

# Insights

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## Accounting

### FASB Proposes Delay in Effective Date of FIN 48 for Certain Nonpublic Enterprises

The Financial Accounting Standards Board (FASB) recently issued proposed FASB Staff Position (FSP) No. FIN 48-c, *Effective Date of FASB Interpretation No. 48 for Certain Nonpublic Enterprises*. If finalized, this FSP would defer the effective date of FASB Interpretation (FIN) No. 48, *Accounting for Uncertainty in Income Taxes*, to the annual financial statements for fiscal years beginning after December 15, 2008, for certain nonpublic enterprises. The deferred effective date is intended to give the FASB additional time to amend the disclosure requirements of FIN 48 for nonpublic enterprises and to develop guidance on the application of FIN 48 by pass-through entities and not-for profit organizations.

If the proposed FSP is finalized, FIN 48 would be effective for nonpublic enterprises for annual periods beginning after December 15, 2008 if they have not yet issued a full set of U.S. GAAP annual financial statements incorporating the recognition, measurement, and disclosure requirements of FIN 48. The definition of "nonpublic enterprise" for this proposed deferral is the same as the definition in FASB Statement No. 109, *Accounting for Income Taxes*, which is: entities other than (a) those with debt or equity securities that trade in a public market, (b) those who are filing to register securities, and (c) conduit bond obligors for conduit debt securities that are traded in a public market. Nonpublic consolidated entities of public companies that apply U.S. GAAP will not be eligible for the deferral for their stand-alone financial statements. U.S. subsidiaries of a foreign public company that applies U.S. GAAP also would not be eligible for the deferral. However, a nonpublic company that is wholly- or majority-owned by a publicly traded company and that is included in the public company's consolidated financial statements at fair value (for example, a private company owned by a publicly traded private equity group) would be eligible for the deferral for its stand-alone financial statements.

The proposed FSP is available for comment until December 3, 2008, after which the FASB will make its final decision on whether to delay the effective date of FIN 48 for nonpublic enterprises. Since the delay is not "official" until the final vote by the FASB, any financial statements issued before then for periods that began after December 15, 2007 must include the adoption of FIN 48. If finalized, the FSP would be effective upon issuance. Once effective, FIN 48 should be applied, including its application to acquired income tax positions in FASB Statement No. 141 (revised 2007), *Business Combinations*, as of the beginning of the enterprise's fiscal year.

The proposed FSP is available in full at [http://www.fasb.org/fasb\\_staff\\_positions/prop\\_fsp\\_fin48-c.pdf](http://www.fasb.org/fasb_staff_positions/prop_fsp_fin48-c.pdf).

## PCFRC Meets

The Private Company Financial Reporting Committee (PCFRC) held its regularly scheduled meeting in New Orleans, Louisiana on November 13 and 14. No new initiatives or projects of the PCFRC were introduced at the meeting. Rather, the meeting was largely devoted to discussing the status of past initiatives and existing projects of the Financial Accounting Standards Board (FASB). Also, a portion of this meeting included the first joint meeting with the Technical Issues Committee (TIC) of the American Institute of Certified Public Accountants. TIC represents the interests of small to medium size accounting firms with respect to accounting and auditing matters. In connection with this representation, TIC usually submits comment letters on proposed accounting and auditing standards, and serves as a sounding board with respect to implementation concerns about newly issued standards on their constituency.

Largely as a result of the initiative of the PCFRC the FASB has again proposed delaying the effective date FASB Interpretation (FIN) No. 48, *Accounting for Uncertainty in Income Taxes*, for most nonpublic enterprises, including not-for-profit organizations. This proposal was issued in the form of a FASB Staff Position, FSP No. FIN 48-c *Effective Date of FASB Interpretation No. 48 for Certain Nonpublic Enterprises*, which is discussed in the preceding article. The PCFRC agreed to submit a comment letter to the FASB on the proposed FSP which will express appreciation to the FASB for its willingness to grant another one-year deferral for nonpublic entities during which time the FASB expects to issue implementation guidance for pass-through entities and not-for-profit organizations. The PCFRC agreed to reach out to its Resource Group seeking topics of concern about pass-through issues which will be included in the PCFRC's comment letter.

The PCFRC also discussed two proposed FASB Statements of Financial Accounting Standards, *Subsequent Events* and *Going Concern*. The PCFRC agreed to submit comment letters to the FASB on those proposed Statements. (Those proposed Statements were discussed in the October 28, 2008 issue of *Insights*.)

