

Insights

A biweekly publication from the National Office of Audit and Accounting

December 6, 2006

By clicking on a heading in the Bookmark section on the left, you will go directly to that subject.

SEC

Documentation of the Election to Use the "Short-Cut" Method in FSP FAS 123(R)-3

The transition provisions of FASB Statement No. 123 (revised 2004), *Share-Based Payment*, indicate that, for purposes of calculating the pool of excess tax benefits available to absorb tax deficiencies recognized subsequent to the adoption of Statement No. 123(R) (referred to as the additional paid-in capital or APIC pool), an entity must include the net excess tax benefits that would have qualified as such had the entity adopted Statement No. 123, *Accounting for Stock-Based Compensation*, for recognition purposes, when it was first effective. A fundamental assumption underlying this requirement is that, for public entities, implementation of the disclosure provisions of Statement No. 123 resulted in information about the amounts that would have qualified as excess tax benefits had the entities adopted Statement No. 123 for recognition purposes. However, a significant number of entities may not have that information readily available and, in some cases, may not be able to recreate that information. It therefore is important that all entities are aware of the possible election of the "short-cut" method to determine the pool of excess tax benefits, as provided in FASB Staff Position (FSP) No. FAS 123(R)-3, *Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards*.

FSP FAS 123(R)-3 provides a practical elective alternative transition method related to accounting for the tax effects of share-based payment awards to employees. Per the FSP, an entity must follow either the transition guidance for the APIC pool in Statement No. 123(R) or the alternative transition method described in the FSP. The alternative method comprises a computational component that establishes a beginning balance of the APIC pool related to employee compensation and a simplified method to determine the subsequent impact on the APIC pool of employee awards that are fully vested and outstanding upon the adoption of Statement No. 123(R).

An entity that adopts Statement No. 123(R) using either modified retrospective or modified prospective application may make a one-time election to adopt the "short-cut" method described in the FSP. An entity may take up to one year from the later of its initial adoption of Statement No. 123(R) or the effective date of the FSP (November 10, 2005) to evaluate its available transition alternatives and make its one-time election. Statement No. 123(R) was effective for public entities that do not file as small business issuers as of the beginning of the first interim or annual reporting period that begins after June 15, 2005. As such, if a public entity that does not file as a small business issuer has a June or September year-end and did not make the one-time election to follow the "short-cut" method, it must follow the "long form" method described in Statement No. 123(R). Statement No. 123(R) was effective for public entities that file as small business issuers as of the beginning of the first interim or annual reporting period that begins after December 15, 2005. A calendar-year-end issuer that adopted Statement No. 123(R) on January 1, 2006 has until January 1, 2007 to make the one-time election. Until and unless an entity elects the "short-cut" method described in

the FSP, the entity should follow the “long form” method described in Statement No. 123(R). **An entity that elects to apply the short-cut method should document their election prior to January 1, 2007.**

To the extent that a nonpublic company used the fair value (as opposed to minimum value) measurement method for accounting or disclosure of its stock options, the “short cut” method could apply.

The FSP is available in full at http://www.fasb.org/fasb_staff_positions/fsp_fas123r-3.pdf.

Two FIN 48 Implementation Issues Addressed by SEC Staff

At its September 26, 2006 joint meeting with the SEC staff, the AICPA SEC Regulations Committee discussed the following issues regarding the implementation of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, (FIN 48) by public companies:

Income Statement Classification of Interest and Penalties

If a registrant changes its income statement classification of interest and/or penalties in connection with the adoption of FIN 48, the SEC staff would not require a preferability letter under Item 601(b)(18) of Regulation S-K. However, if a registrant changes its income statement classification of interest and/or penalties after the adoption of FIN 48, a preferability letter is required for a material change in a registrant's accounting policy.

Disclosures under FIN 48 in Form 10-Q in the Period of Adoption

FIN 48 is effective in the first interim period for fiscal years beginning after December 15, 2006, and requires certain disclosures on an annual basis. The following chart lists the disclosure requirements under FIN 48 and states whether the disclosure is required in interim financial statements in the year of adoption and in interim periods after adoption.

FIN 48 Disclosures (References FIN 48 Paragraph Numbers)	Disclosure as of Date of Adoption ¹	Disclosure as to Interim Periods Post Adoption ²
20. An enterprise shall disclose its policy on classification of interest and penalties in accordance with paragraph 19 of this Interpretation in the footnotes to the financial statements.	Yes ³	Disclose any change in classification ⁴
21. An enterprise shall disclose the following at the end of each annual reporting period presented: a. A tabular reconciliation of the total amounts of unrecognized tax benefits at the beginning and end of the period, which shall include at a minimum:	Total amount of unrecognized tax benefits as of date of adoption	Tabular reconciliation not required for interim periods
(1) The gross amounts of the increases and decreases in unrecognized tax benefits as a result of tax positions taken during a prior period	N/A	Disclose any material changes
(2) The gross amounts of increases and decreases in unrecognized tax benefits as a result of tax positions taken during the current period	N/A	Disclose any material changes ⁵

(3) The amounts of decreases in the unrecognized tax benefits relating to settlements with taxing authorities	N/A	Disclose any material changes ⁵
(4) Reductions to unrecognized tax benefits as a result of a lapse of the applicable statute of limitations	N/A	Disclose any material changes ⁵
b. The total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate	Yes, amount of as of date of adoption	Disclose any material changes
c. The total amounts of interest and penalties recognized in the statement of operations and the total amounts of interest and penalties recognized in the statement of financial position	Total amount of accrued interest and penalties as of date of adoption	Disclose any material changes ⁵
d. For positions for which it is reasonably possible that the total amounts of unrecognized tax benefits will significantly increase or decrease within 12 months of the reporting date:	Yes, amount of as of date of adoption	Disclose any material changes ⁶
(1) The nature of the uncertainty	Yes, as of date of adoption	Disclose any material changes
(2) The nature of the event that could occur in the next 12 months that would cause the change	Yes, as of date of adoption	Disclose any material changes
(3) An estimate of the range of the reasonably possible change or a statement that an estimate of the range cannot be made	Yes, estimate of as of date of adoption	Disclose any material changes
e. A description of tax years that remain subject to examination by major tax jurisdictions.	Yes, as of date of adoption	Disclose any material changes

¹Disclose in all interim financial statements in the year of adoption.

