



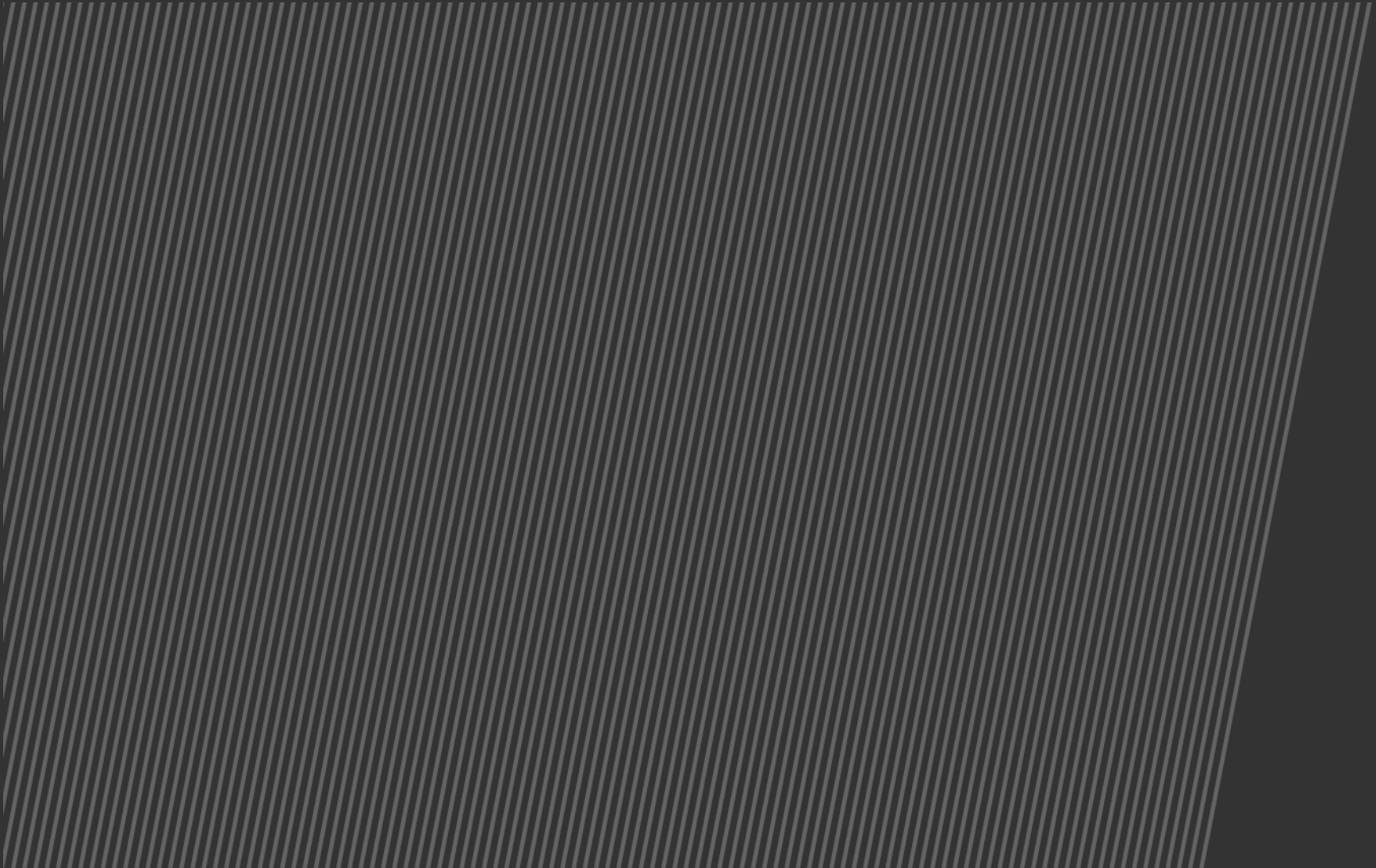
2011 Year-end Corporate Reporting update

