

January 12, 2010

## Accounting

### Two Accounting Standards Updates Issued for Previously Published Statements

In June 2009 the Financial Accounting Standards Board (FASB) published two statements, which were recently added to the FASB Accounting Standards Codification through the issuance of the following Accounting Standards Updates (ASUs):

- ASU No. 2009-16, *Transfers and Servicing (Topic 860): Accounting for Transfers of Financial Assets*, codifies Statement No. 166, *Accounting for Transfers of Financial Assets*, which is a revision to Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. Among other provisions, ASU No. 2009-16 eliminates the concept of a “qualifying special-purpose entity” from Statement No.140 and removes the exception from applying FASB Interpretation (FIN) No. 46 (revised December 2003), *Consolidation of Variable Interest Entities*, to qualifying special-purpose entities. As a result, most securitization entities that previously met the requirements of a qualifying special-purpose entity under Statement No. 140 that are variable interest entities (VIEs) are now required to be evaluated under the revised guidance in the amendment to FIN 46(R), which is discussed in the following bullet point.
- ASU No. 2009-17, *Consolidations (Topic 810): Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities*, codifies Statement No. 167, *Amendments to FASB Interpretation No. 46(R)*. Among other provisions, this ASU amends FIN 46(R) to require an enterprise to perform an analysis to determine whether the enterprise’s variable interest or interests give it a controlling financial interest in a VIE. This analysis identifies the primary beneficiary of a VIE as the enterprise that has both (a) the power to direct the activities of a VIE that most significantly impact the entity’s economic performance, and (b) the obligation to absorb losses of the entity that could potentially be significant to the VIE or the right to receive benefits from the entity that could potentially be significant to the VIE. Additionally, ASU No. 2009-17 requires an enterprise to assess whether it has an implicit financial responsibility to ensure that a VIE operates as designed when determining whether it has the power to direct the activities of the VIE that most significantly impact the entity’s economic performance.

Both of these ASUs are effective at the beginning of a reporting entity’s first fiscal year that begins after November 15, 2009. Earlier application is prohibited.

The ASUs are available in full at <http://www.fasb.org>.

### Accounting for Distributions to Shareholders with Components of Stock and Cash

On January 5, 2010, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) No. 2010-01, *Equity (Topic 505): Accounting for Distributions to Shareholders with Components of Stock and Cash (A Consensus of the FASB Emerging Issues Task Force)*. The objective of this ASU is to address the diversity in

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practice related to the accounting for a distribution to shareholders that offers them the ability to elect to receive their entire distribution in cash or stock of equivalent value with a potential limit on the total amount of cash that shareholders can elect to receive in aggregate. Historically, some entities have accounted for the stock portion of the distribution as a new share issuance that is reflected in earning per share (EPS) prospectively. Other entities have accounted for the stock portion of the distribution as a stock dividend by retroactively restating shares outstanding and EPS for all periods presented. The amendments in this ASU clarify that the stock portion of a distribution to shareholders that allows them to elect to receive cash or shares with a potential limit on the total amount of cash that all shareholders can elect to receive in the aggregate is considered a share issuance that is reflected in EPS prospectively. The stock portion of a distribution to shareholders that allows them to elect to receive cash or shares with a limit on the amount of cash that will be distributed is not a stock dividend for purposes of applying Topics 505 and 260, *Equity and Earnings per Share*.

The amendments in this ASU are effective for interim and annual periods ending on or after December 15, 2009, and should be applied on a retrospective basis. ASU 2010-01 is available in full at <http://www.fasb.org>.

### **Guidance Issued for Investment Companies Involved in a Business Combination**

When investment companies engage in a business combination, shares of one company typically are exchanged for substantially all the shares or assets of another company (or companies). Most mergers of registered investment companies are structured as tax-free reorganizations. The American Institute of Certified Public Accountants has issued new guidance in TIS Section 6910.33, *Certain Financial Reporting, Disclosure, Regulatory, and Tax Considerations When Preparing Financial Statements of Investment Companies Involved in a Business Combination*.

Per the guidance, tax implications must be considered and monitored carefully in the planning, execution, and post-merger stages of a business combination. The tax rules that must be considered include those related to the determination that the transaction is tax-free to the funds involved and their shareholders, the qualification tests affecting regulated investment companies (RICs), and the accounting for tax attributes of specific accounts such as earnings and profits, capital loss carryforwards, and methods of tax accounting. There are important differences in the tax rules affecting business combinations of RICs and non-RIC investment companies.

