Insights

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Accounting

Accounting for and Disclosure of Subsequent Events

The Financial Accounting Standards Board (FASB) has issued FASB Statement No. 165, *Subsequent Events*. This Statement establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued (i.e., complete in a form and format that complies with generally accepted accounting principles (GAAP) and approved for issuance). However, Statement No. 165 does not apply to subsequent events or transactions that are within the scope of other applicable GAAP that provide different guidance on the accounting treatment for subsequent events or transactions. There are two types of subsequent events to be evaluated under this Statement:

- Recognized subsequent events – An entity must recognize in the financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements.

- Nonrecognized subsequent events -- An entity must not recognize subsequent events that provide evidence about conditions that did not exist at the date of the balance sheet but that arose after the balance sheet date but before financial statements are issued or are available to be issued. Some nonrecognized subsequent events may be of such a nature that they must be disclosed to keep the financial statements from being misleading. For such events, an entity must disclose the nature of the event and an estimate of its financial effect or a statement that such an estimate cannot be made.

Statement No. 165 also requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date - that is, whether that date represents the date the financial statements were issued or were available to be issued.

This Statement applies to both interim financial statements and annual financial statements. Statement No. 165 is effective for interim and annual periods ending after June 15, 2009, and should be applied prospectively. The FASB believes that Statement No. 165 will not result in significant changes in the subsequent events that an entity reports - either through recognition or disclosure - in its financial statements.

Statement No. 165 is available in full at www.fasb.org.

Estimating the Fair Value of Certain Investments in Investment Companies

The Financial Accounting Standards Board (FASB) has issued proposed FASB Staff Position (FSP) No. FAS 157-g, *Estimating the Fair Value of Investments in Investment Companies That Have Calculated Net Asset Value per Share in Accordance with the AICPA Audit and Accounting Guide, "Investment Companies"*. If finalized, this proposed FSP would amend FASB Statement No. 157, *Fair Value Measurements*, to provide application guidance for estimating

the fair value of investments in investment companies that have calculated net asset value per share in accordance with the AICPA Audit and Accounting Guide, *Investment Companies*. The proposed FSP would apply to investments in entities that meet the definition of an investment company in the Guide for which the entity's net asset value per share (or its equivalent, for example, partners' capital per share for an investment in a partnership) has been calculated in accordance with that Guide. However, the FSP would not apply if the fair value of the investment is readily determinable as defined in FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*.

The proposed FSP states that in circumstances in which net asset value per share of an investment is not determinative of fair value, a reporting entity is permitted, as a practical expedient, to estimate the fair value of an investment within the scope of the FSP using the net asset value per share of the investment (or its equivalent, for example, partners' capital per share for an investment in a partnership) without further adjustment, if the net asset value per share of the investment is determined in accordance with the AICPA Audit and Accounting Guide, Investment Companies, as of the reporting entity's measurement date. If an investment is within the scope of the FSP, for both recurring and nonrecurring measurements, the FSP would require a reporting entity to disclose certain information that enables users of its financial statements to understand the nature and risks of the investment.

If finalized, the proposed FSP would be effective upon issuance, including prior periods for which financial statements have not been issued, and applied prospectively. The proposed FSP would not require disclosures for earlier periods presented for comparative purposes at initial adoption. In periods after initial adoption, the FSP would require comparative disclosures only for periods ending after initial adoption.

The proposed FSP is available for comment until July 8, 2009, at http://www.fasb.org/cs/ContentServer?c=Document_C&pagename=FASB%2FDocument_C%2FDocumentPage&cid=1176156228477.

Auditing

Proposed Auditing Standard Regarding Confirmations

In conjunction with its efforts to clarify generally accepted auditing standards for audits of nonpublic companies and to converge such standards with International Standards on Auditing (ISAs), the Auditing Standards Board (ASB) of the American Institute of Certified Public Accountants recently issued a proposed Statement on Auditing Standards (SAS), *External Confirmations*. The proposed SAS has been drafted using ISA No. 505, *External Confirmations*, as a base. The two standards are very similar; however, the ASB has retained the presumptive requirement to use external confirmation procedures for accounts receivable, while ISA No. 505 does not include a similar requirement.

