

Insights

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Accounting

Invitation to Comment on Standard-setting Process for Private Companies

The Financial Accounting Standards Board (FASB) and the American Institute of Certified Public Accountants (AICPA) recognize that there currently is a need to carefully evaluate whether financial reporting standards meet the needs of users of private company financial reports. Therefore, they have issued a joint proposal that addresses the FASB’s financial reporting standard-setting process with respect to the needs of private companies. Per the proposal, the FASB staff would seek input specifically from those involved in financial reporting for private companies, including users, preparers, and auditors. Also, during the standard-setting process, the FASB staff would provide the Board with alternatives for private companies. In its standard-setting documents, the FASB would articulate whether differences should exist for recognition, measurement, disclosure, transition, or effective date provisions for private companies, and explicitly request that constituents provide feedback on each proposed standard’s impact on private

companies. Following the receipt of comment letters, the FASB would evaluate whether differences are warranted for private companies.

The FASB and AICPA also would sponsor a new 12-member committee whose mission would be to provide recommendations that will help the FASB determine whether there should be differences in prospective and existing accounting standards for private companies. Committee members would include users (lenders, investors, and sureties/bonding companies) of financial statements, financial management/owners of private companies, and auditors who primarily work with private companies.

The AICPA and FASB are encouraging everyone who plays a role in private company financial reporting to review the proposal and comment on it. The invitation to comment, *Enhancing the Financial Accounting and Reporting Standard-Setting Process for Private Companies*, is available at http://www.privatecompanyfinancialreporting.org/downloads/ITC_private_company_financial_reporting.pdf. The comment period ends on August 15, 2006.

McGladrey & Pullen Responds to Proposed Accounting Standard for Defined Benefit Pension and Other Postretirement Plans

McGladrey & Pullen, LLP has submitted a comment letter to the Financial Accounting Standards Board (FASB) on the March 31, 2006 Exposure Draft (ED) of the proposed Statement of Financial Accounting Standards, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*. Our Firm supports the overall premise of the ED to improve the reporting of pensions and other postretirement benefit plans in the financial statements of employers. In our comment letter, we responded to the issues for which specific comment was sought by the FASB, and also made observations about other matters. Specifically, our Firm disagrees with the Board's proposal to eliminate the ability to measure plan obligations and assets from a date not exceeding three months before the balance sheet date by requiring that those obligations and assets be measured as of the balance sheet date. Also, our Firm encourages the Board to delay the effective date of the proposed standard by one year for public entities and two years for nonpublic entities.

Our Firm's comment letter may be found at http://www.mcgladrey.com/Commentletter_definedbenefit_otherpostretirement.html.

Reminder about Parent-Company-Only Financial Statements

The Accounting Standards Team of the American Institute of Certified Public Accountants has released Technical Practice Aid (TPA) 1400.32, *Parent-Only Financial Statements and Relationship to GAAP*. The purpose of this TPA is to address whether there are any circumstances in which an entity may prepare parent-company-only financial statements without preparing related consolidated financial statements and say that the parent-company-only financial statements are in accordance with generally accepted accounting principles (GAAP). The TPA reaches the same conclusion that our Firm has for many years - the short answer to this question is "no".

Accounting Research Bulletin (ARB) 51, *Consolidated Financial Statements*, and FASB Statement No. 94, *Consolidation of All Majority-Owned Subsidiaries*, are the authoritative pronouncements that address parent-company financial statements. ARB 51 notes the presumption in GAAP that consolidated financial statements are more meaningful than parent-company-only financial statements and states that all majority-owned subsidiaries must be consolidated, with few exceptions. FASB Statement No. 94 precludes the use of parent-company-only financial statements prepared for issuance to stockholders as the primary financial statements of the reporting entity. The Statement concludes that consolidated, rather than parent-

company-only financial statements, are the appropriate general-purpose financial statements. If a parent company is required to prepare parent-company-only financial statements (for example, to comply with a loan covenant), in addition to consolidated financial statements, it may do so, provided the auditor's report on the financial statements has an explanatory paragraph stating that those financial statements are not those of the primary reporting entity. If, on the other hand, a parent company issues only parent-company-only financial statements, this would require the auditor's opinion on the financial statements to be either qualified or adverse, depending on the materiality of this departure from generally accepted accounting principles.

TPA 1400.32 is available in full at http://www.aicpa.org/download/acctstd/Parent_Only_TPA_Final.pdf.

Proposed Amendment to SFAS 123(R) Deferral Provision

FASB Statement No. 123 (revised 2004), *Share-Based Payment*, states that a freestanding financial instrument originally subject to that Statement should become subject to the recognition and measurement requirements of other applicable generally accepted accounting principles (GAAP) when the rights conveyed by the instrument to the holder are no longer dependent on the holder being an employee of the entity. However, because the Financial Accounting Standards Board (FASB) has on its agenda a project to consider the distinction between liabilities and equity, which could significantly change other applicable GAAP, the Board decided in August 2005 to defer the requirements of Statement No.123(R) that make freestanding financial instruments subject to the recognition and measurement requirements of other GAAP when the rights conveyed by the instrument are no longer dependent on the holder being an employee. At that time, FASB Staff Position (FSP) No. FAS 123(R)-1, *Classification and Measurement of Freestanding Financial Instruments Originally Issued in Exchange for Employee Services under FASB Statement No. 123(R)*, was issued.

