

Insights

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Feed the Pig

The average young working American carries \$4,088 in credit card debt, owes \$20,000 in student loans, and claims the nation's second highest personal bankruptcy rate. To help career builders start taking small steps to get on a better financial path, the American Institute of Certified Public Accountants and the Ad Council have launched "Feed the Pig," a national public service announcement campaign. The messages in this campaign will encourage taking small steps to start saving today to build a solid financial future tomorrow.

We hope that you will share this information with your family and friends so that we can all get young working Americans moving in the right financial direction. Information is available at <http://www.feedthepig.org/>.

Accounting

Conduit Bond Obligors Are Public Entities

Questions have been raised as to whether a conduit bond obligor for conduit debt securities that are traded in a domestic or foreign stock exchange or an over-the-counter market should be considered a public entity for the purposes of applying certain existing authoritative pronouncements. *Conduit debt securities* refers to certain limited-obligation revenue bonds, certificates of participation, or similar debt instruments issued by a state or local governmental entity (or an agency or instrumentality thereof) for the express purpose of providing financing for a specific third party that is not a part of the state or local government's financial reporting entity. The third party (conduit bond obligor) is required to make all interest and principal payments as they become due, and any future financial reporting requirements are the responsibility of the conduit bond obligor. The definition of a conduit bond obligor includes all individual conduit bond obligors that participate in a pooled conduit debt security. The types of private entities that can be involved in a conduit debt security are limited by the federal tax code to certain not-for-profit entities (for example, hospitals, museums, and libraries) and to for-profit entities for whom the debt is issued in the form of an industrial revenue or development bond that is issued for a specific purpose allowable by the Internal Revenue Code. In some instances, these conduit debt securities are traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local or regional markets).

FASB Staff Position (FSP) No. FAS 126-1, *Applicability of Certain Disclosure and Interim Reporting Requirements for Obligors for Conduit Debt Securities*, concludes that the definition of a public entity in the following standards should be amended to include an entity that is a conduit bond obligor for conduit debt securities that are traded in a public market:

- APB Opinion No. 28, *Interim Financial Reporting*,

- FASB Statement No. 69, *Disclosures about Oil and Gas Producing Activities*;
- FASB Statement No. 109, *Accounting for Income Taxes*;
- FASB Statement No. 126, *Exemption from Certain Required Disclosures about Financial Instruments for Certain Nonpublic Entities*;
- FASB Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information*;
- FASB Statement No. 132 (revised 2003), *Employers' Disclosures about Pensions and Other Postretirement Benefits*;
- FASB Statement No. 141, *Business Combinations*;
- AICPA Accounting and Auditing Guide, *Not-for-Profit Organizations*; and
- AICPA Accounting and Auditing Guide, *Health Care Organizations*.

The guidance in this FSP should be applied prospectively in fiscal periods beginning after December 15, 2006. An entity may elect to retrospectively apply the guidance to all prior periods. If an entity issues interim financial statements, the FSP should be applied to the first interim period after the date of adoption.

This FSP will significantly affect the accounting and reporting practice of those entities that will now be considered to be public entities.

The FSP is available in full at http://www.fasb.org/fasb_staff_positions/fsp_fas126-1.pdf.

Technical Corrections of FASB Statement No. 123(R)

The Financial Accounting Standards Board (FASB) has issued FASB Staff Position (FSP) No. FAS 123(R)-6, *Technical Corrections of FASB Statement No. 123 (R)*. The FSP made four amendments to FASB Statement No. 123(R), *Share-Based Payment*:

- Paragraph A240(d)(1) was amended to explicitly exempt nonpublic entities from the requirement to disclose the aggregate intrinsic value of outstanding fully vested share options (or share units) and share options expected to vest at the latest balance sheet.
- The computation of the minimum compensation cost that must be recognized in paragraph A102 of Illustration 4(b) was revised to comply with the recognition provisions in paragraph 42.
- Paragraph A170 of Illustration 13(e) was amended to clarify that on the date that a company decides to close a plant and terminate employees, the service condition of the illustrative award is not expected to be satisfied and the awards are no longer probable of vesting because the employees cannot render the requisite service. Therefore, any compensation cost previously recognized as of the date of the plant closing should be reversed.
- Paragraph E1 was amended to exclude an offer to settle an award from the definition of "short-term inducement."

The provisions of this FSP should be applied in the first reporting period beginning after October 20, 2006. The FSP is available in full at http://www.fasb.org/fasb_staff_positions/fsp_fas123r-6.pdf.

