

Insights

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Accounting

Scope Clarification – Accounting for Decreases in Ownership of a Subsidiary

The Financial Accounting Standards Board recently issued Accounting Standards Update (ASU) No. 2010-02, *Consolidation (Topic 810): Accounting and Reporting for Decreases in Ownership of a Subsidiary—a Scope Clarification*. The objective of this ASU is to address implementation issues related to the changes in ownership provisions in Subtopic 810-10, *Consolidation—Overall*, of the FASB Accounting Standards Codification, originally issued as FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements*. Subtopic 810-10 establishes the accounting and reporting guidance for noncontrolling interests and changes in ownership interests of a subsidiary. While Subtopic 810-10 provides general guidance on accounting for the decreases in ownership of a subsidiary, including a deconsolidation, some constituents raised concerns that the guidance appears to conflict with the gain or loss treatment or derecognition criteria of other U.S. generally accepted accounting principles (GAAP), such as the guidance for sales of real estate, transfers of financial assets, conveyances of oil and gas mineral rights, and transactions with equity-method investees.

The amendments in ASU No. 2010-02 remove the potential conflict between the guidance in Subtopic 810-10 and asset derecognition and gain or loss recognition guidance that may exist in other U.S. generally accepted accounting principles. The ASU clarifies that the scope of the decrease in ownership provisions of Subtopic 810-10 and related guidance applies to the following:

- A subsidiary or group of assets that is a business or nonprofit activity
- A subsidiary that is a business or nonprofit activity that is transferred to an equity-method investee or joint venture
- An exchange of a group of assets that constitutes a business or nonprofit activity for a noncontrolling interest in an entity (including an equity-method investee or joint venture).

The amendments in the ASU also clarify that the decrease in ownership guidance in Subtopic 810-10 does not apply to the following transactions even if they involve businesses:

- Sales of in-substance real estate. Entities should apply the sale of real estate guidance in Subtopics 360-20, *Property, Plant, and Equipment*, and 976-605, *Retail/Land*, to such transactions.
- Conveyances of oil and gas mineral rights. Entities should apply the mineral property conveyance and related transactions guidance in Subtopic 932-360, *Oil and Gas—Property, Plant, and Equipment*, to such transactions.



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If a decrease in ownership occurs in a subsidiary that is not a business or nonprofit activity, the entity first considers whether the substance of the transaction causing the decrease in ownership is addressed in other U.S. GAAP and, if not, the guidance in Subtopic 810-10 should be applied. The amendments in this ASU also expand the disclosures about the deconsolidation of a subsidiary or derecognition of a group of assets within the scope of Subtopic 810-10.

An entity will be required to follow the amended guidance beginning in the period that it first adopts Statement No. 160. For those entities that have already adopted Statement No. 160, the amendments are effective at the beginning of the first interim or annual reporting period ending on or after December 15, 2009. The amendments should be applied retrospectively to the first period that an entity adopted Statement No. 160. The ASU is available in full at http://www.fasb.org/cs/ContentServer?c=Document_C&pagename=FASB%2FDocument_C%2FDocumentPage&cid=1176156601576.

Oil and Gas Reserve Estimation and Disclosures

The Financial Accounting Standards Board recently issued Accounting Standards Update No. 2010-03, *Extractive Activities—Oil and Gas (Topic 932): Oil and Gas Reserve Estimation and Disclosures*. This Update describes amendments to the oil and gas reserve estimation and disclosure requirements in FASB Accounting Standards Codification Topic 932, *Extractive Activities—Oil and Gas*. The amendments align the oil and gas reserve estimation and disclosures required by generally accepted accounting principles with the requirements in the SEC's final rule, *Modernization of the Oil and Gas Reporting Requirements*, issued on December 31, 2008. Because of changes to the definition of significant oil- and gas-producing activities, some entities that previously did not provide disclosures about their oil and gas reserves will now be required to do so.

The amendments are effective for annual reporting periods ending on or after December 31, 2009, and early application is not permitted. However, an entity that becomes subject to the disclosures because of the change to the definition oil- and gas- producing activities may elect to provide those disclosures in annual periods beginning after December 31, 2009. The Update is available in full at http://www.fasb.org/cs/ContentServer?c=Document_C&pagename=FASB%2FDocument_C%2FDocumentPage&cid=1176156601659.

FASB Issues ASU Nos. 2010-04 and 2010-05

Recently, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2010-04, *Accounting for Various Topics – Technical Corrections to SEC Paragraphs*. The purpose of this ASU is to make technical corrections to certain guidance issued by the SEC that is included in the FASB Accounting Standards Codification (ASC). Primarily, this ASU changes references to various FASB and AICPA pronouncements to the appropriate ASC paragraph numbers.

