

July 28, 2009

Accounting

FASB Initiates Disclosure Framework Project

The Financial Accounting Standards Board (FASB) has added a project to its agenda that is intended to make financial statement disclosures more effective, coordinated, and less redundant. The project's objective is not intended to be "additive." Rather, it will focus on developing a framework for improved disclosures in accordance with generally accepted accounting principles. It is envisioned that this framework would enable all entities to concentrate on making more coherent disclosures in their annual reporting package and to move away from what some assert has become a compliance exercise.

This project responds to concerns that have been expressed about "disclosure overload". The project is expected to create a principles-based disclosure framework that will enable companies to communicate more effectively with investors and help eliminate redundancy or outdated disclosures.

The framework also may facilitate the use of eXtensible Business Reporting Language (XBRL) electronic tagging of information. XBRL is a global standard that provides unique electronically readable codes (tags) for each item in the financial statements or other business report. Tagging can be thought of as placing a unique barcode on each item of information included in business reports so that XBRL-enabled software can search for a specified tag, recognize it, and retrieve it.

Some specific financial reporting areas the project will evaluate and address include whether the disclosure framework should:

- Apply to all entities or perhaps exclude private or nonprofit entities
- Apply to interim reporting
- Focus only on high-level principles
- Focus only on notes to financial statements or extend to ways to better integrate information provided in financial statements, management's discussion and analysis, and other parts of a company's public reporting package

The FASB expects to begin deliberations this quarter and plans to issue a preliminary views document in the first half of 2010.

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Accounting for Own-Share Lending Arrangements

Corporate entities may enter into share-lending arrangements that are executed in connection with a convertible debt offering. This is done for a reduction in the interest rate or an increase in proceeds received from the issuance of a convertible debt instrument, and due to a lack of liquidity or extensive open short positions in their shares. At its July 1, 2009 meeting, the Financial Accounting Standards Board ratified the final consensuses for Emerging Issues Task Force (EITF) Issue No. 09-1, "Accounting for Own-Share Lending Arrangements in Contemplation of Convertible Debt Issuance or Other Financing." In this Issue, the EITF reached a consensus that at the date of issuance, a share-lending arrangement entered into on an entity's own shares in contemplation of a convertible debt offering or other financing is required to be measured at fair value and recognized as issuance cost in the financial statements of the entity. This Issue only applies to share-lending arrangements that are classified as equity in the financial statements of the share lender.

Issue No. 09-1 is effective for fiscal years beginning on or after December 15, 2009, and interim periods within those fiscal years for arrangements outstanding as of the beginning of those fiscal years. This Issue is effective for interim or annual periods beginning on or after June 15, 2009, for share-lending arrangements entered into in those periods. Arrangements that have been terminated as a result of counterparty default prior to the effective date of this Issue but for which the entity had not reached a final settlement as of the effective date are within the scope of this Issue.

EITF Consensuses-for-Exposure

At its June 18, 2009 meeting, the Emerging Issues Task Force (EITF) reached tentative conclusions on the following Issues:

- *Issue No. 08-1, "Revenue Arrangements with Multiple Deliverables"*
In this Issue, the Task Force reached a consensus-for-exposure that the draft abstract previously exposed on December 1, 2008, be modified to include additional guidance on disclosure, transition, and the effective date. In addition, the Task Force reaffirmed its decision from the March 19, 2009 meeting to eliminate the use of the residual method of allocation and require a vendor to allocate arrangement consideration at the inception of an arrangement to all deliverables in the arrangement using the relative-selling-price method. If finalized, this Issue would be applied on a prospective basis for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010.
- *Issue No. 09-3, "Applicability of AICPA Statement of Position 97-2 to Certain Arrangements That Include Software Elements"*
This Issue applies to multiple-deliverable revenue arrangements that include tangible products and software that is more than incidental to the tangible products. In Issue No. 09-3, the Task Force reached a consensus-for-exposure that tangible products containing software components and non-software components that function together to deliver the tangible product's essential functionality are excluded from the scope of AICPA Statement of Position (SOP) 97-2, *Software Revenue Recognition*. If an arrangement includes deliverables that are within the scope of SOP 97-2 and deliverables that are not within the scope of SOP 97-2, an entity should allocate arrangement consideration to each separate unit of accounting in accordance with Issue No. 08-1. If finalized, Issue No. 09-3 would be applied on a prospective basis for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010.

