

October 20, 2009

Accounting

Estimating the Fair Value of Certain Investments in Investment Companies

The Financial Accounting Standards Board (FASB) has issued Accounting Standards Update (ASU) No. 2009-12, *Fair Value Measurements and Disclosures (Topic 820) - Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*. This ASU amends FASB ASC 820 to provide guidance on using the net asset value per share provided by the investee to estimate the fair value of an alternative investment. The amendments in this ASU apply to an investment that is required or permitted to be measured or disclosed at fair value on a recurring or nonrecurring basis and, as of the reporting entity's measurement date, meets both of the following criteria:

- The investment does not have a readily determinable fair value; and
- The investment is in an entity that has all of the following attributes:
 - The entity's primary business activity involves investing its assets, usually in the securities of other entities not under common management, for current income, appreciation, or both.
 - Ownership in the entity is represented by units of investments, such as shares of stock or partnership interests, to which proportionate shares of net assets can be attributed.
 - The funds of the entity's owners are pooled to avail owners of professional investment management.
 - The entity is the primary reporting entity.

If one or more of the immediately preceding four attributes is not present, the amendments in the ASU will only apply if the investment is in an entity for which it is industry practice to issue financial statements using guidance that is consistent with the measurement principles in Topic 946, *Financial Services – Investment Companies*.

The ASU states that a reporting entity is permitted, as a practical expedient, to measure the fair value of an investment within the scope of the ASU on the basis of the net asset value per share of the investment (or its equivalent, for example, partners' capital per share for an investment in a partnership) if the net asset value of the investment (or its equivalent) is calculated in a manner consistent with the measurement principles in Topic 946 as of the reporting entity's measurement date. If an investment is within the scope of the ASU, for both recurring and nonrecurring measurements, the reporting entity is required to disclose certain information that enables users of its financial statements to understand the nature and risks of the investment.

Also, the ASU states that classification within the fair value hierarchy of a fair value measurement of an investment with the scope of this ASU that is measured at net asset value per share requires judgment considering many factors. Those factors, which may be of particular interest to employee benefit plans invested in collective investment funds, indicate that the fair value measurement of an investment within the scope of the ASU cannot be categorized as a Level 1 fair value measurement.

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The amendments in the ASU are effective for interim and annual periods ending after December 15, 2009. Early application is permitted. Also, if early application of the measurement provisions of this ASU is elected, the adoption of the disclosure provisions may be deferred to periods ending after December 15, 2009. ASU 2009-12 is available in full at www.fasb.org.

ASUs from September EITF Meeting

Beginning with the September 2009 Emerging Issues Task Force (EITF) meeting, consensuses will no longer be issued in the form of abstracts, but rather as Accounting Standards Updates (ASUs). At the September 23, 2009 meeting, the Financial Accounting Standards Board (FASB) ratified two consensuses reached by the EITF at its September meeting and approved the issuance of the following ASUs. The ASUs are available in full at <http://www.fasb.org>, and are effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption is permitted.

Multiple-Deliverable Revenue Arrangements

Vendors often provide multiple products or services to their customers, and those deliverables often are provided at different points in time or over different time periods. The objective of ASU 2009-13, *Revenue Recognition (Topic 605) - Multiple-Deliverable Revenue Arrangements - a consensus of the FASB Emerging Issues Task Force*, is to address the accounting for multiple-deliverable arrangements to enable vendors to account for products or services (deliverables) separately rather than as a combined unit. Subtopic 605-25, *Revenue Recognition - Multiple-Element Arrangements*, establishes the accounting and reporting guidance for arrangements under which the vendor will perform multiple revenue-generating activities. This ASU provides amendments to the criteria in Subtopic 605-25 for separating consideration in multiple-deliverable arrangements. As a result of those amendments, multiple-deliverable arrangements will be separated in more circumstances than under existing U.S. generally accepted accounting principles. The amendments in this ASU also:

