

July 14, 2009

## Accounting

### FASB Issues Statement No. 168

FASB Statement No. 162, *The Hierarchy of Generally Accepted Accounting Principles*, identified the sources of accounting principles and the framework for selecting the principles used in preparing the financial statements of nongovernmental entities that are presented in conformity with U.S. generally accepted accounting principles (GAAP). As previously communicated, the *FASB Accounting Standards Codification* soon will become the source of authoritative GAAP recognized by the Financial Accounting Standards Board (FASB) to be applied by nongovernmental entities. Once the Codification is in effect, all of its content will carry the same level of authority. The FASB therefore has issued Statement No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles - a replacement of FASB Statement No. 162*, to indicate this change to the GAAP hierarchy. Following the issuance of Statement No. 168, the FASB will not issue new standards in the form of Statements, FASB Staff Positions, or Emerging Issues Task Force Abstracts. Instead, it will issue Accounting Standards Updates, which will not be authoritative in their own right but will serve to update the Codification, provide background information about the guidance, and provide the bases for conclusions on the changes to the Codification.

On the effective date of Statement No. 168, the *FASB Accounting Standards Codification* will become the single source of authoritative U.S. accounting and reporting standards to be applied by nongovernmental entities, except for rules and interpretive releases of the SEC under authority of federal securities laws, which are sources of authoritative GAAP for SEC registrants. All other nongrandfathered, non-SEC accounting literature not included in the Codification would become nonauthoritative. Sources of nonauthoritative accounting guidance and literature include, for example, practices that are widely recognized and prevalent either generally or in the industry, FASB Concepts Statements, American Institute of Certified Public Accountants (AICPA) Issues Papers, International Financial Reporting Standards, pronouncements of other professional associations or regulatory agencies, Technical Information Service Inquiries and Replies included in AICPA Technical Practice Aids, and accounting textbooks and articles. Grandfathered guidance consists of two general types. The first is where an entity has followed and continues to follow an accounting treatment that was previously in category (c) or category (d), as described in Statement No. 162, if the effective date of that guidance was before March 15, 1992. The second is superseded accounting standards that have allowed for the continued application of that guidance for transactions that have an ongoing effect on the entity's financial statements.

The FASB believes the Codification retains existing GAAP without changes, except that the FASB decided to include paragraphs 38 through 76 of AICPA Technical Inquiry Service (TIS) Section 5100, *Revenue Recognition*, in the Codification, which may result in an accounting change for nonpublic entities that had not previously applied this guidance. Those TIS paragraphs address various accounting issues related to computer software revenue recognition. Affected nonpublic entities would be required to apply the guidance prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after December 15, 2009, and interim periods within those years.

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Except as discussed in the immediately preceding paragraph, Statement No. 168 will be effective for financial statements issued for interim and annual periods ending after September 15, 2009.

Statement No. 168 is available in full at <http://www.fasb.org>.

### Disclosures about Credit Quality of Financing Receivables and Allowance for Credit Losses

Concerns have been expressed that the existing disclosure requirements about an entity's allowance for credit losses and the credit quality of an entity's financing receivables do not provide adequate information. In response to those concerns, the Financial Accounting Standards Board has issued an Exposure Draft of a proposed Statement, *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*. This proposed Statement would require a creditor to provide enhanced disclosure information that would allow financial statement users to understand the nature of credit risk inherent in the creditor's portfolio of financing receivables, how that risk is analyzed and assessed in arriving at the allowance for credit losses, and the changes, and reasons for those changes, in both the receivables and the allowance for credit losses.

The proposed Statement applies to all financing receivables held by creditors, including all public and nonpublic entities (including not-for-profit organizations) and to both interim and annual reporting periods. The term "financing receivables" is defined as a contractual right to receive money on demand or on fixed or determinable dates that is recognized as an asset in the creditor's balance sheet, whether originated or acquired. However, the following financing receivables are excluded from the scope of the proposed Statement:

- Accounts receivable with contractual maturities of one year or less that arose from the sale of goods or services, except for credit card receivables;
- Debt securities as defined in FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*;
- Unconditional promises to give that are assets of not-for-profit entities that are due in one year or less; and
- Acquired beneficial interests.

