

April 20, 2010

Accounting

Financial Reporting Alert Released

The American Institute of Certified Public Accountants recently issued a Financial Reporting Alert, *Current Economic Instability: Accounting Issues and Risks for Financial Management and Reporting—2010*. This Alert is intended to be used by members of an entity's financial management and audit committee to identify and understand current accounting and regulatory developments affecting the entity's financial reporting. It also is intended to help achieve a more robust understanding of the current economic environment in which entities are operating, and is a tool to help identify the significant risks that may result in the material misstatement of financial statements. Among other topics, the Alert discusses:

- Understanding the current economic environment to assess risks for the entity
- Economic, legislative, and regulatory developments, including key economic indicators
- Issues affecting audit and attestation engagements, such as fair value measurements, accounting estimates, and the consideration of an entity's ability to continue as a going concern
- Financial management issues and developments, including:
 - Strategies to navigate the current business environment
 - Assessing liquidity risk
 - Succession and talent management planning
 - Enterprise risk management
 - Global business risks
 - Internal control and processes
 - The role of the audit committee

The Alert also addresses accounting issues and developments, including the following recently issued Accounting Standards Updates (ASUs) among others:

- 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*
- ASU No. 2010-02, *Consolidation (Topic 810): Accounting and Reporting for Decreases in Ownership of a Subsidiary—a Scope Clarification*
- ASU No. 2010-06, *Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements*
- ASU No. 2010-09, *Subsequent Events (Topic 855): Amendments to Certain Recognition and Disclosure Requirements*
- ASU No. 2010-10, *Consolidation (Topic 810): Amendments for Certain Investment Funds*

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SEC

Disclosures Regarding Repurchase Agreements and Securities Lending Transactions

In March 2010, the SEC's Division of Corporation Finance posted an illustrative letter, which had been sent to certain public companies requesting information about repurchase agreements, securities lending transactions, and other transactions involving the transfer of financial assets with an obligation to repurchase the transferred assets. If any repurchase agreements are accounted for as sales, the letter asks the registrant to:

- Quantify the amount of repurchase agreements qualifying for sales accounting at each quarterly balance sheet date for each of the past three years.
- Quantify the average quarterly balance of repurchase agreements qualifying for sales accounting for each of the past three years.
- Describe all the differences in transaction terms that result in certain repurchase agreements qualifying as sales versus collateralized financings.
- Provide a detailed analysis supporting the use of sales accounting for repurchase agreements.
- Describe the business reasons for structuring the repurchase agreements as sales transactions versus collateralized financings. To the extent the amounts accounted for as sales transactions have varied, discuss the reasons for quarterly changes.
- Describe how the use of sales accounting for certain repurchase agreements impacts any ratios or metrics used publicly.
- Disclose whether the repurchase agreements qualifying for sales accounting are concentrated with certain counterparties and/or concentrated within certain countries and the reasons therefore.
- Disclose certain matters if the original accounting on any repurchase agreements has changed.

For those repurchase agreements accounted for as collateralized financings, the letter asks the registrant to quantify the average quarterly balance for each of the past three years, the period-end balance for each of those quarters, the maximum balance at any month end, and the causes/business reasons for significant variances among these amounts. In addition, the registrant is required to make certain disclosures if it has:

- Any securities lending transactions accounted for as sales
- Any other transactions involving the transfer of financial assets with an obligation to repurchase the transferred assets, similar to repurchase or securities lending transactions that are accounted for as sales
- Offset financial assets and financial liabilities where a right of setoff does not exist

The letter also refers the registrant to paragraphs (a)(1) and (a)(4) of Regulation S-K Item 303 regarding disclosures in Management's Discussion and Analysis for situations in which a registrant accounted for repurchase agreements, securities lending transactions, or other transactions involving the transfer of financial assets with an obligation to repurchase the transferred assets as sales.

The illustrative letter is available in full at <http://www.sec.gov/divisions/corpfin/guidance/cforepurchase0310.htm>.

Retrospective Adjustments to Provisional Amounts in a Business Combination

Topic 13 of the SEC's *Division of Corporation Finance Financial Reporting Manual* discusses the effects of subsequent events on financial statements required in filings. Per Topic 13, certain events that occur after the end

of a fiscal year will require retrospective revision of that year's financial statements if they are reissued after financial statements covering the period during which the event occurred have been filed. Such events include reporting:

- Disclose certain matters if the original accounting on any repurchase agreements has changed.
- A change in accounting principle
- Discontinued operations
- Change in reportable segments
- Change in the reporting entity
- Stock splits

Re-issuance of the pre-event financial statements is required if those financial statements are required to be included or incorporated by reference into a registration or proxy statement, with the exception of Form S-8. If the pre-event financial statements are not reissued in connection with any filing under the Securities Act or Exchange Act, annual information does not need to be retrospectively revised until that information is included in the registrant's next Annual Report on Form 10-K.

