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## Panel IV. Accounting Issues

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Introduction

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Q & A

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# FASB Accounting Standards Codification™



# FASB Codification and Revenue Recognition

**Presenter:**

**Robert J. Cepielik**

**Partner**

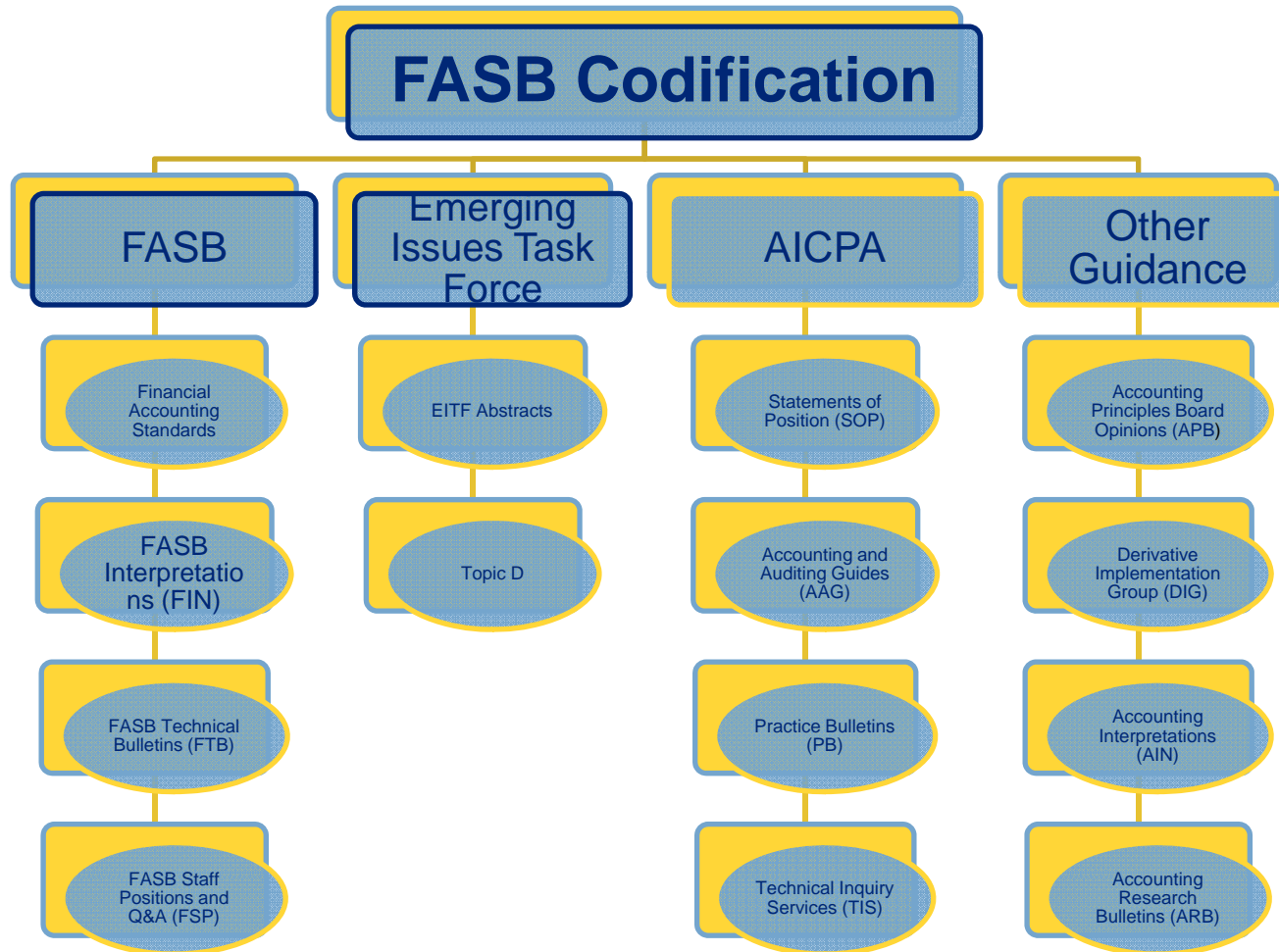
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## What is the FASB Codification?