Further Defining Participating Securities in EPS Calculations

FASB Statement No. 128, *Earnings per Share*, requires the use of the two-class method of computing basic earnings per share (EPS) for those enterprises with participating securities or multiple classes of common stock (each with a different dividend rate from those of the other classes of common stock). Participating securities are defined in Statement No. 128 as securities that may participate in dividends with common stocks according to a predetermined formula with, at times, an upper limit on the extent of participation. This definition was expanded in Emerging Issues Task Force (EITF) Issue No. 03-6, "Participating Securities and the Two-Class Method under FASB Statement No. 128," to include a security that may participate in undistributed earnings with common stock in its current form, whether that participation is conditioned upon the occurrence of a specified event or not. However, neither Statement No. 128 nor Issue No. 03-6 provides guidance about whether unvested instruments granted as share-based compensation are participating securities.

To address this, the Financial Accounting Standards Board has issued proposed FASB Staff Position (FSP) No. EITF 03-6-a, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities*. Following is a summary of the guidance proposed in the FSP:

- Rights to receive dividends or dividend equivalents (whether paid or unpaid) on unvested share-based payment awards that would provide a noncontingent transfer of value to the holder of the share-based payment award constitute participation rights and therefore would be included in the computation of basic EPS pursuant to the two-class method. A share-based payment award that contains a nonforfeitable right to receive cash when dividends are paid to common shareholders irrespective of whether that award ultimately vests or remains unvested would be considered a participating security. However, the right to receive cash dividends that the holder will forfeit if the award does not vest is not a participation right.
- A share-based payment award that participates in undistributed earnings via a reduction in the exercise price of the award when distributions are made to common shareholders would not be considered a participation right because the transfer of value to the holder of the award is contingent upon the exercise of the award.
- Dividends or dividend equivalents that are actually paid and are accounted for as compensation cost because the unvested share-based payment award is not expected to vest (or does not vest) would not be included in the earnings allocation in computing basic EPS.

If finalized, the provisions of this FSP are expected to be applied in the first reporting period beginning after the date the FSP is posted to the FASB website. All prior-period EPS data presented (including in interim financial statements, summaries of earnings, and selected financial data) would be required to be adjusted retrospectively to conform with the provisions of the FSP.

The proposed FSP is available for comment until December 19, 2006 at http://www.fasb.org/fasb_staff_positions/prop_fsp_eitf03-6-a.pdf.

Interim Guidance Proposed for Certain Fair Value Measurements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement No. 157, *Fair Value Measurements*. This Statement did not require any new fair value measurements, but rather, it provided enhanced guidance to other pronouncements that require or permit assets or liabilities to be

measured at fair value. Statement No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007.

While finalizing Statement No. 157, the FASB became aware of diversity in practice about the measurement of nonfinancial assets that are required to be measured at fair value in business combinations and impairment tests. This diversity primarily relates to the circumstances in which a reporting entity uses entity-specific assumptions, rather than the assumptions of market participants, in a fair value measurement. Diversity in practice also relates to the appropriate measurement attribute for certain assets acquired and liabilities assumed in a business combination.

The FASB staff identified certain wording in FASB Statements No. 141, *Business Combinations*, No. 142, *Goodwill and Other Intangible Assets*, and No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, which may have contributed to this diversity. As a result, the FASB has issued proposed FASB Staff Position (FSP) No. FAS 141-b, 142-e, and 144-b, *Fair Value Measurements in Business Combinations and Impairment Tests*, to clarify the current requirements for fair value measurements under those Statements until Statement No. 157 is adopted by the reporting entity. Upon adoption of Statement No. 157, the reporting entity would apply the guidance in that Statement in the circumstances addressed by the proposed FSP.

Per the proposed FSP, if a present value technique is used in a fair value measurement under Statements No. 141, 142, or 144, the measurement must reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability. Those assumptions must be developed based on the best information available in the circumstances, which might include the reporting entity's own data. In developing those assumptions, the reporting entity must not ignore information about market participant assumptions that is reasonably available without undue cost and effort. Therefore, the reporting entity's own data used to develop its assumptions must be adjusted if information is reasonably available without undue cost and effort that indicates that market participants would use different assumptions.

The proposed FSP also would amend paragraph 35 of Statement No. 141 to clarify that it is not intended to suggest that all assets acquired or liabilities assumed in a business combination be measured at fair value. This amendment is necessary because certain of the measurement attributes for specific classes of assets acquired and liabilities assumed in a business combination are not fair value measurement attributes. This amendment to paragraph 35 of Statement No. 141 is not affected by Statement No. 157 and would continue to apply after that Statement is adopted.

