

March 24, 2009

Accounting

Cash Flow Presentation for Trading Securities

On February 15, 2007, the Financial Accounting Standards Board (FASB) issued FASB Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities – Including an amendment of FASB Statement No. 115*, which provided all entities with an option to report selected financial assets and liabilities at fair value. Statement No. 159 also contained an amendment to Statement No. 95, *Statement of Cash Flows*, which may have gone unnoticed by financial statement preparers. Statement No. 159, as well as this amendment, were generally effective as of the beginning of an entity's first fiscal year beginning after November 15, 2007.

The amendment to Statement No. 95 described in Statement No. 159 removed the requirement to classify as operating cash flows those cash flows associated with investments classified as trading securities as discussed in Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. As a result, cash inflows from investing activities can include receipts from sales of, and returns of investment in, securities that are classified as trading securities as discussed in Statement No. 115. Cash outflows for investing activities can include disbursements for payments to acquire securities classified as trading securities as discussed in Statement No. 115. Consequently, Statement No. 159 also amended Statement No. 102, *Statement of Cash Flows—Exemption of Certain Enterprises and Classification of Cash Flows from Certain Securities Acquired for Resale*, as it applies to banks, brokers and dealers in securities, and other enterprises that carry securities and other assets in a trading account. That amendment states that cash receipts and cash payments resulting from purchases and sales of securities classified as trading securities as discussed in Statement No. 115 should be classified pursuant to Statement No. 95 (as amended) based on the nature and purpose for which the securities were acquired.

Statement No. 159 is available in full at http://www.fasb.org/pdf/aop_FAS159.pdf.

Proposed Guidance for Recognition and Presentation of Other-Than-Temporary Impairments

On March 17, 2009, the Financial Accounting Standards Board (FASB) issued proposed FASB Staff Position (FSP) No. FAS 115-a, FAS 124-a, and EITF 99-20-b, *Recognition and Presentation of Other-Than-Temporary Impairments*, to provide additional guidance in accounting for and presenting impairment losses on securities. If finalized, the proposed FSP would apply to both debt and equity securities, and would amend FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, Statement No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations*, FSP No. FAS 115-1/124-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*, and Emerging Issues Task Force Issue No. 99-20, "Recognition of Interest Income and Impairment on Purchased Beneficial Interests and Beneficial Interests That Continue to Be Held by a Transferor in Securitized Financial Assets." It is expected that the SEC's Office of the Chief Accountant will amend Staff Accounting Bulletin Topic 5M, *Other Than Temporary Impairment of Certain Investments in Debt and Equity Securities*, to conform with the guidance in the proposed FSP after it is finalized.

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This proposed FSP would modify the current indicator that, to avoid considering an impairment to be other than temporary, management must assert it has both the intent and the ability to hold an impaired security for a period of time sufficient to allow for any anticipated recovery in fair value. Instead, the proposed FSP provides that if a decline in fair value below the amortized cost exists at the measurement date for a debt or equity security and the entity intends to sell the security or it is more likely than not that an entity will sell the debt or equity security before recovery of its cost basis, an other-than-temporary impairment exists. And, if an other-than-temporary impairment exists, the entire amount of the impairment would be recognized in earnings. The proposed FSP further provides that if a decline in fair value below the amortized cost exists at the measurement date for a debt security and it is more likely than not that an entity will not sell the debt security before recovery of its cost basis but it is probable that the investor will be unable to collect all amounts due according to the contractual terms of the security, the debt security would be considered other than temporarily impaired. The amount of the impairment related to the credit losses would be recognized in earnings and the amount of the impairment related to other factors would be recognized in other comprehensive income. For subsequent accounting, the proposed FSP provides that unless a sale is imminent, the discount or reduced premium recorded for a debt security, based on the new cost basis, would be amortized prospectively over the remaining life of the security based on the amount and timing of future estimated cash flows. The impairment recognized in other comprehensive income for held-to-maturity securities would be amortized prospectively through other comprehensive income over the remaining life of the debt security based on the amount and timing of future estimated cash flows. Accordingly, this FSP would change the total amount recognized in earnings (or the "performance indicator" for certain not-for-profit organizations) when there are credit losses associated with an impaired debt security for which management asserts that it does not have the intent to sell and it is more likely than not that it will not have to sell the security before recovery of its cost basis. In those situations, the impairment would be separated into:

- The amount of the total impairment related to credit losses, which would be included in earnings (or the "performance indicator"); and
- The amount of the total impairment related to all other factors, which would be included in other comprehensive income (or would be excluded from the "performance indicator").