In a recent update to its *Financial Reporting Manual*, the Division of Corporation Finance added another event that requires retrospective revision of financial statements - retrospective adjustments to provisional amounts in a business combination. Under the acquisition method of accounting for a business combination, the acquirer records provisional amounts if there are any items for which the initial accounting is incomplete at the end of the reporting period in which the business combination occurs. If a registrant determines it must make a material retrospective adjustment to provisional amounts it previously reflected in its financial statements pursuant to the requirements of paragraph 51 of FASB Statement No. 141R, *Business Combinations*, (ASC 805-10-25) and this adjustment has not yet been reflected in any historical financial statements, the registrant should provide or incorporate by reference revised financial statements reflecting the retrospective adjustment if the adjustment is material. If this retrospective adjustment has been reflected in subsequent interim historical financial statements, but the acquisition occurred in the preceding fiscal year and the adjustments are not reflected in the annual financial statements, the registrant should provide revised audited financial statements for the year of acquisition reflecting the adjustments. The revised financial statements are generally filed via Form 8-K.

It should be noted that the SEC's guidance for retrospective adjustments to provisional amounts in a business combination is different from the guidance relating to changes in accounting principles, discontinued operations, and changes in reportable segments. In the case of a retrospective accounting change, discontinued operation, or change in reportable segment, previously issued financial statements cannot be retrospectively adjusted until after the financial statements covering the period during which the event occurred have been filed.

The *Division of Corporation Finance Financial Reporting Manual* is available in full at <http://www.sec.gov/divisions/corpfin/cffinancialreportingmanual.pdf>.

PCAOB Proposes Standard for Communications with Audit Committees

On March 29, 2010, the Public Company Accounting Oversight Board (PCAOB) issued a proposed auditing standard, *Communications with Audit Committees*. The PCAOB's primary objectives in proposing this new standard are to enhance the relevance and effectiveness of the communications between the auditor and the audit committee and to emphasize the importance of effective, two-way communications between the auditor and the audit committee to better achieve the objectives of the audit. If finalized, this standard would replace interim

standards AU Section 380, *Communication With Audit Committees*, and AU Section 310, *Appointment of the Independent Auditor*.

The proposed standard carries forward substantially all of the required communications in AU 380, and includes requirements that are consistent with the SEC's audit committee communication requirements in Rule 2-07 of Regulation S-X. The proposed standard also requires communication of certain additional matters, including the following among others:

- An overview of the audit strategy, including a discussion of the significant risks identified by the auditor and the timing of the audit
- Significant changes to the planned audit strategy or the significant risks initially identified
- The anticipated application of new accounting or regulatory pronouncements that are not yet effective, but which may, upon adoption, have a significant effect on the company's financial reporting
- Significant accounting matters on which the auditor has consulted outside the engagement team, including discussions with the firm's national office or industry specialists
- Certain matters, when applicable, relating to the auditor's evaluation of a company's ability to continue as a going concern
- A number of new requirements relating to the communication regarding estimates, such as requiring the auditor to communicate, or to evaluate whether management has adequately communicated:
 - How management subsequently monitors critical accounting estimates
 - Management's significant assumptions used in critical accounting estimates that have a high degree of subjectivity
 - A discussion of any significant changes to assumptions or processes made by management to the critical accounting estimates in the year under audit, a description of the reasons for the changes, the effects on the financial statements, and the information that supports or challenges such changes
 - When critical accounting estimates involve a range of possible outcomes how the recorded estimates relate to the range and how various selections within the range would affect the company's financial statements

In addition, the proposed standard includes requirements related to the establishment of a mutual understanding of the terms of the audit engagement with the audit committee. Unlike AU 310, the proposed standard requires that this understanding be established specifically with the audit committee. Further, the proposed standard requires the auditor to record this understanding in a written audit engagement letter to be provided annually.

The proposed standard provides for written or oral communication of the matters required, unless otherwise specified. Having robust dialogue on key matters is viewed as the most important factor in effective communications with the audit committee. The auditor is required to document the communications, whether communicated orally or in writing, in sufficient detail to enable an experienced auditor, having no previous connection with the engagement, to understand the communications made to comply with the provisions of the standard. All matters required by the proposed standard would be required to be communicated annually prior to the issuance of the auditor's report.

If finalized, the proposed standard would be effective, subject to approval by the SEC, for audits of fiscal years beginning after December 15, 2010. The proposed standard is available for comment until May 28, 2010, at http://pcaobus.org/Rules/Rulemaking/Docket030/Release_No_2010-001.pdf.

Public Sector

Proposed Statement Regarding the Financial Reporting Entity

The Governmental Accounting Standards Board (GASB) recently issued a proposed Statement, *The Financial Reporting Entity, an amendment of GASB Statements No. 14 and No. 34*. The proposed Statement is intended to improve guidance for including, presenting, and disclosing information about component units and equity interest transactions of a financial reporting entity by modifying certain requirements in GASB Statements No. 14, *The Financial Reporting Entity*, and No. 34, *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments*.

Component units are legally separate organizations that state and local governments include in their financial reports. The proposed Statement would modify the existing criteria for inclusion of organizations that are “fiscally dependent” on a government by adding a requirement that the potential component unit and the primary government also have a financial benefit or burden relationship. In cases where the government determines it would be misleading to exclude an organization that does not meet the financial accountability concept from its financial reports, the proposed Statement would clarify the manner in which that determination should be made.

The proposed Statement also would amend the criteria for “blending,” or the reporting of component units as if they were part of the primary government. Further, it would clarify the reporting of equity interests in legally separate organizations. If finalized, the provisions of the proposed Statement would be effective for financial statements for periods beginning after June 15, 2012, with earlier application encouraged.

The Exposure Draft is available for comment until June 30, 2010, at http://www.gasb.org/exp/ED_financial_reporting_entity_an_amendment_stmts_14and34.pdf.