Insights

July 25, 2007

A biweekly audit and accounting publication

Accounting

June EITF Developments

At its June 27, 2007 meeting, the Financial Accounting Standards Board (FASB) ratified the final consensuses for the following Issues reached at the June 14, 2007 Emerging Issues Task Force (EITF) meeting:

- *EITF Issue No. 06-11, "Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards"*

  This Issue applies to share-based payment arrangements with dividend protection features that entitle employees to receive (a) dividends on equity-classified nonvested shares, (b) dividend equivalents on equity-classified nonvested share units, or (c) payments equal to the dividends paid on the underlying shares while an equity-classified share option is outstanding, when those dividends or dividend equivalents are charged to retained earnings under FASB Statement No. 123 (revised 2004), Share-Based Payment, and result in an income tax deduction for the employer. A consensus was reached that a realized income tax benefit from dividends or dividend equivalents that are charged to retained earnings and are paid to employees for equity-classified nonvested equity shares, nonvested equity share units, and outstanding equity share options should be recognized as an increase in additional paid-in capital.

- *EITF Issue No. 07-3, "Accounting for Nonrefundable Advance Payments for Goods or Services Received for Use in Future Research and Development Activities"*

  In this Issue, a consensus was reached that nonrefundable advance payments for future research and development (R&D) activities should be deferred and capitalized. Such amounts should be recognized as an expense as the goods are delivered or the related services are performed. Entities should continue to evaluate whether they expect the goods to be delivered or services to be rendered; if an entity does not expect the goods to be delivered or services to be rendered, the capitalized advance payment should be charged to expense. It should be noted that this consensus does not apply to refundable advance payments for future R&D activities, and entities should not apply any consensus in this Issue by analogy to other types of advance payments.

These consensuses also provide guidance related to disclosures, transition and effective dates.

The FASB deferred to a future meeting whether to ratify a tentative conclusion reached by the EITF on Issue No. 07-1, "Accounting for Collaborative Arrangements". That Issue will be covered in a future Insights article when the FASB ratifies the tentative conclusion and it is exposed for public comment.

Also, at the June EITF meeting the SEC Observer announced that an amendment to EITF Topic No. D-98, "Classification and Measurement of Redeemable Securities," was made to conform to FASB Statement No. 159, The Fair Value Option for Financial Assets and Financial Liabilities. The amendment states that the SEC staff will no longer accept liability classification for financial instruments (or host contracts) that meet the conditions for temporary equity classification under Accounting Series Release (ASR) No. 268, Presentation in Financial Statements of

“Redeemable Preferred Stocks”, and Topic D-98. These financial instruments should be classified on the balance sheet between captions for liabilities and shareholder’s equity. As a consequence, the fair value option may not be applied to any financial instrument (or host contract) that meets the conditions for temporary equity classification under ASR 268 and Topic D-98. The measurement guidance in Topic D-98 applies to these financial instruments.

Minutes of the June 14, 2007 EITF meeting are available at http://www.fasb.org/eitf/06-14-07_mtg_minutes.pdf.

Public Sector

Accounting and Financial Reporting for Intangible Assets

The Governmental Accounting Standards Board (GASB) has issued GASB Statement No. 51, Accounting and Financial Reporting for Intangible Assets. This Statement describes an intangible asset as an asset that lacks physical substance, is nonfinancial in nature, and has an initial useful life extending beyond a single reporting period. Examples of intangible assets include easements, computer software, water rights, timber rights, patents, and trademarks.

The Statement provides guidance regarding how to identify, account for, and report intangible assets, including:

- Requiring that all intangible assets subject to its provisions be classified as capital assets. Accordingly, existing authoritative guidance related to the accounting and financial reporting for capital assets would be applied to these intangible assets, as applicable.
- Providing authoritative guidance that specifically addresses the unique nature of intangible assets, including:
    - Requiring that an intangible asset be recognized in the statement of net assets only if it is considered identifiable (i.e., separable);
    - Establishing a specified-conditions approach to recognizing intangible assets that are internally generated;
    - Providing guidance on recognizing internally generated computer software; and
    - Establishing guidance for the amortization of intangible assets.

