Insights

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Accounting

Fair Value Disclosures for Business Combinations and Other Accounting Events

There are few financial reporting topics that have garnered as much attention in recent times from standard-setters and users of the financial statements as the topic of disclosures for fair value measurements. Topic 820, "Fair Value Measurements and Disclosures," of the Financial Accounting Standards Board's (FASB) Accounting Standards Codification (ASC) requires extensive disclosures about recurring and nonrecurring fair value measurements. FASB ASC 820 codifies the guidance previously included in FASB Statement No. 157, Fair Value Measurements. Since the issuance of Statement No. 157 in September 2006, its disclosure requirements have been enhanced several times.

The nature and extent of the disclosures required by ASC 820 vary depending on whether the fair value measurement is considered recurring or nonrecurring. More extensive disclosures are required for recurring fair value measurements. Questions have arisen about the applicability of the fair value measurement disclosure requirements in ASC 820 to certain fair value measurements reflected in the financial statements. Some of these questions include:

- Do the fair value measurement disclosures apply to a building acquired in a business combination if no impairment charge was recognized on the building between the acquisition date and the end of the reporting period? What if an impairment charge was recognized on the building between the acquisition date and the end of the reporting period?
- Do the fair value measurement disclosures apply to goodwill if an impairment charge was recorded during the reporting period?
- How do the fair value measurement disclosures apply to loans receivable?
- Do the fair value measurement disclosures apply to long-lived assets held for sale?

Fair Value Disclosures for Business Combinations and Other Accounting Events captures our views on these and other related questions to illustrate a variety of accounting events for the which the ASC 820 fair value measurement disclosures may be required. An electronic copy of the document is available on the McGladrey & Pullen Web site at http://www.mcgladrey.com/Resource_Center/fair_value_disclosures.pdf.

Other recent accounting-related publications available on the McGladrey & Pullen Web site include:

- Fundamentals of Fair Value Measurements and Disclosures
- Assigning Assets and Liabilities that Relate to Multiple Reporting Units when Testing Goodwill for Impairment
- Fundamentals of Debt Classification
- Toolkit for Private Equity Group Portfolio Company Accounting
- Subsequent Events: New Standards Apply

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Accounting Considerations Following a Pension Plan Freeze

Economic conditions have caused employers to seek ways in which to reduce costs and burdens on cash flow. Curtailing their defined benefit pension plans is one such way. A curtailment occurs when an event (for example, freezing the plan) significantly reduces the expected years of future service of present employees or eliminates for a significant number of employees the accrual of defined benefits for some or all of their future services. In the context of this discussion, freezing the plan presumes the freeze is not a temporary suspension of employees earning benefits under the plan. Rather, this discussion is based on the premise that a communication has been made to affected plan participants that further benefits will not be earned for future service and there is no expectation that this action will be reversed in the future (i.e., a so called hard freeze). However, future service as an employee may continue to be the basis for vesting of benefits calculated as of the date the plan was frozen.

Whether a plan participant is determined to be active or inactive after a plan is frozen affects the periods that gains or losses are amortized over and thus measurement of future pension cost after the curtailment. An active plan participant is an employee who continues providing service to the employer and continues to earn benefits in accordance with the plan. An inactive participant is one who no longer is earning additional benefits under the plan. An inactive participant includes current employees who are participants in the plan, but whose future services do not earn them additional defined benefits under the plan. Thus, the determination of whether a participant is active or inactive depends on whether that person will earn benefits under the plan, not whether the participant is providing services to the employer.

One of the fundamental principles of accounting for a defined benefit pension plan or a plan that provides other post-employment benefits is an entity's ability to elect to defer gains and losses related to return on plan assets and actuarial gains and losses over future periods. FASB Accounting Standards Codification (ASC) Section 715-30-35-24 provides that if all or almost all of a plan's participants are inactive, the average remaining life expectancy of the inactive participants is to be used for amortization of a net gain or loss. ASC Section 715-30-35-11 provides the same guidance with respect to prior service costs. The rising number of pension plan curtailments has caused a focus to be placed on whether the designation of plan participants as inactive following a pension plan freeze causes a change in the period of amortization of net gains or losses and prior service costs that remain unrecognized after accounting for the plan curtailment. Guidance in this area has also continued to evolve, and has concluded that after a pension plan has been frozen and its participants are determined to be inactive, the period of amortization from that point forward should be changed to the average life expectancy of those participants. This change in amortization period commencing at the date the plan is frozen should be accounted for as a change in accounting estimate and not a change in accounting principle or the application thereof. However, if an employer did not change the amortization period at the time the plan is frozen but chooses to do so at a later date, consultation with the leader in the Regional Professional Practice Office is suggested to assist in determining the appropriate course of action.

