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The BUSINESS of Accounting

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New Revenue Recognition Rules in the Pipeline

Over the past several years, we have seen the adoption of International Financial Reporting Standards (IFRS) in much of the rest of the world. Although the SEC has not mandated the adoption of IFRS for public entities in the United States, the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) have continued chipping away at the differences in accounting principles promulgated by both standard setters.

Over the past couple of years, the FASB and IASB have been working on the convergence of the revenue recognition rules. These new rules are expected to be approved in the fourth quarter of 2013 by the FASB, tentatively requiring public companies to apply the new standard for annual reporting periods beginning after December 15, 2016, including interim reporting periods, which would be March 31, 2017, for calendar-year-end public companies. Private companies would be required to apply the new standard for annual reporting periods beginning after December 15, 2017.

While it may sound like you have plenty of time, it's important to keep in mind what exactly is involved in preparing to adopt the new rules.

One Model for All Companies

Historically, revenue recognition rules were fairly broad and principles based. However, as business models grew increasingly more complex—and in particular with software companies upending traditional revenue models—the FASB created a complicated system of rules governing how U.S. companies in various industries recognized revenue. The differing rules not only created confusion for businesses with cross-industry activities but also introduced a host of complexities for international organizations engaged in commerce around the globe.

Hence the convergence effort to develop a common standard between U.S. generally accepted accounting principles and IFRS. The goal is to remove inconsistencies in existing standards and practices, improve disclosures and comparability between financial statements, and simplify the requirements for financial reporting. The result will be a decrease in the industry-specific rules U.S. companies will have to deal with. The new rules may also result in companies' exercising more judgment in the application of these rules, providing more disclosures, and making certain changes to existing business practices and customer contracts.

Once formally adopted, the new approach will be based on a five-step framework:

1. Identify contracts with the customer that give the company enforceable rights
2. Identify the separate performance obligations in the contract
3. Determine the transaction price
4. Allocate the transaction price to the separate performance obligations in the contract
5. Recognize revenue when the entity satisfies a performance obligation

While this framework is unlikely to change before the expected approval in the fourth quarter, at its most recent joint meeting on September 18, 2013, the FASB and IASB were deliberating on clarifications to the proposed changes primarily around the topics of collectibility, constraints on variable consideration contracts, and licenses. Unlike in the past, this framework will apply to all companies, regardless of industry or location. The goal is to make revenue recognition rules simpler to follow and more helpful to investors.

Preparing for the New Standard

Although the effective date seems far enough away to add this to next year's accounting agenda for most financial and accounting executives, retrospective application may be required, so companies may want to begin gathering the information necessary to record revenues under the new framework sooner rather than later. Companies will have to figure out both what they've been doing historically to recognize revenue and what they'll need to do going forward.

Some key steps to consider:

• Ensure that resources are available to properly evaluate revenue transactions. Current accounting staff may not be sufficient to take on this project when considering their day-to-day responsibilities.

• Review existing contracts and consider how the new rules are going to affect the contracts—a process that may be difficult for companies that engage in long-term contracts that are in effect for several years.

• Plan a road map for implementation. Changes in business processes and accounting systems may require new hardware, software, and training resources.

• Consider using subject-matter experts. Having someone who understands how other companies are thinking and reacting to the new rules can open your eyes to possible options in implementing them.

• Monitor any developments in the joint FASB and IASB revenue project, and identify key stakeholders in your organization whom you should educate on the new guidance, including the timing of coming changes.

Private companies that are likely to go public in the next few years should take special precautions to make sure they're ready by March 2017. Private companies that are acquired by a public company will likely need to conform to revenue recognition policies for reporting as a consolidated entity after the acquisition. Although private companies will have more time to prepare, it may be worthwhile to take these steps sooner in preparation for such a transaction.

