



Financial Reporting

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Key areas of change that affect financial reporting in 2006 and 2007.

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Accounting Year In Review: 2006

BDO Seidman, LLP prepared this *Financial Reporting* letter to help our clients anticipate and respond to questions that may arise in connection with financial statements for 2006 and 2007.

Underfunded pension plans, a frenzy of deal-making, soaring stock prices, and a breathtaking boom in private equity – those were the top business stories of the year in 2006. Many of these same trends also affect the application of new accounting standards and add to the challenges of financial reporting. The key challenges for this year include:

- Moving the funded status of retirement plans out of the footnotes and onto the face of the financial statements.
- Adopting “how-to” guidance for measuring the fair values of assets and liabilities, including goodwill acquired in business combinations.
- Coping with the complexities of accounting for private investments in public equity transactions (PIPEs) and other transactions involving convertible securities and equity derivatives.

But the biggest change confronting companies – and the one for which many appear least prepared – is the adoption of a new accounting interpretation designed to reduce earnings management by making tax contingencies (sometimes loosely referred to as “tax cushion”) more transparent. The risks to avoid and potential consequences of all these changes are discussed in this *Financial Reporting* letter. We hope you find the summaries useful in preparing your 2006 financial statements and in the months to come.

Accounting for Uncertain Tax Positions

Because of its effects on balance sheets, controls, and risk management, FASB Interpretation No. 48 will demand lots of attention from management and audit committees.

FASB Interpretation No. 48 on *Accounting for Uncertainty in Income Taxes* is likely the accounting change for which many companies are least prepared this year. The interpretation was released in July 2006. By January 2007, the FASB had received hundreds of requests from companies and trade associations for a deferral of the effective date. Many requests for deferral were based on a self-assessed lack of readiness combined with an awareness of the Interpretation's potentially significant effects on both financial reporting statements and processes.

OVERVIEW

To help companies come to grips with this complex and controversial new standard, this letter provides answers to questions about the accounting changes and the steps needed to implement them, along with the risks and possible consequences facing companies in the months to come.

What is a tax position?

The issuance of Interpretation 48 adds the everyday term *tax position* to the technical accounting dictionary. It is defined as any position taken (or not taken) in a tax return (either previously filed or future) that affects the accounting for income tax assets and liabilities (either current or deferred). Here are some examples:

- Decisions to take deductions and claim tax credits.
- Decisions to treat income or entities as not taxable, including a decision to exclude reporting taxable income in a tax return or a decision not to file a tax return.

- Allocations or shifts of income between jurisdictions, (e.g., through royalties or licensing agreements with related parties).

Importantly, the tax positions governed by Interpretation 48 apply only to income taxes. The Interpretation does not apply to uncertainty in other types of taxes, such as sales taxes, gross receipts taxes, and property taxes. Uncertainties regarding other types of taxes continue to be guided by FASB Statement No. 5, *Accounting for Contingencies*.

What causes uncertainty in income taxes?

Contrary to the proverbial wisdom that “nothing is certain but death and taxes,” companies can experience considerable uncertainty in income tax positions. The reason is because the body of statutory, regulatory and interpretive guidance on income taxes is voluminous, complex, sometimes ambiguous or internally inconsistent, and constantly changing. As a result, there may be times when the company is not sure that a position taken in good faith will ultimately be sustained upon audit by the taxing authority. In those cases, the position is considered an uncertain tax position, and companies must apply the new model of accounting.

How has the accounting model changed?

Interpretation 48 introduces a new way of thinking about uncertain tax positions. Below is a comparison with past practice.

- *Past practice.* In the past, uncertain tax positions were treated as loss contingencies under Statement 5. Companies recorded accruals (sometimes loosely referred to as “tax cushion”) for tax positions that they thought they would probably lose upon challenge by the taxing authorities. As one FASB member summed up, Interpretation 48 is a new approach to solving the age-old questions of, “When do I set up a tax cushion,” “How much should that cushion be,” and “Do I have to tell anybody I have a tax cushion?”
- *Interpretation 48.* Interpretation 48 rephrases the questions to address the tax benefits associated with an uncertain tax position. The questions become, “When should I recognize a tax benefit,” “How much should I recognize,” and “Do I have to disclose my unrecognized tax benefits?”

As you might expect, Interpretation 48 changes the answers as well as the questions, making significant changes in the requirements for recognition, measurement, and disclosures.

How have the accounting requirements changed?

Interpretation 48 is a principles-based standard. This means judgment is required in applying the standard. Highlights of the changes in requirements, along with the types of judgment required in each of the three areas, are as follows:

1. *Recognition.* Interpretation 48 takes a more disciplined approach to the question of when to recognize an uncertain tax position. Prior to Interpretation 48, the test for setting up a tax accrual typically rested on an evaluation of how much a company would lose upon challenge by a taxing authority. Interpretation 48 refocuses the evaluation by shifting the probability threshold from “probable

loss” to “more likely than not to prevail.” The new approach requires that companies use their judgment to organize tax positions into meaningful components or “units of account” and to identify whether material tax positions are more likely than not of being sustained. If the more-likely-than-not test is met, the tax benefit is recognized.

2. *Measurement.* Interpretation 48 introduces a more complex approach to measurement. This approach requires judgment to assess the possible outcomes and their respective probabilities. For example, if a company identifies a tax credit for research and experimentation as an uncertain tax position that is more likely than not of being sustained by a taxing authority having full knowledge of all relevant information, the next step is for the company to assess the probabilities that the entire amount of the credit will be sustained, or 80% of it, or 50% of it, or some other percentage.
3. *Disclosure.* Interpretation 48 expands the disclosure requirements and calls for judgment in assessing the likelihood and timing of future events. For example, companies are required to discuss reasonably possible changes that might occur in the recognized tax benefits over the coming year. Other disclosure requirements include a description of open tax years by major jurisdiction, a roll-forward of all unrecognized tax benefits (in effect a reconciliation of the beginning and ending balances of the unrecognized tax benefits), the total amount of interest and penalties recognized in the balance sheet and income statement, and the accounting policy for the classification of interest and penalties, (i.e., in the provision for income taxes or as interest and other expense, respectively).

All these requirements are effective starting in 2007.

What factors determine that a position is more-likely-than-not?

The determination of more likely than not is based on technical merits. Key factors to consider:

- A tax position is more likely than not of being sustained on its technical merits, if it has more than a 50% likelihood of being upheld when challenged and considered by the highest court in the relevant jurisdiction.
- The more-likely-than-not threshold is less ambiguous than the “probable” threshold used for loss contingencies. While the FASB says that “probable” is a different (higher) threshold than more-likely-than-not, it has never defined probable in percentages, and practice varies.
- To evaluate technical merits, companies consider relevant tax law, case law, and regulations, as well as external tax opinions. Administrative practices and precedent may also be considered in cases where a position might be considered a technical violation of the tax law, but the tax authority has demonstrated through its administrative practices that it will accept the position.

Importantly, the determination of more likely than not should *not* take into account the probability of a settlement with the taxing authority as a result of negotiations. If a tax position meets the more likely than not threshold on its merits, then the probability of a settlement would be factored into the measurement of the benefit.

What factors determine the unit of account?

There are two key factors for determining the unit of account: (1) the manner in which the company prepares and supports its tax return, and (2) the anticipated level at which the tax authority will address issues during an examination.

In applying these factors, companies should consider their past experience with the tax authorities and the materiality of the tax position within the context of the overall tax reported on the return and compared with other companies in the same industry or with similar business operations. Once determined, the unit of account should be applied consistently from year to year.

The determination of more likely than not is based on technical merits.

How are tax benefits measured for a range of outcomes?

Under Interpretation 48, tax positions are measured individually, rather than in the aggregate. Some have only two possible outcomes, (e.g., either 100% tax-deductible or not deductible at all). Others may have a range of reasonable outcomes.

For uncertain tax positions that meet the more-likely-than-not recognition hurdle and have a range of reasonable outcomes, Interpretation 48 prescribes the use of cumulative probabilities to determine the largest amount that has a greater than 50% probability of being realized upon ultimate settlement with a taxing authority that has full knowledge of all relevant information.

This approach is shown in Exhibit 1. In this example, the company would recognize a tax benefit of \$60 because

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that represents the largest amount of benefit that is more than 50% likely to reflect the ultimate outcome.

In some situations, there might be an almost infinite number of possible outcomes, (e.g., when measuring tax benefits associated with transfer pricing). These situations can require considerable judgment and should be discussed with the external auditors.

How are interest and penalties handled?

Interest and penalties on uncertain tax positions are accrued as follows:

- *Interest.* Interest is accrued on liabilities for tax positions that are not recognized because they do not meet the more-likely-than-not recognition threshold or the measurement guidance.
- *Penalties.* Penalties are accrued on all tax positions that do not meet the statutory threshold to avoid penalties.

The Interpretation gives public companies an unusual opportunity to change their accounting policies on the classification of interest and penalties upon adoption without the classification being considered an accounting change that triggers a need to demonstrate the preferability of the new policy.

What are the requirements for subsequent years?

The Interpretation requires monitoring of tax positions and ongoing evaluations to determine the proper recording of changes in judgments about uncertain tax positions. Subsequent changes may occur only if the changes are based on new information. Specifically:

- *Tax positions that subsequently pass the recognition threshold.* Some tax positions that failed initially to meet the recognition threshold may subsequently pass the more-likely-than-not test. This can happen when an issue is resolved through negotiation or litigation or when the statute of limitations expires. In these cases, the tax benefits should be recognized in the first subsequent financial reporting period in which the test is met.
- *Tax positions that no longer meet the recognition threshold.* A previously recognized tax position may no longer meet the more-likely-than-not recognition threshold. If this happens, the tax benefit should be derecognized in the first subsequent financial reporting period in which that threshold is no longer met.

- *Tax positions that continue to meet the recognition threshold.* If a previously recognized tax position continues to meet the recognition threshold, the company should reevaluate the recorded amount and adjust it as necessary to reflect new information available as of the reporting date about the amounts likely to be accepted by the tax authorities.

What documentation is needed?

Some general guidelines regarding documentation:

- Each step in the accounting process needs to be documented.
- This includes the identification of all uncertain tax positions, assessments of whether the recognition threshold is met, decisions related to units of account, probabilities of expected outcomes, measurements of the benefits, calculations of interest and penalties, and certain classifications and disclosures, such as whether the Interpretation 48 liability is current or noncurrent and whether expected settlements need to be disclosed.
- At a minimum, companies should document their conclusions, the information and factors considered, and the relative weights assigned to the various factors.

Good controls over documentation are critical. If these controls are not already in place at the time of adopting Interpretation 48, they can be established as phase III of a systematic implementation plan as illustrated in Exhibit 2.

Must all tax positions be documented?

No. Most tax positions have clear support in the tax law or regulations. Interpretation 48 deals only with uncertain tax positions.

**Exhibit 1. FASB Interpretation No. 48
Illustrative Measurement of Uncertain Tax Benefit**

Possible Outcome		Probability	Cumulative
Description	Amount	Percent	Percent
Complete acceptance	\$ 100	10%	10%
Very favorable compromise	\$ 80	20%	30%
Fair compromise	\$ 60	25%	55%
Unfavorable compromise	\$ 40	30%	85%
Total rejection	\$ 0	15%	100%

RISKS TO AVOID

Interpretation 48 is a short standard. It weighs in at a mere 58 pages as published by the FASB. Yet it can present significant challenges. Here are eight key risks to avoid.

1. Lack of preparedness

Interpretation 48 had a relatively brief incubation period. It took effect only

months after its issuance date. Although it is effective for fiscal years beginning after December 15, 2006, it must be applied to all outstanding tax positions as of the beginning of the year of adoption, (i.e., January 1, 2007 for calendar year companies).

As many companies have already learned, the computation of the required cumulative effect adjustment as of the beginning of the period of adop-

tion can take a considerable amount of effort. And that is just the start. Because of the need for continual monitoring, Interpretation 48 will continue to demand attention from management and directors throughout 2007.

To avoid unpleasant surprises, companies should approach this standard with an orderly and systematic implementation plan similar to the one illustrated in Exhibit 2.