- An initiative started by FASB in 2004 to reorganize the thousands of US GAAP pronouncements into approximately 90 accounting topics
- The source of authoritative US GAAP to be applied by all nongovernmental entities
- NOT intended to change U.S. GAAP
- Supersedes existing sources of U.S. GAAP
- Eliminates the four levels of the U.S. GAAP hierarchy (for nongovernmental entities)
  - All accounting guidance carries an equal level of authority

Source: AICPA , “Are You Ready For The New FASB Codification,” 2009

## What Is Included in the Codification?



## Why Codify US GAAP?

- According to the FASB's Accounting Standards Codification Notice to Constituents, a survey was taken to poll stakeholders on existing U.S. GAAP
  - 80% believe U.S. GAAP is confusing
  - 85% stated that the current effort to research is excessive
- To reduce the complexity of accounting standards and to facilitate international convergence (IFRS)

Source: AICPA , "Are You Ready For The New FASB Codification," 2009

## Why Codify US GAAP? (continued)

- Difficulty ensuring completeness of all relevant guidance and accuracy of its application to an accounting issue as a result of:
  - Multiple types of standards
  - Various parties setting standards
  - Numerous indexing schemes
  - Different levels of authority creating standards

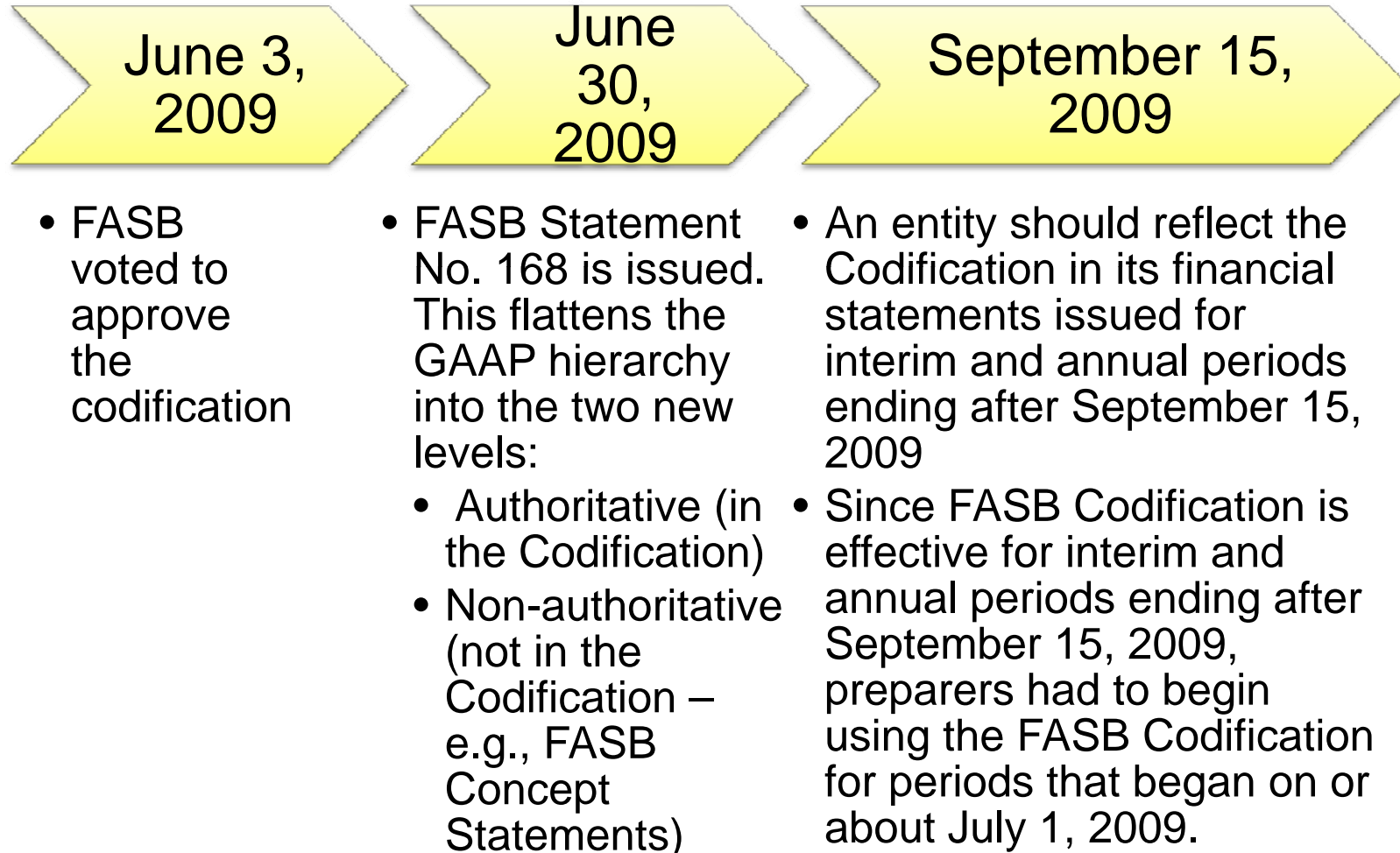
Source: AICPA , “Are You Ready For The New FASB Codification,” 2009

