

September 8, 2009

Accounting

Accounting Standards Update

Effective July 1, 2009, changes to the *FASB Accounting Standards Codification* will be communicated through Accounting Standards Updates (ASUs). The updates will be published for all authoritative U.S. generally accepted accounting principles promulgated by the Financial Accounting Standards Board, regardless of the form in which such guidance may have been issued prior to release of the FASB Codification (*e.g.*, FASB Statements, EITF Abstracts, FASB Staff Positions, *etc.*). ASUs also will be issued for amendments to the SEC content in the FASB Codification as well as for editorial changes.

An ASU is a document that summarizes the key provisions of the project that led to the ASU, details the specific amendments to the FASB Codification, and explains the basis for the FASB's decisions. Although ASUs will update the FASB Codification, the FASB does not consider ASUs as authoritative in their own right. Prior to the release of the FASB Codification, the FASB amended pre-Codification standards and issued them in an "as amended" form. The FASB will not amend ASUs; it will only amend the FASB Codification.

To date, the FASB has issued the following ASUs:

- ASU No. 2009-01, *Topic 105 – Generally Accepted Accounting Principles - amendments based on Statement of Financial Accounting Standards No. 168, The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles*. This ASU reflected the issuance of FASB Statement No. 168.
- ASU No. 2009-02, *Omnibus Update—Amendments to Various Topics for Technical Corrections*. This omnibus ASU detailed amendments to various topics for technical corrections.
- ASU No. 2009-03, *SEC Update – Amendments to Various Topics Containing SEC Staff Accounting Bulletins*. This ASU updated cross-references to Codification text.
- ASU No. 2009-04, *Accounting for Redeemable Equity Instruments – Amendment to Section 480-10-S99*. This ASU represents an update to Section 480-10-S99, *Distinguishing Liabilities from Equity*, per Emerging Issues Task Force Topic D-98, "Classification and Measurement of Redeemable Securities."
- ASU No. 2009-05, *Fair Value Measurements and Disclosures (Topic 820) - Measuring Liabilities at Fair Value*. This ASU is discussed in the following article.

The above ASUs are available in full at

<http://www.fasb.org/cs/ContentServer?c=Page&pagename=FASB%2FPage%2FSectionPage&cid=1176156316498>

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Guidance on the Fair Value Measurement of Liabilities

FASB Statement No. 157, *Fair Value Measurements*, (FASB ASC 820) defines the fair value of a liability as the price that would be paid to transfer the liability in an orderly transaction between market participants at the measurement date. Some entities have expressed concern that there may be a lack of observable market information to determine the fair value of a liability. In many cases, an entity would extinguish a liability by settling the obligation directly with the counterparty rather than by paying another entity to assume the existing obligation. In the limited circumstances when an existing liability may be transferred to a new obligor, the transferee may not have the same nonperformance risk as the transferor. Furthermore, some entities question how to measure the fair value of a liability in a hypothetical transaction when a restriction prevents such a transfer. In addition, questions have arisen about whether prices of debt instruments traded as assets represent the fair value of that instrument for the issuer. Because of these issues, the Financial Accounting Standards Board has issued Accounting Standards Update (ASU) No. 2009-05, *Fair Value Measurements and Disclosures (Topic 820) - Measuring Liabilities at Fair Value*.

This ASU amends FASB ASC 820-10, *Fair Value Measurements and Disclosures*, to provide guidance on the fair value measurement of liabilities within the scope of Topic 820. The ASU states that if a quoted price in an active market for the identical liability is available, it represents a Level 1 fair value measurement. In circumstances in which a quoted price in an active market for the identical liability is not available, a reporting entity must measure fair value using one or more of the following techniques:

- A valuation technique that uses the quoted price of the identical liability when traded as an asset
- A valuation technique that uses the quoted price for similar liabilities or similar liabilities when traded as assets
- Another valuation technique that is consistent with the principles of Topic 820, such as an income approach or a market approach

In all instances, the reporting entity must maximize the use of relevant observable inputs and minimize the use of unobservable inputs. When estimating the fair value of a liability using the quoted price of the identical liability when traded as an asset, the reporting entity must not adjust the quoted price of the asset for the effect of a restriction preventing its sale. However, the quoted price of the liability when traded as an asset must be adjusted for factors specific to the asset that are not applicable to the fair value measurement of the liability. When estimating the fair value of a liability, a reporting entity must not include a separate input or adjustment to other inputs relating to the existence of a restriction that prevents the transfer of the liability.

The quoted price of the identical liability when traded as an asset in an active market when no adjustments to the quoted price of the asset are required is a Level 1 measurement. However, a reporting entity needs to determine whether the quoted price for the identical liability when traded as an asset in an active market should be adjusted for factors specific to the asset and the liability. Any adjustment to the quoted price of the asset renders the fair value measurement of the liability a lower level measurement.

ASU 2009-05 is effective for the first reporting period (including interim periods) beginning after August 28, 2009. The ASU is available in full at <http://www.fasb.org>.

