

August 25, 2009

Accounting

FASB Webcast Regarding Amendments to the Accounting for Securitizations and Special Purpose Entities

In June 2009, the Financial Accounting Standards Board (FASB) issued FASB Statements No. 166, *Accounting for Transfers of Financial Assets*, and No. 167, *Amendments to FASB Interpretation No. 46(R)*. These Statements amend FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, and FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities*, respectively. The amendments are effective for annual and interim periods beginning after November 15, 2009.

The FASB hosted a one-hour webcast on August 24, 2009 to discuss the requirements of these amendments. The archived webcast is free of charge and is available until September 23, 2009. To access the webcast, go to <http://event.on24.com/r.htm?e=158819&s=1&k=64DCC8C326DB8E6C84645EC0C00C285C>.

Financial Institutions

Loans Secured by Junior Liens on Family Residential Properties

The Federal Deposit Insurance Corporation recently issued Financial Institution Letter (FIL) 43-2009, *Allowances for Loan and Lease Losses in the Current Economic Environment: Loans Secured by Junior Liens on 1-4 Family Residential Properties*. The FIL states that the need for financial institutions to consider all significant factors that affect collectibility is especially important for loans secured by junior liens on 1 - 4 family residential properties in areas where there have been declines in the value of such properties. After determining the appropriate historical loss rate for each group of junior lien loans with similar risk characteristics, an institution's management should consider those current qualitative or environmental factors that are likely to cause the estimated credit losses on these loans as of the allowance for loan and lease losses evaluation date to differ from the group's historical loss experience. These qualitative or environmental factors include, but are not limited to, changes in the volume and severity of past due loans in each group of junior lien loans and changes in economic and business conditions and other developments that affect the collectibility of the junior lien loans.

Per the FIL, given the unique nature of junior lien loans, other factors that an institution should take into account would include, for example:

- Changes in the repayment status of the junior lien borrowers' loans secured by first (and any other more senior) liens on the same 1-4 family residential properties, including the extent and severity of delinquencies and the volume of senior lien loan modifications that represent troubled debt restructurings, regardless of whether the junior lien loans themselves are current or past due;

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- Changes in the value of the junior lien borrowers' underlying real estate collateral, including the extent to which these borrowers' more senior lien loan balances, or the combined balances of the more senior lien loans and the institution's junior lien loan, currently exceed the value of the underlying real estate; and
- The institution's policies regarding the initiation of foreclosure action on junior lien loans and the submission of bids on foreclosure sales initiated by more senior lien holders when the value of the underlying real estate collateral is insufficient to adequately protect the institution's junior lien position.

It is important to note that the FIL also states, "...delaying the recognition of estimated credit losses on junior lien loans secured by 1-4 family residential properties by failing to properly consider the current effect of more senior liens on the collectibility of an institution's existing junior lien loans is an inappropriate application of GAAP."

The FIL is available in full at <http://www.fdic.gov/news/news/financial/2009/fil09043a.html>.

International

Guidance Issued for Applying ISAs to Audits of SMEs

To assist auditors in implementing the clarified International Standards on Auditing (ISAs), the staff of the International Auditing and Assurance Standards Board has developed a new question-and-answer publication, *Applying ISAs Proportionately with the Size and Complexity of an Entity*. The publication is relevant in the context of any audit, but will be particularly helpful to those who audit small and medium-sized entities (SMEs). The questions and answers explain how the design of the ISAs enables them to be applied in a manner that is proportionate to the specific characteristics of the entity subject to audit. Furthermore, answers are given to questions relating to audit procedures, work effort, documentation, and professional judgment. The publication is available in full at <http://www.ifac.org/Members/DownLoads/applying-isas-proportionate.pdf>.

Proposed Accounting for Extinguishment of Financial Liabilities with Equity Instruments

In the current environment, some entities are renegotiating the terms of financial liabilities with their creditors. In some circumstances, the creditor agrees to accept an entity's shares or other equity instruments to settle the financial liability fully or partially. These transactions are sometimes referred to as "debt for equity swaps."

The International Financial Reporting Interpretations Committee (IFRIC) has been asked for guidance on how an entity should account for such transactions in accordance with International Accounting Standard (IAS) 39, *Financial Instruments: Recognition and Measurement*, and IAS 32, *Financial Instruments: Presentation*. The IFRIC therefore has published draft Interpretation IFRIC D25, *Extinguishing Financial Liabilities with Equity Instruments*. IFRIC D25 proposes that:

- The entity's equity instruments are part of any "consideration paid" to extinguish the financial liability.
- The equity instruments are measured at either their fair value or the fair value of the financial liability extinguished, whichever is more reliably determinable.
- Any difference between the carrying amount of the financial liability extinguished and the initial measurement amount of these equity instruments is included in the entity's profit or loss for the period.
- If only part of the financial liability is extinguished by the issue of equity instruments, the entity must assess the terms of the financial liability that remains outstanding to determine whether they are substantially different from those of the original financial liability. If the terms of the financial liability that remains outstanding are substantially different from those of the original financial liability, the entity must account for the modification as the extinguishment of the original financial liability and the recognition of a new financial liability in accordance with IAS 39, paragraph 40.

