

Insights

November 18, 2009

A biweekly audit and accounting publication

Financial Institutions

FDIC Adopts Guidance on Prudent Commercial Real Estate Loan Workouts

The Federal Deposit Insurance Corporation (FDIC), in coordination with the other member Agencies of the Federal Financial Institutions Examination Council, recently adopted a policy statement supporting prudent commercial real estate (CRE) loan workouts because they recognize that prudent loan workouts are often in the best interest of both financial institutions and borrowers, particularly during difficult economic conditions. The policy statement provides guidance to examiners, and financial institutions that are working with CRE borrowers who are experiencing diminished operating cash flows, depreciated collateral values, or prolonged delays in selling or renting commercial properties. The policy statement:

- Stresses that performing loans, including those that have been renewed or restructured on reasonable modified terms, made to creditworthy borrowers will not be subject to adverse classification solely because the value of the underlying collateral declined.
- Details risk-management practices for loan workouts that support prudent and pragmatic credit and business decision making within the framework of financial accuracy, transparency, and timely loss recognition.
- Includes examples of CRE loan workouts.
- Reiterates existing guidance that examiners are expected to take a balanced approach in assessing institutions' risk-management practices for loan workout activities.

The policy statement is available in full at <http://www.fdic.gov/news/news/financial/2009/fil09061a1.pdf>.

International

IASB Simplifies Certain Related-party Disclosures for Government-controlled Entities

International Accounting Standard (IAS) 24, *Related Party Disclosures*, required entities to provide disclosures about transactions with related parties. However, entities controlled, jointly controlled, or significantly influenced by a government (government-controlled entities) have found it difficult and costly to provide all the required details for transactions with other government-controlled entities. Because the International Accounting Standards Board (IASB) believes that it is possible to omit some of the required details while still providing sufficient information to users of financial statements, a revised version of IAS 24 was issued recently to exempt government-controlled entities from providing full details about transactions with other government-controlled entities and the government. The revised standard requires disclosure about these transactions only if they are individually or collectively significant. The standard



Keegan, Linscott & Kenon, PC

Certified Public Accountants
Certified Fraud Examiners
Certified Insolvency & Restructuring Advisors

33 N Stone Avenue • Suite 1100 • Tucson, Arizona 85701
(520) 884-0176 • www.klkcpa.com

RSM McGladrey Network

An Independently Owned Member

also provides a simplified definition of a related party. The revised standard is effective for annual periods beginning on or after January 1, 2011, with earlier application permitted.

Foreign Currency Matters: IFRS vs. U.S. GAAP

This article is the thirtieth 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 foreign currency matters. Actual differences in the accounting treatment between the two frameworks depend on specific circumstances.

The primary standard dealing with foreign currency matters under IFRS is International Accounting Standard (IAS) 21, *The Effects of Changes in Foreign Exchange Rates*. Under U.S. GAAP, the literature relating to foreign currency matters is included in FASB Accounting Standards Codification (ASC) Topic 830, Foreign Currency Matters, which codifies FASB Statement No. 52, Foreign Currency Translation. The overall approaches under IFRS and U.S. GAAP are very similar. However, there are some differences including, but not limited to, the following:

Topic	IFRS	U.S. GAAP
Indicators to assess the functional currency	IAS 21 includes primary and secondary indicators to be considered in determining the functional currency of a foreign operation.	ASC 830 does not distinguish between primary and secondary indicators.
Change in functional currency	When there is a change in an entity's functional currency, the entity must apply the translation procedures applicable to the new functional currency prospectively from the date of the change.	U.S. GAAP distinguishes functional currency changes between: (1) from reporting currency to foreign currency; and (2) from foreign currency to reporting currency. Different specific requirements apply.
Foreign exchange gains or losses on available-for-sale financial instruments	For an available-for-sale monetary financial asset, the entity recognizes changes in the carrying amount relating to changes in foreign exchange rates in profit or loss, and other changes in the carrying amount in other comprehensive income.	All changes in fair value relating to financial instruments remeasured at fair value through other comprehensive income (available-for-sale) are recognized in other comprehensive income.
First-time adopters of IFRS: treatment of Cumulative Translation Adjustments (CTA)	On the date of transition to IFRS, a first-time adopter of IFRS may elect to reset CTA to zero.	U.S. GAAP does not include a similar provision. Equity is translated using historical rates.

