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American Institute of Certified Public Accountants. Accounting and Review Services Committee

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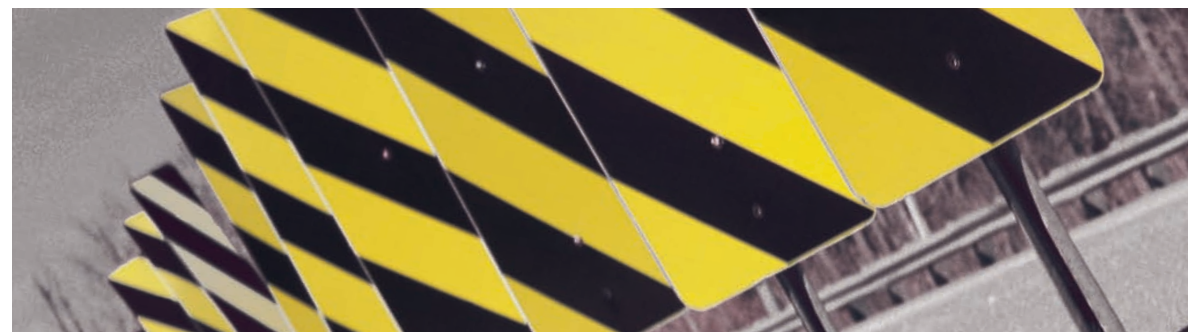
2010/11

# Compilation and Review Developments

COMPILATION AND REVIEW ALERT



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2010/11

# Compilation and Review Developments

## COMPILATION AND REVIEW ALERT

STRENGTHENING ENGAGEMENT QUALITY
SAFEGUARDING FINANCIAL REPORTING

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# Notice to Readers

This Compilation and Review Alert replaces *Compilation and Review Developments—2009*.

This Compilation and Review Alert (alert) is intended to provide accountants with an update on recent practice issues and professional standards that affect compilation and review engagements. This alert also can be used by an entity's internal management to address areas of concern.

This publication is an *other compilation and review publication*, as defined in AR section 50, *Standards for Accounting and Review Services* (AICPA, *Professional Standards*, vol. 2).[1] Other compilation and review publications have no authoritative status; however, they may help the accountant understand and apply Statements on Standards for Accounting and Review Services.

If an accountant applies the guidance included in an other compilation and review publication, he or she should be satisfied that, in his or her judgment, it is both relevant to the circumstances of the engagement and appropriate. The guidance in this document has been reviewed by the AICPA Audit and Attest Standards staff and published by the AICPA and is presumed to be appropriate. This document has not been approved, disapproved, or otherwise acted on by a senior technical committee of the AICPA.

## Recognition

The AICPA gratefully appreciates the invaluable assistance Kristy L. Illuzzi, CPA, and Dennis W. Ridge, Jr., CPA, provided in creating this publication. The AICPA would like to thank the members of the Accounting and Review Services Committee for their invaluable review of this year's publication. We would also like to thank Michael P. Glynn, CPA, technical manager, Audit and Attest Standards, for his essential contributions in creating this publication.

## Feedback

The *Compilation and Review Developments* alert is published annually. As you encounter issues that you believe warrant discussion in next year's alert, please feel free to share them with us. Any other comments that you have about the alert also would be appreciated. You may e-mail these comments to A&APublications@aicpa.org.

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[1] In December 2009, the Accounting and Review Services Committee issued Statement on Standards for Accounting and Review Services (SSARS) No. 19, *Compilation and Review Engagements* (AICPA, *Professional Standards*, vol. 2). Upon becoming effective, this new standard will supersede AR section 50, *Standards for Accounting and Review Services* (AICPA, *Professional Standards*, vol. 2). However, SSARS No. 19 retains essentially the same guidance on interpretive publications as currently exists in AR section 50. SSARS No. 19 is effective for compilations and reviews of financial statements for periods ending on or after December 15, 2010.

# TABLE OF CONTENTS

*Paragraph*

Compilation and Review Developments—2010/11 .01-.187
How This Alert Helps You .01
Economic Developments .02-.11
The Current Economy .02-.08
Small Business Trends and Conditions .09-.11
Legislative and Regulatory Developments .12-.19
The Health Care and Education Reconciliation Act of 2010 and the Patient Protection and Affordable Care Act .12-.19
Recently Issued SSARS .20-.24
Issuance of SSARS No. 19 .20-.24
Proposed SSARS .25-.26
*The Applicability of Statements on Standards for Accounting and Review Services* .25-.26
Proposed Statement on Standards for Attestation Engagements .27-.28
*Reporting on Compiled Prospective Financial Statements When Independence Has Been Impaired* .27-.28
Other Current ARSC Projects .29-.38
The Use of the Accountant's Name in a Document or Communication Containing Unaudited Financial Statements That Have Not Been Compiled or Reviewed .29-.31
Compilation and Review of Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country .32-.34
Applicability of SSARS No. 19 to Personal Financial Statements .35-.38
Current Practice Issues .39-.42
New Reports for Compilations and Reviews of Financial Statements Ending on or After December 15, 2010 .40-.41
Preparation of Financial Statements for Use by an Entity's Auditors .42
Current Accounting and Financial Reporting Issues .43-.46
Other Comprehensive Bases of Accounting Disclosures .43-.46
Common Peer Review Findings .47-.48
Accounting Issues and Developments .49-.114
FASB Statement No. 168 .50-.64
Decreases in Ownership of a Subsidiary .65
Accounting for Uncertainty in Income Taxes .66-.67
Consolidation of Variable Interest Entities .68-.73
Accounting for Transfers of Financial Assets .74-.77
Subsequent Events .78-.81
Fair Value .82-.95

*Paragraph*

Compilation and Review Developments—2010/11—continued
Disclosures About Credit Quality and Allowance for Credit Losses .... .96-.100
Convergence With International Financial Reporting Standards .... .101-.112
Private Company Financial Reporting .... .113-.114
Recent Accounting Pronouncements and Related Guidance for Nonpublic Companies .... .115-.119
Recent ASUs .... .115
Recently Issued Technical Questions and Answers .... .116-.119
Recent AICPA Independence and Ethics Developments .... .120-.124
Establishing and Maintaining Internal Control .... .121-.124
New AICPA Products and Publications .... .125
On the Horizon .... .126-.167
SSARS Pipeline .... .128-.133
Joint FASB and IASB Accounting Pipeline .... .134-.162
FASB Accounting Pipeline .... .163-.167
Resource Central .... .168-.182
PCPS SSARS No. 19 Toolkit .... .169-.170
Publications .... .171
AICPA Online Professional Library: Accounting and Auditing Literature .... .172
Continuing Professional Education .... .173-.178
Webcasts .... .179
Member Service Center .... .180
Hotlines .... .181-.182
Appendix A—Additional Internet Resources .... .183
Appendix B—Significant Change to Compilation Reporting Requirements When Independence Is Impaired .... .184
Appendix C—"Changes on Tap for Compilation and Review Standards" .... .185
Appendix D—"The Accountant's Responsibilities for Subsequent Events in Compilation and Review Engagements" .... .186
Appendix E—"The Accountant's Reporting Responsibility With Respect to Subsequent Discovery of Facts Existing at the Date of the Report" .... .187

# How This Alert Helps You

**.01** This Compilation and Review Alert (alert) helps you plan and perform your compilation and review engagements and can be used by an entity's internal management to address areas of concern. This alert discusses recent Statements on Standards for Accounting and Review Services (SSARSs) developments, addresses emerging practice issues, and provides valuable information regarding current accounting developments. You should refer to the full text of accounting and compilation and review pronouncements, as well as the full text of any rules or publications that are discussed in this alert.

# Economic Developments

## The Current Economy

**.02** When planning and performing compilation and review engagements, the accountant should understand both the general current economy and the specific economic conditions facing the industry in which the client operates. Economic activities relating to factors such as interest rates, availability of credit, consumer confidence, overall economic expansion or contraction, inflation, and labor market conditions are likely to have an effect on an entity's business and, therefore, its financial statements.

