

Insights

March 22, 2010

A biweekly audit and accounting publication

Accounting

McGladrey & Pullen Issues Guidance Regarding the Accounting for Subsequent Events

In May, 2009, the Financial Accounting Standards Board (FASB) issued FASB Statement No. 165, Subsequent Events, which is now codified in ASC Topic 855. Some aspects of Statement No. 165 caused concern and were addressed with an amendment in February 2010 through the issuance of Accounting Standards Update No. 2010-09, Subsequent Events -- Amendments to Certain Recognition and Disclosure Requirements. McGladrey & Pullen's National Professional Standards Group has published Subsequent Events: New Standards Apply, which discusses various aspects of the accounting for subsequent events under ASC Topic 855 as amended. Issues addressed include the following, among others:

- Terminology used
- Requirements for the evaluation of subsequent events
- Disclosure requirements
- Questions and answers about application of the standard in practice

Subsequent Events: New Standards Apply is available in full at http://www.mcgladrey.com/Resource_Center/subsequent_events_new_standards_apply.pdf. This document also is available in the "What's New" section of the Lotus Notes GS Navigator.

What Are Those Guys Thinking???

Comments from National Director of Accounting, Jay Hanson

I presented at an event last week called "CFO Rising," a conference attended by more than 400 CFOs from across the country. The theme of the conference was future oriented: what should CFOs be doing now to prepare for the opportunities in the future? The panel on which I participated discussed accounting changes coming down the road in the next few years. Our panel's session was officially called "A Conversation about Current Reporting Issues," but the unofficial title became "The Accounting Fatigue."

The FASB and IASB have an aggressive agenda for the next 15 months. By June 2011, six new standards are scheduled to be issued that will change the look of every financial statement and most of the numbers in them. We told the participants that the SOX 404 effort will look easy in comparison. In our world, the training and transition to CaseWare and MAPS will look easy in comparison. Did you know that if these standards were to



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come to fruition as currently contemplated:

- The new financial statement format will require the balance sheet and income statement to look more like a cash flow statement does today?
- The percentage-of-completion method of revenue recognition will be gone?
- All leases will be capitalized?
- Most financial instruments, including loans and receivables, will be accounted for at fair value?
- Many instruments classified as equity today will be liabilities in the future?
- The consolidation rules will change again?

The reaction of the participants was one of anger and, "What are those guys thinking?". No doubt, some parts of these projects will change before they become final. The exposure drafts have not been issued but are scheduled to be released in the next few months. The effective dates of all these projects have not been set. I encouraged the participants to send the FASB letters in response to the drafts and more importantly, encourage their financial statement users, such as their banks and analysts, to pay attention and let the FASB know what they think. We are working on a brief summary of each project for your use to discuss with clients, audit committees, banks, and other financial statement users.

For private companies, these are "interesting" times, to say the least. The Blue Ribbon Panel to address standards for private companies has been formed and members have been named. Their work will take about a year. We don't know how their recommendations may affect the application of these major projects for private companies. For public companies, regardless of the ultimate decisions on whether and when IFRS will be required, these standards will be applicable.

Sample Financial Statement Disclosures

Accounting Research Manager has recently published Special Edition: GAAP Financial Statement Disclosures Manual, which provides comprehensive guidance about financial statement disclosures. Also, the Manual contains more than 750 examples of financial statement footnote disclosures incorporating currently effective accounting standards, including those covering areas of unusual difficulty, such as financial instruments, fair value, business combinations, consolidation, income taxes, pensions, accounting changes, and variable interest entities. This edition of the Manual incorporates the financial statement disclosure requirements through Accounting Standards Update No. 2009-13, Revenue Recognition (Topic 605) - Multiple Deliverable Revenue Arrangements. The Manual is available in the "Accounting" section of Accounting Research Manager.