If finalized, the ASB's proposed SAS would supersede SAS No. 67, *The Confirmation Process*. The proposed SAS is not expected to change current practice in any significant respect; however, there are some proposed revisions to the existing standard, the most significant of which are summarized as follows:

- The proposed SAS address the responsibilities of the auditor when management refuses to allow the auditor to send a confirmation request. These responsibilities include communicating with those charged with governance if the auditor concludes that management's refusal is unreasonable, or the auditor is unable to obtain relevant and reliable audit evidence from alternative audit procedures. These procedures are not currently required by SAS No. 67.

- The ASB has added application material to the proposed SAS regarding the use of oral responses to confirmation requests as audit evidence. This guidance clarifies that the receipt of an oral response to a confirmation request does not meet the definition of an external confirmation. These paragraphs provide guidance on how the response may be considered part of alternative procedures performed to obtain sufficient appropriate audit evidence.
- The ASB has expanded the ISA definition of an external confirmation to include direct access by the auditor to information held by a third party.

If finalized, the proposed SAS would be effective for audits of financial statements for periods beginning on or after December 15, 2010. This effective date is provisional but will not be earlier than December 15, 2010.

The Exposure Draft is available for comment until August 31, 2009, at http://www.aicpa.org/download/auditstd/FINAL_ED_External_Confirmations_2.pdf.

SEC

Staff Accounting Bulletin No. 112 Issued

The staff of the SEC has issued Staff Accounting Bulletin (SAB) No. 112, to bring its existing guidance into conformity with FASB Statements No. 141 (revised 2007), *Business Combinations*, and No. 160, *Noncontrolling Interests in Consolidated Financial Statements*. Most of the SAB revisions were made to the guidance in Topic 2, *Business Combinations*, and Topic 5, *Miscellaneous Accounting*. SAB 112 is available in full at http://www.sec.gov/interps/account/sab112.htm.

Compliance and Disclosure Interpretations Updated

Over the last several years, the SEC's Division of Corporation Finance has released "Compliance and Disclosure Interpretations" (C&DIs), and many of these Interpretations were recently updated. C&DIs reflect the views of the staff of the Division of Corporation Finance. They are not rules, regulations, or statements of the SEC, but they can be helpful when researching particular issues. They are primarily categorized according to the Act or regulation to which they relate, for example:

- Securities Act Sections, Rules, and Forms
- Regulation S-K
- Industry Guides
- Exchange Act Sections, Rules, and Forms
- Form 8-K
- Plain English
- Non-GAAP Financial Measures
- Sarbanes-Oxley

The C&DIs are available in full at http://www.sec.gov/divisions/corpfin/cfguidance.shtml.

International

Guidance Proposed for Fair Value Measurement

The International Accounting Standards Board (IASB) recently published proposed guidance on fair value measurement, which discusses how fair value should be measured when it is already required by existing standards. If adopted, the proposals would replace fair value measurement guidance contained in individual International Financial Reporting Standards (IFRS) with a single, unified definition of fair value, as well as provide further authoritative guidance on the application of fair value measurement in inactive markets.

The proposals are part of a long-term program by the IASB and the Financial Accounting Standards Board (FASB) to achieve convergence of IFRS and U.S. generally accepted accounting principles (GAAP). The IASB's starting point in developing its exposure draft was the equivalent U.S. standard, FASB Statement No. 157, *Fair Value Measurements*, as amended. The IASB's Exposure Draft also incorporates recent guidance on fair value measurement published by the FASB. The proposed definition of fair value is identical to the definition in Statement No. 157, and the supporting guidance is also largely consistent with U.S. GAAP. Unlike Statement No. 157, however, the proposed IFRS:

- Would apply to leasing arrangements (except reacquired rights in a business combination or financial liabilities with a demand feature).
- Proposes that an entity should assume that the transaction takes place in the most advantageous market to which the entity has access.
- Proposes presentation requirements for circumstances when an entity uses an asset together with other assets in a way that differs from the highest and best use of the asset.
- Is silent on the unit of account for financial instruments.
- Defers to the relevant standards for the asset or liability to determine whether to recognize the day 1 gain or loss.
- States explicitly that the in-use valuation premise is not relevant to financial assets.
- Discusses how to apply the exit price notion to equity instruments measured at fair value.

