

Response to Client Request II

Name

ACC/541

Date

Instructor Name

MEMORANDUM

TO: Client
FROM: Consulting Firm - Team A
DATE:
SUBJECT: Pending Lawsuit Effects

This memo elaborates on the Financial Accounting Standards Board's (FASB) Codification 450-10-05-4 that details how loss and gain contingencies will be reported and the standards for the financial statements. According to FASB stipulations financial statements, mortgage, and patent are affected when someone loses a case. This memo will provide the information needed to answer many of the questions concerning the upcoming lawsuit.

The general rule (paragraph 450-20-25-1 of the loss contingencies) applies when a loss contingency is present, and the probability that an expected incident or event would validate the loss, the incurrence of a liability, or damage of an asset can vary from probable to remote (FASB, 1975, p. 442). The word loss or losses is used as a way to encompass charges against income (also referred to as expenses). The FASB paragraph 450-20-25-2 states that an approximate loss from a loss contingency reflects a charge to income. However, the two conditions below must be met:

- i) Information available before issuance of the financial statements indicates it is possible a property had been damaged or a liability had incurred at the date of the financial statements. It must be probable that one or more future incidents will occur affirming the detail of the loss.
- ii) The amount of loss can be logically approximated (FASB, 1975, p. 442).

The goal of these two conditions is to require accrual of losses when it is logically applicable and relate to the current or preceding period.

When a case meets the two conditions the loss will come as a liability chargeable to the person's income. The amount of loss can be logically estimated because the amount of the lawsuit is listed. The loss shall therefore be charged on the person's income by virtue of fulfilling the two conditions.

Legally, during a lawsuit, the business becomes wholly liable for any incurred suit award and retains the full responsibility to pay off debts. Based on the FASB guidelines, if mortgage debt is forgiven will depend on a renegotiated contract between the company and its mortgage lender. Some states have enacted laws that allow a lender to require a repayment arrangement, especially if other assets are involved. The lender may choose to forgive or modify the loan, usually through a loan modification process, but determinations are always at the lender's discretion (National Association of Realtors, 2011). A gain or loss resultant from a new contract must be recorded in the current period. If the lender chooses to forgive a portion of the mortgage debt, the amount forgiven is treated as taxable income.

As a general rule of thumb, the borrower is required to pay tax on the debt forgiven. However, under the Mortgage Forgiveness Debt Relief Act of 2007, borrowers have been excused from such tax liabilities limited to primary residences only (IRS, 2012, p. 2). Several restrictions are in place under this legislation so consultation with a reputable bankruptcy attorney is recommended to verify qualification.

Chapter 11 of the Bankruptcy Code protects any business unable to pay its debt through a process of reorganization. Under this option, debts are not discharged or forgiven; business assets are merely restructured under a trustee to repay the debt over time. Additionally, Chapter 11 of the Bankruptcy Code does not allow modifications on the first mortgage for a primary residence but the interest rate and principal balance of mortgages on non-homestead property are eligible for restructuring. Finally, there are ongoing financial reporting requirements tied to Chapter 11 of the Bankruptcy Code relief. Companies must file a monthly financial report that itemizes income and expenses (United States Courts, 2012).

Regarding the impairment of the patent several issues should be considered. Impairment of the asset – the patent – should be reflected on the financial statements under the assets and extraordinary loss accounts. The recovery of the hedge of the patent should be reflected as part of the business other revenues. According to Schroeder, Clark, and Cathey, 2005, patents are categorized as intangible assets that should be amortized over its useful life. The loss probably will cause the patent value to decline in a substantial way and should be tested for impairment (FASB 350-30-35-10). When the carrying amount of the patent cannot be recoverable and the patent carrying amount is more than its fair value an impairment loss should be recognized. Consequently, the new accounting basis of value will be the adjusted carrying amount of the patent. The new value should be reflected on the income statement as a loss reducing also the value of the patent on the balance sheet.

Team “A” hopes this memo provided the information needed in completing the lawsuit. The FASB Codification 450-10-05-4 is vital to remember when reporting any contingencies; gain or loss. If additional questions arise do not hesitate to contact our support group. Thank you for the confidence placed in our consulting firm.