

Insights

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Accounting

FIN 48 Deferral Now Effective

The much anticipated deferral of the effective date of FASB Interpretation (FIN) No. 48, *Accounting for Uncertainty in Income Taxes*, for certain nonpublic entities was finalized on February 1, 2008 when Financial Accounting Standards Board (FASB) Staff Position (FSP) FIN 48-2, *Effective Date of FASB Interpretation No. 48 for Certain Nonpublic Enterprises*, was issued. Nonpublic enterprises that have not issued a full set of U.S. GAAP annual financial statements incorporating the recognition, measurement, and disclosure requirements of FIN 48 are eligible for the deferral. The new effective date of FIN 48 for certain nonpublic enterprises is for annual financial statements for periods beginning after December 15, 2007. Therefore, eligible nonpublic entities will not need to adopt FIN 48 in interim financial statements or financial information (e.g., debt covenant calculations, net asset value, or partner capital statements) issued in 2008. Early adoption is still permitted.

We expect this deferral to affect nearly all stand-alone nonpublic enterprises, including nonpublic banks. Banking regulators recently have indicated that nonpublic banks should follow the guidance of the final FSP even though those regulators had previously required banks to apply FIN 48 in their call reports at the beginning of 2007. The Federal Financial Institutions Examination Council recently posted an update to the call report instructions and a memo on the FIN 48 deferral at <http://www.ffiec.gov/forms031.htm>.

Certain nonpublic enterprises are not eligible for the deferral. Nonpublic consolidated entities of public companies that apply U.S. GAAP are not eligible for the deferral for their stand-alone financial statements. However, we have clarified with the FASB staff that 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. U.S. subsidiaries of a foreign public company that applies U.S. GAAP are also not eligible for the deferral.

Conduit bond obligors for conduit debt securities that are traded in a public market do not meet the definition of a nonpublic enterprise (as provided in paragraph 289, as amended, of FASB Statement No. 109, *Accounting for Income Taxes*). Therefore, those conduit bond obligors are not eligible for the deferral. FSP FAS 126-1, *Applicability of Certain Disclosure and Interim Reporting Requirements for Obligors for Conduit Debt Securities*, issued in October 2006, addresses entities that are included in the definition of a public enterprise.

Nonpublic enterprises should include similar disclosures to those required of public enterprises by SEC Staff Accounting Bulletin (SAB) No. 74, *Disclosure of the Impact that Recently Issued Accounting Standards Will Have on the Financial Statements of the Registrant When Adopted in a Future Period*. SAB 74 requires that, to the extent new accounting standards have been issued but not yet adopted, an enterprise should discuss the potential effects of adopting the new accounting standard in its financial statements. Therefore, calendar year-end clients that take advantage of the deferral should include the required disclosures in their 2007 financial statements.

A key disclosure of SAB 74 is the affect that adoption of a standard is expected to have on the financial statements unless not known or reasonably estimable. Banks that issued call reports during 2007 that included the affect of applying FIN 48 would, therefore, be expected to include a discussion of the affect that the future adoption of FIN 48 will have on their financial statements. The same is true for any nonpublic enterprise that issued interim financial statements in 2007 that included the accounting required by FIN 48.

The final FSP is available in full at http://www.fasb.org/pdf/fsp_fin48-2.pdf.

Accounting Standards Codification Released for Verification

The Financial Accounting Standards Board (FASB) has released for verification the FASB Accounting Standards Codification™. Although the Codification content is not yet approved as authoritative, constituents are encouraged to use the online Codification Research System to provide feedback on whether the Codification content accurately reflects existing U.S. generally accepted accounting principles (GAAP) for nongovernmental entities. Users who register at <http://asc.fasb.org/register> are able to review the Codification free of charge and provide specific content-related feedback at the individual paragraph level as well as general system-related feedback. When using the Codification to research accounting issues during the verification period, users are advised to verify research results using their existing resources for the currently effective literature.

The Codification does not change GAAP; instead it reorganizes the thousands of U.S. GAAP pronouncements into roughly 90 accounting topics, and displays all topics using a consistent structure. The Codification includes all accounting standards issued by the FASB, the American Institute of Certified Public Accountants, and the Emerging Issues Task Force, together with related literature. To improve usability, the Codification will include authoritative content issued by the SEC, as well as selected SEC staff interpretations. The Accounting Standards Codification excludes governmental accounting standards.

The FASB will host a webcast in March regarding the Accounting Standards Codification, however the date and time has not been set yet.

