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The purpose of this publication is to briefly describe key regulatory and professional developments that have recently occurred in the field of accounting and to provide links to locations where additional information can be found on each topic. Readers seeking additional information about a topic should review the information referred to in the hyperlinks and not rely solely on the descriptions included in this communication.

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Invitation to Comment on Accounting for Stock-Based Compensation

On November 18, 2002, the FASB issued an Invitation to Comment, *Accounting for Stock-Based Compensation: A Comparison of FASB Statement No. 123, Accounting for Stock-Based Compensation, and Its Related Interpretations, and IASB Proposed IFRS, Share-based Payment*.

In particular, the Invitation to Comment solicits constituents' views on the similarities and differences in the FASB and IASB documents, and asks for comments on other aspects of the fair value based method of accounting for stock-based compensation, including issues related to measuring the fair value of employee stock options.

The Invitation to Comment is the first step in the FASB's possible redeliberation of the U.S. standards on accounting for stock-based compensation, with the aim of bringing about convergence of accounting standards across the major world capital markets. It is available on the FASB's website at http://www.fasb.org/draft/itc_intropg_stock_based_comp.shtml. The comment period ends on February 1, 2003. Also see the related article in the IASB Update in this issue of *Accounting Roundup*.

FASB Continues Discussions of SPE Issues

The FASB discussed various issues relating to the exposure draft of a proposed Interpretation of ARB No. 51, *Consolidation of Certain Special-Purpose Entities*, at its meetings on November 6 and November 13, 2002. An overview of some of those discussions appears below. A project summary that was prepared by the FASB staff is available on the FASB's website at http://www.fasb.org/project/decisions_spe.shtml.

Scope

The Board tentatively agreed to exclude from the scope of the proposed Interpretation not-for-profit organizations that apply SOP No. 94-3, *Reporting of Related Entities by Not-for-Profit Organizations*. However, those not-for-profit organizations would still be subject to the related-party provisions of the proposed Interpretation. The Board also tentatively concluded that private enterprises are within the scope of the proposed Interpretation.

Primary Beneficiary Evaluation

The Board agreed that for purposes of the primary beneficiary evaluation, a determination must first be made as to whether there is a party that holds meaningful decision-making rights with respect to the SPE. If there is such a party and that party holds either variable interests that would absorb a majority of the expected losses or variable interests that allow the decision maker to obtain a majority of the residual benefits from the entity's operations, then that party would be determined to be the primary beneficiary. The Board agreed that if there are no meaningful decisions to be made with respect to the SPE, an evaluation of all variable interests would be necessary in order to determine whether any entity holds a majority of the variable interests. The FASB staff noted that both the risk and residual benefit associated with a transferor's retained interest would be considered in the evaluation of who the primary beneficiary is for an SPE in which there are no meaningful decisions to be made.

Qualifying Special-Purpose Entities

The Board tentatively decided that a QSPE would not be consolidated by any party that has involvement with it unless that party holds interests in the QSPE that would have precluded derecognition under the requirements of SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*.

Expected Losses

The Board clarified that the benchmark for comparing expected future losses inherent in variable interests is the fair value of the variable interests (as opposed to their contractual cash flows or expected cash flows).

Interests in Selected Assets of an Entity

The Board reconsidered a tentative decision made at its October 30, 2002 meeting and reached a new tentative conclusion that the transferor's subordinate retained interest in assets transferred to an SPE is a variable interest in the SPE that holds the retained interest.

Market-Based Fees

The Board tentatively concluded that market-based fees should be described in the proposed Interpretation as fees that are commensurate with the services performed. The Board noted that a fee that varies based on factors other than the value of the services provided or that differs from the market price of the services provided would be an indication that the provider may have other relationships with the entity that should be analyzed to determine whether they represent a majority variable interest in the aggregate.

Related Parties

The Board tentatively agreed that the two determining factors in identifying a related party as the primary beneficiary are (1) to identify the principal in the principal/agency relationship and (2) if a principal cannot be identified, to look at the activities of the related parties and determine the primary beneficiary by identifying the related party that is most closely related to the activities. The Board also tentatively agreed that it would add employees and board members to the list of related parties in paragraph 15 of the proposed Interpretation and that it would eliminate the guidance in paragraphs 16(a) and 16(d) of the proposed Interpretation.