Scope Exception Related to Embedded Credit Derivatives

Recently, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2010-11, Derivatives and Hedging (Topic 815)—Scope Exception Related to Embedded Credit Derivatives, to resolve potential ambiguity about the breadth of the embedded credit derivative scope exception in FASB Accounting Standards Codification (ASC) 815-15-15-8: "Changes in cash flows attributable to changes in the creditworthiness of an interest resulting from securitized financial assets and liabilities (including derivative instruments) that represent the assets or liabilities that are held by the issuing entity shall not be considered an embedded derivative under this Subtopic." It is clear that the transfer of credit risk that is only in the form of subordination of one financial instrument to another (thereby redistributing credit risk) is an embedded derivative feature that should not be subject to potential bifurcation and separate accounting. However, there is some ambiguity in practice about whether other embedded credit derivative features are considered to be embedded

derivative features that are not subject to bifurcation and separate accounting as a derivative instrument.

ASU 2010-11 amends ASC 815-15, Derivatives and Hedging—Embedded Derivatives, to clarify that only the embedded credit derivative feature between the financial instruments created by subordination should not be analyzed for potential bifurcation from the host contract and separate accounting as a derivative. Consequently, the following circumstances, among others, do not qualify for the scope exception and are subject to potential bifurcation:

- An embedded derivative feature relating to another type of risk (including another type of credit risk) is present in the securitized financial instruments.
- The holder of an interest in a tranche of securitized financial instruments is exposed to the possibility (however remote) of being required to make potential future payments (not merely receive reduced cash inflows) because the possibility of those future payments is not created by subordination.
- The holder owns an interest in a single-tranche securitization vehicle; therefore, the subordination of one tranche to another is not relevant.

Other embedded credit derivative features, including those in some collateralized debt obligations and synthetic collateralized debt obligations, are considered embedded derivatives subject to bifurcation and separate accounting (including an analysis of whether the economic characteristics and risks of the embedded credit derivative features are clearly and closely related to the economic characteristics and risks of the host contract), provided that the overall contract is not a derivative in its entirety.

The amendments in ASU 2010-11 are effective for each reporting entity at the beginning of its first fiscal quarter beginning after June 15, 2010. Early adoption is permitted at the beginning of the first quarter beginning after March 5, 2010 (the date of issuance of the ASU). ASU 2010-11 is available in full at http://www.fasb.org/cs/ContentServer?c=Document_C&pagename=FASB%2FDocument_C%2FDocumentPage&cid=1176156690934.

Presentation of Consolidated Statement of Cash Flows under Statement No. 160

In December 2007 the Financial Accounting Standards Board (FASB) issued a standard that significantly changes (a) how a company prepares its consolidated financial statements when a subsidiary is not wholly owned and (b) the accounting for changes in the ownership percentage. FASB Statement No. 160, Noncontrolling Interests in Consolidated Financial Statements, (now codified in FASB ASC Topic 810) was effective for fiscal years beginning after December 15, 2008. For a calendar year-end company, the December 31, 2009 financial statements are the first time the new guidance will be required in annual financial statements.

The question has been raised as to the proper presentation of net income using the indirect method in the statement of cash flows for entities that adopt Statement No. 160. Per Statement No. 95, Statement of Cash Flows, (now codified in FASB ASC Topic 230), under the indirect method, net income is adjusted to arrive at net cash flows from operating activities. Therefore, upon adoption of Statement No. 160 the consolidated statement of cash flows prepared using the indirect method should begin with net income for the consolidated group as a whole before deducting the noncontrolling interest portion. The consolidated statement of cash flows should not begin with net income allocable to the controlling interest and then show a separate line item for income related to the noncontrolling interest.

FASB and IASB Publish Exposure Draft on the Reporting Entity Concept

As part of a joint project to develop a common conceptual framework that provides the basis for developing future accounting standards, the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) published a discussion paper, *Preliminary Views - Conceptual Framework for Financial Reporting: The Reporting Entity*, in 2008. The boards received 84 comment letters on that discussion paper. After considering respondents' comments, the Boards recently published an exposure draft, *Conceptual Framework for Financial Reporting: The Reporting Entity*, to propose what a reporting entity is and when an entity controls another entity.

