

## Accounting

### Guidance Proposed for Measuring Liabilities under FASB Statement No. 157

FASB Statement No. 157, *Fair Value Measurements*, defines the fair value of a liability as the price that would be paid to transfer the liability in an orderly transaction between market participants at the measurement date. Some entities are concerned that there may be a lack of observable market information to determine the fair value of a liability. In many cases, an entity would extinguish a liability by settling the obligation directly with the counterparty rather than by paying another entity to assume the existing obligation. In the limited circumstances when an existing liability may be transferred to a new obligor, the transferee may not have the same nonperformance risk as the transferor. Furthermore, some entities question how to measure the fair value of a liability in a hypothetical transaction when a contractual restriction prevents such a transfer. In addition, questions have arisen about whether prices of debt instruments traded as assets represent the fair value of that instrument for the issuer. Because of these issues, the Financial Accounting Standards Board has issued proposed FASB Staff Position (FSP) No. FAS 157-f, *Measuring Liabilities under FASB Statement No. 157*, to provide guidance on the fair value measurement of liabilities within the scope of Statement No. 157.

The proposed FSP states that if a quoted price in an active market for the identical liability is available, it represents a Level 1 measurement. In circumstances in which a quoted price in an active market for the identical liability is not available, a reporting entity must measure fair value using one of the following approaches that maximizes the use of relevant observable inputs and minimizes the use of unobservable inputs:

- The quoted price of the identical liability when traded as an asset in an active market
- The quoted price of the identical liability or the identical liability when traded as an asset in markets that are not active
- The quoted price for similar liabilities or similar liabilities when traded as assets in markets that are active
- Another valuation technique that is consistent with the principles of Statement No. 157, such as an income approach or a market approach.

When measuring the fair value of a liability using the price of the liability when traded as an asset, the price must be adjusted for factors specific to the asset that are not applicable to the fair value measurement of the liability. Also, when estimating the fair value of a liability, an entity must not include a separate input or adjustment to other inputs relating to the existence of a contractual restriction that prevents the transfer of the liability. Further, when measuring the fair value of a liability using a valuation technique, an entity must ensure that the fair value measurement is consistent with the principles of Statement No. 157.



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If finalized, the FSP would be effective for the first reporting period (including interim periods) beginning after issuance, with earlier application permitted. The proposed FSP is available for comment until June 1, 2009 at [http://www.fasb.org/fasb\\_staff\\_positions/prop\\_fsp\\_fas157-f.pdf](http://www.fasb.org/fasb_staff_positions/prop_fsp_fas157-f.pdf).

## Auditing

### **Performing Agreed-Upon Procedures on XBRL-Tagged Data**

On January 30, 2009, the SEC issued Final Rule No. 33-9002, *Interactive Data to Improve Financial Reporting*, which will require public companies to use eXtensible Business Reporting Language (XBRL-tagged data) for the reporting of financial information. XBRL is a global standard that provides unique electronically readable codes (tags) for each item in the financial statements or other business report. Tagging can be thought of as placing a unique barcode on each item of information included in business reports so that XBRL-enabled software can search for a specified tag, recognize it, and retrieve it.

On April 28, 2009, the American Institute of Certified Public Accountants issued Statement of Position (SOP) 09-1, *Performing Agreed-Upon Procedures Engagements That Address the Completeness, Accuracy, or Consistency of XBRL-Tagged Data*, which was effective upon issuance. This SOP provides guidance on performing agreed-upon procedures engagements that address the completeness, accuracy, or consistency of an entity's XBRL-tagged data of information as of a specified date and for a specified period. The objective of the engagement described in the SOP generally is to provide information to management or the audit committee of the entity about its XBRL-tagged data. The SOP includes guidance regarding:

- Management assertions
- Establishing an understanding with the client
- Nature, timing, and extent of procedures
- Involvement of a specialist
- Responsibilities and written representations of management
- Reporting considerations
- Illustrative management assertions

At this point, the SEC does not require the auditor to audit, attest to, or otherwise be involved with the submission of financial statements in XBRL. We do not believe it would be appropriate for our Firm to assist our SEC audit clients with services outside the scope of this SOP, such as the tagging of data or other preparation of financial statements in XBRL due to independence considerations. Our Firm can, however, perform agreed-upon procedures to address the completeness, accuracy, and consistency of XBRL-tagged data for an entity that either is, or is not, an SEC audit client.

