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Accounting

McGladrey & Pullen Comments on Proposed Interim Disclosures about Fair Value

Recently, the Financial Accounting Standards Board (FASB) proposed FASB Staff Position (FSP) No. FAS 107-b and APB 28-a, *Interim Disclosures about Fair Value of Financial Instruments*. McGladrey & Pullen, LLP issued a letter of comment in which we supported the efforts of the FASB to address concerns about the lack of comparability resulting from the use of different measurement attributes for financial instruments. We agree that increasing the frequency of the disclosures about fair value for certain companies would improve the transparency and quality of information provided to users of financial statements.

Notwithstanding our support of the proposed FSP, our letter recommends that the scope of the proposed FSP be refined to apply to only those entities with significant financial instruments, and that smaller companies without a significant level of financial instruments not be burdened by the additional disclosure requirements imposed by the proposed FSP. We are concerned that the scope of FASB Statement 107, *Disclosures about Fair Value of Financial Instruments*, is no longer appropriate, and that the scope of the proposed amendment is too broad. Statement No. 107 currently applies to all entities, except those that meet all of the following criteria provided in FASB Statement No. 126, *Exemption from Certain Required Disclosures about Financial Instruments for Certain Nonpublic Entities, an amendment of FASB Statement No. 107*:

- a. The entity is a nonpublic entity.
- b. The entity's total assets are less than \$100 million on the date of the financial statements.
- c. The entity has no instrument that, in whole or part, is accounted for as a derivative instrument under FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, other than commitments related to the origination of mortgage loans to be held for sale during the reporting period.

Our comment letter states that we believe this scope exception should be amended by eliminating criterion "c" above because we fail to understand why the existence of one derivative financial instrument is the appropriate criterion for requiring fair value disclosures on all financial instruments. We believe that the amendments to Statement No. 133 require the appropriate fair value disclosures related to the derivative financial instrument. Further, because the total asset criterion in "b" above has not been changed since Statement No. 126 was issued in 1996, we believe it should be increased to account for the effects of inflation at a minimum.

Our letter of comment is available in full at <http://www.fasb.org/ocl/FSPAPB-1/53607.pdf>

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International

Consolidation: IFRS vs. U.S. GAAP

This article is the fourteenth in a series of articles that takes our readers on a journey through International Financial Reporting Standards (IFRS) with a special focus on the standards' quintessential feature: they are principles-based. In this article, we provide an overview of some of the most significant differences between IFRS and U.S. generally accepted accounting principles (GAAP) with regard to consolidation of financial statements. Actual differences in the accounting treatment between the two frameworks depend on specific circumstances.

The IFRS literature that addresses consolidation consists of International Accounting Standard (IAS) 27, *Consolidated and Separate Financial Statements*, and SIC 12, *Consolidation – Special Purpose Entities*. In addition, the International Accounting Standards Board (IASB) issued guidance on *de facto* control in its October 2005 monthly newsletter, *The IASB Update*. Even though such guidance is not considered to be authoritative, it represents a substantial clarification.

U.S. GAAP related to consolidation is primarily found in Accounting Research Bulletin No. 51, *Consolidated Financial Statements*, FASB Statement No. 94, *Consolidation of all Majority-Owned Subsidiaries*, FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements*, and FASB Interpretation (FIN) No. 46(R), *Consolidation of Variable Interest Entities*. U.S. GAAP also includes a plethora of other interpretations and guidance.

The concept of control under IAS 27 centers around a principles-based definition of “control”. At its core, control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In a nutshell, we might say that IAS 27 is a list of indicators accompanied by some guidance whose purpose is to explain how that core principle of control should be applied in practice. The IASB has recently released an Exposure Draft of a new consolidation standard, but it is not expected to change the basic control principle found in IAS 27.

If we can say that IFRS has only one consolidation model, we cannot say the same about U.S. GAAP. In addition to the more traditional majority-of-voting-rights consolidation model, FIN 46 has introduced the variable interest model, which incorporates the concept of qualified special-purpose entities, which do not exist under IFRS. This concept, combined with a more rules-based approach of U.S. GAAP, can result in different consolidation conclusions, particularly when special purpose entities or other complex arrangements are involved. FIN 46(R) is currently under revision, and its approach may move away from a quantitative analysis to a more qualitative and principles-based analysis.

The concept of control is viewed differently by the two frameworks. Some of the major differences include:

- U.S. GAAP does not have a reference to *de facto* control as does IFRS.
- There is a difference in how potential voting rights are used to assess control.
- U.S. GAAP includes specific exemptions for certain investment companies that are allowed to carry their investment at fair value. Under IFRS, if control is ascertained according to the core principle, line-by-line consolidation must be undertaken.

This list of differences between the two frameworks is not exhaustive. Moreover, both frameworks are under revision, so some of these differences may disappear while others could emerge. Consolidation is a controversial topic, and full convergence between IFRS and U.S. GAAP seems to be a complicated but very necessary goal to be achieved.

For further information, please contact Bob Dohrer (robert.dohrer@rsmi.com) or Marco Marcellan (marco.marcellan@rsmi.com) in our International Assurance Services Group.