If the combination is a taxable reorganization, the fair value of the assets acquired on the date of the combination becomes the assets' new cost basis. For financial reporting purposes, assets acquired in a tax-free reorganization may be accounted for in the same manner as a taxable reorganization. However, investment companies carry substantially all their assets at fair value as an ongoing reporting practice and cost basis is principally used and presented solely for purposes of determining realized and unrealized gain and loss. Accordingly, an investment company, which is an acquirer in a business combination structured as a tax-free exchange of shares, may make an accounting policy election to carry forward the historical cost basis of the acquiree's investment securities for purposes of measuring realized and unrealized gain or loss for statement of operations presentation in order to more closely align the subsequent reporting of realized gains by the combined entity with tax-basis gains distributable to shareholders. The basis for such policy election should be disclosed in the notes to the financial statements, if material.

Certain disclosures are required when business combinations occur during the reporting period or after the reporting date but before the financial statements are issued. Disclosures for all business combinations should include a summary of the essential elements of the combination; that is, the name and description of the acquiree, the acquisition date, the percentage of voting equity interests acquired, the primary reasons for the combination and the manner in which control was obtained, the nature of the principal assets acquired, the number and fair value of shares issued by the acquiring company, and the exchange ratio. In addition, public business enterprises are

required to disclose certain supplemental information. Illustrative financial statement presentations and disclosures are included in the guidance.

TIS Section 6910.33 is available in full at

[http://www.aicpa.org/download/news/2009/Final\\_TIS\\_6910\\_Investment\\_Companies.pdf](http://www.aicpa.org/download/news/2009/Final_TIS_6910_Investment_Companies.pdf).

### More Guidance for Using NAV to Estimate Fair Value of an Alternative Investment

Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 820, *Fair Value Measurements and Disclosures*, provides guidance on using the net asset value (NAV) per share provided by the investee as a practical expedient to estimate the fair value of an alternative investment. Such investments include interests in hedge funds, private equity funds, real estate funds, venture capital funds, commodity funds, offshore fund vehicles, and funds of funds, as well as some bank common/collective trust funds and other similar funds. Companies in various industries, including investment companies, broker-dealers, banks, insurance companies, employee benefit plans, healthcare organizations, and not-for-profit organizations, often invest in alternative investments. Recently, the American Institute of Certified Public Accountants issued the following paragraphs in TIS Section 2220, *Long-Term Investments*, to assist reporting entities when implementing the provisions of FASB ASC 820 to estimate the fair value of their investments in certain entities that calculate net asset value:

- .18, *Applicability of Practical Expedient* - The practical expedient is available for investments of the type described above and held by those types of entities described above.
- .19, *Unit of Account* - For interests in alternative investments, the appropriate unit of account is generally the interest in the investee fund itself, not the underlying investments within the investee fund.
- .20, *Determining Whether NAV is Calculated Consistent with FASB ASC 946, Financial Services—Investment Companies* - To conclude that NAV has been calculated in a manner consistent with the measurement principles of ASC 946, the reporting entity's management must use professional judgment and consider the investee's internal controls and valuation techniques and processes such as those illustrated in the TIS.
- .21, *Determining Whether an Adjustment to NAV is Necessary* - The TIS offers as examples situations where adjustments to the last reported NAV may be necessary when NAV (i) is not as of the reporting entity's measurement date and/or (ii) is not calculated in a manner consistent with the measurement principles of ASC 946.
- .22, *Adjusting NAV When It Is Not as of the Reporting Entity's Measurement Date* - When the last reported NAV is calculated consistently with ASC 946 but not as of the reporting entity's measurement date, the reporting entity may either request the investee fund manager to provide a supplemental NAV calculation as of the reporting entity's measurement date, or it may be necessary to adjust or roll forward the reported NAV for factors that might cause it to differ from the NAV at the measurement date. (The TIS provides a sample roll forward calculation and offers factors to consider in making that calculation.)
- .23, *Adjusting NAV When It Is Not Calculated Consistent with FASB ASC 946* - The TIS offers facts and circumstances to consider when adjusting the NAV is necessary and also suggests that when it is not practicable to calculate an adjusted NAV the practical expedient is not available.
- .24, *Disclosures—Ability to Redeem Versus Actual Redemption Request* - Determining the timing of redemption in relation to the measurement date and whether any adjustments to the NAV are considered level 2 or 3 is a matter of professional judgment as discussed in the TIS.