**Exhibit 2. FASB Interpretation No. 48
Illustrative Company Implementation Plan**

Phase I	Phase II	Phase III
<p>Identify and investigate positions.</p> <ol style="list-style-type: none"> Gain an understanding of the requirements and timeline for adopting Interpretation 48. Develop an implementation plan. Begin SAB 74 disclosures. Identify uncertain tax positions, list all material potentially uncertain tax positions, and inventory the existing documentation. <ul style="list-style-type: none"> <i>Lay out the pieces.</i> Identify relevant tax transactions, jurisdictions, and open years. Include all evidence that would help assess the potential for exposure. Set a threshold for materiality. Put together a team with in-house expertise as well as outside consultants, if needed. <i>Do a "top down" investigation.</i> Analyze federal and state income tax provisions and accruals. Review audit activity. Probe exposures in complex areas, (e.g., transfer pricing or R&D tax credits). <i>Add a "bottoms-up" analysis.</i> Search for latent issues by reviewing legal entities, transaction-level details, source documents, contracts and agreements, such as intercompany pricing with related parties. 	<p>Analyze, document and report.</p> <ol style="list-style-type: none"> Cull through the phase I findings. Explore any potential gaps in documentation. Analyze and document potentially significant uncertain tax positions. <ul style="list-style-type: none"> <i>Prioritize the significant issues.</i> Assess the potential effects of any gaps on the company's financial reporting. <i>Reach agreement with auditors.</i> Discuss the level of tax analysis to be performed and the nature of the documentation requested. <i>Assess the likelihood that the position would be sustained.</i> Determine the unit of account for each tax position. Do "more-likely-than-not" assessment. <i>Measure the tax benefits.</i> Determine the proper measurement for recognized tax benefits. Prepare appropriate documentation. Reflect results in financial reports. Prepare cumulative effect adjustment. Identify reasonably possible changes in next 12 months. Prepare tabular roll-forward. Calculate and record interest and penalties. Prepare MD&A. Monitor subsequent events for possible changes in judgment. 	<p>Build or strengthen controls.</p> <p>Possible areas of weakness:</p> <ol style="list-style-type: none"> Does the company have controls over the authorization of aggressive tax strategies and the taking of uncertain tax positions? Does the company's audit committee review the analysis of uncertain tax positions and the key judgments and estimates involved in reporting of these positions? Does the company have controls in place to ensure the identification of material uncertain tax positions? Does the company have controls in place to ensure the appropriate determination of the unit of account for each tax position? Do the company's documentation procedures show evidence that all relevant tax laws and precedents are being considered? Does the company have procedures in place to monitor new developments in tax laws, regulations, court decisions, etc.? Does the company have controls in place to ensure full disclosure of interest and penalties, expected changes, and unrecognized tax benefits that, if recognized, would affect the effective tax rate?

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2. Insufficient investigations and analysis

The first step in the plan is generally a thorough search for uncertain tax positions. This will involve a “top-down” review of past tax returns and supporting documents, an analysis of disclosures made on tax returns, such as Schedule M-3’s reconciliation of book and tax income, and a review of the results from past tax audits.

It will also typically include looking through tax opinions and other reviews by outside experts, and reviewing the

company’s schedule of tax contingencies that was prepared in prior years in accordance with FASB Statement No. 5.

For best results, companies should add a “bottom-up” review of the company’s legal structure, accounting policies, outstanding SEC comment letters, general ledger, and source documents for transactions.

The findings of all these steps should be discussed with the company’s independent accountants and other external advisors as appropriate.

3. Misperceptions about auditor independence

Some companies may find it difficult to recruit and retain managers with sufficient expertise to handle all phases of Interpretation 48. Companies that lack sufficient in-house expertise will naturally look to their external auditors or other outside advisors for assistance. In so doing, some may be confused by the post-SOX constraints on the provision of tax services by auditors. This can be a complex area, and some of the changes are relatively recent.

Exhibit 3. FASB Interpretation No. 48 Independent Auditor’s Services

Phase	Public Companies	Nonpublic Companies
Phase I: Identify and investigate positions.	<p>The auditor may:</p> <ul style="list-style-type: none"> – Review and provide a reaction to the company’s implementation plan and list of uncertain tax positions. <p>However, the auditor may not draft the implementation plan or perform the identification of uncertain tax positions for the company.</p>	<p>The auditor may:</p> <ul style="list-style-type: none"> – Draft the implementation plan for review by management. – Compile a list of potential uncertain tax positions for review by management to help the company make determinations and decisions about uncertain tax positions.
Phase II: Analyze, document and report.	<p>The auditor may:</p> <ul style="list-style-type: none"> – Provide a reaction to drafts prepared by the company. – Provide technical advice, such as tax opinions on matters that are not precluded by PCAOB rules pertaining to “confidential” or “aggressive” tax positions. <p>However, the auditor may not prepare disclosures or assist in the measurement of tax positions or the cumulative effect adjustment.</p>	<p>The auditor may:</p> <ul style="list-style-type: none"> – Assist in the measurement of tax positions. – Assist in the calculation of the cumulative effect adjustment. – Provide technical advice, such as tax opinions. – Draft disclosures for review by management.
Phase III: Build or strengthen controls.	<p>The auditor may provide reactions, comments and suggestions on proposed controls or modifications. However, the auditor may not design or implement controls for the company.</p>	<p>The auditor may recommend controls and provide examples of best practices for review and implementation by management.</p>

Conditions for compliance

- Audit committees of public companies must pre-approve tax services.
- Conditions for providing tax advice are established in PCAOB rules and IRS Circular 230.
- Tax services to nonpublic companies may be provided if conditions set forth in the AICPA’s ethics rules are met. The client must make all management decisions and perform all management functions. The client must also accept responsibility for the results of the services, designate an appropriate individual to oversee the services, and establish and maintain internal controls, including monitoring activities. BDO clients should ask their engagement partner for more details.

The keys to avoiding troublesome situations are for audit committees of public companies and those charged with governance in nonpublic companies to understand which services are covered by the audit engagement letter, which services are permitted by professional standards, and what precautions the company needs to put in place to ensure compliance with the standards.

For example, technical tax advice is typically not covered in the audit engagement letter. This might include research on tax regulations and court rulings, reviews of open years, transfer pricing studies, nexus studies, or tax opinions for specific tax positions. In public companies, these services must be pre-approved by audit committees.

The permitted services and conditions for compliance with independence standards differ for public and nonpublic companies. The differences are summarized in Exhibit 3.

4. Weak internal controls

Because Interpretation 48 introduces a new model of accounting for uncertain tax positions, many companies will need to modify or strengthen their internal controls over financial reporting.

The risks associated with weak internal controls affect public and private companies in different ways. Companies subject to management reporting on internal controls under Section 404 of the Sarbanes-Oxley Act will want to build and strengthen controls to avoid reporting control deficiencies. Non-public companies will want to establish controls to help ensure effective and efficient audits.

5. Inadequate documentation

When considering recognition of specific tax positions, the amount of documentation considered adequate will vary with the position's material-

ity and complexity. As a general rule, adequate documentation should provide evidence that all relevant tax laws and precedents have been considered. Possible sources range from statutes, rulings, and tax treaties to court cases and legislative intent.

Interpretation 48 does not require third-party tax opinions. However, if the documentation consists of a third-party tax opinion, companies should be aware that dated tax opinions may need to be updated.

Controls over documentation are especially important and should be considered as early as possible. A few helpful techniques:

- Companies should ensure that good documentation practices are a part of the company's normal decision-making process. It helps facilitate timely issuance of financial reports, when companies make their more-likely-than-not assessments and compile their documentation at the time the decision is made to take a tax position.
- One way to incorporate good controls into the documentation process is to build in a step that calls for identification of factors that might be susceptible to change and should therefore be monitored closely in subsequent periods.

6. SAB 74 omissions

Public companies are required to make the disclosures specified in Staff Accounting Bulletin (SAB 74), Topic 11-M. This SAB requires:

- A brief description of Interpretation 48, the date that adoption is required, and the date that the registrant plans to adopt, if earlier.

- A disclosure that Interpretation 48 will be adopted by adjusting tax accounts and retained earnings at the date of adoption.
- A discussion of the impact that adoption of Interpretation 48 is expected to have on the financial statements, unless not known or reasonably estimable.

Because calendar year companies will have adopted the Interpretation as of January 1, 2007, the disclosures in their annual reports are expected to be robust and may include a monetary amount or a range of monetary amounts. Companies should be aware that the FASB intends to issue additional guidance on Interpretation 48. This guidance may not be available until March, and its impact or status may need to be reflected in the SAB 74 disclosure.

7. Misclassification on the balance sheet

The liability for uncertain tax positions and related interest and penalties must be classified separately from deferred tax liabilities, and its classification as short-term or long-term is based on the expected timing of the related cash payments to the taxing authorities. The short-term portion of the liability is the amount for which the company expects to make a payment in the next twelve months. The remainder is long-term.

8. Implementation issues

The FASB is expected to provide implementation guidance for the phrase "the tax matter is ultimately settled through negotiation or litigation" in paragraph 10(b) of Interpretation 48. This phrase has caused confusion when applied to closing agreements of federal and state tax audits, where a matter may be negotiated and presumably settled, but the statute of limitations has not expired.

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In addition, companies typically encounter a host of practical questions when implementing Interpretation 48. Examples of the kinds of questions that can arise:

- Should all companies do both a top-down and bottoms-up analysis of their tax positions?
- Is a transfer pricing study required for companies with international operations?
- What level of documentation is suggested for a company with substantial foreign operations?
- What documentation do auditors expect to see for loss companies that have a full valuation allowance?
- How does a company's settlement strategy affect the measurement of its tax position and unit of account?

9. Not anticipating user reactions.

Many companies have expressed anxiety over the possibility that the Interpretation 48 documentation and disclosure requirements may create a roadmap for the taxing authorities.

Equally important, companies should give some thought to the reactions of other users of the company's financial statements. A well thought out corporate communications program could pay extra dividends this year.

Banks, private equity firms, potential acquirers of the business, investment bankers, shareholders and other investors, and even the general public may have more questions than usual about a company's tax and risk management policies. Companies will want to be prepared with the answers.

POTENTIAL CONSEQUENCES

In addition to wanting to understand the effects of Interpretation 48 on a company's financial statements, the questions on the minds of many will relate to the potential consequences of the new accounting standard on the company's risk management policies and cash tax payments. Here are some examples that may trigger questions and further analysis.

Greater volatility in earnings

Interpretation 48 reduces management's flexibility in managing tax liabilities, and it can result in greater earnings volatility. The increased volatility is caused by the accounting treatment for changes in estimates and judgments about previously filed tax positions. The amounts associated with these changes are treated as discrete adjustments in the period of change if they pertain to a prior year tax position and as adjustments to the estimated annual effective tax rate if they pertain to a current year tax position.

For example, when a tax benefit is no longer considered more likely than not of being sustained, the write-off is taken entirely in the period of the change in judgment. This can have a significant effect on earnings that will need to be carefully explained to the users of the company's financial statements.

Reduced negotiating power with taxing authorities

Some companies have expressed concerns about Interpretation 48's disclosures, saying these disclosures may reduce the company's negotiating power with the tax authorities and result in larger cash outlays for income taxes. For example, this could happen when a company discloses the amount of a significant accrual that is released in anticipation of an expected settlement within the coming year.

As a result, users of financial statements may ask about management's assessment of the risks and how the company is managing them.

Bigger differences between accruals and cash tax payments

Regardless of whether Interpretation 48 creates a roadmap for the taxing authorities, it seems clear that adoption of the Interpretation will cause many companies to report liabilities that are higher than in the past, at least initially. (Other companies will have no immediate effect on their recorded liabilities, and some may even have a decrease).

Where increases in corporate tax liabilities are experienced, the company may also experience bigger differences between its liability and its actual cash tax payments. Users of financial statements may ask about these differences or request an estimate of anticipated cash tax payments.

Changes to risk management

As Interpretation 48 takes hold, companies will need to reevaluate the types of uncertain tax positions that they are willing to take in view of the increased disclosures required by the Interpretation. Some may also reevaluate their use of programs for accelerated dispute resolution. Decisions in these areas form the cornerstones of a company's risk management strategy for taxes.

Users of financial statements will be looking for any indication of a shift toward a more conservative or aggressive risk management strategy. Because of the stakes involved, audit committees and boards of directors may wish to be more involved in managing the risks and determining how aggressive or conservative the company's tax strategy should be. This is becoming a high priority matter for directors, as Interpretation 48 shines a spotlight on the fact that income taxes are both one of a company's greatest costs and one of its greatest risks.

Accounting for Retirement Plans

Pension plan deficits are in the spotlight as FASB Statement 158 moves the funded status out of the footnotes, resulting in lower shareholders' equity for some companies.

Underfunding of retirement plans has been very much in the public spotlight during the past few years. Rising stock prices and interest rates in 2006 have helped to improve the funded status of these plans, and companies will need to report that status on their balance sheets under FASB Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*. Public calendar-year companies must comply with the requirement for this year-end. Private companies and not-for-profit organizations will soon need to comply as well.

