A Carnival of Information

27th annual ACCOUNTING SHOW

September 19-21, 2012

Broward County Convention Center / Ft. Lauderdale

FICPA

27th Annual Accounting Show
September 21, 2012
Ft. Lauderdale

Going Concerns - Past and Present

Ed Plastow, CPA, PhD
and
William Hahn

William H. Hahn, DBA

Professor of Accounting
Southeastern University

Before going into education, Dr. Bill Hahn gained 20 years of experience in the banking industry as both a CFO and COO for NASDAQ-traded companies. In his banking career, he managed several areas, including accounting, investments, loan and deposit operations, legal, facilities, and human resources. He was also with Ernst & Young, CPAs for four years.

Prior to his career at Southeastern, Dr. Hahn taught eight years and served as a Division Chair at the College of St. Joseph in Vermont. Dr. Hahn has contributed numerous academic, refereed, and trade practitioner publications to his field and has written a monthly business trend column for the Rutland Herald newspaper. His academic articles have appeared in *Accounting Forum*, *The Journal of Education for Business, International Journal of Bank Marketing*, and *Journal of Services Marketing.* He believes that the classroom is a place to help students learn bother the theoretical and the applied aspects of their chosen career field.

Dr. Hahn teaches Intermediate Accounting, Managerial Accounting, and Strategic Management and has research interests in accounting theory, strategic planning and performance sustainability.

Ed Plastow, PhD

Professor of Business

Southeastern University

In the mid-1980's, Dr. Plastow was the CFO for a large corporation in California. He has also been a senior manager for Touche Ross, his responsibilities involving working with professional sports franchises. For about two decades, now, he has been teaching at the university level, first at Dakota Wesleyan University and now at Southeastern University. Dr. Plastow was the chair of the business program for five years as it grew from seven students to 160 students and added multiple academic majors. He was also the early collaborator for instigating the evening business program.

Dr. Plastow has been a long-time college basketball coach, and after many years of coaching men, he has spent the past five years coaching the Southeastern Lady Fire, a team which has become a national force. Dr. Plastow and his wife, Shannon, spend their summers doing mission work in the Alaska Bush.

Dr. Plastow teaches the following courses at Southeastern: Not-for-Profit Accounting, Advanced Accounting I, Accounting II, Leadership and Ethical Management (MBA program), Intro to Sports Management, and Auditing I and II. He is published in the area of Sports Management.

The Going Concern Assumption: Its Journey into GAAP

William Hahn, CPA, DBA
Professor
Southeastern University

Dr. Ed Plastow, CPA, Ph.D.
Dean of Graduate Studies
Dakota Wesleyan University

Going Concern Outline

- Introduction
- Recent Attention
- 10 Year History of Going Concern Opinions
- 2008 Financial Crisis—A Large Firm Event Review
- A Short History of the Going Concern Concept
- Audit Guidance and Going Concern Audit Paragraphs
- Academic Research
- Proposed FASB and Existing IFRS Standard
- Case Study

Going Concern

Recent Attention

Going Concern—Audit Guidance

Current Economic Crisis: Going Concern Considerations—2009

The consideration of an entity's ability to continue as a going concern is required in every audit performed under generally accepted auditing standards, and is an especially important consideration in the current state of the economy. An entity's ability to continue as a going concern is affected by many factors related to the current uncertain economy—the industry and geographic area in which it operates, the financial health of its customers, suppliers, and financing sources. (AICPA, 2009)

Going Concern—Public Comment

Auditor "going concern" warnings seen peaking in '09
Emily Chasan
NEW YORK (Reuters)
Thu., Feb 26, 2009

NEW YORK (Reuters) - The number of "going concern" warnings by corporate auditors could hit an all-time high this year, as the U.S. recession has put the survival of hundreds of companies in doubt, the chief executive of accounting firm Grant Thornton predicted on Thursday.

Going Concern—Public Comment

Grant Thornton CEO Ed Nussbaum stated, "We'll see an unprecedented number of going-concern footnote disclosures and clarification from the auditors." (CFO.com, March 5, 2009)

Going-Concern IPOs

When BlackStratus Inc. IPO

"If we do not raise sufficient funds in this offering or otherwise, we may not be able to continue as a going concern," BlackStratus, a Piscataway, N.J., provider of network security services said in its registration statement.

BlackStratus isn't alone. Of the 148 companies who have filed IPO documents this year through April 16, 42% included the same warning.

CFO Journal, April 24, 2012

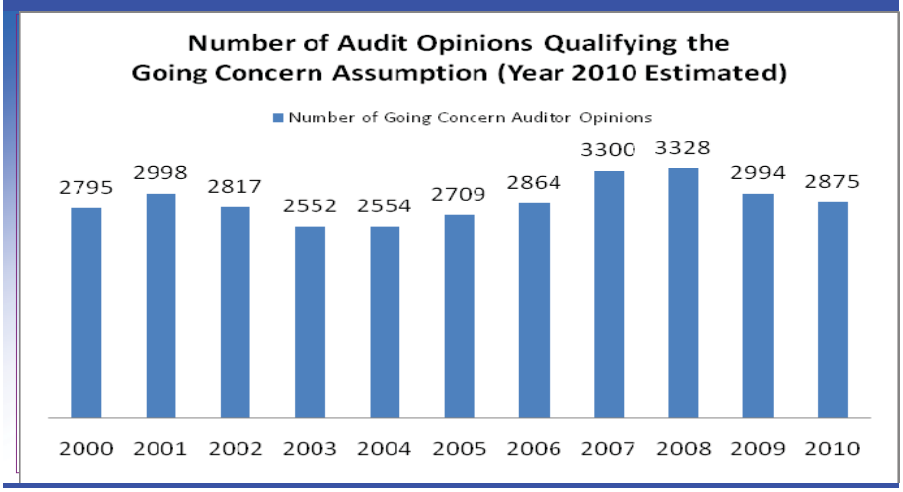
Going Concern

10-Year Going Concern History

The material used in this section (next six slides) is for non-commercial and educational purposes only, and is not for resale.

Going Concern—Trends

Audit Analytics: (For Educational Purposes Only, not for Resale)



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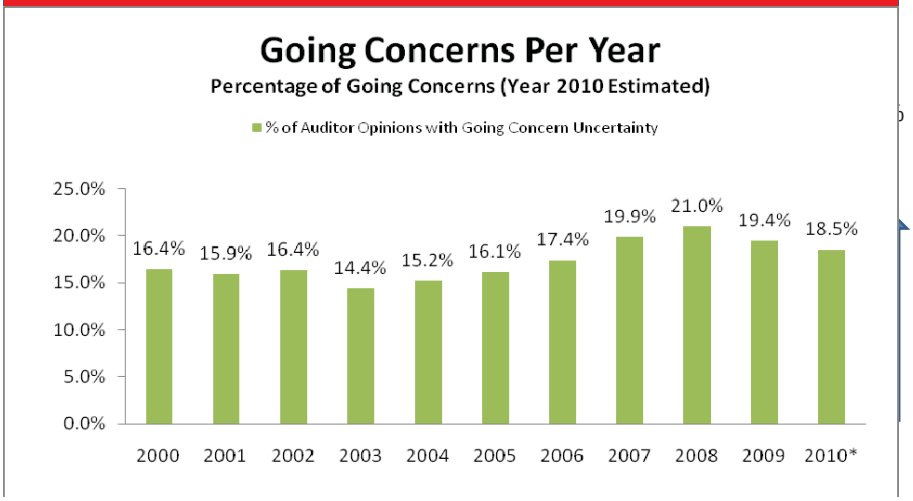


Going Concern Summary

Audit Analytics: (For Educational Purposes Only, Not for Resale)

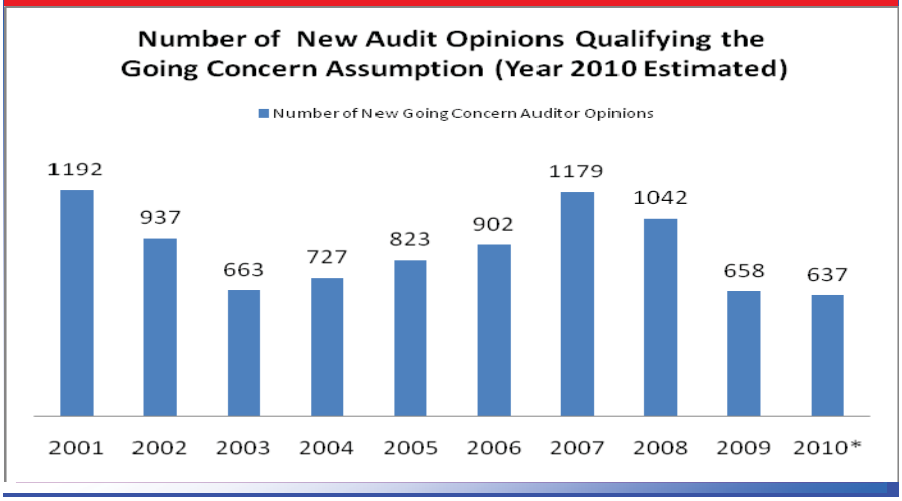
In 2010 the three most common reasons given by auditors for their concerns are:

1. Operating losses (1,361 opinions),
2. Development stage (1,027 opinions)
3. Inadequacy of working capital or current ratio (884 opinions)
4. Net losses since inception (732)
3. Accumulated earnings deficit (633 opinions).

Note: 5.7% percent of the companies which received going concern opinions in 2009 subsequently filed a termination of registration with the SEC.