The exposure draft defines a reporting entity as "a circumscribed area of economic activities whose financial information has the potential to be useful to existing and potential equity investors, lenders and other creditors who cannot directly obtain the information they need in making decisions about providing resources to the entity and in assessing whether the management and the governing board of that entity have made efficient and effective use of the resources provided." Per the exposure draft, the existence of a legal entity is neither necessary nor sufficient to identify a reporting entity. A reporting entity can include more than one entity or it can be a portion of a single entity. A single legal entity that conducts economic activities and does not control any other entity is likely to qualify as a reporting entity. However, a single legal entity may not qualify as a reporting entity if, for example, its economic activities are commingled with the economic activities of another entity and there is no basis for objectively distinguishing their activities. A portion of an entity could qualify as a reporting entity if the economic activities of that portion can be distinguished objectively from the rest of the entity and financial information about that portion of the entity has the potential to be useful in making decisions about providing resources to that portion of the entity.

Per the exposure draft, an entity controls another entity when it has the power to direct the activities of that other entity to generate benefits for (or limit losses to) itself. The exposure draft dictates that if an entity that controls one or more entities prepares financial reports, it should present consolidated financial statements. If two or more entities share the power to direct the activities of another entity to generate benefits for (or limit losses to) themselves, none of these entities would present information about itself and the other entity on a consolidated basis.

In addition to consolidated financial statements, the exposure draft discusses two other types of financial statements – "parent only" and combined financial statements. A controlling entity may desire to present "parent only" financial statements that provide information about its investments in the entities it controls, and the returns on those investments, rather than the economic resources and claims, and changes in those economic resources and claims, of those entities it controls. The exposure draft states that such "parent-only" financial statements might provide useful information if they are presented together with consolidated financial statements. Combined financial statements are defined in the exposure draft as including information about two or more commonly controlled entities, but excluding information about the controlling entity. The exposure draft states that combined financial statements might provide useful information about the commonly controlled entities as a group.

The exposure draft is available for comment until July 16, 2010 on the FASB's Web site at www.fasb.org and on the IASB's Web site at www.iasb.org.

Independence and Ethics

Disclosing the Names of Clients

Recently, engagement teams have asked whether they may include a list of representative McGladrey & Pullen assurance clients in a proposal to provide audit services to a prospective client. By definition, disclosing a list of representative audit clients requires disclosure of the names of individual clients for whom the Firm provides professional services. Ethics Ruling 7 in ET Section 391, "Ethics Rulings on Responsibilities to Clients" of the American Institute of Certified Public Accountants Code of Professional Conduct states that it is permissible for a firm to disclose the name of a client, whether publicly or privately owned, without the client's specific consent unless the disclosure of the client's name constitutes the release of confidential information.

Some types of arrangements (e.g., when we perform an agreed-upon-procedures engagement where the engagement is intended solely for the information and use of specified parties) may be confidential to the point that public disclosure would be inappropriate. Also, if our Firm has signed a confidentiality agreement with the client, the terms of that agreement should be reviewed to see whether they address revealing the name of the client. Many confidentiality agreements include a requirement that our Firm not disclose the relationship we have with the client unless expressly permitted.

Unless the disclosure of the client's name constitutes the release of confidential information, engagement teams do not need client permission to include a McGladrey & Pullen assurance client's name in a list of representative clients in a proposal to provide audit services to a prospective client. It is advisable, however, to get client permission before listing a client officer as a reference in an audit proposal so that they are not surprised if contacted by the prospect. It is the responsibility of the partner who signs the audit proposal to ensure that any representative list of clients truly represents the Firm well (i.e., the clients are current clients, the clients are not in bankruptcy or in an adversarial relationship with the Firm, etc.) Further, it should be noted that although releasing a client name for purposes of demonstrating expertise in an industry is allowed, our Firm will not release the names of clients to outside marketing entities for solicitation purposes.

The above discussion of policies applies only to disclosure of the names of McGladrey & Pullen assurance clients. Policies regarding the disclosure of the names of RSM McGladrey clients are outside the scope of this article.

Auditing

AICPA Newsletter, In Our Opinion – March 2010

The March 2010 edition of In Our Opinion, a newsletter published by the AICPA Audit and Attest Standards Team, has been posted to the "What's New" section of the Lotus Notes GS Navigator. Topics in this issue include:

- SAS No. 117, Compliance Audits
- American Recovery and Reinvestment Act Prompts Auditing Interpretations
- SSARS No. 19 — Most Significant Changes to Compilation and Review Standards Since 1978
- Clarity Project Update
- Lender Requests for "Comfort" Letters
- Highlights of Technical Activities
- Auditing Standards Board Agenda
- Recently Issued and Approved Documents

Personnel who have questions or comments about the contents of the In Our Opinion newsletter should not contact the AICPA staff directly, but rather should contact Bob Dohrer, National Director of Assurance Services, who chairs the Auditing Standards Board Audit Sampling SAS and Guide Task Force and Group Audits Task Force, and is also a member of the International Auditing Standards Task Force.