- An entity must disclose a gain or loss recognized in accordance with the requirements above as a separate line item in the statement of comprehensive income and the separate income statement (if presented) or in the notes.

An effective date for the proposed Interpretation has not been determined. The proposal is available for comment until October 5, 2009 at <http://www.iasb.org/NR/rdonlyres/974EE382-6274-4294-A92B-230D0504C26E/0/IFRICD25.pdf>.

Proposals on the Classification of Rights Issues

The International Accounting Standards Board has published for public comment an Exposure Draft, which, if finalized, would amend International Accounting Standard (IAS) 32 *Financial Instruments: Presentation*. The purpose of the amendment is to clarify the classification of instruments that give the holders the right to acquire an entity's own equity instruments at a fixed price (rights issue) when that price is stated in a currency other than the entity's functional currency. Current practice appears to require such issues to be accounted for as derivative liabilities that are measured at fair value with changes in fair value recognized in earnings. The proposed amendment specifies that a rights issue offered pro rata to all of an entity's existing shareholders on the exercise of which the entity will receive a fixed amount of cash for a fixed number of the entity's own equity instruments is classified as an equity instrument regardless of the currency in which the exercise price is denominated. The proposed amendment is intended to clarify the circumstances in which the currency the entity will receive on the issue of an instrument does not affect its classification as a liability or an equity instrument. The proposed amendment would be effective for annual periods beginning on or after 90 days after the amendment is issued, with earlier application permitted.

Classification of Rights Issues (Proposed amendment to IAS 32) is available for comment until September 7, 2009 at <http://www.iasb.org/NR/rdonlyres/DDAEFAC3-3C20-4EBA-AD71-D21170ADF0EF/0/EDIAS32Classificationrights.pdf>.

Events after the Balance Sheet Date: IFRS vs. U.S. GAAP

This article is the twenty-sixth 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 events after the balance sheet date. Actual differences in the accounting treatment between the two frameworks depend on specific circumstances.

The IFRS standards dealing with events after the balance sheet date are International Accounting Standard (IAS) 10, *Events after the Balance Sheet Date*, and IAS 1, *Presentation of Financial Statements*. U.S. GAAP includes the relevant literature in FASB Statement No. 165, *Subsequent Events* (FASB ASC 855).

Under both IFRS and U.S. GAAP, assets and liabilities are "static" concepts that are measured only at one precise point in time. However, events that occur after the balance sheet date can provide additional relevant information about how to measure or present those assets and liabilities. The reporting date is the "cut-off" date that draws the line between which transactions/information are considered in measuring assets and liabilities and which are not. Identifying the "cut-off" date is not always as easy as it might appear. To tackle this issue, both IFRS and U.S. GAAP classify events after the balance sheet date in two categories - adjusting events and non-adjusting events. Despite the fact that both IFRS and U.S. GAAP are grounded in the same theory, the theory is sometimes interpreted and consequently implemented differently.

Under U.S. GAAP, events after the balance sheet date can be considered only if they occurred before financial statements are issued or are available to be issued. An entity that has a current expectation of widely distributing its financial statements to its shareholders and other financial statement users (including a public entity) must evaluate subsequent events through the date that the financial statements are issued. All other entities must evaluate subsequent events through the date that the financial statements are available to be issued.

Under IFRS, events after the reporting period are those events that occur between the end of the reporting period and the date when the financial statements are authorized for issue. IAS 10 provides specific examples to help explain this concept. Assume, for example, that financial statements are authorized for issue by the Board of Directors and made available to shareholders and others at one date (*e.g.*, in March), but the shareholders approve the financial statements later at their annual meeting (*e.g.*, in May). Under IAS 10, such financial statements are considered authorized for issue when the Board of Directors authorized them in March.

In addition to the general guidance given in these overarching principles, both IFRS and U.S. GAAP provide guidance on specific post-balance sheet activities, such as the declaration of dividends and the refinancing of debt. *For further information, please contact Bob Dohrer (robert.dohrer@rsmi.com) or Marco Marcellan (marco.marcellan@rsmi.com) in our International Assurance Services Group.*