The draft IFRS defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (an exit price). In the absence of an actual transaction at the measurement date, a fair value measurement assumes a hypothetical transaction in the most advantageous market for the asset or liability. A fair value measurement requires an entity to determine:

- The particular asset or liability that is the subject of the measurement (consistently with its unit of account).
- For an asset, the valuation premise that is appropriate for the measurement (consistently with its highest and best use).
- The most advantageous market for the sale or transfer of an asset or liability.
- The valuation technique(s) appropriate for the measurement, considering the availability of data with which to develop inputs that represent the assumptions that market participants would use in pricing the asset or liability and the level of the fair value hierarchy within which the inputs are categorized.

The Exposure Draft proposes a fair value hierarchy that prioritizes into three levels the inputs to valuation techniques used to measure fair value. These levels (1, 2, and 3) are identical to those in Statement No. 157. Various disclosures also are required to explain how assets and liabilities were measured at fair value. As a result, users should be able to understand the methods and inputs used to develop those measurements, and for fair value measurements using significant unobservable inputs (Level 3), the effect of the measurements on profit or loss or other comprehensive income for the period.

The proposals are set out in the Exposure Draft, Fair Value Measurement, which is open for comment until September 28, 2009, at http://www.iasb.org/NR/rdonlyres/C4096A25-F830-401D-8E2E-9286B194798E/0/EDFairValueMeasurement_website.pdf.

Proposed Amendments to IFRIC 14

In July 2007, the International Accounting Standards Board (IASB) issued IFRIC 14, *IAS 19 - The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*, to provide general guidance on how to assess the limit in International Accounting Standard (IAS) 19, *Employee Benefits*, on the amount of the surplus that can be recognized as an asset. IFRIC 14 also explains how the pension's asset or liability may be affected when there is a statutory or contractual minimum funding requirement.

As a result of this Interpretation, entities are in some circumstances not permitted to recognize as an asset some prepayments for minimum funding contributions. The IASB therefore recently published proposed amendments to IFRIC 14 to correct this unintended consequence of IFRIC 14. Per this proposal, if there is a minimum funding requirement for contributions relating to future service, an entity would recognize an asset that would include the amount of any prepayment of the minimum funding requirement contributions (i.e., any amount of any minimum funding requirement contributions that the entity has paid before being required to do so that gives the entity the right to reduce future minimum funding requirement contributions).

The Exposure Draft, *Prepayments of a Minimum Funding Requirement*, is available for comment until July 27, 2009, at http://www.iasb.org/NR/rdonlyres/9B68404D-A007-45FD-8F73-74F3688653E8/0/EDAmendmentsIFRIC14.pdf.

Operating Segments: IFRS vs. U.S. GAAP

This article is the twenty-first 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 operating segments. Actual differences in the accounting treatment between the two frameworks depend on specific circumstances.

IFRS 8, *Operating Segments*, is the standard dealing with segment reporting under IFRS, while FASB Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information*, deals with the same topic under U.S. GAAP. Because IFRS 8 is the result of a joint short-term convergence project between IFRS and U.S. GAAP, its wording is nearly the same as that of Statement No. 131, except for certain changes needed to make its terminology consistent with that in other IFRS and three other differences:

- The term "long-lived assets", as that phrase is used in Statement No. 131, implies hard assets that cannot be readily removed, which would appear to exclude intangibles. Non-current assets as defined in IFRS include intangibles.
- Statement No. 131 does not require disclosure of a measure of segment liabilities. IFRS 8 requires disclosure of segment liabilities if such a measure is regularly provided to the chief operating decision maker.

- Statement No. 131 requires an entity with a matrix form of organization to determine operating segments based on products and services. IFRS 8 requires such an entity to determine operating segments by reference to its core principle: “An entity shall disclose information to enable users of its financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environments in which it operates”.

Both Standards require disclosures about profit or loss and assets, and understanding the terminology and related definitions under U.S. GAAP and IFRS is critical to the proper application of the two frameworks.

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