

# Insights

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## Accounting

### FASB to Form Resource Group to Assist with Valuation Guidance Issues

In January 2007, the Financial Accounting Standards Board (FASB) issued an Invitation to Comment, *Valuation Guidance for Financial Reporting*, seeking views on the need, if any, for valuation guidance related to the use of fair value measurements in financial reporting; who should be involved in developing any such valuation guidance; and the process and form of any such guidance-setting activities. Over 80 comment letters were received and a public roundtable was held to discuss the issues raised in the Invitation to Comment.

Based on the feedback received through this process, the FASB plans to form a resource group that will provide input on potential clarifying guidance for issues relating to the application of FASB Statement No. 157, *Fair Value Measurements*, to fair value information required or permitted under U.S. generally accepted accounting principles. This input will also include alternative views and practical solutions to such issues. Members of the resource group are expected to represent a cross section of the FASB constituency. Members will be expected to have an understanding of fair value measurements used for financial reporting, have significant valuation, accounting and/or auditing experience, and be able and willing to offer thorough and constructive input on the issues.

The FASB expects to hold the first resource group meeting in the third quarter of 2007 to assist the Board in evaluating any known implementation issues.

## Public Sector

### GASB Concepts Statement No. 4 Issued

The Governmental Accounting Standards Board (GASB) has issued Concepts Statement No. 4, *Elements of Financial Statements*, to define the basic elements of state and local government financial statements. The concept of a *resource*, an item with a present capacity to provide service, is central to the definitions. Accordingly, the new Concepts Statement defines the elements of statements of financial position as:

- *Assets* - resources with present service capacity that the government presently controls
- *Liabilities* - present obligations to sacrifice resources that the government has little or no discretion to avoid
- *A deferred outflow of resources* - a consumption of net assets by the government that is applicable to a future reporting period
- *A deferred inflow of resources* - an acquisition of net assets by the government that is applicable to a future reporting period

- *Net position* - the residual of all other elements presented in a statement of financial position.

It should be noted that the Concepts Statement defines deferred outflows and inflows of resources as distinct financial statement elements for the first time. The Concepts Statement also defines elements of resource flows statements as:

- *Outflow of resources* - a consumption of net assets by the government that is applicable to the reporting period
- *Inflow of resources* - an acquisition of net assets by the government that is applicable to the reporting period.

GASB Concepts Statements form a conceptual framework that provides a foundation to guide the development of accounting and financial reporting standards.

### **Proposed Accounting Guidance for Derivative Instruments**

Today state and local governments are more commonly engaged in transactions involving derivative instruments, including interest rate and commodity swaps, interest rate locks, options, forward contracts, and futures contracts. Currently, most derivative instruments are recognized at historical prices in a government's statement of net assets. To provide better disclosure of the impact derivative instruments may have on a governmental entity's finances, the Governmental Accounting Standards Board has proposed a new standard, *Accounting and Financial Reporting for Derivative Instruments*.

The proposed Standard would require that the fair value of all derivatives be reported as assets or liabilities in the financial statements of state and local governments. If a derivative effectively hedges (significantly reduces) a potential risk of adverse changes in cash flows or fair values of associated items, then its annual fair value changes would be deferred until the derivative ends or becomes ineffective, at which time the accumulated changes, if any, generally would be reported in the government's change statement. The annual change in the fair value of all other derivatives would be reported each reporting period in the change statement. The proposed Standard also would require disclosure of additional information about derivatives in the notes to the financial statements, including identification of the risks to which hedging derivatives expose a government, the fair values and notional amounts of derivative instruments, and contingent liabilities contained within derivatives.

If finalized, the requirements of this proposed Standard would be effective for financial statements for periods beginning after June 15, 2009. The proposed Standard is available for comment until October 26, 2007 at [http://www.gasb.org/exp/ed\\_derivatives.pdf](http://www.gasb.org/exp/ed_derivatives.pdf).

## **SEC**

### **SEC Proposes Allowing Foreign Private Issuers to Use IFRS**

Currently, SEC rules require foreign private issuers that prepare their financial statements in accordance with International Financial Reporting Standards (IFRS) to provide a reconciliation of those financial statements to U.S. generally accepted accounting principles (GAAP). The SEC recently announced that they will solicit comments on proposed changes to these rules which would then give foreign private issuers a choice between the use of IFRS and U.S. GAAP in the preparation of their financial statements. If finalized, the proposal would eliminate the requirement to reconcile from IFRS to U.S. GAAP for filings beginning in 2009 with respect to 2008 financial statements prepared in accordance with IFRS.

Ending that requirement is expected to make it much less costly for non-U.S. companies to list shares for trading in U.S. markets. There are, however, other considerations. The SEC is asking whether these non-U.S. companies should then be required to file quarterly reports with the SEC, as mandated for U.S. companies, instead of on a semi-annual basis. Further, because the elimination of the reconciliation requirement will permit some, but not all, registrants to have a choice between IFRS and U.S. GAAP, the SEC is considering the possibility of treating U.S. and foreign issuers similarly in this respect by also providing U.S. issuers the alternative to use IFRS. The SEC plans to issue a Concept Release regarding this possibility later this summer.