Proposed FSP Addresses Fair Value Measurement of a Liability

FASB Statement No. 157, *Fair Value Measurements*, defines the fair value of a liability as the price that would be paid to transfer the liability in an orderly transaction between market participants at the measurement date. Under that definition, the liability to the counterparty is presumed to continue and is not settled. Statement No. 157 also clarifies that the fair value of a liability must reflect the nonperformance risk (including, but not limited to, the reporting entity's own credit risk) relating to that liability and that such nonperformance risk is the same before and after its transfer. Some entities are concerned that there may be a lack of observable markets or observable inputs for the transfer of a liability. Because of these factors, a number of entities have suggested that a fair value measurement of a liability embodies a hypothetical measurement attribute because it is based on a transfer notion that would not occur in the marketplace.

To clarify the principles in Statement No. 157 on the fair value measurement of a liability, the Financial Accounting Standards Board (FASB) has proposed FASB Staff Position (FSP) No. FAS 157-c, *Measuring Liabilities under FASB Statement No. 157*. This proposed FSP states that a quoted price for the identical liability (unadjusted) in an active market is the best evidence of fair value for that liability. Entities that purchase the reporting entity's obligations as assets incorporate the nonperformance risk of the liabilities, as well as other factors, in determining the prices they are willing to pay for the assets. The quoted price for the identical liability in an active market must be used as the fair value measurement for both the obligor of the liability and the asset holder.

The proposed FSP also states that in the absence of a quoted price for the identical liability in an active market, the reporting entity may measure the fair value of its liability at the amount that it would receive as proceeds if it were to issue that liability at the measurement date. A reporting entity must evaluate fair value inputs and prioritize observable inputs over unobservable inputs in determining whether it should use the amount that it would receive as proceeds if it were to issue that liability at the measurement date. The amount that would be paid to transfer a liability at the measurement date is the amount that market participants with the same level of nonperformance risk (including credit risk) would require to assume that liability or to issue an identical liability. The amount that the reporting entity would receive as proceeds if it were to issue that liability at the measurement date provides an equivalent of the amount market participants would demand to assume the reporting entity's liability (that is, fair value).

If finalized, the FSP would be applied on a prospective basis effective on the later of the beginning of the period that includes the issuance date of the FSP or the beginning of the period in which an entity initially applies Statement No. 157. Earlier application would not be permitted.

The proposed FSP is available for comment until February 18, 2008 at http://www.fasb.org/fasb_staff_positions/prop_fsp_fas157-c.pdf.

PCFRC Meets

The Private Company Financial Reporting Committee (PCFRC) met in Norwalk, Connecticut on December 6-7, 2007 and in New York City on January 10-11, 2008.

At both meetings, the PCFRC discussed the Financial Accounting Standard Board's proposal to defer the effective date of FASB Interpretation (FIN) No. 48 through FASB Staff Position (FSP) No. FIN 48-b. FIN 48 requires all entities to recognize, measure and disclose uncertain tax positions. The PCFRC recognizes there are many questions about the meaning of "adoption" in the FSP but concluded that, on balance, it is more important for the FASB to issue the final FSP than it is for it to answer those questions if that would mean the FASB would delay the issuance of the final FSP.

The PCFRC agreed to recommend to the FASB that an appropriate definition of a private company should be based on the definition of an "issuer" as utilized in the United States Code. A letter of recommendation to that effect is expected to be submitted to the FASB.

The FASB is working on a project on financial statement presentation that effectively aggregates items related to an entity's core business, financing activities and income taxes in its balance sheet, income statement and cash flow statement plus reporting that entity's comprehensive income. This project could have a significant impact on a nonpublic entity's financial statements. The PCFRC is closely monitoring this project and expects to recommend, among other matters, to exempt nonpublic entities from the scope of that project.

As part of its outreach activities, the PCFRC continues to explore ways in which to significantly expand the size of its Resource Group. Resource Group members are asked to assist the PCFRC in identifying issues in existing and proposed FASB statements that are particularly troublesome for nonpublic entities to apply or may not be useful to users of financial statements of nonpublic entities.

The PCFRC heard a report from a staff member of the International Accounting Standards Board on its proposal for an International Financial Reporting Standard for small and medium sized entities (the SME project). An SME is generally defined as an entity with no public accountability. An entity does not have public accountability if it is not publicly traded and does not hold assets in a fiduciary capacity (e.g., a financial institution). There is no quantified size test for an entity to be an SME. The PCFRC is monitoring this project and continues to assess the impact the SME project might have for nonpublic entities in the United States.

There was an overview of the FASB Preliminary Views (PV) document on "Financial Instruments with Characteristics of Equity" that was issued in November 2007. The PV adopts a basic ownership approach. Under the basic ownership approach an instrument would be classified as equity if it (a) is the most subordinated interest in an entity and (b) entitles the holder to a share of the entity's net assets after all higher priority claims have been satisfied. Thus, a corporation that has issued both common and preferred stock would report the common stock as equity and preferred stock as a liability in its balance sheet. Any dividends paid or accrued on the preferred stock would be charged to earnings through the income statement. The PCFRC understands that the basic ownership approach results in greater simplicity but has significant consequences on instruments that are reported as liabilities. The PV may also have significant consequences on the accounting treatment for common stock containing mandatory put features (e.g., ESOP-owned companies). The PCFRC expects to utilize its Resource Group to obtain additional input on the effect the PV may have on nonpublic entities.

