



February 2010

Accounting Update

An Overview of Recent Pronouncements Affecting Growth and Middle Market Companies

The accounting standard setters continue to be very busy updating and modifying accounting standards. Following is a brief summary of the most significant changes over the past several months affecting middle market and growth companies:

Statements of Financial Accounting Standards (SFAS's) no longer represent authoritative generally accepted accounting principles in the United States (GAAP). In July 2009, the Financial Accounting Standards Board (FASB) discontinued its SFAS's and other sources of GAAP and replaced these with the *Accounting Standards Codification (ASC)*. The ASC is now the single source of authoritative GAAP in the United States affecting non-public entities. Adoption of the ASC did not change GAAP, however, it introduced a new structure to the accounting literature organized within 90 topics. Entity's with years ending on or after September 15, 2009, can no longer refer to SFAS's. Going forward, entity's may cite the specific ASC Topic and/or Topic number in their accounting policy disclosures or elect to make "Plain English" disclosures.

The accounting for business combinations changes again. While it's been over a year since the FASB issued SFAS No. 141R (now ASC 805), most companies will be dealing with this new guidance for the first time in their calendar year 2009 financial statements. ASC 805 became effective for acquisitions made on or after January 1, 2009 and introduces several major changes from the prior standard, including:

- Bargain purchases are recognized as a gain rather than as an adjustment to non-monetary assets and liabilities.
- Acquisitions costs (finder's fees, advisory, legal and other professional fees) are to be expensed as incurred rather than added to the purchase price. The one exception to this are the costs incurred to issue and register debt and equity securities, which are capitalized.
- Changes in deferred tax asset valuation allowances affect income tax expense rather than goodwill.
- Changes in contingent consideration after the acquisition date no longer represent an adjustment to goodwill. Changes in contingent consideration classified as an asset or liability will be recognized in current earnings during each reporting period. Changes in contingent consideration classified as equity will be accounted for within the equity section when the contingency is resolved.
- All acquired assets must be valued at fair value (highest and best use) even if the acquirer does not intend to use the assets that way. This could result in an immediate impairment right down of certain acquired assets.

The accounting for noncontrolling interests (formerly minority interests) in consolidated financial statements has changed significantly (ASC 810, formerly SAAS No. 160). Noncontrolling interests are now required to be reported within the equity section of the balance sheet, rather than within the mezzanine section. Furthermore, losses attributable to a noncontrolling interest that cause that interest to become negative (a debit balance) must now be recognized. Recognition of losses attributable to noncontrolling interests used to be suspended once the noncontrolling interest (previously known as minority interest) was reduced to zero. *Since this negative noncontrolling interest must now be accounted for within the equity section, this will affect debt to equity ratios possibly causing a violation of debt covenants.* This should be carefully reviewed and brought to the attention of lenders sooner, rather than later. Several additional presentation and disclosure requirements have also been introduced by the new ASC 810.

After many delays, the accounting and disclosure requirements relating to uncertain income tax provisions are finally effective (ASC 740-10, formerly FIN 48). These new rules are effective for private companies in their first annual reporting period which begins on or after December 15, 2008. This standard represents the most significant change to accounting for income taxes since the issuance of SFAS No. 109. The standard establishes a minimum recognition threshold before the benefit of a tax position (or tax deduction) can be recognized and requires a complex probability based analysis to be performed for each and every questionable position. Questionable tax positions can result from basic deductions like travel and entertainment expenses or automobile allowances for executives, as well as from much more complex matters such as the expenditures qualifying for the research and development tax credit. Another significant questionable tax position is the decision not to file a tax return in certain tax jurisdictions where the company may be subject to tax. Fortunately, the requirement to provide detailed disclosure of questionable tax provisions does not apply to private companies.

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Best regards,

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