Financial Institutions

MD&A Disclosures Related to the Allowance for Loan Losses

While generally accepted accounting principles regarding how to account for the provision and allowance for loan losses have not changed in recent years, the SEC believes that the current economic environment may require re-

evaluation of the related disclosures in Management's Discussion and Analysis (MD&A). Therefore, in August 2009, the SEC's Division of Corporation Finance sent a letter to certain public companies identifying a number of issues they may wish to consider in preparing MD&A disclosures related to the provision and allowance for loan losses. A summary of some of the disclosure suggestions is as follows:

- Disclose additional information about higher-risk loans (*e.g.*, option ARM products, junior lien mortgages, high loan-to-value ratio mortgages, interest only loans, subprime loans, and loans with initial teaser rates) that may be useful to an understanding of the risks associated with the loan portfolio and to evaluating any known trends or uncertainties that could have a material impact on results of operations.
- If there have been changes in the practices followed to determine the allowance for loan losses, discuss why the change was made and, to the extent possible, quantify the effect of those changes. Also, consider disclosing and discussing changes in:
 - The historical loss data used as a starting point for estimating current losses;
 - How economic factors affecting loan quality were incorporated into the allowance estimate;
 - The level of specificity used to group loans for purposes of estimating losses;
 - Non-accrual and charge-off policies;
 - Application of loss factors to graded loans; and
 - Any other estimation methods and assumptions used.
- Because a decline in the value of assets serving as collateral for loans may impact the ability to collect on those loans, consider disclosing (a) the approximate amount (or percentage) of residential mortgage loans as of the end of the reporting period with loan-to-value ratios above 100%; (b) how the housing price depreciation and the homeowners' loss of equity in the collateral is taken into consideration in the allowance for loan losses for residential mortgages; and (c) the timing and frequency of appraisals and identify the sources of those appraisals for collateral-dependent loans.
- To the extent relevant and material, consider whether investors would benefit from disclosure regarding (a) any risk mitigation transactions used to reduce credit risk exposure; (b) the reasons why key ratios changed from period to period, and how this information and other relevant credit statistics were considered in determining whether the allowance for loan losses was appropriate; and (c) how the accounting for an acquisition or for loans acquired in a transfer affects trends in the allowance for loan losses.

For more details about these suggested disclosures, see the sample letter at <http://www.sec.gov/divisions/corpfin/guidance/loanlossesltr0809.htm>.

Enhanced Supervisory Procedures for Newly Insured Financial Institutions

Under current policy, newly FDIC-insured financial institutions are subject to higher capital requirements and more frequent examination activities during the first three years of operation.

Recent experience has demonstrated that newly insured institutions pose an elevated risk to the FDIC Deposit Insurance Fund, particularly during an economic downturn. Depository institutions insured less than seven years are over-represented on the list of institutions that failed during 2008 and 2009, with many of those failures occurring during the fourth through seventh years of operation. To address the heightened risks presented by newly insured depository institutions, the FDIC will now extend its procedures for these *de novo* institutions from the current three-year period to seven years for examinations, capital, and other requirements.

Per Financial Institution Letter FIL-50-2009, the FDIC is revising the visitation and examination schedules for risk management and Compliance examinations and the Community Reinvestment Act (CRA) evaluations for newly insured FDIC-supervised institutions. Specifically, for risk management, newly insured state nonmember institutions will undergo a limited-scope examination within the first six months of operation and a full-scope examination within the first 12 months of operation. Subsequent to the first examination and through the seventh year of operation, the institution will remain on a 12-month examination cycle. Extended examination intervals (*i.e.*, 18-month intervals) will not be applied during the first seven years of operation.

For Compliance, newly chartered and insured institutions will undergo a full-scope Compliance examination and CRA evaluation within the first 12 months of operation. A visitation will occur in the second year, a Compliance-only examination in the third year, a visitation in the fourth year, and a Compliance examination and CRA evaluation in the fifth year. Thereafter, the institution may be subject to the regular examination schedule.

Some newly organized institutions have pursued changes in approved business plans during the first few years of operation. In certain cases, those changes led to increased risk and financial problems where accompanying controls and risk management practices were inadequate. Per FIL-50-2009, the FDIC will evaluate proposed material changes to business plans during the *de novo* period to determine if the institution has sufficient capital, management expertise, and internal controls in place to adequately manage the risks. Also, before the end of the third year of operation, newly insured FDIC-supervised institutions will be required to submit updated financial statements and business plans for years four through seven. Required submissions will include a strategic plan (highlighting plans for capital maintenance/dividend payments, establishment of branches, determining product offerings, and other strategies that may alter the institution's risk profile) and pro forma financial statements.

De novo institutions that are subsidiaries of existing eligible holding companies will generally be excluded from the requirements of FIL-50-2009. The FIL is available in full at <http://www.fdic.gov/news/news/financial/2009/fil09050.html>.

International

Proposals to Amend the Discount Rate for Measuring Employee Benefits

International Accounting Standard (IAS) 19, *Employee Benefits*, requires an entity to determine the rate used to discount employee benefits with reference to market yields on high-quality corporate bonds. However, when there is no deep market in corporate bonds, an entity is required to use market yields on government bonds instead. The global financial crisis has led to a widening of the spread between yields on corporate bonds and yields on government bonds. As a result, entities with similar employee benefit obligations may report them at very different amounts.

