

Insights

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Accounting

All Entities Permitted to Report Financial Assets and Financial Liabilities at Fair Value

On February 15, 2007, the Financial Accounting Standards Board (FASB) issued FASB Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities – Including an amendment of FASB Statement No. 115*, which provides all entities, including not-for-profit organizations, with an option to report selected financial assets and liabilities at fair value. The objective of the Statement is to improve financial reporting by providing entities with the opportunity to mitigate volatility in earnings caused by measuring related assets and liabilities differently without having to apply the complex provisions of hedge accounting. The following items are eligible for the irrevocable fair value measurement option established by Statement No. 159:

- Recognized financial assets and financial liabilities except:
 - An investment in a subsidiary that the entity is required to consolidate
 - An interest in a variable interest entity that the entity is required to consolidate
 - Employers' and plans' obligations (or assets representing net overfunded positions) for pension benefits, other postretirement benefits (including health care and life insurance benefits), postemployment benefits, employee stock option and stock purchase plans, and other forms of deferred compensation arrangements, as defined
 - Financial assets and financial liabilities recognized under lease accounting
 - Deposit liabilities, withdrawable on demand, of banks, savings and loan associations, credit unions, and other similar depository institutions
 - Financial instruments that are, in whole or in part, classified by the issuer as a component of shareholder's equity, including "temporary equity".
- Firm commitments that would otherwise not be recognized at inception and that involve only financial instruments
- Nonfinancial insurance contracts and warranties that the insurer can settle by paying a third party to provide those goods or services
- Host financial instruments resulting from separation of an embedded nonfinancial derivative instrument from a nonfinancial hybrid instrument.

The fair value option:

- May generally be applied instrument by instrument
- Is irrevocable unless certain events occur

- Is applied to the entire instrument and not to any portion of it.

The Standard also establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. The new Statement does not eliminate disclosure requirements included in other accounting standards, including requirements for disclosures about fair value measurements in FASB Statements No. 157, *Fair Value Measurements*, and No. 107, *Disclosures about Fair Value of Financial Instruments*.

Statement No. 159 is effective as of the beginning of an entity's first fiscal year beginning after November 15, 2007. Early adoption is permitted as of the beginning of a fiscal year that begins on or before November 15, 2007 provided the entity also elects to apply the provisions of Statement No. 157, *Fair Value Measurements*.

The Statement is available in full at <http://www.fasb.org/pdf/fas159.pdf>.

Public Sector

Revision of Government Auditing Standards

The U.S. Government Accountability Office (GAO) has issued the January 2007 revision of *Government Auditing Standards*. These standards, which are commonly referred to as the "Yellow Book," cover federal entities and those organizations receiving federal funds. Various laws require compliance with the comptroller general's auditing standards in connection with audits of federal entities and funds. Furthermore, many states and local governments and other entities have voluntarily adopted these standards.

The January 2007 version, which supersedes the 2003 revision, contains the final 2007 revisions to the standards, except for the quality control and peer review sections in Chapter 3. Concurrent with the electronic issuance of this revision of *Government Auditing Standards*, which is available at <http://www.gao.gov/govaud/d07162g.pdf>, GAO is exposing for comment redrafted sections on quality control and peer review. The 2007 revision contains fundamental changes that:

- Heighten the emphasis on ethical principles as the foundation, discipline, and structure behind the implementation of the standards, including a description of five key ethical principles that should guide the work of those who audit government programs and operations;
- Clarify and streamline the discussion of the impact of nonaudit services and their impact on auditor independence;
- Update the financial auditing standards based on recent developments in financial auditing and internal control, increased transparency surrounding restatements and significant concerns, uncertainties, or other unusual events that could have a significant impact on the financial condition or operations of a government entity or program;
- Enhance performance-auditing standards that elaborate on the overall framework for high-quality performance auditing, including the concepts of reasonable assurance and its relationship to audit risk and the levels of evidence used to support audit findings and conclusions;
- Clarify the standards through standardized language to define the auditor's level of responsibility and distinguish between auditor requirements and additional guidance; and

- Reinforce the key role of auditing in maintaining accountability and providing information for making improvements in government operations.

The complete 2007 revision of Government Auditing Standards will be available after the quality assurance and peer review sections are finalized and incorporated into the standards and will be effective for financial audits and attestation engagements for periods beginning on or after January 1, 2008, and for performance audits beginning on or after January 1, 2008.

This revision of the standards went through an extensive deliberative process, including public comments and input from the Comptroller General's Advisory Council on Government Auditing Standards. Brian Schebler, director of services to the public sector for McGladrey & Pullen, LLP, is a member of the 26-member Advisory Council.

SEC

SEC Staff Revises Position on Certain FIN 48 Implementation Issues

On November 21, 2006, the SEC Regulations Committee issued a discussion document addressing specific questions regarding the implementation by public companies of the Financial Accounting Standards Board Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). This document was discussed in the December 6, 2006 edition of *Insights*.

Subsequently, the SEC staff requested that the Committee revise the discussion document to clarify the SEC staff's position regarding the financial statement presentation and disclosure when a registrant changes its accounting principle regarding the income statement classification of interest and penalties on uncertain income tax positions. The Committee therefore amended its discussion document on February 6, 2007 to add certain disclosures that the SEC staff believes registrants should consider regarding the classification of interest and penalties under FIN 48, including the following:

Change in classification upon adoption

If upon adoption of FIN 48, a registrant adopts a new financial statement classification of interest and penalties, it should disclose that it has adopted a new accounting principle and disclose its new policy for classification of interest and penalties. Because FIN 48 transition does not allow any form of retroactive application, financial statements for periods presented prior to adoption of FIN 48 should not be retroactively restated or reclassified to conform to the newly adopted accounting principle. However, a registrant should disclose its policy for the classification of interest and penalties for prior periods.

Change in classification subsequent to adoption

If subsequent to the first quarter of the year of adoption of FIN 48, a registrant changes its financial statement classification of interest and penalties, it should provide the disclosures specified by paragraphs 17 and 18 of FASB Statement No. 154, *Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20 and FASB Statement No. 3* and file a preferability letter (post adoption). This change in accounting principle would be retrospectively applied beginning with the first interim period in which FIN 48 was applied. Periods prior to the adoption of FIN 48 should not be retroactively restated or reclassified, because FIN 48 transition does not allow retroactive application.

Additional disclosures for such changes in classification

If a registrant has changed its classification policy, the SEC staff believes the registrant should disclose, in annual financial statements that include any period prior to the adoption of FIN 48, both the

classification and amount of interest and penalties on uncertain income tax positions reflected in each income statement. In those circumstances, if the registrant cannot determine the amount of interest and penalties for periods prior to the adoption of FIN 48 due to its inability to disaggregate the interest or penalties portion of the accrual from the underlying tax exposure, it should disclose that fact.

Registrants should consult the document as revised in its entirety at
http://www.aicpa.org/caq/download/AppendixA_FIN48_092606_revised.pdf.

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