

January 13, 2009

Accounting

FASB Grants Another Year for Certain Nonpublic Enterprises to Apply FIN 48

The Financial Accounting Standards Board (FASB) has issued FASB Staff Position (FSP) No. FIN 48-3, *Effective Date of FASB Interpretation No. 48 for Certain Nonpublic Enterprises*. This FSP defers the effective date of FASB Interpretation (FIN) No. 48, *Accounting for Uncertainty in Income Taxes*, for certain nonpublic enterprises, including nonpublic not-for-profit organizations, until annual financial statements for fiscal years beginning after December 15, 2008. The deferred effective date is intended to give the FASB additional time to amend the disclosure requirements of FIN 48 for nonpublic enterprises and to develop guidance on the application of FIN 48 by pass-through entities and not-for profit organizations.

FIN 48 is therefore effective for nonpublic enterprises for annual periods beginning after December 15, 2008 if they had not issued a full set of U.S. GAAP annual financial statements incorporating the recognition, measurement, and disclosure requirements of FIN 48 prior to December 30, 2008. The definition of "nonpublic enterprise" for this deferral is the same as the definition in FASB Statement No. 109, *Accounting for Income Taxes*, which is: entities other than (a) those with debt or equity securities that trade in a public market, (b) those who are filing to register securities, and (c) conduit bond obligors for conduit debt securities that are traded in a public market. Nonpublic consolidated entities of public companies that apply U.S. GAAP are not eligible for the deferral. U.S. subsidiaries of a foreign public company that applies U.S. GAAP also are not eligible for the deferral. However, a nonpublic company that is wholly- or majority-owned by a publicly traded company and that is included in the public company's consolidated financial statements at fair value (for example, a private company owned by a publicly traded private equity group) is eligible for the deferral for its stand-alone financial statements.

It should be noted that a nonpublic enterprise that elects to defer the application of FIN 48 in accordance with this FSP must explicitly disclose that fact and must disclose its accounting policy for evaluating uncertain tax positions for each set of financial statements where the deferral applies. Once effective, FIN 48 is to be applied as of the beginning of the enterprise's fiscal year, including its application to acquired income tax provisions in business combinations.

The FSP was effective upon issuance on December 30, 2008 and is available in full at http://www.fasb.org/pdf/fsp_fin48-3.pdf.

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Employers' Disclosures about Postretirement Benefit Plan Assets

The Financial Accounting Standards Board (FASB) has issued FASB Staff Position (FSP) No. FAS 132(R)-1, *Employers' Disclosures about Postretirement Benefit Plan Assets*. This FSP amends FASB Statement No. 13 (revised 2003), *Employers' Disclosures about Pensions and Other Postretirement Benefits*, to provide guidance on an employer's disclosures about plan assets of a defined benefit pension or other postretirement plan. Per the FSP, the objectives of the disclosures about plan assets in an employer's defined benefit pension or other postretirement plan are to provide users of financial statements with an understanding of:

- How investment allocation decisions are made, including the factors that are pertinent to an understanding of investment policies and strategies;
- The major categories of plan assets;
- The inputs and valuation techniques used to measure the fair value of plan assets;
- The effect of fair value measurements using significant unobservable inputs (Level 3) on changes in plan assets for the period; and
- Significant concentrations of risk within plan assets.

Additionally, the FSP includes a technical amendment to Statement No. 132(R) that requires a nonpublic entity to disclose net periodic benefit cost for each annual period for which a statement of income is presented. This technical amendment was effective upon issuance of the final FSP on December 30, 2008. The disclosures about plan assets required by the FSP are to be provided for fiscal years ending after December 15, 2009, with earlier application permitted.

The FSP is available in full at http://www.fasb.org/pdf/fsp_fas132r-1.pdf.

Additional Disclosures Proposed for Certain Financial Assets

The Financial Accounting Standards Board (FASB) has issued proposed FASB Staff Position (FSP) No. FAS 107-a, *Disclosures about Certain Financial Assets: An Amendment of FASB Statement No. 107*. This proposed FSP is being issued to amend the disclosure requirements in FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments*, so as to increase the comparability of information about certain financial assets that have related economic characteristics but have different reporting measurement attributes. It should be noted that, if finalized, this proposed FSP would be effective for interim and annual reporting periods ending after December 15, 2008.

