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TOP ACCOUNTING ISSUES FOR 2011 CPE COURSE

Introduction

CCH's *Top Accounting Issues for 2011 CPE Course* helps CPAs stay abreast of the most significant new accounting standards and important projects. It does so by identifying the events of the past year that have developed into hot issues and reviewing the opportunities and pitfalls presented by these changes. The topics reviewed in this course were selected because of their impact on financial reporting and because of the role they play in understanding the accounting landscape in the year ahead.

Module 1 of this course reviews the authoritative literature on IFRS and is designed to assist accounting practitioners in putting these principles into practice.

Chapter 1 reviews the IASB and the basic authoritative literature of IFRS for preparing financial statements. The IASB's formal objectives are to develop and promote use of "a single set of high quality, understandable and enforceable global accounting standards" to help users of financial information obtain high-quality, transparent information with which to make economic decisions.

This chapter outlines the structure of the IASB and the work it does with national accounting standard-setters, discusses the IFRS framework, and details the elements of financial statements that IFRS requires.

Chapter 2 discusses the requirements for first-time adopters of IFRS. Recognizing that the wholesale adoption of International Standards, by switching from a national GAAP system, raised issues of a great magnitude, the IASB issued IFRS 1, "First-Time Adoption of International Reporting Standards," effective from January 1, 2004.

IFRS 1 has been regularly updated to take account of new standards as they appear. This increasingly created a disorganized standard. Accordingly, IASB completely redesigned and re-sequenced the material in IFRS 1. The new version was issued in November 2008, and became fully effective from July 1, 2009.

Module 2 of the course distills requirements of recent FASB literature into a concise analysis that is designed to assist accounting practitioners in putting these principles into practice.

Chapter 3 covers FAS 167 (now codified as part of FASB ASC Topic 810), which has as its primary goal to improve the application of certain provisions found in FIN 46R, including changes made to the Qualified Special Purpose Entity (QSPE) rules. The chapter discusses what characterizes a VIE, the tests that should be performed to determine whether an entity is a VIE, and other requirements related to VIEs.

Chapter 4 continues the analysis of FAS 167 (FASB ASC Topic 810) and looks at how to identify variable interests in a VIE, how to determine the primary beneficiary, what is required for consolidation, what constitutes a variable interest, and more.

Module 3 of the course distills requirements of recent FASB literature into a concise analysis that is designed to assist accounting practitioners in putting these principles into practice.

Chapter 5 discusses FASB No. 165 (now codified as part of ASC Topic 855), *Subsequent Events*, which strives to put U.S. GAAP more in line with international standards and in particular, IAS 10, *Events after the Reporting Period.*

Chapter 6 explains the changes made as a result of FAS 166 (now codified as ASC Topic 860) related to the accounting for the transfer of financial assets. It covers the background and scope of the statement, as well as the accounting and disclosures required by the statement for transfers of financial assets.

Chapter 7 discusses changes to the source of authoritative U.S. GAAP, the FASB Accounting Standards Codification™ (FASB Codification), which are communicated through an Accounting Standards Update (ASU).

Throughout this course you will find Examples and Observations to illustrate the topics covered and assist you with comprehension of the course material, as well as Study Questions to help you test your knowledge. Answers to the Study Questions, with feedback on both correct and incorrect responses, are provided in a special section beginning on page 219. To assist you in your later reference and research, a detailed topical index has been included for this course, beginning on page 241.

This course is divided into three Modules. Take your time and review each course Module. When you feel confident that you thoroughly understand the material, turn to the CPE Quizzer. Complete one or all Module Quizzers for Continuing Professional Education credit. You can complete and return the Quizzers to CCH for grading at an additional charge. If you receive a grade of 70 percent or higher on the Quizzers, you will receive CPE credit for the Modules graded. Further information is provided in the CPE Quizzer Instructions on page 249.