### **Three SSARS Proposed**

The AICPA's Accounting and Review Services Committee has issued three proposed Statements on Standards for Accounting and Review Services (SSARSs):

- *Framework and Objectives for Performing and Reporting on Compilation and Review Engagements*
- *Compilation of Financial Statements*
- *Review of Financial Statements*

The proposed Statements will recodify AR section 100, *Compilation and Review of Financial Statements*, into separate chapters for compilation and review engagements. Other significant changes reflected in these proposed Statements include the following:

- *Framework and Objectives for Performing and Reporting on Compilation and Review Engagements* introduces a discussion of materiality in the context of a review engagement and also introduces the terms review evidence and review risk to the review literature.
- Both *Compilation of Financial Statements* and *Review of Financial Statements* would:
  - Require that an accountant establish an understanding with management regarding the services to be performed for each engagement through a written communication (i.e., an arrangement letter).
  - Establish enhanced documentation requirements for compilation and review engagements, respectively.
  - Provide guidance to practitioners who are engaged to perform internal control services in addition to the compilation or review engagement.
- *Compilation of Financial Statements* would allow an accountant to include a general description in the accountant's compilation report regarding the reason(s) for an independence impairment.
- *Review of Financial Statements* would:
  - Provide expanded guidance with respect to the performance of analytical procedures.
  - Revise the reporting requirements for a review engagement including establishing the reporting requirements when the accountant's independence is impaired during the performance of internal control procedures.

If finalized, the proposed statements would be effective for compilations and reviews of financial statements for periods beginning on or after December 15, 2010. Early application would be permitted.

The proposed SSARS are available for comment until July 31, 2009 at [http://www.aicpa.org/download/auditstd/ED\\_Reliability\\_SSARS.pdf](http://www.aicpa.org/download/auditstd/ED_Reliability_SSARS.pdf).

## Financial Institutions

### **OCC Issues Bulletin Regarding OTTI Accounting and Effect on Regulatory Capital**

The Office of the Comptroller of the Currency (OCC) has issued Bulletin 2009-11, *Other-than-Temporary Impairment Accounting*. The purpose of this Bulletin is to inform financial institutions about potential implications of recently issued Financial Accounting Standards Board (FASB) Staff Position (FSP) No. FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*. The Bulletin provides a brief background of the accounting changes and discusses expectations for bank management when determining whether a security has an other-than-temporary impairment (OTTI).

The Bulletin states that FSP No. FAS 115-2 and FAS 124-2 may affect regulatory capital levels and ratios for banks reporting a non-credit component of OTTI. As a result of this FSP, the non-credit component of OTTI on debt securities (classified as available-for-sale or held-to-maturity) will now flow through other comprehensive income, which will not reduce bank earnings. Under existing regulatory capital requirements, the portion of OTTI for debt securities that flows through other comprehensive income will not affect bank Tier 1 capital. OTTI losses that must be recognized in other comprehensive income should be included on the Call Report balance sheet in "Accumulated Other Comprehensive Income."

FSP No. FAS 115-2 and FAS 124-2 is effective for June 30, 2009 regulatory reports, with early adoption permitted for March 31, 2009 reports. The FASB also released FSP No. FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*. The FSPs on OTTI and fair value must be adopted concurrently.

The Bulletin states that bank management is responsible for assuring that regulatory reports are accurate at each reporting date and consistent with generally accepted accounting principles. Bank management must understand the underlying characteristics of securities they hold and the market factors affecting the fair value of the investment. Bank management should have policies to identify and assess securities for OTTI on an instrument-level basis, and should perform the assessments on at least a quarterly basis. Bank management also should update its policies and practices in accordance with the FSPs and maintain appropriate documentation to support their fair value measurements and OTTI assessments.