The proposed FSP would apply to debt securities classified as held-to-maturity and available-for-sale, and loans and long-term receivables that are not measured at fair value with changes in the fair value recognized through earnings. The disclosures that would be required include a comparison of measurement attributes for financial assets in a tabular format under the following column headings:

- As reported in the statement of financial position;
- At fair value; and
- At the incurred loss amount.

The proposed FSP also would require the following qualitative disclosures:

- The accounting policy for each type of financial asset in the table;
- The methodology used to estimate the key inputs used to measure the incurred loss amount, including any estimates of costs to sell the financial asset; and

- To the extent known, a description of the factors causing the differences in measurements for each financial asset presented in the table.

Further, the proposed FSP would require disclosure of pro forma income from continuing operations (before taxes) as if those financial assets were carried at fair value with changes in fair value recognized through earnings and at the incurred loss amount with changes recognized through earnings. In addition, an entity would be required to disclose for comparison purposes the amount of income from continuing operations (before taxes) reported in the statement of income related to those financial assets. Upon initial application and in subsequent periods, the proposed FSP does not require comparative disclosure for periods prior to the effective date.

The proposed FSP is available for comment until January 15, 2009 at http://www.fasb.org/fasb_staff_positions/prop_fsp_fas107-a.pdf.

Proposed Impairment and Interest Income Measurement Guidance

If the fair value of an available-for-sale or held-to-maturity debt security is less than its cost basis at the measurement date, U.S. generally accepted accounting principles (GAAP) require that the reporting entity assess the impaired security to determine whether the impairment is other than temporary. U.S. GAAP has two models for determining whether the impairment of an available-for-sale or held-to-maturity debt security is other than temporary:

- For debt securities that are beneficial interests in securitized financial assets within the scope of Emerging Issues Task Force (EITF) Issue No. 99-20, "Recognition of Interest Income and Impairment on Purchased Beneficial Interests and Beneficial Interests That Continue to Be Held by a Transferor in Securitized Financial Assets," an impairment is considered other than temporary if, based on the reporting entity's best estimate of cash flows that a market participant would use in determining the current fair value of the beneficial interest, there has been an adverse change in those estimated cash flows. Issue No. 99-20 therefore requires the use of market participant assumptions regarding future cash flows, which cannot be overcome by management judgment regarding the probability of collecting all cash flows previously projected.
- Debt securities that are not within the scope of Issue No. 99-20 must apply FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. Statement No. 115 indicates that an impairment is other than temporary because it is probable that the holder will be unable to collect all amounts due according to the contractual terms. Statement No. 115 does not require exclusive reliance on market participant assumptions regarding future cash flows, thereby permitting the use of reasonable management judgment of the probability that the holder will be unable to collect all amounts due.

Some constituents have indicated that because Issue No. 99-20 requires entities to use market participant assumptions regarding future cash flows without consideration of the probability that all cash flows will be collected, the application of Issue No. 99-20 in a dislocated market automatically results in an other-than-temporary impairment (OTTI) any time the fair value is less than cost. Due to this and other concerns, the Financial Accounting Standards Board (FASB) has issued proposed FASB Staff Position (FSP) No. EITF 99-20-a, *Amendments to the Impairment and Interest Income Measurement Guidance of EITF Issue No. 99-20*, to amend the impairment and related interest income measurement guidance in Issue 99-20. The intent of the FSP is to reduce complexity and achieve more consistent determinations as to whether other-than-temporary impairments of available-for-sale or held-to-maturity debt securities have occurred by aligning the impairment guidance in Issue No. 99-20 with that of Statement No. 115.