Accounting for Certain Tax Effects of the Health Care Reform Acts

On March 30, 2010, the President signed the Health Care and Education Reconciliation Act of 2010, which is a reconciliation bill that amends the Patient Protection and Affordable Care Act that was signed by the President on March 23, 2010. Recently, questions have arisen about the effect, if any, that the different signing dates might have on the accounting for these two Acts. This timing difference, related solely to the signing dates, should not have an impact on a majority of companies because the Acts were both signed within a relatively short time period, which for the vast majority of companies falls into the same reporting period. However, there may be a limited number of companies with a period end that falls between the

signing dates for which the timing difference could raise questions about whether the different signing dates have an accounting impact. For example, FASB Codification Topic 740, Income Taxes, requires the measurement of current and deferred tax liabilities and assets to be based on provisions of enacted tax law; the effects of future changes in tax laws or rates are not anticipated.

In April, 2010 the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2010-12, Income Taxes (Topic 740): Accounting for Certain Tax Effects of the 2010 Health Care Reform Acts, to codify an SEC Staff Announcement in response to these questions. After consultation with the FASB staff, the SEC's Office of the Chief Accountant would not object to a view that the two Acts should be considered together for accounting purposes. That is, in this specific fact pattern the SEC staff would not object to a registrant incorporating the effects of the Health Care and Education Reconciliation Act of 2010 when accounting for the Patient Protection and Affordable Care Act. This view is based in part on the SEC staff's understanding that the two Acts, when taken together, represent the current health care reforms as passed by Congress and signed by the President. The SEC staff does not believe that it would be appropriate to analogize to this view in any other fact patterns. While this guidance is applicable to SEC registrants, it would be reasonable for any entity to which the guidance applies to come to the same conclusion.

ASU 2010-12 is available in full at www.fasb.org.

Currency Considerations in the Classification of Share-based Payment Awards

FASB Accounting Standards Codification Topic 718, Compensation—Stock Compensation, provides guidance on the classification of a share-based payment award as either equity or a liability. A share-based payment award that contains a condition that is not a market, performance, or service condition is required to be classified as a liability. Under Topic 718, awards of equity share options granted to an employee of an entity's foreign operation that provide a fixed exercise price denominated in the foreign operation's functional currency or the currency in which the employee's pay is denominated should not be considered to contain a condition that is not a market, performance, or service condition. Topic 718, however, does not address the classification of an employee share-based payment award with an exercise price denominated in the currency of a market in which the underlying equity security trades.

Recently, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) 2010-13, Compensation—Stock Compensation (Topic 718) - Effect of Denominating the Exercise Price of a Share-Based Payment Award in the Currency of the Market in Which the Underlying Equity Security Trades - a consensus of the FASB Emerging Issues Task Force. This ASU amends Topic 718 to clarify that an employee share-based payment award with an exercise price denominated in the currency of a market in which a substantial portion of the entity's equity securities trades should not be considered to contain a condition that is not a market, performance, or service condition. Therefore, an entity would not classify such an award as a liability if it otherwise qualifies as equity. Accordingly, those entities that have previously considered such awards to be liabilities because of their exercise price will be affected by these amendments to Topic 718.

The amendments in ASU 2010-13 are effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2010. The amendments should be applied by recording a cumulative-effect adjustment to the opening balance of retained earnings. The cumulative-effect adjustment should be calculated for all awards outstanding as of the beginning of the fiscal year in which the amendments are initially applied, as if the amendments had been applied consistently since the inception of the award. The cumulative-effect adjustment should be presented separately. Earlier application is permitted.

ASU 2010-13 is available in full at www.fasb.org.

Modernization of Oil and Gas Reporting

Recently, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) 2010-14, Accounting for Extractive Activities – Oil & Gas - Amendments to Paragraph 932-10-S99-1. This ASU was issued to amend the SEC content in paragraph 932-10-S99-1 to conform to SEC Release No. 33-8995, Modernization of Oil and Gas Reporting. ASU 2010-14 is available in full at www.fasb.org.