Accounting update
Colorado Bioscience Association

October 2011

 **ERNST & YOUNG**
Quality In Everything We Do

Introduction



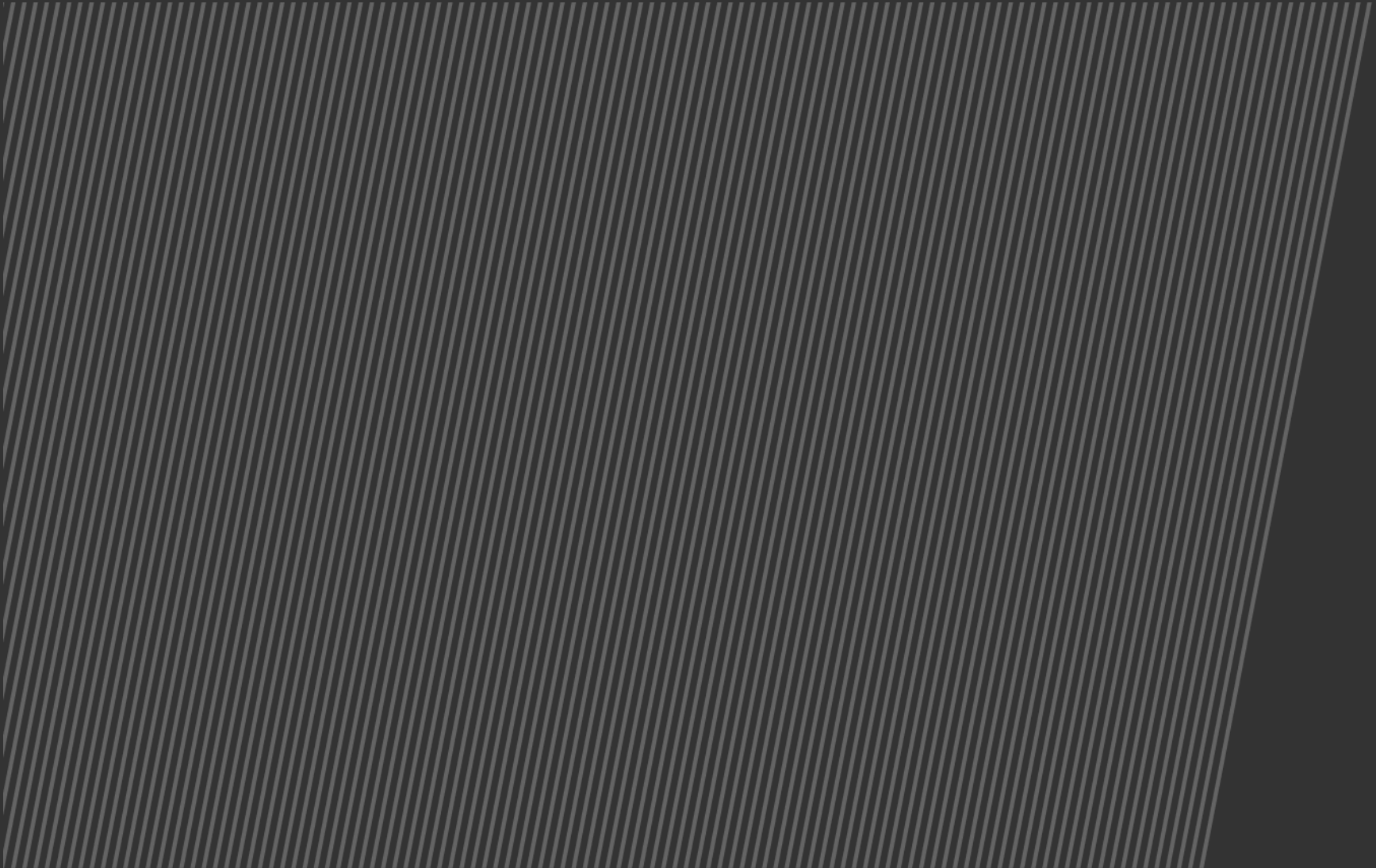
Learning objectives

- ▶ Identify decisions of the FASB and IASB on joint projects and other FASB final or proposed guidance that may call for action on your part, such as providing feedback to standard setters, planning contract revisions or making systems changes

Agenda

- ▶ FASB final guidance
- ▶ Joint projects update
- ▶ Other proposals and projects

FASB final guidance



Final guidance

- ▶ Final guidance was issued on several projects:
 - ▶ Fees paid to federal government by pharma
 - ▶ Goodwill impairment assessments
 - ▶ Troubled debt restructuring
 - ▶ Fair value amendments
 - ▶ Other comprehensive income
 - ▶ EITF issues

ASU 2010-27, *Other Expenses (Topic 720), Fees Paid to the Federal Government by Pharmaceutical Manufacturers*

- ▶ The annual fee, payable beginning in 2011 was mandated by health care reform legislation
- ▶ Fee is calculated based on the entities relative market share
 - ▶ Initial fee calculated based on 2010 sales
- ▶ Record in the period fee is obligated (first commercial sale in 2011). Fee is recorded in 2011, deferred and recognized over the period.
- ▶ IRS regulations: Fee for 2011 calculated based on 2009 sales with a true up in 2012 based on 2010 actual sales data
- ▶ Companies should estimate and accrue the fee for 2011 based on best information available (including 2010 data) and not wait for the IRS true up in 2012

Goodwill impairment assessments (ASU 2011-08)

- ▶ Provides an option to perform a qualitative assessment that may allow companies to skip the two-step impairment test and reduce costs
- ▶ Qualitative screen requires significant judgment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount
- ▶ Changes the economic, industry and company-specific factors used to evaluate whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount
- ▶ Effective date: fiscal years beginning after 15 December 2011
 - ▶ Early adoption is permitted

Troubled debt restructuring

Troubled debt restructuring (ASU 2011-02)

- ▶ Clarifies existing guidance on when creditors should classify loan modifications as troubled debt restructurings
- ▶ Effective dates
 - ▶ Public companies – interim and annual periods beginning on or after 15 June 2011
 - ▶ Nonpublic companies – annual periods ending on or after 15 December 2012, including interim periods within those annual periods

Fair value (ASU 2011-04) (joint project)