The proposed FSP does not amend the requirement in Statement No. 115 and Issue No. 99-20 to apply the OTTI guidance and disclosures in FSP No. FAS 115-1 and 124-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*, and other related literature to all debt securities classified as available-for-sale and held-to-maturity, including beneficial interest in securitized financial assets. If finalized, the proposed FSP will be effective for interim and annual reporting periods ending after December 15, 2008, with prospective application required. The proposed FSP was issued on December 19, 2008, and the comment period expired on December 30, 2008. The proposed FSP is available in full at http://www.fasb.org/fasb_staff_positions/prop_fsp_eitf99-20-a.pdf.

SEC Reports to Congress on Mark-to-Market Accounting

The Emergency Economic Stabilization Act (EESA) of 2008 directed the SEC, in consultation with the Board of Governors of the Federal Reserve System and the Secretary of the Treasury, to study mark-to-market accounting standards as provided by FASB Statement No. 157, *Fair Value Measurements*. As a result, the SEC's Office of the Chief Accountant and Division of Corporation Finance recently delivered *Report and Recommendations Pursuant to Section 133 of the Emergency Economic Stabilization Act of 2008: Study on Mark-To-Market Accounting* to Congress. This report opposes the suspension of fair value accounting standards, and instead, recommends improvements to existing practice, including reconsidering the accounting for impairments and the development of additional guidance for determining fair value of investments in inactive markets.

As mandated by the EESA, the report addresses:

- The effects of fair value accounting standards on a financial institution's balance sheet;
- The impacts of such accounting on bank failures in 2008;
- The impact of such standards on the quality of financial information available to investors;
- The process used by the Financial Accounting Standards Board (FASB) in developing accounting standards;
- The advisability and feasibility of modifications to such standards; and
- Alternative accounting standards to those provided in Statement No. 157.

Among key findings, the report notes that investors generally believe fair value accounting increases financial reporting transparency and facilitates better investment decision making. The report also observes that fair value accounting did not appear to play a meaningful role in the bank failures that occurred in 2008. Rather, the report indicates that bank failures in the U.S. appeared to be the result of growing probable credit losses, concerns about asset quality, and in certain cases, eroding lender and investor confidence.

The report is available in full at <http://www.sec.gov/news/studies/2008/marktomarket123008.pdf>.

Paper Discusses Joint Approach by IASB and FASB for Revenue Recognition Standards

Revenue is an important number to users of financial statements in assessing a company's performance and prospects. However, revenue recognition requirements in U.S. generally accepted accounting principles (GAAP) differ from those in International Financial Reporting Standards (IFRS), and both are considered in need of improvement. The requirements in U.S. GAAP comprise numerous standards — many are industry-specific and some can produce conflicting results for economically similar transactions. Although IFRS contain fewer standards on revenue recognition, its two main standards have different principles and can be difficult to understand and apply beyond simple transactions.

The International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) therefore recently published for public comment a discussion paper setting out a joint approach for the recognition of revenue. The boards' objective is to improve the existing guidance in both U.S. GAAP and IFRS by developing a single revenue model that can be applied consistently, regardless of industry. Applying the underlying principle proposed by the boards, a company would recognize revenue when it satisfies a performance obligation by transferring goods and services to a customer as contractually agreed. That principle is similar to many existing requirements, and the boards expect that many transactions would remain unaffected by the proposals. However, clarifying that principle and applying it consistently to all contracts with customers would improve the comparability and understandability of revenue for users of financial statements.

Preliminary Views on Revenue Recognition in Contracts with Customers is available for comment until June 19, 2009 at http://www.fasb.org/draft/DP_Revenue_Recognition.pdf.

PCFRC Seeking Members for User Group

The Private Company Financial Reporting Committee (PCFRC) is seeking input from users of private-company financial statements (bankers, venture capitalists, non-management shareholders, *etc*) when making its recommendations to the Financial Accounting Standards Board (FASB). Accordingly, the PCFRC is forming a "User Group," which will consist of a list of interested users of private company financial statements. The PCFRC will email this group with specific questions or issues in order to obtain input for its recommendations to the FASB. User Group members will be asked to respond as individuals, not as representatives of their employers or organizations. All responses will be kept confidential.

Also, from time to time the FASB may need a panel of users to meet directly with FASB members. Should the need arise for such a panel, the PCFRC will solicit volunteers from the User Group. To learn more about the PCFRC and the User Group go to www.pcfrc.org.

