

Insights

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A biweekly audit and accounting publication

A Guide Through IFRS for SMEs

In July 2009, the International Accounting Standards Board released *IFRS for SMEs*, a self-contained set of standards that was specifically designed to meet the needs of entities that do not have public accountability. McGladrey & Pullen, LLP is pleased to announce a newly released RSM International publication, *A Guide Through IFRS for Small and Medium-Sized Entities (SMEs)*. Among other topics, this Guide discusses:

- The key cornerstones underlying IFRS for SMEs;
- Disclosure requirements that have been significantly reduced;
- Significant accounting simplifications as compared to Full IFRS; and
- A detailed analysis of differences between IFRS for SMEs and Full IFRS.

This publication was authored by Marco Marcellan and reviewed by Bob Dohrer and Patrick Brown, all from McGladrey's International Assurance Services Group with assistance from other IFRS champions from member firms of RSM International. The Guide is available in full at *A Guide Through IFRS for SMEs*.

Accounting

Fact Sheets Available for New Revenue Recognition Guidance

As discussed in the October 20 edition of *Insights*, the Financial Accounting Standards Board recently ratified two consensus reached by the Emerging Issues Task Force, approving the issuance of the following Accounting Standards Updates (ASUs), which amend existing guidance on revenue recognition:

- ASU No. 2009-13, *Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements (a consensus of the FASB Emerging Issues Task Force)*; and
- ASU No. 2009-14, *Software (Topic 985): Certain Revenue Arrangements That Include Software Elements (a consensus of the FASB Emerging Issues Task Force)*

Understanding the implications of these ASUs and their effective date will assist entities in developing their action plans for adoption of these ASUs, including whether they plan to adopt them early. McGladrey & Pullen's National Accounting Standards Group has developed two fact sheets that provide more details about these revenue recognition ASUs and their requirements. These fact sheets are available at http://mcgladrey.com/Resource_Center/Articles/fact_sheets_available_new_revenue_recognition_guidance.html.



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The Effect of the FASB Codification on Disclosures in Financial Statements

For annual and interim periods ending after September 15, 2009, the FASB Accounting Standards Codification will become the single source of authoritative nongovernmental generally accepted accounting principles (GAAP) in the United States. The Codification does not change GAAP; instead, it introduces a new structure designed to improve the amount of time and effort required to research an accounting issue. The Codification will, however, affect the way companies reference U.S. GAAP in their financial statements. When a company issues financial statements for a period ending after September 15, 2009 any references to specific elements of GAAP should use Codification references. Moreover, references to specific GAAP throughout the financial statements should be on a consistent basis for all periods (*i.e.*, disclosures for comparative periods should not refer to only pre-Codification GAAP literature). Until financial statement users become more familiar with the Codification, financial statements for periods ending after September 15, 2009 may refer to both the Codification and pre-Codification GAAP literature to facilitate the financial statements user's understanding.

The FASB and SEC staff also have both encouraged companies to draft financial statement disclosures that avoid specific GAAP references and more clearly explain accounting concepts (*i.e.*, use "plain English"). For example, to refer to the requirements of the Derivatives and Hedging Topic, the footnote could simply state "as required by the Derivatives and Hedging Topic of the FASB Accounting Standards Codification," rather than numerical citations to the Codification. Where possible, companies should also consider minimizing or eliminating the use of references to specific standards. For example, instead of replacing the FSP AAG INV-1 and SOP 94-4-1 reference with a Codification reference (*e.g.*, FASB ASC 962-XXX-XX-XX or 965-XXX-XX-XX), the reference would be eliminated and the footnote in a defined contribution plan revised to simply state the requirement as follows: "Investment contracts held by a defined-contribution plan are required to be reported at fair value."

The following are example excerpts of common footnotes, which have been revised to reflect the concepts discussed above:

Note X. (In Part) Significant Accounting Policies

Capitalized Software

Costs related to internally-developed software and software purchased for internal use, which are required to be capitalized pursuant **to FASB ASC 350-40 (formerly SOP No. 98-1)**, are included in property, plant and equipment under machinery and equipment.

Note X. (In Part) Goodwill and Other Intangible Assets

~~In accordance with Statement No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets,~~
†The Company records impairment losses on long-lived assets used in operations when events and circumstances indicate that the assets might be impaired and the undiscounted cash flows estimated to be generated by those assets are less than the carrying amounts of those assets.

Note X. (In Part) Fair Value Measurements

~~Statement No. 157~~ **The Fair Value Measurements and Disclosures Topic of the FASB Accounting Standards Codification** establishes a fair value hierarchy that is based on the valuation inputs used in the fair value measurements. Measurements using quoted prices in active markets for identical assets and liabilities fall within Level 1 of the hierarchy, measurements using significant other observable inputs fall within Level 2, and measurements using significant unobservable inputs fall within Level 3.