Compilations

Independence in Compilation Engagements – Paragraph 2.21 of SSARS 19

In December 2009, the AICPA issued Statement on Standards for Accounting and Review Services (SSARS) No. 19, Compilation and Review Engagements. The standard is effective for compilations and reviews of financial statements for periods ending on or after December 15, 2010; however, the standard allows for early implementation of paragraph 2.21. This paragraph removes the long-standing prohibition from stating the reason(s) for an accountant's lack of independence in the compilation report. (A lack of independence precludes issuance of a review report.) As a result, effective immediately, accountants may, but are not required to, state the reasons for a lack of independence in a compilation report, whether due to the accountant's financial or family relationship with the client or to the provision of prohibited services, such as accounting and internal control services. If the accountant chooses to provide this information in the compilation report, all reasons for the lack of independence must be included.

It is our Firm's preference that the reasons for lack of independence not be included in our compilation reports. We believe this information, particularly in situations where the lack of independence relates to providing accounting or internal control related services, could be misunderstood by users of the report. However, if a client requests that our compilation report include this information, we may do so. We will include sample report disclosures in the next update of the Compilation and Review Manual. Until then, consult with a member of the Regional Professional Practice Office if you need help in drafting the report disclosure.

Financial Institutions

New Form to Be Used for Consultations with FICAR Committee

As previously communicated, financial institution client acceptance requires approval by the FI Industry Client Acceptance and Re-evaluation (FICAR) Committee in the following circumstances:

- The prospective client has a CAMELS rating of 4 or 5.
- The prospective client is currently under a cease and desist or similar order.
- The prospective client is below adequately capitalized.
- The National Director of Financial Institution Services determines that the client acceptance decision warrants the involvement of the FICAR committee.

Also, financial institution client continuance must be approved by the FICAR Committee if the existing client has a CAMELS rating of 4 or 5. New form 0162.25 ADD, FI Record of Consultation – FICAR, has been developed to replace existing form 0162.25 ADD that currently resides in MAPS. The new FICAR consultation form should be used for all consultations with the FICAR Committee going forward. The new form is available on the MAPS Resource Site and via this [Link](#).

Clarification of the Risk Weight for Claims on or Guaranteed by the FDIC

The Office of the Comptroller of the Currency, Federal Reserve Board, Federal Deposit Insurance Corporation (FDIC), and Office of Thrift Supervision recently issued a joint statement clarifying the risk weights for claims on or guaranteed by the FDIC for purposes of banking organizations' risk-based capital requirements. Under the agencies' risk-based capital guidelines, direct claims on and claims unconditionally guaranteed by the FDIC, such as FDIC-insured deposits, prepaid assessments of deposit insurance premiums, debt guaranteed under the FDIC's Temporary Liquidity Guarantee Program, and similarly guaranteed debt, may be assigned a zero percent risk weight in the calculation of regulatory capital. By contrast, recent loss-sharing agreements entered into by the FDIC with acquirers of assets from failed institutions are considered conditional guarantees for risk-based capital purposes due to contractual conditions that acquirers must meet. The guaranteed portion of assets subject to a loss-sharing agreement (i.e., indemnification assets) may be assigned a 20 percent risk weight. Because the structural arrangements for these agreements vary depending on the specific terms of each agreement, institutions should consult with their primary federal regulator to determine the appropriate risk-based capital treatment for specific loss-sharing agreements.