- .25, *Impact of "Near Term" on Classification Within Fair Value Hierarchy* - Although assessing what is considered "near term" is a matter of professional judgment which depends on specific facts and circumstances, a redemption period of 90 days or less is generally considered "near term."
- .26, *Categorization of Investments for Disclosure Purposes* - Disclosures should be tailored to address the concentrations of risk that are specifically attributable to the investments.
- .27, *Determining Fair Value of Investments When the Practical Expedient is not Used or is not Available* - The TIS provides a lengthy discussion of inputs and features to be considered in estimating fair value that are distinguished based on whether the alternative investments are redeemable or nonredeemable.

TIS Section 2220.18 - .27 is available in full at [http://www.aicpa.org/download/news/2009/TIS\\_Section\\_2220\\_Long-Term\\_Investments.pdf](http://www.aicpa.org/download/news/2009/TIS_Section_2220_Long-Term_Investments.pdf).

### Amendments Proposed for Certain Subsequent Events Recognition and Disclosure Requirements

Questions have arisen in practice about Financial Accounting Standards Board (FASB) Accounting Standards Codification Topic 855, *Subsequent Events*. Specifically, the SEC has specific requirements related to the identification and disclosure of subsequent events that potentially conflict with certain aspects of Topic 855. To alleviate potential conflicts between Topic 855 and the SEC's requirements, the FASB recently issued a proposed Accounting Standards Update (ASU) under which an entity that files or furnishes financial statements with the SEC would no longer be required to disclose the date through which subsequent events have been evaluated. An entity that files or furnishes financial statements with the SEC would continue to be required to evaluate subsequent events through the date that the financial statements are issued.

If an entity does not file or furnish financial statements with the SEC, it would continue to evaluate subsequent events through the date the financial statements are available to be issued unless the entity has a current expectation of widely distributing its financial statements to its shareholders and other financial statements users, in which case it would evaluate subsequent events through the date that the financial statements are issued. The proposed Update would have no effect on disclosure of the original issuance date for an entity that does not file or furnish financial statements with the SEC.

The proposed ASU also refines the scope of the reissuance disclosure requirements to include restated financial statements only. Restated financial statements include financial statements revised as a result of a correction of an error or retrospective application of U.S. generally accepted accounting principles. An entity that files or furnishes financial statements with the SEC would no longer be required to disclose the original issuance date or the restated issuance date. If the financial statements have been restated, an entity that does not file or furnish financial statements with the SEC would disclose both the original date that the financial statements were issued or available to be issued and the date the restated financial statements were issued or available to be issued.

The proposed ASU would be effective upon issuance of the final Update. The proposed ASU is open for comment until January 28, 2010, and is available in full at <http://www.fasb.org>.

## Auditing

### Proposed Standard Regarding Audit Evidence - Specific Considerations for Selected Items

In conjunction with its efforts to clarify generally accepted auditing standards for audits of nonpublic companies and to converge such standards with International Standards on Auditing (ISAs), the Auditing Standards Board (ASB) of the American Institute of Certified Public Accountants (AICPA) recently issued a proposed Statement on Auditing Standards (SAS), *Audit Evidence—Specific Considerations for Selected Items*. The proposed SAS has been drafted using ISA 501, *Audit Evidence—Specific Considerations for Selected Items*, as a base. If finalized, this

proposed SAS would supersede SAS No. 1 Section 331, *Inventories*; SAS No. 92, *Auditing Derivative Instruments, Hedging Activities and Investments in Securities*; and SAS No. 12, *Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessment*.