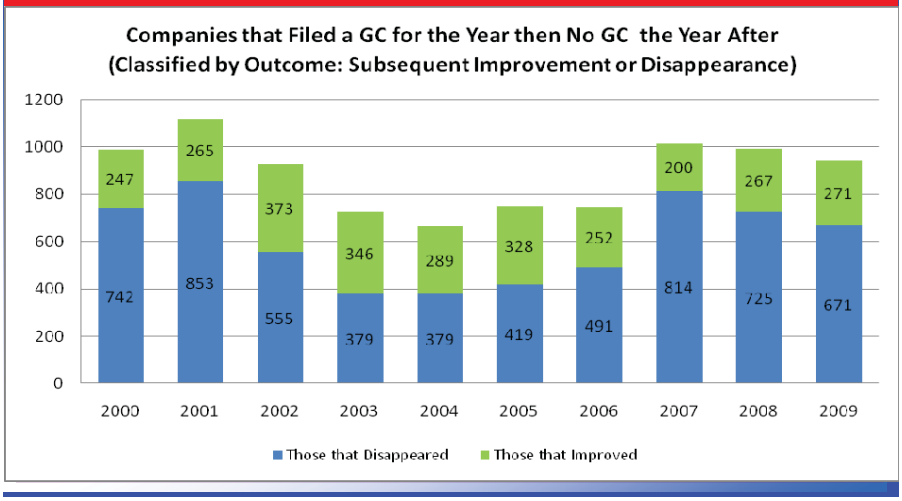
Going Concern—Trends

Audit Analytics: (For Educational Purposes Only, Not for Resale)



Going Concern—New Opinions

Audit Analytics: (For educational purposes only, Not for Resale)



Going-Concern—By Market 2009

Source: Audit Analytics (For education purposes only, Not for Resale)

NYSE	14	.53%
NASDAQ	79	3.00%
AMEX	31	1.18%
OTCBB	1,233	46.78%
Non-Tickered	1,279	48.52%

PCAOB Presentation by Raghunandan, Chair of AAA Research Team

Bankruptcies without prior going-concern opinion averages 30-60% in published studies from 1970 to 2009.

SAS No. 59 did not significantly change going-concern reporting patterns.

Rate of bankruptcies without prior going-concern opinion, increased after 1995 (Reform Act) and 1998 (Uniform Standards Act).

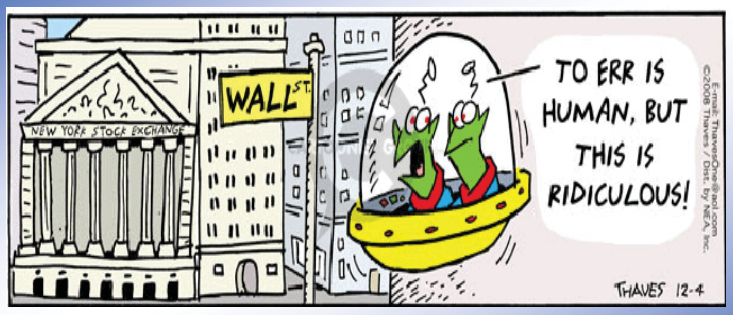
Decreased after ENRON/SOX, but only temporarily:

2000-2001	47%
2002-2003	28%
2004-2005	41%
2006-2007	49%

Going Concern

2008 Financial Crisis

Going Concern



Going Concern—Large 2008 Events

Financial Institution	Audit Firm	Audit Report Date	Failure/Reorg. Date	Months
American Intl. Group	PriceW/Coopers	February 28, 2008	September 16, 2008 (G)	6.5
Bear Sterns Companies	Deloitte & Touche	January 28, 2008	March 16, 2008 (A)	1.5
Countrywide Financial	KPMG	February 28, 2008	June 25, 2008 (A)	4.0
Fannie Mae	Deloitte & Touche	February 26, 2008	September 19, 2008 (G)	6.5
Freddie Mac	PriceW/Coopers	February 27, 2008	September 18, 2008 (G)	6.5
Lehman Brothers	Ernst & Young	January 28, 2008	September 15, 2008 (B)	7.5
Merrill Lynch & Co.	Deloitte & Touche	February 25, 2008	September 15, 2008 (A)	6.5
Wachovia	KPMG	February 25, 2008	September 29, 2008 (A)	7.0
Washington Mutual	Deloitte & Touche	February 28, 2008	September 26, 2008 (B)	7.0

(A) Acquisition (B) Bankruptcy (G) Government Bailout

Source: 2007 Annual Report and 2008 Form 8-K of each company.

Going Concern—Large 2008 Events Discussion

How Did These Twelve Organizations Not Receive A Going Concern Modification?

How Did The Individual Mutual Funds Not Receive an Adverse Opinion Or A Going Concern Modification?

Why Was There No Investigation Of The Lack of Going Concern Attention By The Press?

Going Concern

A Short History of the Going Concern Concept

Going Concern

Date	Event
1620	Court Case. Economist John R. Commons traced the going-concern concept to a 1620 lawsuit (Jollyfe V. Brode, Cro. Jac. 596) in which a court determined that a "going-concern" value was greater than the book value of the plant because the plant could be used to generate excess income through future operations. This appeared in his 1924 book *Legal Foundations of Capitalism.*

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| 2008 | SSARS 17. The AICPA issued its *Omnibus Statement on Standards for Accounting and Review Services No. 17* in a public accountant is required to evaluate the ability of a firm to continue as a going concern when contemplating the issuance of a compilation or review report. |
| 2008 | Exposure Draft. FASB issued *Proposed Statement of Financial Accounting Standards, Going Concern* through its Financial Accounting Series. |

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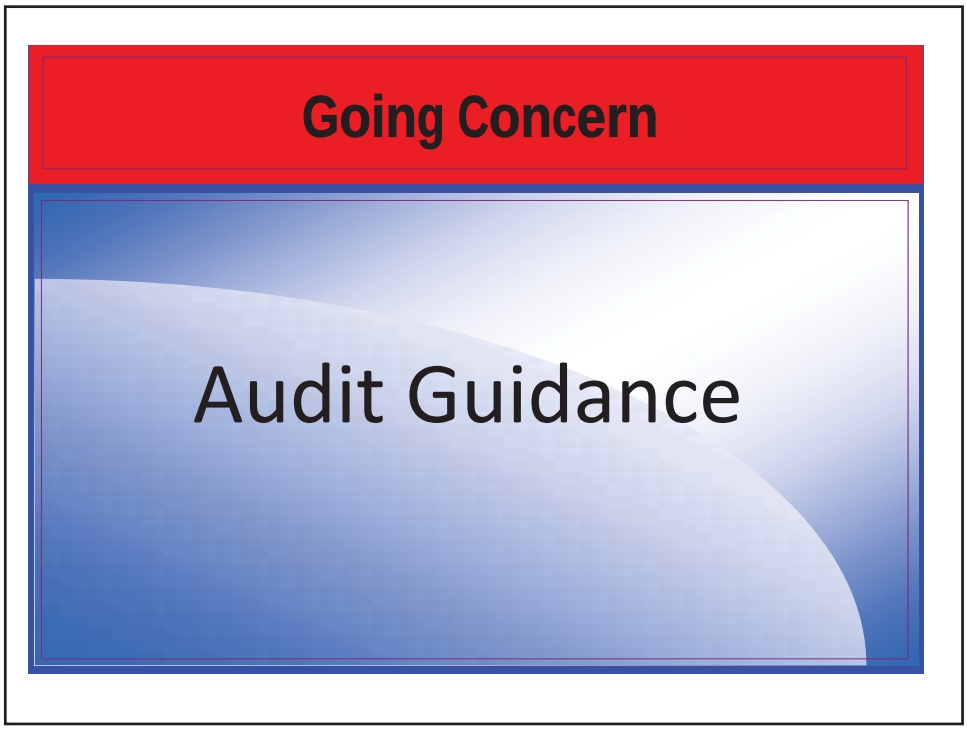
2008	Exposure Draft. FASB issued *Proposed Statement of Financial Accounting Standards, Going Concern* through its Financial Accounting Series.
2011	Projected Publication. FASB projects finalizing the FAS on going concern in the first quarter of 2011.



Going Concern—Audit Guidance

AU Section 341 , adopted and amended by the PCAOB.
The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern
(Supersedes section 340)

Source: SAS No. 59; SAS No. 64; SAS No. 77; SAS No. 96; SAS 113; SAS 114; SAS 130

Proposed FAS –Going Concern

Effective for audits of financial statements for periods beginning on or after January 1, 1989, unless otherwise indicated.

Going Concern—How Many

Covers the ten-year period ending in 2010

Auditors issued an average of 2,875 going concern modifications per year

This is about 18.5% of all audits analyzed

Source: Audit Analytics

Going Concern—Audit Guidance

Continuation of an entity as a going concern is assumed in financial reporting in the absence of significant information to the contrary.

Ordinarily, information that significantly contradicts the going concern assumption relates to the entity's inability to continue to meet its obligations as they become due without substantial disposition of assets outside the ordinary course of business, restructuring of debt, externally forced revisions of its operations, or similar actions. [AU 341]

Going Concern—Auditor's Responsibility

The auditor has a responsibility to evaluate whether there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time, not to exceed one year beyond the date of the financial statements being audited (hereinafter referred to as a reasonable period of time).

Going Concern—Auditor's Responsibility, Continued

The auditor should evaluate whether there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in the following manner:

a) Results of audit tests suggest concerns as to ability to continue as a going concern,

b) Obtain additional information from management related to:

   i. Plans to mitigate or eliminate the issue creating going concern doubts,

   ii. Assess likelihood management's plans can be effectively implemented

c) Assess management plans and arrive at final going concern conclusion

Going Concern—Auditor's Responsibility

If substantial doubt as to ability to continue as a going concern remains, auditor should:

(1) consider the adequacy of disclosure about the entity's possible inability to continue as a going concern for a reasonable period of time, and

(2) include an explanatory paragraph (following the opinion paragraph) in the audit report to reflect this conclusion. If the auditor concludes that substantial doubt does not exist, the need for disclosure should be considered.

Going Concern—Auditor's Report

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note X to the financial statements, the Company has suffered recurring losses from operations and has a net capital deficiency that raise substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also described in Note X. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

[As amended, effective for reports issued after December 31, 1990, by Statement on Auditing Standards No. 64.]