- Establish a selling price hierarchy for determining the selling price of a deliverable. The selling price used for each deliverable will be based on vendor-specific objective evidence if available, third-party evidence if vendor-specific objective evidence is not available, or estimated selling price if neither vendor-specific objective evidence nor third-party evidence is available.
- Replace the term *fair value* in the revenue allocation guidance with *selling price* to clarify that the allocation of revenue is based on entity-specific assumptions rather than assumptions of a marketplace participant.
- Eliminate the residual method of allocation and require that arrangement consideration be allocated at the inception of the arrangement to all deliverables using the relative selling price method. The relative selling price method allocates any discount in the arrangement proportionally to each deliverable on the basis of each deliverable's selling price.
- Require that a vendor determine its best estimate of selling price in a manner that is consistent with that used to determine the price to sell the deliverable on a standalone basis.
- Significantly expand the disclosures related to a vendor's multiple-deliverable revenue arrangements.

Certain Revenue Arrangements That Include Software Elements

The objective of ASU 2009-14, *Software (Topic 985) - Certain Revenue Arrangements That Include Software Elements - a consensus of the FASB Emerging Issues Task Force*, is to address concerns raised by constituents relating to the accounting for revenue arrangements that contain tangible products and software. The amendments in this ASU change the accounting model for revenue arrangements that include both tangible products and software elements. Tangible products containing software components and nonsoftware components that function together to deliver the tangible product's essential functionality are no longer within the scope of the software

revenue guidance in Subtopic 985-605, *Software - Revenue Recognition* (formerly AICPA Statement of Position 97-2, *Software Revenue Recognition*). In addition, hardware components of a tangible product containing software components are always excluded from the software revenue guidance. If the software contained on the tangible product is essential to the tangible product's functionality, the software is excluded from the scope of the software revenue guidance. This exclusion includes essential software that is sold with or embedded within the product and undelivered software elements that relate to that tangible product's essential software.

The amendments in this ASU also provide guidance on how a vendor should allocate arrangement consideration to deliverables in an arrangement that includes both tangible products and software. Vendors that are affected by the amendments in this ASU are required to provide the disclosures that are included within ASU 2009-13.

Proposed ASUs from September EITF Meeting

Beginning with the September 2009 Emerging Issues Task Force (EITF) meeting, consensus-for-exposure will no longer be issued in the form of draft abstracts, but rather as proposed Accounting Standards Updates (ASUs). At the September 23, 2009 meeting, the Financial Accounting Standards Board (FASB) ratified three consensus-for-exposure reached by the EITF at its September meeting and approved the issuance of the following proposed ASUs for public comment. The proposed ASUs are available for comment until October 26, 2009 at <http://www.fasb.org>.

Proposed Revisions to Accounting for R&D Assets Acquired

As a result of the business combination amendments, research and development assets acquired in a business combination are now initially recognized and measured at fair value, while research and development assets acquired in an asset acquisition are recognized only if the assets have a future alternative use; otherwise the assets are expensed at the acquisition date. To address this inconsistency, the FASB issued a proposed ASU, *Research and Development (Topic 730) - Research and Development Assets Acquired and Contingent Consideration Issued in an Asset Acquisition (A Consensus of the FASB Emerging Issues Task Force)*. If finalized, the amendments in this proposed ASU would require all tangible and intangible research and development assets acquired in an asset acquisition to be capitalized regardless of whether those assets have a future alternative use. Acquired intangible research and development assets would be considered indefinite-lived assets until completion or abandonment of the related research and development activities. Once the research and development efforts are completed or abandoned, the entity would determine the useful life of the assets.

In addition, per the proposed ASU, any contingent consideration arrangements related to the acquisition of an asset or asset group (regardless of whether the asset group includes research and development assets) would continue to be accounted for in accordance with existing U.S. generally accepted accounting principles (GAAP) (e.g., Topic 815 (formerly FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*) or Topic 450 (formerly Statement No. 5, *Accounting for Contingencies*)). Where contingent consideration is recognized in accordance with existing authoritative guidance, such amount would be included in the initial measurement of the cost of the acquired assets. If the contingent consideration is not required to be initially accounted for, but subsequently the contingency is resolved and the consideration is paid or becomes payable, such amount would be included in the measurement of the cost of the acquired assets. However, if the contingent arrangement is a derivative, any changes in the carrying value of the derivative instrument after the inception of the arrangement would not be included in the cost of the acquired asset or group of assets.

