

Insights

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Accounting

FASB Issues Statement No. 158, Which Changes Employers' Reporting of Defined Benefit Postretirement Plans

The accounting guidance for defined-benefit pension plans and other postretirement benefit plans is being reconsidered by the Financial Accounting Standards Board (FASB) in a comprehensive project that is being conducted in two phases. The second phase, which will be conducted jointly with the International Accounting Standards Board, is expected to take several years. However, the first phase of the project was completed in late September 2006 when the FASB issued Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans - an amendment of FASB Statements No. 87, 88, 106, and 132(R)*. This Statement applies to employers that sponsor single-employer defined benefit pension and other postretirement plans who are either business enterprises or nongovernmental not-for-profit organizations.

The Statement requires employers to fully recognize the overfunded or underfunded positions (the difference between the fair value of plan assets and the benefit obligation) of defined benefit pension, retiree healthcare and other postretirement plans in their balance sheets. For a pension plan, the benefit obligation would be the projected benefit obligation; for any other postretirement benefit plan, the benefit obligation would be the accumulated postretirement benefit obligation. Under past accounting standards, information about the current funded status of such plans was reported in the notes to the financial statements.

FASB Statements No. 87, *Employers' Accounting for Pensions*, and No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*, required that plan assets and benefit obligations be measured as of the date of the employer's balance sheet or, if used consistently from year to year, as of a date not more than three months prior to that date. With limited exceptions, Statement No. 158 eliminates the choice of a measurement date and requires that employers measure plan assets and obligations as of the balance sheet date.

The Statement also requires employers to recognize as a component of other comprehensive income, net of tax, the actuarial gains and losses and the prior service costs and credits that arise during the period but pursuant to past standards are not recognized as components of current net periodic benefit cost and any remaining transition asset or obligation. Amounts recognized in accumulated other comprehensive income should be adjusted as they are subsequently recognized as components of net periodic benefit cost pursuant to the recognition and amortization provisions of those Statements. Further, the Statement requires additional financial statement footnote disclosure about certain effects on net periodic benefit cost in the upcoming fiscal year that arise from delayed recognition of the actuarial gains and losses, prior service costs or credits, and transition asset or obligation. We emphasize that Statement No. 158 does not change an employer's approach to measuring plan assets, benefit obligations, or net periodic benefit cost.

The requirement to recognize the funded status of a benefit plan and the disclosure requirements for entities with publicly traded equity securities are effective as of the end of the fiscal year ending after December 15, 2006; for all other entities those requirements are effective at the end of the fiscal year ending after June 15, 2007. However, an employer without publicly traded equity securities is required to disclose the following information in financial statements for a fiscal year ending after December 15, 2006, but before June 16, 2007, unless it has applied the recognition provisions of Statement No. 158 in preparing those financial statements:

- A brief description of the provisions of Statement No. 158;
- The date that adoption is required; and
- The date the employer plans to adopt the recognition provisions of the Statement, if earlier.

The requirement to measure plan assets and benefit obligations as of the date of the employer's fiscal year-end balance sheet is effective for fiscal years ending after December 15, 2008 for all affected employers.

Since this Statement can affect employers' assets, liabilities and net worth, employers will need to consider their ability to meet certain financial statement requirements of contractual agreements (for example, a debt-to-equity ratio of a loan covenant). Accordingly, these indirect effects must be considered when planning the initial application of the requirements of the Statement.

Statement No. 158 is available in full at <http://www.fasb.org/pdf/fas158.pdf>.

Final Consensuses Ratified for Three EITF Issues

At its September 20, 2006 meeting, the Financial Accounting Standards Board (FASB) ratified the final consensuses for the following Issues reached at the September 7, 2006 Emerging Issues Task Force (EITF) meeting:

- *EITF Issue No. 06-1, "Accounting for Consideration Given by a Service Provider to a Manufacturer or Reseller of Equipment Necessary for an End-Customer to Receive Service from the Service Provider"*

Certain companies provide services to their customers that require the customers to purchase equipment in order to utilize their services. The required equipment often is manufactured and distributed by third parties and sold through resellers. The accounting question being addressed in this Issue is whether any incentives given by service providers to third-party manufacturers or resellers should be accounted for in accordance with Issue No. 01-9, "Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products)." A consensus was reached that if the consideration given by a service provider to a manufacturer or reseller (that is not a customer of the service provider) can be linked contractually to the benefit received by the service provider's customer, the service provider should account for the consideration in accordance with Issue 01-9.