OVERVIEW

Statement 158 is an attempt to reflect the economic value of promises made in connection with retirement plans on the balance sheet. When companies adopt this standard, they are likely to experience lower shareholders' equity (or net assets for not-for-profits)

The funded status is one of the most important pieces of information about retirement plans. It represents the difference between the fair value of a plan's assets and its benefit obligation. But prior accounting standards have relegated this measure to the footnotes, reflecting a different amount on the balance sheet.

Under the preceding balance sheet guidance in FASB Statements (No. 87 for defined benefit plans and 106 for other postretirement benefit plans), the prepaid asset or accrued liability on the balance sheet represents the cumulative difference between the expense under generally accepted accounting principles and the cash disbursements for funding a plan or paying benefits.

Because of the way expense is computed under Statements 87 and 106, the difference between the funded status and the amount on the balance sheet is made up of three items that may seem difficult to understand and less important than the funded status. The three items are:

- Unrecognized (deferred) gains and losses from experience different from assumptions and from changes in assumptions.
- Unrecognized prior service cost from plan amendments that give participants retroactive credit for prior years of employee service.
- Unrecognized transition amounts from the adoption of Statement 87 or 106.

Statement 158 requires that these three items be shown instead on the balance sheet as adjustments to shareholders' equity. A summary of the other key provisions and requirements of Statement 158 is provided in Exhibit 4.

The effects of Statement 158 will vary by industry. Companies in all industries have taken actions to shore up retirement plan deficits, such as making larger contributions in the past few years, cutting back benefits and/or switching to plans with more predictable costs, making analysis difficult. Still, the hardest hit industries will likely include heavily unionized industries, such as automotive, steel, telecommunications, aerospace, defense, and airlines. Other companies may be less affected, but they still must be prepared to timely adopt this complex Statement.

RISKS TO AVOID

1. Unexpected reductions in equity or working capital

A key lesson learned from the experiences of the companies that have already adopted the Statement is that early review of the provisions can help avoid unpleasant surprises, including adverse effects on key ratios such as debt-to-equity and return on equity.

Statement 158 is an attempt to reflect the true economic value of promises made to retirees.

The two steps that can reduce equity or working capital are as follows:

- *Recognition of funded status.* The adjustment made to recognize the funded status may be significant, causing key ratios to fall out of line with targets and expectations. Companies with severely underfunded plans can experience negative shareholders' equity. Even companies with fully funded plans or overfunded plans may experience reductions in shareholders' equity because they may need to reduce their balance sheet asset with an offsetting reduction to shareholders' equity.
- *Classification of balance sheets.* The step of breaking down the balance sheet into current and non-current portions can have unexpected effects on a company's working capital. This can occur because all benefit plan net assets are classified as non-current while some portion of a net benefit liability may be classified as current.

**Exhibit 4. FASB Statement No. 158
Key Provisions, Calculations and Disclosure Requirements**

Recognition of funded status	Classification of balance sheets	Additional requirements
<p>Recognition of funded status</p> <p>Statement 158 requires that companies with single-employer defined benefit pension plans or other postretirement benefit plans recognize the funded status of their plans as a net asset or net liability.</p> <ul style="list-style-type: none"> √ The net asset or liability is calculated as the difference between the fair value of the plan's assets and the benefit obligation. √ For pension plans, the benefit obligation used in the calculations is the projected benefit obligation (PBO). This measure includes an allowance for future salary growth in plans where benefits are based on salaries. √ For other postretirement benefit plans, the obligation is the accumulated postretirement benefit obligation (APBO). This measure includes an allowance for future medical cost inflation. <p>Calculated on a plan-by-plan basis</p> <p>Companies with multiple defined benefit pension plans or other postretirement benefit plans will need to calculate their net assets or liabilities on a plan-by-plan basis.</p> <ul style="list-style-type: none"> √ A company cannot offset one plan's net benefit assets against another plan's net benefit liabilities. √ Instead, a single net asset is reported for the aggregate of all overfunded plans, and a single net liability is recorded for the aggregate of all unfunded or underfunded plans. 	<p>Classified balance sheets</p> <p>Companies that present classified balance sheets (current and non-current assets and liabilities) will classify all benefit plan net assets as non-current, but some portion of the benefit plan net liability may be classified as current. To determine the current portion, companies will need to consider their expected benefit payments over the coming year.</p> <ul style="list-style-type: none"> √ For an overfunded plan, the net asset is non-current. A refund anticipated from the plan in the coming year would be disclosed but not classified as a current asset. √ For an unfunded plan, the portion of the liability that represents expected benefit payments over the coming year is classified as a current liability. √ For an underfunded plan, the liability is non-current, unless the company's expected benefit payments over the coming year exceed the plan assets. In that unusual case, the excess is a current liability. <p>Other changes</p> <ul style="list-style-type: none"> √ Companies will need to adjust their deferred income taxes for the effects of the changes required by the Statement. This adjustment can be fraught with complexity. √ There is little or no change in the income statement. 	<p>Added disclosure requirements</p> <p>The transition provisions do not allow retrospective application of the balance sheet requirements. Instead, Statement 158 requires additional disclosures that address the effects on the balance sheet in the year of adoption and provide other supplemental information.</p> <ul style="list-style-type: none"> √ For each period an income statement is presented, companies disclose in their annual financial statements, separately for pension and other postretirement plans, the changes in other comprehensive income (OCI) that resulted from application of the Statement. √ For each period a balance sheet is presented, companies disclose in their annual financial statements the changes in accumulated OCI (AOCI) that resulted from application of the Statement. √ For the most recent balance sheet, companies disclose the amounts in AOCI that will be recognized as a component of benefit expense in the next fiscal year (that is, the amount that will be amortized in the next fiscal year). √ In the unusual case that a company expects to withdraw assets from a retirement benefit plan in the coming year, it should disclose the amount. <p>Additional requirements</p> <ul style="list-style-type: none"> √ Starting no later than 2008 for calendar year companies, the balance sheet date must be used as the measurement date for plan assets and obligations.

2. Uncoordinated changes in timing requirements for actuaries and investment managers

Statement 158 requires that the measurement date be the same as the sponsoring employer's balance sheet date starting in 2008. If a company or not-for-profit organization currently uses an earlier measurement date, the new requirement may lead to changes in timing for actuaries and investment managers. To avoid unnecessary stress and pressure, companies should take precautions to ensure all the necessary information will be available to prepare and timely file their annual financial statements.

3. Complexities in accounting for the deferred tax effects

There are major differences between the financial accounting for retirement plans and the accounting used on income tax returns. Typically, the tax basis balance sheet has no comparable asset or liability because only cash disbursements are deductible for U.S. income tax purposes.

Differences in book-tax bases existed prior to Statement 158. The new standard simply changes the amount of the differences. This may not seem like a huge change. But it introduces added complexities that can mount up fast. Examples:

- Companies will need to adjust their deferred tax assets and liabilities for the effects of the accounting changes. Because the change in the pension asset or liability affects accumulated other comprehensive income (rather than net income), the deferred tax effects also are classified in AOCI and, with a few exceptions, do not affect net income
- If the accounting change results in a deferred tax asset, the balance will need to be assessed for realizability. For companies that

find the effect of adopting Statement 158 is to record a significant deferred tax asset, the task of assessing the realizability of that asset can be challenging. In most cases, the reversal of the temporary difference is far in the future and hard to predict.

- If the effect of adoption is to record a smaller net pension asset and, as a result, smaller deferred tax liabilities for pensions, the company may need to record a new or increased valuation allowance relating to pre-existing deferred tax assets.

Because of the complexities involved, companies will want to discuss these matters with their auditors and actuaries to avoid risks related to the implementation of the standard and its application is subsequent years.

POTENTIAL CONSEQUENCES

Depending on their particular facts and circumstances, companies may experience one or more of the following potential consequences.

Amendments to loan covenants or stock buyback agreements

Companies may need to deal with adverse effects on covenants contained in loan or other financial agreements, such as bonding requirements and minimum equity to be eligible to bid on government or other contracts. It may be possible to amend the agreements by writing in a provision that prevents the covenants from being tripped solely by accounting changes. In addition, private companies that have compensation arrangements or stock buyback agreements tied to book value may want to amend these agreements to exclude the impact of Statement 158.

Effects on debt ratings and stock prices

It is unclear how financial markets will react to the new accounting requirements. Logically there should be no reaction to the accounting change, because all of the information about the funded status of plans has been readily available in the notes to financial statements. One of the major debt rating agencies states that the change will have no impact on debt ratings, because they already consider the funded status in the analyses. Without a crystal ball, however, nobody can be sure how the markets will react, and it's best to be prepared.

The Pension Protection Act of 2006 will lessen the flexibility that companies have in funding their pension plans.

Interaction with the Pension Protection Act of 2006

President Bush signed the Pension Protection Act of 2006 into law in August 2006. It is unrelated to Statement 158, but it is an interesting coincidence that significant new legislation and accounting requirements were enacted at about the same time.

The new law takes effect for plan years beginning in 2008. It will increase the pension funding requirements for many companies and lessen the flexibility they have in funding their pension plans. It will also more closely align the required annual contributions with the funded status of the pension plan by reducing many of the smoothing mechanisms currently in place.

Companies that sponsor the types of pension plans covered by the Act will likely want to review their existing plans for compliance and consider plan

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design changes to mitigate any adverse impacts on their cash flows.

Financial markets may react more strongly to the legislative changes than to the new accounting requirements. The major debt-rating agency referred to above noted that the Act could affect debt ratings.

Modifications to benefit plans and strategies

In recent years, the media have reported many techniques that companies use to manage the costs and risks of their plans. Notable trends include freezing or terminating retirement plans, replacing defined-benefit plans with defined contribution plans or 401(k) plans, and discontinuing retiree medical benefit plans or capping the amounts of benefits available to retirees under these arrangements.

Another trend that has gathered momentum in recent years is the use of union-funded trusts that operate like small insurance companies. These trusts are typically created through an organization known as a voluntary employees' beneficiary association (VEBA). The VEBA shifts the obligation for providing postretirement benefits from the employer to the union.

Other techniques may be helpful. For example, companies might consider changing the investment strategies used to fund their plans by putting a greater portion of the plan assets into fixed income securities. The objective would be to help reduce the volatility of the funded status, because plan assets and obligations would respond similarly to changes in interest rates. The downside of such a change is that fixed income securities typically have lower rates of return than equities.

Explanations to investors and others of noncomparability

For initial implementation, companies should consider how they will explain the balance sheet changes to investors, credit agencies, lending institutions, and employees.

Relevant points to make:

- Non-comparability may occur from company to company, and this may be reflected in comparisons with industry benchmarks or averages.
- Typical causes include the phased-in effective dates (that differ for public and private companies), along with the transition provisions and exceptions for measurement dates.

The noncomparability is a temporary problem. Overall, users of financial statements will likely be pleased to gain a better understanding of the value of the promises made by companies to their workers, and investors will appreciate the added insights into how the firm's retirement plans might affect their claims on the corporation.

Overall, users of financial statements will likely be pleased to gain a better understanding of the value of the promises made by companies to their workers.

Adopting Standards that Involve Fair Values

Recently issued standards and proposals in process involve the use of fair values; application of the new “how-to” guidance could have surprising effects.

In recent years, the FASB has expanded the use of fair value in financial reporting. This trend continued in 2006, but with some unique twists. The FASB added one narrow requirement to use fair value, created three new options to use fair value and issued a comprehensive standard on the definition and measurement of fair value measurement that takes effect in 2008 for calendar year companies.

OVERVIEW OF STATEMENT 157

Although it is not a requirement for this year-end, companies will want to start now to familiarize themselves with the “how-to” guidance in FASB Statement No. 157, *Fair Value Measurement*. The Statement affects a broad range of assets and liabilities for which measurement at fair value currently is required (or permitted), and it adds disclosures about the reliability of these measures. Statement 157 does not extend the use of fair value.

Examples of items covered by Statement 157 include:

- Investment securities accounted for under FASB Statement No. 115.
- Derivative assets and liabilities accounted for under FASB Statement No. 133.
- “Short sales” of securities under AICPA audit guides for certain industries.
- Certain assets and liabilities acquired in a business combination.
- Impaired assets, (e.g., those accounted for under FASB Statement No. 144).

Items not covered include share-based payment transactions and revenue rec-

ognition transactions that are measured based on vendor-specific objective evidence of fair value.

