

September 22, 2009

Accounting

Implementation Guidance for and Amendments to the Accounting for Uncertainty in Income Taxes

The Financial Accounting Standards Board (FASB) has issued Accounting Standards Update (ASU) No. 2009-06, *Income Taxes (Topic 740) - Implementation Guidance on Accounting for Uncertainty in Income Taxes and Disclosure Amendments for Nonpublic Entities*. This ASU includes guidance on the application of FASB Interpretation No.48, *Accounting for Uncertainty in Income Taxes* (FASB ASC 740) by pass-through entities and tax-exempt not-for-profit entities, and eliminates certain disclosures for nonpublic entities.

ASU 2009-06 takes a principles-based approach to providing guidance on three issues related to the application of Topic 740 to pass-through entities and tax-exempt not-for-profit entities. The overriding principle established in the ASU is that all entities are subject to Topic 740, even if the only tax position in question is the entity's status. Additionally, even if it is more likely than not that the entity's status as a pass-through entity or tax-exempt not-for-profit entity would be sustained upon examination, the entity may have other tax positions to consider that fall within the scope of Topic 740. The three issues addressed in the ASU are:

- Clarification of a tax position – The amendments clarify that management's determination of the taxable status of the entity, including its status as a pass-through entity or tax-exempt not-for-profit entity, is a tax position subject to the standards required for accounting for uncertainty in income taxes.
- Attribution of income taxes to the entity or its owners - If the taxing jurisdiction's laws and regulations attribute income taxes to the entity, amounts due to or from the taxing jurisdiction would be classified as income taxes, and the recognition, measurement, and disclosure provisions of Topic 740 would be applied to those income taxes. If the taxing jurisdiction's laws and regulations attribute income taxes to the owners, amounts due to or from the taxing jurisdiction would be classified as a transaction with owners. A conclusion about whether income taxes are attributable to the entity or its owners is to be based on the laws and regulations of the taxing authority rather than on who pays the income taxes.
- Financial statements of a group of related entities – Per the ASU, regardless of the tax status of a consolidated or combined reporting entity, the consolidated or combined financial statements would include all tax positions for each entity within the consolidated or combined group that is subject to income taxes or that has taxable income assigned to it from a pass-through entity.

In addition, the amendments eliminate the disclosures required by paragraph 740-10-50-15(a) through (b) for nonpublic entities. As a result, only a public enterprise would need to disclose the tabular reconciliation of the total amounts of unrecognized tax benefits at the beginning and end of each annual reporting period presented. Also, nonpublic entities would no longer be required to disclose the total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate.

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For entities that are currently applying the standards for accounting for uncertainty in income taxes, the guidance and disclosure amendments are effective for financial statements issued for interim and annual periods ending after September 15, 2009. For those entities that have deferred the application of accounting for uncertainty in income taxes, the guidance and disclosure amendments are effective upon adoption of those standards (*i.e.*, annual financial statements for years beginning after December 15, 2008). ASU 2009-06 is available in full at <http://www.fasb.org>.

Accounting and Disclosure Guidance Issued for Nonregistered Investment Partnerships

The American Institute of Certified Public Accountants (AICPA) has issued new guidance for nonregistered investment partnerships in TIS Section 6910, *Investment Companies*, which is summarized as follows:

- 6910.30, *Disclosure Requirements of Investments for Nonregistered Investment Partnerships When Their Interest in an Investee Fund Constitutes Less Than 5 Percent of the Nonregistered Investment Partnership's Net Assets*

Nonregistered investment partnerships are subject to the disclosure requirements of AICPA Statement of Position No. 95-2, *Financial Reporting by Nonpublic Investment Partnerships* (FASB ASC 946-210-50-6) related to investments in the partnership's portfolio. These disclosures require reporting investment partnerships to individually disclose an investment by name, type, and so on if the reporting investment partnership's investment constitutes more than 5 percent of its net assets. In accordance with paragraphs 8–9 of FASB ASC 946-210-50, nonregistered investment partnerships that own interests in another investment partnership (investee fund) are required to disclose the investment partnership's proportional share of any underlying investment owned (either directly or through an investee fund) in any issuer that exceeds 5 percent of the reporting investment partnership's net assets at the reporting date. Section 6910.30 concludes that if the nonregistered investment partnership owns an interest in an investee fund that constitutes less than 5 percent of the nonregistered investment partnership's net assets, the reporting investment partnership should apply the guidance in paragraphs 8–9 of FASB ASC 946-210-50.