In December 2007 the FASB issued Statements No. 141R and 160. Those Statements provide guidance on accounting for business combinations and reporting noncontrolling interest in consolidated financial statements. Those Statements are effective for periods beginning after December 15, 2008. The PCFRC will monitor implementation issues unique to nonpublic entities.

The next meeting of the PCFRC is scheduled for late April 2008 in San Diego, California. Further information about the PCFRC and its activities may be found on its Web site at <http://pcfrc.org/>.

Public Sector

Growing Fiscal Challenges Expected to Emerge for State and Local Governments

Given the nature of the partnership among levels of government in providing services to Americans and the economic interrelationships among levels of government, the U.S. Government Accountability Office (GAO) believes it is important for federal policymaking to understand potential future fiscal conditions of the state and local government sector. To provide Congress and the public with this broader context, the GAO recently released a report, *State and Local Governments: Growing Fiscal Challenges Will Emerge during the Next 10 Years*. This report describes a fiscal model of the state and local sector and provides simulations of the state and local government sector's long-term fiscal outlook, an analysis of the underlying causes of potential fiscal difficulties for the sector, a discussion of the extent to which the long-term simulations are sensitive to alternative assumptions, and an examination of how the state and local government sector could add to future federal fiscal challenges. To develop these long-term simulations, the GAO developed a state and local model that projects the level of receipts and expenditures of the sector in future years based on current and historical spending and revenue patterns. The model shows that in less than a decade the state and local government sector will begin to face growing fiscal challenges. The GAO projects that, absent policy changes, state and local governments will face an increasing gap between receipts and expenditures in the coming years. Since most state and local governments actually face requirements that their operating budgets be balanced or nearly balanced in most years, the declining fiscal conditions the simulations suggest are viewed by the GAO as foreshadowing the extent to which these governments will need to make substantial policy changes to avoid potential growing fiscal imbalances.

The GAO's report is available in full at <http://www.gao.gov/new.items/d08317.pdf>.

SEC

Guidance for Changing to New Smaller Company Disclosure Rules

Recently, the SEC adopted a new system of disclosure rules for smaller companies filing periodic reports and registration statements with the SEC. The new rules are available to all "smaller reporting companies" effective February 4, 2008. The "smaller reporting company" category includes companies that qualified as "small business issuers" before the new rules, as well as most companies that qualify as "non-accelerated filers." In general, companies that enter the system with less than \$75 million in common equity public float qualify as smaller reporting companies. Companies unable to calculate the public float typically qualify if they have less than \$50 million in annual revenues upon entering the system.

Under the new disclosure rules, small business issuers will have the option to file their next annual report for a fiscal year ending after December 15, 2007 on Form 10-KSB or the standard Form 10-K. Any quarterly reports due before this annual report may be filed on Form 10-QSB or Form 10-Q. After the next annual report, all future annual and quarterly reports must be on the standard forms instead of the "SB" forms.

On January 25, 2008, the SEC issued a compliance guide that explains how current small business issuers and other smaller companies newly eligible to use the SEC's scaled disclosure rules, primarily non-accelerated filer companies, can make the changeover to the new rules. Although the guide is not a substitute for the SEC's rules, it summarizes and explains the following topics:

- Qualifying as a "smaller reporting company"
- Compliance date guidance for current small business issuers
- Transition to non-SB forms – guidance for current small business issuers
- Guidance for newly eligible smaller reporting companies
- Scaled item requirements in Regulation S-K for smaller reporting companies

Changeover to the SEC's New Smaller Reporting Company System by Small Business Issuers and Non-Accelerated Filer Companies - A Small Entity Compliance Guide is available in full at <http://www.sec.gov/info/smallbus/secg/smrepcosysguid.pdf>.

Evaluating Consistency of Financial Statements

The Public Company Accounting Oversight Board has adopted Auditing Standard (AS) No. 6, *Evaluating Consistency of Financial Statements*, to update the auditor's responsibilities to evaluate and report on the consistency of a company's financial statements. The Standard aligns the auditor's responsibilities with FASB Statement No. 154, Accounting Changes and Error Corrections. AS 6 also clarifies that the auditor's report should indicate whether an adjustment to previously issued financial statements results from a change in accounting principle or the correction of a misstatement.