- ▶ Primary focus of the ASU is to converge fair value measurement guidance between US GAAP and IFRS
 - ▶ ASU 2011-04 amends ASC 820, *Fair Value Measurement*
 - ▶ IFRS 13, *Fair Value Measurement*, provides a uniform fair value framework under IFRS
- ▶ Guidance is generally converged, although certain differences still exist
- ▶ Many changes to ASC 820 relate to wording and style
- ▶ Other clarifications and changes could have significant effects
- ▶ New disclosures are required
- ▶ Effective dates
 - ▶ Public companies – interim and annual periods beginning after 15 December 2011
 - ▶ Nonpublic companies – annual periods beginning after 15 December 2011

Fair value (ASU 2011-04) (joint project)

New disclosures

- ▶ Primary effect for many companies will be the new disclosures
 - ▶ Quantitative information about the significant unobservable inputs used for Level 3 measurements
 - ▶ Description of the valuation processes surrounding Level 3 measurements
 - ▶ Narrative description of the sensitivity of recurring Level 3 measurements to unobservable inputs, including interrelationships (only public companies)
 - ▶ Hierarchy classification for items whose fair value is only disclosed in the footnotes (only public companies)
 - ▶ Information about when the current use of a nonfinancial asset measured at fair value differs from its highest and best use
 - ▶ Any (not just significant) transfers between Levels 1 and 2 of fair value hierarchy (only public companies)

Presentation of other comprehensive income (ASU 2011-05) (joint project)

- ▶ Increases the prominence of items reported in other comprehensive income
 - ▶ One continuous statement or two separate but consecutive statements
 - ▶ No longer allowed to present changes solely in the statement of stockholders' equity
- ▶ Interim reporting required
- ▶ Full retrospective application
- ▶ Effective dates
 - ▶ Public companies – fiscal years and interim periods within those years beginning after 15 December 2011
 - ▶ Nonpublic companies – fiscal years ending after 15 December 2012 and interim and annual periods thereafter
- ▶ FASB plans to propose deferral of the requirement to present reclassification adjustments directly on the face of the financial statements