If finalized, the proposed Statement would require disclosure of a creditor's accounting policies for estimating the allowance for credit losses, qualitative and quantitative information about the credit risk inherent in its financing receivables portfolio, the methods used in determining the components of the allowance for credit losses, and quantitative information about the change in receivables and the related allowance for credit losses. As such, the proposed Statement requires six major categories of required disclosures, the content of which must be disaggregated by two levels as follows:

- The content of the following disclosures must be disaggregated by portfolio segment (the level at which a creditor develops and documents a systematic methodology for determining its allowance for credit losses (e.g., by type of financing receivable, industry, and risk rates)):
  - Rollforward schedules of both the allowance for individually evaluated impaired financing receivables and the allowance for collectively evaluated impaired financing receivables
  - Rollforward schedules of financing receivables
  - Fair value of loans at the end of the reporting period
- The content of the following disclosures must be further disaggregated by class of financing receivable (a level of information that enables users of financial statements to evaluate the nature and extent of exposure to credit risk arising from financing receivables that a creditor holds at the date of the financial statements):
  - Credit quality of the financing receivables portfolio at the end of the reporting period

- Aging of the past due financing receivables at the end of the reporting period
- Nonaccrual status and impaired financing receivables at the end of the reporting period

If finalized, the proposed Statement would be effective for financial statements beginning with the first interim or annual reporting period ending after December 15, 2009. The proposed Statement is available for comment until August 24, 2009 at <http://www.fasb.org>.

### PCFRC Meets

The Private Company Financial Reporting Committee (PCFRC) met at the offices of the American Institute of Certified Public Accountants (AICPA) in Washington, D.C. on June 25 and 26, 2009. The majority of the meeting was devoted to a discussion of proposed new accounting standards and their effect on private companies. The PCFRC usually provides comments to the Financial Accounting Standards Board (FASB) about the effects those proposed standards are expected to have on the financial statements of private companies as well as their independent accountants.

The FASB project on lease accounting will impact virtually every business enterprise, public and private. The proposal requires that lessees record the lease obligation based on the rental payments required by the lease contract discounted using the lessee's incremental borrowing rate and that a corresponding asset be recorded at the same time. From that point forward, the asset and liability are generally accounted for separately. The PCFRC generally agreed with this core principle. However, the PCFRC does believe that all leases of twelve months or less be excluded from the capitalization requirement and be accounted for simply as rent expense as rental payments are incurred. Matters of disagreement with the FASB proposal that were discussed largely focused on accounting for contingent rent, the fact that the proposal does not address accounting for related-party leases (a matter of major concern for private companies), and that the proposal does not concurrently discuss lessor accounting. These matters will be further refined and discussed as the PCFRC finalizes its comment letter to the FASB on its lease accounting project.

The PCFRC has been particularly active in commenting to the FASB on FASB Interpretation (FIN) No. 48, *Accounting for Uncertainty in Income Taxes*. The PCFRC has been instrumental in getting the FASB to agree to delay the effective date of FIN 48 for private companies, having the FASB develop further guidance on applying FIN 48 by pass-through entities, and reducing the disclosure requirements for private companies. To that end, the PCFRC discussed proposed FASB Staff Position (FSP) No. FIN 48-d, *Application Guidance for Pass-through Entities and Tax-Exempt Not-for-Profit Entities and Disclosure Modifications for Nonpublic Entities*. The PCFRC was generally supportive of FSP No. FIN 48-d, although the comment letter being drafted to the FASB on the proposal is expected to encourage the FASB to define the term "income tax".