ASU Issued for Accounting for Own-Share Lending Arrangements

As discussed in the July 24, 2009 edition of Insights, at its July 1, 2009 meeting, the Financial Accounting Standards Board (FASB) ratified the final consensus for Emerging Issues Task Force (EITF) Issue No. 09-1, "Accounting for Own-Share Lending Arrangements in Contemplation of Convertible Debt Issuance or Other Financing." In this Issue, the EITF reached a consensus that at the date of issuance, a share-lending arrangement entered into on an entity's own shares in contemplation of a convertible debt offering or other financing is required to be measured at fair value and recognized as issuance cost in the financial statements of the entity. On October 13, 2009, the FASB added this consensus to its Accounting Standards Codification by issuing Accounting Standards Update (ASU) No. 2009-15, *Accounting for Own-Share Lending Arrangements in Contemplation of Convertible Debt Issuance or Other Financing*.

ASU No. 2009-15 is effective for fiscal years beginning on or after December 15, 2009, and interim periods within those fiscal years for arrangements outstanding as of the beginning of those fiscal years. This ASU is effective for interim or annual periods beginning on or after June 15, 2009, for share-lending arrangements entered into in those periods. Arrangements that have been terminated as a result of counterparty default prior to the effective date of this Issue but for which the entity had not reached a final settlement as of the effective date are within the scope of this ASU.

Scope Exception Related to Embedded Credit Derivatives

Recently, the Financial Accounting Standards Board (FASB) issued Proposed Accounting Standards Update (ASU), *Derivatives and Hedging (Topic 815) - Scope Exception Related to Embedded Credit Derivatives*, to resolve potential ambiguity about the breadth of the embedded credit derivative scope exception in FASB ASC 815-15-15-9: "The concentration of credit risk in the form of subordination of one financial instrument to another shall not be considered an embedded derivative under this Subtopic." It is clear that the transfer of credit risk that is only in the form of subordination of one financial instrument to another (thereby redistributing credit risk) is an embedded derivative feature that should not be subject to potential bifurcation and separate accounting. However, there currently is some ambiguity in practice about whether other embedded credit derivative features are considered to be embedded derivative features that are not subject to bifurcation and separate accounting as a derivative instrument.

The proposed ASU amends ASC 815-15, *Derivatives and Hedging—Embedded Derivatives*, to clarify that only the embedded credit derivative feature between the tranche holders created by subordination should not be analyzed for potential bifurcation from the host contract and separate accounting as a derivative. Consequently, the following circumstances, among others, would not qualify for the scope exception and would be subject to potential bifurcation:

- The holder of an interest in a tranche of those securitized financial instruments is exposed to the possibility (however remote) of being required to make potential future payments (not merely receive reduced cash inflows); consequently, any transfer of credit risk for that tranche could not be considered to be only in the form of subordination of one financial instrument to another because those future payments are considered to be related to credit risk outside that created by subordination.
- The holder owns an interest in a single-tranche securitization vehicle; therefore, the subordination of one tranche to another is not relevant.

Other embedded credit derivative features, including those in some collateralized debt obligations and synthetic collateralized debt obligations, are considered embedded derivatives subject to bifurcation and separate accounting (including an analysis of whether the economic characteristics and risks of the embedded credit derivative features are clearly and closely related to the economic characteristics and risks of the host contract), provided that the overall contract is not a derivative in its entirety.

If finalized, the effective date of the amendments in the proposed ASU for each reporting entity would be the first day of its first fiscal quarter beginning after December 15, 2009.

The proposed ASU is available for comment until November 12, 2009 at <http://www.fasb.org>.

PCFRC Meets

The Private Company Financial Reporting Committee (PCFRC) met October 22-23 in Charlotte, North Carolina. As is customary for PCFRC meetings, there was an overview of FASB projects that were recently completed as well as those that are in progress and their effects on private company financial reporting. Notable among those projects discussed were:

- Financial statement presentation. This project is expected to result in major changes in financial reporting for all enterprises.
- Going concern. This project was initially designed to move the limited guidance available on going concern from the auditing literature to the accounting literature. However, since (and largely as a result of) publication of an Exposure Draft on the project it has grown to include such matters as whether to address when the going concern basis of accounting is no longer appropriate and whether or when to adopt the liquidation basis of accounting. The FASB is expected to deliberate whether to issue a revised Exposure Draft in mid November.
- Subsequent events. The FASB has issued guidance about disclosures related to subsequent events. However, since that guidance has been issued, it has been determined that there are definitional issues for public entities, not-for-profit organizations, and employee benefit plans related to the terms “available to be issued” and “widely distributed”. It is uncertain whether the FASB will issue any further clarification on such matters, and if so, in what form.
- Financial instruments with characteristics of equity. This project has been ongoing for several years and is now being pursued jointly by the FASB and the International Accounting Standards Board (IASB). Several alternative approaches have been considered that have varying degrees of difficulty in application and unintended consequences. A variation of an existing approach is now under consideration that seems to reduce the likelihood of unintended consequences, especially for private companies having buy-sell agreements with owners, and entities owned by employee stock ownership plans.