## FASB Codification Goals

- Simplify/ reorganize US GAAP accounting guidance
  - Reduce the amount of time and effort required to solve an accounting research issue
  - Provide accurate information with real-time updates as Accounting Standards Updates are released
  - Improve usability of the accounting guidance mitigating risk of noncompliance or misinterpretation of standards
  - Assist the FASB with the research and convergence efforts required during the standard-setting process
  - To become the authoritative source of literature for the completed XBRL taxonomy

Source: AICPA , “Are You Ready For The New FASB Codification,” 2009

## The FASB Codification Timeline



Source: AICPA , “Are You Ready For The New FASB Codification,” 2009

## How Is the Codification Organized?

- | <i>If you referred to...</i>   | → | <i>Now you would consult...</i> |
|--|---|---------------------------------|
| ■ FASB Statement 141(R)<br>■ (guidance on accounting for business combinations)          | → | ASC 805                         |
| ■ FASB Statement 5<br>■ (guidance on loss contingencies)                                 | → | ASC 450                         |
| ■ EITF 00-21<br>■ (guidance on revenue recognition for multiple element arrangements)    | → | ASC 605-25                      |
| ■ FASB Statement 13, paragraph 7<br>■ (guidance on the classification of a lease)        | → | ASC 840-10-25-1                 |
| ■ SOP 97-2, paragraph 10<br>■ (guidance on software arrangements with multiple elements) | → | ASC 905-605-25-6                |

*Note: The above are selected examples. This is not a complete listing of codification references.*

## Financial Statement Impact

- Financial statement footnotes will no longer reference the authoritative source of GAAP
  - E.g., “as required by FASB Statement No. 133.”
- FASB encourages the use of plain English for financial statement footnotes in the future
  - E.g., “as required by the Derivatives and Hedging Topic of the FASB Accounting Standards Codification.”
- References to authoritative literature in financial statements and related footnotes should be to FASB codification rather than to pre-FASB codification standards

Source: AICPA , “Are You Ready For The New FASB Codification,” 2009 and McGladery & Pullen, “The Effect of the FASB Codification Disclosures in F/S”

## How to Access the FASB Codification

- It is available online, after a quick registration, at <http://asc.fasb.org>
  - free access to a *basic view* of the FASB Codification
  - fee based subscription to the *professional view* which has enhanced functionality
    - Includes: search and retrieval functions, printer-friendly with sources utility, cross reference features, personal annotations, and dynamic linking capabilities
- FASB will evaluate whether to print future editions of the Codification based on the demand for the printed version.