For those securities with fair value less than cost, bank management should have documentation to support whether that impairment is temporary or other than temporary. The determination of the credit component should include a careful assessment of all changes in underlying cash flows. For structured investments, a diligent evaluation of the underlying assets should be incorporated. The bank's methodology and process for assessing securities for OTTI and for determining the credit and non-credit components of OTTI should be periodically reviewed and validated by a party who is independent of the bank's investment management processes.

OCC Bulletin 2009-11 is available in full at <http://www.occ.treas.gov/ftp/bulletin/2009-11.html>.

### **FDIC Issues Guidance on Complex Structured Credit Products**

A number of insured banks with portfolio holdings in private label mortgage-backed securities, collateralized debt obligations (CDOs), or asset-backed securities are facing heightened losses as a result of significant investments in these products. Certain structured credit products, particularly private label mortgage-backed securities and CDOs, have experienced deteriorating collateral performance, price declines, and credit rating downgrades. Per the Federal Deposit Insurance Corporation (FDIC), management due diligence regarding purchases of these products was often lacking.

Recently, the FDIC published Financial Institution Letter 20-2009 to reiterate and clarify existing guidance for the purchase and holding of complex structured credit products. Topics addressed in the Letter include investment suitability and due diligence, the use of external credit ratings, pricing and liquidity, and adverse classification of investment securities. The Letter encourages FDIC-supervised institutions to incorporate the Letter's clarifications into existing policies and processes. Banks should expect that risk management policies and procedures as well as investment portfolio composition, performance, and risks will be evaluated closely and that weaknesses in these areas will be reflected in supervisory ratings and capital requirements.

The Letter states that risk management of investments in structured credit products should include adequate due diligence, reasonable exposure limits, accurate risk measurement, an understanding of the tranching structure, knowledge of the collateral performance, and a determination of investment suitability. Institutions should have a reasonable, documented, and consistently applied approach to pricing high-risk, illiquid, complex structured credit products. Institutions should consider credit ratings as a factor in the risk management process; however, credit ratings should not be the sole factor considered when evaluating the risk present in structured credit products. The letter states that examiners are permitted to adversely classify a security when supported by current credit information despite an investment grade credit rating.

Financial Institution Letter 20-2009 is available in full at <http://www.fdic.gov/news/news/financial/2009/fil09020a.pdf>.

## **Computing the Disallowance of Deferred Tax Assets when Calculating Regulatory Capital**

Many financial institutions reported a net loss for the year ended December 31, 2008. As economic conditions continue to deteriorate, it is likely that financial institutions will continue to report losses in 2009. As a result of these losses, many of the financial institutions reporting losses also have recorded a valuation allowance on their deferred tax assets.

When completing Schedule RC-R, *Regulatory Capital*, of the call report, financial institutions should note that the calculation of deferred taxes in this Schedule is not necessarily in accordance with generally accepted accounting principles. Certain deferred tax assets are disallowed in the calculation of regulatory capital. The call report instructions require financial institutions to report as “disallowed deferred tax assets” the portion of net deferred tax assets that does not qualify for inclusion in Tier 1 capital, based on the capital guidelines of the reporting bank’s primary federal supervisory authority. Generally, deferred tax assets that are dependent upon future taxable income for realization are limited to the lesser of (a) the amount of such deferred tax assets that the bank expects to realize within one year of the calendar quarter-end date, based upon its projected future taxable income for that year, or (b) 10% of the bank’s Tier 1 capital. For purposes of this item, all temporary differences should be assumed to fully reverse at the report date.

Deferred tax assets that can be realized from taxes paid in prior carryback years generally are not included in “disallowed deferred tax assets.” However, for a bank that is a subsidiary of a holding company, the parent holding company may not have the financial capability to reimburse the reporting bank for tax benefits derived from the bank’s carryback of net operating losses or tax credits. In such a situation, when determining the amount of deferred tax assets that are dependent upon future taxable income, the amount of carryback potential the bank may consider as being available for the realization of its deferred tax assets should be limited to the amount that the bank could reasonably expect to have refunded by its parent.

Although when looking at its GAAP-basis financial statements a financial institution may believe it is well capitalized, it is possible that the difference in the calculation of deferred taxes for regulatory capital purposes could cause a bank to no longer be well capitalized.