Governments are required to implement Statement No. 51 for periods beginning after June 15, 2009. Early implementation is encouraged.

SEC

SEC Proposes to Expand Eligibility for Scaled Reporting by Smaller Companies

For purposes of scaled disclosure and reporting requirements, SEC rules currently include two major categories of smaller companies – “small business issuers” and “non-accelerated filers.” The SEC recently proposed to simplify its disclosure and reporting requirements for smaller companies by combining for most purposes the “small business issuer” and “non-accelerated filer” categories into one “smaller reporting companies” category. The use of this new category would also expand the eligibility for using the SEC’s scaled disclosure and reporting requirements by making them available to most companies with a public float of less than $75 million. To further simplify its disclosure and reporting requirements for smaller reporting companies, the SEC also has proposed to integrate current Regulation S-B disclosure requirements into the disclosure requirements of Regulation S-K and rescind the use of “SB” forms.

Under the SEC’s proposal, companies with a public float of less than $75 million, or revenues below $50 million if their public float cannot be calculated, would meet the definition of “smaller reporting company” and would be eligible to use the SEC’s scaled disclosure and reporting requirements. Smaller reporting companies would lose their

eligibility to claim that status in the first fiscal year following a fiscal year in which the smaller reporting company's public float rises above $75 million as of the last business day of the second fiscal quarter. Where an issuer does not have a public float or no public market for its common equity securities exists and it has less than $50 million in revenue, it may use the scaled disclosure item requirements until it exceeds $50 million in annual revenue. The $75 million public float and $50 million revenue ceilings would be adjusted for inflation on September 1, 2012, and every fifth year thereafter.

The SEC also proposed to integrate into Regulation S-K the substantive "small business issuer" disclosure requirements currently found in Regulation S-B. To do this, a new "smaller reporting companies" paragraph will be added to each item of Regulation S-K, which will contain separate disclosure standards for smaller reporting companies, to the extent that a particular item permits such disclosure. A company that qualifies as a smaller reporting company, however, may choose, on an item-by-item basis, to comply with either the scaled disclosure requirements made available in Regulation S-K for smaller reporting companies or the disclosure requirements for other companies in Regulation S-K, when the requirements for other companies are more rigorous. The SEC further proposes to mainstream smaller reporting company filers into the Regulation S-K framework by eliminating all "SB" forms associated with Regulation S-B (Forms 10-SB, 10-QSB, 10-KSB, SB-1, and SB-2).

It should be noted that many of these proposals stem from recommendations of the SEC's Advisory Committee on Smaller Public Companies. This Committee was appointed by the SEC to assess the current regulatory system for smaller companies under the federal securities laws and to recommend changes to that system. Leroy Dennis, Executive Partner - Assurance Services for McGladrey & Pullen, LLP, served as a member of the Advisory Committee.

The SEC's proposed rule is available in full at http://www.sec.gov/rules/proposed/2007/33-8819.pdf.

Proposed Exemptions from Registration for Certain Stock Options

Under Section 12(g) 7 of the Securities Exchange Act of 1934, an issuer with 500 or more holders of record of a class of equity security and assets in excess of $10 million at the end of its most recently ended fiscal year must register that class of equity security, unless there is an available exemption from registration. Stock options, including stock options issued to employees under stock option plans, are a separate class of equity security for purposes of the Exchange Act. Accordingly, an issuer with 500 or more optionholders and more than $10 million in assets is required to register that class of options under the Exchange Act, absent an available exemption. Currently there is no exemption from Exchange Act Section 12(g) registration for compensatory employee stock options.

The SEC believes that it is appropriate at this time to propose two new exemptions from the registration requirements of Exchange Act Section 12(g) for compensatory employee stock options:

- The first amendment would provide an exemption from Exchange Act Section 12(g) registration for compensatory employee stock options issued under written compensatory stock option plans of an issuer that does not have a class of securities registered under Exchange Act Section 12 and is not subject to the reporting requirements of Exchange Act Section 15(d), where the following conditions are present:
    - Eligible optionholders are limited to employees, directors, consultants, and advisors of the issuer;
    - Transferability by optionholders and holders of shares received on exercise of the options of compensatory employee stock options, shares received, or to be received, on exercise of those options, and shares of the same class as those underlying those options is restricted; and
    - Certain risk and financial information is provided to optionholders and holders of shares received on exercise of those options.