IASB Publishes Exposure Draft on the Impairment of Financial Assets

Both International Financial Reporting Standards (IFRS) and U.S. generally accepted accounting principles currently use an incurred loss model for the accounting for impairment of financial assets. An incurred loss model assumes that all loans will be repaid until evidence to the contrary (known as a loss or trigger event) is identified. Only at that point is the impaired loan (or portfolio of loans) written down to a lower value. The global financial crisis has led to criticism of the incurred loss model for presenting an initial, overly optimistic assessment of no credit losses, only to be followed by a large adjustment once a trigger event occurs.

On November 5, 2009, the International Accounting Standards Board (IASB) published for public comment an exposure draft on amortized cost measurement and impairment of financial instruments. This exposure draft, which is applicable to generally all financial instruments, forms the second part of a three-part project to replace International Accounting Standard 39, *Financial Instruments: Recognition and Measurement*, with a new standard to be known as IFRS 9, *Financial Instruments*. Proposals on the first part of the project, classification and measurement of financial instruments, were published in July, with a final standard expected shortly. Proposals on the third part of the project, hedge accounting, continue to be developed.

Under the exposure draft on amortized cost measurement and impairment of financial instruments, expected losses are recognized throughout the life of the loan (or other financial asset measured at amortized cost), and not just after a loss event has been identified. This approach is referred to as the expected loss model. Under this model, a financial asset is initially measured at the discounted amount of the cash flows expected to be derived from that asset. Those expected cash flows are then remeasured at each reporting date. This would avoid the front-loading of interest revenue that currently occurs before a loss event is identified. Therefore, under the proposals, a provision against credit losses would be built up over the life of the financial asset. Extensive disclosure requirements would provide investors with an understanding of the loss estimates.

The IASB expects to finalize this exposure draft in 2010 and expects the IFRS will be required to be applied three years later. The IASB also expects the IFRS may be applied early.

The exposure draft, *Financial Instruments: Amortised Cost and Impairment*, is available for comment until June 30, 2010 at <http://www.iasb.org/NR/rdonlyres/888CC00C-5D55-4A90-9718-372F91D1BD72/0/EDFIImpairmentNov09.pdf>.

Insights is a biweekly publication of Keegan, Linscott & Kenon, P.C. and should not be construed as accounting, auditing, consulting, or legal advice on any specific facts or circumstances. The contents are intended for general information purposes only. Please contact Carolyn Mallonee at (520) 884-0176, fax (520) 884-8767, or e-mail cmallonee@klkcpa.com.

Keegan, Linscott & Kenon, P.C. is an independently owned member of the RSM McGladrey Network. RSM McGladrey Network is the premier affiliation of independent accounting and consulting firms in the United States that leverages the resources of RSM McGladrey. RSM McGladrey is a leading provider of financially focused business services to mid-sized companies. The RSM McGladrey group of companies offers accounting, tax services, business consulting, retirement resources, employer services, corporate finance, wealth management and financial process outsourcing.

RSM McGladrey and McGladrey & Pullen, a CPA firm, have an alternative practice structure. Though separate and independent legal entities, RSM McGladrey and McGladrey & Pullen work together to serve clients' business needs. They are members of RSM International, an affiliation of separate and independent legal entities.

Information provided in this publication has been obtained by Keegan, Linscott & Kenon, P.C. and McGladrey & Pullen from sources believed to be reliable. However, Keegan, Linscott & Kenon, P.C. and McGladrey & Pullen guarantee neither the accuracy nor completeness of any information and are not responsible for any errors or omissions or for results obtained by others as a result of reliance upon such information. This publication does not, and is not intended to, provide legal, tax or accounting advice.