August 2010

COURSE OBJECTIVES

This course provides an overview of important accounting developments. At the completion of the course, the reader will be able to:

- Outline the objectives of the IASB
- Describe the IFRS Framework
- List the elements of financial statements according to IFRS
- Describe what is included in the definition of IFRS
- Point out the significance of cost in generating an entity's first IFRS financial statements
- List the requirements for an entity's opening IFRS balance sheet
- List the situations in which retrospective application is prohibited by IFRS and in which cases it is optional
- Describe how historical information should be presented under IFRS
- Describe what characterizes a VIE
- Explain the tests, both qualitative and quantitative, that are used to determine whether an entity is a VIE and who should perform those tests
- List the requirements under FIN 46R (now codified as part of FASB ASC Topic 810) that must be satisfied in order for one entity to consolidate an off-balance sheet entity
- State when a VIE should be recharacterized and at what value
- List examples of variable interests
- Determine whether an entity has an interest in a VIE
- Determine who is the primary beneficiary in a VIE
- List the disclosure requirements under FIN 46R (FASB ASC 810)
- Describe the scope, terms, and requirements of ASC Topic 855
- Explain the disclosure requirements of ASC Topic 855
- Describe the scope of FASB 166 (ASC Topic 860)
- List what is required in order for the transfer of a financial asset to be accounted for as a sale
- Identify what constitutes an entire financial asset
- Explain the accounting required for different situations described in ASC Topic 860
- Describe the objectives for the disclosure requirements of ASC Topic 860
- Explain how to determine whether to aggregate disclosures for multiple transfers of financial assets
- Describe the changes made to GAAP due to recently issued ASUs
- List the specific requirements of several selected ASUs in 2009 and 2010

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IFRS: Introduction to International Financial Reporting Standards

LEARNING OBJECTIVES

Upon completion of this chapter, the reader will be able to:

- Outline the objectives of the IASB
- Describe the IFRS Framework
- List the elements of financial statements according to IFRS

THE INTERNATIONAL ACCOUNTING STANDARDS BOARD

Introduction

The present International Accounting Standards Board (IASB) is a result of a comprehensive restructuring in 2001 of the former International Accounting Standards Committee (IASC):

> an independent, private sector body, formed in 1973 with the objective of harmonising the accounting principles which are used by businesses and other organisations for financial reporting around the world.

The IASB's formal objectives, as stated in its International Financial Reporting Standards (IFRS), are:

> (a) to develop, in the public interest, a single set of high quality, understandable and enforceable global accounting standards that require high quality, transparent and comparable information in financial statements and other financial reporting to help participants in the various capital markets of the world and other users of the information to make economic decisions;
>
> (b) to promote the use and rigorous application of those standards; and
>
> (c) to work actively with national standard-setters to bring about convergence of national accounting standards and IFRSs to high quality solutions.

Thus, the original objective of "harmonising accounting principles" has evolved into the objectives of "develop[ing] . . . a single set of *high quality* . . . *global accounting standards* . . . to help participants in *capital markets* and others make *decisions*," "promot[ing] the . . . *rigorous application* of those standards" and "bring[ing] about *convergence* . . . *[toward] high quality solutions*."

This evolution of its objectives is associated with its collaboration with the International Organization of Securities Commissions since 1995, which led in 2000 to a comprehensive restructuring of the IASC, which took effect in 2001.

The New Structure

Like the FASB in 1972, and the U.K. Accounting Standards Board in 1990, which replaced the APB and the ASC, respectively, the new IASB differs from its predecessor by having a two-tier structure, based on an organ of governance not involved in standard-setting (the Trustees), and a standard-setting Board. According to Clause 3 of the IASC Constitution:

> The governance of IASC shall rest with the Trustees and the Board and such other governing organs as may be appointed by the Trustees or the Board in accordance with the provisions of this Constitution. The Trustees shall use their best endeavors to ensure that the requirements of this Constitution are observed; however, they are empowered to make minor variations [in the Constitution] in the interest of feasibility of operation if such variations are agreed by 75% of all the Trustees.

The new structure is broadly the one proposed in the Strategic Working Party's November 1999 report, "Recommendations on Shaping IASC for the Future." There are 22 Trustees of the IASC Foundation, of whom six should be from North America, six from Europe, six from the Asia/Pacific region, and four from any area, subject to establishing an "overall geographical balance." The new Board differs significantly from its predecessor (the Committee) by having 12 full-time members as well as two part-time members. Moreover, its members are to be chosen for their technical expertise and background experience and (in contrast to the Trustees) not on the basis of geographical representation. The original (2000) constitution contained tightly defined requirements concerning liaison responsibilities with national standard-setters and also as regards the professional backgrounds of the membership. These have now been relaxed (from 2005). Liaison with "national standard setters and other official bodies concerned with standard-setting" is to be maintained, and the IASB membership should provide "an appropriate mix of recent practical experience among auditors, preparers, users and academics" (Constitution, clauses 22 and 21). Each member has one vote and most decisions are to be made by a simple majority of members attending in person or by a telecommunications link, with a quorum being such attendance by "at least 60% of the members" and the Chairman having a casting vote. The publication of an exposure draft, final IFRS, or final interpretation of the IFRIC, which replaced the Standing Interpretations Committee (SIC), requires approval by at least nine members of the Board. This change to majority voting is significant, as the old IASC required a 75 percent majority.