The “how-to” guidance in Statement 157 introduces and redefines a number of key terms and adds a hierarchy of inputs to fair value measurement. This guidance forms the basis for the new disclosures about the reliability of the measures.

Key terms and definitions

The key terms include fair value, market participants, orderly transaction, and measurement date.

- *Fair value*. Statement 157 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.” Note that fair value is measured based on an “exit value” perspective—how much would be received from selling an asset or how much would be paid to settle a liability.
- *Orderly transaction*. An orderly transaction reflects the market conditions in place at the measurement date. It excludes forced sales, liquidation transactions, and distress sales.
- *Market participants*. The market participants are buyers and sellers in the principal (or the most advantageous) market for the asset or liability. The participants need to be knowledgeable parties who are willing and able to contract and who are not related parties.

- *Measurement date*. The measurement dates are set by the existing accounting standards that require or permit the use of fair values. Currently, there are more than 40 standards of this type.

Surprising Effects

The new definition has some surprising effects on measurement, in particular immediate gains and losses on certain transactions.

Under an “exit value” approach, fair value excludes transaction costs, so for assets measured at fair value, transaction costs are generally charged to expense as incurred rather than added to the asset. On the other side, a dealer in derivatives might enter into a derivative with a corporate customer based on pricing in the “retail” market and be able to receive a fee from assigning the derivative to another dealer in the dealer (“wholesale”) market. Under certain circumstances, the dealer could record an immediate gain from adjusting the derivative to the price at which it could be settled with another dealer.

Getting ready for Statement 157

Just as implementing Interpretation 48 is the greatest accounting challenge for 2007 for most companies, implementing Statement 157 is likely to be the greatest accounting challenge for 2008. After completing implementation of Interpretation 48, companies should turn their attention to Statement 157, following a three-phase approach similar to Exhibit 1:

1. Identify the assets and liabilities measured at fair value, including assets for which fair value is an impairment measure (for example, plant and intangible assets).
2. Analyze how the current valuation procedures compare to the guidance in Statement 157 and where changes are needed.

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3. Build or strengthen processes and controls, including processes to accumulate information for the new disclosure requirements.

OVERVIEW OF STATEMENT 155

FASB Statement No. 155, *Accounting for Certain Hybrid Financial Instruments*, took effect for fiscal years that begin on or after October 1, 2006 for financial instruments acquired, issued or subject to a remeasurement event occurring after that date.

What is a hybrid financial instrument?

A hybrid financial instrument is an instrument with an embedded derivative. Examples include loans indexed to commodity prices and convertible debt.

Statement 133 establishes criteria for when an embedded derivative should be separated (bifurcated) from the host instrument and accounted for separately, as if it were a freestanding derivative, at fair value. Statement 155 provides a fair value measurement option for hybrid financial instruments that Statement 133 otherwise would require be separated. Under that measurement option, an entity can choose to carry any individual hybrid instrument at fair value with changes in the value of the entire instrument recognized currently in earnings. That election only can be made at the date of issuance, acquisition or a remeasurement event and must be supported by concurrent or preexisting documentation. Once made, the election is irrevocable.

Why would an entity choose to use fair value measurement for hybrid financial instruments?

The separate accounting for the embedded derivative and the host contract can be quite complicated. The embedded derivative may have complex features that make it challenging to value. By contrast, if the hybrid finan-

cial instrument is a traded security, the fair value of the hybrid instrument can be looked up in the newspaper. Even if the hybrid instrument isn't traded, in some cases it may be easier to value the whole instrument than the embedded derivative. The tradeoff is that if the embedded derivative is accounted for separately, it may qualify for hedge accounting. An entire hybrid instrument would not qualify for hedge accounting.

OVERVIEW OF STATEMENT 156

FASB Statement No 156, *Accounting for Servicing of Financial Assets*, is effective for fiscal years that begin after September 15, 2006. Statement 156 incorporates the one new required application of fair value. It requires fair value for initial recognition of certain servicing rights, whereas previously servicing rights were considered retained interests and valued at allocated basis.

After initial recognition, Statement 156 provides the option to account for each class of these rights at either fair value with gains and losses recorded currently in earnings or using the amortization method previously required under FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. That choice should be documented in the accounting records and a choice to measure at fair value, once made, is irrevocable.

Why would an entity choose to use fair value measurement for servicing rights?

The values of servicing rights fluctuate as interest rates change. Many entities that hold servicing rights use derivatives to hedge the fair value of the rights. Because of the unique attributes of servicing rights, it is often difficult to satisfy the requirements of hedge accounting in Statement 133. By contrast, if an entity elects to carry

servicing rights at fair value, then it doesn't need to apply hedge accounting. Both the servicing rights and the derivatives used as economic hedges are adjusted to fair value. To the extent the economic hedges are effective, the changes in fair value offset. To the extent the economic hedges are not perfectly effective, the ineffectiveness will impact current income.

OTHER FASB FAIR VALUE ACTIVITY

This month, the FASB issued FASB Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. This Statement is an extension of the optional fair value approach in Statements 155 and 156 and permits an entity to carry most financial assets and liabilities at fair value. The election generally can be made for individual assets or liabilities, and once made is generally irrevocable. Statement 159 represents Phase 1 of a two-phase project. In Phase 2, the FASB will consider permitting the fair value option for certain nonfinancial assets and liabilities, as well as the financial assets and liabilities excluded from the scope of Phase 1.

In addition, the FASB has proposals outstanding that would expand the use of fair value. For example, the business combinations proposal would require fair value measurement for more assets and liabilities including contingent consideration, acquired contingent assets and liabilities, and liabilities for restructuring or exit activities.

In January, the FASB issued an Invitation to Comment on the need for valuation standards and the FASB's role in setting these standards.

While the FASB in 2006 required only one new application of fair value, it seems clear that the standards issued or exposed for comment during 2006 laid the groundwork for expanded requirements to use fair value in the future.

Private Company Financial Reporting

After decades of study, the FASB and AICPA are moving forward with an initiative to consider how current and proposed standards affect private companies.

After decades of studies and reports, the FASB and the AICPA have formed a committee on Private Company Financial Reporting. The formation of this committee is viewed as the first step in a new process to help resolve questions about whether there should be differences in current or future standards for private companies. This step results largely from the efforts of the AICPA and the work of its Private Company Financial Reporting Task Force.

Why now?

Questions about the need for separate sets of generally accepted accounting principles for companies based on size (smaller versus larger) or ownership (private versus public) date back almost to the year the FASB was formed. The main reason the FASB is taking action now is because of the report of the AICPA's task force.

The task force's report made a number of recommendations based on a survey of groups of people believed to be the key constituents of private company financial reporting. These constituents included external users (lenders, equity investors, and sureties), company owners and financial managers, and public accounting practitioners.

In a nutshell, the survey found that a majority of each of the constituencies that had an opinion believe it would be useful if the underlying accounting in GAAP for private companies differed, in certain instances, from the accounting used by public companies.

Objectives

Based on the survey results and taking into account preliminary views expressed in a discussion paper released in 2004, the task force reached a series of conclusions including the following:

- GAAP for private companies should be developed based on concepts and accounting that are appropriate for the distinctly different needs of constituents of private company financial reporting.
- Rather than try to create a new and separate set of GAAP for private companies, changes in the current standard-setting process should be made to ensure that the financial reporting needs of private company constituents are met.

Assessments of GAAP

The survey probed areas of GAAP to determine their relevance and usefulness for decisionmaking. The findings:

- The accrual basis of accounting, the cash flow statement, and classification of liabilities and equity were at the top of this list – all were uniformly seen as highly relevant and useful.
- Variable interest entities and share-based payments were at the bottom of the list – both these areas received low marks for relevance and usefulness by private companies.
- Fair value measurements and retirement plans – two subjects covered in this letter – were gen-

erally in the mid-range, but the ratings were mixed. External users rated fair value measurements higher and retirement plans lower than owners and managers.

- Overall, investors and venture capital funds rated retirement plans and deferred income taxes as two of the three least relevant and useful areas. (The survey was taken prior to FASB Statement 158 and Interpretation 48.)

Reasons for assessments

The task force's report and discussion paper list possible reasons for the perceived need for different GAAP for public and private companies. These reasons include:

- (1) The notion that public company financial reporting focuses primarily on valuation, while private company usage focuses primarily on stewardship.
- (2) The suspicion that users of financial statements (internal and external) are not using all the information required by GAAP, with the result that the benefits of using the information do not justify the costs of preparing it, especially the costs of topical experts in areas such as valuation.

Actions taken to date

To address these concerns, the FASB and the AICPA jointly issued an Invitation to Comment in 2006 on "Enhancing the Financial Accounting and Reporting Standard-Setting Process for Private Companies."

The Invitation to Comment made two main suggestions: (1) The FASB should modify its procedures to consider the impact of its standards (both current and proposed) on private companies. (2) The AICPA and the FASB should jointly establish a committee to make recommendations to help the FASB gain a better appreciation of the

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perspective of private companies and the users of their financial statements.

The profession is moving forward with these suggestions. A chairperson for the committee was appointed in late 2006, and the first public meeting is expected in the spring of 2007. The direction set by this committee could have important consequences for future private company reporting.

Website to watch

Information about the private company financial reporting initiative is available at <http://www.pcfr.org>.

Shared concerns

The Sarbanes-Oxley Act of 2002 formalized the SEC's reliance on the FASB as the accounting standard-setter for public companies, and the SEC has said it will exercise vigorous oversight of the FASB's agenda.

Among the priorities agreed upon by the FASB and the SEC are some that may be posing more challenges for both public and private companies than in the past. The priorities include:

- More timely guidance.
- Moving toward convergence with international standard setters.
- Moving toward principles-based standards that are anchored in an asset/liability approach rather than a revenue/expense approach.
- Moving toward fair value measurement.

The SEC staff has been following up on the results of these trends to see what problems are arising for public companies. As part of their follow-up efforts, the staff conducted an informal study of the reasons for restatements to determine how, if at all, GAAP has contributed to the problem. The findings may have relevance for private company financial reporting as well.

Generally improvable GAAP

The number of accounting restatements has grown dramatically over the years. Results of the SEC staff's informal study of restatements over the past three years suggest that well over half of the errors that resulted in restatements were caused by factors described as "ordinary books and records deficiencies" or "simple misapplication of the accounting standards."

The staff said the study showed approximately one-third of the errors were caused by errors in judgment or attributes of the accounting literature:

- *Errors in judgment.* The study found that a significant minority of the errors was caused by errors in judgment in applying an accounting standard. This percentage is seen as important in view of the movement toward principles-based standards, which involve greater amounts of judgment. On the list of standards misapplied due to errors in judgment are several mentioned in this letter: reserves and allowances, taxes, and impairments of long-lived assets and intangible assets.
- *Attributes of accounting literature.* Another significant minority of errors was caused by attributes of the accounting literature. Prime examples include the issuance of convertible securities with beneficial conversion features and the issuance of equity instruments to third parties. The staff said the troubling attributes involved a lack of clarity in the standards and difficulty in identifying all the relevant accounting literature.

Overall, the areas of accounting in which errors occurred most frequently include leases, income taxes, revenue recognition, derivatives and hedging, and convertible securities. The FASB currently has agenda projects to address all these areas of accounting. For

more details, see the speech by Scott Taub, former Deputy Chief Accountant of the SEC, dated November 17, 2006, available on the SEC's web site.

Decades of Study

1973. The Financial Accounting Standards Board is established.

1974. AICPA's Accounting Standards Division forms committee to study the application of GAAP to small and closely held businesses.

1978. FASAC receives "Report of Task Force on GAAP Requirements of Concern to Small or Closely Held Businesses."

1981. FASB publishes Invitation to Comment on "Financial Reporting by Private and Small Public Companies."

1983. FASB publishes research report on "Financial Reporting by Private Companies: Analysis and Diagnosis."

1995. AICPA publishes "Report of the Private Companies Practice Section Special Task Force on Standards Overload."

2004. AICPA publishes "Private Company Financial Reporting Discussion Paper."

2005. AICPA publishes "Private Company Financial Reporting Task Force Report."

2006. FASB and AICPA issue Invitation to Comment on "Enhancing the Financial Accounting and Reporting Standard-Setting Process for Private Companies."

2006. FASB and AICPA appoint chair of joint AICPA/FASB Committee on Private Company Financial Reporting.

International standard-setters are also looking at differential standards. The IASB issued in 2004 a discussion paper of its preliminary views and in 2007 an Exposure Draft of a proposed International Financial Reporting Standard for Small and Medium-sized Entities.