Also, recently the FASB issued ASU No. 2010-05, *Compensation – Stock Compensation (Topic 718) – Escrowed Share Arrangements and the Presumption of Compensation*. This ASU codifies Emerging Issues Task Force Topic D-110, "Escrowed Share Arrangements and the Presumption of Compensation," which was issued on June 18, 2009 to clarify SEC staff views on overcoming the presumption that for certain shareholders escrowed share arrangements represent compensation. Historically, the SEC staff has expressed the view that an escrowed share arrangement involving the release of shares to certain shareholders based on performance-related criteria is presumed to be compensatory, equivalent to a reverse stock split followed by the grant of a restricted stock award under a performance-based plan. Topic D-110 concludes that when evaluating whether the presumption of compensation has been overcome, registrants should consider the substance of the arrangement, including whether the arrangement was entered into for purposes unrelated to, and not contingent upon, continued employment. The SEC staff believes that an escrowed share arrangement in which the shares are automatically forfeited if employment terminates is compensation.

ASU Nos. 2010-04 and 2010-05 are available in full at <http://www.fasb.org/jsp/FASB/Page/SectionPage&cid=1176156316498>.

Financial Institutions

Accounting for Subsequent Discount Accretion for Loans Acquired in a Business Combination

Members of the AICPA Depository Institutions Expert Panel (DIEP) and representatives of the Accounting Standards Executive Committee (AcSEC) and AICPA staff recently discussed an emerging practice issue with the staff of the SEC. The issue relates to accounting in subsequent periods for discount accretion associated with loan receivables acquired in a business combination or asset purchase. At issue is recognition of discount accretion for acquired loan receivables with a fair value (if acquired through a business combination) or relative fair value (if acquired through an asset purchase) that is lower than the contractual amounts due (principal amount) that are not required to be accounted for in accordance with the guidance in FASB Accounting Standards Codification (ASC) 310-30 (originally issued as AICPA Statement of Position No. 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer*). The issue arises for loan receivables that:

- Are acquired in a business combination or asset purchase;
- Result in recognition of a discount attributable, at least in part, to credit quality; and
- Are not subsequently accounted for at fair value.

The discount relating to such acquired loan receivables must be accounted for subsequently through accretion. In absence of further standard setting, for the acquired loan receivables described above the DIEP understands that the SEC Staff would not object to either of the following accounting policies:

- An accounting policy of recognizing discount accretion based on the acquired loan's contractual cash flows as described in the guidance for accounting for loan origination fees and costs that is included in FASB ASC 310-20 (originally issued as FASB Statement No. 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*); or
- An accounting policy of recognizing interest income based on the acquired loan's expected cash flows, as described in the guidance for accounting for loans acquired in a transfer that have deteriorated in credit quality since origination that is included in FASB ASC 310-30. Applying the guidance in FASB ASC 310-30 for interest income would result in recognition of the difference between the initial recorded investment and the loan's expected principal and interest cash flows using the interest method.

An entity should disclose its accounting policy election and apply that accounting policy consistently. The DIEP further understands that the SEC Staff believes that an entity that has an accounting policy based on expected cash flows should follow all of the accounting and disclosure guidance in FASB ASC 310-30, including, for example, following the guidance on maintaining the integrity of a pool of multiple loans accounted for as a single asset.

The above guidance was stated in an open letter from the AICPA to the SEC's Office of the Chief Accountant at <http://www.aicpa.org/download/acctstd/Confirmation-letter-on-Day-2.pdf>.

SEC

SEC Approves PCAOB Standard on Engagement Quality Review

On January 15, 2010, the SEC approved Public Company Accounting Oversight Board (PCAOB) Auditing Standard (AS) No. 7, *Engagement Quality Review*, which applies to all audit engagements, and engagements to review interim financial information, conducted pursuant to the standards of the PCAOB. The standard is effective for engagement quality reviews of audits and interim reviews for fiscal years that began on or after December 15, 2009. Accordingly, for interim reviews of public companies that file financial reports on a calendar-year basis, the standard is applicable beginning with the quarter ending March 31, 2010.