²Regarding interim balances or activity during the current and year-to-date interim periods.

³If upon adoption of FIN 48, a registrant changes its financial statement classification of interest and penalties, it should provide the disclosures specified by paragraph 17 of FASB Statement No. 154, *Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20 and FASB Statement No. 3*. However, see above discussion regarding preferability.

⁴If upon adoption of FIN 48, a registrant changed its financial statement classification of interest and penalties, it should provide the disclosures specified by paragraph 18 of Statement No. 154, with respect to the interim periods in the year of adoption. If subsequent to 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 Statement No. 154 and file a preferability letter (post adoption).

⁵If material amounts are recognized during the quarter, disclosure in management's discussion and analysis may be required.

⁶If material amounts are updated during the quarter, disclosure in management's discussion and analysis may be required and critical accounting policies may need to be updated.

International

Standard Issued for Segment Reporting

The International Accounting Standards Board (IASB) has issued International Financial Reporting Standard (IFRS) 8, *Operating Segments*. This Standard was issued as a result of the IASB's joint short-term convergence project with the U.S. Financial Accounting Standards Board (FASB) to eliminate major differences between IFRSs and U.S. generally accepted accounting principles. IFRS 8 replaces International Accounting Standard 14, *Segment Reporting*, and aligns segment reporting with the requirements of FASB Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information*.

IFRS 8 requires a listed entity to report financial and descriptive information about its reportable segments. Reportable segments are operating segments or aggregations of operating segments that meet specified criteria. Operating segments are components of an entity about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. A component of an entity that sells primarily or exclusively to other operating segments of the entity is included in the definition of an operating segment if the entity is managed that way.

Generally, financial information is required to be reported on the basis that it is used internally for evaluating operating segment performance and deciding how to allocate resources to operating segments. Such information may be different from what is used to prepare the income statement and balance sheet. IFRS 8 therefore requires an explanation of how segment profit or loss and segment assets and liabilities are measured for each reportable segment. Among other disclosures, IFRS 8 requires reconciliations of total reportable segment revenues, total profit or loss, total assets, total liabilities and other amounts disclosed for reportable segments to corresponding amounts in the entity's financial statements.

IFRS 8 applies to the annual financial statements for periods beginning on or after January 1, 2009. Earlier application is permitted.

Accounting for Service Concession Arrangements

In many countries, infrastructure used to provide public services—such as roads, bridges, prisons, hospitals, airports, water distribution facilities, and telecommunication networks—traditionally has been constructed and maintained by the public sector and financed through public budget appropriation. However, in some countries, governments have introduced contractual service concession arrangements to attract private participation in the development, financing and operation of such infrastructure. Under these service concession arrangements, control of the assets remains in public hands but the private sector operator is responsible for construction activities, as well as for operating and maintaining the public sector infrastructure.

The International Financial Reporting Interpretations Committee (IFRIC) has released IFRIC 12, *Service Concession Arrangements*. IFRIC 12 addresses how service concession operators should apply existing International Financial Reporting Standards to account for the obligations they undertake and rights they receive in service concession arrangements. IFRIC 12 does not address accounting for the government side of service concession arrangements.

IFRIC 12 draws a distinction between two types of service concession arrangements:

- In one, the operator receives a financial asset (an unconditional contractual right to receive cash or another financial asset from the government in return for constructing or upgrading the public sector asset). The financial asset is recognized to the extent the operator has an unconditional contract right to receive cash or another financial asset from or at the direction of the grantor for the construction services, and is measured at fair value.
- In the other, the operator receives an intangible asset (no more than a right to charge for use of the public sector asset that it constructs or upgrades). A right to charge users is not an unconditional right to receive cash because the amounts are contingent on the extent to which the public uses the service. The operator recognizes the intangible asset to the extent it receives a right (a license) to charge users of the public services, and the asset is measured at fair value.

For both types, the operator of a service concession arrangement recognizes and measures revenue in accordance with International Accounting Standards 11 and 18 for the services it performs.

IFRIC 12 allows for the possibility that both types of arrangement may exist within a single contract: to the extent that the government has given an unconditional guarantee of payment for the construction of the public sector asset, the operator has a financial asset; to the extent that the operator has to rely on the public using the service in order to obtain payment, the operator has an intangible asset.

IFRIC 12 is effective for annual periods beginning on or after January 1, 2008.

Insights is a biweekly publication of McGladrey & Pullen, LLP and should not be construed as accounting, auditing, consulting, or legal advice on any specific facts or circumstances. The contents are intended for general information purposes only, and you are urged to consult your McGladrey & Pullen, LLP service provider concerning your situation and any specific questions you may have. You may call 1.888.214.1416 for a contact person in your area.

For further information about McGladrey & Pullen or to retrieve archived issues of *Insights*, visit our Web site: <http://www.mcgladrey.com/>. If you do not wish to continue receiving *Insights*, or if you wish to place another person on the distribution list, please contact mpinsights@rsmi.com.