Coping with Complexity

Widely heralded as the year of private equity, 2006 brought unprecedented complexity in accounting for funds raised by PIPEs, convertible securities and equity derivatives.

Curbing complexity is one of the hottest topics in financial reporting today. Perhaps nowhere in accounting is the problem more acute than in the area of equity derivatives (such as warrants to buy common stock) and convertible securities. A recent study of restatements by Audit Analytics found that the single area causing the most errors is the measurement and recognition of debt and stock or equity instruments. The report showed that this is mainly a problem for smaller companies. Smaller public companies and companies about to go public are among the heavier issuers of equity derivatives and convertible securities, so the burden of this most complex area of accounting falls on companies with smaller accounting staffs.

RECENT TRENDS

The boom in private equity was both a cause and cure of complexity in 2006. Every week seemed to bring new headlines of private equity firms announcing the biggest deal of the year. Lenders offering low-cost loans and pension funds investing in buyout firms provided the catalysts to help growing numbers of companies avoid the costs and complexities of the Sarbanes-Oxley Act of 2002 by going private.

At the same time, PIPE (private investment in public equity) transactions have risen steadily, adding other forms of complexity. PIPE transactions involve privately issued equity or equity-linked securities sold by public com-

panies to accredited investors under Regulation D. Securities sold in these transactions include common stock, convertible preferred stock, warrants, and equity credit lines.

RISKS AND RECENT GUIDANCE

Because of their propensity for complex financial instruments, PIPE transactions may result in a lack of transparency to users of financial statements. A common criticism is the feeling that PIPE investors, primarily hedge funds, may be profiting at the expense of existing shareholders. This has drawn the scrutiny of the SEC.

1. Accounting for arrangements with registration rights

In some PIPE transactions, the issuer will agree to register the securities with the SEC within a certain period of time. The arrangement may call for payments to the investors if the registration is not completed – or not completed within a certain period of time.

In December 2006, the FASB issued FASB Staff Position (FSP) No. EITF 00-19-2, “Accounting for Registration Payment Arrangements.” This FSP eases some of the complexity by requiring that the registration payment arrangements be accounted for separately from the shares, warrants, convertible debt or other instruments involved in the deal. It also results in the treatment of more instruments as equity (rather than liabilities) than under prior accounting.

2. Accounting for other forms of financing

The warm reception to the FSP is an indication of just how complex the former accounting treatment was – and continues to be for other financing structures involving equity derivatives and convertible securities.

The relevant pronouncements—FASB Statement Nos. 133 and 150 and EITF Issue No. 00-19—are complex, and they interact in complex ways. An instrument that is in the scope of Statement 133 may be scoped out of EITF 00-19, but it may be necessary to go through EITF Issue 00-19 to decide whether an instrument is in the scope of Statement 133. It is not uncommon for accountants to feel as if they are going in circles.

A list of the accounting principles that apply to equity derivatives and convertible securities can be found in the AICPA’s working draft of a practice aid on *Convertible Debt, Convertible Preferred Shares, Warrants, and Other Equity-Related Financial Instruments*.^{*} The draft practice aid also provides roadmaps, flowcharts, and examples to illustrate how the standards should be applied. These tools help illuminate an otherwise difficult area and provide a logical sequence for working through all of the interrelated accounting issues. But more is needed to help companies cope with these complexities.

The EITF has been awash in issues involving convertible securities (see the following section), and the FASB has begun a project on liabilities and equity that might ease some complexities. In the meantime, companies are urged to consult early on with their auditors to avoid last-minute surprises and delays in completing their financial statements.

^{*} The working draft of the AICPA’s practice aid is available at <http://www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Accounting+Standards/Working+Draft+of+Convertible+Debt+Convertible+Preferred+Shares+Warrants+and+Other+Equi.htm>.

Other Recent Developments in Accounting and Reporting

Summaries of FASB Statements 155 through 159 and FASB Interpretation 48 were provided in the preceding pages. Additional guidance issued or effective in 2006 is summarized below, with details of effective dates provided in Table 1.

FASB Statements

FASB Statement No. 123(R), *Share Based Payment*

FASB Statement No. 123(R), *Share Based Payment*, was issued in December 2004 and took effect for calendar year private companies in 2006. BDO has published a separate *Financial Reporting* letter on this Statement. The letter is dated April 17, 2006 and is available on www.bdo.com.

EITF Consensuses

The FASB's Emerging Issues Task Force reached consensuses in 2006 on nine new issues and revised one old consensus.

As in recent years, the EITF spent significant time trying to fine-tune the accounting for convertible securities. The EITF has done so as a stopgap while awaiting an expected fundamental change in the accounting for convertible securities from the FASB's long-running (since 1990) project on liabilities and equities. The Task Force has discovered that each attempted fine-tuning raised new issues.

Toward the end of the year, the EITF asked the FASB to separate convertible securities issues from the broader project and expedite resolution. The FASB declined to do so, but said that it

would try to accelerate completion of the liabilities and equities project.

We have divided discussion of the EITF consensuses in 2006 between convertible securities issues and all other issues.

CONVERTIBLE SECURITIES ISSUES

Issue No. 03-7, "Accounting for the Settlement of the Equity-Settled Portion of a Convertible Debt Instrument That Permits or Requires the Conversion Spread to be Settled in Stock (Instrument C of Issue No. 90-19)."

The EITF reconsidered the consensus on this issue. Instrument C from EITF Issue No. 90-19, "Convertible Bonds with Issuer Option to Settle for Cash upon Conversion," is a convertible security that upon conversion is settled in cash for the accreted amount and in shares for the value of the conversion right in excess of the accreted amount.

Such an instrument is not conventional convertible debt and, as a result, the conversion right needs to be assessed based on the guidance in EITF Issue No. 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock," and FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, to decide whether it should be split out (bifurcated).

The revised consensus applies if the conversion right is not split out and if the conversion transaction is not treated as an extinguishment under EITF Issue No. 05-1, "Accounting for the Conversion of an Instrument That Became Convertible upon the Issuer's Exercise of a Call Option." In this circumstance, the EITF reached a revised consensus that the cash paid should be compared to the carrying amount of the instruments to compute an extinguishment gain or loss (if any) and that the value

of the shares issued should be excluded from the computation.

Issue No. 06-6, "Debtor's Accounting for a Modification (or Exchange) of Convertible Debt Instruments."

EITF Issue No. 96-19, "Investor's Accounting for an Investee when the Investor Has a Majority of the Voting Interest but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights," provides guidance on when a change to the terms of a borrowing should be accounted for as a modification for accounting purposes and when a change should be accounted for as in substance an extinguishment of the original borrowing and a replacement by a new borrowing.

The guidance in Issue 96-19 was based on a comparison of cash flows before and after the change, so that a change in conversion rights was ignored. The SEC staff disagreed with that approach, and so in Issue No. 05-7, "Accounting for Modifications to Conversion Options Embedded in Debt Instruments and Related Issues," the Task Force amended Issue 96-19 to include the change in the fair value of a conversion right as a factor in the analysis.

The Task Force focused in its initial deliberations on a change that *increased* the fair value of a conversion right. Over the ensuing year, a number of transactions occurred in which a conversion right was changed in a way that *decreased* its fair value. The Task Force was not comfortable with the application of the consensus in Issue 05-7 to such transactions, and so reconsidered the Issue 05-7 model.

In Issue 06-6, the EITF reached a consensus that the evaluation of a change in the terms of convertible debt should be evaluated in a three-step process. Note that Issue 06-6 applies only for conversion rights that are *not* ac-

counted for separate from the debt instrument.

- *Step One.* If a substantive conversion right is added or eliminated, the transaction is an extinguishment for accounting purposes.
- *Step Two.* Perform the original EITF 96-19 analysis of change in future cash flows. If the present value of future cash flows changes by 10% or more, the transaction is an extinguishment for accounting purposes.
- *Step Three.* Compare the change in fair value of the conversion right to the carrying amount of the debt before the change. If the change in fair value is 10% or more of the carrying amount, the transaction is an extinguishment for accounting purposes.

If the transaction is not an extinguishment under any of the three steps, then an increase in the fair value of a conversion right should be accounted for as an increase to shareholders' equity and a decrease in the carrying amount of the debt, which affects interest expense over the remaining life of the debt. A decrease in the fair value of a conversion right is ignored for accounting purposes.

Issue No. 06-7, "Issuer's Accounting for a Previously Bifurcated Conversion Option in a Convertible Debt Instrument When the Conversion Option No Longer Meets the Bifurcation Criteria in FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities.*"

In the original accounting model under APB Opinion No. 14, "Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants," an issuer of convertible securities accounts for the security and the conversion right as a unit. Statement 133 retained this treatment. The EITF in recent years, as part of its fine-tuning of the accounting for convertible securities, has required conversion rights in certain

circumstances to be split out (bifurcated) for accounting purposes.

Issue 06-7 deals with the accounting when a conversion right that was previously split out no longer meets the criteria to be split out. The EITF reached a consensus that a conversion right that no longer meets the criteria should be reclassified to shareholders' equity. The carrying amount of the debt, and therefore any discount being amortized, is unaffected. The consensus also addresses the accounting if the debt is subsequently converted or extinguished before maturity.

ALL OTHER EITF ISSUES

Issue No. 06-1, "Accounting for Consideration Given by a Service Provider to a Manufacturer or Reseller of Equipment Necessary for an End-Customer to Receive Service from the Service Provider."

EITF Issue No. 01-9, "Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products)," dealt with the proper accounting for consideration paid by a vendor to a customer. It concluded that a cash incentive generally would be classified as a reduction in revenue, whereas a noncash incentive would be classified as an expense.

Issue 06-1 deals with a related situation in which a service provider pays consideration to a manufacturer or reseller of equipment that customers need to use the service, with the idea that the manufacturer or reseller will pass the consideration to the end customer.

For example, a provider of internet-based telephone service might pay consideration to the reseller of the modem needed by a customer to use the service, with the understanding that the reseller will reduce the price of the modem or provide a rebate to the end customer.

The Task Force reached a consensus that the Issue 01-9 consensus should apply, even though the consideration is not paid directly to a customer. That is, if the service provider directs that the end customer should receive cash consideration, for example, a rebate check, then the service provider generally should classify the consideration paid to the manufacturer or reseller as a reduction in revenue. Conversely, if the end customer receives noncash consideration or the service provider doesn't control the form of consideration to the end customer, then the service provider should classify the consideration paid as an expense.

Issue No. 06-2, "Accounting for Sabbatical Leave and Other Similar Benefits Pursuant to FASB Statement No. 43, *Accounting for Compensated Absences.*"

Sabbaticals have been common for many years at colleges and universities; in recent years they have become more popular in the business world. This Issue deals with unrestricted sabbaticals in which an employee is not required to perform direct or indirect services for the employer during the sabbatical.

The Task Force reached a consensus that if an employee becomes entitled to an unrestricted sabbatical after a specified period of service, then the sabbatical meets the definition of "accumulates" in FASB Statement No. 43, *Accounting for Compensated Absences*. Accordingly, the cost of the sabbatical generally should be accrued over the specified service period if the other conditions in paragraph 6 of Statement 43 are met.

Issue No. 06-3, "How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation)."

This issue deals with the display of taxes that are both imposed on and

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concurrent with a specific revenue-producing transaction between a seller and a customer, including sales, use, value added, and excise taxes. (The scope excludes gross receipts taxes, because they are not imposed on individual transactions.)

Some companies had become concerned that EITF Issue No. 99-19, "Reporting Revenue Gross as a Principal versus Net as an Agent," would apply to such taxes, and that it would be necessary for a company to analyze each tax to determine whether it was agent or principal with respect to collection of the tax.

In Issue 06-3, the EITF reached a consensus that it is unnecessary to analyze agent/principal issues for such taxes. Instead, the display is an accounting policy choice between gross and net presentation. Gross presentation includes the taxes in revenues and expenses; net presentation excludes the taxes from income statements. If an entity chooses to display such taxes gross, it should disclose the amount of tax included in revenues and expenses.

Issue No. 06-4, "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements."

In these transactions, an employer pays the premium on life insurance on the lives of selected employees. The employer owns the policy but conveys (endorses) part of the death benefit to the employee or his estate.

The Task Force reached a consensus that these transactions constitute an employer-provided postretirement life insurance benefit to the employee that should be accounted for in accordance with APB Opinion No. 12, "Omnibus Opinion – 1967," (for an individual arrangement) or FASB Statement No. 106, *Employers' Accounting for Post-retirement Benefits Other Than*

Pensions, (for a group arrangement that constitutes a plan).