The FASB continues to redeliberate its proposed FSP on going concern. The PCFRC is pleased the FASB expects to conclude that the time period to consider whether an entity is a going concern is not a bright line, nor is the time period to be indefinite. Also, the FASB is expected to define the term "going concern" and provide guidance on when an entity should adopt the liquidation basis of accounting.

The PCFRC continues to draft its comment letter to the FASB on its revenue recognition proposal. During its discussion of its draft letter, the PCFRC is generally concerned the FASB has not sufficiently applied real-world examples to the revenue recognition model being developed by the FASB. Further, a number of the PCFRC members want the FASB to retain the principles of accounting contained in AICPA Statement of Position 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*, for construction contractors. They are concerned that the FASB's reliance on contract terms for revenue recognition determination may result in contract manipulation or diversity in practice, or both.

As to other matters, the FASB has announced the addition of another staff member to work with the PCFRC to develop and better understand the effects the FASB standard-setting process has on private companies. Assigning two FASB staff members to this activity seems to demonstrate the FASB's concern about the effects its decisions have on private companies. A FASB staff member gave a brief demonstration on the use of the FASB's Codification, which went fully active on July 1, 2009, and will be effective for interim and annual periods ending after September 15, 2009. The PCFRC is concerned that a vast majority of private companies and their independent accountants are not aware that the Codification is now the sole source of authoritative generally accepted accounting principles in the United States. The members of the PCFRC will endeavor to increase awareness of the Codification as each opportunity presents itself.

The next meeting of the PCFRC is tentatively scheduled for early August 2009.

## Financial Institutions

### Amendments to Part 363 of FDIC Regulations

The Federal Deposit Insurance Corporation (FDIC) has amended Part 363 of its regulations, which sets forth annual independent audit and reporting requirements for insured institutions with \$500 million or more in total assets. Among other provisions, these amendments:

- Require an institution's management and the independent public accountant to identify the internal control framework used to evaluate internal control over financial reporting and disclose all identified material weaknesses that have not been remediated prior to the institution's most recent fiscal year-end;
- Require management's assessment of compliance with the laws and regulations pertaining to insider loans and dividend restrictions to state management's conclusion regarding compliance and disclose any noncompliance with such laws and regulations;
- Clarify that auditors of institutions subject to Part 363 should continue to comply with all of the independence standards applicable to both nonpublic and public institutions that are established by the American Institute of Certified Public Accountants, the SEC, and the Public Company Accounting Oversight Board;
- Require certain communications by independent public accountants to audit committees;
- Establish a uniform seven-year retention requirement for audit documentation;
- Extend the time period for a non-public institution to file its Part 363 Annual Report by 30 days;
- Specify that the duties of the audit committee include the appointment, compensation, and oversight of the independent public accountant, including ensuring that audit engagement letters do not contain unsafe and unsound limitation of liability provisions;
- Require boards of directors to develop and apply written criteria for evaluating audit committee members' independence (effective December 31, 2009); and
- Require the total assets of a holding company's insured depository institution subsidiaries to comprise 75 percent or more of the holding company's consolidated total assets in order for an institution to be eligible to comply with Part 363 at the holding company level (effective for fiscal years ending on or after June 15, 2010).

Except as noted above, the amendments are effective 30 days after publication in the Federal Register. Part 363 Annual Reports with a filing deadline on or after the effective date of these amendments should be prepared in accordance with the final rule. The amendments are available in full at <http://www.fdic.gov/news/board/june2309no10.pdf>.

## Public Sector

### OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans

The Governmental Accounting Standards Board (GASB) has issued an Exposure Draft of a proposed Statement, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*. If finalized, the proposed Statement would amend GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, to permit an agent employer that has an individual-employer OPEB plan with fewer than 100 total plan members to use the alternative measurement method, at its option, regardless of the number of total plan members in the agent multiple-employer OPEB plan in which it participates. Consistent with the proposed change to the employer-reporting requirements, the proposed Statement also would amend the requirement of Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, that a defined benefit OPEB plan obtain an actuarial valuation. The proposed amendment would permit the requirement to be satisfied for an agent multiple-employer OPEB plan by reporting an aggregation of results of actuarial valuations of the individual-employer OPEB plans or measurements resulting from use of the alternative measurement method for individual-employer OPEB plans that are eligible. In addition, the proposed Statement clarifies that when actuarially determined OPEB measures are reported by an agent multiple-employer OPEB plan and its participating employers, those measures should be determined as of a common date and at a minimum frequency to satisfy the agent multiple-employer OPEB plan's financial reporting requirements.