Per AS 7, the objective of the engagement quality reviewer is to perform an evaluation of the significant judgments made by the engagement team and the related conclusions reached in forming the overall conclusion on the engagement and in preparing the engagement report, if a report is to be issued, in order to determine whether to provide concurring approval of issuance. The engagement quality reviewer must be independent of the company, perform the engagement quality review with integrity, and maintain objectivity in performing the review. Some of the other requirements of AS 7 are summarized as follows:

- The person who served as the engagement partner on the audit for less than five years cannot become the engagement quality reviewer until they have taken a two-year time-out from participation on the audit engagement.
- In an audit and a review of interim financial information, the engagement quality reviewer should evaluate the significant judgments that relate to engagement planning.
- In an audit, the engagement quality reviewer should evaluate the engagement team's assessment of, and audit responses to, significant risks identified by the engagement team, including fraud risks, and other significant risks identified by the engagement quality reviewer through performance of the procedures required by AS 7.
- Whether in an audit or an interim review, the engagement quality reviewer also should review the engagement team's evaluation of the Firm's independence in relation to the engagement.
- The engagement quality reviewer should evaluate judgments made about the materiality and disposition of corrected and uncorrected identified misstatements and the severity and disposition of identified control deficiencies.
- Based on procedures required by AS 7, the engagement quality reviewer is required to evaluate whether appropriate consultations have taken place on difficult or contentious matters. The engagement quality reviewer must review the documentation, including conclusions, of such consultations.
- Based on procedures required by AS 7, the engagement quality reviewer also must evaluate whether appropriate matters have been communicated, or identified for communication, to the audit committee, management, and other parties, such as regulatory bodies.

In its order approving the standard, the SEC encouraged the PCAOB to issue guidance on the standard's documentation requirements. The PCAOB plans to publish Staff Questions and Answers on implementation of the standard in the near future. AS 7 is available in full at http://www.pcaobus.org/Rules/Docket_025/2009-07-28_Release_No_2009-004.pdf.

Frequent SEC Comment Letter Issues for Smaller Registrants

During presentations at the PCAOB's 2009 Forums on Auditing in the Small Business Environment, the Staff of the SEC's Division of Corporation Finance discussed, among other issues, financial reporting issues that are frequently raised in SEC comment letters issued to smaller registrants. Such issues included the following, among many others:

- The SEC continues to focus on the measurement of certain investments in light of the current economic environment. The Financial Accounting Standards Board has provided additional guidance on how companies should consider whether an investment trades in an active market for determining fair value as well as guidance on the measurement and recognition of other than temporary impairment. Equity securities continue to be evaluated based upon the ability and intent to hold to recovery. These judgments are expected to be consistent with other disclosures throughout the filing including going concern, liquidity

in Management's Discussion and Analysis (MD&A), *etc.* For debt securities, generally accepted accounting principles require that a company consider whether it intends to sell the debt security or it is more likely than not that it will be required to sell the debt security prior to its recovery of amortized cost. These conclusions should also be consistent with other disclosures throughout the filing.

- MD&A has three general objectives: to provide a narrative explanation of a company's financial statements through the eyes of management; to enhance the overall financial disclosure and provide the context within which financial information should be analyzed; and to provide information about the quality of, and potential variability of, a company's earnings and cash flow so that investors can ascertain the likelihood that past performance is indicative of the future. In accomplishing these objectives, the SEC generally recommends that companies provide an overview highlighting both financial and non-financial key performance indicators as background to understanding the company's overall performance for the periods. Depending on the nature of a company's operations, it may have certain estimates that have a material impact on the underlying financial statements and are subject to significant judgment and uncertainty. With the intent of providing insight into the quality and variability of the financial statements, management is encouraged to clearly identify those estimates, provide readers with an understanding of the methodology and underlying assumptions to arrive at the estimate, and analyze the impact that reasonable changes in the assumptions could have on the financial statements.
- Companies tend to overlook the importance of a discussion of liquidity and capital resources. A good discussion focuses on how the company has been able to meet its cash requirements in historical periods through a thorough analysis of the statements of cash flows and how they expect to meet them in the future through a discussion of commitments, debt covenants, and significant contractual obligations.

Many other financial reporting issues that are frequently raised in SEC comment letters issued to smaller registrants are highlighted on pages 19 through 38 of a PowerPoint presentation at <http://sec.gov/news/speech/2009/slides1209wc.pdf>. Pages 10 through 13 of this presentation also contain information about how the comment letter process works and how to best respond to comment letters.

Non-GAAP Financial Measures

Regulation G, a disclosure regulation, applies when a company publicly discloses or releases material information that includes a non-GAAP financial measure. For purposes of Regulation G, a non-GAAP financial measure is a numerical measure of a registrant's historical or future financial performance, financial position, or cash flows that:

- Excludes amounts, or is subject to adjustments that have the effect of excluding amounts, that are included in the most directly comparable measure calculated and presented in accordance with generally accepted accounting principles (GAAP) in the balance sheet, income statement, or statement of cash flows (or equivalent statements) of the issuer; or
- Includes amounts, or is subject to adjustments that have the effect of including amounts, that are excluded from the most directly comparable GAAP measure so calculated and presented.