This proposed SAS addresses specific considerations by the auditor in obtaining sufficient appropriate audit evidence regarding certain aspects of a potpourri of topics, including:

- Investments in securities and derivative instruments - The ASB concluded that it was appropriate to include certain requirements (primarily addressing auditing the valuation assertion) from SAS No. 92 in this proposed SAS. The ASB also decided that many of the requirements of SAS No. 92 are essentially similar to requirements in other clarified standards; therefore, the ASB concluded that the application of those requirements in the other clarified standards to the subject matter addressed by SAS No. 92 is most appropriately addressed as interpretative guidance in the AICPA Audit Guide, *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities*.
- Litigation, claims, and assessments involving the entity – The proposed SAS requires the auditor to seek direct communication with the entity's external legal counsel through a letter of inquiry if the auditor assesses a risk of material misstatement regarding litigation or claims, or when audit procedures performed indicate that material litigation or claims may exist. This new requirement may change existing practice because there potentially could be situations when, based on the assessment of the risk of material misstatement, the auditor might not be required to send letters of inquiry to lawyers with whom management consulted concerning litigation, claims, and assessments (for example, if the auditor does not assess a risk of material misstatement regarding identified litigation).
- Inventory – The proposed SAS addresses how the auditor should obtain sufficient appropriate audit evidence regarding the existence and condition of inventory if inventory is material to the financial statements.
- Segment information in an audit of financial statements – The proposed SAS addresses how the auditor should obtain sufficient appropriate audit evidence regarding the presentation and disclosure of segment information.

The proposed SAS would be effective for audits of financial statements for periods beginning on or after December 15, 2010. This effective date is provisional but will not be earlier than December 15, 2010. The proposed SAS is available for comment until April 30, 2010 at [http://www.aicpa.org/download/auditstd/ED\\_Select\\_Items.pdf](http://www.aicpa.org/download/auditstd/ED_Select_Items.pdf).

### Proposed Standard Regarding Using the Work of an Auditor's Specialist

In conjunction with its efforts to clarify generally accepted auditing standards for audits of nonpublic companies and to converge such standards with International Standards on Auditing (ISAs), the Auditing Standards Board of the American Institute of Certified Public Accountants recently issued a proposed Statement on Auditing Standards (SAS), *Using the Work of an Auditor's Specialist*. The proposed SAS has been drafted using ISA 620, *Using the Work of an Auditor's Expert*, as a base. If finalized, this proposed SAS would supersede SAS No. 73, *Using the Work of a Specialist*.

SAS No. 73 addresses the use of the auditor's specialist and the use of management's specialist. SAS No. 73 specifically scopes out the use of specialists employed by the firm who participate in the audit. To be consistent with ISA 620, the proposed SAS now encompasses in-firm specialists. The ASB believes that this change in the scope of the standard will affect current practice because it will create incremental documentation requirements. Also, to be consistent with the ISAs, the evaluation of evidence created by management's specialist has been

moved to a previously proposed SAS, *Audit Evidence (Redrafted)*, via a conforming amendment that accompanies this proposed SAS.

The proposed SASs would be effective for audits of financial statements for periods beginning on or after December 15, 2010. This effective date is provisional but will not be earlier than December 2010. The proposed SAS, *Using the Work of an Auditor's Specialist*, is available for comment until April 30, 2010 at [http://www.aicpa.org/download/auditstd/ED\\_Auditor\\_Specialist.pdf](http://www.aicpa.org/download/auditstd/ED_Auditor_Specialist.pdf).

### Proposed Standard Regarding Communicating Internal Control Related Matters

In conjunction with its efforts to clarify generally accepted auditing standards for audits of nonpublic companies and to converge such standards with International Standards on Auditing (ISAs), the Auditing Standards Board (ASB) of the American Institute of Certified Public Accountants recently issued a proposed Statement on Auditing Standards (SAS), *Communicating Internal Control Related Matters Identified in an Audit (Redrafted)*. The proposed SAS has been drafted using ISA 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*, as a base. If finalized, this proposed SAS would supersede SAS No. 115, *Communicating Internal Control Related Matters Identified in an Audit*.

Some of the changes that have been made to SAS No. 115 to converge with ISA 265 are the inclusion of requirements in the proposed SAS for the auditor to:

- Determine whether, on the basis of the audit work performed, the auditor has identified one or more deficiencies in internal control. Although this requirement is not specifically stated in SAS No. 115, it is implied.
- Include in the written communication an explanation of the potential effects of the significant deficiencies and material weaknesses identified. The proposal includes guidance to clarify that the potential effects need not be quantified.
- Communicate, in writing or orally, only to management other deficiencies in internal control identified during the audit that have not been communicated to management by other parties and that, in the auditor's professional judgment, are of sufficient importance to merit management's attention. The ASB does not view this new requirement as a difference between SAS No. 115 and the proposed SAS because auditor judgment is the sole determinant regarding whether a deficiency, other than a material weakness or a significant deficiency, is of sufficient importance to communicate to management.
- Include specific matters in a written communication stating that no material weaknesses were identified during the audit that are similar to those in the written communication of significant deficiencies and material weaknesses. SAS No. 115 implied that these matters be included by presenting them in the second example of Exhibit A of SAS No. 115, which is an illustrative written communication indicating that no material weaknesses were identified.