Sources: AICPA , “Are You Ready For The New FASB Codification,” 2009 and FASB, “FASB Codification Expected to Become Single Source of Authoritative US GAAP,” July 2009.



# Revenue Recognition – Update with respect to Codification

## **Presenter:**

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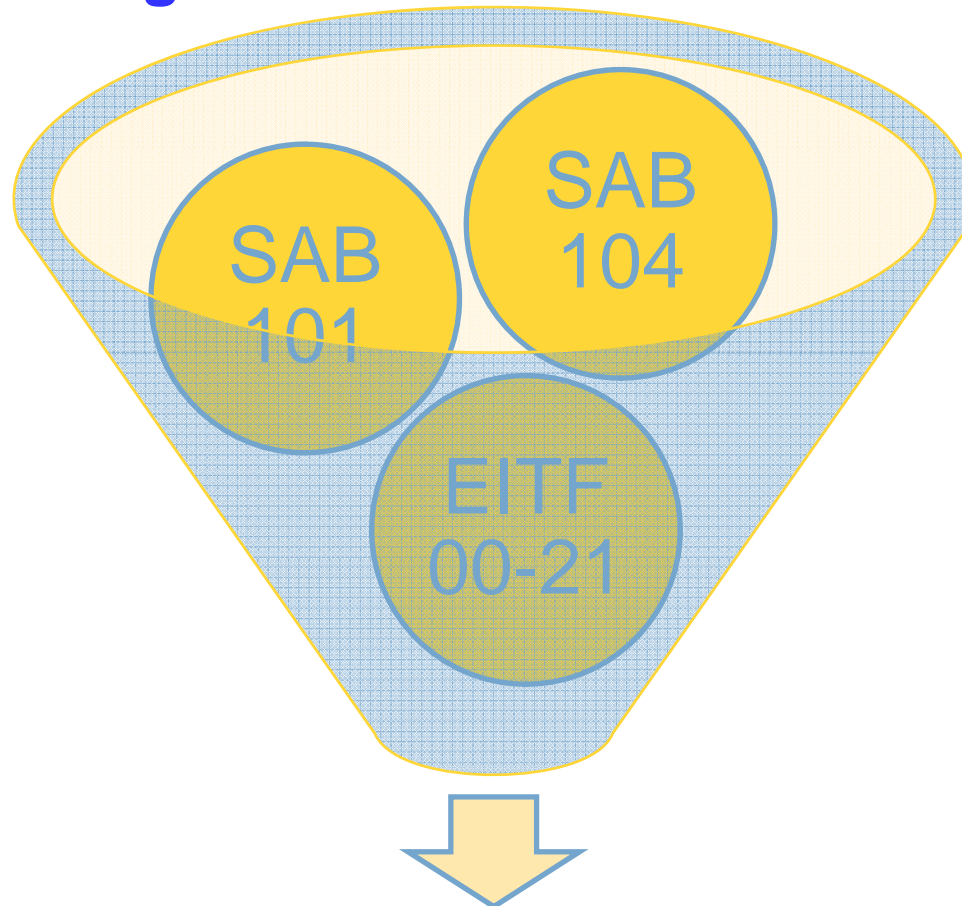
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# Revenue Recognition – Update with respect to Codification

## Revenue Recognition

- Existing US GAAP has been adopted in the FASB Codification process
- General revenue recognition guidance has not changed as a result of the FASB Codification
- Revenue Recognition has been consolidated for convenience

## Revenue Recognition



**Codified Revenue  
Recognition (Section 605)**

## Revenue Recognition Requirements

- Section 605: Revenue should not be recognized until it is realized or realizable and earned
  - Revenue is generally realized or realizable and earned when all four criteria are met:
    - Persuasive evidence of an arrangement exists
    - Delivery has occurred or services have been rendered
    - The seller's price to the buyer is fixed or determinable
    - Collectability is reasonably assured

