L·B·B BRIEFS FOR SMALLER REPORTING COMPANIES

FASB, IASB Leaders Say International Convergence Is Winding Down . . . The FASB and IASB are ready to end the international convergence effort they pursued for the past decade. The decision to bow to the inevitable comes six months after a self-imposed deadline expired without the boards completing the projects in their Memorandum of Understanding, the document that outlined the standards in U.S. GAAP and IFRS that would be merged into a single set of accounting principles. By 2010, the boards jettisoned most of the MOU projects to focus on three—financial instruments, revenue recognition, and lease contracts. A fourth project on insurance accounting that had been begun by the IASB was rolled into the convergence effort after the FASB signed on. The U.S. board is committed to finishing the four remaining projects, but going beyond them is not viable, "politically or practically," said Leslie Seidman, FASB Chairman, who added she was speaking for herself, not the board.

SEC and U.S. exchanges tighten the reins on reverse merger companies . . . The SEC has been keeping a close eye on companies accessing the U.S. markets through reverse mergers. The SEC and U.S. exchanges have recently suspended or halted trading in a number of companies that were formed by reverse mergers. Back in June, the SEC issued an investor bulletin warning investors about the risks associated with reverse mergers, citing instances of fraud and other abuses. And now, the SEC has approved new rules proposed by the three major U.S. exchanges designed to toughen listing standards for these companies. Per Mary Schapiro, SEC Chairman, on November 9, 2011, "Placing heightened requirements on reverse merger companies before they can become listed on an exchange will provide greater protections for investors."

"Gross vs. net" revenue still a challenge . . . The guidance for assessing whether to recognize revenue on a "gross" or a "net" basis is over a decade old. The issue originally arose during the internet boom, precipitated by the increase in the number of companies that act as resellers of goods or services. Now, new business models and types of transactions have emerged, bringing new revenue recognition challenges with them.

The starting point is to fully understand the company's business model and all of the contractual arrangements between the parties involved. The accounting guidance provides indicators that should be analyzed to assess which party is the principal in the arrangement. The principal recognizes revenue from a transaction on a gross basis (the amount billed to the customer), while an agent recognizes revenue net. However, the assessment is not a simple exercise of tallying up the indicators. While there are several indicators listed in the guidance, there are some that should be given more weight than others.

Which are the most important indicators? Assessing which party is the primary obligor will often—but not always—point to the party that is the principal in the arrangement. The primary obligor is the party responsible for fulfilling the ordered product or service. Another strong indicator is whether the company takes title to the product before it is ordered by the customer and therefore, holds inventory risk. The focus should not be on how cash changes hands—whether the company physically receives the gross or net amount of cash is not determinative.

If you're stumped, there's no substitute for revisiting the accounting guidance and the "principal versus agent" indicators. The guidance also includes a number of examples that can be helpful when navigating the indicators.

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