There also would be required disclosures of the methodology and key inputs used to measure the portion of the total impairment that relates to credit losses.

If approved, the FSP would be effective for interim and annual periods ending after March 15, 2009, and would be applied prospectively. The proposed FSP is available for comment until April 1, 2009 at http://www.fasb.org/fasb_staff_positions/prop_fsp_fas115-a_fas124-a_and_eitf99-20-b.pdf.

Proposed Guidance Regarding Fair Value Measurements

FASB Statement No. 157, *Fair Value Measurements*, provides a framework for measuring fair value and a definition of fair value that contemplates an orderly transaction between market participants, not a forced or distressed sale. In the current economic crisis, many constituents have requested additional authoritative application guidance to assist them in determining whether a market is active or inactive, and whether a transaction is distressed. On March 17, 2009, the Financial Accounting Standards Board (FASB) issued proposed FASB Staff Position (FSP) No. FAS 157-e, *Determining Whether a Market Is Not Active and a Transaction Is Not Distressed*, to provide this application guidance. If finalized, proposed FSP No. FAS 157-e would establish a two-step process for determining whether a market is not active and a transaction is not distressed:

1. In step 1, the reporting entity must evaluate all factors that indicate that a market is not active, considering the significance and relevance of each factor. Such factors include:
 - a. Few recent transactions (based on volume and level of activity in the market).

- b. Price quotations are not based on current information.
- c. Price quotations vary substantially either over time or among market makers.
- d. Indexes that previously were highly correlated with the fair values of the asset are demonstrably uncorrelated with recent fair values.
- e. Abnormal (or significant increases in) liquidity risk premiums or implied yields for quoted prices when compared with reasonable estimates (using realistic assumptions) of credit and other nonperformance risk for the asset class.
- f. Abnormally wide bid-ask spread or significant increases in the bid-ask spread.
- g. Little information is released publicly (*e.g.*, a principal-to-principal market).

After evaluating such factors, the reporting entity must use its judgment in determining whether the market is active. If the reporting entity concludes that the market for the asset is not active, it must proceed to step 2.

2. In step 2, the reporting entity must presume that a quoted price is associated with a distressed transaction unless the reporting entity has evidence that (a) there was sufficient time before the measurement date to allow for usual and customary marketing activities for the asset and (b) there were multiple bidders for the asset. If the reporting entity has evidence that both factors are present for a given quoted price, that price is presumed not to be associated with a distressed transaction and may be a relevant observable input that should be considered in estimating fair value. (However, the reporting entity should consider whether any other factors or conditions warrant making an adjustment to the quoted price.) If the reporting entity does not have evidence that both factors are present for a given quoted price, it must consider that quoted price to be associated with a distressed transaction. When that is the case, the reporting entity must use a valuation technique other than one that uses that quoted price without significant adjustment.

If approved, the FSP would be effective for interim and annual periods ending after March 15, 2009, and would be applied prospectively. Any revisions that result from a change in the valuation technique or its application would be accounted for as a change in an accounting estimate. The proposed FSP is available for comment until April 1, 2009 at http://www.fasb.org/fasb_staff_positions/prop_fsp_fas157-e.pdf.

FASB Proposes Various Technical Corrections

On March 16, 2009, the Financial Accounting Standards Board (FASB) issued an Exposure Draft of a proposed Statement, *Rescission of FASB Technical Bulletin No. 01-1, Nullification of EITF Topics No. D-33 and No. D-67, Amendments, and Technical Corrections*. If finalized, this proposed Statement would rescind FASB Technical Bulletin No. 01-1, *Effective Date for Certain Financial Institutions of Certain Provisions of Statement 140 Related to the Isolation of Transferred Financial Assets*. Technical Bulletin 01-1 addresses certain issues that arose in transitioning from the previous isolation standards and practices under FASB Statement No. 125, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, to the new practices under FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. Technical Bulletin No. 01-1 provided additional transition time for certain transfers, and that additional transition period ended June 30, 2006; therefore, the guidance in Technical Bulletin 01-1 is no longer relevant.