## **Disclosure of Non-GAAP Financial Measures**

Recently, the SEC reviewed press releases and other information published by financial institutions that presented amounts and ratios for certain financial measures, such as tangible common equity. In some circumstances, this financial information may have been prepared in accordance with guidance published by a government, governmental authority, or self-regulatory organization that is applicable to the registrant, although the information was not a required disclosure by the government, governmental authority, or self-regulatory organization. To address the publication of such information, the Division of Corporate Finance has issued new Compliance & Disclosure Interpretations (C&DIs).

C&DI Question 102.05 of Regulation S-K Item 10, General, states that if a registrant discloses a financial measure or information that is not in accordance with generally accepted accounting principles (GAAP) or calculated exclusively from amounts presented in accordance with GAAP and if such information is not required to be disclosed by a system of regulation that is applicable to the registrant, it is considered to be a “non-GAAP financial measure”. Registrants that disclose such non-GAAP financial information must provide the disclosures required by Regulation G or Item 10 of Regulation S-K, if applicable, including the quantitative reconciliation from the non-GAAP financial measure to the most comparable measure calculated in accordance with GAAP. This reconciliation should be in sufficient detail to allow a reader to understand the nature of the reconciling items. CD&Is related to Regulation S-K are available in full at <http://www.sec.gov/divisions/corpfm/guidance/regs-kinterp.htm>.

C&DI Question 106.07 of Form 8-K Item 2.02, *Results of Operations and Financial Condition*, states that if a registrant reports “preliminary” earnings and results of operations for a completed quarterly period, the registrant must comply with all of the requirements of, and instructions to, Item 2.02 of Form 8-K. These instructions include the

requirements in Item 10 (e) (1) (i) of Regulation S-K for the use of non-GAAP financial measures. CD&Is related to Form 8-K are available in full at <http://www.sec.gov/divisions/corpfin/guidance/8-kinterp.htm>.

## SEC

### Resources for Integrated Audits of Non-Accelerated Filers

Because Section 404(b) of the Sarbanes-Oxley Act of 2002 is effective for smaller public companies for fiscal years ending on or after December 15, 2009, thousands of smaller public companies and their auditors are now preparing to comply with the auditor attestation requirements related to the effectiveness of internal control over financial reporting for the first time. The Center for Audit Quality (CAQ) has created a new resource on its Web site to provide auditors with information they need to comply in one central location. Resources for Integrated Audits of Non-Accelerated Filers includes links to information such as:

- Public Company Accounting Oversight Board (PCAOB) Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*
- *Staff Views – An Audit of Internal Control Over Financial Reporting that Is Integrated with An Audit of Financial Statements: Guidance for Auditors of Smaller Public Companies* published by the PCAOB
- *Management’s Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports Frequently Asked Questions* published by the SEC
- *Guidance on Monitoring Internal Control Systems* published by the Committee of Sponsoring Organizations of the Treadway Commission
- *Lessons Learned – Performing an Audit of Internal Control in an Integrated Audit* published by the CAQ

The CAQ will monitor the activities of regulators and standards setters and update this Web resource as necessary. Resources for Integrated Audits of Non-Accelerated Filers is available at <http://www.thecaq.org/resources/ICFR.htm>.

### Guide to Public Company Auditing

The Center for Audit Quality has released a *Guide to Public Company Auditing*, which provides a basic overview of the key processes, participants, and issues related to public company auditing. This new resource demonstrates to investors the important role public company auditing plays in preserving the strength and stability of U.S. capital markets. The Guide is available in full at <http://www.thecaq.org/newsroom/pdfs/GuidetoPublicCompanyAuditing.pdf>.

## Public Sector

### Preparing for the Receipt of American Recovery and Reinvestment Act Awards

It’s not just major corporations that will benefit from the American Recovery and Reinvestment Act (ARRA). A large number of governmental and not-for-profit organizations also will find that they, too, have access to a large portion of the more than \$780 billion marked for economic recovery. Of specific importance regarding these funds is the President’s promise of accountability, “We are asking the American people to trust their government with an unprecedented level of funding to address the economic emergency. In return, we must prove to them that their dollars are being invested in initiatives and strategies that make a difference in their communities and across the country. Following through on our commitments for accountability and openness will create a foundation upon which we can build as we continue to tackle the economic crisis and the many other challenges facing our nation.”