The PCFRC also discussed the growing burden being placed on private companies with the ever increasing complexity and extensive disclosures of accounting standards, both recently issued and under development. Accounting standards are believed to be primarily designed to meet the needs of analysts and equity holders. Private companies, on the other hand, have a greater need to meet the requirements of lenders. For example, disclosure requirements related to rollforward analysis has little incremental benefit to users of private company financial statements. Further, it is the belief that the current direction of accounting standards is essentially lifting the disclosures in management’s discussion and analysis required of public companies into the basic financial statements of all enterprises. In addition to having what many believe to have limited usefulness to private company financial statement users, there is a significant cost to prepare and audit those financial statements. Some also believe the disclosures being required may be duplicative of what may be derived from the cash flow statement. Because of this increasing concern, the PCFRC agreed to submit a letter to the FASB that expresses such concerns on behalf of private companies.

On a related matter, the AICPA Council recently expressed overwhelming support for the development of accounting standards for private companies. Impetus for this development comes from the recently issued IFRS for SMEs (a

standalone set of generally accepted accounting principles issued by the IASB that may be used by entities that publish general purpose financial statements and that do not have public accountability). The PCFRC discussed its role in pursuing standard setting for private companies. Members of the PCFRC agreed to submit a letter to the FASB recommending that it take the lead and consider developing generally accepted accounting principles for private companies, preferably on a standalone basis (as contrasted to a carve-out or exemption approach), rather than allowing market forces to mandate such. The December meeting of the PCFRC will be conducted jointly with the FASB, and this topic is expected to be a significant focus of that meeting.

International

Earnings per Share: IFRS vs. U.S. GAAP

This article is the twenty-ninth 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 the calculation of earnings per share (EPS). Actual differences in the accounting treatment between the two frameworks depend on specific circumstances.

The standard that addresses earnings per share under IFRS is International Accounting Standard 33, *Earnings per Share*. Under U.S. GAAP, this topic is addressed in FASB Accounting Standards Codification (ASC) Topic 260, *Earnings Per Share*, which codifies FASB Statement No. 128, *Earnings per Share*, and a series of Emerging Issues Task Force Issues. The International Accounting Standards Board and the Financial Accounting Standards Board currently are in the midst of a short-term convergence project to reduce the differences between IFRS and U.S. GAAP with regard to the calculation of earnings per share. The following table summarizes the existing differences between IAS 33 and ASC 260 as identified by the Boards while working on the convergence project.

Topic	IAS 33	ASC 260
Contracts that may be settled in ordinary shares or cash	IAS 33 presumes that the contract will be settled in ordinary shares; thus, the resulting potential ordinary shares affect diluted EPS if they are dilutive.	The presumption that the contract is settled in shares may be overcome if past experience or a stated policy provides a reasonable basis for believing that the contract will be paid partially or wholly in cash.
Year-to-date calculations	Dilutive potential ordinary shares are determined independently for each period presented. Therefore, the number of dilutive potential ordinary shares included in the year-to-date period is not a weighted average of the dilutive potential ordinary shares in each interim calculation.	Requires the number of potential ordinary shares included in quarterly diluted EPS to be determined for year-to-date periods on a weighted-average basis.

Topic	IAS 33	ASC 260
Contracts to repurchase an entity's own shares	Ordinary shares subject to a contract to repurchase for cash or other financial assets are treated as not outstanding for the calculation of basic EPS. For diluted EPS, if the contract is dilutive, the denominator is adjusted.	The denominator of the basic and diluted EPS calculation excludes ordinary shares that are to be redeemed or repurchased.
Participating instruments and two-class ordinary shares	For the purpose of calculating diluted EPS, conversion is assumed for participating equity instruments and two-class ordinary shares that are convertible into ordinary shares if the effect is dilutive. For those instruments that are not convertible into ordinary shares, profit or loss for the period is allocated to the different classes of shares and participating equity instruments in accordance with their dividend rights or other rights to participate in undistributed earnings.	ASC 260 currently does not state explicitly how to calculate diluted EPS for those instruments.
Mandatorily convertible instruments	Basic EPS includes ordinary shares that will be issued upon conversion of a mandatorily convertible instrument from the date the contract is entered into.	Basic EPS does not include those instruments until they are converted into common (ordinary) shares.

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