An Insurer's Consolidation Analysis: Investments Held Through Separate Accounts

Separate accounts represent assets that are typically maintained by a life insurance entity for purposes of funding obligations to individual contract holders under fixed-benefit or variable annuity contracts, pension plans, and similar contracts. The contract holder generally assumes the investment risk, and the insurance entity receives a fee for investment management, certain administrative expenses, and mortality and expense risks assumed. While the insurance entity cannot make investment allocation decisions for contract holders, the insurance entity does hold title to the investments in a separate account and generally has certain rights associated with those investments, such as the ability to vote on behalf of the contract holder. A separate account is not a distinct legal entity. Rather, a separate account is an accounting entity created by and under the control of the insurance entity that owns all the assets held in the separate account. It has not been clear whether an insurance entity should consider investments held either separately in its separate accounts, or collectively in its general account interests, for purposes of assessing whether the insurer has a controlling financial interest in the investment and should therefore consolidate that investment in its financial statements.

Recently, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) 2010-15, Financial Services—Insurance (Topic 944) - How Investments Held through Separate Accounts Affect an Insurer's Consolidation Analysis of Those Investments - a consensus of the FASB Emerging Issues Task Force. The amendments in this ASU clarify that an insurance entity should not consider any separate account interests held for the benefit of policy holders in an investment to be the insurer's interests. An insurance entity should not combine those separate account interests with its general account interest in the same investment when assessing the investment for consolidation, unless the separate account interests are held for the benefit of a related-party policy holder as defined in the Variable Interest Subsections of Subtopic 810-10, Consolidation—Overall, and those Subsections require the consideration of related parties. Also, this ASU provides amendments to Subtopic 944-80, Financial Services—Insurance—Separate Accounts, to clarify that for the purpose of evaluating whether the retention of specialized accounting for investments in consolidation is appropriate, a separate account arrangement should be considered a subsidiary. The amendments do not require an insurer to consolidate an investment in which a separate account holds a controlling financial interest if the investment is not or would not be consolidated in the standalone financial statements of the separate account. Further, the amendments in this ASU provide guidance on how an insurer should consolidate an investment fund in situations in which the insurer concludes that consolidation is required.

The amendments in this ASU affect insurance entities that have separate accounts that meet the definition of a separate account in paragraph 944-80-25-2 when evaluating whether to consolidate an investment held through its separate account or through a combination of investments in its separate and general accounts. The accounting for situations in which an insurer's general account has a controlling financial interest in an investment is not affected by this ASU and should follow existing GAAP on consolidations. The amendments in this ASU are specific to insurance entities that have separate accounts and should not be analogized by other entities in nonseparate-account arrangements or other investment situations.

The amendments in ASU 2010-15 are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2010. Early adoption is permitted. The amendments in the ASU should be applied retrospectively to all prior periods upon the date of adoption.

ASU 2010-15 is available in full at www.fasb.org.

Accruals for Casino Base Jackpot Liabilities
Currently, some entities that generate revenue from gaming activities do not accrue liabilities for a base jackpot before it is won because they can avoid the payment. Other entities accrue liabilities for a base jackpot ratably over the period of play expected to precede payout. To address this diversity in practice in the accounting for casino base jackpot liabilities, the Financial Accounting Standards Board recently issued Accounting Standards Update (ASU) 2010-16, Entertainment—Casinos (Topic 924) - Accruals for Casino Jackpot Liabilities - a consensus of the FASB Emerging Issues Task Force.

The amendments in this ASU clarify that an entity should not accrue jackpot liabilities (or portions thereof) before a jackpot is won if the entity can avoid paying that jackpot. Jackpots should be accrued and charged to revenue when an entity has the obligation to pay the jackpot. This guidance applies to both base and progressive jackpots; however, the amendments are expected to only affect the accounting for base jackpots because the guidance uses the same principle that was previously applied to the incremental portion of progressive jackpots.

The amendments in this ASU are effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2010. The amendments should be applied by recording a cumulative-effect adjustment to opening retained earnings in the period of adoption. The cumulative-effect adjustment is the difference between the amounts recognized in the statement of financial position before initial application of the amendments in the ASU and the amounts recognized in the statement of financial position at initial application of those amendments.

ASU 2010-16 is available in full at www.fasb.org.

Presentation of Insurance Claims and Related Insurance Recoveries by Health Care Entities
In accounting for medical malpractice and similar liabilities and their related anticipated insurance recoveries, most health care entities have netted insurance recoveries against the accrued liability. However, some entities have presented the anticipated insurance recovery and the liability on a gross basis. To address this diversity in practice, the Financial Accounting Standards Board has issued a proposed Accounting Standards Update (ASU), Health Care Entities (Topic 954) - Presentation of Insurance Claims and Related Insurance Recoveries - a consensus of the FASB Emerging Issues Task Force. If finalized, the amendments in this proposed ASU would clarify that a health care entity within the scope of Topic 954, Health Care Entities, should not net insurance recoveries against a related claim liability. The amount of the claim liability would be determined without consideration of insurance recoveries. The proposed amendments would eliminate an industry exception and thus conform to the general principle of Subtopic 210-20 which does not permit offsetting of conditional or unconditional liabilities with anticipated insurance recoveries from third parties. The amendments in the proposed ASU would be effective as of the beginning of the period of adoption, and any net difference between existing liabilities and insurance recoveries compared to those recorded as a result of applying the amendments would be recognized as a cumulative effect adjustment in opening retained earnings at that time.