The employer's liability might be computed based on the premiums on the life insurance policy (where the employer agrees to maintain the policy in force after retirement) or based on the cost of the benefit (where the employer is directly responsible for the death benefit).

Issue No. 06-5, "Accounting for Purchases of Life Insurance—Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4, Accounting for Purchases of Life Insurance."

Technical Bulletin 85-4 specifies that an employer should measure the asset for company-owned life insurance based on its cash surrender value. Sometimes an employer is entitled to an amount different from the stated cash surrender value of a policy, for example, a rebate of premium taxes.

The Task Force reached a consensus that the employer's asset should be based on the amount that the employer would receive upon surrender, regardless of how that amount is labeled in the policy.

The Task Force also reached a consensus that the asset should be measured on a policy-by-policy basis. If an employer owns multiple policies and would receive an additional amount if it surrendered all policies at the same time, the additional amount would be ignored for purposes of measuring the policy assets. However, if the employer would receive an additional amount upon surrender of the last policy, even if the policies are surrendered on different dates, the additional amount would be included in measuring the employer's asset.

Issue No. 06-8, "Applicability of the Assessment of a Buyer's Continuing Investment under FASB Statement No. 66, Accounting for Sales of Real Estate, for Sales of Condominiums."

This issue deals with the conditions for a condominium developer to apply the percentage-of-completion method to account for sales of individual condominium units in a project under construction. One of the conditions in Statement 66 for using the percentage-of-completion method is that the developer is reasonably assured of collecting the receivable from the customer.

The Task Force reached a consensus that reasonable assurance of collection means compliance with the initial and continuing investment provisions of Statement 66. If the buyer's initial or continuing investments don't meet the Statement 66 minimums, the developer should account for cash received from a buyer as a deposit rather than using the percentage-of-completion method.

Issue No. 06-9, "Reporting a Change in (or the Elimination of) a Previously Existing Difference between the Fiscal Year-End of a Parent Company and That of a Consolidated Entity or between the Reporting Period of an Investor and That of an Equity Method Investee."

Some consolidated subsidiaries or equity method investees have fiscal year ends different from their parent company/investor. This issue deals with how to account for a change in a subsidiary's/investee's fiscal year end that changes or eliminates a previous difference.

The Task Force reached a consensus that the change is a change in accounting principle and should be accounted for and disclosed in accordance with FASB Statement No. 154, *Accounting Changes and Error Corrections*. While Statement 154 generally requires retrospective application of a new accounting principle, the Task

Force noted that retroactive application is not required if it is impracticable.

FASB Staff Positions

The following represent selected FSPs that were issued in 2006 or affect standards that took effect in 2006. As in prior years, the FASB used FSPs to revise recently issued standards. We have divided the discussion of FSPs between the revisions and the other FSPs that establish new GAAP.

FSPS THAT REVISE RECENT STANDARDS

FSP FAS 123(R)-4, "Classification of Options and Similar Instruments Issued as Employee Compensation That Allow for Cash Settlement upon the Occurrence of a Contingent Event."

One of the key distinctions in Statement 123(R) is between employee awards that are classified as equity instruments (for which compensation is measured once, at grant date) and those that are classified as liabilities (for which compensation is measured every period from grant until final settlement).

Statement 123(R) as originally issued required liability classification if "the entity can be required under any circumstances to settle the option or similar instrument by transferring cash or other assets." It was brought to the FASB's attention that some companies have "change in control" clauses in option or other awards under which employees are entitled to a cash settlement in the event of a change in control. Under the original wording, a change in control clause would require liability classification even though a change in control is outside the employee's control and, in most cases, remote.

This FSP amends Statement 123(R) to state that a cash settlement feature that

can be exercised only upon the occurrence of an event outside an employee's control would not trigger this provision until or unless occurrence of the event is probable.

FSP FAS 123(R)-5, "Amendment of FASB Staff Position FAS 123(R)-1."

As noted in the discussion of FSP FAS 123(R)-4, the distinction between liability and equity classification is a key issue in Statement 123(R). The criteria for equity or liability classification for employee awards are different from the criteria for equity or liability classification for other, nonemployee equity derivatives.

Statement 123(R) as originally issued stated that the classification criteria should shift to the nonemployee criteria at the point that an employee was no longer receiving any benefit under the award from being employed. This would have required some employee equity awards to be reclassified to liabilities as soon as an employee reached that point. FSP FAS 123(R)-1 amended Statement 123(R) to state that the classification of an employee award would continue to be governed by Statement 123(R), rather than the nonemployee guidance, for the entire life of an employee award, unless the award was modified after the recipient had ceased employment.

Questions were raised about whether a modification in response to an equity restructuring, such as a spinoff after the recipient had ceased employment, would trigger the nonemployee classification. FSP FAS 123(R)-5 concludes that generally a modification in response to an equity restructuring would not cause the classification to change.

FSP FAS 123(R)-6, "Technical Corrections of FASB Statement No. 123(R)."

This FSP corrects four narrow issues in Statement 123(R), two of which are illustrative examples.

FSP FIN 46(R)-6, "Determining the Variability to be Considered in Applying FASB Interpretation No. 46(R)."

Variability is a key concept in FASB Interpretation No. 46(R), *Consolidation of Variable Interest Entities*. If a party other than an equity owner absorbs an entity's variability, that entity is a variable interest entity (VIE). An interest that absorbs variability is a variable interest, and a holder of variable interest might be a primary beneficiary that is required to consolidate a VIE. Unfortunately, the FASB issued Interpretations 46 and 46(R) in such a rush that the definition of variability was internally inconsistent.

Some accountants believed that variability in cash flows was most important. Others believed that variability in fair value was most important. Still others believed that variability in both cash flows and fair value were important, and others believed that it was necessary to assess the design of the entity to identify variability.

For most potential VIEs, this debate made little difference, because the same entity would be a primary beneficiary under any of these approaches to variability. For certain highly structured VIEs with limited activities, however, the different approaches led to dramatically different conclusions about whether an entity was a VIE and, if so, who the primary beneficiary was.

The FASB originally asked the FASB Interpretation 46(R) Resource Group to attempt to resolve this issue. Because of the internal contradictions in Interpretation 46(R), the Resource Group was unable to do so. Next, the FASB asked the EITF to attempt to resolve the issue. For the same reason, the EITF was unable to reach a consensus. Finally the FASB added the issue to its agenda and issued this FSP to address the question. The FSP endorses the "by design" approach,

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stating that in evaluating a potential VIE, it is necessary to analyze what risks the entity was intended to bear and which interest holders were intended to bear those risks.

FSPS THAT ESTABLISH NEW GAAP

FSP FAS 13-2, "Accounting for a Change or Projected Change in the Timing of Cash Flows Relating to Income Taxes Generated by a Leveraged Lease Transaction."

This FSP deals with lessors (investors) in leveraged leases. Leveraged lease accounting is unique in that a lessor's income is recorded based on after-tax cash flows. This created an issue of whether a change in the timing, but not amount, of income tax benefits should affect income recognition.

Practice was uniform in concluding that a change in timing only, with no change in the ultimate amount of tax benefits, would not affect income recognition. Conversely, a change in the amount of tax benefits would affect income recognition. For example, a change in depreciable life for income tax purposes would not affect income recognition, because the lessor would receive the same deductions over the revised life of the leased property. By contrast, a change in the amount of tax benefits, such as a disallowance of part of the depreciation for income tax purposes, would affect income recognition.

The FASB rejected this past practice and concluded that a change in the timing of tax benefits directly related to a leveraged lease should be considered a change in a significant assumption and require a lessor to recompute its model for recording lease income.

FSP FAS 126-1, "Applicability of Certain Disclosures and Interim Reporting Requirements for Obligors of Conduit Debt Securities."

State and local government units may issue municipal bonds (referred to as conduit bonds) to raise funds for speci-

fied purposes for not-for-profit organizations or for-profit businesses. The organization that receives the funds is obligated to pay the interest and principal on the bonds. If the bonds are traded on a public market, including a regional or local market, the obligor is considered a public entity for disclosure and accounting purposes.

FSP FTB 85-4-1, "Accounting for Life Settlement Contracts by Third-Party Investors."

FASB Technical Bulletin 85-4 specifies that companies should measure life insurance contracts on employees equal to cash surrender value. Questions were raised about whether cash surrender value was the most meaningful measurement for companies that invest in life insurance contracts (sometimes referred to as viatical settlement enterprises). Typically such investors pay an amount in excess of cash surrender value, so measuring the contract at cash surrender value would result in an immediate loss. This FSP concludes that an investor in life insurance contracts should apply either the investment method defined in the FSP or carry the contracts at fair value.

FSP EITF 00-19-2, "Accounting for Registration Payment Arrangements."

This FSP is one of the rare FASB pronouncements that actually simplify accounting. It deals with registration payment arrangements, under which an entity agrees to file a registration statement for resale of securities, maintain the effectiveness of such registration statement, obtain a listing on an exchange, etc. or pay consideration to the investors if it does not fulfill the commitment.

Previously, under EITF Issue 00-19, registration payment agreements were considered in deciding whether an instrument met the requirements to be classified as equity. Often a registration payment arrangement caused a

security to fail the conditions for equity classification.

In this FSP, the FASB concluded that a registration payment arrangement should be viewed as an instrument separate and apart from the related securities, so that it has no effect on the classification of the related securities. Instead, a registration payment arrangement should be viewed as a separate instrument, and the issuer should account for it in accordance with Statement 5, accruing a liability if payment is probable and the amount can be reasonably estimated.

FSP AUG AIR-1, "Accounting for Planned Major Maintenance Activities."

The AICPA Guide, *Audits of Airlines*, specifies four acceptable methods to account for planned major maintenance activities, such as periodic overhauls of jet engines. That Guide was applied by analogy in many other industries with major maintenance activities that occur at intervals. This FSP eliminates one method, accrue in advance, leaving only three acceptable methods.

In addition, the FSP concludes that accruing maintenance in advance, including routine maintenance, is not in accordance with GAAP, including in interim periods. Therefore, companies that accrue maintenance costs evenly over the four quarters, building a liability for accrued maintenance in some quarters of the year, will be required to cease that practice.

AICPA Statements of Position

The Accounting Standards Executive Committee (AcSEC) of the AICPA agreed with the FASB in 2002 to cease issuing general purpose SOPs. Hence, AcSEC issued no SOPs in 2006.

AICPA Technical Practice Aids

TPA 1400.32, Parent-Company-Only Financial Statements and Relationship to GAAP.

If consolidation is required under GAAP, this TPA indicates there are no circumstances in which an entity may prepare parent company-only financial statements without preparing related consolidated financial statements and still state the financial statements are in accordance with GAAP. The issue has become more common with the advent of FASB Interpretation 46(R). This does not impact a company's ability to provide non-GAAP statements, such as parent-only financial statements.

TPA 2130.09-37, Questions about Applying Statement of Position (SOP) No. 03-3, Accounting for Certain Loans or Debt Securities Acquired in a Transfer.

This TPA addresses 29 questions that arose in connection with SOP 03-3.

TPA 2210.28, Accounting for Certain Liquidated Damages.

This TPA indicates that the buyer of property, plant, and equipment (PP&E) should record liquidated damages as a reduction of the payments it has made to the vendor for the PP&E (that is, a reduction of the cost of the PP&E), because the buyer does not provide the payer of the damages with an identifiable benefit in exchange for the payment. The buyer should recognize liquidated damages in excess of the total cost of PP&E as income.

TPA 5700.01, Income Tax Accounting for Contributions to Certain Nonprofit Scholarship Funding Organizations.

This TPA indicates that corporate income taxpayers should report contributions made during the year to a nonprofit scholarship funding organization as contributions, rather than income tax expense, in their income

statements in accordance with FASB Statement No. 116, *Accounting for Contributions Received and Contributions Made*. The issue arises because some states provide substantial income tax credits, sometimes 100%, for such contributions.

TPA 6910.21-24, Investment Companies.

The following four issues are discussed in Q&A format:

- Recognition of Premium/Discount on Short Positions in Fixed-Income Securities.
- Presentation of Reverse Repurchase Agreements.
- Accounting Treatment of Offering Costs Incurred by Investment Partnerships.
- Meaning of "Continually Offer Interests."

GASB Pronouncements

This section contains selected releases of the Governmental Accounting Standards Board (GASB).

GASB Statement No. 43, Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans.

Statement 43 establishes accounting guidance for OPEB plans that are included as trust funds in the financial reports of plan sponsors or employers, or issued in standalone financial reports.

GASB Statement No. 45, Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions.