Also at the June EITF meeting, the SEC Observer made an announcement of the SEC staff's position on escrowed share arrangements in Topic No. D-110, "Escrowed Share Arrangements and the Presumption of Compensation," to clarify the SEC staff's views on overcoming the presumption that for certain shareholders these arrangements

represent compensation. Historically, the SEC staff has expressed the view that an escrowed share arrangement involving the release of shares to certain shareholders based on performance-related criteria is presumed to be compensatory, equivalent to a reverse stock split followed by the grant of a restricted stock award under a performance-based plan. Topic No. D-110 concludes that when evaluating whether the presumption of compensation has been overcome, registrants should consider the substance of the arrangement, including whether the arrangement was entered into for purposes unrelated to, and not contingent upon, continued employment. The SEC staff believes that an escrowed share arrangement in which the shares are automatically forfeited if employment terminates is compensation.

The minutes of the June 18, 2009 EITF meeting are available in full at <http://www.fasb.org>.

Employee Benefit Plans

DOL Issues Transition Relief for 403(b) Plan Reporting and Audits

Starting with plan years beginning on or after January 1, 2009, 403(b) plans that are considered to be ERISA-covered plans will be required to file complete Form 5500s, including schedules such as Schedules A and either H (for large plans) or I (for small plans). As with other ERISA-covered plans, those plans with over 100 participants will be required to have an annual audit performed by a qualified independent auditor. Some plan administrators have expressed concern that the historical treatment of 403(b) plans as a collection of individual contracts with respect to which employees could engage in a range of actions without the consent or involvement of an employer or plan administrator could make it costly, and in some cases impossible, to identify and obtain financial information about certain pre-2009 contracts and custodial accounts to which the employer is no longer making employer contributions or forwarding employee salary reduction contributions.

On July 20, 2009, the U.S. Department of Labor issued Field Assistance Bulletin (FAB) No. 2009-02, *Annual Reporting Requirements for 403(b) Plans*, to provide certain transition relief for administrators of 403(b) plans that make good faith efforts to transition for the 2009 plan year to ERISA's generally applicable annual reporting requirements. The FAB indicates that certain inactive contracts will not be part of the employer's Title I plan or as plan assets for purposes of the annual report (Form 5500) provided that:

- The contract or account was issued to a current or former employee before January 1, 2009;
- The employer ceased to have any obligation to make contributions (including employee salary reduction contributions), and in fact ceased making contributions to the contract or account before January 1, 2009;
- All of the rights and benefits under the contract or account are legally enforceable against the insurer or custodian by the individual owner of the contract or account without any involvement by the employer; and
- The individual owner of the contract is fully vested in the contract or account.

The number of participants included in the plan as reported on the Form 5500 will not include those holding only such excluded contracts. Additionally, acknowledging that 403(b) audit reports may still result in modified opinions due to difficulty in auditing and accounting for pre-2009 contracts, the DOL has indicated it will not reject the Form 5500 filing on the basis of a qualified, adverse, or disclaimed opinion if the accountant expressly states that the sole reason for such an opinion was because such pre-2009 contracts were not covered by the audit or included in the plan's financial statements. We are still evaluating the impact, if any, of this action on the plan's financial statements and auditor's report and plan to issue additional guidance in the near future.

FAB No. 2009-02 is available in full at <http://www.dol.gov/ebsa/regs/fab2009-2.html>.

International

IASB Publishes IFRS for SMEs

The International Accounting Standards Board (IASB) has issued an International Financial Reporting Standard (IFRS) designed for use by small and medium-sized entities (SMEs). The *IFRS for SMEs* is a self-contained 230-page standard tailored for the needs and capabilities of smaller businesses. The new pronouncement defines SMEs as entities that do not have public accountability but do publish general purpose financial statements for external users. An entity has public accountability if either its debt or equity instruments are traded in a public market, it is in the process of issuing such instruments for trading in a public market, or one of its primary businesses is holding assets in a fiduciary capacity for a broad group of outsiders (typically the case for banks, credit unions, insurance companies, security brokers and dealers, mutual funds, and investment banks). For purposes of applying this criteria, a subsidiary whose parent uses full IFRS would not be prohibited from using the SME standard in its separate financial statements as long as the subsidiary does not have public accountability. Since the parent's consolidated financial statements would be based on full IFRS the parent would be required to convert the subsidiary's information from IFRS for SMEs to full IFRS for consolidation.

Many of the principles in full IFRS for recognizing and measuring assets, liabilities, income, and expenses have been simplified (*e.g.*, borrowing costs are recognized as an expense rather than capitalized as required for borrowing costs related to qualifying assets under full IFRS, and financial instruments accounting is simplified by reducing the number of categories for investments in financial assets and establishing less restrictive hedge accounting requirements). Also, topics not relevant to SMEs (such as earnings per share and segment reporting) have been omitted, and the number of required disclosures has been significantly reduced. To further reduce the reporting burden for SMEs revisions or amendments to the *IFRS for SMEs* will be limited to once every three years. *IFRS for SMEs* was effective upon issuance.

The complete *IFRS for SMEs* (together with the basis for conclusions, illustrative financial statements, and a presentation and disclosure checklist) can be downloaded free of charge at <http://www.iasb.org>.