If finalized, the provisions of the proposed Statement would be effective for actuarial valuations first reported in OPEB plan or employer financial statements for periods beginning after June 15, 2010.

The Exposure Draft is available for comment until August 28, 2009 at [http://www.gasb.org/exp/ed\\_opeb.pdf](http://www.gasb.org/exp/ed_opeb.pdf).

### Proposed Statement on Financial Instruments

The Governmental Accounting Standards Board has issued an Exposure Draft (ED) of a proposed Statement, *Financial Instruments Omnibus*. If finalized, the proposed Statement would revise the following existing standards regarding financial reporting and disclosure requirements of certain financial instruments and external investment pools for which significant issues have been identified in practice:

- Statements No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, and No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, would be amended to remove the fair value exemption for unallocated insurance contracts such that unallocated insurance contracts would be measured at fair value instead of contract value.
- Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, would be amended to indicate that a 2a7-like pool, as described in Statement No. 31, is an external investment pool that is not registered with the SEC as an investment company but that operates in a manner compliant with the SEC's Rule 2a7.
- Statement No. 40, *Deposit and Investment Risk Disclosures*, would be amended to indicate that interest rate risk information should be disclosed only for *bond* mutual funds that do not meet the requirements of a 2a7-like pool.

- Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, would be amended to:
  - Clarify that the net settlement characteristic of Statement No. 53 that defines a derivative instrument would not be satisfied by a contract provision for a penalty payment for nonperformance.
  - Provide that certain financial guarantees would no longer be exempted from the scope of Statement No. 53. The effect of this amendment is that certain financial guarantees, and specifically certain credit default swaps, would be measured at fair value.
  - Clarify that certain contracts based on a specific volume of sales or service revenues would be excluded from the scope of Statement No. 53.
  - Provide that the “leveraged yield” criteria of Statement No. 53 would be met if the initial rate of return on the companion instrument has the *potential* for at least a doubled yield.

If finalized, the proposed Statement would be effective for financial statements for periods beginning after June 15, 2010.

The ED is available for comment until October 30, 2009 at [http://www.gasb.org/exp/ed\\_fio.pdf](http://www.gasb.org/exp/ed_fio.pdf).

### Proposed Accounting and Financial Reporting for Chapter 9 Bankruptcies

At present, there is no authoritative accounting or financial reporting guidance for governments filing for bankruptcy. Therefore, the Governmental Accounting Standards Board has issued an Exposure Draft of a proposed Statement, *Accounting and Financial Reporting for Chapter 9 Bankruptcies*. If finalized, the proposed Statement would provide guidance for state and local governments that have petitioned for protection from creditors by filing for bankruptcy under Chapter 9 of the United States Bankruptcy Code. It would establish requirements for recognizing and measuring the effects of the bankruptcy process on assets and liabilities, and for classifying changes in those items and related costs.

Specifically, the proposed Statement would require governments to remeasure liabilities that are adjusted in bankruptcy when the bankruptcy court confirms a new payment plan. For accounts payable, notes, debentures and bonds, and related interest payable, the proposed Statement would require governments to base remeasurement on the new payment plan. Reductions in future interest payments would result in lower interest costs reported in future periods. Reductions to principal or to accrued interest payable may result in gains reported at the time of the reduction. If the new payment plan does not indicate whether it reduces principal payments or future interest payments that have not been accrued, the debt would be remeasured at the present value of the future payments using the original discount rate, and a gain would be reported at the time of the reduction.