Going Concern—Auditor's Report 10-K

As discussed in Note 5 to the financial statements, the Company has suffered **recurring losses** from operations that have resulted in an accumulated deficit. This raises substantial doubt about the Company's ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 5. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Source: Amerityre Corporation Form 10-K.
Auditor: HJ & Associates, LLC
Salt Lake City, Utah
September 28, 2009

Going Concern—Amerityre 10-Q

Our financial statements are prepared using generally accepted accounting principles applicable to a going concern which contemplates the realization of assets and liquidation of liabilities in the normal course of business. We **have historically incurred significant losses which have resulted in a total retained deficit of $55,710,488 at March 31, 2010 which raises substantial doubt about our ability to continue as a going concern.**

[March 31, 2010]

Going Concern—Auditor's Report

As discussed in Note 1to the financial statements, Cardica, Inc.'s **recurring losses from operations** raise substantial doubt about its ability to continue as a going concern. Management's plans as to these matters also are described in Note 1. The financial statements for the year ended June 30, 2009 do not include any adjustment that might result from the outcome of this uncertainty.

Source: Cardica, Inc.
Auditor: Ernst & Young
Palo Alto, California
September 18, 2009

Going Concern—Auditor's Report

As discussed in Note 1 to the financial statements, the Company has suffered **recurring losses** from operations and has a **net capital deficiency**. These conditions raise substantial doubt about the Company's ability to continue as a going concern. Management's plans in regard to these matters are also describedin Note 1. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Hana Biosciences, Inc.
BDO SEIDMAN LLP
San Francisco, California
March 25, 2010

Going Concern—Auditor's Report

As discussed in Note 2 to the consolidated financial statements, the corporation's **recurring losses from operations, stockholders' deficit and inability to generate sufficient cash flow to meet its obligations and sustain its operations** raise substantial doubt about its ability to continue as a going concern.

No going concern in 2011 Auditor' Report

General Motors, Deloitte and Touche, 2008

Going Concern—Auditor's Report

As discussed in Note 1 to the financial statements, the Company has suffered **recurring losses from operations**, has **limited resources available to fund current research and development activities**, and **will require substantial additional financing to continue to fund its research and development activities**. These conditions raise substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 1. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Genaera Corporation
KPMG LLP
Philadelphia, Pennsylvania
March 31, 2008

Going Concern—Auditor's Escape Clause

The auditor is not responsible for predicting future conditions or events. The fact that the entity may cease to exist as a going concern subsequent to receiving a report from the auditor that does not refer to substantial doubt, even within one year following the date of the financial statements, does not, in itself, indicate inadequate performance by the auditor.

Accordingly, the absence of reference to substantial doubt in an auditor's report should not be viewed as providing assurance as to an entity's ability to continue as a going concern.

Going Concern—Auditor's Escape Clause

Grant Thornton CEO Nussbaum expects there will be faulty forecasts in the year to come.

"The high level of volatility resulting from the downturn in the economy makes it almost impossible for the auditor or even the company to predict successfully what will happen 12 months from now."

Going Concern

Academic Research

Going Concern: Academic Research

The Going-Concern Assumption Revisited: Assessing A Company's Future Viability (Elizabeth Venuti, The CPA Journal, 2004)

1) Study of 202 publicly traded companies with assets of $258 billion that filed bankruptcy in 2001 and 2002

   + 96 (or 48%) contained a going concern explanatory paragraph

2) 12 of the largest 20 bankruptcy filings in U.S. history took place in 2001 and 2002. These had over $381 billion in assets

   + All twelve received an unqualified opinion

   + None of the 12 received a going concern explanatory paragraph

Going Concern: Academic Research, Venuti Continued

Why Auditors Fail to Comment on Exceptions to the Going-Concern Assumption

1. Fear of a self-fulfilling prophecy (Venuti)

Auditors are placed at the center of a moral and ethical dilemma: whether to issue a going-concern opinion and risk escalating the financial distress of their client, or not issuing a going-concern opinion and risking not informing interested parties of the possible failure of the company. (Venuti)

Going Concern: Academic Research, Venuti Continued

Venuti: Why Auditors Fail to Comment on Going-Concerns

1. Fear of a self-fulfilling prophecy (AICPA)

AICPA (the Cohen Commission, 1978) issued a report expressing this sentiment: Creditors often regard a subject to qualification as a separate reason for not granting a loan, a reason in addition to the circumstances creating the uncertainty that caused the qualification. This frequently puts the auditor in the position, in effect, of deciding whether a company is able to obtain the funds it needs to continue operating. Thus, the auditor's qualification tends to be a self-fulfilling prophecy. The auditor's expression of uncertainty about the company's ability to continue may contribute to making it a certainty.

Going Concern: Academic Research, Venuti Continued

Why Auditors Fail to Comment on Going-Concerns.

2. Lack of Auditor Independence (Venuti)

a. Management determines auditor tenure

b. Management determines auditor remuneration & may change auditors.

c. If a going concern is issued and client goes bankrupt, audit fees are lost.

Venuti: The above could compromise an auditor's judgment

Going Concern: Academic Research, Venuti Continued

Why Auditors Fail to Comment on Going-Concerns.

3. The Private Securities Litigation Reform Act of 1995 (Venuti)

a. Made it more difficult for a plaintiff to bring a lawsuit against auditors.

b. Act tipped the judgment scales in favor of not issuing a going-concern

i. Lost revenue due to lost client compared to

ii. Litigation costs of not issuing a going-concern

Going Concern—Academic Research

Geiger and Raghunandan, Going-Concern Opinions in the "New" Legal Environment (March, 2001)

Basis For Research:
The SEC recently asserted that the litigation environment facing auditors had changed significantly since 1994, and that the reduced threat of litigation can influence auditor behavior.

Going Concern—Academic Research, Geiger and Raghunandan

Examined audit reports of 1,871 companies under financial stress (negative working capital, negative retained earnings, a net loss) (no banks, real estate companies or utilities)

1992-1993

1995: Passage of the Private Securities Litigation Reform Act of 1995

1996-1997

1999-2001

Going Concern—Academic Research, Geiger and Raghunandan

Of the 1,871 companies in the study:

1992-1993 [9.5% of stressed companies received going-concern]

1995: Passage of the Private Securities Litigation Reform Act of 1995

1996-1997 [5.5% of stressed companies received going-concern]

1999-2001 [3.5% of stressed companies received going-concern]

Going Concern—Academic Research

Ryu and Roh, The Auditor's Going-Concern Opinion Decision International Journal of Business and Economics, 2007

+Sample of 1,332 firms (banking, real estate, utility omitted)

+Non-bankrupt, but financially distressed as determined by the Altman Z model

+Study timeframe 1997 to 1999

+Sample divided: Big Six and Non-Big Six

+Study focus on firms with going-concern but did not go bankrupt

Going Concern—Academic Research

Blay, Geiger, and North, The Auditor's Going-Concern Opinion as a Communication of Risk, Auditing: A Journal of Practice and Theory, May, 2011

Findings Related to Firms in Financial Distress:

	Unqualified	Going Concern
Big 6	65.0%	35.0%
Non-Big 6	24.3%	75.7%

Reasons:

1. Big 6 have higher materiality thresholds
   a. More audit experience?
   b. Quality of service and staff training?

Going Concern—Academic Research

Knechel and Vanstraelen, The Relationship between Auditor Tenure and Audit Quality Implied by Going Concern Opinions -- Conducted in Belgium

Auditing: A Journal of Practice and Theory, 2007

Primary finding: Auditor tenure does not impact the decision related to a going concern opinion

Going Concern—Academic Research

Fargher and Jiang, Changes in the Audit Environment and Auditors' Propensity to Issue Going-Concern Opinion
Auditing: A Journal of Practice and Theory, 2008

Conducted in Australia, 1,769 firms in financial distress

Focus: Propensity to issue going-concern opinions before and after the 2000-2002 economic crisis (Enron, WorldCom, Adelphia, etc.). Is the past prologue?

Going Concern—Academic Research

Fargher and Jiang, Changes in the Audit Environment and Auditors' Propensity to Issue Going-Concern Opinions, Auditing: A Journal of Practice and Theory, 2008

Primary Finding:

1998-1999---8% of firms issued going-concern

2000-2002---Economic Crisis

2003-2005---12% of firms issued going-concern

Going Concern—Academic Research

O'Reilly, Do Investors Perceive the Going-Concern Opinion as Useful for Pricing Stocks?, Managerial Auditing Journal, 2010

Case Experiment Using Input From Financial Analysts

Finding: Investors Find the Going-Concern Opinion Relevant for Stock Valuing Purposes

Going Concern—Academic Research

O'Reilly, Do Investors Perceive the Going-Concern Opinion as Useful for Pricing Stocks?, Managerial Auditing Journal, 2010

431 first-time going-concern modified firms.

Time period 1989–2006

Financial distress defined as: operating loss, bottom line loss, negative working capital, or negative retained earnings in the last three years

Going Concern—Academic Research

O'Reilly, Do Investors Perceive the Going-Concern Opinion as Useful for Pricing Stocks?, Managerial Auditing Journal, 2010

Market valuation is significantly altered from a focus on both the income statement and balance sheet to a balance sheet-only focus in the year a company receives a first-time going-concern modified opinion.

The **market devalues a company's inventory and places increased weight on cash, receivables, and long-term assets and liabilities** as a result of the auditor's modification. This indicates that the going-concern modification provides incremental information specifically related to abandonment or adaptation risk

Going Concern

Proposed FASB Standard—Going Concern

Going Concern: FASB Timeline

May 2007 FASB Meeting: Added Going Concern as a Project

Sept 2007 FASB Meeting: Moved Going Concern Project to the Codification and Retrieval Project

August 2007 FASB Meeting: Discussion of How to Incorporate Going Concern into the Codification.