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Submitted by Moss Adams LLP

Widening the GAAP? Accounting Changes for Private Companies

Most businesspeople are aware that financial results are reported based on U.S. generally accepted accounting principles, or GAAP. Some also know that in certain areas, GAAP for public companies (generally those that report through the SEC) differs from GAAP for private companies. Those areas of difference, however, have historically been intentionally minimal, under a general idea that all companies should follow the same standards.

This issue has sparked debate over the years: Should there be more differences? After all, does it really make sense that a "too big to fail" financial institution and, say, a family-owned construction company should report under the same GAAP?

At present, perhaps more than any other time since the Financial Accounting Standards Board became the GAAP standard setter in 1973, some are saying it doesn't make sense. More specifically, there is a feeling that in certain areas, GAAP is too complex or expensive to implement and, in either case, results in numbers that are not informative to financial statement users.

In the face of increasing discussion and concern about this issue, the Private Company Council was established in 2012 to be a special advisor to the FASB. The PCC identifies, deliberates, and votes on proposed modifications to existing GAAP for private companies. However, the PCC isn't merely an advisory board; it appears to have real influence to effect changes in GAAP for private companies.

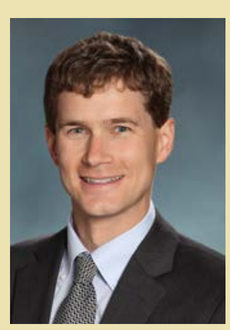
The first batch of topics the PCC has addressed relates to aspects of accounting for business combinations and reporting intangible assets, accounting for certain interest-rate swaps, and accounting for certain involvement with so-called variable interest entities. In each of these areas, the PCC has proposed substantive changes to GAAP for the benefit of private companies.

For example, a PCC proposal for certain receive-variable, pay-fixed interest-rate swaps would allow private companies to use a simplified method to report those swaps. Another PCC proposal, one involving goodwill recorded in a business combination, would permit a private company to subsequently amortize goodwill over a period of 10 years, or less under certain circumstances, and to apply a simplified impairment model to goodwill. These proposed changes to GAAP were not final as of this writing, but, if finalized in the near future, they could be available to private companies for 2013 reporting.

Time will tell how these changes will be accepted in practice. Financial statement preparers might welcome the simplification. Auditors of private companies might do the same, and they will need to prepare to advise their clients on the accounting elections that become available.

And what about lenders, regulators, and other users of financial statements? It is difficult to predict what their reactions would be, but in general they will need to be mindful of the fact that differences in reporting standards will likely mean a wider range of accounting elections for companies to choose from, which will make comparing companies' reports that much more difficult.

For now the PCC is shaking things up a bit, and it bears watching to see how financial reporting will change.



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Submitted By Moss Adams LLP

Big Data Can Grow Private Equity and Venture Capital

If you have ever let hundreds of emailed newsletters, solicitations, and memos sit in your inbox because you cannot take time to read, sort, process and analyze them, congratulations—you have confronted the problem of Big Data.

Information experts define Big Data as data that has significant volume, velocity, and variety—so much so that it requires sophisticated additional filtering and analysis for organizations to make sense of it. Big Data ranges from the detailed line items on countless types of business transactions, to the millions of advertising "clicks" on Internet websites, to the many hours of recorded video on security cameras in retail stores.

The flood of information keeps coming fast and furious. Intel co-founder Gordon Moore famously predicted that computing power would double every 18 months. According to some sources, every minute, users on the Internet generate 48 hours of YouTube videos; Facebook users share 684,478 pieces of content; Instagram users share 3,600 new photos; and Tumblr sees 27,778 new posts published. The sheer volume of data requires that companies become more sophisticated in their ability to collect data if they want to leverage that data to make business decisions. Those who utilize the right technologies and develop the capabilities to make sense out of all of these data are most likely to establish the basis for distinct competitive advantages.

Challenges for Private Equity Firms

The challenge of Big Data may not be so clear for the investment and portfolio company teams at private equity (PE) funds who may not have an in-depth familiarity with how to leverage that data to improve entity value.