Financial Institutions

Application of Statement No. 114 to Modifications of Residential Mortgage Loans

Recently, the accounting for loan modifications has become a significant issue for many entities due to an increased volume of modifications of residential mortgage loans to borrowers experiencing financial difficulty. This increase in loan modifications will result in FASB Statement No. 114, *Accounting by Creditors for Impairment of a Loan--an Amendment of FASB Statements No. 5 and 15*, being applied to residential mortgage loans, on a large scale, for the first time. Questions have arisen about the application of Statement No. 114 to modifications of residential mortgage loans that qualify as troubled debt restructurings.

The Center for Audit Quality therefore has issued a white paper, *Application of Statement 114 to Modifications of Residential Mortgage Loans that Qualify as Troubled Debt Restructurings*, to assist financial statement preparers and auditors in this first-time application of Statement No. 114 on a large scale. The white paper describes key provisions of Statement No. 114, and presents questions and answers about the application of Statement No. 114 to modifications of residential mortgage loans that qualify as troubled debt restructurings. Although this nonauthoritative white paper highlights certain issues that have arisen about the accounting for loan modifications, it does not establish new generally accepted accounting principles (GAAP) and is not intended to serve as a substitute for relevant authoritative accounting standards. Rather, it is intended to articulate certain existing requirements of GAAP as well as common accounting practices related to the specific issues discussed, with the objective of helping preparers and auditors understand the application of existing GAAP to residential mortgage loans.

The white paper is available in full at http://thecaq.org/newsroom/pdfs/FAS114_LoanModifications.pdf.

SEC

SEC Requires Use of Interactive Data for Reporting of Financial Information

The SEC has voted to require public companies and mutual funds to use interactive data for the reporting of financial information. With interactive data, all of the facts in a financial statement are labeled with unique computer-readable extensible business reporting language (XBRL) reporting software "tags," which function like bar codes to make financial information more searchable on the internet and more readable by spreadsheets and other software. Investors will be able to instantly find specific facts disclosed by companies and mutual funds, and compare that information with details about other companies and mutual funds.

For public companies, interactive data financial reporting will occur on a phased-in schedule beginning next year. The largest companies (with a public float above \$5 billion) that file using U.S. GAAP will be required to provide interactive data reports starting with their first quarterly report for fiscal periods ending on or after June 15, 2009. The remaining companies that file using U.S. GAAP will be required to file with interactive data on a phased-in schedule over the next two years. Companies that file using IFRS will be required to provide their interactive data reports starting with fiscal years ending on or after June 15, 2011. Companies will be able to adopt interactive data earlier than their required start date.

Starting in 2011 mutual funds will be required to begin including data tags in their public filings that supply investors with information such as objectives and strategies, risks, performance, and costs. A mutual fund also would be required to post the interactive data on its Web site, if it maintains one.

Last year the SEC unveiled its new financial reporting system, Interactive Data Electronic Applications (IDEA), a database to collate the XBRL tags attached to electronic filings. IDEA users will be able to instantly gather information from thousands of companies and forms, giving investors faster and easier access to key financial information about public companies and mutual funds. The new IDEA system is supplementing and eventually replacing the agency's EDGAR database, marking the SEC's transition from collecting forms and documents in EDGAR to making financial data itself freely available to investors in IDEA.

Investors can begin seeing this new information at <http://idea.sec.gov>. For participants in the SEC's Voluntary Filer Program, investors can find clearly labeled buttons taking them to a company's or mutual fund's voluntary interactive data submissions. As soon as companies and funds make their mandatory interactive data submissions to the SEC, their financial information will be immediately available to investors through the SEC's IDEA system as well as on the Web sites of companies and funds disclosing the data.