Going Concern: FASB Timeline

October 8, 2008: Exposure Draft Released

February 2009 FASB Meeting: Discussed Comment Letters (define going concern and time period)

June 2009 FASB Meeting: Considered "Substantial Doubt", February 2009 Meeting Items, and Effective Date

Going Concern: FASB Timeline

January 2010 FASB Meeting: Considered Scope Changes to Project, but Made None

March 2010 FASB Meeting: No Going Concern Definition, added Disclosures Related to Going Concern, added Liquidation Accounting

November 2010 FASB Meeting: Considered Aspect of the Final Standard and Impact on SEC and PCAOB

Going Concern: FASB Timeline

December 2010 FASB Meeting: Fussed with the Subsequent Event, Ability to Meet Obligations Language, and "Imminent" in Liquidation Considerations

February 2011: Hahn Article in *The CPA Journal*

October 2011 FASB Meeting: Postponed Decision as to Whether Management or Outside Auditors Should make Going Concern Determination

Going Concern: FASB Timeline

October 2011 FASB Meeting, Continued:

Decided that improving disclosures that would serve as an early warning of an entity's potential inability to continue as a going concern ***would not*** be an objective of this project, since the Board tentatively decided to add incremental disclosures about liquidity risk in the separate project on accounting for financial instruments.

Going Concern: FASB Timeline

January 2011 FASB Meeting:

The Board decided **not to require that management of an entity assess** whether there is substantial doubt about the entity's ability to continue as a going concern.

A majority of Board members observed that such a requirement would be difficult to apply and that users of financial statements would benefit to a greater extent from ongoing disclosures about risks and uncertainties than they would from disclosures that would be made only after management concludes that there is substantial doubt about an entity's ability to continue as a going concern.

Going Concern: FASB Timeline

February 2012 FASB Meeting: Consideration of the Liquidation Basis of Accounting.

The Board affirmed that under the liquidation basis of accounting, an entity should **prepare, at a minimum, a statement of net assets in liquidation and a statement of changes in net assets in liquidation** and that it should disclose all measurement bases and significant assumptions.

Going Concern: FASB Timeline

May 2012 FASB Meeting: The Board decided that a **limited-life entity should prepare financial statements using the liquidation basis of accounting** when significant management activities are limited to those necessary to carry out a plan of liquidation other than that which was contemplated in the entity's governing documents.

Going Concern: FASB Timeline

May 2012 FASB Meeting, Continued:

The Board will revisit the question of whether management should be required to assess whether there is doubt about an entity's ability to continue as a going concern in light of its recent decision not to pursue going-concern-type disclosures in the project about liquidity and interest rate risk disclosures.

Going Concern: FASB Timeline

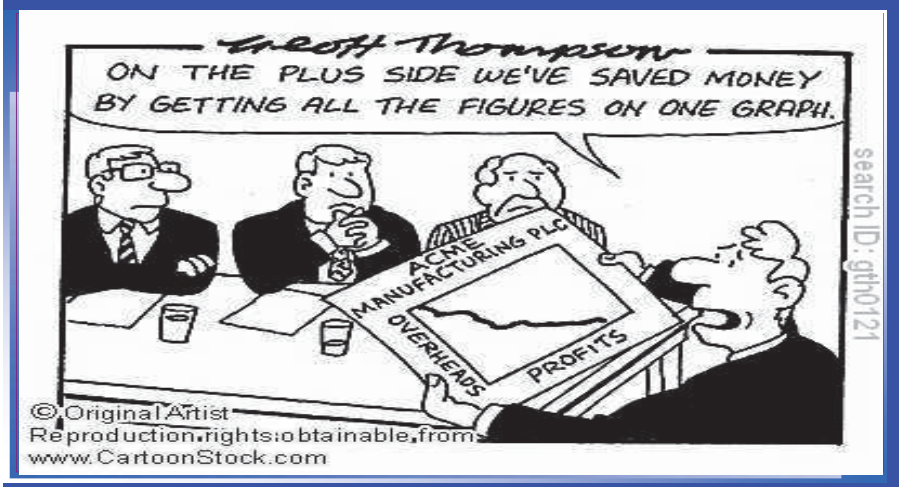
So Where Are We?

We feel like the King of Siam in the musical, *The King and I*, befuddled by Anna who has been hired to tutor his children, who said,

"Sometimes I think I am not sure of what I absolutely know."

Rogers and Hammerstein 1951 Broadway Play

Going Concern—Proposed Standard



Going Concern: FASB Guidance

NO. 1650-100 | OCTOBER 9, 2008

Financial Accounting Series

EXPOSURE DRAFT

Proposed Statement of Financial Accounting Standards

Going Concern

This Exposure Draft of a proposed Statement of Financial Accounting Standards is issued by the Board for public comment. Written comments should be addressed to:

Technical Director
File Reference No. 1650-100

Comment Deadline: December 8, 2008

Financial Accounting Standards Board of the Financial Accounting Foundation

Going Concern: Proposed FASB Standard

Provides guidance on the preparation of financial statements as a going concern and on management's responsibility to evaluate a reporting entity's ability to continue as a going concern.

Going Concern: Proposed FASB Standard

Proposed Standard does four things:

1. Incorporates the Going Concern assumption and GAAS guidance (AU Section 341) into GAAP,

2. Amends the FASB Accounting Standard Codification for proposed changes (specifically 205 Presentation of Financial Statements>30 Going Concern, and

3. Clearly places the responsibility on management for determination of ability of firm to remain as a going concern

Going Concern: Proposed FASB Standard

Proposed Standard, continued:

4. Changes the time horizon for determination of a going concern

a. AU Section 341 states, in part, responsibility to evaluate whether there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time, **not to exceed one year** beyond the date of the financial statements being audited" (paragraph .02).

b. The proposed standard requires that an entity consider **"all available information about the future, which is at least, but is not limited to, twelve months from the end of the reporting period."**

Going Concern: IAS vs. GC Standard

International Accounting Standard 1 Presentation of Financial Statements Issued September 1997	Financial Accounting Series Exposure Draft: Going Concern Issued October 9, 2008
25 When preparing financial statements, management shall make an assessment of an entity's ability to continue as a going concern. An entity shall prepare financial statements on a going concern basis unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so. When management is aware, in making its assessment, of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern, the entity shall disclose those uncertainties. When an entity does not prepare financial statements on a going concern basis, it shall disclose that fact, together with the basis on which it prepared the financial statements and the reason why the entity is not regarded as a going concern.	3. When preparing financial statements, management shall assess the reporting entity's ability to continue as a going concern. An entity shall prepare financial statements on a going concern basis unless management either intends to liquidate the entity or to cease operations or has no realistic alternative but to do so. 7. When management is aware, in making its assessment, of material uncertainties about events or conditions that may cast substantial doubt upon the entity's ability to continue as a going concern, the entity shall disclose those uncertainties. 8. When an entity does not prepare financial statements on a going concern basis, it shall disclose that fact, together with the basis on which it prepared the financial statements and the reason why the entity is not regarded as a going concern.

Going Concern: IAS vs. GC Standard

26 In assessing whether the going concern assumption is appropriate, management takes into account all available information about the future, which is at least, but is not limited to, twelve months from the end of the reporting period. The degree of consideration depends on the facts in each case. When an entity has a history of profitable operations and ready access to financial resources, the entity may reach a conclusion that the going concern basis of accounting is appropriate without detailed analysis. In other cases, management may need to consider a wide range of factors relating to current and expected profitability, debt repayment schedules and potential sources of replacement financing before it can satisfy itself that the going concern basis is appropriate.	4. In assessing whether the going concern assumption is appropriate, management shall take into account all available information about the future, which is at least, but is not limited to, 12 months from the end of the reporting period. The degree of consideration depends on the facts in each case. If an entity has a history of profitable operations and ready access to financial resources, management may conclude that the going concern basis of accounting is appropriate without detailed analysis. In other cases, management may need to consider a wide range of factors relating to current and expected profitability, debt repayment schedules, and potential sources of replacement financing before it can satisfy itself that the going concern basis is appropriate.

Going Concern—Exposure Draft

Presentation

3. **When preparing financial statements, management shall assess the reporting entity's ability to continue as a going concern. An entity shall prepare financial statements on a going concern basis unless management either intends to liquidate the entity or to cease operations or has no realistic alternative but to do so.**

Going Concern—Exposure Draft

Presentation, Continued:

4. In assessing whether the going concern assumption is appropriate, management shall take into account all available information about the future, which is at least, but is not limited to, 12 months from the end of the reporting period. The degree of consideration depends on the facts in each case. If an entity has a history of profitable operations and ready access to financial resources, management may conclude that the going concern basis of accounting is appropriate without detailed analysis. In other cases, management may need to consider a wide range of factors relating to current and expected profitability, debt repayment schedules, and potential sources of replacement financing before it can satisfy itself that the going concern basis is appropriate.

Going Concern—Exposure Draft

5. Management may identify information about certain conditions or events that, if considered in the aggregate, indicate there could be substantial doubt about the reporting entity's ability to continue as a going concern. The significance of such conditions and events will depend on the circumstances, and some may have significance only when viewed in conjunction with other conditions or events. The following are examples of those conditions and events:

a. Negative trends
b. Other indicators of possible financial difficulties (e.g. loan default, dividend arrears, creditor trade denials, noncompliance with loan or regulatory guidance.
c. Internal matters such as operational issues
d. External matters such as legal proceedings, legislation, loss of key business franchise, license, or patent, customer, or environmental occurrence.

Going Concern—Exposure Draft

6. If, after considering the information in the aggregate, management believes that there is substantial doubt about the reporting entity's ability to continue as a going concern, management shall consider its plans for dealing with the adverse effects of those conditions and events and whether those plans will mitigate the adverse effects and whether those plans can be effectively implemented. Management's considerations relating to its plans may include the following:

a. Plans to dispose of assets:
(1) Restrictions on the disposal of assets, such as covenants limiting such transactions in loan or similar agreements or encumbrances against assets
(2) Apparent marketability of assets that the entity plans to sell
(3) Possible direct or indirect effects of disposal of assets

b. Plans to borrow money or restructure debt:
(1) Availability of debt financing, including existing or committed credit arrangements, such as lines of credit or arrangements for factoring receivables or sale-leaseback of assets
(2) Existing or committed arrangements to restructure or subordinate debt or to guarantee loans to the entity

Going Concern—Exposure Draft

6, Continued.