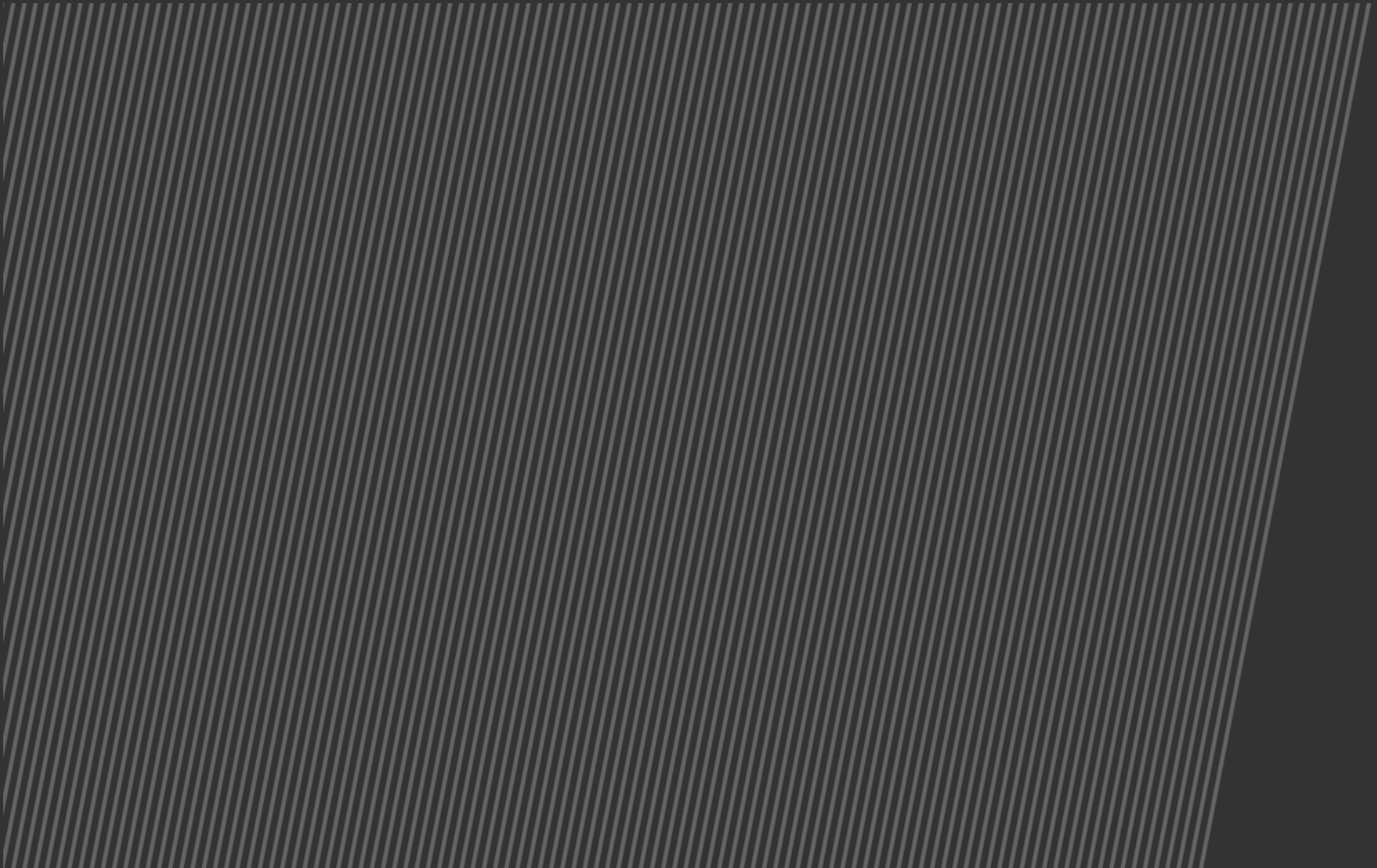
Other ASUs effective in 2011 and 2012

- ▶ Credit quality disclosures
 - ▶ ASU 2010-20, *Receivables (Topic 310), Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*
- ▶ Business combination and supplementary pro forma information
 - ▶ ASU 2010-29, *Business Combinations (Topic 805), Disclosure of Supplementary Pro Forma Information for Business Combinations*
- ▶ Goodwill step 2
 - ▶ ASU 2010-28, *Intangibles — Goodwill and Other (Topic 350), When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts*

Other ASUs effective in 2011 and 2012

- ▶ Health care entities
 - ▶ ASU 2010-24, *Health Care Entities (Topic 954), Presentation of Insurance Claims and Related Insurance Recoveries*
 - ▶ ASU 2010-23, *Health Care Entities (Topic 954), Measuring Charity Care for Disclosure*
 - ▶ ASU 2011-07, *Health Care Entities (Topic 954), Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities*
- ▶ Disclosures about an employer's participation in a multiemployer plan (ASU 2011-09)

Joint projects update



Joint projects overview

- ▶ FASB and IASB goal – improved, high-quality, converged accounting standards
- ▶ Boards revised their work plans to focus on financial instruments, revenue recognition, leases and insurance contracts
 - ▶ Timelines were extended on several projects
 - ▶ Decisions to re-expose revenue and leases proposals will cause additional delays
 - ▶ Certain lower-priority projects have been further delayed
- ▶ Boards are redeliberating many projects, making tentative decisions
 - ▶ These decisions are subject to change
- ▶ Boards have not finalized effective dates and transition methods related to several joint projects

Joint projects timeline

		2010	Q1/Q2 2011	Q3 2011	Q4 2011	2012
Statement of Comprehensive Income	Joint	ED	Final			
Fair Value Measurement	Joint	ED ¹	Final ²			
Financial Instruments						
Classification and measurement	FASB	ED ³	RT			ED ⁴
	IASB	Final ⁵		ED ⁵		
Impairment	FASB	ED ³	RT	SD		ED ⁴
	IASB		SD		ED ⁶	
Hedging	FASB	ED ³	RT	DP		
	IASB	ED			Staff draft	Final ⁷
Balance Sheet – Offsetting	FASB		ED	RT	Final	
	IASB		ED	RT	Final	
Revenue Recognition	FASB	ED	RT		ED	⁸
	IASB	ED	RT		ED	Final
Leases	FASB	ED	RT			ED ⁸
	IASB	ED	RT			ED Final

ED – Exposure Draft RT – Roundtable SD – Supplementary Document DP – Discussion Paper RV – Request for views

- ¹ The FASB's ED includes various amendments and implementation guidance to achieve convergence. The IASB re-exposed one new disclosure requirement.
- ² The disclosures related to measurement uncertainty are being separately analyzed.
- ³ The FASB issued a single comprehensive proposal on all three phases of this project.
- ⁴ The FASB will at a minimum expose the proposed amendments to the Codification, and may decide to fully re-expose the model, most likely in the first half of 2012.
- ⁵ IASB's final IFRS on classification and measurement for liabilities. In Q3 2011, the IASB issued an ED to defer the mandatory effective date of IFRS 9.
- ⁶ The IASB will issue an ED or review draft.
- ⁷ The IASB expects to issue a separate ED on macro hedge accounting in Q4 2011 or 2012.
- ⁸ Our expectation is that the FASB will follow timing that is similar to the IASB on finalizing the Revenue and Leases projects.

Note: FASB timing for some projects has been based on discussions with staff and/or Board members and may differ from the FASB site technical plan.

Joint projects timeline (continued)

		2010	Q1/Q2 2011	Q3 2011	Q4 2011	2012
Insurance Contracts	FASB	DP	RT			ED
	IASB	ED	RT			ED ⁶
Consolidation	Joint ⁹			ED ⁹		
	FASB	RT			ED ¹⁰	
	IASB	Staff draft	Final			
Financial Statement Presentation	Joint	Staff draft				
Reporting Discontinued Operations	FASB					
	IASB					
Financial Instruments with Characteristics of Equity	Joint					
Emissions Trading Schemes	Joint					
Effective Dates and Transition	Joint	DP/RV ¹¹				

ED – Exposure Draft RT – Roundtable SD – Supplementary Document DP – Discussion Paper RV – Request for views

⁶ The IASB will issue an ED or review draft.