## TIS Section 5100-Revenue Recognition

- FASB codified sections .38-.76 of the AICPA TIS section 5100, elevating them from previously non-authoritative guidance to authoritative GAAP for nonpublic/nongovernmental entities.
  - Upon its release as authoritative on July 1, 2009, FASB is the source of authoritative U.S accounting and reporting standards for nonpublic/nongovernmental entities in addition to guidance issued by the SEC.
  - For those entities that require change of revenue recognition policies, guidance will be applied prospectively for revenue arrangements entered into or materially modified in annual periods beginning on or after December 15, 2009, and interim periods within those years

Source: AICPA , “Are You Ready For The New FASB ASC,” June 30, 2009

## TIS Section 5100-Revenue Recognition

Paragraph Number	Title
.46	Nonmonetary Exchanges of Software
.49	Application of Contract Accounting in Software Arrangements
.56	Concessions and Software Revenue Recognition
.67	Customer Acceptance and Software Revenue Recognition
.78	Fair Value in Multiple-Element Arrangements That Include Contingent Usage Based Fees and Software Revenue Recognition

*Note: The above are selected examples. This is not a complete listing of TIS Section 5100 references.*



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# **RECENT ACCOUNTING DEVELOPMENTS FAIR VALUE MEASUREMENTS**



PMA Capital Corporation

# RECENT ACCOUNTING DEVELOPMENTS FAIR VALUE MEASUREMENTS

**Presenters: William E. Hitzelberger  
EVP & CFO**

## Overview

- **Pace of change from cost basis to fair value basis in financial reporting accelerated over past several years**
- **Logical start was financial instruments with plan to report virtually all**
- **Recent financial crisis highlighted several issues**
  - Valuation in a distressed market
  - Other than temporary impairments- rules based approach led to illogical write-downs and significant earnings charges
  - Disclosure
    - Level of detail varied
    - Difficult to determine who owned the “riskier” assets

## Topic 820 - Fair Value Measurements and Disclosures (formerly FAS 157)

- **Effective for fiscal years beginning after November 15, 2007**
- **Applicable to all GAAP requiring fair value (except stock-based compensation)**
  - Defines fair value – price received to sell an asset or paid to transfer a liability
    - An “exit” price
    - Orderly transaction by market participants
    - Assumes highest and best use of the asset by market participants
  - Establishes a framework for measuring fair value
  - Expanded disclosure about fair value measurements

## Valuation

- **Permitted valuation techniques- used individually or combination**
  - Market approach- prices from transactions of identical or comparable assets/liabilities
  - Income approach- present value of estimated cash flows
  - Cost approach- replacement or cost to construct
- **Techniques require “input” assumptions**
  - Interest rates, timing of cash flows, risk factors, etc.
  - Topic 820 categorizes inputs as:
    - Level 1 – quoted prices (unadjusted) in active markets
    - Level 2 – observable (directly or indirectly), other than quoted
    - Level 3 – unobservable inputs

## Disclosure

- **The level within the fair value hierarchy that the measurements fall**
- **For Level 3 assets / liabilities**
  - Roll forward of balances
  - Realized versus unrealized gains / losses and treatment in financials
  - Valuation technique used and discussion of any changes between periods

## Recent Changes Due to Financial Crisis

- **Valuation**
  - Flexibility when markets are disrupted
- **Other than temporary impairments on debt securities**
  - Rules replaced with principles-based evaluation
  - Decrease in fair value from cost is bifurcated between “credit related loss” and “all other factors”
  - Only “credit related loss” decline runs through earnings
- **Additional required disclosure**
  - Details on specific asset classes including additional aging data for unrealized losses
  - Full annual disclosures now required in quarterly filings

## Issues

- **Difficulties involved in applying fair value to financial instruments- next step is to apply to other assets/liabilities where no market transactions exist**
- **Disclosures expanded due to financial crisis- when markets back to normal do disclosures go away? (additional costs to complete, probability of errors increase with additional data)**
- **Comparability of Level 3 assets/liabilities due to differing assumptions**
- **Auditing values**
- **Recent SEC comments:**
  - Referring to use of third party deems them experts- increases liability and cost?
  - Questions regarding bucketing of asset-backed securities- principles based standard?