If finalized, the proposed FSP would be effective for financial statements issued for fiscal years beginning after December 15, 2006, and interim periods within those fiscal years. The proposed FSP would be applied prospectively as of the beginning of the interim or annual period in which it is initially applied.

The proposed FSP is available for comment until November 22, 2006 at http://www.fasb.org/fasb_staff_positions/prop_fsp_fvm.pdf.

Proposed Accounting for Registration Payment Arrangements

An entity may issue financial instruments, such as equity shares, stock purchase warrants or debt instruments, that are subject to a registration payment arrangement, which is an arrangement with both of the following characteristics:

- The arrangement specifies that the issuer will endeavor (1) to file a registration statement for the resale of specified financial instruments and/or for the resale of equity shares that are issuable upon exercise or conversion of specified financial instruments and for that registration statement to be declared effective by the SEC (or other applicable securities regulator if the registration statement will be filed in a foreign jurisdiction) within a specified grace period, and/or (2) to maintain the effectiveness of the registration statement for a specified period of time (or in perpetuity); and
- The arrangement requires the issuer to transfer consideration, such as a cash payment or series of cash payments, additional equity shares or an interest rate adjustment, to the counterparty if the registration statement for the resale of the financial instrument or instruments subject to the arrangement is not declared effective or if effectiveness of the registration statement is not maintained.

Because of the potential significance of the consideration that may become payable under registration payment arrangements, questions have arisen as to the accounting for those arrangements. Questions also have arisen about whether the existence of a registration payment arrangement affects the accounting for the financial instruments subject to the registration payment arrangement, particularly when the financial instrument or instruments are accounted for in accordance with Emerging Issues Task Force Issue No. 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock." The Financial Accounting Standards Board (FASB) therefore has issued proposed FASB Staff Position (FSP) No. EITF 00-19-b, *Accounting for Registration Payment Arrangements*, which addresses an issuer's accounting for registration payment arrangements as follows:

- The proposed FSP specifies that the contingent obligation to make future payments or otherwise transfer consideration under a registration payment arrangement, whether issued as a separate agreement or included as a provision of a financial instrument or other agreement, would be separately recognized and measured in accordance with FASB Statement No. 5, *Accounting for Contingencies*, and FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss*.
 - If the transfer of consideration under a registration payment arrangement is probable and can be reasonably estimated at inception, the contingent liability under the registration payment arrangement would be included in the allocation of proceeds from the related financing transaction using the measurement guidance in Statement No. 5. The remaining proceeds would be allocated to the financial instruments issued in conjunction with the registration payment arrangement based on the provisions of other applicable generally accepted accounting principles (GAAP).
 - If the transfer of consideration under a registration payment arrangement becomes probable and can be reasonably estimated subsequent to the inception of the arrangement or if the measurement of a previously recognized contingent liability increases or decreases in a subsequent period, the initial recognition of the contingent liability or the change in the measurement of the previously recognized contingent liability would be recognized in earnings.
- The proposed FSP further clarifies that a financial instrument subject to a registration payment arrangement would be separately recognized and measured in accordance with other applicable GAAP (for example, APB Opinion No. 21, *Interest on Receivables and Payables*, FASB Statement

No. 133, *Accounting for Derivative Instruments and Hedging Activities*, or Issue No. 00-19) without regard to the contingent obligation to transfer consideration pursuant to the registration payment arrangement.

- The issuer of a registration payment arrangement would be required to provide certain disclosures about each registration payment arrangement or each group of similar arrangements, regardless of the probability of having to make such payments.

If finalized, this proposed FSP would be effective immediately for registration payment arrangements and the financial instruments subject to those arrangements that are entered into or modified subsequent to the date of issuance of the FSP. For registration payment arrangements and financial instruments subject to those arrangements that were entered into prior to the issuance of the FSP and that continue to be outstanding at the beginning of the period of adoption, the guidance would be effective for financial statements issued for fiscal years beginning after December 15, 2006, and interim periods within those fiscal years. However, an entity would not apply the guidance in this FSP to registration payment arrangements that are no longer outstanding upon adoption of the FSP.

The proposed FSP is available for comment until December 4, 2006 at http://www.fasb.org/fasb_staff_positions/prop_fsp_eitf00-19-b.pdf.