- *EITF Issue No. 06-4, "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements"*

The accounting question being addressed in this Issue is whether the postretirement benefit associated with an endorsement split-dollar life insurance arrangement (that is, an arrangement in which the employer owns and controls the insurance policy) is effectively settled in accordance

with either FASB Statement No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*, or APB Opinion No. 12, *Omnibus Opinion—1967*, upon entering into such an arrangement. The scope of this Issue is limited to the recognition of a liability and related compensation costs for endorsement split-dollar life insurance policies that provide a benefit to an employee that extends to postretirement periods. A consensus was reached that for a split-dollar life insurance arrangement within the scope of the Issue, an employer should recognize a liability for future benefits in accordance with Statement No. 106 (if, in substance, a postretirement benefit plan exists) or Opinion No. 12 (if the arrangement is, in substance, an individual deferred compensation contract) based on the substantive agreement with the employee.

- *EITF Issue No. 06-5, "Accounting for Purchases of Life Insurance—Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4, 'Accounting for Purchases of Life Insurance'"*

The accounting questions being addressed in this Issue center on determining the amount that could be realized under the insurance contract in accordance with FASB Technical Bulletin No. 85-4. A consensus was reached that a policyholder should consider any additional amounts included in the contractual terms of the insurance policy other than the cash surrender value in determining the amount that could be realized under the insurance contract. A consensus also was reached that a policyholder should determine the amount that could be realized under the life insurance contract assuming the surrender of an individual-life by individual-life policy (or certificate by certificate in a group policy).

These consensus also provide guidance related to disclosures, transition and effective dates. The consensus are available in full at <http://www.fasb.org/eitf/eitfissu.shtml>. The minutes of the September 7, 2006 EITF meeting are available at http://www.fasb.org/eitf/09-07-06_mtg_minutes.pdf.

Tentative Conclusions Reached on Four EITF Issues

Draft abstracts of the following Emerging Issues Task Force (EITF) Issues were recently approved for exposure for public comment by the Financial Accounting Standards Board (FASB):

- *EITF Issue No. 06-6, "Debtor's Accounting for a Modification (or Exchange) of Convertible Debt Instruments"*

The accounting question addressed in this Issue is how to take into account the effects on the terms of an embedded conversion option in determining whether a modification or exchange of a convertible debt instrument should be accounted for as a debt extinguishment. A tentative conclusion was reached that three tests are required to determine whether extinguishment accounting is appropriate:

- The first test results in extinguishment accounting if a substantive conversion option is either added or eliminated as a result of the modification or exchange of the convertible debt instrument.
- The second test is the analysis required by Issue 96-19, "Debtor's Accounting for a Modification or Exchange of Debt Instruments," if the first test does not result in a conclusion that a substantial modification or an exchange has occurred.

- The third test results in extinguishment accounting if the change in the fair value of the embedded conversion option is at least 10 percent of the carrying value of the debt instrument just before the modification.

If extinguishment accounting is not applied, the EITF tentatively concluded that fair value accounting should be applied when the terms of the embedded conversion option are otherwise affected by the modification or exchange of the convertible debt instrument.

- *EITF Issue No. 06-7, "Issuer's Accounting for a Previously Bifurcated Conversion Option in a Convertible Debt Instrument When the Conversion Option No Longer Meets the Bifurcation Criteria in FASB Statement No. 133, 'Accounting for Derivative Instruments and Hedging Activities'"*

The accounting question addressed in this Issue is how to account for a previously bifurcated conversion option in a convertible debt instrument when it no longer meets the conditions for separate accounting as a derivative instrument in Statement No. 133. A tentative conclusion was reached that when such a conversion option no longer meets the bifurcation criteria, reclassification of the carrying value of the liability for the conversion option to shareholders' equity should occur and amortization of the debt discount recorded at issuance should continue over the remaining term of the agreement.

- *EITF Issue No. 06-8, "Applicability of the Assessment of a Buyer's Continuing Investment under FASB Statement No. 66, 'Accounting for Sales of Real Estate', for Sales of Condominiums"*

The accounting question addressed in this Issue is whether the adequacy of a buyer's continuing investment to demonstrate a commitment to pay for the property must be evaluated for purposes of determining whether it is appropriate to recognize profit from a real estate sale involving a condominium unit or time-sharing interest under the percentage-of-completion method under Statement No. 66. A tentative conclusion was reached that an entity is required to evaluate the adequacy of the buyer's initial and continuing investment for purposes of determining whether it is appropriate to recognize profit using the percentage-of-completion method.