If finalized, the recent proposed Statement would nullify Emerging Issues Task Force (EITF) Topic No. D-67, "Isolation of Assets Transferred by Financial Institutions under FASB Statement No. 125," because it is redundant with guidance included in Statement No. 140, and refers to Technical Bulletin No. 01-1, which is no longer relevant. Also, the proposed Statement would nullify EITF Topic No. D-33, "Timing of Recognition of Tax Benefits for

Prereorganization Temporary Differences and Carryforwards," because FASB Statement No. 141 (revised 2007), *Business Combinations*, modifies the guidance in FASB Statement No. 109, *Accounting for Income Taxes*, to no longer require tax benefits acquired in a business combination to be separately classified between pre- and post-reorganization amounts. Topic No. D-33 refers to the guidance for subsequent recognition of carryforward benefits under the purchase method in Statement No. 109, which was deleted by Statement No. 141(R).

Further, if finalized, the recent proposed Statement would make certain technical corrections and amend certain existing authoritative pronouncements to update terminology, correct references to pronouncements issued by the American Institute of Certified Public Accountants or the FASB that have been revised or superseded since the issuance of the pronouncements, and eliminate inconsistencies in existing pronouncements. The FASB does not expect that the provisions of the proposed Statement to result in significant changes in practice; however, in certain cases, a technical correction may change current practice. The proposed Statement is expected to be effective upon issuance.

The proposed Statement is available for comment until May 15, 2009 at http://www.fasb.org/draft/ed_technical_corrections.pdf.

Financial Institutions

Limits on Trust Preferred Securities in Tier 1 Capital Delayed

Limits on restricted core capital elements have stated that a bank holding company generally could include in tier 1 capital cumulative perpetual preferred stock and trust preferred securities up to 25 percent of the sum of core capital elements. However, in March of 2005, the Federal Reserve Board published a final rule, which was to become effective on March 31, 2009 and which would amend the risk-based capital standards for bank holding companies. When effective, the new limits would have limited restricted core capital elements (*i.e.*, cumulative perpetual preferred stock and trust preferred securities) includable in the tier 1 capital of a bank holding company to 25 percent of the sum of core capital elements (including restricted core capital elements), net of goodwill less any associated deferred tax liability. In addition, the amount of restricted core capital elements (other than qualifying mandatory convertible preferred securities) that an internationally active bank holding company could include in tier 1 capital could not exceed 15 percent of the sum of core capital elements (including restricted core capital elements), net of goodwill less any associated deferred tax liability.

The economic conditions of the past 18 months have created a situation in which requiring adherence to the new limits by the March 31, 2009 effective date would create a substantial burden for many bank holding companies in a way that was not anticipated when the final rule was adopted in 2005. Therefore, to promote stability in the financial markets and the banking industry as a whole, on March 17, 2009, the Federal Reserve Board decided to further delay the effective date of the new limits until March 31, 2011. As a result of delaying implementation of the new limits until the new effective date in 2011, all bank holding companies may continue to include in tier 1 capital cumulative perpetual preferred stock and trust preferred securities up to 25 percent of total core capital elements.

The Federal Reserve Board's final rule is available in full at <http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20090317a1.pdf>.

Evaluate FHLB Stock for Impairment

Recently, the Federal Home Loan Bank (FHLB) of Seattle reported that it had exhausted its retained earnings, which had totaled more than \$162 million on September 30, 2008. In fact, most FHLBs are showing considerable signs of financial stress because they hold significant positions in private-labeled mortgage-backed securities and home equity loans. Continued deterioration in the housing market could lead to evaporating retained earnings at other FHLBs. This situation, along with other economic events, indicates the need for financial institutions to

evaluate their investments in FHLB stock for impairment. Certain accounting and disclosure issues must be addressed by all financial institutions with investments in FHLB stock. McGladrey & Pullen's National Office of Audit and Accounting has issued a summary and analysis of these issues, which is available at http://mcgladrey.com/Resource_Center/FHLB%20Stock%20Evaluation.pdf.