⁹ IASB and FASB project related only to consolidation by investment companies. The IASB issued its ED in Q3. The FASB issued its ED in Q4.

¹⁰ FASB amendments to principal-agent guidance in ASC 810.

¹¹ FASB DP and IASB request for views.

Joint project update – financial instruments

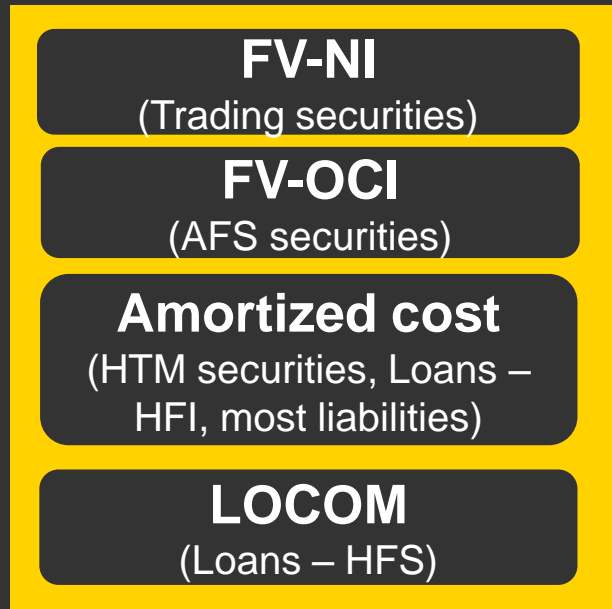
Overview

- ▶ FASB issued financial instruments ED in May 2010
 - ▶ Covers classification and measurement, impairment and hedging
- ▶ IASB issued IFRS 9 on classification and measurement of financial assets and financial liabilities and separate EDs on impairment and hedging
- ▶ Redeliberations
 - ▶ Classification and measurement – FASB has made significant progress in its redeliberations and made changes to the model proposed in the ED
 - ▶ Impairment – Boards are jointly developing a new approach
 - ▶ Hedging – IASB has finished redeliberations; FASB issued Discussion Paper requesting input on IASB’s proposals but has not yet begun to redeliberate

Joint project update – financial instruments

Classification and measurement

Current model



Proposed model



- ▶ Classification based on characteristics of the instrument and the business strategy
- ▶ No reclassifications and no tainting

Joint project update – financial instruments

Classification and measurement (continued)

- ▶ Classification and measurement of equity securities
 - ▶ Investments in equity securities would be classified at FV-NI
 - ▶ Nonpublic entities – exception for nonmarketable equity securities
- ▶ Classification and measurement of equity method investments
 - ▶ US GAAP guidance for the equity method unchanged
 - ▶ Fair value option not permitted
 - ▶ FV-NI if held for sale at initial qualification for equity method
- ▶ Current requirements to bifurcate embedded derivatives would be retained
- ▶ Conditional fair value option only for certain instruments at initial recognition
 - ▶ Hybrid financial assets and liabilities to avoid bifurcation
 - ▶ Groups of financial assets and financial liabilities managed on the basis of net exposure and information provided to management on that basis
- ▶ More comprehensive risk-based disclosures required