Disclosures

The Board agreed to retain the disclosure requirements of paragraph 24 of the proposed Interpretation and to replace the requirements of paragraph 25 with a series of disclosures for entities that have a significant variable interest in a nonconsolidated SPE.

Effective Date and Transition

The Board reaffirmed that the effective date for newly formed SPEs will be upon issuance of the Interpretation, and that for existing SPEs the effective date will be for periods beginning after June 15, 2003. The Board agreed that the Interpretation will not be effective until January 1, 2004 for existing SPEs of calendar-year-end companies that do not prepare interim financial statements (i.e., private enterprises). Restatement of prior periods will be encouraged but not required. Also, enterprises will be permitted to restate all periods, even those not presented, thereby avoiding any cumulative effect as of the beginning of the earliest period presented. The cumulative effect transition method described in the proposed Interpretation will be retained as an alternative.

The Board tentatively agreed that, on transition, enterprises would base the measurement of the SPE's assets and liabilities on their carrying values rather than using the fair value measurement proposed in the exposure draft. If determining the carrying values is impracticable, the assets and liabilities will be measured at fair value. The Board reaffirmed its tentative conclusion that there will be no grandfather provisions for existing SPEs.

Following its discussion on November 13, 2002, the Board authorized the staff to proceed to a final Interpretation.

Current FASB exposure drafts can be obtained on the FASB's website at <http://www.fasb.org/draft/>. Summaries of all FASB discussions are available in the FASB staff's *Action Alert* newsletter, available on the FASB's website at <http://www.fasb.org/action>.

FASB Clears SOP for Issuance

At its meeting on November 6, 2002, the FASB met with representatives of AcSEC to consider the clearance of an exposure draft of a proposed SOP, *Accounting for Derivative Instruments and Hedging Activities by Not-for-Profit Health Care Organizations and Clarification of the Performance Indicator*. The FASB staff noted that there have been two significant changes made to the draft SOP: (1) the effective date has been deferred by six months, but the SOP will permit early adoption, and (2) the requirement to present pro forma information after adoption has been deleted. After the FASB staff recommended that the pro forma requirement be reinstated, AcSEC proposed that, in lieu of the pro forma requirement, the draft SOP require disclosure of the adoption of the SOP in the year in which the not-for-profit entity adopts the provisions of the SOP and that a change in accounting had occurred for cash flow hedging. The Board agreed to AcSEC's proposal and cleared the SOP for issuance.

Note: Conclusions of the FASB are subject to change at future Board meetings and generally do not affect current accounting requirements until an official position (Statement or Interpretation) is issued. Official positions of the FASB are determined only after extensive deliberation and due process, including a formal vote by written ballot to issue a Statement or Interpretation.

FASB Chairman Speaks at FEI Conference

On November 4, 2002, FASB Chairman Robert H. Herz spoke at the Financial Executives International (FEI) conference on Current Financial Reporting Issues, regarding the FASB's recent efforts to "contribute to improving the overall state of financial reporting in the U.S. and internationally." Chairman Herz's speech is summarized below. The entire speech is available on the FASB's website at http://www.fasb.org/herz_11-04-02.pdf.

Technical Developments

Chairman Herz noted a number of "important projects" that are currently underway at the FASB, such as the application of the purchase method of accounting and improving disclosures relating to the fair value of financial instruments. Chairman Herz said that the FASB has "significantly" modified its agenda in light of "recent financial reporting scandals" to include, for example, projects on accounting for special-purpose entities and equity derivatives.

Standard-Setting Challenges

Chairman Herz said that he has spoken with various people to obtain an understanding of their views on standards-setting and that "implicit in these comments is a view that standard-setters have been too focused on the views and needs of preparers and auditors and must be more attuned to the needs of investors and other users of financial information." He also said that many people believe that international convergence of accounting standards is a "highly desirable goal."

