	Objectives
340.10.15	Scope and Scope Exceptions
340.10.20	Topical Definitions/Glossary
340.10.25	XRBL Definitions
340.10.30	Recognition
340.10.35	Initial Measurement
340.10.40	Subsequent Measurement
340.10.45	De-recognition
340.10.50	Other presentation matters (B/S classification, cash flow, EPS, taxes, etc.)
340.10.55	Disclosure
340.10.60	Implementation guidance and illustrations
340.10.65	Relationships
340.10.70	Transition and Open Effective Date Information
340.10.75	Links to Granfathered Material

340 Inventory
.20 LIFO

340.20.ZZ Same section structure as shown above

340 Inventory
.30 Agriculture

340.30.ZZ Same section structure as shown above

Financial Accounting Foundation Decisions

Voted on February 26, 2008 to

- Reduce size of FASB Board to five members, retain simple majority voting requirement, and eliminate proposed requirements for composition of Board
  - Board in its totality needs to have knowledge of and experience in investing, accounting, business, finance, accounting education and research
- Increase role of Board chairman in agenda setting
- Change way Trustees are selected, size and terms of Trustee Board
- Enhance oversight of Board processes by Trustees
  - Including agenda setting and post-implementation reviews
- Changes effective July 1, 2008

International Convergence Major Initiatives

- **SEC Roadmap for eliminating reconciliation**
  - Consistent application of IFRS
  - Sufficient user understanding
  - Continued progress on IASB/FASB convergence project
- **2006 IASB/FASB “MOU”/Convergence project**
  - Short term: remove major differences in focused areas
  - Medium term: develop new joint standards where significant improvement required
  - Limited progress to date
- **Recent SEC Actions**
  - The 20-F reconciliation eliminated for 2007 reporting
  - August Concepts Release: Should it permit voluntary adoption of IFRS by U.S. registrants?

International Convergence FASB Proposed Path Forward

- Convergence of accounting standards—move to IFRS on improve and adopt program with target completion dates
- Single global accounting standard setter and interpretive body—IASB needs improved governance, stable funding, and more staffing
- Removal of international review and endorsement processes for accounting standards
- Cooperative international regulatory, enforcement and corporate governance regimes focused on investors
- High-quality auditing standards and auditor independence requirements
- Systems for training and educating all capital market participants
- Due consideration to effects on private and not-for-profit entities
- Need for blueprint specifying timing, milestones and changes in U.S. financial reporting infrastructure needed to effectuate adoption

SEC Advisory Committee on Improvements to Financial Reporting

- **Background**
  - Some parts of financial reporting system not fully aligned with changes in the economy, business operations, technology, and investor needs
  - Conflicting perspectives of companies, investors, standard setters, auditors, and attorneys
- **Goal**
  - Improve the financial reporting system by reducing complexity and making information more useful and understandable to investors
- **Structure and Timing**
  - 17 Member committee with one-year charter

SEC Advisory Committee on Improvements to Financial Reporting

- **What Creates Complexity in Accounting Standards?**
  – Volume of GAAP and multiple standard setters
  – Length and readability of standards
  – Complex transactions and business arrangements
  – Scope (including exceptions)
  – Different measurement attributes
  – Optionality
  – Rules and “bright lines” vs. principles
  – Disclosure vs. recognition

SEC Advisory Committee on Improvements to Financial Reporting

- **Why Is Complexity Created?**
  - Desire to reduce earnings volatility
  - Desire for certainty in application
  - Structuring of transactions for favorable accounting treatment
  - Fear of second-guessing by auditors/regulators
  - Demand for industry-specific guidance
  - Conflicting perspectives from constituents including regulators and other standard setters
  - Certain resistance to change
  - Legal environment

SEC Advisory Committee on Improvements to Financial Reporting

Preliminary Recommendations:

- Importance of user focus
- FASB as single U.S. standard setter
- Continued convergence
- Avoid options in accounting
- Activity based standards, not industry based
- Support for concepts in financial statement presentation project
- Support for more principles-based standards
- Reduce size and better manage FASB agenda
- Enhancements to cost/benefit procedures
- Post-implementation review of major new standards
- "Professional judgement framework" idea
- Revise materiality guidance
- Implementation of XBRL

Questions

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