IASB Addresses Classification and Measurement of Financial Instruments

The International Accounting Standards Board (IASB) recently published an Exposure Draft (ED) to address how financial instruments are classified and measured, which is one phase of the IASB's comprehensive review of financial instrument accounting and ultimate replacement of International Accounting Standard (IAS) 39, *Financial Instruments: Recognition and Measurement*. The other two phases of the project will address impairment methodology and hedge accounting. The recent ED proposes two measurement categories: amortized cost and fair value. The classification approach to determine which financial assets or financial liabilities would be accounted for at amortized cost would use two criteria: (a) Does the financial instrument have basic loan features (contractual terms that give rise to cash flows that are payments of principal and interest on the principal outstanding)?; and (b) Is the instrument managed on a contractual yield basis (*i.e.*, whereby the business model is to pay and receive the contractual cash flows that are generated when held or issued)?.

The major impact that the ED would have are:

- The current classification categories would be replaced with the two measurement categories discussed above – fair value and amortized cost.
- Debt instruments that are today classified as “available for sale” and measured at fair value could be measured using amortized cost, if certain criteria are met.

- The existing “tainting” requirements for held-to-maturity assets would be eliminated. Separate presentation of gains and losses arising on the derecognition of items measured at amortized cost before maturity would enable users to understand the effects of such transactions within the context of a business model based on the payment or receipt of contractual cash flows.
- One impairment method would be applied to all financial assets measured at amortized cost.
- One classification approach would be used for all types of financial instruments. This would include financial contracts that have derivative features embedded.
- All equity instruments would be measured at fair value and there would be an option to present gains or losses for some equity investments in other comprehensive income. There would be no impairment requirements for such circumstances.

The IASB plans to complete the replacement of IAS 39 during 2010, although mandatory application will not be before January 2012.

The ED, *Financial Instruments: Classification and Measurement*, is available for comment until September 14, 2009 at <http://www.iasb.org/NR/ronlyres/D1598224-3609-4FOA-82D0-6DC598C3249B/0/EDFinancialInstrumentsClassificationandMeasurement.pdf>.

Interim Financial Reporting: IFRS vs. U.S. GAAP

This article is the twenty-fourth 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 interim financial reporting. Actual differences in the accounting treatment between the two frameworks depend on specific circumstances.

International Accounting Standard (IAS) 34, *Interim Financial Reporting*, and IFRIC 10, *Interim Financial Reporting and Impairment*, represent the core IFRS literature related to interim financial reporting. U.S. GAAP literature on this subject is primarily based on Accounting Principles Board (APB) Opinion No. 28, *Interim Financial Reporting*, (FASB ASC 270-10) and a few other standards. Both frameworks allow preparers to make some simplification when reporting interim results, such as presenting condensed financial statements that include significantly less disclosure compared with year-end financial statements. It is important to note, however, that IAS 34 and APB 28 use substantially different approaches to interim reporting.

IAS 34 generally requires an entity to apply the same accounting policies in its interim financial statements as are applied in its annual financial statements. This approach suggests that interim period measurements are made as if each interim period stands alone as an independent reporting period. However, IAS 34 also states that the frequency of an entity's reporting must not affect the measurement of its annual results. In other words, IAS 34 acknowledges that an interim period is a part of a larger financial year, but this does not change the concept that the principles for recognizing assets, liabilities, income, and expenses for interim periods are the same as in annual financial statements. Interim period income tax expense, however, is accrued using the tax rate that would be applicable to expected total annual earnings (*i.e.*, the estimated average annual effective income tax rate applied to the pre-tax income of the interim period).

APB 28 views each interim period primarily as being an integral part of the annual period. Under this view, deferrals, accruals, and estimations at the end of each interim period are affected by judgments made at the interim date as to results of operations for the balance of the annual period. Thus, an expense item that might be considered as falling wholly within an annual accounting period (*i.e.*, with no fiscal year-end accrual or deferral)

could be allocated among interim periods based on estimated time, sales volume, production activity, or some other basis.

It is important to note that it is unlikely that first-time adopters of IFRS will be able to issue condensed financial statements for their first interim report (*i.e.*, assuming the first IFRS financial statements will be issued for the year ending December 31, 200X, and the first interim financial statements will be released for the period ending March 31, 200X). IAS 34 requires minimum disclosures, which are based on the assumption that users of the interim financial report also have access to the most recent annual IFRS financial statements. In its most recent annual financial statements under previous GAAP, it is likely that a first-time adopter of IFRS did not disclose information material to an understanding of the first-interim IFRS period (*i.e.*, full IFRS accounting policies). As a result, the interim financial report will have to disclose that information or include a cross-reference to another published document that includes it.

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