In discussing concerns about the volume and complexity of U.S. accounting standards, Chairman Herz referred to the standard-setting process as a four-legged stool with the FASB, SEC, AcSEC and EITF making up the legs. He said that the FASB has proposed that, after a transition period, AcSEC will no longer issue SOPs; however, AcSEC will continue to develop industry-based accounting and auditing guides. Chairman Herz also said the FASB will have "more direct involvement" with the EITF's agenda, deliberations, and ratification of consensus and that the FASB hopes to broaden the composition of the EITF by appointing one or more representatives to "ensure that the user perspective is properly considered."

In his concluding remarks, Chairman Herz said that the overriding goal is to improve the financial and corporate reporting system in the United States.

Jackson M. Day Appointed Acting Chief Accountant

On November 12, 2002, SEC Chairman Harvey L. Pitt announced that the SEC has unanimously selected Jackson M. Day as Acting Chief Accountant for the SEC. Mr. Day has served as the SEC's Deputy Chief Accountant since Sept. 15, 2000. Prior to joining the SEC staff, Mr. Day was a partner in Ernst & Young's National Office of Professional Practice in New York. As previously reported in the November 11, 2002 issue of *Accounting Roundup*, Chief Accountant Robert K. Herdman submitted his resignation effective November 8, 2002.

The press release announcing Mr. Day's appointment is available at <http://www.sec.gov/news/press/2002-160.htm>.

Frequently Asked Questions on Sarbanes-Oxley

The SEC's Division of Corporation Finance maintains a frequently asked questions (FAQs) database relating to the Sarbanes-Oxley Act of 2002. The FAQs are available at <http://www.sec.gov/divisions/corpfin/faqs/soxact2002.htm>.

November 2002 IASB Meeting

At its November 12-14, 2002 meeting in Hong Kong, the IASB took the following actions:

- Considered comments received on the exposure draft of its project to improve existing IFRS, and reached certain tentative decisions
- Discussed certain issues in its projects on insurance contracts (phase I), business combinations (phase II), and convergence, and reached certain tentative decisions
- Held an educational session on aspects of various projects, including its projects on liabilities and equity and revenue recognition.

Additionally, the IASB met with its Standards Advisory Council on November 15-16, 2002, to discuss a number of recent accounting and regulatory developments, including the status and direction of various IASB projects.

The next IASB meeting is scheduled for December 18-20, 2002, in London.

Further information about the IASB can be obtained on the IASB's website at <http://www.iasb.org.uk> and on Deloitte & Touche's IAS Plus website at <http://www.iasplus.com/index.htm>.

IASB Meetings for 2003

For the benefit of those who monitor IASB deliberations on an ongoing basis and may wish to plan ahead, a list of IASB meeting dates and locations for 2003 has been posted to the IASB's website at <http://www.iasb.org.uk/cmt/0001.asp?s=1503228&sc={AD59EDA8-A0E6-4E33-9545-0514CF0F995D}&n=65>.

IASB Issues Exposure Draft on Stock-Based Compensation (Share-Based Payment)

On November 7, 2002, the IASB issued an exposure draft of a proposed IFRS, *Share-based Payment* (e.g., transactions in which companies issue shares of their stock, or options on such shares, to employees or others in exchange for goods or services).

General Provisions of Exposure Draft

In general, the exposure draft would require companies that prepare their financial statements under IASB standards to recognize the fair value of share-based payments, including employee stock-based compensation, as an expense.

Current U.S. accounting standards, in contrast, permit companies to report employee stock-based compensation in one of two ways:

1. The fair value based method, in which compensation cost is measured at the grant date based on the value of the award and is recognized as expense over the service period, which is usually the vesting period, or

2. The intrinsic value based method (the predominant U.S. practice), in which compensation cost is measured as the amount by which the quoted market price of the stock at grant date exceeds the amount an employee would have to pay to purchase it. Since fixed stock option plans—the most common type of stock compensation plan—typically have no intrinsic value at grant date, no compensation cost is recognized.

A final IFRS would be effective for periods beginning on or after January 1, 2004.

Comments Sought

The exposure draft consists of three separate documents—the proposed IFRS itself, the IASB's basis for tentative conclusions, and draft implementation guidance. Comments on the documents should be received by the IASB by March 7, 2003.