The proposed ASU is available for comment until May 17, 2010 at www.fasb.org.

Measuring Charity Care Disclosure by Health Care Entities

Existing professional guidance does not prescribe a specific measurement basis of charity care for disclosure purposes by health care entities. Some health care entities that provide charity care determine their charity care disclosures on the basis of a cost measurement, while others use a revenue measurement. To reduce the diversity in practice about these disclosures, the Financial Accounting Standards Board has issued a proposed Accounting Standards Update (ASU), Health Care Entities (Topic 954) - Measuring Charity Care for Disclosure - a consensus of the FASB Emerging Issues Task Force. The amendments in this proposed ASU would require that the measurement of charity care for disclosure purposes be based on the direct and indirect costs of providing the charity care. Since health care entities do not recognize revenue when charity care is provided, the amendments in the proposed ASU have no effect on the amounts reported on the primary financial statements. However, the disclosures affected by the proposed ASU would be adjusted retrospectively for all prior periods presented.

The proposed ASU is available for comment until May 17, 2010 at www.fasb.org.

Auditing

Attestation Manual Updated

On April 23, 2010, Version 3.0 of the Attestation Manual was released. Many revisions in this version of the Manual reflect changes in Firm policy associated with the launch of MRAM and continuing implementation of the Quality Control Delivery Structure (QCDS). Some of the other changes made in this update include:

- Revisions to arrangement letter policies and samples to conform with prior MCAP changes
- New policy related to integrated audits under AT 501, An Examination of an Entity's Internal Control over Financial Reporting That Is Integrated with an Audit of Its Financial Statements, together with samples of the related arrangement letter, representation letter, and reports. These policy changes do not impact integrated audits conducted for SEC registrants pursuant to PCAOB Auditing Standard No. 5, nor do the changes impact policies and guidance currently contained in the Financial Institutions Manual for FDICIA engagements.
- New guidance on the following AICPA Statements of Position:
  - 06-1, Reporting Pursuant to the Global Investment Performance Standards
  - 07-2, Attestation Engagements That Address Specified Compliance Control Objectives and Related Controls at Entities That Provide Services to Investment Companies, Investment Advisers, or Other Service Providers
  - 09-1, Performing Agreed-Upon Procedures Engagements That Address the Completeness, Accuracy, or Consistency of XBRL-Tagged Data

New and updated policies and procedures are effective for attestation engagements beginning on or after July 1, 2010. Auditors should refer to the Release Notes in the Manual for complete details.

Reporting on Controls at a Service Organization

In April 2010 the AICPA's Auditing Standards Board issued Statement on Standards for Attestation Engagements (SSAE) No. 16, Reporting on Controls at a Service Organization. SSAE 16 is applicable when an entity (the user entity) outsources a business task or function to another entity (the service organization) and the data resulting from that task or function is incorporated in the user entity's financial statements. One example of this is a health insurance company outsourcing the processing of medical claims to a claims processor and the resulting claims data being used to record the insurance company's claims expense

and related liability. In this example, even though the claims data is generated by the claims processor, management of the insurance company is still responsible for the accuracy of that data because it is included in their financial statements.

The auditor of a user entity's financial statements (the user auditor) has the same responsibility for auditing data provided by a service organization as the auditor has for auditing other financial statement information. One way a user auditor may obtain evidence about the quality and accuracy of the data provided to a user entity by a service organization is to obtain a CPA's report (a service auditor's report) on controls at the service organization that affect data provided to the user entity and incorporated in the user entity's financial statements. SSAE 16 enables a CPA to provide two types of service auditor's reports:

- In a type 1 report, the service auditor expresses an opinion on whether the description of the service organization's system (the nature of the service provided, how the service is performed, and the service organization's controls over the service and related control objectives) is fairly presented and whether the controls included in the description are suitability designed.
- In a type 2 report, the service auditor's report contains the same opinions that are included in a type 1 report but also includes an opinion on whether the controls were operating effectively.