If the proposed ASU is finalized, an entity would be required to disclose how contingent consideration in an asset acquisition will be accounted for when the contingent payment is made. This disclosure is in addition to disclosures currently required by other specific applicable U.S. GAAP, which may include the nature of the contingent payment arrangement, and an estimate of the possible contingent consideration or range of contingent consideration or a statement that such an estimate cannot be made.

If finalized, the amendments in this proposed ASU would be effective for acquisitions of assets occurring in fiscal years beginning on or after December 15, 2009. The amendments would be applied on a prospective basis to all acquisitions of assets occurring after the effective date. Early application would not be permitted.

Proposed Revisions to an Insurer's Accounting for Certain Majority-Owned Investments

The second proposed ASU issued by the FASB is *Financial Services - Insurance (Topic 944) - Consideration of an Insurer's Accounting for Majority-Owned Investments When Ownership Is through a Separate Account (A Consensus of the FASB Emerging Issues Task Force)*. This proposed ASU affects insurance entities that have separate accounts that meet the definition of an investment company under U.S. generally accepted accounting principles (GAAP) in their separate financial statements or would meet such a definition if they issued separate financial statements and are evaluating whether to consolidate a majority-owned voting-interest investment when that investment is held through its separate account or through a combination of investments in its separate and general accounts. The objective of the proposed ASU is to address questions about whether a life insurance entity is required to consolidate a majority-owned voting-interest investment when ownership is held through the insurer's separate account or through a combination of investments in the insurer's separate and general accounts.

If finalized, the proposed ASU would clarify that solely for the purpose of evaluating whether the retention of specialized accounting for investments in consolidation is appropriate, a separate account arrangement would be considered a subsidiary. Additionally, the proposed amendments would not require an insurer to consolidate a majority-owned voting-interest investment held by a separate account if the investment is not or would not be consolidated in the standalone financial statements of the separate account. Further, if finalized, the proposed amendments would clarify that the insurer is not required to combine its general account interest in an investment with any separate account interest in the same investment when assessing whether the insurer has a controlling interest in that investment for purposes of evaluating whether to consolidate that investment.

If finalized, the amendments in the proposed ASU would be effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2010. Early adoption would not be permitted. The amendments in the proposed ASU would be applied on a retrospective basis to all prior periods upon the date of adoption.

Proposed Revisions to Accounting for Stock Dividends and EPS

The first objective of the last proposed ASU, *Equity (Topic 505) and Earnings per Share (Topic 260) - Accounting for Stock Dividends, Including Distributions to Shareholders with Components of Stock and Cash (A Consensus of the FASB Emerging Issues Task Force)*, is to address the diversity in practice related to the accounting for a distribution to shareholders that offers them the ability to elect to receive their entire distribution in cash or stock of equivalent value with a limit on the amount of cash that will be distributed in total. Historically, some entities have accounted for the stock portion of the distribution as a new share issuance that is reflected in earnings per share (EPS) prospectively. Other entities have accounted for the stock portion of the distribution as a stock dividend by retroactively restating shares outstanding and EPS for all periods presented. If finalized, the amendments in the proposed ASU would clarify that the stock portion of a distribution to shareholders that allows them to elect to receive cash or stock with a limit on the amount of cash that will be distributed is a stock dividend, regardless of whether the actual stock distribution is proportionate to each individual shareholder. However, only the minimum portion that will be issued in shares (*i.e.*, the portion that cannot be issued in cash) would be accounted for as a stock dividend.