It should be noted that this exemption would apply only to a private, non-reporting issuer's compensatory employee stock options and would not extend to the class of securities underlying those options.

- The second exemption would apply only to compensatory employee stock options of issuers that are required to file reports under the Exchange Act because they have registered under Exchange Act Section 12 the class of equity security underlying those options. The proposed exemption would be available only where the options were issued pursuant to a written compensatory stock option plan and the class of persons eligible to receive or hold the options is limited appropriately.

The proposed rule is available in full at http://www.sec.gov/rules/proposed/2007/34-56010.pdf.

International

Effect of Minimum Funding Requirement on Defined Benefit Pension Asset

Currently, International Accounting Standard (IAS) 19, Employee Benefits, limits the measurement of a defined benefit pension asset to "the present value of economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan." At the same time, however, a statutory or contractual minimum funding requirement may stipulate a minimum level of contributions that must be paid into a plan over a given period. Such funding requirements would not normally affect the accounting for a plan under IAS 19. However, a minimum funding requirement may result in contributions being paid into a plan that do not become available to the entity subsequently as a refund or a reduction in future contributions.

To address questions that have arisen as a result of the interaction between statutory or contractual minimum funding requirements and the limit on the measurement of the defined benefit pension asset under IAS 19, the International Financial Reporting Interpretations Committee (IFRIC) has released IFRIC 14, IAS 19 - The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction. This Interpretation clarifies how to determine the limit in IAS 19 on the amount of the surplus that can be recognized as an asset. It also explains how the pension's asset or liability may be affected when there is a statutory or contractual a statutory or contractual minimum funding requirement. The Interpretation will standardize practice and ensure that entities recognize an asset in relation to a surplus on a consistent basis.

No additional liability need be recognized by the employer under IFRIC 14 unless the contributions that are payable under the minimum funding requirement cannot be returned to the company. IFRIC 14 is likely to have the most impact in countries that have a minimum funding requirement and where there are restrictions on a company's ability to get refunds or reduce contributions. The Interpretation is mandatory for annual periods beginning on or after January 1, 2008. Earlier application is permitted.

A Q&A for applying IFRIC 14 is available at http://www.iasb.org/NR/rdonlyres/3453435B-FBBD-4EAB-B638-9C5FD13FFC91/0/IFRIC14QAs.pdf. However, whether and how IFRIC 14 applies to a specific entity will depend on the exact terms of the pension plan and the regulatory requirements in the relevant jurisdiction, and should be determined by reference to IFRIC 14 itself.

Guidance Proposed for Real Estate Sales

Currently, real estate developers interpret International Financial Reporting Standards differently and record revenue for the sale of units, such as apartments or houses, at different times. Some record revenue only when they have handed over the completed unit to the buyer in accordance with International Accounting Standard (IAS) 18, Revenue. Others record revenue earlier as construction progresses by reference to the stage of completion of the development under IAS 11, Construction Contracts. Accordingly, the International Financial Reporting Interpretations Committee (IFRIC) has released for comment draft Interpretation IFRIC D21, Real Estate Sales, which is intended to standardize accounting practice among real estate developers for sales of units before construction is complete.

IFRIC D21 proposes that revenue should be recorded as construction progresses under IAS 11 only if the developer is providing construction services to the buyers' specifications, rather than selling completed real estate units. The proposal provides features to help distinguish whether the seller is providing construction services to the buyer's specifications in which case IAS 11 would be applied, or whether the seller is providing completed real estate in which case IAS 18 would be applied. The proposed Interpretation would in many cases require developers that are currently applying IAS 11 to apply IAS 18 instead. If approved, IFRIC D21 would be effective three months after it has been finalized, and earlier application would be permitted.

The proposal will be open for comment until October 5, 2007 at http://www.iasb.org/Open+to+Comment/Open+to+Comment.htm.

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