For leases, pollution remediation liabilities, and liabilities for pension and other postemployment benefit plans, the Statement would require remeasurement based on existing authoritative guidance. However, if a benefit plan is rejected in bankruptcy and becomes general unsecured debt, the proposed Statement would require the existing liability to be removed and a new approved payment plan to be recognized as a judgment, with a gain or loss recognized for the difference.

For governments that are not expected to emerge from bankruptcy as going concerns, the proposed Statement would require remeasurement of assets to a value that represents the amount expected to be received. The proposed Statement would classify gains resulting from remeasurement of liabilities and assets as extraordinary items.

Under the proposed Statement, governments that have filed for bankruptcy would be required to disclose information regarding, among other things, the pertinent conditions and events giving rise to the petition for bankruptcy, the effects upon services, and the expected outcomes.

If finalized, the proposed Statement would be effective for reporting periods beginning after June 15, 2009. The Exposure Draft is available for comment until August 28, 2009 at [http://www.gasb.org/exp/ed\\_chapter9\\_bankruptcies.pdf](http://www.gasb.org/exp/ed_chapter9_bankruptcies.pdf).

### **Proposed Accounting for Service Concession Arrangements**

A service concession arrangement (SCA) is an arrangement between a government (the transferor) and an operator in which (a) the transferor conveys to an operator the right and related obligation to provide services through the use of infrastructure or another public asset (a facility), and (b) the operator collects fees from third parties. An example of an SCA is a long-term arrangement associated with toll roads. To establish accounting and financial reporting requirements for these types of partnership arrangements between governments and private entities and between multiple governmental entities, the Governmental Accounting Standards Board recently issued an Exposure Draft (ED) of a proposed Statement, *Accounting and Financial Reporting for Service Concession Arrangements*.

The primary issue addressed by the ED is determining whether the transferor should report the facility subject to an SCA as its capital asset. If finalized, the proposed Statement would apply specific criteria to determine whether a transferor has control over the facility. If the transferor meets all control criteria, it would report the facility as its capital asset, subject to existing guidance for capital assets. Existing facilities would be reported at their current carrying amount; new or improved facilities would be reported at fair value along with a corresponding liability that would be amortized in a systematic and rational manner over the term of the arrangement.

If the transferor does not meet the service-related control criteria, it would derecognize any existing facility and report only a residual interest in the facility. The amount of the residual interest in an existing facility would be determined based on its carrying amount, but the amount of the residual interest in a new or improved facility would be determined based on its fair value. If the SCA requires the operator to provide the transferor with up-front or installment payments, the transferor would consider these payments in determining the gain or loss on derecognition of the facility.

The proposed Statement also provides guidance for governments that are operators in an SCA. The governmental operator would report an intangible asset at cost for its right to access the facility and collect third-party fees; it would amortize the intangible asset over the term of the arrangement in a systematic and rational manner. For existing facilities, a governmental operator's cost may be the amount of an up-front payment. For new or improved facilities, a governmental operator's cost may be its cost of improving an existing facility or constructing or acquiring a new facility.

The proposed Statement would require disclosures about an SCA, including a general description of the arrangement and information about the associated assets and liabilities, the rights granted and retained, and guarantees and commitments.

If finalized, the proposed Statement would be effective for financial statements for periods beginning after June 15, 2011. The proposed Statement generally would be required to be applied retroactively for all periods presented.

### **Proposed Guidelines for Voluntary Reporting of SEA Performance Information**

An important component of public sector financial reporting is information about service efforts and accomplishments (SEA). Such information provides insight into how effectively and efficiently state and local

governments utilize resources to achieve their missions on behalf of their citizens. Recently the Governmental Accounting Standards Board issued *Proposed Suggested Guidelines for Voluntary Reporting - SEA Performance Information* to provide state and local governments with suggested guidelines for voluntary reporting of SEA performance information to users. The suggested guidelines are intended to provide a common framework for the effective external communication of SEA performance information that will (a) assist users in assessing governmental accountability and making economic, social, and political decisions and (b) assist governments in demonstrating their accountability and stewardship over public resources.