Trustees

The trustees consist of 20 individuals with diverse geographic and functional backgrounds. Trustees will:

- Appoint the Members of the Board, the Standing Interpretations Committee, and the Standards Advisory Council
  - Monitor IASB's effectiveness
  - Raise its funds
  - Approve IASB's budget
- Have responsibility for constitutional change

STANDARDS ADVISORY COUNCIL	**BOARD** **14 members** **12 full-time, 2 part-time**	**INTERNATIONAL FINANCIAL REPORTING INTERPRETATIONS COMMITTEE**

The first Chairman of the IASC Foundation Trustees was Paul A. Volcker, former Chairman of the U.S. Federal Reserve Board. The first Chairman of the new Board was Sir David Tweedie, who moved from being Chairman of the U.K. Accounting Standards Board and was formerly U.K. technical partner for KPMG, after an academic career in Scotland.

The International Financial Reporting Interpretations Committee (IFRIC) has a role similar to that of its predecessor, the SIC. The IFRIC has 12 voting members and a non-voting Chairman, all appointed by the Trustees. An interpretation is approved if no more than three members have voted against it after considering public comments on the draft interpretation.

The Standards Advisory Council, with about 40 members, provides a forum for participation by organizations and individuals with an interest in international financial reporting and having diverse geographic and functional backgrounds, with the objective of giving advice to the Board on agenda decisions and priorities, informing the Board of the view of members of the Council on major standard-setting projects, and giving other advice to the Board or the Trustees. The Chairman of the Standards Advisory Council, from 2005, is appointed by the Trustees and is not to be a member of the IASB or a member of its staff. He or she is invited to attend and participate in the Trustees' meetings.

Despite the complicated appointments procedures, the original membership of the Board was widely felt to be excessively "Anglo-Saxon" in its orientation and, in particular, lacking in representation from developing and emerging economies, where the determination of fair value by reference to market prices, among other things required by IASB GAAP, may be particularly problematic. The Standards Advisory Council may have been designed to allow at least some input from such other directions. The IASB is in the process of revising both constitution and membership. The number of members is being raised to 16, and the proportion of "Anglo-Saxon" membership of the Board is being reduced.

The Current Positions

In the report of the Strategic Working Party, "Recommendations on Shaping IASC for the Future" it was stated that:

> The primary attributes [considered desirable to establish the legitimacy of a standard setting organization] identified were the representativeness of the decision making body, the independence of its members, and technical expertise. . . . The proposed structure . . . provides a balanced approach to legitimacy based upon representativeness among members of the Trustees, the Standing Interpretations Committee (SIC), and the Standards Advisory Council, and technical competence and independence among Board Members.

The restructured IASB is undoubtedly much better equipped than its predecessor in these respects, as well as being far better resourced. Yet, the key to the IASB's future as a global accounting standard-setter will be the acceptance of its standards for cross-border listings by securities markets worldwide, by all members of IOSCO, *including the SEC for foreign registrants in the United States,* without the need for reconciliations to national GAAP. One of the watchwords of the IASB is *convergence*. This is a two-way process: national sets of accounting standards are to converge toward one another, with IFRSs as the points of convergence, but IFRSs are also expected to converge toward certain national standards in some cases where the latter are recognized as conceptually or technically superior to existing IASs. On certain particularly important and difficult matters, such as financial instruments, the IASB may look, as it has done in the past, to joint working parties composed of experts from countries such as Australia/New Zealand, Canada, the United Kingdom, and the United States, who with the former IASC formed the so-called G4+1.

The SEC's decision, announced in November 2007, not to require foreign registrants that comply with all applicable IFRSs to file reconciliations to U.S. GAAP is a most important milestone for the IASB.

Of major significance also was the decision of the European Commission to make compliance with IASB GAAP mandatory by 2005 for the consolidated financial statements of all corporations listed on stock exchanges in the EU. In its communication dated June 2000, the Commission set out this policy, but also referred to the need for an "endorsement mechanism" at EU level, "because it would not delegate accounting standard setting unconditionally and irrevocably to a private organization [the IASB] over which the EU has no influence . . . [and] it is important to create legal certainty by identifying the standards which listed companies will have to apply in the future. . . . Because the endorsement mechanism will have an important pro-active role, it can be expected that the new standards adopted by [IASB] will also be acceptable in an EU environment." The reference to "an important pro-active role" suggests an intention to influence the "convergence process" in a "European" direction, as a counterweight to other influences, particularly from the United States and the other countries whose accounting standard-setters made up, with the IASC, the now defunct G4+1 (Australia/New Zealand, Canada, and the U.K.).