Statement 45 provides guidance on how to account for and report the costs and obligations related to postemployment healthcare and other forms of OPEB. The accounting requirements are based on actuarial-

determined amounts similar to requirements for pensions. The OPEB cost is generally the actuarial-determined amount that, if paid on an ongoing basis, would provide sufficient resources to pay benefits as they come due.

GASB Statement No. 47, Accounting for Termination Benefits.

Statement 47 establishes accounting standards for termination benefits. Key points:

- In financial statements prepared on the accrual basis of accounting, employers should recognize a liability and expense for *voluntary* termination benefits (for example, early-retirement incentives) when the offer is accepted and the amount can be estimated.
- A liability and expense for *involuntary* termination benefits (for example, severance benefits) should be recognized when three conditions are met: (a) a plan of termination has been approved by those with the authority to commit the government to the plan, (b) the plan has been communicated to the employees, and (c) the amount can be estimated.
- In financial statements prepared on the modified accrual basis of accounting, liabilities and expenditures for termination benefits should be recognized to the extent the liabilities are normally expected to be liquidated with expendable available financial resources.
- Healthcare-related termination benefits that are provided as the result of a large-scale, age-related program, (e.g., an early-retirement incentive program that affects a significant portion of employees), should be measured at their discounted present values based on projected total claims costs (or age-adjusted premiums approximating claims costs) for

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terminated employees, with consideration given to the expected future healthcare cost trend rate.

GASB Statement No. 48, Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues.

Governments sometimes transfer an interest in their expected cash flows from collecting specific future revenues in exchange for immediate cash payments – generally in a lump sum. Examples of these types of transactions include the sale of delinquent taxes, certain mortgages, student loans, and future revenues, such as those arising from tobacco settlement agreements.

Statement 48 establishes criteria for determining if these transactions should be regarded as a sale or collateralized borrowing. It indicates that a transaction should be reported as a collateralized borrowing unless certain criteria are met that indicate a sale has taken place. If a transaction involving *receivables* is treated as a sale, the difference between the carrying value of the receivables and the proceeds should be recognized in the period of the sale. If a transaction involving *future revenues* is reported as a sale, the revenue should be deferred and amortized, except when specific criteria are met.

Statement 48 also provides enhanced disclosures pertaining to future revenues that have been pledged or sold.

GASB Statement No. 49, Accounting and Financial Reporting for Pollution Remediation Obligations.

Statement 49 provides guidance on the accounting for pollution remediation obligations. These are obligations to address the current or potential detrimental effects of existing pollution by participating in remediation activities, such as site assessments and cleanups.

The Statement establishes five events and circumstances that obligate the government to analyze its expected future outlays for pollution remediation and consider which components should be set up as liabilities.

The triggering factors include being compelled to take action because of an imminent endangerment, violating a pollution prevention-related permit or license, being named as a responsible party or potentially responsible party, being named in a lawsuit to compel participation in pollution remediation, and commencing or legally obligating itself to commence pollution remediation.

Pollution remediation outlays may be capitalized in limited circumstances under the standard, but most pollution remediation outlays will not qualify for capitalization and should be accrued as a liability.

GASB Technical Bulletin No. 2004-2, Recognition of Pension and Other Postemployment Benefit [OPEB] Expenditures/Expense and Liabilities by Cost-Sharing Employers.

Technical Bulletin 2004-2 provides guidance on questions that may arise in applying GASB Statements 27, *Accounting for Pensions by State and Local Governmental Employers*, and 45 to cost-sharing employers. Cost-sharing refers to the practice of pooling by employers of their benefit obligations and assets under a pension or OPEB plan.

GASB Technical Bulletin No. 2006-1, Accounting and Financial Reporting by Employers and OPEB Plans for Payments from the Federal Government Pursuant to the Retiree Drug Subsidy Provisions of Medicare Part D.

Technical Bulletin 2006-1 provides guidance on questions that may arise in connection with the accounting for a retiree drug subsidy (RDS) received

under the Medicare Prescription Drug, Improvement, and Modernization Act of 2003. The payments are made by the federal Department of Health and Human Services to the employer (in the case of a single-employer plan) or the plan (in the case of a multi-employer arrangement).

The Technical Bulletin clarifies that an RDS should be accounted for as a voluntary nonexchange transaction, with an asset and revenue recognized in accordance with GASB Statement No. 33, *Accounting and Reporting for Nonexchange Transactions*.

Guide to Implementation of GASB Statements 43 and 45 on Other Postemployment Benefits.

This guide provides the answers to over 250 questions. Topics include:

- Differences between OPEB benefits and other forms of employee benefits, such as compensated absences, termination benefits, and pensions.
- The timing and frequency of actuarial valuations associated with OPEB, selection of methods and assumptions, and application of criteria related to the projection of benefits for employers that participate in community-rated plans.
- Treatment of implicit rate subsidies that arise when retirees are insured in a group with current employees.

The guide also includes questions and answers, along with expanded illustrations, for certain employers and plans with small plan memberships.

Table 1

Listing of Recent Pronouncements

The following summary was prepared for reference purposes using excerpts from the pronouncements about their effective dates wherever practicable.

Pronouncement	Title and Dates (Issued and Effective)
FASB Statement No. 155	FASB Statement No. 155, <i>Accounting for Certain Hybrid Financial Instruments—an amendment of FASB Statements No. 133 and 140</i> , was issued in February 2006. It is effective for all financial instruments acquired, issued, or subject to a remeasurement (new basis) event occurring after the beginning of an entity's first fiscal year that begins after September 15, 2006.
FASB Statement No. 156	FASB Statement No. 156, <i>Accounting for Servicing of Financial Assets—an amendment of FASB Statement No. 140</i> , was issued in March 2006. It is effective as of the beginning of an entity's first fiscal year that begins after September 15, 2006. Earlier application is permitted if the entity has not yet issued interim or annual financial statements for that fiscal year.
FASB Statement No. 157	FASB Statement No. 157, <i>Fair Value Measurements</i> , was issued in September 2006. It is effective for fiscal years beginning after November 15, 2007, and all interim periods within those fiscal years. Earlier application is permitted if the entity has not yet issued interim or annual financial statements for that fiscal year.
FASB Statement No. 158	<p>FASB Statement No. 158, <i>Employers Accounting for Defined Benefit Pension and Other Postretirement Plans</i>, was issued in September 2006.</p> <p>Its requirements are effective as follows:</p> <ul style="list-style-type: none"> – For an employer with publicly traded equity securities, the requirement to recognize the funded status of a benefit plan and the disclosure requirements are effective as of the end of the fiscal year ending after December 15, 2006. – For an employer without publicly traded equity securities, the requirement to recognize the funded status of a benefit plan and the disclosure requirements are effective as of the end of the fiscal year ending after June 15, 2007. – The requirement to measure plan assets and benefit obligations as of the date of the employer's fiscal year-end statement of financial position (paragraphs 5, 6, and 9) is effective for fiscal years ending after December 15, 2008.
FASB Statement No. 159	FASB Statement No. 159, <i>The Fair Value Option for Financial Assets and Financial Liabilities—including an amendment of FASB Statement No. 115</i> , was issued in February 2007. Its requirements are effective as of the beginning of the first fiscal year that begins after November 15, 2007. Early adoption is permitted as of the beginning of a fiscal year that begins on or before November 15, 2007, provided the entity also elects to apply the provisions of FASB Statement No. 157, <i>Fair Value Measurements</i> . Retrospective application is not permitted to fiscal years beginning prior to the effective date, unless the entity elects early adoption.

Listing of Recent Pronouncements (continued)

Pronouncement	Title and Dates (Issued and Effective)
FASB Interpretation No. 48	<p>FASB Interpretation No. 48, <i>Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109</i>, was issued in July 2006. It is effective for fiscal years beginning after December 15, 2006. Earlier application is permitted if the entity has not yet issued interim or annual financial statements for the period of adoption.</p>
EITF Issue No. 96-19	<p>The consensus on EITF Issue No. 96-19, "Debtor's Accounting for a Modification or Exchange of Debt Instruments," was modified as part of Issue 06-6, and the modification was ratified by the FASB in November 2006.</p> <p>The November 2006 amendment to this Issue is effective concurrently with related provisions of Issue No. 06-6, "Debtor's Accounting for a Modification (or Exchange) of Convertible Debt Instruments" which supersedes the amendments on Issue 96-19 made by Issue 05-7. The revised consensus is effective for modifications or exchanges of debt instruments occurring in interim or annual reporting periods beginning after Board ratification (November 29, 2006).</p> <p>Earlier application is permitted for modifications or exchanges of debt instruments in periods for which financial statements have not yet been issued. Retrospective application to previously issued financial statements is not permitted.</p>
EITF Issue No. 03-7	<p>The consensus on EITF Issue No. 03-7, "Accounting for the Settlement of the Equity-Settled Portion of a Convertible Debt Instrument That Permits or Requires the Conversion Spread to Be Settled in Stock (Instrument C of Issue No. 90-19)," was modified in June 2006 and ratified by the FASB the same month.</p> <p>The June 2006 amendment to this Issue is effective concurrently with the related provisions of Issue 05-1, ratified in June 2006.</p>
EITF Issue No. 05-1	<p>The FASB ratified the consensus on EITF Issue No. 05-1, "Accounting for the Conversion of an Instrument That Becomes Convertible upon the Issuer's Exercise of a Call Option" in June 2006.</p> <p>This Issue applies to all conversions within the scope of this Issue that result from the exercise of call options and is effective in interim or annual reporting periods beginning after June 28, 2006 (the date the FASB ratified the consensus), irrespective of whether the instrument was entered into prior or subsequent to Board ratification of this Issue. For instruments issued prior to the effective date of this consensus, the assessment as to whether a substantive conversion feature exists at issuance should be based only on assumptions, considerations, and/or marketplace information available as of the issuance date.</p> <p>Early application of this Issue is permitted in periods for which financial statements have not yet been issued. Retrospective application to previously issued financial statements is not permitted.</p>

Table 1

Listing of Recent Pronouncements (continued)

Pronouncement	Title and Dates (Issued and Effective)
EITF Issue No. 06-1	<p>The FASB ratified the consensus on EITF Issue 06-1, "Accounting for Consideration Given by a Service Provider to a Manufacturer or Reseller of Equipment Necessary for an End-Customer to Receive Service from the Service Provider" in September 2006.</p> <p>Issue 06-1 is effective for the first annual reporting period beginning after June 15, 2007. Earlier application is permitted for financial statements that have not yet been issued.</p>
EITF Issue No. 06-2	<p>The FASB ratified the consensus on EITF Issue 06-2, "Accounting for Sabbatical Leave and Other Similar Benefits Pursuant to FASB Statement No. 43, <i>Accounting for Compensated Absences</i>," in June 2006.</p> <p>Issue 06-2 is effective for fiscal years beginning after December 15, 2006. Earlier application is permitted if an entity has not yet issued interim or annual financial statements for that fiscal year.</p>
EITF Issue No. 06-3	<p>The FASB ratified the consensus on EITF Issue No. 06-3, "How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation)" in June 2006.</p> <p>Issue 06-3 is effective for interim and annual reporting periods beginning after December 15, 2006. Earlier application is permitted.</p>
EITF Issue No. 06-4	<p>The FASB ratified the consensus on EITF Issue No. 06-4, "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements," in September 2006.</p> <p>Issue 06-4 is effective for fiscal years beginning after December 15, 2007, with earlier application permitted.</p>
EITF Issue No. 06-5	<p>The FASB ratified the consensus on EITF Issue No. 06-5, "Accounting for Purchases of Life Insurance-Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4, <i>Accounting for Purchases of Life Insurance</i>," in September 2006.</p> <p>Issue 06-5 is effective for fiscal years beginning after December 15, 2006. Earlier application is permitted as of the beginning of a fiscal year for periods in which interim or annual financial statements have not yet been issued.</p>

Listing of Recent Pronouncements (continued)