(3) Possible effects on the entity's borrowing plans of existing restrictions on additional borrowing or the sufficiency of available collateral

c. **Plans to reduce or delay expenditures**:
(1) Apparent feasibility of plans to reduce overhead or administrative expenditures, to postpone maintenance or research and development projects, or to lease rather than purchase assets
(2) Possible direct or indirect effects of reduced or delayed expenditures

d. Plans to increase ownership equity:
(1) Apparent feasibility of plans to increase ownership equity, including existing or committed arrangements to raise additional capital
(2) Existing or committed arrangements to reduce current dividend requirements or to accelerate cash distributions from affiliates or other investors.

Going Concern—Modified Exposure Draft

Paragraph 7. The following disclosures are required when management, applying commercially reasonable business judgment, is aware of conditions and events that indicate, based on current facts and circumstances, that it is reasonably foreseeable that an entity may not be able to meet its obligations as they become due without substantial disposition of assets outside the ordinary course of business, restructuring of debt, issuance of equity, externally or internally forced revisions of its operations, or similar actions.

a. Pertinent conditions and events giving rise to the assessment, including when such conditions and events are anticipated to occur, if reasonably estimable
b. The possible effects of those conditions and events
c. Possible discontinuance of operations
d. Management's evaluation of the significance of those conditions and events and any mitigating factors
e. Management's plans to mitigate the effects of the conditions and events, whether those plans can be effectively implemented, and the likelihood that such plans will mitigate the adverse effects.
f. Information about the recoverability or classification of recorded asset amounts or the amounts or classification of liabilities.

[Note: The above is the language the FASB used in setting forth their alternative to a specific going concern definition requested by respondents to the exposure draft.]

Going Concern—Modified Exposure Draft

8. When an entity does not prepare financial statements on a going concern basis, it shall disclose that fact, together with the basis on which it prepared the financial statements and the reason why the entity is not regarded as a going concern.

Going Concern--Respondents

Respondent Type	Number	Percentage
Auditors	9	31%
Others (individuals)	9	31%
Preparers	1	3%
AICPA and affiliates	2	7%
CPA Societies	7	24%
Academics	1	3%
Total	29	100%

Going Concern—Respondents

FLORIDA INSTITUTE OF CPAS/APASC
MCGLADREY PULLEN, LLP
KPMG LLP
WASHINGTON SOCIETY OF CPAS
MARYLAND ASSOCIATION OF CPAS
DELOITTE TOUCHE LLP
GRANT THORNTON LLP
OHIO SOCIETY OF CPAS/AAC
INSTITUTE OF MANAGEMENT ACCOUNTANTS/FRC
NYSSCPA
AICPA/ACSEC/ASB
ILLINOIS CPA SOCIETY
ERNST YOUNG LLP
LOUISIANA SOCIETY OF CPAS
PRICEWATERHOUSECOOPERS LLP
AICPA/PCPS/TIC
BDO SEIDMAN, LLP

FLORIDA INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

925 WEST COLLEGE AVENUE • P.O. BOX 5437 • TALLAHASSEE, FLORIDA 32314
TELEPHONE (850) 224-9727 • FAX (850) 222-8190

LETTER OF COMMENT NO. 5

Technical Director – File Reference No. 1650-100
Financial Accounting Standards Board
of the Financial Accounting Foundation
401 Merritt 7, PO Box 5116
Norwalk, Connecticut 06856-5116

Dear Technical Director:

The Accounting Principles and Auditing Standards Committee "the Committee" of the Florida Institute of Certified Public Accountants (FICPA) has reviewed and discussed the Financial Accounting Standard Board's (FASB) Exposure Draft titled Proposed Statement of Financial Accounting Standards: *Going Concern*.

The Committee has the following comments regarding the Time Horizon over Which an Entity Should Evaluate Its Ability to Continue as a Going Concern:

The Committee agrees with the Board's conclusion that management of a reporting entity has the responsibility to assess the reporting entity's ability to continue as a going concern. The Committee conceptually agrees with the removal of the "bright line" test used in practice to evaluate going concern situations. We believe that the "bright line" test represented an arbitrary deadline which could serve to limit management's ability to consider all relevant and useful information necessary to determine appropriate accounting treatment and related financial statement disclosure. However, the Committee believes that use of the phrase "at least, but not limited to" effectively creates a flexible bright line test requiring significant judgment on the part of (1) management in carrying out its going concern assessment responsibilities and (2) the auditing profession in evaluating management's going concern assessments and resultant conclusions. Accordingly, additional implementation guidance may be necessary.

The Committee believes that the requirement to "take into account all available information about the future" is considered to be all encompassing and should be modified to read "take into account all available information about the reasonably foreseeable future" or similar qualifying language.

The Committee appreciates this opportunity to share its views and concerns and to comment on this Exposure Draft. Members of the Committee are available to discuss any questions you may have regarding this communication.

Exposure Draft—Comments

Comments made in four general areas:

1. The type of information required as part of management's assessment
2. The time horizon over which such an assessment must be made
3. The specific disclosure requirements
4. The definition of a going concern.

Exposure Draft—Comments

1. The type of information required as part of management's assessment:

   a. Language conflict AU 341 and E D

      I. "Knowledge or relevant conditions and events that exist at or have occurred prior to the date of the auditor's report" [AU 341.02]

      II. "management shall take into account all available information about the future" [E D]

Exposure Draft—Comments

Comments, continued:

b. Cost of performing required analysis greater than benefits to be obtained from it.

c. Wording will result in inconsistent application in practice.

Exposure Draft—Change

The FASB decided to modify paragraph 4 of the E D by removing the word "all":

". . . management shall take into account available information about the future . . ." [E D]

Exposure Draft—Comments

2. The time horizon over which such an assessment must be made:

   a. Too long and too nebulous

   b. Difficult for practitioners to apply

   c. Language conflicts with GAAS [SOP 94, FASB No. 6, AU 341]

   d. Legal implications in the U.S.

Exposure Draft—Change

management shall take into account [~~all~~] available information about the foreseeable future, which is [~~at least~~] generally, but not limited to, 12 months from the end of the reporting period. **Certain events that are expected to occur or are reasonably foreseeable beyond 12 months, and would materially affect the assessment, are considered part of the foreseeable future. The time frame beyond 12 months is limited to a practical amount of time thereafter in which significant events or conditions that may affect the evaluation can be identified.**

Exposure Draft—Comments

Specific disclosure requirements:

1. Inconsistency between the proposed disclosures and those in IAS 1

2. Omission of certain disclosures currently set forth in AU section 341, paragraph 11.

3. It is unclear as to whether disclosures were required in each year's annual report only if there is doubt as to an organization's ability to continue as a going concern.

4. It was suggested that the proposed language be changed to explicitly state that management had made a determination as to going concern status.

Exposure Draft—Change

"substantial doubt" as it appears in paragraph 7 of the exposure draft will be modified. Language under Board consideration is either : (1) "it is more than remote that the entity will not continue as a going concern," or (2) "it is more likely than not that the entity may not continue as a going concern."

Decision to be consistent with SFAS No. 109?

Exposure Draft—Comment

Respondents suggested that the FASB include a definition of a going concern in order to provide clarity which would remove judgment and uncertainty in this area.

Exposure Draft—Revised Disclosures

The FASB decided not to provide a going concern definition. Rather, a going concern will be determined by means of the disclosures discussed in the previous section and through application of revised disclosure instructions. Specifically, paragraph 7.

Exposure Draft—Revised Disclosures, Continued

7. The following disclosures are required when management, applying commercially reasonable business judgment, is aware of conditions and events that indicate, based on current facts and circumstances, that it is reasonably foreseeable that an entity may not be able to meet its obligations as they become due without substantial disposition of assets outside the ordinary course of business, restructuring of debt, issuance of equity, externally or internally forced revisions of its operations, or similar actions.

Exposure Draft—Revised Disclosures, Continued

a. Pertinent conditions and events giving rise to the assessment, including when such conditions and events are anticipated to occur, if reasonably estimable

b. The possible effects of those conditions and events

c. Possible discontinuance of operations

d. Management's evaluation of the significance of those conditions and events and any mitigating factors

e. Management's plans to mitigate the effects of the conditions and events, whether those plans can be effectively implemented, and the likelihood that such plans will mitigate the adverse effects.

f. Information about the recoverability or classification of recorded asset amounts or the amounts or classification of liabilities.

Going Concern—Exposure Draft

8. When an entity does not prepare financial statements on a going concern basis, it shall disclose that fact, together with the basis on which it prepared the financial statements and the reason why the entity is not regarded as a going concern.

Going Concern—Liquidation

We have audited the accompanying statements of financial condition of the Employees' Stock Purchase Plan of Logicon, Inc. (the *"Plan"*) as of May 18, 2000 (liquidation basis) and December 31, 1999 (liquidation basis), and the related statements of income and changes in plan equity for the period ended May 18, 2000 (liquidation basis) and for the years ended December 31, 1999 (liquidation basis) and 1998. These financial statements are the responsibility of the Plan's Administrative Committee. Our responsibility is to express an opinion on these financial statements based on our audits.

Going Concern—Liquidation, Continued

As discussed in Note 4 to the accompanying financial statements, the board of directors of Logicon, Inc., the Plan's Sponsor, elected on December 18, 1999 to terminate the Plan. In accordance with accounting principles generally accepted in the United States of America, the Plan has changed its basis of accounting used to determine the amounts at which investments and benefit distribution information is stated from the ongoing basis **[accrual]** used in presenting 1998 financial statements to the liquidation basis used in presenting the 1999 and 2000 financial statements.