To address this issue, the International Accounting Standards Board (IASB) has published proposals to amend the discount rate for measuring employee benefits. If finalized, the proposals would eliminate the requirement to use yields on government bonds. Instead, entities would estimate the yield on high-quality corporate bonds. If adopted, the amendments would ensure that the comparability of financial statements is maintained across jurisdictions, regardless of whether there is a deep market for high-quality corporate bonds.

The IASB also agreed that additional guidance should be provided on how to estimate a high-quality corporate bond rate. This would draw on the principles being developed in the Fair Value Measurement project but, until that project is finalized and a standard is issued, no cross-references would be used. Instead, the current guidance in paragraphs AG69 – AG82 of IAS 39, *Financial Instruments: Recognition and Measurement*, would be referenced and is applicable until replaced and/or revised.

If finalized, the amendments to IAS 19 would be permitted to be used in December 2009 financial statements. The Exposure Draft, *Discount Rate for Employee Benefits - proposed amendments to IAS 19*, is available for comment until September 30, 2009 at <http://www.iasb.org/NR/ronlyres/25D72699-B629-44EC-841C-2F02A1FBDBE5/0/EDProposedAmendmentsIAS19DiscountRates.pdf>.

Proposed Amendments to 11 IFRS

Under its annual improvements project the International Accounting Standards Board (IASB) discusses and decides on proposed improvements to International Financial Reporting Standards (IFRS) as they arise each year, and an omnibus Exposure Draft of the collected proposals is published for public comment. The improvements focus on areas of inconsistency in IFRS or where clarification of wording is required. The proposals in this year's Exposure Draft address certain matters within eleven IFRS as follows:

- IFRS 1, *First-time Adoption of International Financial Reporting Standards* - accounting policy changes in the year of adoption, and revaluation basis as deemed cost
- IFRS 3, *Business Combinations* - transition requirements for contingent consideration from a business combination that occurred before the effective date of the revised IFRS; measurement of non-controlling interests; and un-replaced and voluntarily replaced share-based payment awards
- IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations* - application of IFRS 5 to loss of significant influence over an associate or a jointly controlled entity
- IFRS 7, *Financial Instruments: Disclosures* - clarifications of disclosures
- International Accounting Standard (IAS) 1, *Presentation of Financial Statements* - clarification of statement of changes in equity
- IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors* - change in terminology to the qualitative characteristics
- IAS 27, *Consolidated and Separate Financial Statements* - impairment of investments in associates in the separate financial statements of the investor, and transition requirements for amendments made as a result of IAS 27 (as amended in 2008) to IAS 21, *The Effects of Foreign Exchange Rates*; IAS 28, *Investments in Associates*; and IAS 31, *Interests in Joint Ventures*
- IAS 28, *Investments in Associates* - partial use of fair value for measurement of associates
- IAS 34, *Interim Financial Reporting* - significant events and transactions
- IAS 40, *Investment Property* - change from fair value model to cost model
- IFRIC 13, *Customer Loyalty Programmes* - fair value of award credit

Unless otherwise specified, the proposed effective date for the amendments is generally for annual periods beginning on or after January 1, 2011, although entities would be permitted to adopt them earlier. The proposed effective date for the amendments arising from IFRS 3 and the consequential amendments to the transition requirements of IAS 27 is July 1, 2010.

The Exposure Draft, *Improvements to IFRSs*, is available for comment until November 24, 2009 at <http://www.iasb.org/NR/ronlyres/BA0DC098-9956-49A3-990E-2573AE1ACF21/0/EDImprovementsFRS09.pdf>.

Non-current Assets Held for Sale and Discontinued Operations: IFRS vs. U.S. GAAP

This article is the twenty-seventh 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 non-current assets held for sale and discontinued operations. Actual differences in the accounting treatment between the two frameworks depend on specific circumstances.

The IFRS standard dealing with non-current assets held for sale and discontinued operations is IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations*. Under U.S. GAAP, FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* (FASB ASC 360-10), addresses the classification, measurement, and presentation of assets held for sale, and the classification and presentation of discontinued operations. When it was issued in 2004, IFRS 5 achieved substantial convergence with the requirements of FASB Statement No. 144 relating to assets held for sale, the timing of the classification of operations as discontinued, and the presentation of such operations.

The only substantial remaining difference between IFRS 5 and the related topics covered by Statement No. 144 is the definition of discontinued operations. In 2008, the Financial Accounting Standards Board and the International Accounting Standards Board each issued an Exposure Draft to amend their standards to achieve a converged definition of discontinued operations. The final amendments are expected to be published by the end of 2009.

It should be noted that Statement No. 144 addresses an additional topic - the impairment of long-lived assets to be held and used. This topic is addressed in International Accounting Standard 36, *Impairment of Assets*. The extensive differences between IFRS and U.S. GAAP with respect to the impairment of long-lived assets to be held and used are discussed in our February article, [*Impairment of Non-financial Assets: IFRS vs. U.S. GAAP*](#).

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