As well as pressure from the U.S., therefore, the IASB has to contend with this endorsement mechanism set up by the European Commission. In this connection, a new private sector body, the European Financial Reporting Advisory Group (EFRAG), has been set up, and EFRAG has formed a Technical Expert Group (TEG) to advise the European Commission on the appropriateness of IASB standards for use in the EU. The TEG is composed of representatives from the accounting profession, financial analysts, stock exchange regulators, accounting standard-setters and financial statement preparers. The final component of the endorsement mechanism is the Accounting Regulatory Committee (ARC), which makes the final decision on whether to endorse IASB standards for use in the EU. The ARC is composed of government representatives from all of the EU member states and chaired by a representative of the EC; in other words, it has a political character.

When the endorsement mechanism was first set up, the issue arose of whether it would serve merely to satisfy the considerable body of legal opinion in the EU that does not accept the legitimacy of private sector standard-setting and therefore content itself with performing a purely formal legitimization role, or whether it would seek actively to influence IASB standards and thus provide a forum for lobbying intended to influence them. The experience of the endorsement in November 2004 of the standards existing at that date throws some light on this issue. All of those standards were endorsed, with the exception of IAS 39, "Financial Instruments: Recognition and Measurement," which received only partial endorsement, largely as a result of lobbying by banks in four EU member states: Belgium, France, Germany, and Italy.

In fact, 95 percent of the text of IAS 39 was endorsed, but there were two significant "carve-outs" involving a number of paragraphs dealing with:

- The "fair-value option" insofar as it permits the designation of any financial liability as "at fair value through profit and loss"
- Certain restrictions in hedge accounting on portfolio hedges of interest rate risk (e.g., the prohibition of designating a non-derivative financial asset or liability as a hedging item for interest rate risk)

Without the first carve-out, the second would have been superfluous, since items accounted for at fair value can act as hedges or hedged items without any need for being so designated, thus making hedge accounting unnecessary. The first carve-out, regarding the fair value option, has now been reversed ("carved back in"). The original fair value option was revised by the IASB, and this revised version was fully endorsed by the EU mechanism, with its application backdated to January 1, 2005. The second carve-out, though of less significance for the reason noted, still remains. It would seem that legalistic objections to the fair-value option (on the grounds that it contravenes the prohibition in the EC Fourth Directive of the recognition of unrealized gains), were overcome by use of the "true and fair override" contained in the Directive.

This experience with IAS 39 both indicates that the operation of the endorsement mechanism can influence the IASB's standard-setting process (the amendments to the fair-value option being a case in point) and suggests that lobbying of the ARC will be part of the picture. It has to be said, however, that IAS 39 has been a particularly controversial standard with respect to its requirements on hedges and hedge accounting. Some future standards may also be controversial.

The endorsement process and, in particular, the phase that consists of approval by the European Parliament, can have the effect of delaying the implementation of an IFRS or an amendment for what appear to be purely "bureaucratic" reasons. Thus, while both the EFRAG and the ARC approved IFRS 8, "Operating Segments" (issued in November 2006), the IFRS did not receive final endorsement until November 2007 (with the effect that the right to early adoption of the IFRS by EU reporting entities was effectively removed). There are other examples. As the majority of the reporting entities expected to apply IFRSs are domiciled in the EU, these bureaucratic (or political) delays can be tiresome. However, they may turn out to be a price that is worth paying, insofar as the EFRAG brings to bear on the IASB's way of thinking, a well-informed and friendly but critical view, notably on such topics as "fair value measurement" (see, for example, the EFRAG's Comment Letter, dated May 29, 2007, on the IASB's November 2006 Discussion Paper, "Fair Value Measurements").

Nevertheless, there are tensions that result from the fact that the IASB's close cooperation with the FASB in the "convergence program" is quite understandably perceived in the EU to be at the expense of the EU "voice" at the critical stages of the development of a new IFRS or a major revision of an existing one. The EFRAG has a formal say only when a new or revised IFRS is published; and, although it is kept informed of the development of the work, it does not have the same involvement as that of the FASB. During 2008 and 2009 these tensions were manifested in increasing "anti-IASB" feelings in parts of Europe, noticeably France, and a number of highly critical comments were expressed in the European Parliament (which, compared with national parliaments, has little, but gradually increasing, power).