Pronouncement	Title and Dates (Issued and Effective)
EITF Issue No. 06-6	<p>The FASB ratified the consensus on EITF Issue No. 06-6, "Debtor's Accounting for a Modification (or Exchange) of Convertible Debt Instruments," in November 2006.</p> <p>Issue 06-6 is effective for modifications or exchanges of debt instruments occurring in interim or annual reporting periods beginning after Board ratification (November 29, 2006). Earlier application is permitted for modifications or exchanges of debt instruments in periods for which financial statements have not yet been issued. Retrospective application to previously issued financial statements is not permitted.</p>
EITF Issue No. 06-7	<p>The FASB ratified the consensus on EITF Issue No. 06-7, "Issuer's Accounting for a Previously Bifurcated Conversion Option in a Convertible Debt Instrument When the Conversion Option No Longer Meets the Bifurcation Criteria in FASB Statement No. 133, <i>Accounting for Derivative Instruments and Hedging Activities</i>" In November 2006.</p> <p>Issue 06-7 is effective for previously bifurcated conversion options in convertible debt instruments that cease to meet the bifurcation criteria in Statement 133 in interim or annual periods beginning after December 15, 2006, regardless of whether the debt instrument was entered into prior or subsequent to Board ratification (November 29, 2006). Earlier application is permitted in periods for which financial statements have not yet been issued.</p>
EITF Issue No. 06-8	<p>The FASB ratified the consensus on EITF Issue No. 06-8, "Applicability of the Assessment of a Buyer's Continuing Investment under FASB Statement No. 66, <i>Accounting for Sales of Real Estate</i>, for Sales of Condominiums." In November 2006.</p> <p>Issue 06-8 is effective for the first annual reporting period beginning after March 15, 2007. Earlier application is permitted as of the beginning of a fiscal year provided that the entity has not yet issued financial statements for that fiscal year.</p>
EITF Issue No. 06-9	<p>The FASB ratified the consensus on EITF Issue No. 06-9, "Reporting a Change in (or the Elimination of) a Previously Existing Difference between the Fiscal Year-End of a Parent Company and That of a Consolidated Entity or between the Reporting Period of an Investor and That of an Equity Method Investee," in November 2006.</p> <p>Issue 06-9 is effective for changes occurring in interim or annual reporting periods beginning after Board ratification (November 29, 2006). Earlier application of this guidance is permitted in periods for which financial statements have not yet been issued.</p>

Table 1

Listing of Recent Pronouncements (continued)

Pronouncement	Title and Dates (Issued and Effective)
FASB Staff Position FSP FAS 13-2	<p>The FASB released FSP FAS 13-2, "Accounting for a Change or Projected Change in the Timing of Cash Flows Relating to Income Taxes Generated by a Leveraged Lease Transaction," in July 2006.</p> <p>FSP FAS 13-2 is effective for fiscal years beginning after December 15, 2006. Earlier application is permitted if the entity has not yet issued interim or annual financial statements.</p>
FASB Staff Position FSP FAS 123(R)-4	<p>The FASB released FSP FAS 123(R)-4, "Classification of Options and Similar Instruments Issued as Employee Compensation That Allow for Cash Settlement upon the Occurrence of a Contingent Event" in February 2006.</p> <p>FSP FAS 123(R)-4 is effective upon initial adoption of Statement 123(R) or, in the case of an entity that adopted Statement 123(R) prior to the issuance of this FSP, the first reporting period after February 3, 2006. Early application of this guidance is permitted in periods for which financial statements have not yet been issued.</p>
FASB Staff Position FSP FAS 123(R)-5	<p>The FASB released FSP FAS 123(R)-5, "Amendment of FASB Staff Position FAS 123(R)-1," in October 2006.</p> <p>FSP FAS 123(R)-5 is effective for the first reporting period beginning after October 10, 2006. Early application of this guidance is permitted in periods for which financial statements have not yet been issued.</p>
FASB Staff Position FSP FAS 123(R)-6	<p>The FASB released FSP FAS 123(R)-6, "Technical Corrections of FASB Statement No. 123(R)" in October 2006.</p> <p>FSP FAS 123(R)-6 is effective for the first reporting period beginning after October 20, 2006. Early application of this guidance is permitted in periods for which financial statements have not yet been issued.</p>
FASB Staff Position FSP FAS 126-1	<p>The FASB released FSP FAS 126-1, "Applicability of Certain Disclosure and Interim Reporting Requirements for Obligor for Conduit Debt Securities," in October 2006.</p> <p>FSP FAS 126-1 is effective for the fiscal periods beginning after December 15, 2006.</p>

Listing of Recent Pronouncements (continued)

Pronouncement	Title and Dates (Issued and Effective)
FASB Staff Position FSP FIN 46(R)-6	<p>The FASB released FSP FIN 46(R)-6, "Determining the Variability to Be Considered in Applying FASB Interpretation No. 46(R)," in April 2006.</p> <p>FSP FIN 46(R)-6 should be applied by an enterprise to all entities (including newly created entities) with which that enterprise first becomes involved and to all entities previously required to be analyzed under Interpretation 46(R) when a reconsideration event has occurred pursuant to paragraph 7 of Interpretation 46(R) beginning the first day of the first reporting period beginning after June 15, 2006. Early application is permitted for periods for which financial statements have not yet been issued. Retrospective application to the date of the initial application of Interpretation 46(R) is permitted but not required. Retrospective application, if elected, must be completed no later than the end of the first annual reporting period ending after July 15, 2006.</p>
FASB Staff Position FSP FTB 85-4-1	<p>The FASB released FSP FTB 85-4-1, "Accounting for Life Settlement Contracts by Third-Party Investors," in March 2006.</p> <p>FSP FTB 85-4-1 is effective for fiscal years beginning after June 15, 2006. Earlier application is permitted as of the beginning of an investor's fiscal year, provided that the investor has not yet issued its first quarter financial statements for that fiscal year. The disclosure requirements of FSP FTB 85-4-1 should be applied as of the most recent statement of financial position or income statement presented.</p>
FASB Staff Position FSP EITF 00-19-2	<p>The FASB released FSP EITF 00-19-2, "Accounting for Registration Payment Arrangements," in December 2006.</p> <p>FSP EITF 00-19-2 is effective for registration payment arrangements and the financial instruments subject to those arrangements that are entered into or modified after December 21, 2006. For registration payment arrangements and financial instruments subject to those arrangements that were entered into prior to December 21, 2006, this guidance is effective for financial statements issued for fiscal years beginning after December 15, 2006, and interim periods within those fiscal years.</p>
FASB Staff Position FSP AUG AIR-1	<p>The FASB released FSP AUG AIR-1, "Accounting for Planned Major Maintenance Activities," in September 2006.</p> <p>FSP AUG AIR-1 is effective for the first fiscal year beginning after December 15, 2006. Earlier adoption is permitted as of the beginning of the entity's fiscal year.</p>

Table 1

Listing of Recent Pronouncements (continued)

Pronouncement	Title and Dates (Issued and Effective)
<p>GASB Statement No. 43</p>	<p>The GASB released Statement No. 43, <i>Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans</i>, in April 2004.</p> <p>The requirements of GASB Statement 43 for OPEB plan reporting are effective <i>one year prior</i> to the effective date of the related Statement for the employer (single-employer plan) or for the largest participating employer in the plan (multiple-employer plan). The requirements of the related Statement are effective in three phases based on a government's total annual revenues, as defined in that Statement, in the first fiscal year ending after June 15, 1999. This means the effective dates for Statement 43 are as follows:</p> <ul style="list-style-type: none"> – Plans in which the sole or largest participating employer is a <i>phase 1 government</i> (those with total annual revenues of \$100 million or more) are required to implement this Statement in financial statements for periods beginning after December 15, 2005. – Plans in which the sole or largest participating employer is a <i>phase 2 government</i> (total annual revenues of \$10 million or more but less than \$100 million) are required to implement this Statement in financial statements for periods beginning after December 15, 2006. – Plans in which the sole or largest participating employer is a <i>phase 3 government</i> (total annual revenues of less than \$10 million) are required to implement this Statement in financial statements for periods beginning after December 15, 2007. <p>If comparative financial statements are presented, restatement of the prior-year financial statements is required. Early implementation of this Statement is encouraged.</p>
<p>GASB Statement No. 45</p>	<p>The GASB released Statement No. 45, <i>Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions</i>, in June 2004.</p> <p>GASB Statement 45 generally provides for prospective implementation—that is, that employers set the beginning net OPEB obligation at zero as of the beginning of the initial year. Implementation is required in three phases based on a government's total annual revenues in the first fiscal year ending after June 15, 1999. The definitions and cutoff points for that purpose are the same as those in Statement No. 34, <i>Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments</i>. This Statement is effective for periods beginning after December 15, 2006, for <i>phase 1 governments</i> (those with total annual revenues of \$100 million or more); after December 15, 2007, for <i>phase 2 governments</i> (those with total annual revenues of \$10 million or more but less than \$100 million); and after December 15, 2008, for <i>phase 3 governments</i> (those with total annual revenues of less than \$10 million). Earlier implementation is encouraged.</p>

Listing of Recent Pronouncements (continued)

Pronouncement	Title and Dates (Issued and Effective)
<p>GASB Statement No. 47</p>	<p>The GASB released Statement No. 47, <i>Accounting for Termination Benefits</i>, in June 2005.</p> <p>The requirements of this Statement are effective in two parts. For termination benefits provided through an existing defined benefit OPEB plan, the provisions of this Statement should be implemented simultaneously with the requirements of Statement 45. For all other termination benefits, this Statement is effective for financial statements for periods beginning after June 15, 2005. Earlier application is encouraged.</p> <p>In the initial year of implementation, the requirements of this Statement should be applied to any previous commitments of termination benefits that remain unpaid at the effective date of the Statement. The cumulative effect of applying this Statement should be reported as a restatement of beginning net assets (or equity or fund balance, as appropriate). Financial statements for prior periods are not required to be restated.</p>
<p>GASB Statement No. 48</p>	<p>The GASB released Statement No. 48, <i>Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues</i>, in September 2006.</p> <p>GASB Statement 48 is effective for periods beginning after December 15, 2006. Earlier adoption is encouraged. In the first period that this Statement is applied, changes made to comply with Statement 48, except those that would result from applying the deferral provisions in paragraphs 14 and 15 relative to sales of future revenues, should be treated as an adjustment of prior periods, and financial statements presented for the periods affected should be restated. The deferral requirements in paragraphs 14 and 15 may be applied prospectively. If restatement of the financial statements for prior periods is not practical, the cumulative effect of applying Statement 48 should be reported as a restatement of beginning net assets (or equity or fund balance, as appropriate) for the earliest period restated (generally, the current period). In the first period that Statement 48 is applied, the financial statements should disclose the nature of the restatement and its effect.</p>

Table 1

Listing of Recent Pronouncements (continued)

Pronouncement	Title and Dates (Issued and Effective)
GASB Statement No. 49	<p>The GASB released Statement No. 49, <i>Accounting and Financial Reporting for Pollution Remediation Obligations</i>, in November 2006.</p> <p>GASB Statement 49 is effective for financial statements of periods beginning after December 15, 2007, with earlier adoption encouraged. Governments that have sufficient objective and verifiable information to apply the expected cash flow technique to measurements in prior periods should apply the provisions of this Statement retroactively for all such prior periods presented. Governments that do not have that information should apply the provisions of this Statement as of the effective date. In that case, pollution remediation liabilities should be measured at the beginning of that period so that beginning net assets can be restated. In the period Statement 49 is first applied, the financial statements should disclose the nature of any restatement and its effect. Also, the reason for not restating prior periods presented should be explained.</p>
GASB Technical Bulletin No. 2004-2	<p>The GASB released Technical Bulletin No. 2004-2, <i>Recognition of Pension and Other Postemployment Benefit [OPEB] Expenditures/Expense and Liabilities by Cost-Sharing Employers</i>, in December 2004.</p> <p>For pension transactions, GASB Technical Bulletin 2004-2 is effective for financial statements for periods ending after December 15, 2004; earlier application is encouraged.</p> <p>For OPEB transactions, the provisions of GASB Technical Bulletin 2004-2 should be applied simultaneously with the requirements of Statement 45.</p>
GASB Technical Bulletin No. 2006-1	<p>The GASB released Technical Bulletin No. 2006-1, <i>Accounting and Financial Reporting by Employers and OPEB Plans for Payments from the Federal Government Pursuant to the Retiree Drug Subsidy Provisions of Medicare Part D</i>, in June 2006.</p> <p>GASB Technical Bulletin 2006-1 was effective immediately upon issuance, except for portions of answers pertaining specifically to measurement, recognition, or required supplementary information requirements of Statement 43 or Statement 45. Those provisions should be applied simultaneously with the implementation of Statement 43 or Statement 45.</p>

Accounting Year In Review: 2006

A Financial Reporting letter



For More Information

If you would like further information or to discuss the implications of the matters discussed in this Financial Reporting letter, please contact the BDO Seidman engagement partner serving you or one of the following partners: Ben Neuhausen or Wayne Kolins.

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Material discussed in this *Financial Reporting* letter is meant to provide general information and should not be acted upon without first obtaining professional advice appropriately tailored to your individual circumstances.
