Insights

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Accounting

Disclosures Concerning Subsequent Events under OCBOA

Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 855, Subsequent Events, sets forth general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. FASB ASC 855 also requires disclosure of the date through which an entity has evaluated subsequent events and the basis for that date (i.e., whether that date represents the date on which the financial statements were issued or were available to be issued). Recently, the American Institute of Certified Public Accountants issued Technical Information Service (TIS) 1500.07, Disclosure Concerning Subsequent Events in Financial Statements Prepared on an Other Comprehensive Basis of Accounting, to clarify that full-disclosure financial statements prepared on an other comprehensive basis of accounting (OCBOA) should contain the disclosures set forth in FASB ASC 855. Therefore, the date through which an entity has evaluated subsequent events and the basis for that date should be disclosed. Furthermore, some nonrecognized subsequent events are of such a nature that they must be disclosed to keep the financial statements prepared on an OCBOA from being misleading. Such events should be disclosed following the guidance in FASB ASC 855.

TIS 1500.07 is available in full at http://www.aicpa.org/download/acctstd/FINAL_TIS1500-07_DisclosureofSubsequentEvents.pdf.

SEC

The Effect of the FASB Codification on Disclosures in Financial Statements

For annual and interim periods ending after September 15, 2009, the FASB Accounting Standards Codification will become the single source of authoritative generally accepted accounting principles (GAAP) in the United States. At its July 2009 meeting with the SEC Regulations Committee, the SEC staff addressed certain issues that have been raised as to the proper financial statement disclosures once the FASB Codification becomes effective. The SEC staff began its discussion of these issues by first encouraging companies to draft financial statement disclosures that avoid specific GAAP references and more clearly explain accounting concepts (*i.e.*, use "plain English").

If references to specific GAAP are made in financial statements for periods ending on or before September 15, 2009 (*i.e.,* before the Codification becomes effective) the SEC Staff believes pre-Codification GAAP references continue to be acceptable, even if those financial statements were issued after September 15, 2009 (*e.g.,* in a Form 10-K or Form 10-Q for the annual or quarterly period ended August 31, 2009). Further, the SEC staff will not object if those financial statements refer to either the Codification or both the Codification and pre-Codification GAAP literature.

Once a company issues financial statements for a period ending after September 15, 2009 the SEC staff believes any references to specific elements of GAAP should use Codification references. That is, if references to specific

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GAAP are made in financial statements for periods ending after September 15, 2009 (*e.g.*, annual or interim financial statements as of September 30, 2009), those references should be to the Codification. Moreover, references to specific GAAP throughout the financial statements should be on a consistent basis for all periods (*i.e.,* disclosures for comparative periods should not refer to only pre-Codification GAAP literature). Until financial statement users become more familiar with the Codification, the SEC staff will not object if financial statements for periods ending after September 15, 2009 refer to both the Codification and pre-Codification GAAP literature to facilitate investor understanding.

After the Codification becomes effective, the SEC staff does not expect companies to revise or amend financial statements previously filed for prior periods simply because financial statements for periods ending after September 15, 2009 refer to the Codification. That is, a company's December 31, 2008 Form 10-K, with references to only pre-Codification GAAP literature, may be incorporated by reference into a Form S-3 registration statement that becomes effective after September 15, 2009, even if the Form S-3 also incorporates by reference the September 30, 2009 Form 10-Q that refers to the Codification.

The Codification includes relevant portions of authoritative content issued by the SEC and the SEC staff for reference by public companies. The inclusion of the SEC content is intended to increase the utility of the Codification for public companies who file with the SEC. The Codification does not intend to replace the specific rules and interpretive releases of the SEC or its staff and does not change the SEC content. Therefore, specific SEC rules and interpretive releases still may be referenced in financial statements.

The SEC staff will not require a preferability letter if an accounting change is in response to a newly issued update of the Codification.

PCAOB Adopts Standard on Engagement Quality Review

The Public Company Accounting Oversight Board (PCAOB) has adopted Auditing Standard (AS) No. 7, *Engagement Quality Review*, which applies to all audit engagements, and engagements to review interim financial information, conducted pursuant to the standards of the PCAOB. If adopted by the SEC, this Standard will become effective for audits and interim reviews for fiscal years beginning on or after December 15, 2009.