The challenge of Big Data may not be so clear for the investment and portfolio company teams at private equity (PE) funds who may not have an in-depth familiarity with how to leverage that data to improve entity value.

Most PE firms likely have companies in their portfolios that are spread across numerous industries. It is likely that the level of sophistication in the amount, variety, and quality of data that each company collects will vary greatly, as does its system for gathering information. Each portfolio company also is producing its own reports and analysis. Even if PE firms know which data is available to their portfolio companies, the portfolio companies may have challenges in aggregating, filtering, and organizing the data for meaningful decision-making. These challenges add to complications for PE firms that may want to analyze data across their portfolio companies in a particular industry.

Where Does a PE Firm Start?

The first step is to identify the organization's information needs. "We look at the kind of data a company needs and could potentially use to improve agility, drive competiveness, and improve EBITDA," says David Rubin, CohnReznick Principal and Management Consulting National Director. "We cannot anticipate the full breadth of decisions a company will have to make at any point in time. We need to establish platforms that are flexible and agile so that management can rapidly gain access to new forms and views of data as necessary," says Rubin.

Executives match the need for information with the entire data set that the company has access to; however, organizations are likely to face challenges in making that data usable. Internally, companies frequently have problems leveraging all of the data available to them. This issue is magnified for PE firms that may want to compare key metrics among and across multiple companies within the same industry. Organizations that grow through acquisition frequently deal with many data management issues. As the organizations join together, these companies typically face differences in nomenclature, data structure, etc. that make it difficult to extract meaningful information.

Next Steps for PE Fund Managers

Many PE fund managers are familiar with the challenges in processing Big Data into useful information for decision making. As a result, most PE firms still generate reports in Excel, instead of using a uniform system to manage and aggregate information. Further their analysis and access to data is frequently limited to aggregated information supplied by the portfolio companies.

By deploying an effective Big Data strategy, PE firms and their portfolio companies can meaningfully combine and leverage data from a variety of typically disparate sources. Companies should regularly re-examine the data they produce and the goals they seek to accomplish in order to discover whether their Big Data strategies have improved their capabilities to extract meaningful analysis from disparate sources of information.

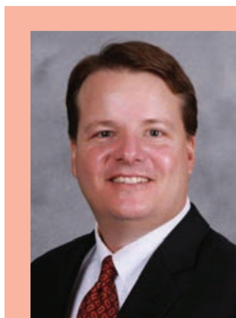
Opportunities

Companies also can access Big Data beyond their own hard drives. It is more and more common for companies to be mentioned in social media and other external sources. Apartment managers face harsh reviews of their properties on Yelp and Apartments.com. Manufacturers have their products reviewed on Amazon and Facebook pages. Employees report their likes and dislikes about their companies on Glass Door. The key to the successful use of Big Data is developing a strategy to assess the value, trends, and potential impact of the review comments made as well as other unstructured external data. Establishing sentiment trends is an emerging but potentially valuable science. How many poor reviews does a restaurant generally receive before revenue is impacted?

PE firms should consider tackling Big Data according to the indicators that increase valuation. When reviewing social media data, the sentiment analysis tools may not interpret all the comments correctly; but because the scale of the data is so large, false positives and false negatives typically average out to produce a meaningful result.

This data also can help companies identify opportunities to grow business. For example, online retailers capture information on their customers every time a buyer creates an online account and makes a purchase. A vendor that puts this information together may be able to glean valuable insight on the intersection between such factors as customer demographics, geography, and buying patterns. An online store can become a giant focus group for these retailers. Stores can gain insights into changes in brand preferences, demographics, buying patterns, and their own potential competitive advantages as well as disadvantages.

Once a company has established a sound basis of market information, Big Data techniques can be used to leverage this data on buying trends to help it decide about its future operations, capital expenditures, and supply chains. The information can help companies evaluate their production schedules, labor costs, inventory levels, marketing costs, capital expenditures, and overall supply chain requirements.