- *EITF Issue No. 06-9, "Reporting a Change in (or the Elimination of) a Previously Existing Difference between the Fiscal Year-End of a Parent Company and That of a Consolidated Entity or between the Reporting Period of an Investor and That of an Equity Method Investee"*

Accounting Research Bulletin No. 51, *Consolidated Financial Statements*, and APB Opinion No. 18, *The Equity Method of Accounting For Investments in Common Stocks*, allow for the use of a lag period to consolidate the results of a subsidiary's operations or recognize the proportionate share of earnings and losses in an equity method investment. In the situation in which there is a change to the reporting year-end of either a consolidated subsidiary or an equity-method investee that results in a change to the lag period, there has been diversity in practice in accounting for the change. Given the new requirements of FASB Statement No. 154, *Accounting Changes and Error Corrections*, questions have arisen regarding a parent's or investor's accounting when there has been a change to the reporting year-end of either a consolidated subsidiary or an equity method investee that results in a change to the lag period. A tentative conclusion was reached that a parent or investor would be required to account for a change in or elimination of a previously existing difference between its year-end and that of a consolidated subsidiary or equity method investee as a change in accounting principle through retrospective application, if practicable.

Also at the September meeting, the SEC staff announced that the following Topics were nullified because the FASB has issued guidance that addresses the accounting issues addressed in those Topics:

- Topic No. D-63, "Call Options 'Embedded' in Beneficial Interests Issued by a Qualifying Special-Purpose Entity";
- Topic No. D-73, "Reclassification and Subsequent Sales of Securities in Connection with the Adoption of FASB Statement No. 133"; and
- Topic No. D-88, "Planned Major Maintenance Activities".

Further, the SEC staff announced the addition of a new paragraph to Topic D-98, "Classification and Measurement of Redeemable Securities," to highlight the notion set forth in FASB Statement No. 155, *Accounting for Certain Hybrid Financial Instruments*, that hybrid financial instruments that are classified in stockholders' equity are not included in the scope of Statement No. 155, and therefore the guidance in Topic D-98 continues to be applicable.

Draft abstracts of the above Issues are available for comment until October 13, 2006 at http://www.fasb.org/eitf/eitf_draft_abstracts.shtml.

Public Sector

GASB Statement No. 48 Issued

The Governmental Accounting Standards Board has issued Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*, to establish criteria governments should use to determine whether certain transactions should be reported as a sale or a collateralized borrowing. Such transactions are likely to comprise the sale of delinquent taxes, certain mortgages, student loans, or future revenues such as those arising from tobacco settlement agreements. There has been considerable diversity in practice in the manner that such transactions have been reported.

The criteria used to ascertain whether the transactions should be reported as revenue or as a liability will help to determine the extent to which a transferor government either retains or relinquishes control over the receivables or future revenues through its continuing involvement with those receivables or future revenues. Active involvement is a key consideration in determining whether a transaction transferring the right to a future revenue stream could qualify as a sale. In addition to clarifying guidance on accounting for sales and pledges of receivables and future revenues, the Statement:

- Requires enhanced disclosures pertaining to future revenues that have been pledged or sold;
- Stipulates that governments should not revalue assets that are transferred between financial reporting entity components; and
- Provides guidance on recognizing other assets and liabilities arising from the sale of specific receivables or future revenues.

Statement No. 48 is effective for financial statements for periods beginning after December 15, 2006.

SEC

Executive Compensation Disclosure Transition Questions and Answers

On August 29, 2006, the SEC adopted changes to the rules requiring disclosure of executive and director compensation, related-person transactions, director independence and other corporate governance matters, and security ownership of officers and directors. The SEC's Division of Corporation Finance staff recently issued transition questions and answers to address the effective date of and early compliance with the new rules. The questions and answers also provide hypothetical situations that an issuer may encounter and discusses whether the new rules would require compliance in those situations.

The *Executive Compensation and Related Person Disclosure Transition Questions and Answers* are available in full at <http://www.sec.gov/divisions/corpfina/faqs/execcompqa.pdf>. The new rules regarding executive compensation and related person disclosure are available at <http://www.sec.gov/rules/final/2006/33-8732a.pdf>.

SEC's Disclosure System to Become "Real-Time"

The SEC has decided to transform its current public company disclosure system from a forms-based electronic filing cabinet to a real-time search tool with interactive capabilities. By moving to interactive data using the XBRL (Extensible Business Reporting Language) computer language, the SEC will be joining the Federal Deposit Insurance Corporation, the Federal Reserve, and the Comptroller of the Currency, which already require banks to use it. This investment in an interactive data system signals the SEC's widespread adoption of interactive data filing by all companies that report their financial information to the SEC.

Currently under the SEC's XBRL voluntary financial reporting program, registrants may file XBRL data as supplemental financial information, in addition to the currently required financial information in HTML or ASCII format. XBRL is a technology standard that provides a common format for electronic financial information. Essentially, XBRL enables the "bar-coding" of electronic financial information, including data presented in audited or reviewed financial statements or other financial information.

Although the SEC has awarded contracts totaling \$54 million to transform its public company disclosure system to a real-time search tool, there has been no announcement at this time as to a deadline by which all registrants will need to adopt interactive data filing using XBRL.

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