Currently the guidance for service auditors reporting on controls at a service organization and for user auditors auditing the financial statements of a user entity is contained in AU Section 324 (originally issued as Statement on Auditing Standards (SAS) No. 70, Service Organizations). There are two major significant changes in SSAE 16, among others, that will affect a service auditor's engagement: (1) management of the service organization will now be required to provide the service auditor with a written assertion about the fairness of the presentation of the description of the system, and about the suitability of the design and, in a type 2 engagement, the operating effectiveness of the controls; and (2) in a type 2 engagement, the description of the service organization's system and the service auditor's opinion on the description will cover a period, rather than being as of a specified date.

The guidance for user auditors, currently in AU Section 324, will be unchanged until a currently proposed SAS for user auditors, Audit Considerations Relating to an Entity Using a Service Organization (Redrafted), becomes effective. The proposed SAS does not contain any significant changes for user auditors. The new guidance for user auditors will remain in the SASs. SSAE 16 will be located in Section 801 of the attestation standards.

SSAE 16 is effective for service auditor's reports for periods ending on or after June 15, 2011, with earlier implementation permitted.

SEC

Registration with the Canadian Public Accountability Board

McGladrey & Pullen, LLP is pleased to announce that effective April 12, 2010 our Firm became registered with the Canadian Public Accountability Board (CPAB). The CPAB oversees auditors of Canadian reporting issuers, that is, companies that have raised funds from the Canadian investing public and who, for that reason, must file financial statements with one or more provincial securities commissions. Under Canadian Securities Administrators Rule 52-108, accounting firms that audit Canadian reporting issuers must be participants in the CPAB's oversight program.

Variable Interest Entities – ICFR Reporting Requirements

Section 4310.11 of the Division of Corporation Finance Financial Reporting Manual addresses how a registrant should apply the requirements of Section 404 of the Sarbanes-Oxley Act of 2002 to an entity consolidated pursuant to FASB Interpretation (FIN) No. 46 (revised December 2003), Consolidation of Variable Interest Entities -- An Interpretation of ARB No. 51, now codified within Accounting Standards Codification (ASC) Topic 810. In Section 4310.11(a), the SEC staff concluded that a variable interest entity (VIE) in existence prior to December 15, 2003 that is consolidated may be scoped out of the internal control over financial reporting (ICFR) requirements if the registrant does not have the right or authority to assess the internal controls of the FIN 46(R) consolidated entity and also lacks the ability, in practice, to make that assessment. A similar exception also is available for an entity accounted for via proportionate consolidation in accordance with ASC 810-10-45-14 (EITF 00-1) if management does not have the ability to assess ICFR. In Section 4310.11(c) the SEC staff also provided for a short deferral of the requirement to review internal controls for a newly acquired business.

Recently, the SEC staff shared with the CAQ SEC Regulations Committee its views regarding the ICFR reporting requirements for an entity newly consolidated pursuant to FASB Statement No. 167, Amendments to FASB Interpretation No. 46(R), which is now codified within ASC Topic 810-10, Consolidation. The SEC staff stated that VIEs consolidated upon adoption of Statement No. 167 should be included in management's reports on ICFR. Because the criteria for consolidation of a VIE are based upon control, the SEC staff stated that a registrant will no longer be able to justify excluding consolidated VIEs from the scope of their internal controls assessment. Registrants likely will have the right or authority to assess the internal controls of those VIEs. Furthermore, because the consolidation of VIEs under Statement No. 167 will occur as of the first day of the registrant's fiscal year, the SEC staff believes the registrant will have sufficient time to perform that assessment and would be unable to rely on the temporary relief provided in Section 4310.11(c) of the Division of Corporation Finance Financial Reporting Manual.

The SEC staff stated the guidance included in Section 4310.11(a) continues to apply only in the rare circumstance in which the VIE was in existence prior to December 15, 2003, and the registrant, despite having control, does not possess the right or authority to assess the VIE's internal controls and lacks the ability, in practice, to make that assessment. Registrants may continue to follow the guidance in Section 4310.11(a) in this rare circumstance.

A registrant may exclude an acquired business from the scope of its internal control assessment in a situation where a registrant acquires a business during a year but it is not possible to conduct an assessment of an acquired business' internal controls during the period between the consummation date and year end. The SEC staff stated that after adoption of Statement No. 167, an SEC registrant may apply the guidance in Section 4310.11(c) when considering whether it would be appropriate to exclude a VIE that is newly consolidated due to events or changes in circumstances from the scope of its internal control assessment in the fiscal year consolidation first occurs if an assessment is not possible.

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