**.03** The year 2010 may be the beginning of a wave of economic recovery. Although many key indicators, such as unemployment, are still uncomfortably high, 2010 began with rising commodity prices, a jump in new factory orders that caused the largest expansion in production in 3 years, and an increase in U.S. auto sales that approached prerecessionary levels. Further, after experiencing a considerable decline in the stock market through March 2009, the markets have rebounded substantially. In March 2009, the S&P 500 and the Dow Jones Industrial Average reached their 12-year lows, and NASDAQ closed at its lowest point since October 2002. By March 2010, only a year later, all 3 had increased in value by at least 59 percent from the previous year's lows. However, all 3 remained unmoved 4 months later, in July 2010. This exhibits the continuing uncertainty in the markets due to the varying economic indicators, the financial reform regulatory changes, and Europe's economy, among other reasons.

### *Key Economic Indicators*

**.04** These key economic indicators further illustrate the severity of the recent recessionary period experienced by the United States.

**.05** The gross domestic product (GDP) measures output of goods and services by labor and property within the United States. It increases as the economy grows or decreases as it slows. According to the Bureau of Economic Analysis, real GDP increased at an annual rate of 1.6 percent in the second quarter of 2010 (second estimate), 3.7 percent in the first quarter of 2010, and 5.6 percent in the fourth quarter of 2009. This data indicates a turnaround in the economy because in the fourth quarter of 2008 and the first quarter of 2009, real GDP decreased 6.3 percent and 5.5 percent, respectively. Further, in June 2010, the Treasury reported that banks had repaid about 75 percent of the bailout money they received through the Troubled Asset Relief Program and that taxpayers

made $21 billion on the investment. However, other bailouts are not yet repaid, and they may yield losses to taxpayers.

**.06** From July 2009 to July 2010, the unemployment rate fluctuated between 9.4 percent and 10.1 percent. An unemployment rate of 10.0 percent represents approximately 15.3 million people. The annual average rate of unemployment increased from 4.6 percent in 2007 to 9.3 percent in 2009. However, through June 2010, the rate has remained below 10.0 percent. Additionally, one reason for the continued high unemployment rate is that more Americans are resuming their search for work.

**.07** The Federal Reserve decreased the target for the federal funds rate more than 5.0 percentage points to less than 0.25 percent, where it remained through early August 2010. The Federal Reserve described the current economic recovery in its August 10, 2010, press release as follows:

- Household spending is increasing gradually but remains constrained by high unemployment, modest income growth, lower housing wealth, and tight credit.
- Business spending on equipment and software is rising; however, investment in nonresidential structures continues to be weak and employers remain reluctant to add to payrolls.
- Housing starts remain at a depressed level.
- Bank lending has continued to contract in recent months.
- The pace of economic recovery is expected to be more modest in the near term than had been anticipated.

**.08** The Federal Reserve also noted in the press release that "economic conditions, including low rates of resource utilization, subdued inflation trends, and stable inflation expectations, are likely to warrant exceptionally low levels of the federal funds rate for an extended period." The Federal Reserve will keep constant their holdings of securities by reinvesting principal payments from mortgage-backed securities in longer-term Treasury securities; additionally, as current holdings of Treasury securities mature, the proceeds will be reinvested in Treasury securities. Since the economic crisis, the Federal Reserve's balance sheet has grown to $2.3 trillion. Further, the Federal Reserve will continue to monitor the economy and employ other policy tools as necessary.

## Small Business Trends and Conditions

**.09** Private companies and, more specifically, small businesses are a main driver for the U.S. economy. According to the National Federation of Independent Businesses (NFIB), small businesses have produced roughly half of the private GDP and approximately 2 out of every 3 net new jobs in the United States since the early 1970s. Businesses employing less than 100 people constitute 96 percent of all employers.

**.10** According to the July 2010 *NFIB Small Business Economic Trends*, the June Index of Small Business Optimism lost 1 point over the previous month, falling to 87.9, after posting a gain of 6.9 points since March 2010. Four of the 10 index components posted gains, but 6 lost ground. The decline, although small in magnitude, was primarily a result of declines in expected real sales and expected business conditions.

**.11** In summary, the economic outlook remains uncertain. Pay close attention to how economic factors, such as interest rates, consumer confidence, the housing market, overall economic expansion or contraction, inflation, and the labor market, will affect your clients and your compilation and review engagements.

## Legislative and Regulatory Developments

### The Health Care and Education Reconciliation Act of 2010 and the Patient Protection and Affordable Care Act

**.12** In March 2010, the president signed into law a sweeping overhaul of the health care system. Almost everyone in the United States will be affected by these changes—individuals, insurance companies, health care providers, and employers. The three primary goals of the reform are to expand coverage to those without health insurance, reform the delivery system of benefits to improve quality, and decrease the costs of providing health care. The various provisions of the reform will become effective over time, through 2020. The new laws contain many changes for employers to consider for financial reporting purposes, in addition to many new tax rules to help offset the overall cost of the reform.

**.13** The complete changes are contained in two acts. The Health Care and Education Reconciliation Act of 2010 was signed on March 30 and is a reconciliation bill that amends the Patient Protection and Affordable Care Act signed into law by the president one week earlier. In April, the Securities and Exchange Commission (SEC) issued a staff announcement, *Accounting for the Health Care and Education Reconciliation Act of 2010 and the Patient Protection and Affordable Care Act*, to address questions that have arisen about the effect, if any, that the different signing dates might have on accounting for the two acts. This timing difference, related solely to the signing dates, should not have an impact on a majority of registrants because the acts were both signed within a relatively short time period, which for the vast majority of entities, falls into the same reporting period. However, there may be a limited number of registrants 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.

**.14** After consultation with the Financial Accounting Standards Board (FASB) staff, the 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 reform 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.

#### *Significant Accounting and Tax Considerations*

**.15** FASB *Accounting Standards Codification* (ASC) 740-10-30-2 states that the following basic requirements are applied to the measurement of current and deferred income taxes at the date of the financial statements:

- The measurement of current and deferred tax liabilities and assets is based on provisions of the enacted tax law; the effects of future changes in tax laws or rates are not anticipated.
- The measurement of deferred tax assets is reduced, if necessary, by the amount of any tax benefits that, based on available evidence, are not expected to be realized.

**.16** FASB ASC 715-60-35-102 further explains that benefit coverage for medical claims by governmental programs or other providers of health care benefits should be assumed to continue as provided by the present law and other providers, pursuant to their present plans. Consistent with FASB ASC guidance, presently enacted changes in the law or amendments of the plans of other health care providers that take effect in future periods and that will affect the future level of their benefit coverage should be considered in current period measurements for benefits expected to be provided in those future periods. Future changes in laws concerning medical costs covered by governmental programs and future changes in the plans of other providers should not be anticipated.

**.17** The two primary accounting considerations resulting from this reform are the effects of the tax law changes on deferred income tax balances and other postretirement health benefits. One of the most significant changes relates to the government subsidy for providing qualifying prescription drug coverage to Medicare-eligible retirees becoming an offset for prescription drug income tax deductions. Specifically, because entities will need to reduce their income tax deduction for providing prescription drug coverage by the subsidy received, they currently need to record a charge to earnings to write off a portion of their deferred tax assets related to postretirement health care obligations. Such deferred tax assets were based on the gross liability amount. Because the tax deductible prescription drug costs liability will be reduced by the subsidy, the deferred tax asset will be computed net of the subsidy, resulting in a lower deferred tax asset. The federal subsidy will not reduce the tax deductions until 2013. Even though the changes may not be effective until future periods, the effects are accounted for in the period that includes the enactment date. FASB ASC 715-60 discusses accounting and reporting guidance for other postretirement plans, including the Medicare prescription drug plan. Many public entities have already posted large noncash charges in early 2010 related to the nondeductibility of the subsidy.