Deloitte & Touche, LLP (2000)

Going Concern

How To Identify – Altman Z?

Going Concern

For Public Companies

Z = 1.2*X1 + 1.4*X2 + 3.3*X3 + 0.6*X4 + 1.0*X5.

X1 = (Working Capital/Total Assets).
X2 = (Retained Earnings/Total Assets).
X3 = (EBITDA/Total Assets).
X4 = (Market Value of Equity/Total Liabilities).
X5 = (Net Sales/Total Assets).

Going Concern

Z-SCORE ABOVE 3.0 –The company is considered 'Safe' based on the financial figures only.

Z-SCORE BETWEEN 2.7 and 2.99 – 'On Alert'. This zone is an area where one should 'Exercise Caution'.

Z-SCORE BETWEEN 1.8 and 2.7 – Yikes!! Good chance of the company going bankrupt within 2 years of operations from the date of financial figures given.

Z-SCORE BELOW 1.80- Probability of Financial Catastrophe is Very High.

If the Altman Z-Score is close to or below 3, amplified due diligence is warranted

Going Concern

Case Study

Going Concern--Resources

International Auditing and Assurance Standards Board
http://www.ifac.org/sites/default/files/downloads/iaasb_staff_audit_practice_alerts_2009_01.pdf

Report to PCAOB, November 2011
http://pcaobus.org/News/Events/Documents/11092011_SAGMeeting/Going_Concern_Academic_Research_Slides.pdf

Going Concern

Thank You For Your Attention

Do You Have Questions?

Revenue Recognition

Cecil “Pat” Patterson, Jr., CPA, MBA

Cecil “Pat” Patterson, Jr., CPA, MBA

President

Patterson & Associates, P.A.

Cecil "Pat" Patterson, Jr., CPA is a recognized author, speaker, and discussion leader for continuing education courses and state societies. Mr. Patterson is the President of Patterson & Associates, P. A. His degrees include a Bachelor of Science in Accounting (Honors) and a Master of Business Administration. Mr. Patterson has experience at the national CPA firm level, at the corporate level as a chief financial officer, and as an adjunct professor at the university level.

His firm is involved in the full spectrum of CPA activities including auditing, accounting services, federal and state corporate and individual income tax preparation, and consulting services to clients, businesses, and other professionals.

Memberships include:

- Member, American Institute of Certified Public Accountants (AICPA)
- Member, Florida Institute of Certified Public Accountants (FICPA)
- Member, FICPA Board of Governors
- Member, FICPA Common Interest Realty Associations Section
- Member, FICPA Accounting & Auditing Section
- Member, FICPA Accounting Shows Committee

Honors and Awards include:

- Outstanding Discussion Leader, FICPA
- Outstanding Author, FICPA
- Distinguished Discussion Leader, New York Society of CPAs

Revenue Recognition

Presented by

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Major FASB Projects

The Big Three

1. Revenue Recognition
2. Financial Instruments
3. Leases

Revenue Recognition

Why Revenue Recognition?

- FASB and IASB joint project.
- US GAAP has more than 100 areas of guidance.
  - Many are industry specific.
  - Can produce conflicts for similar transactions.
- IFRSs principles has two main standards:
  - IAS 18, Revenue
  - IAS 11, Construction Contracts
  - Inconsistent and vague.

Revenue Recognition

- Purpose of the project
  - Remove inconsistencies in current standards
    - Over 100 methods to consider
  - Provide a framework for revenue recognition
    - Net income
    - Comprehensive income
  - Improve comparability
  - Improve disclosure requirements
  - Simplify financial statements

Timeline

- December 19, 2008 – Discussion Paper
- June 24, 2010 – Exposure Draft
- November 24, 2011 – Reissue Exposure Draft
- January 4, 2012 – Amended Re-exposure
- March 13, 2012 – Comment deadline

Timeline (cont.)

- Possible completion in 2014 but probably 2015.

Scope

- All contracts with customers except:
  - Lease contracts within FASB ASC Topic 840, *Leases* or IAS 17, *Leases*
  - Insurance contracts within FASB ASC Topic 944, *Financial Services – Insurance* or IFRS 4, *Insurance Contracts*
  - Certain financial instruments in FASB 825, *Financial Instruments*, or IAS 39, *Financial Instruments: Recognition and Measurement*
  - Guarantees in FASB 460, *Guarantees*, IFRS 4 or IFRS 39

Recognition

- Contract-Based Revenue Recognition Principle
- Identification of Performance Obligations
- Satisfaction of Performance Obligations
- Measurement
- Accounting for costs of obtaining a contract

Recognition (cont.)

- Contract-Based Revenue Recognition Principle
  - Recognize revenue on basis of increases in an entities net position in a contract with a customer.
  - Combination of rights and obligations in a contract give rise to a *net contract position*.
  - Revenue is recognized when contract asset increases or a contract liability decreases or a combination of the two.

Recognition (cont.)

- Identification of Performance Obligations
  - Contract with customer obligates an entity to transfer a good or service to that customer.
  - Variations may exist on the transfers.

Recognition (cont.)

- Satisfaction of Performance Obligations
  - Results in revenue recognition.
  - Control in the transfer is key.

Recognition (cont.)

- Measurement
  - Not entirely settled yet.
  - Probably based on the transaction price, the promised consideration.
  - Some allocation for multiple items may be required.
  - Revenue is recognized as performance obligations are satisfied.

Potential Effects

- Little effect for many contracts (retail)
- Revenue recognition may be delayed in some cases
- Revenue may be recognized sooner in some situations
- Less capitalization of contract costs

Changes from Re-Exposure

- Criteria to assist when performance obligations are satisfied
- Simplifying criteria for determining separate performance obligations
- No requirement to adjust transaction price for collectability
- No discounts for contracts of less than one year
- Permitting the of “most likely amount” approach when estimating variable consideration

Next Steps

- Review comments received
- Public roundtable meetings
- Final document Q4 2012
- Earliest likely effective date – Perhaps 2015 but unknown at this date.

Revenue Recognition

Potential Changes to US GAAP and often asked questions.

Who would be Affected?

- Any entity that enters into contracts with customers unless those contracts are in the scope of other standards (such as insurance contracts or lease contracts.

Why are the FASB and the IASB issuing the Revised Exposure Draft?

- To clarify the principles for recognizing revenue and to develop a common revenue standard for U.S. GAAP and IFRSs that would:
- o Remove inconsistencies and weaknesses in existing revenue requirements.
- o Provide a more robust framework for addressing revenue issues.

Why… (cont.)

- o Improve comparability of revenue recognition practices across entities, industries, jurisdictions, and capital markets.
- o Provide more useful information to users of financial statements through improved disclosure requirements.
- o Simplify the preparation of financial statements by reducing the number of requirements to which an entity must refer.

Underlying Revenue Recognition Concepts

- **Current Guidance**
  - Realized or realizable and earned

  General Recognition Concepts

  1. Persuasive evidence of an arrangement exists.
  2. Delivery has occurred or services have been rendered.
  3. Price is fixed or determinable.
  4. Collectability is reasonably assured.
  5. Multiple industry options exist also.

Underlying Revenue Recognition Concepts (cont.)

- **Proposed Model:**
  - The transfer of a promised good or service determines when revenue is recognized and occurs when (or as) the customer obtains control of the asset.
  - Transfer can be made either at a point in time or over time.

Core Principles of the Revised Model

- Recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

Steps to Apply the Core Principle

1. Identify the contract(s) with the customer.
2. Identify the separate performance obligations.
3. Determine the transaction price.
4. Allocate the transaction price.
5. Recognize revenue when a performance obligation is satisfied.

Explanation of Key Terms

- **Current Guidance:**
  - The term persuasive evidence refers to evidence of he final understanding between parties about the specific nature and terms of an agreed-upon transaction.
  - Persuasive evidence is one of four revenue recognition conditions.
  - The form of persuasive evidence must be consistent with customary business practice (e.g., contract, purchase order, etc.)

Explanation of Key Terms (cont.)

- **Proposed Model:**
- A contract is an agreement that creates legally enforceable rights and obligations.
- • A contract with a customer must exist to be
- within scope of the model.
- • May be oral, written, or implied by
- customary business practices.

Explanation of Key Terms (cont.)

- To recognize revenue for a contract with a customer, the following criteria must be met:
  - Contract has commercial substance
  - Parties have approved contract and are committed to perform
  - Rights are identifiable
  - Payment terms are identifiable.

Delivery of product or performance of service

- **Current Guidance:**
- Revenue should not be recognized until the seller has substantially accomplished what it must do pursuant to the terms of the arrangement.
- Substantial accomplishment of performance usually occurs upon delivery of good(s) or performance of service(s).
- Delivery/performance is one of four revenue recognition conditions : Risks and rewards of ownership of the good(s) / service(s) must pass upon delivery / performance for revenue to be recognized.

Delivery of product or performance of service (cont.)

- **Proposed Model:**
- Delivery of goods or the performance of services is an indicator that control over contractually promised goods or services has transferred to the customer and that revenue may be recognized.
- Delivery or performance may occur at a point in time or over time.

Delivery of product or performance of service (cont.)

- **Proposed Model (cont.):**
- Indicators of the transfer of control include, but are not limited to, the following:
  - Right to payment
  - Passage of legal title
  - Physical possession
  - Significant risks and rewards
  - Customer acceptance.

Collectability

- **Current Guidance:**
- An arrangement's consideration (the seller's price) must be considered collectible for revenue to be recognized.
- • Collectability is one of four revenue recognition conditions (see slide 5).
- • Collectability must be reasonably assured.
- Real estate and some industry-specific guidance, such as that for franchisors, provide factors to consider when evaluating
- collectability.
- If a receivable has been recorded and revenue recognized, the receivable may be considered impaired if it is subsequently
- assessed as uncollectible (Sections 310-10-35 and 450-20-25).

Collectability (cont.)