The second objective of this proposed ASU is to address the diversity in practice that exists on the timing of when entities have recognized a stock dividend distribution in EPS. Historically, some entities have reflected a stock dividend in EPS on the date the dividend is declared. Other entities have reflected a stock dividend in EPS when

the trading price of the shares has been adjusted to reflect the effects of the stock dividend or when the dividend is settled. If finalized, the proposed amendments for EPS would require that:

- The computation of diluted EPS should not include the stock portion of a distribution to shareholders that is accounted for as a stock dividend that has not yet been retroactively reflected in EPS.
- An entity should reflect a stock dividend in EPS in its financial statements on the later of the ex-dividend date or the date the number of shares to be issued is known. (This guidance would apply to all stock dividends and not just arrangements in which a shareholder has an election to receive distributions in the form of cash or stock with a limitation on the amount of cash that will be distributed.)
- An entity should disclose that EPS for all periods presented is subject to change if EPS has not yet been adjusted retroactively for all periods presented to reflect the stock dividend.
- An entity should disclose the number of shares that would be issued if the stock dividend occurred on the reporting date.

If finalized, the amendments in this proposed ASU would be effective for interim and annual periods ending on or after December 15, 2009, and would be applied on a retrospective basis.

SEC

SEC Delays SOX 404 Audit Requirement for Non-accelerated Filers, including Smaller Reporting Companies

The SEC has approved a six-month delay in the requirement for an audit of internal controls over financial reporting in accordance with Section 404(b) of the Sarbanes-Oxley Act (SOX) for non-accelerated filers (*i.e.*, generally those with a public float below \$75 million). With this extension, the auditor's attestation report on internal control over financial reporting will first be required when a non-accelerated filer files an annual report for a fiscal year ending on or after June 15, 2010. It should be noted that this six-month grace period does **not** relieve companies of the obligation to provide management's report on internal control over financial reporting for annual reports for fiscal years ending on or after December 15, 2007. Further, in the SEC's announcement, SEC Chairman Mary L. Schapiro stated, "Since there will be no further Commission extensions, it is important for all public companies and their auditors to act with deliberate speed to move toward full Section 404 compliance."

MD&A Disclosures for Impairment of Goodwill and Long-Lived Assets

With current market conditions, impairment remains an important issue for the SEC. The SEC believes registrants should give investors more insight into management's process of accounting for impairment of goodwill and long-lived assets. Registrants should consider the following matters when preparing Management's Discussion and Analysis (MD&A).

Goodwill Impairment

We understand that the SEC staff has issued several comment letters asking registrants for expanded disclosures regarding goodwill impairment. The SEC staff currently is developing guidance regarding goodwill impairment risk disclosures in MD&A. The purpose of the guidance will be to provide suggestions for how registrants can provide information that will give investors the opportunity to assess the likelihood of a material future goodwill impairment. Although SEC guidance is evolving, it is likely that the suggested disclosures will focus on reporting units with a significant risk of future material impairment (*i.e.*, it is reasonably likely that the reporting unit with a material amount of goodwill will fail a future "Step 1" impairment test under ASC 350, *Intangibles—Goodwill and Other*). Such disclosures are expected to help users of financial statements identify which reporting units with material amounts of goodwill are at risk of being impaired. The SEC's guidance likely will recommend that a registrant disclose in

MD&A the future implications to its business of the conditions that resulted in an impairment of goodwill, as well as meaningful information for investors about its critical accounting policies relating to goodwill impairment testing. It is likely that for each reporting unit with a material amount of goodwill that has a significant risk of impairment, the SEC will recommend that a registrant disclose the following in MD&A:

- The percentage by which the fair value of the reporting unit exceeds its carrying value at the date of the last impairment test;
- The amount of goodwill allocated to the reporting unit;
- A discussion of the nature of key assumptions that drive the fair value of the reporting unit (*i.e.*, the SEC staff encourages, but does not require, disclosure of the key numerical assumptions or a quantitative sensitivity analysis);
- Any uncertainties surrounding those key valuation assumptions; and
- Events that could have a negative effect on the fair value of the reporting unit.

If a registrant does not have any reporting units that are at significant risk of a future material goodwill impairment, it is likely that the SEC staff will recommend that the registrant disclose that fact in MD&A. It is expected that the SEC staff will communicate the guidance at the AICPA National Conference on Current SEC and PCAOB Developments in December and post the guidance on the SEC Web site.