**.18** Some of the other provisions of the reform that may affect an entity's tax position include the nondeductible pharmaceuticals fee, the medical device excise tax, and the therapeutic discovery project tax credit, which will have an effect on the pharmaceutical and medical device industries. Additionally, employer group health plans may not impose lifetime limits and can only impose "restricted" annual limits beginning with the 2011 plan year (for calendar year plans); no annual limits would be permitted beginning in 2014. Because these health benefits can no longer be limited, entities may need to increase accruals for future medical obligations. Many small businesses and tax-exempt organizations that provide health insurance coverage to their employees will now qualify for a special tax credit that is designed to encourage small employers to offer health care coverage for the first time or maintain the coverage they have. Lastly, under the new reform, a 40 percent penalty will apply to tax understatements attributable to transactions lacking economic substance (20 percent with adequate disclosure) or failing to meet the requirements of

any similar rule of law. A transaction is treated as having economic substance only if the transaction changes in a meaningful way (apart from federal income tax effects) the taxpayer's economic position, and the taxpayer has a substantial purpose (apart from federal income tax effects) for entering into the transaction.

**.19** The full text of these acts can be found at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_public_laws&docid=f:publ152.111.pdf and http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_public_laws&docid=f:publ148.111.pdf. Readers are also encouraged to refer to the Audit Risk Alerts *Health Care Entities—2010/11* (product no. 0223410) and *Not-for-Profit Entities—2010* (product no. 0224210).

# Recently Issued SSARS

## Issuance of SSARS No. 19

**.20** In December 2009, the Accounting and Review Services Committee (ARSC) issued SSARS No. 19, *Compilation and Review Engagements* (AICPA, *Professional Standards*, vol. 2). The standard's effective date is for periods ending on or after December 15, 2010, with the exception of paragraph 2.21 (AR sec. 80 par. .21), which may be implemented early. Paragraph 2.21 (AR sec. 80 par. .21) states in part, "The accountant is not precluded from disclosing a description about the reason(s) that his or her independence is impaired." See appendix B, "Significant Change to Compilation Reporting Requirements When Independence Is Impaired," of this alert for questions and answers regarding this new independence reporting option. It should be noted that SSARS No. 19 does not change the independence literature in any way—it just provides a reporting option for accountants performing compilation engagements.

**.21** Another significant change that smaller firms should appreciate is that this new standard separates the compilation guidance from the review guidance. Other significant changes to SSARSs included the following:

- A discussion of how the accountant obtains limited assurance through the performance of review procedures
- The introduction of the term *review evidence* to the review literature
- A discussion of tailoring the review procedures based on the accountant's understanding of the client's industry, knowledge of the client, and awareness of the risk that the accountant may unknowingly fail to modify his or her review report on financial statements that are materially misstated
- A discussion of materiality in the context of a review engagement
- A requirement that an accountant document the establishment of an understanding with management through a written communication (that is, an engagement letter) regarding the services to be performed
- The establishment of enhanced documentation requirements for compilation and review engagements

**.22** The final standard differs from the exposure draft in two major ways:

- First, ARSC decided to retain the concept of limited assurance rather than moderate assurance. ARSC proposed to use the term *moderate assurance* to describe the level of assurance that the accountant aims to obtain in a review engagement in order to harmonize with the terminology used in the international review standards. However, after the exposure draft was issued, the International Auditing and Assurance Standards Board (IAASB) began looking to revise the international review standard from moderate to limited.
- The other major difference is that the nonindependent review is not part of the final standard. ARSC received a number of comments on this proposal, both for and against. As a result of the great interest in this topic, ARSC decided it made the most sense to defer this issue so it could hold additional meetings with key stakeholders. These additional meetings will be used to further discuss with stakeholders the issues that many smaller firm members face in trying to serve their small business clients and to better understand why some stakeholders are opposed to the nonindependent review concept. The focus of the issues deal with the ARSC proposal that would have permitted an accountant to provide a review service while also performing a nonattest service to help smaller businesses maintain aspects of their internal control over financial reporting, the purpose of which is to improve the reliability of the client's financial statements.

**.23** Although the nonindependent review is not part of SSARS No. 19, ARSC remains committed to allowing practitioners to review financial statements when they also perform services that are intended to assist the client in preparing high-quality, reliable financial statements.

**.24** To assist practitioners with understanding and implementing the new guidance contained in SSARS No. 19, the Private Companies Practice Section (PCPS) has developed a SSARS No. 19 toolkit. For additional information on the SSARS No. 19 toolkit, refer to "PCPS SSARS No. 19 Toolkit" section of this alert.

## Proposed SSARS

### *The Applicability of Statements on Standards for Accounting and Review Services*

**.25** In July 2010, ARSC exposed for public comment a proposed SSARS, *The Applicability of Statements on Standards for Accounting and Review Services*. In February 2009, ARSC issued SSARS No. 18, *Applicability of Statements on Standards for Accounting and Review Services* (AICPA, *Professional Standards*, vol. 2). SSARS No. 18 revised the applicability of SSARSs so that SSARSs do not apply when the provisions of Statement on Auditing Standards (SAS) No. 116, *Interim Financial Information* (AICPA, *Professional Standards*, vol. 1, AU sec. 722), apply.

**.26** The revisions to SSARSs that were made effective by SSARS No. 18 were included in paragraph 3.1 (AR sec. 90 par. .01) of SSARS No. 19. That

paragraph states that SSARSs are not applicable when an auditor performs the audit of the latest annual financial statements and expects to be engaged to audit the current year financial statements. SSARSs are effective when the auditor expects that a new auditor may be appointed for the current year but that such appointment is not yet effective prior to the period covered by the review. The proposed SSARS would revise the review literature to exclude such an engagement from SSARSs; instead, the auditor would follow the requirements and guidance in the proposed SAS *Interim Financial Information* (Revised).

## Proposed Statement on Standards for Attestation Engagements

### *Reporting on Compiled Prospective Financial Statements When Independence Has Been Impaired*

**.27** In June 2010, ARSC released a proposed Statement on Standards for Attestation Engagements, *Reporting on Compiled Prospective Financial Statements When the Practitioner's Independence Is Impaired*. This proposal was done in response to the issuance of SSARS No. 19, which now allows the accountant to disclose the reason(s) for any independence impairments in his or her compilation report. ARSC determined that the attestation standards should also be revised so that the accountant, if he or she chooses, can disclose the reason(s) for an independence impairment in his or her compilation report on prospective financial information.

**.28** If issued as a final standard, the standard would result in revisions to AT section 301, *Financial Forecasts and Projections* (AICPA, *Professional Standards*, vol. 1).

## Other Current ARSC Projects

### The Use of the Accountant's Name in a Document or Communication Containing Unaudited Financial Statements That Have Not Been Compiled or Reviewed

**.29** The Auditing Standards Board (ASB), as part of its auditor's reports project, considered the requirements and guidance in AU section 504, *Association With Financial Statements* (AICPA, *Professional Standards*, vol. 1). The ASB's Auditor's Report Task Force determined that because ARSC is the senior technical committee of the AICPA designated to issue enforceable standards in connection with the unaudited financial statements or other unaudited financial information of a nonissuer, the requirements and guidance related to unaudited financial information should be contained in SSARSs.

**.30** The ASB voted to ballot to withdraw AU section 504 at its meeting in August 2010. The relevant guidance with respect to reporting on audited and unaudited financial statements in comparative form is addressed in the proposed SAS *Forming and Opinion and Reporting on Financial Statements*. SAS No. 118, *Other Information in Documents Containing Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1), addresses the auditor's responsibility in relation to other information in documents containing audited financial statements and the auditor's report thereon. In addition, amendments

to other clarified SASs to address the auditor's association with financial statements, as well as to address the situation when the auditor is not independent but is required by law or regulation to perform the audit, resulting from the withdrawal of AU section 504 will be included in a proposed Omnibus SAS that will address all of the amendments necessary at the end of the clarity project.