- 6910.31, *The Nonregistered Investment Partnership's Method for Calculating Its Proportional Share of Any Investments Owned by an Investee Fund in Applying the "5 Percent Test" Described in TIS Section 6910.30*

Section 6910.31 concludes that the nonregistered reporting investment partnership should calculate its proportional share of any investments owned by the investee fund as its percentage ownership of the investee fund in applying the "5 percent test" described in Section 6910.30. Additionally, indirect long and short positions of the same issuer held by the investee fund should not be netted. The disclosure of investments in issuers exceeding 5 percent of reporting investment partnership net assets should be made either on the face of the schedule of investments or within the financial statement footnotes.

- 6910.32, *Additional Financial Statement Disclosures for Nonregistered Investment Partnerships When the Partnership Has Provided Guarantees Related to the Investee Fund's Debt*

Section 6910.32 states that in addition to considering the recognition provisions described in FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others - An Interpretation of FASB Statements No. 5, 57, and 107 and Rescission of FASB Interpretation No. 34* (FASB ASC 460-10-50), a nonregistered reporting investment partnership should disclose any guarantees it has provided on investee fund debt even though the risk of loss may be remote. These disclosure requirements are described in FASB ASC 460-10-50.

TIS Sections 6910.30 - .32 are available in full at http://www.aicpa.org/download/acctstd/FINAL_TPA_6910_30-32.pdf.

Additional Fair Value Measurement Disclosures Proposed

To provide more and improved disclosures about fair value measurements, the Financial Accounting Standards Board (FASB) has issued an Exposure Draft (ED) of a proposed Accounting Standards Update, *Fair Value Measurements and Disclosures (Topic 820) – Improving Disclosures about Fair Value Measurements*. The proposed Update would affect all entities that are required to make disclosures about recurring and nonrecurring fair value measurements under FASB Statement No. 157, *Fair Value Measurements* (FASB ASC 820). If finalized, the proposed Update would require the following new disclosures:

- Sensitivity disclosures: For fair value measurements using significant unobservable (Level 3) inputs, if changing one or more of those inputs to reasonably possible alternative inputs would increase or decrease the fair value measurement significantly, the reporting entity must state that fact and disclose the total effects of the changes on the fair value measurement.
- Transfers in and/or out of Levels 1 and 2: The reporting entity must disclose the amounts of significant transfers in and/or out of Level 1 and Level 2 fair value measurements and the reasons for the transfers.
- Activity in Level 3 fair value measurements: In the reconciliation for fair value measurements using significant unobservable inputs, information about purchases, sales, issuances, and settlements would be required on a gross basis rather than as one net number.

The proposed Update also would clarify two existing disclosures as follows:

- Level of disaggregation: Currently, entities are required to provide disclosures about fair value measurements for each *major category* of assets and liabilities. Some users noted that many companies seem to have interpreted the phrase *major category* to mean a line item in the statement of financial position. The FASB decided that disclosures about fair value measurements would be more useful if the entities provided them for each *class* of assets and liabilities within the line items in the statement of financial position.
- Disclosures about inputs and valuation techniques: The proposed Update clarifies that an entity is required to provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements – not just nonrecurring fair value measurements. Also, those disclosures are required for fair value measurements that fall in either Level 2 or Level 3 – not just those in Level 3.

If finalized, the new disclosures and clarifications of existing disclosures would be effective for interim and annual reporting periods ending after December 15, 2009, except for the sensitivity disclosures about Level 3 fair value measurements. Level 3 sensitivity disclosures would be effective for interim and annual reporting periods ending after March 15, 2010.

The ED is available for comment until October 12, 2009 at <http://www.fasb.org>.

Proposed Clarification of the Scope of Statement No. 160

To address certain implementation issues related to the change-in-ownership provisions in FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements* (FASB ASC 810-10), the Financial Accounting Standards Board (FASB) has issued proposed Accounting Standards Update, *Consolidation (Topic 810) - Accounting and Reporting for Decreases in Ownership of a Subsidiary - a Scope Clarification*. The proposed Update clarifies that the decrease-in-ownership provisions of Subtopic 810-10 apply to the following:

- A subsidiary or group of assets that is a business or nonprofit activity

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

The proposed Update also clarifies that the decrease-in-ownership guidance in Subtopic 810-10 does not apply if the transaction is in substance the sale of real estate.