SEC

Updated Financial Reporting Manual Available

The SEC's Division of Corporation Finance recently updated its Financial Reporting Manual, which is available online. Among the revisions in this update are revisions to Topic 8, Non-GAAP Measures of Financial Performance, Liquidity and Net Worth, and the addition of Section 9500, "Critical Accounting Estimates — Goodwill Impairment." Although the Manual is intended only to provide general guidance to Division staff, it contains helpful information to auditors and preparers of issuer financial statements. Topics discussed in the Manual include the following, among others:

- Registrant's financial statements
- Other financial statements required
- Pro forma financial information
- Independent accountant's involvement
- Smaller reporting companies
- Related-party matters
- Non-GAAP measures of financial performance, liquidity, and net worth
- Management's discussion and analysis of financial position and results of operations
- Reverse acquisitions and reverse recapitalizations
- Effects of subsequent events on financial statements required in filings
- Employee stock benefit plans

The updated Financial Reporting Manual is available in full at <http://www.sec.gov/divisions/corpfin/cffinancialreportingmanual.pdf>.

Public Sector

Single Audit Report Samples Updated for SAS 115

On March 11, 2010, the Office of Management and Budget (OMB) posted illustrative auditor's reports for engagements to report on compliance with requirements applicable to each major program and on internal control over compliance for audits performed under OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. Circular A-133 includes guidelines for reporting "significant deficiencies" and "material weaknesses." These terms are to be used as defined in generally accepted auditing standards issued by the AICPA and Government Auditing Standards issued by the Government Accountability Office. The OMB's report illustrations are based on Statement on Auditing Standards (SAS) No. 115, Communicating Internal Control Related Matters Identified in an Audit, and recently issued related Interpretation No. 1, "Communicating Deficiencies in Internal Control Over Compliance in an Office of Management and Budget (OMB) Circular A133 Audit," which provides updated definitions of the internal control deficiency terminology that are adapted in the context of reporting on internal control over compliance in a single audit. The new illustrative reports should be used for all single audits for periods ending on or after December 15, 2009. The illustrative reports are available at http://gaqc.aicpa.org/NR/rdonlyres/A917A3B1-C237-4025-8FD6-DC3F467F7D82/0/Illustrative_Auditors_Reports_Under_OMB_Final.pdf.

Employee Benefit Plans

McGladrey & Pullen Issues Additional Guidance on 403(b) Plan Form 5500 Reporting

As previously communicated, starting with plan years beginning on or after January 1, 2009, 403(b) plans that are considered to be ERISA-covered plans will be required to electronically file complete Form 5500s, including schedules such as Schedules A and either H (for large plans) or I (for small plans). As with other ERISA-covered plans, those plans with over 100 participants will be required to have an annual audit performed by a qualified independent auditor. The U.S. Department of Labor (DOL) recently issued Field Assistance Bulletin (FAB) 2010-01, Annual Reporting and ERISA Coverage for 403(b) Plans, to address, among other things, previously issued FAB 2009-02, Annual Reporting Requirements for 403(b) Plans, and FAB 2007-02, ERISA Coverage of IRC 403(b) Tax-Sheltered Annuity Programs. The guidance in FAB 2010-01 can be categorized into four general groups of questions:

- Is the plan exempt from ERISA?
- Who counts as a participant in the Plan?
- When is an annuity contract or custodial account a plan asset for reporting and disclosure purposes?
- How does the employer account for plan assets?

McGladrey & Pullen has issued a publication addressing the DOL's guidance in FAB 2010-01 with respect to these questions. This document is available in full at http://mcgladrey.com/Resource_Center/dol_403b_planreporting.pdf.

A&A LPD

April Webcasts

44220, Engagement Quality Reviews – April 5 and 19

This one-hour web conference is required for partners who serve SEC clients.

67120, Full Scope Form 11-K Filers - April 9

This annual course is suggested for professionals who hold a designation in employee benefits and will be serving on full-scope audits or audits of Form 11-K filers.

45735, Q1 Current Accounting Topics Quarterly Update 2010 - April 22 and 29

This is a suggested course for partners, directors, managers, in-charge accountants, concurring reviewers, and independent report reviewers.

67100, Audits of Employee Benefit Plans - April 27

This course is required for assurance services professionals at the supervisor level and above (including concurring partners and independent report reviewers) who have responsibility for employee benefit plan engagements. This course is suggested for assurance services professionals at the associate through senior associate level.

67150, Audits of Health and Welfare Plans - April 29

This course is required for all professionals who will be serving as a member of an engagement team on audits of health and welfare employee benefit plans. This course is also required for concurring reviewers designated for health and welfare employee benefit plan audits.

To enroll in these webcasts or any other courses, please log into LearningLinks.

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