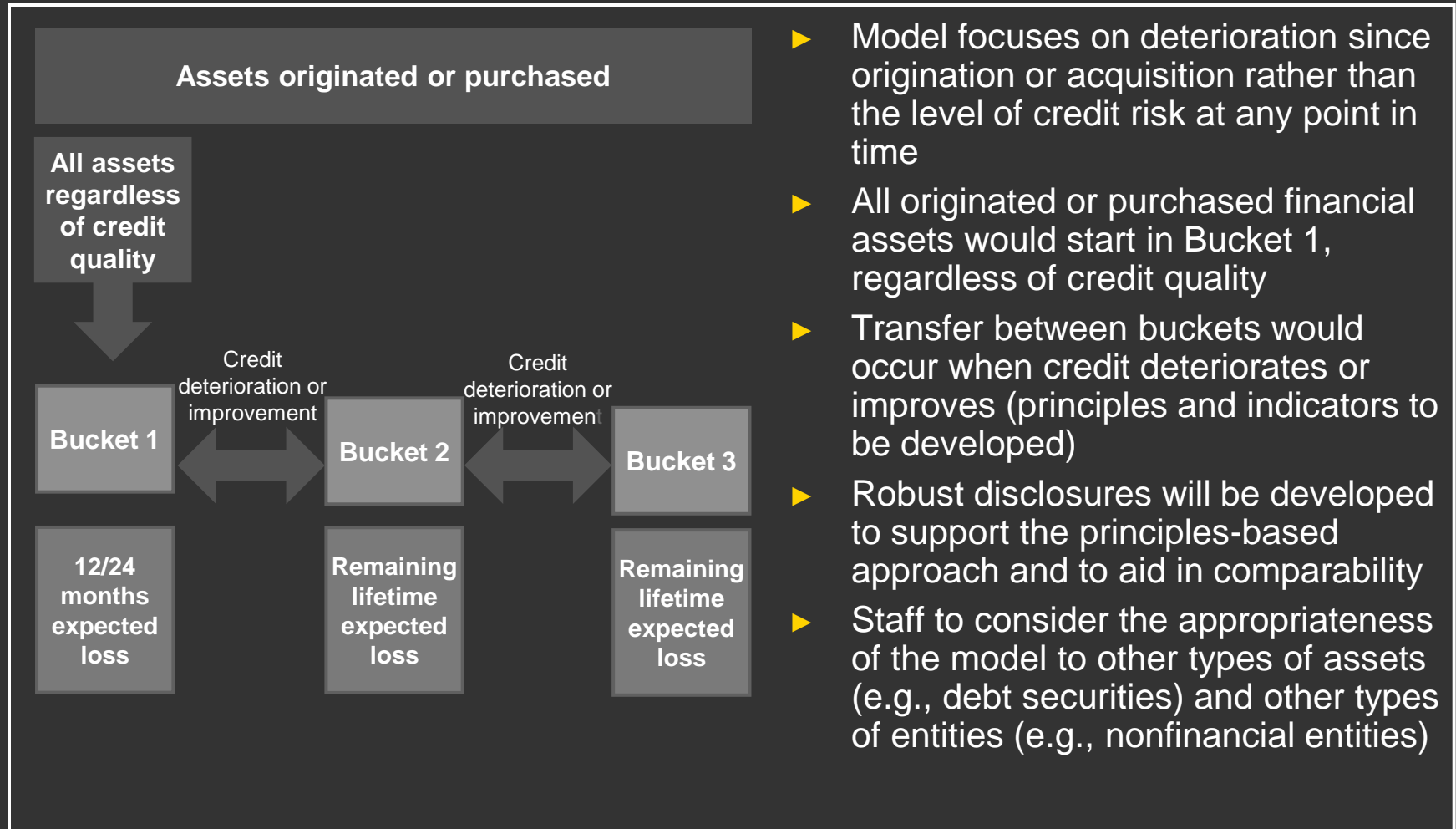
Joint project update – financial instruments

Impairment model

- ▶ Boards initially proposed different approaches to impairment
 - ▶ Feedback strongly supported a converged solution
- ▶ After joint discussions, the IASB and the FASB proposed a joint approach in a Supplementary Document (SD)
 - ▶ Feedback was mixed with no clear consensus on a way forward
- ▶ The IASB and the FASB decided not to move forward with the SD approach and decided to pursue a new “three-bucket approach”

Joint project update – financial instruments

Impairment model – the three-bucket approach



Joint project update – financial instruments

Hedging

- ▶ FASB proposed several changes to hedge accounting in its May 2010 ED
- ▶ IASB also issued an ED in December 2010 proposing major changes to its existing guidance
- ▶ IASB's proposed hedging model differs significantly from the FASB's current and proposed hedging models
- ▶ FASB exposed the IASB proposals to its constituents in February 2011
- ▶ IASB has completed redeliberations, will post a staff draft on its website for 90 days and expects to issue final guidance in 2012 (except for macro hedging)
- ▶ FASB has not yet begun its redeliberations and will consider whether and how to incorporate some of the IASB's concepts into its hedging model

Joint project update – financial instruments

Next steps

- ▶ IASB will expose FASB's final decisions on classification and measurement to its constituents
- ▶ FASB and IASB plan to expose a new joint credit impairment approach in early 2012
- ▶ FASB does not expect to begin redeliberating its hedging proposals until classification and measurement and impairment guidance is final
 - ▶ IASB finished redeliberating its hedging proposals and plans to finalize guidance in 2012
- ▶ FASB will re-expose any changes to Codification before issuing final guidance and may fully re-expose classification and measurement and impairment
- ▶ No decisions yet on effective date and transition requirements from FASB

Joint project update – balance sheet offsetting

- ▶ Boards issued joint exposure draft in January 2011, but subsequently decided to retain their current approaches
- ▶ The following common disclosures were agreed to:
 - ▶ Gross amounts of financial assets and financial liabilities
 - ▶ Amounts presented in the balance sheet
 - ▶ Any other amounts that can be offset in the event of bankruptcy, insolvency or default of either party (including collateral) not taken into account in arriving at the amounts presented in the balance sheet
 - ▶ The entity's net exposure
- ▶ Final guidance to be issued this year, effective for annual and interim periods beginning on or after 1 January 2013, with retrospective application

Joint project update – revenue recognition

Status

- ▶ The Boards completed redeliberations and elected to re-expose the proposal
- ▶ Revised ED expected in Q4 2011
- ▶ Final standard no sooner than Q3 2012
- ▶ Will require retrospective application, with some relief provided
 - ▶ Additional disclosures required if relief is applied
- ▶ Effective date has not been decided, but will not be before fiscal years beginning 1 January 2015

Joint project update – revenue recognition

Summary of model

- ▶ Identify the contract(s) with the customer
 - ▶ Agreement between two or more parties
 - ▶ May be written, oral or implied
 - ▶ Does not include wholly cancelable arrangements
- ▶ Identify the separate performance obligations in the contract
 - ▶ Promise (explicit or implicit) to provide goods or services to a customer
 - ▶ Are promised goods and services “separate performance obligations”?
 - ▶ Is there a promise to provide a bundle of integrated goods and services?
 - ▶ Do goods and services have a distinct function?