Per FSP No. FAS 123(R)-1, a freestanding financial instrument issued to an employee in exchange for past or future employee services that is subject to Statement No.123(R) or was subject to Statement No.123(R) upon initial adoption of that Statement must continue to be subject to the recognition and measurement provisions of Statement No.123(R) throughout the life of the instrument, unless its terms are modified when the holder is no longer an employee. Following such modification, recognition and measurement of the instrument should be determined through reference to other applicable GAAP.

Questions have been raised about whether a modification of an instrument in connection with an equity restructuring or a business combination should be considered a modification for purposes of applying FSP No. FAS 123(R)-1. In a recently proposed FSP, the FASB concludes that for purposes of the deferral, a modification does not include an exchange or a change to the terms of an award if that exchange or change is made only to reflect an equity restructuring or business combination provided that (a) either there is no increase in value to the holders of the instrument or the change in the terms of the award is not done in contemplation of an equity restructuring or a business combination and (b) all holders of the same class of equity instruments (for example, stock options) are treated in a similar manner. Therefore, under those circumstances, no change in the recognition and measurement (due to a change in classification) of those instruments would result.

The provisions in this proposed FSP would be applied in the first reporting period beginning after the date the FSP is posted to the FASB website. If in applying Statement No. 123(R) an entity did so in a manner consistent with the provisions of the proposed FSP, then that entity would continue to apply the provisions in the FSP to prior periods. However, if an entity did not apply Statement No. 123(R) in a manner consistent

with the provisions of the FSP, then that entity would be required to retrospectively apply the provisions in the FSP to prior periods when those periods' financial statements are included for comparative purposes with current-period financial statements.

Proposed FSP No. FAS 123(R)-e is available for comment until July 8, 2006 at http://www.fasb.org/fasb_staff_positions/prop_fsp_fas123r-e.pdf.

Public Sector

Exposure Draft of Government Auditing Standards 2006 Revision

The U.S. Government Accountability Office has issued an Exposure Draft of *Government Auditing Standards, 2006 Revision* and is requesting comments on the draft from audit officials and financial management at all levels of government, the public accounting profession, academia, professional organizations, public interest groups, and other interested parties.

The proposed 2006 revision to generally accepted government auditing standards (GAGAS), more commonly known as the Yellow Book, seeks to emphasize the critical role of high-quality government audits in achieving credibility and accountability in government. The overall focus of the proposed 2006 revised standards includes an increased emphasis on audit quality and ethics and an extensive update of the performance audit standards to include a specified level of assurance within the context of risk and materiality. In addition, this proposed revision modernizes GAGAS, with updates to reflect major developments in the accountability and audit environment.

To help ensure that the standards meet the needs of the audit community and the public it serves, the Comptroller General of the United States appointed the Advisory Council on Government Auditing Standards to review the standards and recommend necessary changes. The Advisory Council includes experts in financial and performance auditing drawn from all levels of government, private enterprise, public accounting, and academia. Brian Schebler, director of services to the public sector for McGladrey & Pullen, is a member of the Comptroller General's Advisory Council on Government Auditing Standards.

When issued, the 2006 revision will supersede the 2003 revision of the standards. The finalized standards are anticipated to be effective for audits beginning on or after July 1, 2007. For financial audits, certain standards issued by the Auditing Standards Board (ASB) of the American Institute of Certified Public Accountants have earlier effective dates. For financial audits performed under GAGAS, the effective dates of the new ASB standards will apply.

The Exposure Draft is available for comment until August 15, 2006 at <http://www.gao.gov/govaud/d06729g.pdf>.

SEC

FAQ on Auditing Adjustments to Prior-period Financial Statements

The Office of the Chief Auditor of the Public Company Accounting Oversight Board (PCAOB) has prepared 11 questions and answers related to audit issues regarding adjustments to prior-period financial statements audited by a predecessor auditor. Circumstances that may require a company to make adjustments to prior-period financial statements include, for example, the reporting of discontinued operations, and the retrospective application of a change in accounting principle or the correction of an error in prior-period financial statements pursuant to FASB Statement No. 154, *Accounting Changes and Error Corrections*.

The statements contained in the questions and answers have not been approved by the PCAOB, however they set forth the staff's opinions on issues related to the implementation of the standards of the PCAOB. The FAQ is available at http://www.pcaobus.org/Standards/Staff_Questions_and_Answers/2006/QA_Adjustments.pdf.

SEC Information Now Fully Searchable

The SEC has announced that the full text of every SEC document filed by companies within the last two years is now fully searchable online. This new search engine enables real-time general-purpose searches with the ability to find companies and associated filings, view the most recent filings as they are processed by the SEC, or search the full text of filings from the last two years. It also offers searches for special purposes, such as finding current-event notices. The new search tool can be found at <http://www.sec.gov/edgar/searchedgar/webusers.htm>.

The Critical Role of Financial Reporting in the Capital Markets

The Securities and Exchange Commission Historical Society held its seventh annual meeting on June 6, 2006. The meeting featured a panel discussion - "Who's Counting? The Critical Role of Financial Reporting in the Capital Markets." This discussion focused on the usefulness of the current financial reporting model to investors, how simplification of complex accounting standards might be achieved as a benefit to investors, and the challenges of preparing financial statements based on fair value rather than historical costs. The discussion is available online free of charge at <http://www.sechistorical.org/news/index.php>, and runs for one and one-half hours.

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