Submitted by CohnReznick LLP

By Craig Golding CPA, Partner

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New Reporting Options

Changes in Financial Reporting Options for Private Companies

When I entered public accounting 40 years ago, there were 31 Accounting Principles Board Opinions and nine Accounting Research Bulletins (43-51).

There were a few interpretations and some additional requirements, imposed by laws that public companies had to follow in their financial reporting. In spite of the simplicity compared to today, there was already discussion of "Big GAAP" and "Little GAAP." The idea that the complexity of financial reporting had exceeded the needs of small companies was already being debated.

Today we have a much more voluminous and complex set of financial reporting standards and the calls for simpler reporting for small companies have grown in their frequency and volume. There are two avenues being taken to address the complexity of financial reporting:

- The first is within the structure of the Financial Accounting Foundation (FAF), the oversight body for FASB that will work with FASB to modify GAAP for private companies.
- The second is an AICPA developed framework, separate from GAAP that provides a new non-GAAP, Other Comprehensive Basis of Accounting (OCBOA).

Why Are These Changes Occurring?

A Blue Ribbon Panel on Financial Reporting Standards for Private Companies—with members from the AICPA, the FAF and the National Association of State Boards of Accountancy—proposed in 2011 a separate standard-setting body for small businesses that would operate under the FAF umbrella, parallel to FASB. The FAF rejected the proposed establishment of a separate standard setting body for small businesses and, instead, a Private Company Council (PCC) was established with an advisory role to FASB.

The PCC has two primary responsibilities:

Today we have a much more voluminous and complex set of financial reporting standards and the calls for simpler reporting for small companies have grown in their frequency and volume.

- To determine whether modifications or exceptions to existing nongovernmental GAAP are required to address the needs of users of private company financial statements, based on criteria mutually agreed to by the PCC and FASB.
- To serve as the primary advisory body to FASB on the appropriate treatment for private companies for items under active consideration on FASB's technical agenda.

The PCC has had three meetings, has issued an exposure draft asking for input about its process and has identified the initial standards on which it will focus. The result of its work will be GAAP modifications that may be elected by private companies.

Since FAF rejected the proposal for a separate standard-setting body for private companies, the AICPA has issued its Financial Reporting Framework for Small- and Medium-sized Entities (FRF for SME)—a 188-page, simplified reporting framework for private companies. Unlike the PCC, the AICPA's FRF for SME does not purport to be GAAP, but rather represent an OCBOA that can be adopted by any company that chooses to do so—as long as the users of the information are willing to accept the statements prepared in accordance with that framework.

What About International Standards?

The International Organization of Securities Commissions began an initiative in 1988 to develop a single, high-quality and comprehensive set of accounting standards, and to work with accounting standard setters around the world to harmonize national standards. The result of this initiative was the International Financial Reporting Standards (IFRS) that have been adopted by more than 100 countries worldwide and caused a great reduction in the diversity in financial reporting around the world. While the United States has not adopted IFRS, FASB and the International Accounting Standards Board (IASB) have been cooperating to harmonize their standards. Also, foreign registrants are allowed to file financial statements in accordance with IFRS with the SEC without reconciliation to U.S. GAAP.

The needs of smaller companies have not been ignored by the IASB that promulgates IFRS. The IASB has issued IFRS for Small- and Medium-sized Enterprises (SMEs), a self-contained standard of about 230 pages that is designed to meet the needs and capabilities of SMEs. Compared with full IFRS—and many national GAAPs—IFRS for SMEs is less complex.

While the SEC will not allow a U.S. domestic company to use IFRS financial statement filings, there is nothing to prevent a U.S. company from preparing financial statements in accordance with IFRS or IFRS for SMEs. A U.S. CPA also may issue an audit, review or compilation report on those statements—as long the CPA discloses the fact that IFRS is the accounting framework being followed.

