

Insights

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Accounting

Proposed ASU - Fair Value Measurements and Disclosures

The Financial Accounting Standards Board (FASB) has issued an Exposure Draft of a proposed Accounting Standards Update (ASU), Fair Value Measurements and Disclosures (Topic 820): Amendments for Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. The purpose of this proposed ASU is to develop common requirements for measuring fair value and for disclosing information about fair value measurements in U.S. generally accepted accounting principles (GAAP) and International Financial Reporting Standards (IFRS). This proposed ASU is the result of joint efforts of the FASB and the International Accounting Standards Board (IASB) to ensure that fair value will have the same meaning in U.S. GAAP and IFRS and that their respective fair value measurement and disclosure requirements will be the same (except for minor differences in wording and style).

The amendments in this proposed ASU would apply to all reporting entities that are required or permitted to measure or disclose the fair value of an asset, a liability, or an instrument classified in shareholders' equity in the financial statements. The proposed amendments that would clarify the FASB's intent about the application of existing fair value measurement guidance include the following:

- Highest and best use and valuation premise –The proposed amendments would specify that the concepts of highest and best use and valuation premise in a fair value measurement are relevant only when measuring the fair value of nonfinancial assets and are not relevant when measuring the fair value of financial assets or of liabilities.
- Measuring the fair value of an instrument classified in shareholders' equity – The proposed amendments would provide guidance for measuring the fair value of an instrument classified in shareholders' equity, such as equity interests issued as consideration in a business combination.

The proposed amendments that would change a particular principle or requirement for measuring fair value or disclosing information about fair value measurements include the following:

- Measuring the fair value of financial instruments that are managed within a portfolio – A reporting entity that holds a group of financial assets and financial liabilities is exposed to market risks (that is, interest rate risk, currency risk, or other price risk) and to the credit risk of each of the counterparties. The proposed amendments would permit an exception to the requirements in Topic 820 for measuring fair value when a reporting entity manages its net exposure, rather than its gross exposure, to those risks.



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- Application of blockage factors and other premiums and discounts in a fair value measurement – Blockage factors would be prohibited at any level of the fair value hierarchy (as opposed to current U.S. GAAP, which prohibits them at Level 1).
- Additional disclosures about fair value measurements – The proposed amendments would expand the disclosures on fair value measurements to include more information about:
 - o The measurement uncertainty inherent in fair value measurements categorized within Level 3 of the fair value hierarchy. The IASB is publishing a proposal, Measurement Uncertainty Analysis Disclosure for Fair Value Measurements, which is the same as this proposed disclosure requirement. See related article in the “International” section.
 - o A reporting entity’s use of an asset in a way that differs from the asset’s highest and best use when that asset is recognized at fair value in the statement of financial position on the basis of its highest and best use.
 - o The categorization by level of the fair value hierarchy for items that are not measured at fair value in the statement of financial position, but for which the fair value of such items is required to be disclosed.

The Exposure Draft is available for comment until September 7, 2010 at www.fasb.org. Also, for a synopsis of the fair value measurement project and other joint FASB/IASB projects, see our summary, More Accounting Changes Coming, at http://mcgladreypullen.com/Resource_Center/more_accounting_changes_coming.pdf.

Financial Statement Presentation – Staff Draft of an Exposure Draft

The Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) are in the midst of a joint project on financial statement presentation to establish a common standard to improve how information is organized and presented in the financial statements. In an unprecedented approach, the staffs of the IASB and the FASB recently released a staff draft of an exposure draft that reflects the boards’ cumulative tentative decisions on financial statement presentation as of April 2010. The summary and the proposals included in the staff draft have been made publicly available only for information as a basis for outreach activities. Those activities will focus primarily on two areas: (a) the perceived benefits and costs of the proposals, and (b) the implications of the proposals for financial reporting by financial services entities.

The overriding objective of the joint financial statement presentation project is to make financial statements more relevant to users of the financial statements. The core principles embodied by the FASB and IASB in this project are to: (a) portray a cohesive financial picture of an entity’s activities, and (b) disaggregate information so it can be used in predicting an entity’s cash flows. The “cohesive” principle is primarily achieved through a common organizational structure across the financial statements. The Statement of Financial Position, Statement of Comprehensive Income, and Statement of Cash Flows will each have “Business” and “Financing” sections. The “Business” section will be categorized between operating and investing balances or activities. The “Financing” section will be categorized between debt and equity balances or activities. In addition, there will be separate sections for “Discontinued Operations” and “Income Taxes” on each of these statements. The “further disaggregation” principle will be primarily achieved by requiring balances and results to be broken out into material classes of similar items. These classes may be based on function, nature, and/or measurement basis.