Editor's Note: This is a critical proposal on which U.S. companies may wish to comment because (1), as indicated in the FASB update section of this issue of Accounting Roundup, the FASB has released an Invitation to Comment as the first step in a possible redeliberation of the U.S. standards on accounting for stock-based compensation with the aim of bringing about convergence of accounting standards across the major world capital markets, and (2) the SEC may ultimately accept financial statements prepared in accordance with IFRS as the primary reporting basis for at least certain registrants.

The exposure draft and a related press release are available on the IASB's website at <http://www.iasb.org.uk/cmt/0001.asp?s=1595829&sc={43546E62-51EA-4875-AA0C-41989318C8C4}&n=67> and <http://www.iasb.org.uk/cmt/0001.asp?s=1526440&sc={5BE6A34B-4223-402E-BD18-C2B43AC97536}&n=4120>, respectively. Also see the related FASB Update article on stock-based compensation in this issue of *Accounting Roundup*.

PCAOB Chairman Announces Resignation on Eve of Group's First Meeting

On November 13, 2002, the PCAOB held its first meeting, in closed session, in Washington, DC. The meeting was presided over by William H. Webster, the group's chairman, who had submitted his resignation to the SEC the previous day, less than three weeks after his appointment.

In a press briefing held after the meeting, Mr. Webster told reporters that the PCAOB had begun to address various organizational matters, including finding office space, recruiting a staff, and setting a budget. It is expected that Mr. Webster will continue in the role as chairman until either an interim or permanent replacement is chosen. He expects his replacement to be named by January 2003.

Further information about the PCAOB's first meeting can be found in various media sources, for example, the November 14, 2002 editions of the *New York Times* ("Audit Board Holds Meeting on Its Goals") and the *Washington Post* ("Webster Chairs First Session of Audit Panel").

An SEC press release regarding Mr. Webster's resignation is available on the SEC's website at <http://www.sec.gov/news/press/2002-159.htm>.

PCAOB Appointment Process, Composition, and Responsibilities

As a follow-up to both the foregoing article and an article on the PCAOB in the October 28, 2002 issue of *Accounting Roundup*, following is a brief discussion of the PCAOB appointment process, composition, and responsibilities.

Appointment Process and Composition

Created by the Sarbanes-Oxley Act of 2002 to oversee the audits of public companies subject to the securities laws, the PCAOB consists of five full-time members, appointed by the SEC after consultation with the Chairman of the Federal Reserve Board and the Secretary of the Treasury. Two of the five members must be current or former CPAs.

The Sarbanes-Oxley Act sets a five-year term of service for each member, with a two-term limit. The terms of the initial board members, other than the chairman, expire in annual increments (i.e., one expiring in each of the years 2003 through 2006). The Act also contains provisions related to vacancies.

Responsibilities

Under the Sarbanes-Oxley Act, the PCAOB's responsibilities include:

- Registering public accounting firms that prepare audit reports for issuers
- Establishing or adopting standards (e.g., auditing, quality control, ethics, and independence standards) related to the preparation of such reports
- Performing inspections of registered firms
- Conducting investigations and disciplinary proceedings, as necessary
- Imposing sanctions, as justified
- Performing such other duties as the Board or SEC determine are necessary.

The PCAOB, which is subject to SEC oversight, is required to take such actions as are necessary to enable the SEC to determine, by April 2003, that the Board has the capability to carry out its responsibilities.

Further information about the PCAOB can be found in the Sarbanes-Oxley Act, which is available at [http://thomas.loc.gov/cgi-bin/cpquery/R?cp107:FLD010:@1\(hr610](http://thomas.loc.gov/cgi-bin/cpquery/R?cp107:FLD010:@1(hr610).

Abbreviations Frequently Used in Accounting Roundup

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|-------|--|-------|---|
| AcSEC | Accounting Standards Executive Committee | IFAC | International Federation of Accountants |
| AICPA | American Institute of Certified Public Accountants | IFRS | International Financial Reporting Standard |
| EITF | Emerging Issues Task Force | PCAOB | Public Company Accounting Oversight Board |
| FASB | Financial Accounting Standards Board | SAS | Statement on Auditing Standards |
| GASB | Governmental Accounting Standards Board | SEC | Securities and Exchange Commission |
| IAS | International Accounting Standard | SFAS | Statement of Financial Accounting Standards |
| IASB | International Accounting Standards Board | SOP | Statement of Position |

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