**.31** ARSC is currently considering the requirements and guidance that would apply when the accountant's name is used in a document or communication containing unaudited financial statements that the accountant has not compiled or reviewed.

## Compilation and Review of Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country

**.32** At its meeting in April 2009, the ASB reconsidered the applicability of AU section 534, *Reporting on Financial Statements Prepared for Use in Other Countries* (AICPA, *Professional Standards*, vol. 1). Paragraph .08 of AU section 534 states as follows:

> Financial statements prepared in conformity with accounting principles generally accepted in another country ordinarily are not useful to U.S. users. Therefore, if financial statements are needed for use both in another country and within the United States, the auditor may report on two sets of financial statements for the entity—one prepared in conformity with accounting principles generally accepted in another country for use outside the United States, and the other prepared in accordance with accounting principles generally accepted in the United States. . . . If dual statements are not prepared, or for some other reason the financial statements prepared in conformity with accounting principles generally accepted in another country will have more than limited distribution in the United States, the auditor should report on them using the U.S. standard form of report, modified as appropriate for departures from accounting principles generally accepted in the United States. . . .

**.33** After discussion and input from legal counsel regarding Rule 203, *Accounting Principles* (AICPA, *Professional Standards*, vol. 2, ET sec. 203 par. .01), the ASB concluded to retain the reporting provisions of AU section 534.

**.34** As a result of the ASB's decision, the AICPA staff believes that similar reporting provisions should apply to compilations and reviews of financial statements prepared in accordance with a financial reporting framework generally accepted in another country.

## Applicability of SSARS No. 19 to Personal Financial Statements

**.35** Historically, the authoritative accounting literature on personal financial statements was included in Statement of Position 82-1, *Accounting and Financial Reporting for Personal Financial Statements*. This guidance was subsumed into FASB ASC on July 1, 2009, and now resides in FASB ASC 274, *Personal Financial Statements*.

**.36** Accountants are often engaged to compile personal financial statements. The standard report wording contained in SSARS No. 19 includes

wording stating the fact that "management is responsible for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework [and] for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements."

**.37** Members have questioned whether the language about "designing, implementing, and maintaining internal control" would be applicable to reports on personal financial statements.

**.38** Although individuals usually do not have formal systems of internal control over financial reporting, individuals still need to have controls to permit the preparation of financial statements. An accountant's independence would be impaired if he or she establishes or maintains internal control for a client (see Interpretation No. 101-3, "Performance of Nonattest Services," under Rule 101, *Independence* [AICPA, *Professional Standards*, vol. 2, ET sec. 101 par. .05]). Therefore, the standard report wording is appropriate in engagements to compile or review personal financial statements. The AICPA staff is working on nonauthoritative illustrative reports in order to clarify the appropriate language for reports on compiled or reviewed personal financial statements.

## Current Practice Issues

**.39** In May 2010, the article "Changes on Tap for Compilation and Review Standards" was published in the AICPA *Journal of Accountancy*. The article was written by Carolyn McNerney, CPA (chair of ARSC); Charles E. Landes, CPA (AICPA vice president of Professional Standards); and Michael P. Glynn, CPA (AICPA Audit and Attest Standards technical manager and staff liaison to ARSC). This article discusses the major changes to compilation and review standards resulting from the issuance of SSARS No. 19 that affect practitioners performing compilations and reviews on financial statements for periods ending on or after December 15, 2010. This article was intended to serve as plain English implementation guidance for SSARS No. 19 and is included as appendix C, "'Changes on Tap for Compilation and Review Standards,'" of this alert.

### New Reports for Compilations and Reviews of Financial Statements Ending on or After December 15, 2010

**.40** The May 2010 *Journal of Accountancy* article includes a discussion of the revisions to the reporting requirements for compilation and review engagements that are included in SSARS No. 19 to make the reports clearer regarding management's responsibilities and the accountant's responsibility. The following is a comparison of the pre-SSARS No. 19 compilation report with the new report prescribed by SSARS No. 19.

| | ***Pre-SSARS No. 19 Compilation Report*** | ***SSARS No. 19 (New) Compilation Report*** |
|---|---|---|
| Title | Not required | Accountant's Compilation Report |
| Addressee | Not required | [*Appropriate Salutation*] |
| Introductory paragraph | I (we) have compiled the accompanying balance sheet of XYZ Company as of December 31, 20X1, and the related statements of income, retained earnings, and cash flows for the year then ended, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. | I (we) have compiled the accompanying balance sheet of XYZ Company as of December 31, 20XX, and the related statements of income, retained earnings, and cash flows for the year then ended. I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with accounting principles generally accepted in the United States of America. |
| Paragraph outlining management's responsibilities | None | Management (owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of financial statements. |

| | *Pre-SSARS No. 19 Compilation Report* | *SSARS No. 19 (New) Compilation Report* |
|---|---|---|
| Paragraph outlining the accountant's responsibilities | None | My (our) responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements. |
| Conclusion paragraph | A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them. | The communication is moved to the introductory paragraph. |
| Paragraph disclosing the independence impairment | I am (we are) not independent with respect to XYZ Company. The accountant is precluded from disclosing the reasons for the independence impairment. | I am (we are) not independent with respect to XYZ Company. The accountant is not precluded from disclosing the reasons for the independence impairment. |

**.41** The following is a comparison of the pre-SSARS No. 19 review report to the new report prescribed by SSARS No. 19.

| | ***Pre-SSARS No. 19 Review Report*** | ***SSARS No. 19 (New) Review Report*** |
|---|---|---|
| Title. | Not required | Independent Accountant's Report |
| Addressee. | Not required | [*Appropriate Salutation*] |
| Introductory paragraph. In the new report, the scope of the engagement is described (it was included in the second paragraph of the previous review report). Management's responsibilities are moved to a separate paragraph. | I (We) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 20X1, and the related statements of income, retained earnings, and cash flows for the year then ended in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of management (owners) of XYZ Company. | I (We) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 20XX, and the related statements of income, retained earnings, and cash flows for the year then ended. A review includes primarily applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion. |
| Second paragraph. The new report describes management's responsibilities. The scope of the engagement is included in the introductory paragraph. | A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an audit in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion. | Management (owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements. |

| | *Pre-SSARS No. 19 Review Report* | *SSARS No. 19 (New) Review Report* |
|---|---|---|
| Paragraph describing the accountant's responsibilities. | None | My (our) responsibility is to conduct the review in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. Those standards require me (us) to perform procedures to obtain limited assurance that there are no material modifications that should be made to the financial statements. I (We) believe that the results of my (our) procedures provide a reasonable basis for our report. |
| Paragraph describing the results of the engagement. | Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles. | Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with accounting principles generally accepted in the United States of America. |

## Preparation of Financial Statements for Use by an Entity's Auditors

**.42** In December 2008, ARSC issued Interpretation No. 31, "Preparation of Financial Statements for Use by an Entity's Auditors," of AR section 100, *Compilation and Review of Financial Statements* (AICPA, *Professional Standards*, vol. 2, AR sec. 9100 par. .136–.137). The interpretation clarifies that in the situation when a client engages an accountant, other than its auditor, to prepare unaudited financial statements on behalf of management and when those financial statements are provided by management to its outside auditor for the purposes of the annual audit, the client's outside auditor is not deemed to be a third party using the financial statements. As such, the accountant can avail himself or herself of the nonreporting exemption provided when compiled financial statements are not expected to be used by a third party. All of the interpretations of AR section 100 are available at www.aicpa.org/Research/Standards/CompilationReview/DownloadableDocuments/AR-00100_9.pdf.