Joint project update – revenue recognition

Summary of model (continued)

- ▶ Determine the transaction price
 - ▶ Variable consideration
 - ▶ Include variable consideration in estimated transaction price
 - ▶ Recognize revenue when “reasonably assured”
 - ▶ Time value of money
 - ▶ Must be considered if arrangement has a significant financing component
 - ▶ No requirement to consider if timing of payment and delivery of services are within 12 months of one another
 - ▶ Nonmonetary transactions – similar to current practice

Joint project update – revenue recognition

Summary of model (continued)

- ▶ Allocate the transaction price to the separate performance obligations
 - ▶ Allocation based on a relative selling price approach
 - ▶ Selling price is the price at which the entity would sell the good or service separately
 - ▶ Maximize use of observable inputs
 - ▶ Apply estimation methods consistently for similar goods and services
- ▶ Recognize revenue as each performance obligation is satisfied
 - ▶ Determine the pattern of transfer of each performance obligation, may be transferred over time
 - ▶ Revenue allocated to licenses and rights to use recognized when customer obtains benefit

Joint project update – revenue recognition

Other aspects of the model

- ▶ Onerous performance obligations
- ▶ Collectibility
- ▶ Warranty
- ▶ Contract costs (fulfillment and obtaining contract)
- ▶ Rights of return
- ▶ Principal versus agent

Joint project update – consolidation

- ▶ Variable interest model
 - ▶ Remove deferral for investment funds
 - ▶ Add agent/principal guidance to evaluate the capacity in which a decision maker is using its power
 - ▶ Four criteria to make evaluation (scope of decision making, remuneration, other interests held by decision maker, rights held by other interest holders)
 - ▶ Agents generally would not consolidate VIE
 - ▶ Principals would consolidate VIE
- ▶ Voting interest model – limited partnerships and similar entities
 - ▶ Currently, a general partner is presumed to have power
 - ▶ Proposed model would align with the VIE model by using the same “capacity” evaluation

Joint project update – leases

Overview

- ▶ Addressed from the perspective of lessees and lessors
- ▶ Objective is to record lease contracts on balance sheet
 - ▶ Project responds to criticisms of current model
- ▶ “Right-of-use” model applicable:
 - ▶ For lessees – all leases
 - ▶ For lessors – all leases other than leases of real estate investment property
- ▶ Boards are redeliberating and decided to re-expose due to significant changes from the 2010 exposure draft
- ▶ Effective date not determined
- ▶ Differences between US GAAP and IFRS for other standards could cause differences in accounting treatment for leases

Joint project update – leases

Scope

- ▶ A lease is a contract in which the right to use an asset is conveyed, for a period of time, in exchange for consideration
- ▶ Contracts that contain lease components and non-lease components (including services and executory costs)
 - ▶ Both lessors and lessees would be required to separately account for lease and non-lease components
 - ▶ Lessors would allocate payments in accordance with revenue recognition standard
 - ▶ Lessees would generally use observable prices to allocate payments on a relative purchase price basis

Joint project update – leases

Lessee and lessor right-of-use model

- ▶ Lessee would initially recognize
 - ▶ A liability to make lease payments
 - ▶ A right-of-use asset for the right to use the leased asset
- ▶ Lessor would initially
 - ▶ Recognize a receivable
 - ▶ Allocate leased asset carrying amount between amount to derecognize and residual asset
 - ▶ Recognize profit related to the right of use granted to the lessee
- ▶ Subsequently
 - ▶ Use the interest method on the receivable and liability
 - ▶ Amortize the right-of-use asset, accrete the residual asset
 - ▶ Assess for impairment and reassess key considerations

Joint project update – leases

Lessee example

A company enters into a 3-year lease for office space and agrees to pay the following: \$10,000 in year 1, \$12,000 in year 2 and \$14,000 in year 3. The present value of lease payments is \$32,500 (using a discount rate of 5%).