The federal government has concluded that the single audit process will be a major component of its plan for determining accountability and evaluating the expenditure of federal awards by governmental and not-for-profit organizations. Most ARRA programs will bear unique Catalog of Federal Domestic Assistance (CFDA) numbers,

specifically identifying them as ARRA awards. However, program participants should not assume this information will be readily available, especially if they do not receive such funds directly from the federal government. Although the funding source is required to provide this information to award recipients, we suggest recipients obtain formal representations from providers concerning the source and CFDA number for any awards suspected to be of federal origin. This information should be obtained before the participant starts to actually receive or expend funds because it is needed to obtain relevant information about applicable laws, regulations, and award provisions concerning the use and accountability for such funds.

To demonstrate accountability, when an organization is planning to participate in any federally funded programs, steps should be taken as soon as possible to develop or enhance existing internal controls to ensure compliance with all of the many laws, regulations, and award provisions that will apply to the various federal programs, including those under which ARRA awards will be made. To avoid noncompliance and reports of control deficiencies, these controls should be in place before program participants start to expend federal awards.

To date, key provisions of the Single Audit Act and OMB Circular A-133 have not changed as a result of the ARRA. However, because of the President's pledge of accountability, it is likely that many governmental and not-for-profit organizations participating in federal awards that were not previously subject to a single audit will be required to have one. Other governmental or not-for-profit organizations that have had single audits in the past may find that they have a number of new programs, or they are participating in new clusters, that will need to be audited as major programs.

Under provisions of the ARRA, single audit information, which includes the entity's financial statements and auditor's reports, including those on internal control and compliance, will be made readily available to the public. While this is clearly in line with the President's mandate for accountability, this could be especially embarrassing for organizations if their single audit reports are other than unqualified or if findings are reported. Additionally, members of the Federal Inspectors General community have indicated their plans to closely monitor single audit quality and the results of single audits.

For organizations planning to participate in ARRA awards, we recommend (a) as much information as possible be obtained about the proposed awards before a decision is made to participate; (b) the organization be prepared for any additional cost and effort associated with the potential design/re-design and implementation of effective internal controls; and (c) the organization be prepared for the impact and cost of any additional single audit requirements.

More information about the ARRA is available at [www.recovery.gov](http://www.recovery.gov).

## Employee Benefit Plans

### **Fair Value Measurement Disclosures for Master Trusts**

Employee benefit plans often hold investments under master trust arrangements. A master trust is a trust for which a regulated financial institution serves as trustee or custodian and in which assets of more than one plan, sponsored by a single employer or by a group of employers under common control, are held. In a typical master trust arrangement, the plan does not hold units or shares of the master trust but has an undivided interest in the assets of the master trust. However, for participant-directed defined contribution plans, the plan typically has a divided interest in the individual assets of the master trust based upon participant direction. The AICPA Audit and Accounting Guide *Employee Benefit Plans* requires investments in master trusts to be shown as a single line item on the statement of net assets available for benefits; however, the plan does not "purchase" and "dispose" of its interest in the master trust but is allocated an interest once the plan sponsor chooses to transfer the plan's assets into the master trust. The Guide also requires the master trust investments to be shown by general type in the footnotes.

According to paragraph 32 of FASB Statement No. 157, *Fair Value Measurements*, for assets that are measured at fair value on a recurring basis in periods subsequent to initial recognition, the reporting entity must disclose

information that enables users of its financial statements to assess the inputs used to develop those measurements, and for recurring fair value measurements using significant unobservable inputs (level 3), the effect of the measurements on earnings (or changes in net assets) for the period. To provide guidance on the application of certain Statement No. 157 disclosure requirements to master trusts, the AICPA recently issued Technical Information Service (TIS) Section 6931.11, *Fair Value Measurement Disclosures for Master Trusts*. This TIS concludes that the disclosure requirements of paragraphs 32 through 34 of Statement No. 157 are required for individual investments under a master trust arrangement and are not required for the plan's total interest in the master trust. Because of the nature of the plan's ownership interest in the master trust (i.e., the plan does not hold units or shares of a master trust), the disclosures required by Statement No. 157 should be presented for the underlying master trust investments. Therefore, the plan should disclose separately certain information for each period for each major category of master trust assets and liabilities.