# Current Accounting and Financial Reporting Issues

## Other Comprehensive Bases of Accounting Disclosures

**.43** Accountants are often requested to compile or review financial statements prepared in accordance with a comprehensive basis of accounting other than generally accepted accounting principles (GAAP). These bases of accounting are often referred to as an other comprehensive basis of accounting (OCBOA) and include bases such as the income tax basis of accounting and the cash basis of accounting.

**.44** A significant challenge in compiling or reviewing financial statements prepared in accordance with an OCBOA is that, unlike GAAP, authoritative guidance, with respect to the form and content of the financial statements, does not exist. However, that does not alleviate the requirement that the financial statements be appropriate in form.

**.45** Financial statements prepared in accordance with an OCBOA are not considered appropriate in form unless the financial statements include the following:

*a.* A description of the OCBOA, including a summary of significant accounting policies and a description of how the OCBOA differs from GAAP, although the effects of the differences need not be quantified

*b.* Informative disclosures similar to those required by GAAP if the financial statements contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP

**.46** If the OCBOA financial statements do not include the preceding information, the accountant should modify his or her compilation or review report accordingly to disclose the departure from the OCBOA.

# Common Peer Review Findings

**.47** In 2008, the AICPA Peer Review Program reported approximately 9,600 peer reviews, of which approximately 5,200 pertained to compilation and review engagements. The importance of the peer review findings cannot be overemphasized. The following is a brief listing of just some of the most recent deficiencies that were encountered:

- Compilation reports that failed to include the paragraph regarding the omission of required disclosures as applicable in the circumstances.
- Compilation reports that do not comply with minimum reporting requirements.
- Issuance of a review report when the accountant is not independent.
- Failure to disclose the lack of independence in a compilation report.
- In an engagement to compile financial statements that omit substantially all disclosures, failure to disclose, in the accountant's compilation report, management's omission of substantially all disclosures.

- The engagement letter in an engagement to compile financial statements that are not expected to be used by a third party did not refer to supplementary information, which was presented along with the basic financial statements.
- Failure to use a work program or a reporting and disclosure checklist when required by firm policy (this is not required by professional standards).
- For review engagements, failure to perform analytical and inquiry procedures and failure to adequately document the procedures.
- For review engagements, failure to obtain a client management representation letter.
- Failure to include a GAAP departure in the accountant's compilation or review report when management failed to segregate the current portion of long-term debt.
- Engagement letters with respect to engagements to compile financial statements that are not expected to be used by third parties and that omit the required descriptions or statements documenting the understanding with the client.
- Reference to the accountant's compilation report was not present on the financial statements.

**.48** Although there are many recurring deficiencies noted in peer review, the accountant can take steps to avoid them by keeping these common mistakes in mind during the planning and performance of future compilation and review engagements. To view the latest full peer review report, please visit "Interest Areas—Peer Review" at www.aicpa.org.

## Accounting Issues and Developments

**.49** Given the current economic climate, certain accounting and financial reporting issues, such as the following, may be important to consider when compiling or reviewing financial statements:

- Fair value, including fair value measurements in illiquid markets
- Impairment

### FASB Statement No. 168

**.50** FASB Statement No. 168, *The* FASB Accounting Standards Codification™ *and the Hierarchy of Generally Accepted Accounting Principles—a replacement of FASB Statement No. 162*, as codified in FASB ASC 105, *Generally Accepted Accounting Principles*, is effective for financial statements issued for interim and annual periods ending after September 15, 2009. On the effective date of FASB Statement No. 168, FASB ASC became the source of authoritative U.S. accounting and reporting standards for nongovernmental entities, in addition to guidance issued by the SEC. FASB ASC superseded all then-existing, non-SEC accounting and reporting standards for nongovernmental entities. This new standard flattens the U.S. GAAP hierarchy to two levels: one that is authoritative (in FASB ASC) and one that is nonauthoritative (not in FASB ASC). Exceptions include all rules and interpretive releases of the SEC under the authority of federal securities laws, which are sources of authoritative U.S.

GAAP for SEC registrants, and certain grandfathered guidance having an effective date before March 15, 1992. If an accounting change results from the application of this guidance, an entity should disclose the nature and reason for the change in accounting principle in their financial statements.

### *Referencing FASB ASC in Your Engagement Documentation*

**.51** It is only prudent to reflect current U.S. GAAP in your engagement documentation. The FASB notice to constituents includes a section on referencing FASB ASC in footnotes and other documents. In this notice, FASB encourages the use of plain English to describe broad topic references in the future. For example, to refer to the requirements of the *Derivatives and Hedging* topic, they suggest a reference similar to "as required by the *Derivatives and Hedging* topic of the FASB *Accounting Standards Codification*." Conversely, FASB suggests using the detailed numerical referencing system in engagement documentation, articles, textbooks, and related items.

**.52** Also, because FASB ASC is not intended to change U.S. GAAP, the consistent use of references to only FASB ASC for all periods presented (including periods before the authoritative release of FASB ASC) is appropriate. It is prudent to expect that engagement documentation associated with financial statements for a period ending after September 15, 2009, also would reflect FASB ASC because the underlying financial statements, which are the subjects of those engagements, reference FASB ASC.

**.53** However, if your firm's policies and procedures regarding engagement documentation will continue to follow grandfathered guidance not included in FASB ASC, it would be appropriate to continue to reference those standards (and not FASB ASC). A listing of examples of grandfathered guidance can be found in FASB Statement No. 168.

**.54** Examples of disclosures using references to FASB ASC can be found at the AICPA's dedicated FASB ASC website at www.aicpa.org/InterestAreas/AccountingAndAuditing/Resources/AcctgFinRptg/AcctgFinRptgGuidance/Pages/FASBAccountingStandardsCodification.aspx.

### *Postcodification FASB References*

**.55** In spring 2010, the AICPA judgmentally selected 50 SEC filers and reviewed their 2009 Form 10-Ks to understand what type of references are actually being used in practice. All financial statements reviewed were for those entities having a fiscal year-end between December 1, 2009, and January 31, 2010, when the FASB codification was fully effective for all of these entities. The entities selected comprised the following:

- Fourteen large accelerated filers (28 percent of the sample)
- Twenty accelerated filers (40 percent of the sample)
- Seven nonaccelerated filers (14 percent of the sample)
- Nine smaller reporting companies (18 percent of the sample)

**.56** Of all the entities selected, 50 percent had gone to mostly plain English references in their annual financial statements. However, among these entities, in the "Summary of Significant Accounting Policies" section of the financial statements, many entities did still use specific references to either old

FASB standards (pre-FASB Statement No. 168 standards or legacy standards) or specific Accounting Standards Updates (ASUs), when appropriate. There did not seem to be much of a difference in this percentage among large accelerated filers, accelerated filers, and nonaccelerated filers. However, smaller reporting companies were less likely to use plain English (only 33 percent used plain English references).

**.57** As for the remaining 50 percent of filers selected, they chose to use either FASB ASC-specific references (36 percent) or to do some sort of dual references (12 percent) between the precodification standards and new FASB ASC guidance. There was one entity that continued to use the old FASB references and did not mention FASB ASC in its financial statements.

**.58** For those entities using FASB ASC references, most only referenced to the topic level and did not go down to the subtopic or section level. For those using dual references, in most cases, the new FASB ASC topic was listed first, with the historical FASB reference noted parenthetically. See the following table for a full breakout of the results:

| | ***Plain English References*** | ***FASB ASC References*** | ***Dual References*** | ***Old FASB References*** |
|---|---|---|---|---|
| Large Accelerated Filers | 7 | 4 | 2 | 1 |
| Accelerated Filers | 12 | 6 | 2 | 0 |
| Nonaccelerated Filers | 3 | 3 | 1 | 0 |
| Smaller Reporting Companies | 3 | 5 | 1 | 0 |
| Total Sample | 25 | 18 | 6 | 1 |

**.59** The sampling results make it clear that although both FASB and the SEC have stated that the use of plain English is most appropriate when dealing with financial statements and notes to financial statements, not everyone is there yet. It will be interesting to see if the plain English references trend continues upward once entities have had another full year to get used to FASB ASC. In addition, all new guidance issued in 2010 was issued through ASUs, and there were no legacy standards issued. Therefore, we would expect that in 2010 filings, even the "Summary of Significant Accounting Policies" section of financial statements would no longer refer to any legacy standards.