The proposed SAS would be effective for audits of financial statements for periods beginning on or after December 15, 2010. This effective date is provisional but will not be earlier than December 2010. The proposed SAS is available for comment until April 30, 2010 at [http://www.aicpa.org/download/auditstd/ED\\_Communicating\\_Internal\\_Control.pdf](http://www.aicpa.org/download/auditstd/ED_Communicating_Internal_Control.pdf).

## Public Sector

### New Auditing Standard Issued for Compliance Audits

Governments frequently establish governmental audit requirements for entities to undergo an audit of their compliance with applicable compliance requirements. To address such governmental audit requirements, the Auditing Standards Board has issued Statement on Auditing Standards (SAS) No. 117, *Compliance Audits*, which supersedes SAS No. 74, *Compliance Auditing Considerations in Audits of Governmental Entities and Recipients of Governmental Financial Assistance*. SAS No. 117 was primarily developed in response to the results of a federal study on the quality of audits performed under Office of Management and Budget Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations* (also referred to as single audits), which showed that improvements were needed in many areas.

SAS No. 117 establishes standards and provides guidance on performing and reporting (in accordance with auditing standards generally accepted in the United States, Government Auditing Standards, and a governmental audit requirement that requires an auditor to express an opinion on compliance) on an audit of an entity's compliance with applicable compliance requirements of a governmental audit requirement. Examples of such engagements include single audits and audits performed under the U.S. Department of Housing and Urban Development (HUD) Consolidated Audit Guide for Audits of HUD Programs. SAS No. 117 updates SAS No. 74 to reflect changes in the compliance audit environment and incorporates the risk assessment standards. It also requires the auditor to adapt and apply the AU sections of AICPA Professional Standards to a compliance audit and provides guidance on how to do so. The SAS is effective for compliance audits for fiscal periods ending on or after June 15, 2010 with earlier application permitted.

### OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans

The Governmental Accounting Standards Board (GASB) recently issued Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*. This Statement amends GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, to permit an agent employer that has an individual-employer OPEB plan with fewer than 100 total plan members to use the alternative measurement method, at its option, regardless of the number of total plan members in the agent multiple-employer OPEB plan in which it participates. The alternative measurement method is a less complex and potentially less expensive alternative to a full actuarial valuation.

Consistent with this change to the employer-reporting requirements, the Statement also amends the requirement of Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, that a defined benefit OPEB plan obtain an actuarial valuation. The amendment permits the requirement to be satisfied for an agent multiple-employer OPEB plan by reporting an aggregation of results of actuarial valuations of the individual-employer OPEB plans or measurements resulting from use of the alternative measurement method for individual-employer OPEB plans that are eligible. In addition, the Statement clarifies that when actuarially determined OPEB measures are reported by an agent multiple-employer OPEB plan and its participating employers, those measures should be determined as of a common date and at a minimum frequency to satisfy the agent multiple-employer OPEB plan's financial reporting requirements.

The provisions of Statement No. 57 related to the use and reporting of the alternative measurement method are effective immediately. The provisions related to the frequency and timing of measurements are effective for actuarial valuations first used to report funded status information in OPEB plan financial statements for periods beginning after June 15, 2011.

### **Accounting and Financial Reporting for Chapter 9 Bankruptcies**

Because there was no authoritative accounting or financial reporting guidance for governments filing for bankruptcy, the Governmental Accounting Standards Board has issued Statement No. 58, *Accounting and Financial Reporting for Chapter 9 Bankruptcies*. This Statement provides guidance for state and local governments that have petitioned for protection from creditors by filing for bankruptcy under Chapter 9 of the United States Bankruptcy Code. It establishes requirements for recognizing and measuring the effects of the bankruptcy process on assets and liabilities, and for classifying changes in those items and related costs.

Statement No. 58 is effective for reporting periods beginning after June 15, 2009. Retroactive application is required for all prior periods presented during which a government was in bankruptcy.