On other matters, the PCFRC agreed to monitor the effects of fair value accounting on nonpublic entities but did not see a current need to take on any new initiative on this topic at this time. Also, the PCFRC discussed the uncertainty that surrounds the timing with respect to the use of International Financial Reporting Standards (IFRS) by entities (both public and nonpublic) in the United States. However, certain PCFRC members expressed their belief that the proposed IFRS for Private Entities may appeal to smaller preparers because of lesser compliance costs (e.g., the frequency of impairment testing) which might also lead to reduced audit costs. Other members were not sure about this because of the learning costs that must be incurred by preparers and auditors in learning a new accounting basis and the uncertainty that users will accept financial statements prepared on a basis other than U.S. generally accepted accounting principles.

The portion of the joint meeting with TIC was devoted to discussing matters of mutual interest. TIC is also expected to submit a comment letter to the FASB on FSP No. FIN 48-c which will include examples of concern over the application of FIN 48 to pass-through and not-for-profit entities. Other topics discussed included the future of financial reporting by private companies and concerns over the cost/benefit of the application of FIN No. 46(R), *Consolidation of Variable Interest Entities (revised) - an interpretation of ARB No. 51*, to certain transactions.

The next meeting of the PCFRC is scheduled to be held in Norwalk, Connecticut on January 8 and 9, 2009. A portion of the meeting will be held jointly with the FASB.

## Financial Institutions

### Proper Reporting of Troubled Debt Restructurings

In today's economic environment, many debtors experience financial difficulties that result in debt restructuring. When a debtor is experiencing financial difficulties, it is important that loan officers be able to discern whether the ensuing debt restructuring is a "troubled debt restructuring." If loan officers can identify a restructuring as such, they are then able to inform the financial institution's accounting department so that the proper accounting for the transaction can be applied. Loan officers therefore should be trained as to which types of loan modifications result in a troubled debt restructuring and how to report them to the financial institution's accounting department. It is important that financial institutions have the proper procedures in place for the accounting for debt restructurings because troubled debt restructurings are accounted for differently than routine loan renewals in the normal course of business.

A troubled debt restructuring is a restructuring of debt in which the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider. That concession either stems from an agreement between the creditor and the debtor or is imposed by law or a court. For example, a creditor may restructure the terms of a debt to alleviate the burden of the debtor's near-term cash requirements, and many troubled debt restructurings involve modifying terms to reduce or defer cash payments required of the debtor in the near future to help the debtor attempt to improve its financial condition and eventually be able to pay the creditor. Or, for example, the creditor may accept cash, other assets, or an equity interest in the debtor in satisfaction of the debt though the value received is less than the amount of the debt because the creditor concludes that step will maximize recovery of its investment.

As shown in these examples, a troubled debt restructuring is often thought of as a restructuring in which a portion of the principal is forgiven or interest payments are eliminated for a period of time. A troubled debt restructuring, however, may include other modifications of the terms of a debt, such as an extension of the maturity date at a stated interest rate that is lower than the current market rate for new debt with similar risk. Therefore if the inherent risk of a loan has increased, renewal at the existing interest rate may be a troubled debt restructuring because that interest rate is below what a market participant would require in interest.

Financial institutions should implement appropriate internal control activities to identify and report troubled debt restructurings. For example, if the financial institution utilizes a loan renewal approval form, a "TDR Checklist" could be added to the loan renewal form. The "TDR Checklist" would list the various factors that should be considered when evaluating whether a loan renewal constitutes a troubled debt restructuring. A copy of the loan renewal form should then be submitted to the accounting department to ensure that troubled debt restructurings are properly reported in the financial statements. Financial institutions may also want to consider inviting a member of the accounting department to loan committee meetings in order to assist with the identification of troubled debt restructurings.

FASB Statement No. 15, *Accounting by Debtors and Creditors for Troubled Debt Restructurings*, establishes standards of financial accounting and reporting by the debtor and by the creditor for a troubled debt restructuring and provides examples of modifications of terms of debt that result in a troubled debt restructuring. A creditor in a troubled debt restructuring involving a modification of terms should account for the restructured loan in accordance with the provisions of FASB Statement No. 114, *Accounting by Creditors for Impairment of a Loan*.