**.60** We found that with the plain English references, some entities chose instead to say something like, "in accordance with the purchase method of accounting and as updated with FASB's April 2009 additional authoritative guidance for business combinations, we. . . ." Here the entity uses plain English but also makes it clear which new guidance they are following. This would be most important for those FASB changes with early adoption provisions to make it clear which method an entity used.

**.61** FASB has stated that ASUs do not carry any authority. It is the updates that are made to the codification once the ASU is effective that are authoritative.

Therefore, entities would be wise to ensure that when they are referring to authoritative literature, use of either plain English or the FASB ASC references would be appropriate, rather than just naming the ASU that brought about the change in accounting.

**.62** In addition, entities would want to be sure that they do not refer to any legacy standards in their 2010 financial statements. Because all changes made to the codification in 2010 were through ASUs, referring to legacy standards is no longer correct. For example, since the codification became effective, there have been several updates to the *Fair Value Measurements and Disclosures* topic. Therefore, referring to FASB Statement No. 157, *Fair Value Measurements*, is no longer accurate because this standard does not incorporate changes made since the codification became effective in 2009. We would expect that entities that used dual references to both the legacy standards and FASB ASC references would not continue to use those dual references in 2010 financial statements.

**.63** Many entities also have a section of their notes to financial statements titled "Effect of Accounting Pronouncements Not Yet Adopted." In 2010, we would expect the title of this section to change to something like "Effect of Authoritative Accounting Guidance Not Yet Adopted."

**.64** It will be interesting to see if both public and nonpublic entities make any additional refinements or changes to their 2010 financial statements as we move into our first full year with FASB ASC. It is our understanding that the SEC may be issuing comment letters to those entities that are not properly reflecting the current state of U.S. GAAP in their financial statements, whether that be by using plain English or using the new FASB ASC references.

## Decreases in Ownership of a Subsidiary

**.65** In January 2010, FASB issued FASB ASU No. 2010-02, *Consolidation (Topic 810): Accounting and Reporting for Decreases in Ownership of a Subsidiary—a Scope Clarification*. This ASU addresses implementation issues related to the changes in ownership provisions in FASB ASC 810-10 (issued as FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements—an amendment of ARB No. 51*). These amendments clarify that the scope of the decrease in ownership provisions of FASB ASC 810-10 and related guidance applies to 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, and an exchange of a group of assets that constitutes a business or nonprofit activity for a noncontrolling interest in an entity (including an equity method investee or joint venture). Further, the amendments clarify that the decrease in ownership guidance in FASB ASC 810-10 does not apply to the following transactions, even if they involve businesses: sales of in-substance real estate and conveyances of oil and gas mineral rights. The amendment also expands the required disclosures about the deconsolidation of a subsidiary or derecognition of a group of assets within the scope of FASB ASC 810-10. This ASU is effective beginning in the period that an entity adopts FASB Statement No. 160. If an entity has already adopted this guidance, then the amendments in this ASU are effective beginning in the first interim or annual reporting period ending on or after December 15, 2009. The amendments in this ASU should be applied retrospectively to the first period that an entity adopted FASB Statement No. 160.

## Accounting for Uncertainty in Income Taxes

**.66** For many calendar year nonpublic entities, 2009 was the first year of application of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109*. In September 2009, FASB issued ASU No. 2009-06, *Income Taxes (Topic 740)—Implementation Guidance on Accounting for Uncertainty in Income Taxes and Disclosure Amendments for Nonpublic Entities*. This update affects all nongovernmental entities, and the disclosure amendments only apply to nonpublic entities. The four main provisions of the ASU include the following:

- If income taxes paid by the entity are attributable to the entity, the transaction should be accounted for in accordance with the guidance on uncertainty in income taxes in FASB ASC 740, *Income Taxes*. If the taxes paid by the entity are attributable to the owners, the transaction should be accounted for as a transaction with the owners. Attribution should be based on the laws and regulations of the jurisdiction and should be made for each jurisdiction where the entity is subject to income taxes.
- 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.
- Regardless of the tax status of the reporting entity, the tax positions of all entities within a related group of entities must be considered.
- For nonpublic entities, it eliminates the disclosures of a tabular reconciliation of the total amount of unrecognized tax benefits at the beginning and end of the periods presented and the total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate (see FASB ASC 740-10-50-15[a]–[b]).

**.67** For entities that are currently applying the guidance on accounting for uncertainty in income taxes, this ASU is effective for interim and annual periods ending after September 15, 2009.

## Consolidation of Variable Interest Entities

**.68** For calendar year entities, 2010 is the first year of application of FASB Statement No. 167, *Amendments to FASB Interpretation No. 46(R)*, which changes how to determine when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. FASB Statement No. 167 was incorporated into FASB ASC through ASU No. 2009-17, *Consolidations (Topic 810): Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities.* This statement is effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009; for interim periods within that first annual reporting period; and for interim and annual reporting periods thereafter. Earlier application is prohibited.

**.69** The determination of whether a company is required to consolidate an entity is based on, among other things, an entity's purpose and design and a company's ability to direct the activities of the entity that most significantly impact the entity's economic performance. This statement also amends

P1: PjU
ACPA165-CRA ACPA165.cls October 7, 2010 21:34



consolidation of variable interest entities (VIE) guidance to eliminate the quantitative approach previously required for determining the primary beneficiary of a VIE, which was based on determining which enterprise absorbs the majority of the entity's expected losses, receives a majority of the entity's expected residual returns, or both.

**.70** Entities will be required to provide additional disclosures about involvement with VIEs and any significant changes in risk exposure due to that involvement. Entities also will be required to disclose how involvement with a VIE affects the entity's financial statements.

**.71** FASB Statement No. 167 retains the scope of previous VIE consolidation accounting guidance, with the addition of entities previously considered qualifying special purpose entities because the concept of these entities was eliminated in FASB Statement No. 166, *Accounting for Transfers of Financial Assets—an amendment of FASB Statement No. 140,* which was incorporated into FASB ASC by ASU No. 2009-16, *Transfers and Servicing (Topic 860): Accounting for Transfers of Financial Assets*.

**.72** This statement also discusses the objectives of its required disclosures and notes that an entity may need to supplement the minimum required disclosures to meet these objectives. The objectives are for the financial statement users to have an understanding of the following:

- The significant judgments and assumptions made by an enterprise in determining whether it must consolidate a VIE or disclose information about its involvement in a variable interest entity, or both
- The nature of restrictions on a consolidated VIE's assets and on the settlement of its liabilities reported by an enterprise in its statement of financial position, including the carrying amounts of such assets and liabilities
- The nature of, and changes in, the risks associated with an enterprise's involvement with the VIE
- How an enterprise's involvement with the VIE affects the enterprise's financial position, financial performance, and cash flows

**.73** This statement is effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009; for interim periods within that first annual reporting period; and for interim and annual reporting periods thereafter. Earlier application is prohibited.

## Accounting for Transfers of Financial Assets

**.74** Calendar year entities must also start applying the provisions of FASB Statement No. 166 in 2010. FASB Statement No. 166, which is a revision to FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities—a replacement of FASB Statement No. 125*, requires more information about transfers of financial assets, including securitization transactions, and those circumstances in which entities have continuing exposure to the risks related to transferred financial assets. FASB Statement No. 166 was incorporated into FASB ASC by ASU No. 2009-16 and is discussed in FASB ASC 860, *Transfers and Servicing*. It eliminates the concept of a qualifying special purpose entity, changes the requirements for derecognizing financial assets, and requires additional disclosures. The purpose of this

statement is to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial statements about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor's continuing involvement, if any, in transferred financial assets. It is effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009; for interim periods within that first annual reporting period; and for interim and annual reporting periods thereafter. Earlier application is prohibited. This statement must be applied to transfers occurring on or after the effective date; however, the disclosure provisions should be applied to transfers that occurred both before and after the effective date.