International

Change in Effective Date of Revised IFRS 1

At its December 2008 meeting the International Accounting Standards Board decided to change the effective date of revised International Financial Reporting Standard (IFRS) 1, *First-time Adoption of International Financial Reporting Standards*, (published in November 2008) from annual periods beginning on or after January 1, 2009 to annual periods beginning on or after July 1, 2009. The amendment corrects a potential technical problem arising from the interaction of IFRS 1 with revised IFRS 3, *Business Combinations*, and amended International Accounting Standard 27, *Consolidated and Separate Financial Statements*, both published in January 2008. The amendment does not affect the application of IFRS 1 by first-time adopters because the content of the Standard is exactly the same as before, except for the change in the effective date.

Proposed Revisions to Consolidation Standard

The use of special structures (referred to as structured entities) by reporting entities has created a concern that financial statements do not convey the extent to which reporting entities are exposed to risks from those types of structures. Also, there has been an inconsistent application of consolidation guidance due to different consolidation models in existing accounting principles. Therefore, the International Accounting Standards Board recently published a proposed standard, ED 10, *Consolidated Financial Statements*, to address those concerns. The project's main objectives are to improve the definition of control in International Accounting Standard (IAS) 27, *Consolidated and Separate Financial Statements*, and indicators of control in Interpretation SIC-12, *Consolidation—Special Purpose Entities*, so that a control model can be applied by all entities, and to improve the disclosure requirements about consolidated and unconsolidated entities. To meet one of the main objectives, the Exposure Draft (ED) proposes the following new principle-based definition of "control of an entity": "A reporting entity controls another entity when the reporting entity has the power to direct the activities of that other entity to generate returns for the reporting entity." As a consequence, the IASB expects that entities will be consolidated on a more consistent basis, making the financial statements of groups more comparable and understandable.

The ED would require a reporting entity to present financial statements that consolidate its assets, liabilities, equity, income, expenses and cash flows with those of the entities that it controls. The ED also includes enhanced disclosure requirements that would enable an investor to assess the extent to which a reporting entity has been involved in setting up special structures and the risks to which these special structures expose the entity. The standard would apply to all entities with limited exceptions. If adopted, the new standard would replace existing consolidation requirements in IAS 27 and SIC-12. The ED has not specified an effective date.

The ED is available for comment until March 20, 2009 at http://www.iasb.org/NR/rdonlyres/DAEA5425-4ABE-4217-8429-DB395333E8CC/0/ED10_STANDARD_1208.pdf.

Proposed Clarification of the Accounting Treatment for Embedded Derivatives

The International Accounting Standards Board recently published an Exposure Draft (ED), *Embedded Derivatives - Proposed amendments to IFRIC 9 and IAS 39*, to clarify the accounting treatment for embedded derivatives in International Accounting Standard 39, *Financial Instruments: Recognition and Measurement*, and IFRIC 9, *Reassessment of Embedded Derivatives*. This ED proposes amendments that would require:

- An entity to assess whether an embedded derivative is required to be separated from a host contract when the entity reclassifies a hybrid (combined) financial asset out of the fair value through profit or loss category.
- The assessment to be made on the basis of the circumstances that existed when the entity first became a party to the contract.
- That if the fair value of an embedded derivative that would have to be separated cannot be reliably measured, the entire hybrid financial instrument must remain in the fair value through profit or loss category.

If finalized, the ED is expected to be effective for annual reporting periods ending on or after December 15, 2008. The ED is available for comment until January 21, 2009 at http://www.iasb.org/NR/rdonlyres/7421736D-6390-4F7B-9F0A-BE4B21CBCABD/0/ED_IFRIC9andIAS391208.pdf.

Additional Disclosures Proposed for Investments in Debt Instruments

Those taking part in the public round-table meetings held by the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board in November and December 2008 in response to the global financial crisis advised the IASB that disaggregated information about impairment losses on available-for-sale debt instruments would be useful. Respondents suggested that disaggregation of the impairment loss should identify the incurred loss portion (the loss amount that would be recognized under the impairment model) for debt instruments measured at amortized cost (the incurred loss model). The IASB believes that even more comprehensive disclosures would allow users of financial statements to compare investments in all debt instruments (other than those classified as at fair value through profit or loss), and therefore improve financial reporting.