Impairment of Long-lived Assets

Further, in a recent comment letter, the SEC asked a registrant that had been experiencing a significant shift in the nature of its business to disclose the following to provide investors with a better insight into management's judgments in accounting for long-lived assets:

- How the company groups long-lived assets for impairment and the company's basis for that determination;
- A description of the valuation methodology used;
- A description of the material assumptions used and a sensitivity analysis of those assumptions based upon reasonably likely changes; and
- How the assumptions and methodologies used for valuing long-lived assets in the current year have changed since the prior year, highlighting the impact of any changes.

International

Classification of Rights Issues

The International Accounting Standards Board has published *Classification of Rights Issues (Amendment to IAS 32)*. This Standard amends International Accounting Standard (IAS) 32, *Financial Instruments: Presentation*, to clarify the classification of instruments that give the holders the right to acquire an entity's own equity instruments at a fixed price (rights issue) when that price is stated in a currency other than the entity's functional currency. Previously, such rights issues (rights, options, or warrants) were accounted for in practice as derivative liabilities that were measured at fair value with changes in fair value recognized in earnings. The amendment specifies that rights, options, or warrants to acquire a fixed number of an entity's own equity instruments for a fixed amount of any currency are equity instruments regardless of the currency in which the exercise price is denominated if the entity offers the rights, options or warrants pro rata to all of its existing owners of the same class of its own non-derivative equity instruments. The amendment is intended to clarify the circumstances in which the currency the entity will receive on the issue of an instrument does not affect its classification as a liability or an equity instrument. The amendment is effective for annual periods beginning on or after February 1, 2010, with earlier application permitted.

Service Concession Arrangements: IFRS vs. U.S. GAAP

This article is the twenty-eighth 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 service concession arrangements. Actual differences in the accounting treatment between the two frameworks depend on specific circumstances.

Service concession arrangements generally are those contracts where a private sector entity (an operator) constructs the infrastructure used to provide a public service and/or operates and/or maintains it for a specified period of time. Typically the operator is obliged to return the infrastructure to the government (grantor) in a specified condition at the end of the period of the arrangement, for little or no incremental consideration, irrespective of which party initially financed it. An example of a service concession arrangement is a long-term arrangement associated with toll roads.

IFRIC 12, *Service Concession Arrangements*, provides guidance to IFRS preparers who engage in service concession arrangements. IFRIC 12 distinguishes concession arrangements between two macro categories – one in which the grantor gives the operator a financial asset (*i.e.*, the operator has an unconditional right to receive cash if the grantor contractually guarantees to pay the operator specified or determinable amounts), and the other in which the grantor gives the operator an intangible asset (*i.e.*, the operator does not have an unconditional right to receive cash because the amounts are contingent on the extent to which the public uses the service). Sometimes agreements can include a combination of both types of arrangements.

Depending on the above classification, the operator recognizes an “asset” following the requirements of International Accounting Standard (IAS) 39, *Financial Instruments: Recognition and Measurement*, or IAS 38, *Intangible Assets*. Contract revenues are recognized using the percentage of completion method under IAS 18, *Revenue*, or IAS 11, *Construction Contracts*. Preparers also are required to separate the various components included in the concession arrangement (*e.g.*, construction of the road, subsequent operating and maintenance of the road, periodic significant road resurfacing activities, *etc.*). Each component must be measured at fair value. Most importantly, it should be noted that the grantor does not recognize the tangible assets that it has been requested to build or operate under the concession arrangements.

Unlike IFRS, U.S. GAAP does not provide specific accounting guidance addressing concession arrangements, and accordingly, the general framework of revenue recognition must be considered as well as industry-specific guidance, if applicable, such as Accounting Research Bulletin No. 45 (As Amended), *Long-Term Construction-Type Contracts*, and SOP 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*, (FASB ASC 605-35) for construction accounting. Under U.S. GAAP, the issues that are addressed by IFRIC 12 (revenue recognition, *etc.*) must be resolved by navigating through various pronouncements. Applying U.S. GAAP may require significant preliminary analysis simply to understand which standards are applicable based on specific facts and circumstances.

Because of the differences in the ways IFRS and U.S. GAAP approach this subject, it is likely that different accounting answers result. Considering that the terms of concession arrangements can span for several decades, these differences can affect amounts recognized in financial statements for many years.

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