## Going Concern Considerations for Financial Institutions

Several financial institutions have defaulted on their trust preferred securities payments this year – a phenomenon that has never happened before. And, on November 7, 2008, the nineteenth bank failure took place in the United States this year. These financial institutions don't always fail due to a lack of capital; they sometimes fail due to a lack of liquidity or a run on deposits. Therefore, in assessing whether a going concern assumption is appropriate, management of a financial institution must consider certain factors, such as the following, in addition to those assessed by a commercial entity:

- Being considered less than adequately capitalized by regulators
- Material unrealized losses on investment securities
- Large provisions for loan losses and/or charge-offs
- A large percentage of the institution's deposits being brokered deposits
- A large percentage of the institution's loans being construction and/or land development loans

If, after considering this and other information in the aggregate, management believes that there is substantial doubt about the institution's ability to continue as a going concern, management must consider its plans for dealing with the adverse effects of those conditions and events, whether those plans will mitigate the adverse effects, and whether those plans can be effectively implemented. When management is aware, in making its assessment, of material uncertainties about events or conditions that may cast substantial doubt upon the institution's ability to continue as a going concern, the financial statements should disclose those uncertainties and management's plans to mitigate the effects of the uncertainties, among other matters.

## Proposed Interagency Appraisal and Evaluation Guidelines

The federal bank, thrift, and credit union regulatory agencies recently jointly issued proposed *Interagency Appraisal and Evaluation Guidelines* that reaffirm supervisory expectations for sound real estate appraisal and evaluation practices. The proposed guidance clarifies risk management principles and internal controls for ensuring that financial institutions' real estate collateral valuations (both appraisals and evaluations) are reliable and support their real estate-related transactions. If finalized, the proposed guidance would replace the *1994 Interagency Appraisal and Evaluation Guidelines* to incorporate recent supervisory issuances and to reflect changes in industry practice, uniform appraisal standards, and available technologies. As with prior issuances, the proposed guidance would apply to all real estate lending functions within a federal financial institution, including commercial and residential lending departments, capital market groups, and asset securitization and sales units. The proposed guidance includes:

- An expanded discussion of portfolio management techniques and circumstances under which an institution should update or replace a collateral valuation for an existing real estate transaction.
- Additional detail on the agencies' expectations for an independent appraisal and evaluation function.
- Greater explanation of the agencies' minimum appraisal standards, including clarification of requirements for appraisals of residential tract developments.
- Revisions to the Uniform Standards of Professional Appraisal Practice, which are incorporated by reference in the agencies' appraisal regulations.

- Risk-focused appraisal and evaluation reviews separate and apart from an institution's compliance function.
- Further clarification on real estate transactions that are exempt from the agencies' appraisal regulations.
- Acceptable evaluation alternatives and use of automated valuation models.

The proposed guidance is available in full at <http://www.fdic.gov/news/news/press/2008/pr08117a.pdf>.

## SEC

### The SEC's Plan for IFRS

Currently, U.S. issuers use generally accepted accounting principles in their financial statements that are filed with the SEC. Approximately 113 countries around the world currently require or permit International Financial Reporting Standards (IFRS) reporting for domestic, listed companies.

Per the SEC, the increasing integration of the world's capital markets, together with U.S. investors' increasing ownership of securities issued by foreign companies, has made the establishment of a single set of high-quality accounting standards a matter of growing importance. As a result, the SEC recently voted to publish a proposed multi-year plan setting out several milestones that could lead to the use of IFRS by U.S. issuers beginning in 2014. The SEC will make a decision in 2011 on whether the adoption of IFRS is in the public interest.

The SEC's *Roadmap for the Potential Use of Financial Statements Prepared in Accordance with International Financial Reporting Standards by U.S. Issuers* is available in full at <http://www.sec.gov/rules/proposed/2008/33-8982.pdf>. Upon publication in the *Federal Register*, this proposal will be subject to a 90-day comment period.

### Hanson Is Panelist at SEC Roundtable on "Mark-to-Market" Accounting

On November 21, 2008, the SEC hosted the second of two roundtables on "mark-to-market" accounting and current market conditions. This roundtable, along with the previous roundtable hosted by the SEC on October 29, will provide input to the SEC as part of a Congressionally mandated study pursuant to the Emergency Economic Stabilization Act of 2008. Jay Hanson, National Director of Accounting for McGladrey & Pullen, LLP, was selected to be a panelist on the November 21 roundtable, which focused on potential improvements to the current accounting model and implications of possible changes. The panel included investors, accountants, regulators, business leaders, and other interested parties. Additionally, representatives from the U.S. Department of Treasury, Federal Reserve Board, Financial Accounting Standards Board, International Accounting Standards Board, and Public Company Accounting Oversight Board were present as observers.

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