Accordingly, in December 2008, the IASB published an Exposure Draft (ED), *Investments in Debt Instruments - Proposed Amendments to IFRS 7*, to require entities to provide additional disclosures on all investments in debt instruments, other than those classified in the fair value through profit or loss category. If finalized, the ED would amend International Financial Reporting Standard 7, *Financial Instruments: Disclosures*, to require an entity to state in tabular form the fair value, amortized cost, and amount at which the investments are actually carried in the financial statements. The amendments also would require disclosure of the effect on pre-tax profit or loss as if all debt instruments had been accounted for at fair value and at amortized cost.

If finalized, the ED is expected to be effective for annual periods ending on or after December 15, 2008; however, comparative information relating to periods before the date of initial adoption would not be required. The ED is available for comment until January 15, 2009 at http://www.iasb.org/NR/rdonlyres/43D44A92-5BB8-411B-8684-81E38C0CE9F0/0/ED_AmdmentsIFRS7DebtInstruments0812.pdf.

Paper Discusses Joint Approach by IASB and FASB for Revenue Recognition Standards

The International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) recently published for public comment a discussion paper setting out a joint approach for the recognition of revenue. *Preliminary Views on Revenue Recognition in Contracts with Customers* is available for comment until

June 19, 2009 at http://www.iasb.org/NR/rdonlyres/0E3D5E00-B961-42F0-BA64-AB1D20BB9FE9/0/DP_PreliminaryViewsRevenueRecognition1208.pdf. See related article in the "Accounting" section above.

Intangible Assets: IFRS vs. U.S. GAAP

This article is the tenth in a series of articles that takes our readers on a journey through International Financial Reporting Standards (IFRS) with a special focus on the standards' quintessential feature: they are principles-based. In this article, we provide an overview of some of the most significant differences between IFRS and U.S. generally accepted accounting principles (GAAP) with regard to the accounting for intangible assets. Actual differences in the accounting treatment between the two frameworks depend on specific circumstances.

The accounting treatment of intangible assets is an area where significant differences exist between IFRS and U.S. GAAP. Under IFRS, International Accounting Standard (IAS) 38, *Intangible Assets*, is the primary accounting standard for intangible assets, and it uses a very principles-based approach. On the other hand, relevant U.S. GAAP consists of very specific and detailed guidance, which denotes a substantial anti-ethical overall approach to the subject.

With regard to internally generated intangible assets, IAS 38 distinguishes between the research phase and the development phase. All costs incurred during the research phase are expensed as incurred. Costs incurred during the development phase are capitalized only when an entity can demonstrate that certain criteria are met. In a

nutshell, IAS 38 requires that development costs be capitalized after commercial viability has been assessed. To assess commercial viability, IAS 38 explains that the principles in IAS 36, *Impairment of Assets*, have to be followed. Therefore an analysis of projected cash flows to be generated by the development costs is a crucial step in demonstrating that the recognition criteria are met. Costs are capitalized only from the moment in time at which all the criteria in IAS 38 are met.

Generally, under U.S. GAAP, internally generated costs are not capitalized unless a specific rule requires capitalization. For example, specific rules apply to costs associated with the development of software. U.S. GAAP distinguishes between software developed for sale to third parties and software developed for internal use. IFRS do not contain any specific guidance for software, and therefore the international accounting for software follows the general criteria of IAS 38. Also, under U.S. GAAP, specific rules apply to direct-response advertising costs, which are eligible for capitalization if certain specific criteria are met. Under IFRS, advertising costs are always expensed as incurred.

For subsequent measurement of intangible assets, IFRS allows preparers to use both the cost method and the revaluation model. However, the revaluation model can be used only when the fair value is determined by reference to an active market. IAS 38 provides an extremely restrictive definition of an active market, resulting in very few circumstances in which it is possible to use the revaluation method. U.S. GAAP only allows the cost method for subsequent measurement.

As already highlighted in previous articles, IAS 38 also interacts with many other standards. This can lead to a series of other differences that are indirectly triggered by those standards. In particular, application of IAS 36 and IFRS 3, *Business Combinations*, might further significantly increase the gap between IFRS and U.S. GAAP in accounting for intangible assets.

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