On January 11, 2010, the SEC's Division of Corporation Finance issued Compliance & Disclosure Interpretations (C&DIs), which comprise the Division's interpretations of the rules and regulations on the use of non-GAAP financial measures. The C&DIs supersede the previous FAQs issued by the SEC on non-GAAP financial measures. These Interpretations primarily discuss the application of Item 10(e) of Regulation S-K, *Use of Non-GAAP Financial Measures in Commission Filings*. The C&DIs also address rules and regulations related to several specific aspects of non-GAAP financial measures including the following, among others:

- The use of non-GAAP financial measures in disclosures related to business combination transactions;

- The use of earnings before interest and taxes (EBIT) and earnings before interest, taxes, depreciation, and amortization (EBITDA) as performance measures;
- Non-GAAP financial measures contained in segment information; and
- The use of non-GAAP financial measures in public announcements disclosing material nonpublic information regarding the registrant's results of operations or financial conditions in accordance with Item 2.02 of Form 8-K.

The C&DIs are available in full at <http://www.sec.gov/divisions/corpfin/guidance/nongAAPinterp.htm>.

Employee Benefit Plans

Use of EFAST2 Online Filing System Required for Form 5500

On December 31, 2009, the U.S. Department of Labor's Employee Benefits Security Administration (EBSA) converted to an electronic system of online filing for Form 5500 and Form 5500-SF. Filers must submit the 2009 and 2010 annual return/report forms and schedules electronically through EFAST2. Prior-year delinquent or amended Form 5500 filings also now must be filed electronically. Timely 2008 plan year filings may still be filed through the original EFAST on paper until October 15, 2010 or electronically through June 30, 2010.

Filers and preparers can register for an account, complete the required forms and schedules online in multiple sessions, print a copy for their records, and submit it at no cost. There is an excellent set of questions and answers on the filing registration and submission process at <http://www.dol.gov/ebsa/faqs/faq-efast2.html>.

The EFAST2 system allows the public to submit and access filings online at <http://www.efast.dol.gov/portal>. The revised EFAST Web site has been updated to provide filers with a variety of tools and guidance, including the 2009 and 2010 Form 5500 and new Form 5500-SF schedules and instructions, frequently asked questions, user guides, and a tutorial. Some of the important changes for the 2009 and 2010 forms include:

- Introduction of the new, two-page Form 5500-SF for eligible small plan filers
- Expanded disclosure on Schedule C of indirect service provider compensation
- Expanded reporting by Code Section 403(b) plans
- Removal of IRS Schedules E and SSA. Information on participants with deferred vested benefits who separated from the service covered by the plan now must be filed directly with the IRS

A helpful video on electronic filing is available. Assistance with the EFAST2 system, Form 5500, and Form 5500-SF is available toll-free at 1.866.463.3278.

International

Limited Re-Exposure of Proposed Amendment to IAS 37

International Accounting Standard (IAS) 37, *Provisions, Contingent Liabilities and Contingent Assets*, applies to liabilities not covered by other accounting standards, such as liabilities to decommission assets, environmental liabilities, and liabilities arising from legal disputes. The International Accounting Standards Board (IASB) previously published proposals to amend IAS 37, including revised measurement requirements. In light of the comments received, the IASB has issued Exposure Draft 2010/1, *Measurement of Liabilities in IAS 37*. The main goals of the project are to: (i) align the criteria in IAS 37 for recognizing a liability with those in other

International Financial Reporting Standards; (ii) eliminate certain differences between IAS 37 and U.S. generally accepted accounting principles, primarily those related to the timing of recognition of business restructuring costs; and, (iii) clarify the measurement of liabilities in IAS 37. The main features of the proposed measurement requirements are summarized as follows:

- An entity must measure a liability at the amount that it would rationally pay at the end of the reporting period to be relieved of the present obligation.
- The amount that an entity would rationally pay to be relieved of an obligation is the lowest of:
 - The present value of the resources required to fulfill the obligation;
 - The amount that the entity would have to pay to cancel the obligation; and
 - The amount that the entity would have to pay to transfer the obligation to a third party.
- An entity must adjust the carrying amount of a liability at the end of each reporting period to the amount that it would rationally pay to be relieved of the present obligation at that date.
- Changes in the carrying amount of a liability resulting from the passage of time are recognized as a borrowing cost.

The Exposure Draft is available for comment until April 12, 2010 at <http://www.iasb.org/NR/rdonlyres/6FF9E7E5-2129-451B-B591-5A8911AF8BB5/0/EDIAS37Liabilities0110.pdf>.

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