### **SEC Establishes Advisory Committee on Improvements to Financial Reporting**

The SEC has announced the establishment of the SEC Advisory Committee on Improvements to Financial Reporting to examine the U.S. financial reporting system with the goals of reducing unnecessary complexity and making information more useful and understandable for investors. The Committee also will discuss how technological advances, such as Extensible Business Reporting Language (XBRL) and hyperlinks, can help address accounting complexity by making financial information more useful to a greater number of investors. The following areas will be addressed by the Committee before making recommendations to the SEC:

- The current approach to setting financial accounting and reporting standards;
- The current process of regulating compliance by registrants and financial professionals with accounting and reporting standards;
- The current systems for delivering financial information to investors and accessing that information;
- Other environmental factors that drive unnecessary complexity and reduce transparency to investors;
- Whether there are current accounting and reporting standards that impose costs that outweigh the resulting benefits; and
- Whether this cost-benefit analysis is likely to be impacted by the growing use of international accounting standards.

Robert C. Pozen, chairman of MFS Investment Management in Boston and former vice chairman of Fidelity Investments, will chair the Committee. The SEC will name 13 to 17 additional members with various backgrounds within the next few weeks. The Committee will begin its work after additional members are named and the SEC staff files the Committee's charter with Congress.

### **Standing Advisory Group Meeting**

The Public Company Accounting Oversight Board (PCAOB) held a Standing Advisory Group (SAG) meeting on June 21, 2007 in Washington, DC. Leroy Dennis, Executive Partner Assurance Services for McGladrey & Pullen, LLP, is a member of the Standing Advisory Group, which is composed of approximately 30 people representing the auditing profession, public companies, investors and others.

The meeting began with a continuation of discussions about accounting estimates and fair value measurements. Many of the accounting and auditing aspects of this topic were addressed, including the need for more training and education in this area by universities and by public accounting firms. Issues resulting from related parties were also discussed by the SAG. Those issues included fraud risk,

understanding the company's related-party transactions, identification of undisclosed relationships, and market response to related-party transactions.

The SAG also discussed the following issues related to engagement team performance:

- The level of involvement the audit partner should have in the planning and supervision of the audit engagement;
- Whether the auditing standards should specify the audit partner's role in the planning of the audit, the staffing of the engagement team, determining the proper level of supervision of less experienced engagement team members, or other aspects of the planning and supervision of the audit engagement;
- Whether the auditing standards should direct the senior member or members of the engagement team to be directly involved in the highest risk areas of the audit, such as risk assessment, fraud risk analysis, and other aspects of the audit that involve analysis of complex issues or the extensive use of professional judgment;
- Whether the auditing standards should define or outline specific roles for the auditors at each level of the engagement team (audit partner, manager, staff); and
- Whether special consideration should be given to audit engagements based on the size and complexity of the issuer being audited or the size of the accounting firm.

There was also a discussion about the recent signs of crisis in the subprime mortgage market, including what effect this will have on equity markets and the broader credit markets. Two areas that are viewed as having the potential for future similar problems are hedge funds (especially those that invest in subprime debt) and leveraged buyout transactions, where leverage is so high that even the slightest financial danger could threaten to cause a significant problem.

The agenda and related briefing papers for the SAG meeting can be found in full at [http://www.pcaobus.org/News\\_and\\_Events/Events/2007/06-21.aspx](http://www.pcaobus.org/News_and_Events/Events/2007/06-21.aspx).

### **Proposed Electronic Filing and Simplification of Form D**

Form D is the official notice of an offering of securities made without registration under the Securities Act of 1933 in reliance on an exemption provided by Regulation D. The Form D filing:

- Collects data for use in the SEC's rulemaking efforts and aids in the federal enforcement of the exemptions in Regulation D;
- Is used by the staffs of state securities regulators and NASD, formerly the National Association of Securities Dealers, to enforce federal and state securities laws and the rules of securities self-regulatory organizations; and
- Has become a source of disclosure for investors.

The SEC has published for comment proposals that would mandate the electronic filing of information required by Form D. The SEC also is proposing revisions to Form D and to Regulation D that would simplify and restructure Form D and update and revise its information requirements. The data filed on Form D would then be available on the SEC Web site for regulators and members of the public who choose to access it.

The proposed rule is available in full at <http://www.sec.gov/rules/proposed/2007/33-8814.pdf>.

## International

### IFRIC Issues Guidance on Accounting for Customer Loyalty Programs

Customer loyalty programs are widespread in a range of businesses that grant “points”, “miles” or other award credits when customers buy goods or services. Such award credits can then be redeemed in the future for free or discounted goods or services. Their purpose is to provide a customer with an incentive to buy the goods or services and to develop customer loyalty. Currently, International Financial Reporting Standards lack detailed guidance on how businesses should account for their obligations related to the customer loyalty award credits. Therefore, on June 28, 2007, the International Financial Reporting Interpretations Committee issued IFRIC 13, *Customer Loyalty Programmes*, to standardize the accounting for such programs.

The Interpretation states that entities should recognize their obligations to provide free or discounted goods or services as a separately identifiable component of the initial sales transaction in which the award credits are granted. The fair value of the consideration received or receivable in the initial sale should be allocated between its components (i.e., the goods/services sold and the award credits granted) based upon the relative fair values for which each component could be sold separately. Entities should then defer recognition of the revenue in respect of the award credits until they have fulfilled their obligations to supply the free or discounted goods or services or until such time as the obligation is assumed by a third party.

The Interpretation should be applied for annual periods beginning on or after July 1, 2008, with earlier application permitted. A Q&A for applying IFRIC 13 is available at <http://www.iasb.org/NR/rdonlyres/DE35E5B9-037A-4540-B6B6-9785FD989AD8/0/IFRIC13QAsfinal.pdf>. However, whether and how IFRIC 13 applies to a specific transaction will depend on the exact terms of the transaction, and should be determined by reference to IFRIC 13 itself, which is available for purchase at <http://www.iasb.org>.

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