Credit Unions - Accounting for Recent Regulatory Actions and Financial Results

In January 2009, the U.S. Central Federal Credit Union (U.S. Central) announced it expects to report a \$1.1 billion loss for 2008, which includes charges for other-than-temporary impairment of \$1.2 billion. The National Credit Union Administration (NCUA) took a number of actions after that announcement, including a National Credit Union Share Insurance Fund (NCUSIF) capital injection of \$1 billion into U.S. Central and offering a voluntary temporary guarantee of member deposits in corporate credit unions. The January 2009 unaudited NCUSIF financial statements reflect a \$3.7 billion addition to the loss reserves, as well as an impairment charge for the capital injection into U.S. Central. On January 28, 2009, the NCUA announced a partial write-off of every credit union's existing one percent deposit in the NCUSIF and its intention to assess a premium to return the NCUSIF to an acceptable level.

These recent announcements and actions of U.S. Central and the NCUA, along with other economic events, have indicated the need for credit unions to evaluate their NCUSIF deposits and their investments in corporate credit unions for impairment. Certain accounting issues posed by these announcements and actions must be addressed for the December 31, 2008 financial statements of credit unions. McGladrey & Pullen's National Office of Audit and Accounting has issued a summary and analysis of these issues, which is available at http://www.mcgladrey.com/creditunions_acct_reg.pdf. Also, subsequent to the issuance of our analysis, the American Institute of Certified Public Accountants issued two Technical Information Services (TIS) related to these issues in TIS Section 6995, *Credit Unions*:

- .01, *Financial Reporting Issues Related to Actions Taken by the National Credit Union Administration on January 28, 2009 in Connection with the Corporate Credit Union System and the National Credit Union Share Insurance Fund*, which is available at http://www.aicpa.org/download/acctstd/TIS_6995_01_final.pdf.
- .02, *Evaluation of Capital Investments in Corporate Credit Unions for Other-Than-Temporary Impairment*, which is available at http://www.aicpa.org/download/acctstd/TIS_6995_02_final.pdf.

Public Sector

Fund Balance Reporting and Governmental Fund Type Definitions

Fund balance (*i.e.*, the difference between assets and liabilities in the governmental fund financial statements) is among the most frequently used information in state and local government financial reports. To address the diversity of practice and the resulting lack of consistency that has evolved in fund balance reporting, the Governmental Accounting Standards Board recently issued Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*. Statement No. 54 is intended to improve the usefulness of information provided to financial report users about fund balance by providing clearer, more structured fund balance classifications, and by clarifying the definitions of existing governmental fund types.

The new Standard interprets certain terms within the definition of special revenue fund types, while further clarifying the debt service and capital projects fund type definitions. The Standard also specifies how economic stabilization or "rainy-day" amounts should be reported. Further, Statement No. 54 establishes a hierarchy of fund balance classifications based primarily on the extent to which a government is obligated to observe spending constraints

imposed upon how resources reported in governmental funds may be used. Beginning with the most binding constraints, fund balance amounts will be reported in the following classifications:

- *Restricted* - amounts constrained by external parties, constitutional provision, or enabling legislation
- *Committed* - amounts constrained by a government using its highest level of decision-making authority
- *Assigned* - amounts a government intends to use for a particular purpose
- *Unassigned* - amounts that are not constrained at all will be reported in the general fund

Statement No. 54 is effective for financial statements for periods beginning after June 15, 2010. Governments that wish to implement earlier than that date are encouraged to do so.