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# Key Provisions of SFAS 141(R) and FSP FAS 141(R)-1

# Key Provisions of SFAS 141(R) and FSP FAS 141(R)-1

**Presenter:**

**Ellen C. Wolf**

**Senior Vice President and Chief Financial Officer**

## Overview of FAS 141R

- Primarily converged standards between US GAAP and IFRS
  - US issued December 2007
  - IFRS Issued January 2008
  - FAS 141 R and IFRS 3R – Business Combinations
- Effective Date
  - Annual periods beginning on or after December 15, 2008
  - Early adoption prohibited under US GAAP; allowed under IFRS
- Fundamental principle underlying FAS 141R is that the acquired business should be recorded at fair value

## SFAS 141(R) – The Key Changes

- Reflects a business combination as a fair value exchange between independent parties.
- Definition of a business is expanded
  - A business is an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing either (i) a return to investors or (ii) dividends, lower costs, or other economic benefits.
- Transactions costs are expensed
  - Payments to investment bankers, advisors, attorneys, accountants and other third parties are expensed in the period incurred.
  - No change for fees related to debt or equity issued for acquisition consideration.
    - Cost of raising acquisition debt capitalized separately
    - Cost of raising new equity netted against proceeds received

## SFAS 141(R) – The Key Changes (continued)

- Can adjust values assigned to acquired assets and assumed liabilities during measurement period (up to one year)
  - Caveat: No adjustment unless waiting for information about facts and circumstances that existed as of the acquisition date.
  - Treat any adjustments as though they occurred on the acquisition date.
  - Will need to re-cast previously reported information to reflect revised value, including impact on depreciation or amortization.
- Equity securities issued as part of the purchase price will be measured on the acquisition date, not at announcement
  - Acquisition date is the date on which the acquirer obtains control of the acquiree.

## SFAS 141(R) – The Key Changes (continued)

- Earn-out arrangements are recognized at fair value on the acquisition date and classified as a liability or equity
  - If liability, mark-to-market through earnings each period until resolved.
  - If equity, no subsequent mark-to-market.
  - Under 141, contingent consideration was recognized as additional purchase price when the contingency was resolved.
- Restructuring charges intended to achieve synergies between combined entities will be expensed unless certain conditions, similar to those to recognize a liability for restructuring activities outside an acquisition, are met.

## SFAS 141(R) – Acquired Contingencies

- Contractual contingencies are recognized at fair value at the acquisition date
- Noncontractual contingencies are recognized at the acquisition date at fair value if it is “more likely than not” the contingency will give rise to an asset or liability.
  - The SFAS 141(R) threshold of “more likely than not” is an assessment of whether an asset or liability exists.
  - The more-likely-than-not threshold is a lower threshold for recording an asset or liability than the FAS 5 probable threshold.
- If more-likely-than-not threshold is not met as of the acquisition date, the acquirer will not recognize an asset or liability at acquisition.
- Creates disparity in accounting for contingencies associated with a business combination and those not associated with a business combination.

## FSP FAS 141(R)-1

- Subsequent to the issuance of SFAS 141(R), preparers, auditors and members of the legal profession expressed concerns about the application of SFAS 141(R) to assets and liabilities arising from contingencies in a business combination.
- FASB issued FASB Staff Position No. FAS 141(R)-1, “Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies,” on April 1, 2009.
- Effective for business combinations for which the acquisition date is on or after January 1, 2009.