A number of key decisions have been tentatively reached by the FASB and IASB in this joint project. Many of these decisions illustrate how the core principles of the project have been integrated into the fiber of the financial statements. Other decisions represent key changes to historical requirements or practices. Included below is a very brief summary of a few of these tentative decisions:

- Complete set of financial statements – In addition to the Statement of Financial Position, Statement of Comprehensive Income, and Statement of Cash Flows, an entity's financial statements would also include a Statement of Changes in Equity and footnotes.
- Consistent categorization between financial statements – Where an entity categorizes a balance on the Statement of Financial Position will drive where the related activity is categorized on the Statement of Comprehensive Income and Statement of Cash Flows. In other words, if an account is categorized as operating on the Statement of Financial Position, the activity related to that account balance would also be shown as operating on the Statement of Comprehensive Income and Statement of Cash Flows.
- Extraordinary items – An entity will no longer be required (or allowed) to classify gains and losses as “extraordinary” on the Statement of Comprehensive Income.
- Unusual or infrequently occurring events – An entity will be required to separately present on the Statement of Comprehensive Income amounts related to events that are either unusual or occur infrequently. An entity will not be able to label these amounts as “extraordinary.” In addition, an entity will be required to provide disclosures about these amounts and events.
- Cash flows from operating activities – While an entity will be required to use the direct method to determine cash flows from operating activities on the Statement of Cash Flows, it also will have to reconcile operating income to operating cash flows on the face of that statement. In addition, an entity will be required to provide information about noncash transactions on the face of the Statement of Cash Flows.

The Staff Draft of the Exposure Draft on Financial Statement Presentation is available in full at www.fasb.org. Also, for a synopsis of the financial statement presentation project and other joint FASB/IASB projects, see the summary, *More Accounting Changes Coming*, at http://mcgladreypullen.com/Resource_Center/more_accounting_changes_coming.pdf.

Financial Institutions

Accounting and Regulatory Implications for Loan Participation and Other Partial Loan Sales

FASB Accounting Standards Codification Topic 860 (formerly FASB Statements No. 140 and 166) has modified the accounting for transfers and servicing of financial assets. While this amended guidance has a meaningful impact on companies that have “qualifying special-purpose entities,” it also introduced a new definition for “participating interest,” which has a significant impact on how community banks account for loan participations and other partial loan sales such as the guaranteed portion of Small Business Administration loans. This amended guidance becomes effective for transfers of participating interests on or after the beginning of the first annual reporting period beginning after November 15, 2009.

Application issues specific to participations and other partial loan sales have come to light in the months that

have elapsed since the 2009 issuance of Statement No. 166. McGladrey & Pullen's National Professional Standards Group has published a summary of those issues and a recommended action plan. Significant Accounting and Regulatory Implications to Accounting for Loan Participation and Other Partial Loan Sales is available at http://mcgladreypullen.com/Resource_Center/significant_accounting_reg_implications.pdf.

Public Sector

Standard Issued Regarding Financial Reporting of Certain Financial Instruments

The Governmental Accounting Standards Board recently issued Statement No. 59, Financial Instruments Omnibus. The Statement clarifies existing standards regarding financial reporting of certain financial instruments and external investment pools. The new guidance addresses significant practice issues that have arisen when accounting for financial instruments by:

- Emphasizing the applicability of SEC requirements to certain external investment pools (known as 2a7-like pools) to provide users more consistent information on qualifying pools;
- Addressing the applicability of Statement No. 53, Accounting and Financial Reporting for Derivative Instruments, to certain financial instruments to clarify which financial instruments are within the scope of that pronouncement and to provide greater consistency in financial reporting; and
- Applying the reporting provisions for interest-earning investment contracts of Statement No. 31, Accounting and Financial Reporting for Certain Investments and for External Investment Pools, to unallocated insurance contracts to improve the consistency of reporting by pension and OPEB plans.

Statement No. 59 is effective for financial statements prepared by state and local governments for periods beginning after June 15, 2010, with earlier application encouraged.

International

Proposed Uncertainty Analysis Disclosure for Fair Value Measurements

The International Accounting Standards Board (IASB) recently published for public comment further enhancements to a disclosure proposal on Level 3 fair value measurements that formed part of the IASB's Exposure Draft, Fair Value Measurement, published in May 2009. In that Exposure Draft, the IASB proposed a three-level fair value hierarchy that categorizes observable and non-observable market data used as inputs for fair value measurements. According to that hierarchy, Level 3 inputs are "unobservable inputs" used for the fair value measurement of assets or liabilities for which market data are not available. In response to comments received, the IASB proposes to enhance its original proposal by requiring a measurement uncertainty analysis disclosure to reflect the interdependencies between unobservable inputs used to measure fair value in Level 3 unless another International Financial Reporting Standard specifies that such a disclosure is not required for a particular asset or liability.

The proposal states that if changing one or more of the unobservable inputs used in a fair value measurement to a different amount that could have reasonably been used in the circumstances would have resulted in a significantly higher or lower fair value measurement, an entity must disclose the effect of using those different amounts and how it calculated that effect. When preparing a measurement uncertainty analysis, an entity must not take into account unobservable inputs that are associated with remote

scenarios. An entity must take into account the effect of correlation between unobservable inputs if such correlation is relevant when estimating the effect on the fair value measurement of using those different amounts. For that purpose, significance should be judged with respect to profit or loss, and total assets or total liabilities, or, when changes in fair value are recognized in other comprehensive income, with respect to total equity.

The Exposure Draft, Measurement Uncertainty Analysis Disclosure for Fair Value Measurements, is available for comment until September 7, 2010 at <http://www.iasb.org/NR/rdonlyres/07855A41-D0A9-4197-ADF9-15A1088E466A/0/EDMeasurementUncertaintyAnalysis0610.pdf>. The Financial Accounting Standards Board is publishing the same disclosure requirement as part of its recent Exposure Draft, Amendments for Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. See related article in the “Accounting” section. Both boards will consider the comments received on the Exposure Drafts jointly as they continue their discussions about fair value measurement.

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