The proposed Update also expands the disclosures about the deconsolidation of a subsidiary or group of assets that constitute a business or nonprofit activity. The expanded disclosures include (a) the valuation techniques used to measure the fair value of any retained investment in the former subsidiary, and (b) the nature of continuing involvement with the subsidiary after it has been deconsolidated.

The amendments in the proposed Update would be effective beginning in the period an entity adopts Statement No. 160 (FASB ASC 810-10). If an entity has previously adopted Statement No. 160 as of the date a final Update is issued, the amendments in the proposed Update would be effective beginning in the first interim or annual reporting period ending on or after December 15, 2009. The amendments in the proposed Update would be applied on a retrospective basis to the first period that an entity adopted Statement No. 160.

The proposed Update is available for comment until September 28, 2009 at <http://www.fasb.org>.

Auditing

Proposed Standard Regarding Audits of Group Financial Statements

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 (AICPA) recently issued a proposed Statement on Auditing Standards (SAS), *Audits of Group Financial Statements (Including the Work of Component Auditors)*. If finalized, this proposed SAS would supersede AU Section 543, *Part of Audit Performed by Other Independent Auditors*.

The proposed SAS has been drafted using ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*, as a base. The focus of ISA 600 and, accordingly, the proposed SAS is on how to conduct an effective audit of group financial statements. The proposed SAS is significantly broader in scope than AU Section 543, the focus of which is on how to conduct an audit that involves component auditors. Because the scope of the proposed SAS is significantly broader, its objective, requirements, and guidance have been significantly expanded. Also, the proposed SAS includes requirements established in other SASs that are applied in audits of group financial statements, such as the risk assessment standards.

Under both ISA 600 and the proposed SAS, the auditor responsible for signing the auditor's report on the group financial statements (referred to as the *group engagement partner*) is responsible for (1) the direction, supervision, and performance of the group audit engagement in compliance with professional standards and regulatory and legal requirements and (2) determining whether the auditor's report that is issued is appropriate in the circumstances. However, the proposed SAS diverges from ISA 600 in one regard: ISA 600 does not permit the auditor's report on the group financial statements to make reference to another independent auditor (referred to as a *component auditor*), unless required by law or regulation to include such reference. The proposed SAS, consistent with extant AU Section 543, permits the auditor's report to make reference to a component auditor. Accordingly, the proposed SAS contains requirements and application material relating to making reference that are not in ISA 600, which results in substantive differences in the wording of the objectives, requirements, and application material between ISA 600 and the proposed SAS. When no reference is made to a component auditor

in the auditor's report on the group financial statements, no substantive differences in the requirements exist between ISA 600 and the proposed SAS.

If finalized, the proposed SAS would be effective for audits of nonpublic 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 December 15, 2009 at [Proposed Statement on Auditing Standards, Group Financial Statements](#).

Bob Dohrer, McGladrey & Pullen's National Director of Assurance Services, is the chair of the AICPA task force responsible for drafting this proposed SAS. As such, he brought his experience of several years of dealing with other audit firms, especially RSM International member firms, to bear on the proposed SAS.

Proposed Standard Regarding Auditing Accounting Estimates

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), *Auditing Accounting Estimates, Including Fair Value Accounting Estimates and Related Disclosures (Redrafted)*, which, if finalized, would supersede SAS No. 57, *Auditing Accounting Estimates and Auditing Fair Value Measurements and Disclosures*, and SAS No. 101, *Auditing Fair Value Measurements and Disclosures*. The proposed SAS does not change or expand SAS No. 57 or SAS No. 101 in any significant respect; however, to reflect a more principles-based approach to standard setting, certain requirements that are duplicative of broader requirements have been moved to application and other explanatory material.