**.75** Additionally, on and after the effective date, the concept of a qualifying special-purpose entity is no longer relevant for accounting purposes. Therefore, formerly qualifying special purpose entities (as defined under previous accounting standards) should be evaluated for consolidation by reporting entities on and after the effective date in accordance with the applicable consolidation guidance.

**.76** The primary objectives of the disclosure requirements of this guidance are to provide the financial statement users with a clear understanding of the following:

- A transferor's continuing involvement (as defined by the FASB ASC glossary), if any, with transferred financial assets
- The nature of any restrictions on assets reported by an entity in its statement of financial position that relate to a transferred financial asset, including the carrying amounts of those assets
- How servicing assets and servicing liabilities are reported under this pronouncement
- For transfers accounted for as sales when a transferor has continuing involvement with the transferred financial assets and for transfers of financial assets accounted for as secured borrowings, how the transfer of financial assets affects a transferor's financial position, financial performance, and cash flows

**.77** These objectives must be met by the disclosures, regardless of the specific requirements of the pronouncement. It may be the case that an entity provides greater detail than what is a required disclosure to meet these objectives, depending on the facts and circumstances.

## Subsequent Events

**.78** FASB Statement No. 165, *Subsequent Events*, which has been codified in FASB ASC 855, *Subsequent Events*, is effective for interim and annual periods ending after June 15, 2009. This statement is intended to establish general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. It requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date (that is, whether that date represents the date the financial statements were issued or were available to be issued). The purpose of this disclosure is to alert all users of financial statements that an entity has not evaluated subsequent events after that date in the set of financial statements being presented.

**.79** In particular, this statement sets forth the following:

- The period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements
- The circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements
- The disclosures that an entity should make about events or transactions that occurred after the balance sheet date

**.80** FASB states that this guidance should not result in significant changes in current practice with regard to the subsequent events that an entity reports, either through recognition or disclosure, in its financial statements. In September 2009, the AICPA issued Technical Questions and Answers (TIS) section 8700.01, "Effect of FASB ASC 855 on Accounting Guidance in AU Section 560" (AICPA, *Technical Practice Aids*), which notes that preparers of financial statements for nongovernmental entities are required to follow the accounting guidance in FASB ASC 855. Additionally, the accounting guidance contained in AU section 560, *Subsequent Events* (AICPA, *Professional Standards*, vol. 1), would no longer be applicable to audits of nongovernmental entities. This question and answer can be accessed at www.aicpa.org/InterestAreas/AccountingAndAuditing/Resources/Pages/RecentlyIssuedTechnicalQuestionsandAnswers.aspx.

**.81** For additional discussion regarding the accountant's responsibilities for subsequent events in compilation or review engagements, refer to the "TIS section 9150.26, 'The Accountant's Responsibilities for Subsequent Events in Compilation and Review Engagements'" section of this alert.

## Fair Value

**.82** FASB ASC 820-10-20 defines *fair value* and establishes a framework for measuring fair value; however, it does not dictate when an entity must measure something at fair value, nor does it expand the use of fair value in any way. The need to understand fair value accounting has increased in importance as alternative investments increased in popularity and complexity. *Fair value* is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

### *Measuring Liabilities at Fair Value*

**.83** FASB issued ASU No. 2009-05, *Measuring Liabilities at Fair Value* to increase the consistency in the application of FASB ASC 820 to liabilities because many constituents had expressed concern. This ASU applies to all entities that measure liabilities at fair value under FASB ASC 820 and amends sections of FASB ASC 820-10.

**.84** This ASU states that, in circumstances in which a quoted price in an active market for the identical liability is not available, fair value of the liability must be measured by either (*a*) a valuation technique that uses the quoted price of the identical liability when traded as an asset or quoted prices for similar liabilities, or similar liabilities when traded as assets, or (*b*) another

valuation technique that is consistent with the principles of FASB ASC 820, such as an income approach or a market approach. Further, if a restriction on the transference of the liability exists, the ASU clarifies that an entity is not required to factor that in to the inputs of the fair value determination. Lastly, the ASU also clarifies that a quoted price in an active market for the identical liability, or an unadjusted quoted price in an active market for the identical liability, when traded as an asset, are level 1 measurements within the fair value hierarchy. The guidance in this ASU is effective for the first reporting period (including interim periods) beginning after its issuance in August 2009. The full text of the ASU can be accessed from FASB's website at www.fasb.org.

### *Investments in Certain Entities That Calculate Net Asset Value per Share (or its Equivalent)*

**.85** FASB issued ASU No. 2009-12, *Fair Value Measurements and Disclosures (Topic 820): Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*, because of the complexities and practical difficulties in estimating the fair value of alternative investments. It is applicable to all reporting entities that hold an investment that is required or permitted to be measured or disclosed at fair value on a recurring or nonrecurring basis, and as of the reporting entity's measurement date, if the investment both

- does not have a *readily determinable fair value*. The FASB ASC glossary states that an equity security has a readily determinable fair value if it meets any of the following conditions:
  - The fair value of any equity security is readily determinable if sales prices or bid-and-asked quotations are currently available on a securities exchange registered with the SEC or in the OTC market, provided that those prices or quotations for the OTC market are publicly reported by NASDAQ or by Pink Sheets LLC. Restricted stock meets that definition if the restriction terminates within one year.
  - The fair value of an equity security traded only in a foreign market is readily determinable if that foreign market is of a breadth and scope comparable to one of the U.S. markets referred to previously.
  - The fair value of an investment in a mutual fund is readily determinable if the fair value per share (unit) is determined and published and is the basis for current transactions.
- is in an entity that has all of the attributes specified in FASB ASC 946-10-15-2 or, if one of those attributes are not met, is in an entity for which it is industry practice to issue financial statements using guidance that is consistent with the measurement principles in FASB ASC 946, *Financial Services—Investment Companies.*

**.86** As a practical expedient, this ASU permits a reporting entity to measure the fair value of an investment within its scope on the basis of the net asset value (NAV) per share of the investment (or its equivalent) if the NAV is calculated in a manner consistent with the measurement principles of FASB ASC 946 as of the reporting entity's measurement date, including measurement of

P1: PjU
ACPA165-CRA ACPA165.cls October 7, 2010 21:34



all or substantially all of the underlying investments of the investee in accordance with FASB ASC 820. If the practical expedient is used, certain attributes of the investment (such as restrictions on redemption) and transaction prices from principal-to-principal or brokered transactions will not be considered in measuring the investment's fair value.

**.87** This ASU also requires disclosures by major category of investment about the attributes of investments, such as the nature of any restrictions on the investor's ability to redeem its investments at the measurement date, any unfunded commitments, and the investment strategies of the investees. The major category of investment is required to be determined based on the guidance in FASB ASC 320-10-50-1B. These disclosures are required for all investments within the scope of this ASU. The ASU adds an example of its required disclosures in FASB ASC 820-10-55-64A.

**.88** These amendments are effective for interim and annual periods ending after December 15, 2009, and are included in FASB ASC 820-10. The AICPA practice aid *Alternative Investments—Audit Considerations* also is available. The practice aid focuses on the existence and valuation assertions associated with alternative investments. Although that practice aid was written as a tool for auditors, accountants performing compilation or review engagements may find some useful information contained therein.

**.89** In December 2009, the AICPA issued sections .18–.27 of TIS section 2220, *Long-Term Investments* (AICPA, *Technical Practice Aids*), 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 NAV. TIS sections 2220.18–.27 apply to investments that are required to be measured and reported at fair value and are within the scope of paragraphs 4–5 of FASB ASC 820-10-15. These questions and answers compliment the guidance provided in ASU No. 2009-12.