## FSP FAS 141(R)-1 Acquired Contingencies

- Requirements under FSP FAS 141(R)-1 are generally consistent with pre-SFAS 141(R) requirements.
- An acquired contingency is recognized at acquisition-date fair value if the fair value can be determined during the measurement period.
- If the fair value cannot be determined, an acquired contingency is recognized if both of the following are met:
  - Information available before the end of the measurement period indicates that it is probable that an asset existed or that a liability had been incurred at the acquisition date.
  - The amount of the asset or liability can be reasonably estimated.
- If the above criteria are not met using information available during the measurement period about facts and circumstances that existed as of the acquisition date, the acquirer shall not recognize an asset or liability at acquisition.

## FSP FAS 141(R)-1 Acquired Contingencies – Subsequent Recognition

- An acquirer shall develop a systematic and rational basis for subsequently measuring and accounting for assets and liabilities arising from contingencies depending on their nature.
  - While allowing judgment to determine the method for subsequent accounting, the FASB does not believe, for example, it would be appropriate to recognize an acquired warranty obligation at fair value on the acquisition date and in the immediate subsequent period value the warranty obligation in accordance with FAS 5 and recognize a gain or loss for the difference.
- In periods after the acquisition, the acquirer shall account for an asset or liability arising from a contingency that does not meet the recognition criteria at the acquisition date in accordance with other applicable GAAP, including FAS 5.



**International Financial Reporting Standards  
Update  
September 2009**

# International Financial Reporting Standards Update September 2009

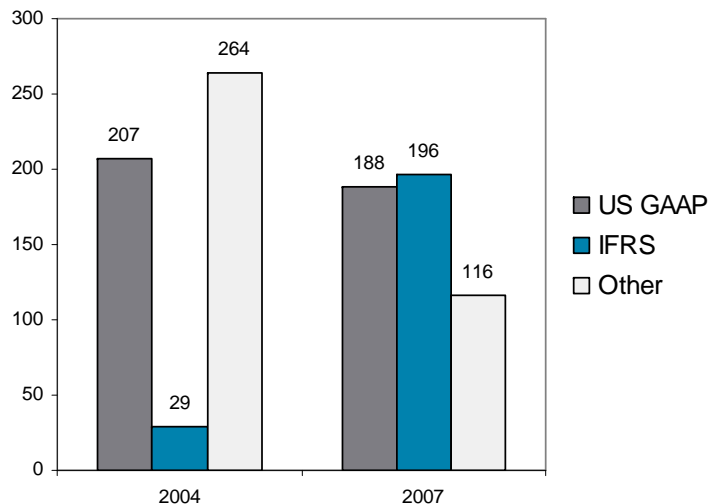
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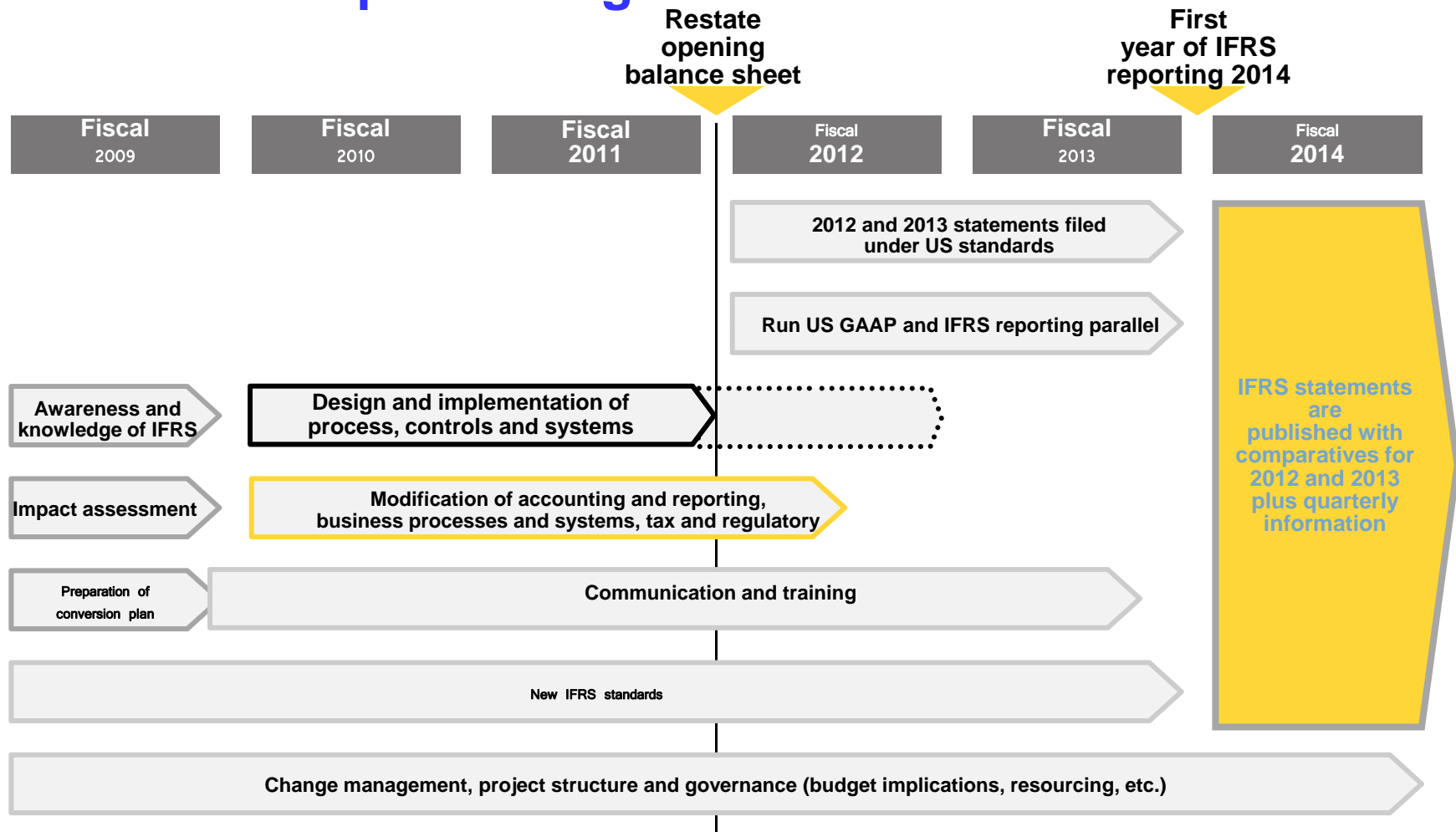
## What are the Global Markets doing?