The proposed SAS has been drafted using ISA 540 (Revised and Redrafted), *Auditing Accounting Estimates, Including Fair Value Estimates and Related Disclosures*, as a base. Consistent with the approach taken in ISA 540, the proposed SAS combines AU Section 342, *Auditing Accounting Estimates* with AU Section 328, *Auditing Fair Value Measurements and Disclosures*. No differences exist between the proposed SAS and ISA 540 other than the omission from the proposed SAS of paragraphs 22 and 23 of ISA 540, which contain requirements dealing with management representations and communications with those charged with governance, respectively. These requirements will be or are addressed in the proposed SAS, *Written Representations*, and in AU Section 380, *The Auditor's Communication With Those Charged With Governance (Redrafted)*, respectively.

If finalized, the proposed SAS would be effective for audits of nonpublic 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 November 30, 2009 at <http://www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Audit+and+Attest+Standards/Exposure+Drafts+of+Proposed+Statements/Proposed+Statement+on+Auditing+Standards+Estimates.htm>.

Omnibus Proposals of Professional Ethics Division Interpretations and Rulings

The AICPA Professional Ethics Executive Committee (PEEC) has issued an Exposure Draft that proposes revisions to the following Interpretations and Rulings:

- Subsections "Application of the Independence Rules to Covered Members Formerly Employed by a Client or Otherwise Associated With a Client" and "Application of the Independence Rules to a Covered Member's Immediate Family" of Interpretation No. 101-1, under Rule 101, *Independence*, of the AICPA Code of Professional Conduct;
- Ethics Ruling No. 107, "Participation in Employee Benefit Plan Sponsored by Client," of ET Section 191, *Ethics Rulings on Independence, Integrity, and Objectivity*; and

- Subsection "Retirement, Savings, Compensation, or Similar Plans" of Interpretation No. 101-15, "Financial Relationships," under Rule 101.

These proposals provide clarification, and in some cases new guidance, for members who were formerly employed or associated (*e.g.*, an officer or board member) with an attest client of the firm and immediate family members who participate in an employer's benefit plan that is either a client, sponsored by a client, or invests in a client. In certain cases, exceptions to the independence requirements are provided.

The Exposure Draft also includes a proposed revision to Ethics Ruling No. 2, "Distribution of Client Information to Third Parties," of ET Section 391, *Ethics Rulings on Responsibilities to Clients*, along with a proposed new definition of *confidential client information* under ET Section 92. With respect to these proposals, the PEEC proposes that the use or disclosure of client information (including masked information) that is not known to be in the public domain or is not available to the public would be considered a breach of client confidentiality unless the member received the client's consent to disclose or use such information. To provide further clarification concerning which client information would be considered confidential, a proposed definition for *confidential client information* is also included. The proposed definition indicates that information that is not known to be in the public domain or available to the public is considered confidential. The definition also provides examples of information that would not be considered confidential because it would be considered to be in the public domain or available to the public.

The Exposure Draft is available for comment until November 6, 2009 at http://www.aicpa.org/download/ethics/Final_Ethics_Exposure_Draft_090209.pdf. Bruce Webb, Executive Partner of McGladrey & Pullen's National Professional Standards Group, is a member of the PEEC.

SEC

References to Accounting Guidance in PCAOB Standards

For annual and interim periods ending after September 15, 2009, the FASB Accounting Standards Codification will become the single source of authoritative generally accepted accounting principles (GAAP) in the United States. Recently the staff of the Public Company Accounting Oversight Board (PCAOB) published a series of questions and answers as a reminder that auditors should look to the FASB Codification and the rules of the SEC for authoritative U.S. GAAP guidance for SEC registrants, even though PCAOB standards may contain descriptions of and references to U.S. GAAP. Some PCAOB standards include descriptions of and references to accounting requirements that are no longer current. Further, some PCAOB standards include descriptions of accounting requirements that may not represent the final language as adopted in the Codification. Therefore, auditors should disregard descriptions of and references to accounting requirements in PCAOB standards that are inconsistent with the Codification. Auditors should look to the relevant sections of the Codification and to SEC requirements to identify the applicable accounting and reporting requirements for the company under audit.

The staff questions and answers also address:

- The auditor's responsibility if, in using the Codification, the auditor believes that an item in the financial statements should be accounted for differently under the Codification than under pre-Codification U.S. GAAP
- The other responsibilities of an auditor with respect to the Codification, such as becoming knowledgeable about using the Codification and updating documentation containing previous references to U.S. GAAP prepared prior to the Codification

- What consideration an auditor should give to descriptions of and references to U.S. GAAP in the standards of the PCAOB if he or she is auditing the financial statements of a foreign private issuer prepared in conformity with International Financial Reporting Standards

The staff questions and answers are available in full at

http://www.pcaobus.org/Standards/Staff_Questions_and_Answers/2009/09-02_FASB_Codification.pdf.