- **Proposed Model:**
- The term collectability refers to a customer's credit risk, that is, the risk that the entity will be unable to collect contract consideration from the customer to which it is entitled.
- • There is no recognition threshold for expectations about collectability.
- • Revenue is recognized based on the amount to which the entity expects to be entitled, without regard to collection risk.
- • If collectability is significantly in doubt, a contract may not exist.
- • Any impairment losses (and reversals) would be presented as a separate line item adjacent to revenue.

Fixed or Determinable

- **Current guidance:**
- The seller's price (an arrangement's consideration) must be fixed or determinable for revenue to be recognized.
- • A fixed or determinable sales price is one of four revenue recognition conditions.
- • A fixed fee is a fee required to be paid at a set amount that is not subject to refund or adjustment.
- • The sales price in cancellable arrangements is generally not fixed or determinable until cancellation privileges lapse.
- The multiple-element arrangement guidance also contains criteria for price to be fixed or determinable.
- SEC guidance includes examples of determining whether a fee is fixed or determinable.

Fixed or Determinable (cont.)

- **Proposed model:**
- A contract's transaction price represents the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer.
- This price may include variable consideration components.
- An entity would estimate variable consideration using either:
- (1) An expected value (probability weighted amount)
- (2) The most likely amount depending on which method better predicts the amount of consideration to which the entity is entitled.
- If there is variable consideration, cumulative recognizable revenue may be constrained .

Constraint on the amount of revenue that can be recognized

- **Current guidance:**
- The amount of arrangement consideration that can be recognized is limited to the amount that is fixed or determinable.
- As indicated, having a fee that is fixed or determinable is one of four revenue recognition conditions.
- Certain industry guidance provide additional revenue recognition constraint considerations (for example, the guidance for sales of real estate and nonutility generators with a power sales contract containing scheduled price changes).

Constraint on the amount of revenue that can be recognized (cont.)

- **Proposed model:**
- If consideration is variable, then the cumulative amount of revenue an entity may recognize is limited to the amount that is "reasonably assured."
- Consideration attributed to a performance obligation is considered reasonably assured – and hence revenue recognition is not restricted – if both:
- (1) The entity has experience (or other evidence) with similar types of performance obligations.
- (2) The entity's experience (or other evidence) is predictive of the amount of consideration to which the entity will be entitled for satisfying its performance obligations.

Loss recognition (onerous test)

- **Current guidance:**
- Guidance on loss recognition is generally limited to guidance on loss contingencies in Topic 450, Contingencies.
- However, industry-specific guidance on recognizing losses on contracts is provided for construction- and production-type contracts.
- Under this guidance, provisions for losses are measured at the contract or segment level and consider total revenues and costs.
- Other loss recognition guidance pertains to:
- • Multiple-element software arrangements (concerning undelivered elements)
- • Extended warranty or product maintenance contracts.

Loss recognition (onerous test) (cont.)

- **Proposed model:**
- Each separate performance obligation within a contract with a customer determined at contract inception that is both (a) to be delivered or performed over time and (b) satisfied over a period greater than one year is subject to the onerous test.
- An onerous performance obligation, and corresponding expense, would be measured at the amount by which the lowest cost of settling the remaining performance obligation exceeds the amount of the transaction price allocated to that remaining performance obligation.

Licenses and rights to use

- **Current guidance:**
- Revenue from an intellectual property licensing agreement or similar arrangement (e.g., licenses of motion pictures, software, technology, other intangibles) cannot be recognized before inception of the license term.
- Once the term begins, revenue should be recognized consistent with the nature of the transaction and the earnings process.
- Additional license revenue recognition guidance is industry-specific

Licenses and rights to use (cont.)

- **Proposed model:**
- Revenue from a license or other right to use arrangement is recognized when the customer obtains control of the rights.
- • Revenue cannot be recognized before the beginning of the period the customer can use and benefit from the license property.
- • Revenue is generally recognized at a point in time, unless:
  - The fee is sales-based.
  - The fee is not sales-based but the entity is otherwise constrained by the reasonably assured criterion.
  - The right to use is combined with other performance obligations (i.e., is not distinct).

Deliverables

- **Current guidance:**
- Deliverables within an arrangement must be identified to determine whether each is a separate unit of accounting or if any/all must be treated as a bundle and accounted for as a single unit of accounting.
- While there is no formal definition of a deliverable, criteria are provided for determining whether a deliverable is a separate unit of accounting:
- (1) The delivered item(s) has standalone value to the customer.
- (2) If there is a general right of return relative to the delivered item, delivery or performance of the undelivered item or items is considered probable and substantially in control of the vendor.
- For software transactions, the software guidance contains examples of deliverables.

Deliverables (Cont.)

- **Proposed model:**
- All goods or services promised in a contract with a customer must be evaluated to determine which are distinct and should be accounted for as separate performance obligations (that is, as separate units of accounting).
- A performance obligation is a promise to provide a good or service, and may be implied by customary business practices, published policies, or specific statements.
- All promises to provide goods or services must create a valid expectation of the customer that the entity will transfer those goods or services.
- To determine if a promised good or service is distinct, criteria in paragraphs 27–30 would be applied.
- Separate performance obligations are allocated a portion of the transaction price.

Recognizing revenue over a period of time

- **Current guidance:**
- Generally, once all four revenue recognition conditions are met for service deliverables, service revenue should be recognized on a straight-line basis, unless evidence suggests revenue is earned in a different pattern, over the contractual term or expected service period (whichever is longer).
- For construction- and production-type contracts, the percentage-of-completion method for recognizing income over time should be applied if all of the following criteria are met:
- (1) Reasonably dependable estimates of progress toward completion, revenues and costs can be made.
- (2) The contract stipulates enforceable rights, consideration, and settlement.
- (3) The buyer expects to satisfy all obligations.
- (4) The contractor is expected to perform.

Recognizing revenue over a period of time (cont.)

- **Proposed model**
- Control of a promised good or service is considered to transfer to a customer over a period of time and, hence, revenue would be recognized over a period of time, if one of two criteria is met (otherwise, control is considered to transfer at a point in time).
- Specifically, a performance obligation is satisfied over time if at least one of the following two criteria is met:
- (1) The customer controls the asset as it is created or enhanced.
- (2) The asset created has no alternative use to the entity and either
  - (a) the customer receives a benefit (e.g., cleaning services),
  - **(b) another entity would not have to reperform (e.g., transport), or**
  - **(c) the entity has right to payment.**

Contract modifications

- **Current guidance:**
- Guidance on accounting for contract modifications is limited to industry-specific guidance such as that for construction- and production-type contracts.
- Under the guidance for construction- and production type contracts, contract revenue and costs must be adjusted for approved contract modifications involving scope and price.
- More detailed guidance is provided for unpriced change orders, which addresses the treatment for costs (expense or defer) and revenue if the percentage-of-completion method is applied.

Contract modifications (cont.)

- **Proposed model:**
- Accounting for contract modifications depends on the type of modification.
- The proposed model contains specific guidance to account for the following types of contract modifications:
- (1) Scope change with pending price change (unpriced change orders) [ED par. 19]
- (2) Price change only [ED par. 20]
- (3) Price and scope changes that constitute a separate contract [ED par. 21]
- (4) Price and scope changes that constitute a termination of the original contract and the creation of a new contract [ED par. 22(a)]
- (5) Price and scope change that constitute part of the original contract [ED par. 22(b)].

Disclosures

- **Current guidance :**
- No single Topic or Subtopic provides comprehensive disclosure requirements for revenue.
- Disclosure requirements are included in industry-specific and general recognition standards.
- The SEC also requires certain revenue disclosures for publicly traded companies.
- Disclosure requirements include:
- • General requirements (e.g., accounting policies, seasonal revenue, segments, related parties)
- • Specific requirements (e.g., multiple element arrangements, nonmonetary revenue transactions, bill-and-hold, fees for services)
- • Industry requirements (e.g., construction contractors, Franchisors).

Disclosures (CONT.)

- **Proposed model:**
- The objective of the disclosures is for users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows from contracts with customers.
- Certain tabular roll forwards of balances would be required to address this objective.
- Annual disclosures would be expanded to include the following areas:
- • Contracts with customers
- • Significant judgments and changes in judgments in applying the proposed guidance
- • Assets recognized from costs incurred to obtain or fulfill a contract.
- Interim disclosures would be required for certain of the above noted areas.

Repurchase agreements

- **Current guidance:**
- Guidance on accounting for repurchase agreements is limited to industry and transaction-specific guidance.
- Notably:
- (1) For sales of real estate, if the seller retains an obligation or option to
- repurchase the property or the buyer can compel the seller to repurchase, the transaction would not qualify for sale accounting. Instead, it would be treated as a financing, lease, or profit-sharing arrangement.
- (2) For product financing arrangements, sale accounting does not apply. Instead, they are accounted for as financing arrangements.

Repurchase agreements (cont.)

- **Proposed model:**
- The accounting for repurchase agreements depends on (a) which party holds the obligation or right, and (b) the relative repurchase price as compared to the original selling price:
- Forward or a call option - account for as either a lease or a financing arrangement depending on whether the repurchase price is less than or equal to/greater than the original selling price, respectively.
- Put option - account for as a lease, a sale with a right of return, or a financing agreement.
- Whether the customer has a significant economic incentive to exercise is a key accounting determinant for these types of repurchase arrangements.

Time value of money

- **Current guidance:**
- Interest should be imputed for receivables arising from transactions with customers in the normal course of business that are due in customary trade terms exceeding approximately one year.
- There is no requirement for entities to recognize interest on advance payments received from transactions with customers.

Time value of money (cont.)

- **Proposed model:**
- In determining the transaction price, the promised amount of consideration is adjusted to reflect the time value of money if the contract has a significant financing component.
- The proposed model includes some factors to consider when evaluating whether the financing component is significant.
- The time value of provisions need not be applied when the period between payment and the transfer of goods or services is one year or less.