Accounting for a Depreciable Asset when an Equity Method Investment Is Obtained

There currently is diversity in practice regarding the classifying and accounting for a depreciable long-lived asset when it is expected that once the asset is sold, the entity plans to account for its interest in the entity that holds the long-lived asset as an equity method investment. In these situations, the entity often sells less than a 100 percent interest in a long-lived asset that is currently being consolidated, and the entity accounts for its remaining interest in the entity that holds the long-lived asset as an equity method investment. In proposed FASB Staff Position (FSP) No. FAS 144-c, *Classifying and Accounting for a Depreciable Asset as Held-for-Sale When an Equity Method Investment Is Obtained*, the Financial Accounting Standards Board has proposed that an entity should classify the entire long-lived asset as held-for-sale and cease depreciating the long-lived asset once the long-lived asset meets the held-for-sale criteria even if the entity plans to account for its direct or indirect interest in the long-lived asset under the equity method of accounting. However, the proposed FSP would not change the accounting for investments in joint ventures or equity method investments and whether a new basis of accounting should be applied.

If finalized, the guidance in the proposed FSP would be applied prospectively in the first reporting period beginning after the FSP is posted to the FASB website. For long-lived assets that are initially classified as held-for-sale after the effective date of the FSP, an entity would cease depreciating the long-lived assets when the long-lived assets are classified as held-for-sale. For long-lived assets classified as held-for-sale before the effective date of the FSP, an entity would maintain its current accounting policy for depreciating those long-lived assets.

The proposed FSP is available for comment until December 15, 2006 at http://www.fasb.org/fasb_staff_positions/prop_fsp_fas144-c.pdf.

Auditing

Fraud and the Tone at the Top

In the current environment, all business leaders must be keenly aware of the need for fraud prevention and an ethical tone at the top of their organizations. To help educate auditors and corporate executives about the important role executives and management play in the fight against fraud, the American Institute of Certified Public Accountants (AICPA) and the Association of Certified Fraud Examiners (ACFE) have created a video, "Fraud and the Tone at the Top." This 20-minute video features Joseph Wells, ACFE founder and chairman, Barry Melancon, chief executive officer of the AICPA, and Dr. Stephen Salbu, an organizational behavior expert. Walt Pavlo, former MCI Worldcom Senior Manager and convicted criminal, also is interviewed in this anti-fraud video. Mr. Pavlo has served a 41-month sentence for money laundering, wire fraud and obstruction of justice and is now speaking to bring awareness of fraud within the business environment.

To find out what can be done to better protect a company against fraud, view "Fraud and the Tone at the Top" at <http://antifraud.aicpa.org/Resources/Fraud+and+the+Tone+at+the+Top.htm>.

Public Sector

GASB Invites Public Comment on Fund Balance Reporting Issues

Fund balance is among the most universally used metrics in state and local government external financial reports; it reflects the difference between assets and liabilities in governmental funds. Ideally, this information allows financial statement users to identify resources that are available. However, recent research by the Governmental Accounting Standards Board (GASB) has identified several issues that may significantly diminish the usefulness of fund balance information, including:

- The actions taken to set aside fund balance for specific purposes vary from government to government making it difficult to assess the likelihood that resources will be used for the purposes that are reported.
- Some governments transfer resources from the general fund to other governmental funds without an intention to use the resources in the receiving fund, a practice which may mislead financial statement users regarding the amount of available resources and the purposes for which those resources can be used.
- Some governments report fund balance as reserved for specific purposes when, in fact, it should be unreserved, perhaps because the current standards are not sufficiently clear.

In its current project on fund balance reporting and governmental fund type definitions, the GASB is addressing the diversity with which governments report their fund balance information. Recently, the GASB issued an Invitation to Comment (ITC) to set forth opinions about these issues and to seek comments at an early stage of the project. Among other matters, the ITC considers possible revisions to the definitions of governmental fund types that would clarify their intention. Also, the ITC sets forth three alternative models of classifying the components of fund balance:

- One alternative retains the current fund balance components—reserved and unreserved—and continues to base the reporting of reserved fund balance on the relationship of purpose limitations

to the overall purpose of the fund, but it makes certain changes to address the problematic issues that have been identified.

- A second alternative continues to approach distinctions in components from the perspective of the individual fund, but it employs categories of fund balance that distinguish between resources that have been committed to more specific purposes within the fund they are reported in and those that can be used for any purpose consistent with the fund.
- A third alternative distinguishes fund balance based in part on whether it represents restricted or unrestricted resources.

The public is encouraged to comment on the questions presented in the ITC at www.gasb.org/survey/cgi-bin/fbr.html. The deadline for comments is January 31, 2007.

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