The proposed suggested guidelines for voluntary SEA reporting are composed of:

- The four essential components of an effective SEA report:
  - Purpose and scope;
  - Major goals and objectives;
  - Key measures of SEA performance; and
  - Discussion and analysis of results and challenges;
- The six qualitative characteristics representing the attributes SEA performance information needs to possess as set forth in Concepts Statement No. 1, *Objectives of Financial Reporting*:
  - Relevance;
  - Understandability;
  - Comparability;
  - Timeliness;
  - Consistency; and
  - Reliability; and
- A discussion of how to effectively communicate SEA performance information.

The proposed suggested guidelines are available for comment until October 30, 2009 at [http://www.gasb.org/exp/SEA\\_Proposal.pdf](http://www.gasb.org/exp/SEA_Proposal.pdf).

## International

### Provisions and Contingent Liabilities: IFRS vs. U.S. GAAP

*This article is the twenty-third 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 provisions and contingent liabilities. Actual differences in the accounting treatment between the two frameworks depend on specific circumstances.*

The general IFRS literature regarding provisions and contingent liabilities is International Accounting Standard (IAS) 37, *Provisions, Contingent Liabilities and Contingent Assets*, and a few IFRIC Interpretations that specifically deal with decommissioning liabilities. U.S. GAAP includes various standards that cover specific topics. Some general guidance can be found in FASB Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*, and Concepts Statement No. 6, *Elements of Financial Statements*. Other specific U.S. GAAP literature includes FASB Statement No. 5, *Accounting for Contingencies* (FASB ASC 450), FASB Statement

No. 143, *Accounting for Asset Retirement Obligations* (FASB ASC 410-20), FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss* (FASB ASC 450-20), and many others.

IAS 37 states that one of the criteria for a provision to be recognized is when it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation. "Probable" is defined as "more likely than not" (say a 50% threshold). Also U.S. GAAP has "probable" as a recognition threshold. However, probable is generally interpreted as "likely to occur," and generally is considered to be a higher threshold than "more likely than not." As a result, it is generally understood that U.S. GAAP has a higher recognition threshold than IFRS.

In terms of measurement, IAS 37 talks about "best estimate," which should be the amount that an entity would rationally pay to settle the obligation at the end of the reporting period or to transfer it to a third party at that time. IAS 37 states that uncertainties surrounding the amount to be recognized as a provision are dealt with by various means according to the circumstances, and in particular, where the provision being measured involves a large population of items, the obligation is estimated by weighting all possible outcomes by their associated probabilities. This method of estimation is known as "expected value". The "settle" vs. "transfer" features, combined with some ambiguity surrounding the meaning of "best estimate" vs. "expected value" has generated some divergence in practice over the years. That is why the IASB currently is undertaking a project on "liabilities" which, among other goals, will attempt to clarify the measurement attribute of IAS 37. U.S. GAAP generally refers to "the most likely outcome", which, depending on specific standards dealing with specific facts and circumstances, might end up being fair value or expected value or the minimum amount in the range of possible outcomes, *etc.*

In terms of disclosures, IAS 37, in extremely rare cases, allows entities not to disclose the information in detail if this is expected to seriously prejudice the position of the entity in a dispute with other parties on the subject matter of the provision, contingent liability, or contingent asset. Instead, the entity must disclose the general nature of the dispute, together with the fact that, and reason why, the information has not been disclosed. U.S. GAAP does not contain a similar provision.

There are other differences between IFRS and U.S. GAAP. Moreover, as mention earlier, the IASB is working on a new "liability" project that is expected to result in important amendments by the end of 2009. This project has important interactions with other projects, particularly revenue recognition, leasing, insurance, and the conceptual framework, and will have a significant impact on existing IFRS literature.

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