International

IASB Amends Financial Instrument Disclosures

On March 5, 2009, the International Accounting Standards Board (IASB) issued amendments that revise the disclosure requirements about fair value measurements and reinforce existing principles for disclosures about the liquidity risk associated with financial instruments. The amendments to International Financial Reporting Standards (IFRS) 7, *Financial Instruments: Disclosures*, introduce a three-level hierarchy for fair value measurement disclosures and require entities to provide additional disclosures about the relative reliability of fair value measurements. The disclosures required by the amendments are classified using a fair value hierarchy that reflects the significance of the inputs used in making the measurements as follows:

- Level 1 - quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 - inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (*i.e.*, as prices) or indirectly (*i.e.*, derived from prices); and
- Level 3 - inputs for the asset or liability that are not based on observable market data (unobservable inputs).

Additional disclosures are required for fair value measurements in Level 3 of the fair value hierarchy.

In addition, the amendments clarify and enhance the existing requirements for the disclosure of liquidity risk to enable users of an entity's financial statements to evaluate the nature and extent of liquidity risk arising from financial instruments and how the entity manages that risk.

The amendments bring the disclosure requirements of IFRS more closely into line with U.S. standards. The amendments to IFRS 7 apply for annual periods beginning on or after January 1, 2009, with earlier application permitted. However, an entity will not be required to provide comparative disclosures in the first year of application.

Income Taxes: IFRS vs. U.S. GAAP

This article is the fifteenth 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 the accounting for income taxes. Actual differences in the accounting treatment between the two frameworks depend on specific circumstances.

Under IFRS, the pronouncement that provides guidance for the accounting for income taxes is International Accounting Standard (IAS) 12, *Income Taxes*, which is accompanied by two interpretations: SIC-21 *Income Taxes - Recovery of Revalued Non-Depreciable Assets*, and SIC-25, *Income Taxes - Changes in the Tax Status*

of an Entity or its Shareholders. Under U.S. GAAP, the primary standard dealing with the accounting for income taxes is FASB Statement No. 109, *Accounting for Income Taxes*, which is surrounded and interpreted by an abundance of U.S. GAAP literature. Both IAS 12 and Statement No. 109 are based on the balance sheet liability approach whereby an entity recognizes deferred tax assets and liabilities for temporary differences (differences between the carrying amount of an asset or liability on the balance sheet and its tax base) and for operating loss and tax credit carryforwards. However, numerous differences arise because both frameworks have various exceptions to the basic principle. Following are a few of the major differences currently existing between IAS12 and Statement No. 109:

	IFRS	U.S. GAAP
Tax rate used to calculate deferred taxes	Deferred taxes are calculated using the “substantively enacted” tax rate as of the balance sheet date.	Deferred taxes are calculated using the “enacted” tax rate as of the balance sheet date.
Recognition of deferred tax assets	A deferred tax asset is recognized to the extent that it is “probable” that it will be realized.	All deferred tax assets are recognized and a valuation allowance is recognized to the extent that it is “more likely than not” that the deferred tax assets will not be realized.
Classification of deferred tax assets and liabilities	Deferred taxation is always classified as “non-current”.	Deferred taxation follows the classification of the related non-tax asset or liability.
Uncertain tax positions	IAS 12 is silent on this matter. General criteria of IAS 12 and IAS 37, <i>Provisions, Contingent Liabilities and Contingent Assets</i> , are commonly applied.	FASB Interpretation No. 48, <i>Accounting for Uncertainty in Income Taxes</i> , applies.
Intercompany transfers of assets remaining within the group	There are no exceptions allowed, and therefore deferred taxes are recorded using the buyer’s tax rate.	Buyers cannot recognize deferred taxes. Income tax paid by the seller is deferred upon ultimate realization.

Income taxes are frequently identified as a source of significant reconciling items for U.S. listed foreign registrants applying IFRS. On this basis, in 2002 the International Accounting Standards Board (IASB) added a convergence project to its agenda with the objective of reducing the differences between IAS 12 and Statement No. 109. The IASB is expected to soon release an exposure draft of revised IAS 12. The Financial Accounting Standards Board is waiting for the IASB to complete its project and will decide what to do once the revised IAS 12 is released. As a result of such convergence efforts, the differences illustrated above are expected to narrow in the future. However, based on the current status of IASB deliberations on the exposure draft, it is likely that IAS 12 and Statement No. 109 will not reach full convergence.

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