Per AS 7, the objective of the engagement quality reviewer is to perform an evaluation of the significant judgments made by the engagement team and the related conclusions reached in forming the overall conclusion on the engagement and in preparing the engagement report, if a report is to be issued, in order to determine whether to provide concurring approval of issuance. In an engagement quality review, a qualified reviewer takes a fresh, objective look at the engagement, and, based on that review, evaluates whether it is appropriate for the Firm to issue its report. The engagement quality reviewer must be independent of the company, perform the engagement quality review with integrity, and maintain objectivity in performing the review.

Some of the other requirements of AS7 are summarized as follows:

- The person who served as the engagement partner during either of the two audits preceding the audit subject to the engagement quality review may not be the engagement quality reviewer.
- In an audit and a review of interim financial information, the engagement quality reviewer should evaluate the significant judgments that relate to engagement planning.
- In an audit, the engagement quality reviewer should evaluate the engagement team's assessment of, and audit responses to, significant risks identified by the engagement team, including fraud risks, and other significant risks identified by the engagement quality reviewer through performance of the procedures required by AS 7.

- Whether in an audit or an interim review, the engagement quality reviewer also should review the engagement team's evaluation of the Firm's independence in relation to the engagement.
- The engagement quality reviewer should evaluate judgments made about the materiality and disposition of corrected and uncorrected identified misstatements and the severity and disposition of identified control deficiencies.
- Based on procedures required by AS 7, the engagement quality reviewer is required to evaluate whether appropriate consultations have taken place on difficult or contentious matters. The engagement quality reviewer must review the documentation, including conclusions, of such consultations.
- Based on procedures required by AS 7, the engagement quality reviewer also must evaluate whether appropriate matters have been communicated, or identified for communication, to the audit committee, management, and other parties, such as regulatory bodies.

The engagement quality reviewer may provide concurring approval of issuance only if, after performing the required review with due professional care, he or she is not aware of a significant engagement deficiency. The Firm may grant permission to the client to use the engagement report (or communicate an engagement conclusion to its client, if no report is issued) only after the engagement quality reviewer provides concurring approval of issuance.

AS 7 is available in full at http://www.pcaobus.org/Rules/Docket_025/2009-07-28_Release_No_2009-004.pdf.

Updated Financial Reporting Manual Available

The SEC's Division of Corporation Finance recently updated its *Financial Reporting Manual*, which is available online. Although the Manual is intended only to provide general guidance to Division staff, it contains helpful information to auditors and preparers of issuer financial statements. Topics discussed in the Manual include the following, among others:

- Registrant's financial statements
- Other financial statements required
- Pro forma financial information
- Independent accountant's involvement
- Smaller reporting companies
- Related-party matters
- Non-GAAP measures of financial performance, liquidity, and net worth
- Management's discussion and analysis of financial position and results of operations
- Reverse acquisitions and reverse recapitalizations
- Effects of subsequent events on financial statements required in filings
- Employee stock benefit plans

The updated *Financial Reporting Manual* is available in full at http://www.sec.gov/divisions/corpfin/cffinancialreportingmanual.pdf.

Restated Financial Statements in a Form S-8

Item 11(b) of Form S-3 requires the inclusion of restated financial statements when there has been a change in accounting principles that requires a material retroactive restatement of financial statements. Therefore, if a registrant has a change in accounting principles (or changes in segment presentation or discontinued operations)

after its Form 10-K is filed, which will cause the financial presentation in its subsequent Form 10-Qs to differ from that in the Form 10-K, Item 11(b) of Form S-3 would require the annual audited financial statements filed in the Form 10-K to be restated to reflect the change in accounting principles (or changes in segment presentation or discontinued operations). Form S-8, however, does not necessarily require the restatement of financial statements to reflect specified events.