TIS Section 6931.11 is available in full at [http://www.aicpa.org/download/acctstd/TIS\\_6931\\_11\\_Fin\\_State\\_Report\\_and\\_Disclosure\\_EBP.pdf](http://www.aicpa.org/download/acctstd/TIS_6931_11_Fin_State_Report_and_Disclosure_EBP.pdf).

## International

### **Employee Benefits: IFRS vs. U.S. GAAP**

*This article is the nineteenth in a series of articles that takes our readers on a journey through International Financial Reporting Standards (IFRS) with a special focus on the standards' quintessential feature: they are principles-based. In this article, we provide an overview of some of the most significant differences between IFRS and U.S. generally accepted accounting principles (GAAP) with regard to employee benefits. Actual differences in the accounting treatment between the two frameworks depend on specific circumstances.*

Because the accounting for defined contribution plans is quite straightforward under both IFRS and U.S. GAAP, this article focuses only on defined benefit pension plans. The international standard that deals with pension obligations is International Accounting Standard (IAS) 19, *Employee Benefits*. Prominent U.S. GAAP literature on this subject includes FASB Statements No. 87, *Employers' Accounting for Pensions*, No. 88, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits*, and No. 132 (R), *Employers' Disclosures about Pensions and Other Postretirement Benefits*, together with various interpretations.

Under both frameworks, an actuarial technique is used to determine the value of the pension plan liability. U.S. GAAP mandates measurement at least annually, while IAS 19 states that an entity must determine the present value of defined benefit obligations and the fair value of plan assets with sufficient regularity to ensure that the valuation is reasonably up to date.

Plan assets are measured at fair value under both U.S. GAAP and IFRS. However, under U.S. GAAP, the expected return on plan assets is applied to the market-related value of plan assets, which can be either fair value or a calculated value that recognizes changes in fair value in a systematic and rational manner over not more than five years. The expected return on plan assets is determined based on the expected long-term rate of return on plan assets and the market-related value of plan assets. Under IFRS, the expected return on plan assets is based on market expectations, at the beginning of the period, for returns over the entire life of the related obligation and is applied to the fair value of the plan assets. If the net amount of the pension plan results in a net asset, there is a limit above which the "negative" pension liability cannot be recognized under IFRS. This "asset ceiling" provision is not present in U.S. GAAP.

Under both IFRS and U.S. GAAP, entities have to recognize a minimum amount of actuarial losses using the "10% corridor approach." Under U.S. GAAP, actuarial gains and losses recognized in Other Comprehensive Income (OCI) are eventually recognized in the income statement. For annual periods beginning on or after January 1, 2009, as a

result of the introduction of the Statement of Comprehensive Income in IFRS, actuarial gains and losses recognized in OCI will not eventually be recognized in the income statement.

This summary analysis of differences is not exhaustive. Other differences exist between the two frameworks, but a complete analysis can be performed only based on specific facts and circumstances.

## Learning and Professional Development

### **AICPA Fair Value Measurements Conference**

On June 8 and 9, 2009, the American Institute of Certified Public Accountants will host a Fair Value Measurements Conference at the Hyatt Regency Hotel in downtown Chicago. Speakers at this conference will lead a broad range of sessions on the most current issues impacting fair value. They will provide tools and technical resources with the latest information on FASB Statement No. 157, *Fair Value Measurements*, and related matters. This conference offers sessions in three specialized tracks – audit, preparer, valuation – so that attendees can customize the agenda to meet their needs.

For more information about the conference, go to [http://www.cpa2biz.com/AST/Main/CPA2BIZ\\_Primary/AuditAttest/PRDOVR~PC-FVM09/PC-FVM09.jsp](http://www.cpa2biz.com/AST/Main/CPA2BIZ_Primary/AuditAttest/PRDOVR~PC-FVM09/PC-FVM09.jsp).

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