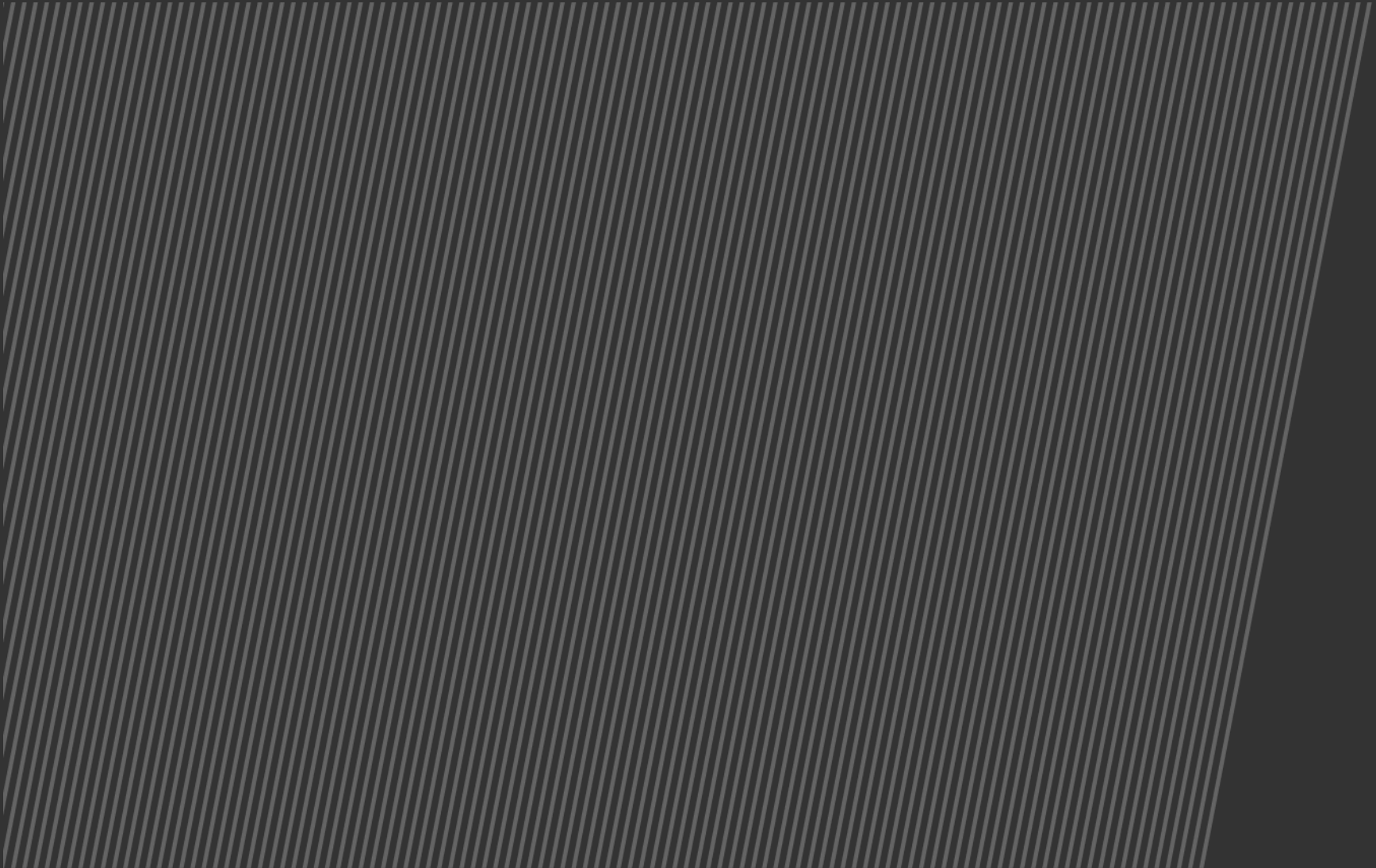
	Initial	Year 1	Year 2	Year 3
<i>Balance sheet</i>				
Right-of-use asset	32,500	21,667	10,834	–
Liability to make lease payments	(32,500)	(24,125)	(13,333)	–
<i>Income statement</i>				
Interest expense		1,625	1,208	667
Amortization expense		<u>10,833</u>	<u>10,833</u>	<u>10,834</u>
Total expense		12,458	12,041	11,501
Operating lease expense		12,000	12,000	12,000
Higher (lower) expense vs. operating		458	41	(499)

Joint project update – leases

Major changes compared with current lessee accounting

- ▶ Lease classification would be eliminated
 - ▶ Lessees would apply a single approach
 - ▶ Assumes all leases include a financing element
- ▶ All leases would be recognized on balance sheet
 - ▶ Short-term leases – may elect to continue current operating lease accounting for leases with a *maximum possible* term of 12 months or less
- ▶ Financial statement metrics would change
- ▶ Reassessment required
- ▶ Processes, systems and controls would likely require enhancements

Other proposals and projects



Disclosure framework project

- ▶ Objectives of project
 - ▶ Establish an overarching framework to make financial statement disclosures more effective
 - ▶ Reduce redundancies and increase utility of disclosures
 - ▶ Seek ways to better integrate information provided in financial statements, MD&A and other parts of the financial reporting package
- ▶ Board is evaluating and testing a decision process to use in considering potential disclosures
- ▶ Discussion Paper expected in early 2012

Private company standard setting

- ▶ Financial Accounting Foundation (FAF) proposed a Private Company Standards Improvement Council (PCSIC)
 - ▶ Concluded that an autonomous Board would likely result in two separate sets of US accounting standards
 - ▶ New council would have the authority to identify and vote on specific improvements to US accounting standards for private companies
 - ▶ Changes would be subject to ratification by the FASB and due process
 - ▶ Proposed PCSIC would have 11 to 15 members who are users, preparers and practitioners with significant private company experience
 - ▶ Comments are due by 14 January 2012
- ▶ FASB has various initiatives to improve private company standard setting