General Instruction G.2 of Form S-8 requires that "material changes in the registrant's affairs" be disclosed in the registration statement. The fact that financial statements eventually will be retroactively restated does not necessarily mean that there are "material changes in the registrant's affairs," thereby requiring the financial statements to be restated for inclusion, or incorporation by reference, in a Form S-8. In recently updated Section 13100 of its *Financial Reporting Manual*, the SEC's Division of Corporation Finance notes that financial statements for which Item 11(b)(ii) of Form S-3 would require restatement may not necessarily need to be restated for incorporation by reference in Form S-8. The registrant is responsible for determining if there has been a material change and, if so, the related information that is required to be disclosed in Form S-8. Correspondingly, it is the auditor's responsibility to determine if it will issue a consent to use its report in a Form S-8 if there has been a change in the financial statements in a subsequent Form 10-Q where the financial statements in the Form 10-K have not been retroactively restated.

SEC Reporting and FASB Forum for Mid-sized and Smaller Public Companies

McGladrey & Pullen, LLP has assisted in the development of a two-day forum for the SEC Institute, *SEC Reporting and FASB Forum for Mid-sized and Smaller Public Companies,* which will be held September 24 and 25 in Las Vegas. This forum will include complete updates by the Financial Accounting Standards Board, the SEC's Division of Corporation Finance, the Office of the Chief Accountant, and the Public Company Accounting Oversight Board. There will also be a discussion of the current economic environment by a CFO roundtable. Other topics that will be covered during the Forum include:

- Resources needed to measure fair value
- MD&A in troubled times
- Researching in the new FASB Codification
- Implementation plan suggestions to get ready for XBRL

To register for the Forum, visit the SEC Institute's Web site at http://www.secinstitute.com/sched/menu_srf.html or call 305.529.1550. Arrangements have been made to give our clients a substantial discount to attend the forum.

Potential Requirement for Engagement Partner to Sign Audit Report

The Public Company Accounting Oversight Board (PCAOB) is seeking comment on a Concept Release to consider the effects of a potential requirement for the engagement partner (*i.e.,* the auditor with final responsibility for the audit) to sign the audit report. Any such requirement would be in addition to the existing requirement for the audit firm to sign its name on the audit report. The intent of any signature requirement would not be to suggest that the firm as a whole is not accountable for the contents of its audit report, or that the engagement partner is solely responsible for the audit.

Any such requirement would not increase or otherwise affect the duties and obligations of the engagement partner under PCAOB standards in performing the audit. At the same time, the PCAOB believes that the engagement partner should be – and is – responsible for the audit work performed and the contents of the audit report. Engagement partners may be liable in PCAOB and SEC enforcement actions without regard to whether they signed the audit report. Accountants may also be held liable to private parties in both state and federal courts under a variety of different legal theories depending upon the facts of a particular case.

Per the PCAOB, a requirement for the engagement partner to sign the audit report could improve audit quality in two ways. First, it might increase the engagement partner's sense of accountability to financial statement users, which could lead him or her to exercise greater care in performing the audit. Second, it would increase transparency about who is responsible for performing the audit, which could provide useful information to investors and, in turn, provide an additional incentive to firms to improve the quality of all of their engagement partners. While the PCAOB agrees with those who have noted the importance of the expertise, quality control system, and skill of a firm as a whole, they believe that the skill and expertise of the engagement partner also undoubtedly contribute to audit quality.

The Concept Release is available for comment until September 11, 2009 at http://www.pcaobus.org/Rules/Docket_029/2009-07-28_Release_No_2009-005.pdf.

International

Exemptions for First-time Adopters of IFRS

The International Accounting Standards Board recently published amendments to International Financial Reporting Standard (IFRS) 1, *First-time Adoption of International Financial Reporting Standards*, to provide certain exemptions for first-time adopters of IFRS. The amendments exempt:

- Entities that used full cost accounting under previous generally accepted accounting principles from retrospective application of IFRS for oil and gas assets; and
- Entities with existing leasing contracts from reassessing the classification of those contracts in accordance with IFRIC 4, *Determining whether an Arrangement contains a Lease,* when the application of their national accounting requirements produced the same result.

The amendments are effective for annual periods beginning January 1, 2010 with earlier application allowed.