The PCAOB also removed the hierarchy of generally accepted accounting principles (GAAP) from its interim auditing standards. The GAAP hierarchy identifies the sources of accounting principles and the framework for selecting principles to be used in preparing financial statements. Because the Financial Accounting Standards Board (FASB) intends to incorporate the hierarchy in the accounting standards, it no longer will be needed in the auditing standards.

Auditing Standard No. 6 will not be finalized until it is approved by the SEC. It would become effective 60 days after SEC approval.

International

IFRS 2 Amended

The International Accounting Standards Board has amended International Financial Reporting Standard 2, Share-based Payment, to clarify that vesting conditions are service conditions and performance conditions only. Per the amendment, other features of a share-based payment are not vesting conditions. The amendment also specifies that all cancellations, whether by the entity or by other parties, should receive the same accounting treatment.

The amendment will apply for annual periods beginning on or after January 1, 2009, with earlier application permitted.

Proposed Accounting Guidance for Customer Contributions

The International Financial Reporting Interpretations Committee (IFRIC) has released a draft Interpretation, IFRIC D24, Customer Contributions, to clarify the accounting for the receipt of customer contributions. Customer contributions are transactions in which an entity - the access provider - receives an asset it uses to provide access to an ongoing supply of goods or services to a customer or customers. In some cases, the access provider receives cash, which it must use to acquire or construct the asset that will provide access. IFRIC D24 clarifies:

- Whether a customer contribution should be recognized as an asset and, if so, whether it should be initially recognized at cost or fair value;
- Whether an agreement to provide ongoing services using a contributed asset contains a lease;
- How to account for the credit that arises from the recognition of a customer contribution at fair value; and
- How to account for a cash contribution.

If adopted, IFRIC D24 will require all access providers to recognize contributed assets and revenue from providing access to a supply of goods or services over the period access is provided. Those access providers that have previously not recognized contributed assets will now recognize increased property, plant and equipment and revenue. Those access providers that have previously recognized revenue immediately on the receipt of a contributed asset may now be required to recognize it over a longer period. If finalized, the guidance in IFRIC D24 would be applied prospectively to all future transactions.

The proposal is available for comment until April 25, 2008 at <http://www.iasb.org/Open+to+Comment/Open+to+Comment.htm>.

Proposed Accounting Guidance for Distributions of Non-cash Assets to Owners

Currently, International Financial Reporting Standards do not address the measurement of non-cash distributions to owners. The International Financial Reporting Interpretations Committee (IFRIC) therefore has released draft Interpretation D23, *Distributions of Non-cash Assets to Owners*, to provide guidance on how an entity should measure distributions of assets other than cash when it pays dividends to its owners acting in their capacity as owners. The proposed Interpretation addresses how an entity should measure an obligation to distribute non-cash

assets to its owners (a dividend payable). It also addresses how the entity should account for any difference between the carrying amount of the assets distributed and the carrying amount of the dividend payable when the entity settles the dividend payable.

IFRIC D23 proposes that all types of distributions of non-cash assets would be measured at the fair value of the assets to be distributed (generally the declaration date). When the obligation is settled, IFRIC D23 proposes that the difference between the carrying amount of the assets distributed and the carrying amount of the dividend payable would be recognized in earnings. The IFRIC proposes that the guidance should be applied only to future distributions because it recognizes the difficulty entities would face in recognizing past distributions at their fair values. If finalized, IFRIC D23 would apply to all types of distributions of non-cash assets, except for a distribution of an asset to another entity within the same consolidated group.

The proposal will be available for comment until April 25, 2008 at <http://www.iasb.org/Open+to+Comment/Open+to+Comment.htm>.

Redrafting of Auditing Standards Completed

The International Auditing and Assurance Standards Board (IAASB) recently completed the first phase of its program to redraft existing International Standards on Auditing (ISAs) and to develop new and revised ISAs following the new drafting conventions. The IAASB has released the last two Exposure Drafts that were redrafted in accordance with the clarity drafting conventions - proposed ISA 210 (Redrafted), Agreeing the Terms of Audit Engagements, and proposed ISA 710 (Redrafted), Comparative Information - Corresponding Figures and Comparative Financial Statements. Key elements of the new drafting conventions included: basing each standard on the objective of the auditor with respect to the subject matter of the standard; separating the requirements that the auditor is required to follow from guidance on their application; eliminating the present tense to describe actions by the auditor, which raised ambiguity about whether such actions were required; and other structural and drafting improvements to enhance the overall readability and understandability of the standards. Standards redrafted in this way are described as "redrafted." If further revision has been undertaken, a standard is described as "revised and redrafted."

The complete set of clarified ISAs will be effective for audits of financial statements for periods beginning on or after December 15, 2009. The Exposure Drafts of proposed ISAs 210 and 710 are available for comment until April 15, 2008 at <http://www.ifac.org/EDs>.

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