The IASB also has developed guidance to help micro-sized entities apply IFRS for SMEs. These very small companies, with just a few employees, can access this guidance that extracts from IFRS for SMEs only those requirements that are likely to be necessary for a typical micro-sized entity—without modifying any of the principles for recognizing and measuring assets, liabilities, income and expenses. It contains additional guidance, examples and cross-references to IFRS for SMEs. If the guidance is followed, the financial statements and auditor's report could refer to conformity with IFRS for SMEs because they do not modify its requirements.

What's on the PCC's Agenda?

The PCC has been in existence for a few months and has already issued an exposure draft for an overall approach to standard setting for private companies, Private Company Decision-making Framework—A Guide for Evaluating Financial Accounting and Reporting for Private Companies.

It also has issued three proposals for changing standards for private companies:

1. Business Combinations (Topic 805): Accounting for Identifiable Intangible Assets in a Business Combination would allow a private company— if it chooses to—to report fewer intangible assets separately from goodwill than current GAAP would require.
2. Intangibles—Goodwill and Other (Topic 350): Accounting for Goodwill would allow a private company to amortize goodwill over the useful life of the primary asset (primary asset is the most significant long-lived asset) acquired in a business combination, not to exceed 10 years. It also would allow goodwill to be tested (at the entity-wide level instead of the reporting level) for impairment only when a triggering event occurs that would more likely than not reduce the fair value of an entity below its carrying amount.
3. Derivatives and Hedging (Topic 815): Accounting for Certain Receive-Variable, Pay-Fixed Interest Rate Swaps would allow two alternative approaches in accounting for certain types of swaps that are entered into by a private company for the purposes of economically converting variable-rate borrowing to fixed-rate borrowing.

The PCC is also taking up accounting for variable interest entities, as well as working on simplifying GAAP, but it will be a process that will take time and continue to evolve.

Should My Private Company or Client Consider FRF for SME?

The idea is that FRF for SME is somewhere between GAAP and accrual income tax basis reporting. It's historical, cost-based and allows the private company to choose among accounting policies. The framework is less prescriptive than GAAP and encourages the use of professional judgment in deciding how to account for a transaction or event.

The International Organization of Securities Commissions began an initiative in 1988 to develop a single, high-quality and comprehensive set of accounting standards, and to work with accounting standard setters around the world to harmonize national standards.

An entity using FRF for SME must not:

- Have regulatory reporting requirements that require GAAP.
- Intend to go public.
- Operate in an industry with specialized accounting.
- Have complicated transactions or significant foreign operations.
- Must be for-profit.

Users of FRF for SME statements should have direct access to management and be primarily interested in cash flows, liquidity and the balance sheet. Lenders using FRF for SME statements should have collateral or a basis for evaluation beyond the financial statements. Unless there is a legal or regulatory requirement for a company to issue GAAP financial statements, it's between company management and the users and potential users of the financial statements to decide the basis of the financial statements.

What Are Some of the Specific Differences?

The main difference is that FRF for SME is OCBOA, not GAAP. Some of the specific differences compared to GAAP are:

- Limited use of fair values.
- No impairment assessment for long-lived assets.
- No comprehensive income reporting.
- No variable interest entity reporting.
- No evaluation of uncertain tax positions.
- Option to use deferred income tax or taxes payable method.
- Blend of GAAP and income tax accounting for leases.
- Allows revaluation of assets on subsidiary's financials upon by parent acquisition (push-down accounting).
- No impairment testing for goodwill.
- Goodwill is amortized over tax life or 15 years.

Should I Change My Accounting?

The answer to this question lies in a candid discussion between company management, its outside accountants and the users of the company's financial statements. If there's agreement that an alternative to U.S. GAAP will better serve the parties involved, a change can be made.

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Headquartered in San Mateo, Calif., the California Society of Certified Public Accountants (CalCPA) (www.calcpa.org) is the nation's largest state accounting organization and the largest CPA association in California. It serves 40,000 members in public practice, private industry, consulting, education and government. Additionally, through CalCPA Institute, a 501(c)3 nonprofit, CalCPA members provide financial literacy programs to high schools and community groups. For more information, contact Maria Nazario at maria.nazario@calcpa.org.

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