Options for additional goods or services

- **Current guidance:**
- The general concepts for accounting for options to purchase additional goods or services are provided in Subtopic 605-25, Multiple-Element Arrangements.
- For software arrangements, the software guidance provides that if a vendor offers a more-than-insignificant incremental discount on a customer's future purchase of a good or service, the discount would be allocated to each element in the arrangement.

Options for additional goods or services (cont.)

- **Proposed model:**
- If a contract provides an option for the customer to purchase additional goods or services, an entity would assess whether that option provides the customer with a "material right."
- If it does, then the option would be accounted for as a separate performance obligation (that is, as a separate unit of accounting) and allocated a portion of the transaction price.

Determining standalone selling price

- **Current guidance:**
- An entity is generally required to determine the standalone selling price of a good or service based on the following hierarchy of evidence:
- (1) Vendor-specific objective evidence (VSOE)
- (2) Third-party evidence
- (3) Best estimate.
- Some industry-specific guidance, such as that for software and films, have specific guidance on allocating arrangement consideration to individual deliverables in multiple-element arrangements.
- For example, for multiple-element software arrangements, only VSOE of fair value may be used to allocate the fee.
- If VSOE does not exist, revenue is generally deferred.

Determining standalone selling price (cont.)

- **Proposed model:**
- Standalone selling price is the price at which an entity would sell a promised good
- or service separately to a customer.
- The best evidence of standalone selling price is the observable selling price of a good or service when the entity sells that good or service separately.
- Otherwise, an estimate of the standalone selling price must be made.
- Suitable estimation methods may include:
- • Adjusted market assessment
- • Expected cost plus a margin
- • Residual (if the standalone selling price is highly variable or uncertain).

Allocating contingent consideration

- **Current guidance:**
- In a multiple-element arrangement, an entity would generally allocate fixed or determinable consideration based on relative selling prices.
- However, an entity that has research or development deliverables or other units of accounting that include milestones that are satisfied over a period of time for which a portion or all of the consideration is contingent upon uncertain future events or circumstances can elect to apply the milestone method.
- Under this method, an entity recognizes revenue upon the achievement of a substantive milestone in its entirety when the milestone is achieved.

Allocating contingent consideration (cont.)

- **Proposed model:**
- While a contract's transaction price, which includes any contingent consideration, is generally allocated to each separate performance obligation based on relative standalone selling price the estimated contingent amount and subsequent changes would be allocated entirely to a distinct good or service if both:
- • The contingent payment terms relate specifically to the entity's performance for that distinct good or service.
- • The allocation to that distinct good or service is consistent with the allocation principle considering all performance obligations and contract payment terms

Transfers of nonfinancial assets

- **Current guidance:**
- Guidance on accounting for the derecognition of nonfinancial assets is limited to transaction specific guidance, such as that for disposals of long-lived assets and sales of real estate (excluding consideration of business dispositions).
- The guidance on sales of real estate applies to all entities, regardless of the
- nature of the seller's business.
- Specific criteria must be met for profit to be recognized in full on the date of sale, such as, but not limited to, the following conditions:
- - Buyer's initial and continuing investment demonstrates a commitment to pay.
- - No substantial continuing involvement bythe seller

Transfers of nonfinancial assets (cont.)

- **Proposed model:**
- For the derecognition of nonfinancial assets, including intangibles (within the scope of Topics 350) and plant, property, and equipment (within the scope of Topic 360), that are not an output of an entity's ordinary activities, an entity would apply the
- (a) the proposed guidance on control to determine when to derecognize the asset and
- (b) the proposed measurement guidance to determine the amount of gain or loss to recognize upon derecognition of the asset.

Costs of obtaining a contract

- **Current guidance:**
- Guidance on accounting for the costs of obtaining a contract varies by transaction and industry.
- Generally, an accounting policy determines whether incremental direct costs incurred related to the acquisition or origination of a customer contract are capitalized or expensed.
- For SEC registrants, the policy for determining which costs to capitalize as contract acquisition and origination costs should be disclosed.

Costs of obtaining a contract (cont.)

- **Proposed model:**
- An entity would recognize an asset for incremental costs of obtaining a contract with a customer if the costs are recoverable. Incremental costs are those costs that an entity incurs in its efforts to obtain a contract that it would not have incurred if the contract had not been obtained (for example, sales commissions).
- Capitalized costs would be amortized consistent with the pattern of transfer of the goods or services to which the asset relates.
- If the amortization period would be one year or less, an entity may elect to expense the costs.
- Capitalized costs also would be subject to impairment testing.

Direct-response advertising costs

- **Current guidance:**
- Direct-response advertising costs are capitalized if both of the following conditions are met:
- • The primary purpose of the advertising is to elicit sales to customers who could be shown to have responded specifically to the advertising.
- • The direct-response advertising results in probable future benefits.

Direct-response advertising costs (cont.)

- **Proposed model:**
- Costs relating to direct-response advertising would be expensed as incurred because such costs are not incremental costs of obtaining the contract.

Costs of fulfilling a contract

- **Current guidance:**
- Guidance on accounting for contract fulfillment costs is limited to industry-specific guidance for construction- and productiontype contracts.
- Under this guidance, the following costs are accumulated in the same manner as inventory costs and are charged to operations as the related revenue from contracts is recognized:
- • Precontract costs.
- • Direct costs, such as material, labor, and subcontracting costs.
- • Indirect costs allocable to contracts.
- General and administrative and selling costs are expensed as incurred

Costs of fulfilling a contract (cont.)

- **Proposed model:**
- If the costs incurred in fulfilling a contract are not in the scope of another Topic (for example, Topic 330, Inventory), an entity would recognize an asset if those costs meet all of the following criteria:
- (1) Relate directly to a contract or a specific anticipated contract (e.g. direct labor and direct allocations of costs)
- (2) Generate or enhance resources that will be used in satisfying performance obligations in the future
- (3) Are expected to be recovered.
- Certain costs are expensed as incurred, such as most general and administrative costs.
- Capitalized costs would be amortized consistent with the pattern of transfer of the goods or services to which the asset relates, and subject to impairment testing.

Other accounting topics that may be affected by the proposed model

- **Accounting topic:**
- Allocating a discount entirely to one (or some) separate performance obligations [Exposure Draft paragraphs 74, 75, and IG68]
- Inconsequential or perfunctory obligations [Exposure Draft paragraphs 23–30, IG16, IG20, and IG62]
- Presentation of taxes collected from customers and remitted to governmental authorities [Exposure Draft paragraph 50]
- Loyalty programs [Exposure Draft paragraphs IG23 and IG79]

Other accounting topics that may be affected by the proposed model (cont.)

- Noncash (nonmonetary) consideration [Exposure Draft paragraphs 63 and 64]
- Right of return asset [Exposure Draft paragraphs IG2–IG9 and IG76]
- Amount of arrangement consideration allocated to warranty deliverables [Exposure Draft paragraphs IG10–IG15 and IG77]
- Uninstalled materials [Exposure Draft paragraph 46]

Other accounting topics that may be affected by the proposed model (cont.)

- Customer's unexercised rights (breakage) [Exposure Draft paragraphs IG25–IG28]
- Bill-and-hold arrangements [Exposure Draft paragraphs 37 and IG51–IG54]
- Combining contracts [Exposure Draft paragraphs 16 and 17]
- Funded software-development arrangements [if the counterparty is a customer, then the Exposure Draft applies]

Codification guidance affected by the revised Exposure Draft

- **Underlying revenue recognition concepts**
- Section 605-10-S99 (SAB Topic 13)
- Real Estate Sales – criteria for recognizing profit on sales of real estate under full accrual method; recognition of profit when the full accrual method is not appropriate [Section 360-20-40]
- Construction – recognition [Section 605-35-25]
- Agriculture – patron transactions with marketing cooperatives [Section 905-605-25]
- Airlines – passenger and air cargo; sales-life match and sampling methods [Section 908-605-25]

Codification guidance affected by the revised Exposure Draft (cont.)

- Contractors–Federal Government – fees under cost-plus-fixed fee contracts; convenience terminations [Subtopic 912-605]
- Development Stage Entities – general recognition principles [Subtopic 915-605]
- Broadcasters – exchanges of unsold advertising time for products and services [Section 920-605-25]
- Cable Television – hookup revenue [Section 922-605-25]
- Films – film sales; licensing arrangements [Section 926-605-25]
- Music – other fees paid [Section 928-605-25]
- Oil and gas – take or pay contracts [Section 932-605-25]

Codification guidance affected by the revised Exposure Draft (cont.)

- Underlying revenue recognition concepts (cont'd) (see slide 5)
- • Brokers and Dealers – underwriting commitment fees; mutual fund distribution fees [Subtopic 940-605]
- • Depository and Lending – insurance commissions [Subtopic 942-605]
- • Mortgage Banking – fees for services rendered [Subtopic 948-605]
- • Franchisors – initial franchise fee [Subtopic 952-605]
- • Health Care Entities – revenue from health care services [Section 954-605-25]

Codification guidance affected by the revised Exposure Draft (cont.)

- Not-for-Profits – general recognition principles for exchange transactions [Section 958-605-25]
- Real Estate–General – initial rental operations; investor profit recognition; real estate syndication [Section 970-605-25]
- Real Estate–Common Interest Realty Associations – special assessments [Section 972-605-25]
- Retail Land – methods of profit recognition [Section 976-605-25]
- Time-Sharing Activities – profit recognition issues-continuing seller involvement [Section 978-605-35]
- Regulated Operations – long-term power sales contracts [Subtopic 980-605]
- Software – recognition [Section 985-605-25)

FASB Project Website

- www. fasb.org
- Projects tab
- Revenue Recognition project
- Revised Exposure Draft (Nov 2011)
- Podcast (Nov 2011)
- Webcast (Dec 2011)
- FASB in Focus (Dec 2011)
- Codification amendments (Jan 2012)

Thank you for your attention

Audit Update - SAS

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