The banking and credit crisis during 2008–2009 has also impacted the work of the IASB, which had to be seen as "doing something" in the face of the crisis. The IASB issued a press release in September 2008 to announce "a range of projects that collectively address issues highlighted by the current dislocation in credit markets." This has opened the door to direct political interference in the IASB standard-setting process, especially regarding IAS 39 and the use of fair values, resulting in the accelerated issuance of Exposure Drafts "Derecognition" in April 2009 and "Fair Value Measurement" in May 2009, mirroring similar political interference in the work of the SEC/FASB in the United States. Moreover, in July 2009, in response to recommendations from the G20 leaders that the IASB should "take action by the end of 2009 to improve and simplify the accounting requirements for financial instruments," the IASB issued a further exposure draft, "Financial Instruments: Classification and Measurement," containing proposals that "would necessitate extensive consequential amendments to IAS 39 and other IFRS and to the guidance on those IFRS." The IASB has been planning for some time to replace IAS 39 by a new IFRS, but following the G20 recommendations the intent is to gain time by doing this in three phases, the first of which is represented by the July 2009 exposure draft. (The quotation marks above indicate text from the Introduction to the ED.) Other forces have called strongly for the technical independence of the IASB to be preserved and respected. Conflicting demands seem to be at work.

Likely Future Developments

As discussed above, from January 1, 2005, approximately 7,000 European listed companies were required to use full IASB GAAP in their consolidated financial statements. This now includes 12 member countries largely from Eastern Europe who joined the European Union in 2004-2007 and whose accountants and regulators generally lack experience in operating within a capitalist context.

It is crucial that everyone involved, whether in Europe or in any other relevant countries, such as Australia, is aware of the exact regulations that they are supposed to be trying to follow. In other words, a period of stability regarding the detailed content of IASB GAAP is extremely important. This has created a major problem for the IASB, which both wishes and needs to make many changes to the standards it inherited, if true global convergence around IASB GAAP is to be achievable. The approach it has adopted is to attempt to divide its work into two parts.

Thus, the Board made many changes through the end of 2004, mostly effective from January 1, 2005, and a number of further important changes as part of the "convergence process" in 2007–2008, to be effective from either January 1 or July 1, 2009.

However, two more general issues are worthy of mention. The first, although the timing is unclear, is the project on reporting financial performance. The original essence of this initiative was to replace the income statement with, to use the full jargon, a layered matrix structure. Information would be presented vertically analyzed (layered) under various subheadings as well as horizontally so as to separate out the effects of remeasurements (as opposed to transactions). An idea of this proposal, though not the precise final detail, is given in Table 1.1.

Table 1.1: The Possible Format for Presenting Information under the Reporting Financial Performance Project

		Total	Profit Before Remeasurements	Remeasurements
Business	Revenue	500	Revenue	-
	Cost of sales	(200)	Materials, labour etc	Inventory impairments
	Selling, general, admin expenses	(125)	Depreciation/amortisation Rental/other income Provision – initial recognition Service cost	PPE/intangible impairment Provision – remeasurement Change in pension obligation cash flow assumptions
	Operating Profit	175		
	Disposal gain/loss	50	-	Disposal gain/loss
	PPE revaluation	75	-	PPE revaluation
	Goodwill	(50)	Negative goodwill	Goodwill impairment
	FX gain/loss on net investment	(25)	-	FX gain/loss on net investment
	Investment property		-	Investment property fair value change
	Other Business Profit	50		
	Income from associates	25	Income from associates	-
	Write-down of accounts receivable	(5)	-	Write-down of accounts receivable
	Equity investments	(30)	-	Return on equity investments
	Debt investments	10	Interest income	Fair value changes on debt investments
	Pension plan assets	(75)		Return on pension plan assets
	Financial Income	(75)		
	Business Profit	150		
Financing	Interest on liabilities	(40)	Interest expenses	Change in provision discount rate
	Pension financing expenses	(60)	Unwinding of discount rate	Change in pension obligation discount rate
	Financing expense	(100)		
Tax		(15)	-	-
Discontinuing activities		(5)	Net discontinuing	Net discontinuing
Cash flow hedges		25	-	Fair value changes in cash flow hedging instruments
	Profit	55		