Financial Institutions

Impaired Loans – The Regulatory View on Charge-offs

FASB Statement No. 114, *Accounting by Creditors for Impairment of a Loan*, (ASC 310-10-35) provides guidance to creditors on the measurement and recognition of impairment of loans that are individually being evaluated for impairment. Statement No. 114 indicates the initial measure of impairment is recorded as a valuation allowance (specific reserve) and subsequent revisions to the impairment measure are recorded as an adjustment to the valuation allowance. However, Statement No. 114 does not address when a creditor should record a direct write-down or write-off (partial or complete charge-off) of an impaired loan. Some say that it does not matter whether there is a partial or complete charge-off of an impaired loan versus retaining the measure of impairment in the valuation (reserve) account because the net carrying value of the loan is the same. However, there are a number of reasons the banking regulators have been requiring financial institutions to record charge offs of impaired loans.

One reason for recording a charge-off is that once recorded, the charge-off increases the historical loss factors used to calculate the general reserves in the overall allowance for loan losses. Another reason is the banking regulators generally permit the allowance for loan losses to be included in Tier 2 capital for regulatory purposes. The allowance for loan losses can be included in Tier 2 capital as long as it is a “general reserve,” and only to the extent the allowance does not exceed 1.25% of gross risk-weighted assets. With respect to impaired collateral-dependent loans, any portion of the loan balance that exceeds the amount that is adequately secured by the fair value of the collateral is generally classified as loss by bank examiners. Consequently, such losses on collateral dependent loans are excluded from the general allowance and Tier 2 capital.

OTS Issues Guidance Regarding OTTI

Recently, the Office of Thrift Supervision (OTS) issued guidance regarding accounting considerations related to other-than-temporary impairment (OTTI) of securities. This guidance generally covers two topics, which are summarized as follows:

- Three key steps in assessing OTTI of investment securities:
 - Step 1 - Determine whether an investment is impaired.
 - Step 2 - Evaluate whether the impairment is temporary or other than temporary.
 - Step 3 - If the impairment is other than temporary, recognize an impairment loss.
- Supervisory expectations: This section concludes that thrift management is responsible for assessing and documenting quarterly whether each impaired security is OTTI under U.S. generally accepted accounting principles (GAAP). The thrift's Board of Directors is ultimately responsible for ensuring that the assessment has been completed in a timely manner and that the assessment is reasonable. Reporting systems should be in place to monitor the severity and duration of securities impaired on an instrument-by-instrument basis. Management should have detailed written policies that state the criteria that lead to the rebuttable presumption that OTTI exists. Robust, documented evidence should support conclusions that impaired securities are not OTTI. Thrift management is also responsible for ensuring that there are robust

processes for ensuring that security valuations are consistent with FASB Statement No. 157, *Fair Value Measurements* (FASB ASC 820).

In addition, the OTS guidance incorporates a listing of authoritative references. Also, the appendices to the guidance include a chart summarizing the application of GAAP for different types of securities, a discussion about the scope of Emerging Issues Task Force Issue No. 99-20, "Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets" (FASB ASC 325-40), and a summary of the recognition of changes in the fair value of forward contracts and purchased options to acquire investment securities that are not derivatives.

The OTS guidance is available in full at <http://files.ots.treas.gov/25320.pdf>.

International

Guide to International Financial Reporting Standards

Last November, the SEC proposed a roadmap outlining key activities that need to be completed prior to U.S. adoption of International Financial Reporting Standards (IFRS). The SEC will evaluate progress against these milestones in 2011, and at that time, it will decide whether to require mandatory use of IFRS beginning in 2014. In recognition of this timeline and the critical decisions that must be made regarding the use of global accounting standards in the United States, the Center for Audit Quality has developed a *Guide to International Financial Reporting Standards*. The purpose of the Guide is to provide an introduction to the challenges and opportunities of IFRS. The Guide also includes summaries of the evolution of accounting standards, global market trends, and additional resources. The Guide is available in full at <http://www.thecaq.org/publications/GuidetoIFRS.pdf>.