Proposed Accounting for Rate-Regulated Activities

For some businesses, such as utilities, the charges they can make to their customers are subject to regulation. Rate regulation is a restriction in the setting of prices that can be charged to customers for services or products. Generally, it is imposed by regulatory bodies or governments when an entity has a monopoly or a dominant market position that gives it excessive market power.

International Financial Reporting Standards (IFRS) currently do not provide specific guidance on the recognition and measurement of assets and liabilities resulting from rate regulation by regulatory bodies or governments. The International Accounting Standards Board recently published proposals to establish the accounting for how assets and liabilities resulting from rate-regulated activities should be recognized and measured under IFRS. If adopted, the proposed IFRS would:

- Define regulatory assets and regulatory liabilities;
- Establish criteria for their recognition;
- Specify how they should be measured; and
- Require disclosures about their financial effects.

The proposals in the Exposure Draft, *Rate-regulated Activities,* are open for comment until November 20, 2009 at http://www.iasb.org/NR/rdonlyres/E934E979-B3CF-44EE-AC62-C21C73F5CE6E/0/Rate_regulated_Activities_Standard.pdf.

Accounting for Government Grants: IFRS vs U.S. GAAP

This article is the twenty-fifth 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 accounting for government grants. Actual differences in the accounting treatment between the two frameworks depend on specific circumstances.

Under IFRS the main accounting standards dealing with the accounting treatment of government grants are International Accounting Standard (IAS) 20, *Accounting for Government Grants and Disclosure of Government Assistance*, IAS 41, *Agriculture,* and SIC-10, *Government Assistance - No Specific Relation to Operating Activities.* Unlike IFRS, U.S GAAP does not include specific guidance on government grants. However, there are some standards that deal with "contributions" in various ways, such as FASB Statement No. 116, *Accounting for Contributions Received and Contributions Made* (FASB ASC 958), Statement No. 143, *Accounting for Asset Retirement Obligations* (FASB ASC 410-20), and AICPA Statement of Position No. 96-1, *Environmental Remediation Liabilities* (FASB ASC 410-30)*, etc*. Under U.S. GAAP, the manner in which government grants are recognized depends on the specific facts and circumstances of each individual transaction. As a result, it is difficult to compare the two frameworks unless a specific transaction is identified.

IAS 20 distinguishes between government grants and government assistance. Government assistance is an economic benefit specific to an entity or range of entities provided by the government and qualifying under certain criteria. Government grants are assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity.

Government grants are recognized when there is reasonable assurance that the entity will comply with the conditions attached to them and the grants will be received. The basic principle of IAS 20 is that government grants are recognized in profit or loss on a systematic basis over the periods in which the entity recognizes as expense the related costs for which the grants are intended to compensate. Government grants related to assets are presented in the statement of financial position either by setting up the grant as deferred income or by deducting the grant in arriving at the carrying amount of the asset. Grants related to income are presented as a credit in the statement of comprehensive income, either separately or under a general heading such as "other income" or, alternatively, they are deducted in reporting the related expense. Government assistance is not recognized, but is disclosed in terms of the nature, extent, and duration of the assistance provided.

IAS 41 includes a specific accounting model for recognizing government grants specifically for the agricultural industry which distinguishes between conditional and unconditional grants. An unconditional grant is recognized in income when the grant is receivable, and a conditional grant is recognized in income when the conditions are met. Grants are measured at the fair value of the asset received or receivable, and grants received before the income recognition criteria are satisfied are recognized as deferred income. The model of IAS 41 has been adopted by IFRS for SMEs. As a result, entities applying IFRS for SMEs will apply the IAS 41 model for all types of grants.

The way government grants are recorded under IFRS is not exempt from criticism. As a result, the IASB is undertaking a project to revise the accounting for government grants. This project focuses on eliminating inconsistencies with the Framework and eliminating options that can reduce the comparability of financial statements.

For further information, please contact Bob Dohrer (robert.dohrer@rsmi.com) or Marco Marcellan (marco.marcellan@rsmi.com) in our International Assurance Services Group.