- Every major non-US capital market is moving to IFRS
- Adoption of IFRS in the EU in 2005 (8,000 companies)
- Over 100 countries around the world require or permit IFRS
- IFRS quickly picking up share of Global Fortune 500 companies
- IFRS is becoming the predominant accounting framework outside the US



Top 10 Global Capital Markets	
US	US GAAP – moving towards IFRS
Japan	Convergence to IFRS
UK	IFRS
France	IFRS
Canada	Convergence to IFRS
Germany	IFRS
Hong Kong	HKFRS (equivalent to IFRS)
Spain	IFRS
Switzerland	IFRS or US GAAP
Australia	AIFRS (equivalent to IFRS)

# IFRS Roadmap & Timing



## IFRS US Update- Recent Commentary

- Wayne Carnell (Chief Accountant of SEC's Division of Corporate Finance) – Responding to questions at the American Accounting Association (AAA) annual meeting in August, he indicated that the SEC is still reviewing comment letters, but that IFRS is coming, without a doubt. He expressed some concerns with IFRS being applied differently across national and regional borders.
- David Tweedie (Chairman of the IASB) – Speaking at an August meeting of the AAA, he stated that a delay in its decision would be problematic. More important than the date itself is an identification of a “date certain”.
- Obama administration promotes convergence - The administration's summer 2009 white paper on financial reform includes unequivocal call for transparency and convergence of international accounting standards.
- Paul Volcker (chair of Obama's Economic Recovery Advisory Board) – Expressed unequivocal support for IFRS adoption in the US.

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