Financial Reporting
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Forward-looking Estimates & Valuation Problems in Accounting

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Scott A. Taub joined Financial Reporting Advisors, LLC (FRA) as a Managing Director in 2007. Based in Chicago, Illinois, FRA provides consulting services related to accounting and SEC reporting and litigation support services. Mr. Taub is a member of FASB/IASB Joint Transition Resource Group for Revenue Recognition and is a former member of the IFRS Interpretations Committee and the FASB's Valuation Resource Group.

From September 2002 through January 2007, Mr. Taub was a senior official at the Securities and Exchange Commission (SEC). As a Deputy Chief Accountant and Acting Chief Accountant, he played a key role in the SEC's implementation of the accounting reforms under the landmark Sarbanes-Oxley Act, and was responsible for the day-to-day operations of the Office of the Chief Accountant, including resolution of accounting and auditing practice issues, rulemaking, oversight of private sector standard-setting efforts, and regulation of auditors. He also served as Chair of the Accounting and Disclosure committee of the International Organization of Securities Commissions (IOSCO). Mr. Taub was a Professional Accounting Fellow in the Office of the Chief Accountant between 1999 and 2001.

Before joining the SEC staff, Mr. Taub was a partner in Arthur Andersen's Professional Standards Group (PSG). In that role, he consulted on complex financial reporting matters; helped establish and disseminate Andersen's policies on financial reporting matters; and represented the firm before the FASB, SEC, AICPA, and IASB. Mr. Taub consulted and authored interpretive guidance on a wide variety of reporting issues, including revenue recognition, business combinations, compensation, intangible assets, and investment accounting. Prior to joining the PSG, he was an auditor in the firm's Detroit office serving publicly held and privately owned companies in a variety of industries.

Mr. Taub is a frequent speaker, having addressed numerous audiences sponsored by a variety of organizations such as the Financial Executives International, the AICPA, the Institute of Management Accountants, the Securities Regulation Institute, and the Practising Law Institute. He was the primary author of several SEC reports and publications, including reports on off-balance activities and principles-based accoiunting standards. He is the author of the *Revenue Recognition Guide*, a comprehensive guide to accounting for revenue recognition published by CH, and a co-author of CCH's Financial Instruments guide.

Mr. Taub attended the University of Michigan in Ann Arbor, where he received an degree in economics in 1990, and won the William A. Paton Award for his performance on the CPA exam. In 2005 Mr. Taub won the SEC's award for Supervisory Excellence. He is a licensed CPA in Illinois and is a member of the American Institute of Certified Public Accountants.

Asset Impairment Tests – Every Asset Has One

All non-cash assets have an impairment test

- Receivables and debt securities – CECL (ASC 326): Record estimate of credit losses as a valuation account
- Equity securities – OTTI (ASC 321 or 323): Write-down to fair value if there is a qualitative indicator of impairment
- Inventory and contract costs – NRV (ASC 330 and 340-40): Write-down to NRV, which is selling price less remaining costs

Other assets are evaluated for impairment before long-lived assets, including ASC 350 and 360 tests

Asset Impairment – ASC 350/360

Intangible assets (other than goodwill) not being amortized

- Compare carrying value to FV, annually or upon a triggering event

Long-lived assets being depreciated or amortized

- Grouped with other assets (and liabilities) to identify an "asset group" with largely independent cash flows
- Tested only upon triggering event
  - Step 1 – Recoverability based upon undiscounted cash flows
  - Step 2 (if fail step 1) – Assess fair value of asset group
  - If fail step 2, write-down individual long-lived assets proportionally, but not below their fair values.

Asset Impairment – Goodwill

Tested at level of "reporting unit"

- Component that has separate financial information and whose performance is separately evaluated
- Test annually and upon triggering events
- Goodwill is also included in ASC 350/360 asset group if the asset group is a whole reporting unit and there has been a triggering event; if not, run separate test
- Compare carrying value of reporting unit to fair value; if carrying value is greater, write-down goodwill

Impairment Refresher – Assets Held for Sale

When assets are "held for sale", as defined in ASC 360, test is of "disposal group" – whatever is being sold (including liabilities, if any)

- Includes goodwill if the disposal group is a business that was part of a reporting unit with goodwill
  - Allocate goodwill based upon relative fair value of part being sold vs. kept

Write-down disposal group to FV less cost to sell

- Allocate impairment to all long-lived assets proportionally, but limit write-down to fair value of individual assets

Frequent Issues in Impairment Testing

Definition of Fair Value – Price at which asset could be sold at measurement date in an orderly market transaction

- Fact that company believes market price is too low is irrelevant
- Must use market participant assumptions, including risk factors
  - If potential buyers would incur higher costs or lose economies of scale, adjust forecasted cash flows
  - Consider post-retirement benefits (pensions), borrowing costs, stock compensation, etc.
- Cannot assume future changes in market (e.g., must use current interest environment to assess discount rate)

Frequent Issues in Impairment Testing

Definition of Fair Value – Price at which asset could be sold at measurement date in an orderly transaction

- Cannot use old assumptions if something has changed
  - Even if change simply means reduced cash flows are "possible"
  - Cannot wait for uncertainty to resolve to reassess forecasts
- If anticipated sale price is less than valuation, consider implications
  - If Company assesses that sale would occur at less than DCF valuation, explain why – as concept is "exit price", anticipated sale price likely correct
  - Don't wait until "held for sale" is met to consider estimated sale price
  - Deciding to sell doesn't reduce fair value, since fair value is based on exit price

Frequent Issues in Impairment Testing

Uncertainty Cannot be Ignored

- E.g., company is considering options for business/assets
  - Cannot just stick with "status quo" until a decision is reached on what to do; instead, must consider possible different paths
  - Consideration of restructuring/sale might be a triggering event, and might result in need for probability-weighted approach to DCF
- E.g., economic events may create uncertainty in future cash flows
  - Forecasts based on "stable" markets not appropriate if that doesn't match reality
  - E.g, supply chain problems – may need to probability weight different cash flow forecasts to capture uncertainty

Current Environment

Global events could be triggering events and affect valuation

- Ukraine and Middle East conflicts
- Government uncertainty (shut-down, change in priorities after election)
- Inflation and interest rate environment may cause changes in discount rates and cash flow forecasts
- Supply chain problems