**.90** Topics covered in these questions and answers include the following:

- The circumstances when NAV may be used to estimate the fair value of investments as a practical expedient
- How to identify the unit of account for interests in alternative investments
- Considerations for determining whether the reported NAV has been calculated in a manner consistent with FASB ASC 946
- Examples of circumstances when an adjustment to the reported NAV may be necessary
- How to adjust the reported NAV when it is not as of the reporting entity's measurement date
- How to adjust the reported NAV when it has not been calculated in accordance with FASB ASC 946
- The determination of the appropriate level within the fair value hierarchy for NAV of alternative investments in relation to the ability to redeem the investment versus the actual redemption request for the investment
- The definition of *near term* for the purposes of determining the appropriate level within the fair value hierarchy

- The tailoring of disclosures categories to address the nature and risks of investments
- Some considerations for determining the fair value of alternative investments when not utilizing NAV as a practical expedient

**.91** Recently issued questions and answers can be located on the AICPA website at www.aicpa.org/InterestAreas/AccountingAndAuditing/Resources/Pages/RecentlyIssuedTechnicalQuestionsandAnswers.aspx.

### *Fair Value Measurements Disclosures*

**.92** ASU No. 2010-06, *Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements*, was issued to increase the transparency in financial reporting of fair value measurements. FASB noted that due to the different degrees of subjectivity and reliability on level 1, level 2, and level 3 fair value measurements, information about significant transfers between the three levels and the underlying reasons for such transfers would be useful to financial statements users.

**.93** This ASU amends FASB ASC 820-10 to require the following new disclosures:

- *Transfers in and out of levels 1 and 2*. A reporting entity should disclose separately the amounts of significant transfers in and out of level 1 and level 2 fair value measurements and describe the reasons for the transfers.
- *Activity in level 3 fair value measurements*. In the reconciliation for fair value measurements using significant unobservable inputs (level 3), a reporting entity should present separately information about purchases, sales, issuances, and settlements (that is, on a gross basis rather than as one net number).

**.94** Additionally, the ASU amends FASB ASC 820-10 to clarify certain existing disclosures as follows:

- *Level of disaggregation*. A reporting entity should provide fair value measurement disclosures for each class of assets and liabilities. A class is often a subset of assets or liabilities within a line item in the statement of financial position. A reporting entity needs to use judgment in determining the appropriate classes of assets and liabilities.
- *Disclosures about inputs and valuation techniques*. A reporting entity should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements. Those disclosures are required for fair value measurements that fall in either level 2 or level 3.

**.95** The amendments in ASU No. 2010-06 are effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the rollforward of activity in level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years.

## Disclosures About Credit Quality and Allowance for Credit Losses

**.96** In July 2010, FASB issued ASU No. 2010-20, *Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*, which requires an entity to provide a greater level of disaggregated information about the credit quality of its financing receivables and its allowance for credit losses. The ASU amends the existing disclosures to require an entity to provide the following disclosures about its financing receivables on a disaggregated basis:

- A rollforward schedule of the allowance for credit losses from the beginning of the reporting period to the end of the reporting period on a portfolio segment basis, with the ending balance further disaggregated on the basis of the impairment method. For each disaggregated ending balance, the related recorded investment in financing receivables should also be disclosed.
- The nonaccrual status of financing receivables by class of financing receivables.
- Impaired financing receivables by class of financing receivables.

**.97** The amendments in this ASU require an entity to provide the following additional disclosures about its financing receivables:

- Credit quality indicators of financing receivables at the end of the reporting period by class of financing receivables (see FASB ASC 310-10-55-19 for examples of credit quality indicators)
- The aging of past due financing receivables at the end of the reporting period by class of financing receivables
- The nature and extent of troubled debt restructurings that occurred during the period by class of financing receivables and their effect on the allowance for credit losses
- The nature and extent of financing receivables modified as troubled debt restructurings within the previous 12 months that defaulted during the reporting period by class of financing receivables and their effect on the allowance for credit losses
- Significant purchases and sales of financing receivables during the reporting period disaggregated by portfolio segment

**.98** An entity must also describe, by portfolio segment, its accounting policies and methodology used to estimate its allowance for credit losses, including the identification of any changes to the entity's accounting policies or methodology from the prior period and the entity's rationale for the change.

**.99** The amendments in this ASU apply to all entities with financing receivables. Examples of financing receivables include loans; trade receivables; notes receivable; and receivables relating to a lessor's leveraged, direct financing, and sales-type leases. See the "Pending Content" in paragraphs 13–15 of FASB ASC 310-10-55 for more information on the definition of *financing receivable*, including a list of items that are excluded from the definition (for example, debt securities). In addition, the "Pending Content" in paragraphs 7–12 of FASB ASC 310-10-55 illustrates certain disclosures required by this ASU.

**.100** For public entities, the disclosures as of the end of a reporting period are effective for interim and annual reporting periods ending on or after December 15, 2010. The disclosures about activity that occurs during a reporting period are effective for interim and annual reporting periods beginning on or after December 15, 2010. For nonpublic entities, the disclosures are effective for annual reporting periods ending on or after December 15, 2011.

## Convergence With International Financial Reporting Standards

**.101** Since the signing of the Norwalk Agreement by FASB and the International Accounting Standards Board (IASB), the bodies have had a common goal—one set of accounting standards for international use. *International convergence of accounting standards* refers to both the goal of this project and the path taken to reach it. The path toward reaching this goal will both improve U.S. GAAP and International Financial Reporting Standards (IFRSs) and eliminate the differences between them. In the Norwalk agreement, each body acknowledged its commitment to the development of high quality, compatible accounting standards that could be used for both domestic and cross-border financial reporting. FASB and the IASB have undertaken several joint projects, which are being conducted simultaneously in a coordinated manner to further the goal of convergence of U.S. GAAP and IFRSs. The "On the Horizon" section of this alert discusses these joint projects. For more information, visit www.fasb.org and www.iasb.org.

### *SEC Work Plan for Consideration of IFRSs*

**.102** In February 2010, the SEC issued Release No. 33-9109, *Commission Statement in Support of Convergence and Global Accounting Standards*. This release provides an update to the SEC's roadmap on its consideration of global accounting standards, including a confirmation of its continued support for the convergence of U.S. GAAP and IFRSs in order to narrow the differences between the two sets of standards. The SEC believes that a more comprehensive work plan is necessary to transparently lay out the work that must be done to support a decision on the appropriate course to incorporate IFRSs into the U.S. financial reporting system for U.S. issuers, including the scope, time frame, and methodology for any such transition. Therefore, the SEC has indicated that it will carefully consider and deliberate whether these changes are in the best interest of U.S. investors and markets.

**.103** The SEC directed its staff to execute a work plan, the results of which will aid the SEC in its evaluation of the impact that the use of IFRSs by U.S. entities would have on the U.S. securities market. The work plan includes consideration of IFRSs, both as they currently exist and after the completion of the various convergence projects underway by FASB and the IASB. Among other things, the work plan addresses some of the comments and concerns received on the roadmap, including the following:

- Sufficient development and application of IFRSs for the U.S. reporting system
- The independence of standard setting for the benefit of investors
- Investor understanding and education regarding IFRSs
- Examination of the U.S. regulatory environment that would be affected by a change in accounting standards

- The impact on issuers, both large and small, including changes to accounting systems, changes to contractual arrangements, corporate governance considerations, and litigation contingencies
- Human capital readiness

**.104** Beginning no later than October 2010, and frequently thereafter, the SEC staff will provide public progress reports on the work plan, as well as the status of the FASB and IASB convergence projects, until the work is complete. By 2011, assuming completion of these convergence projects and the staff's work plan, the SEC will decide whether to incorporate IFRSs into the U.S. financial reporting system and, if so, when and how. Commentors provided feedback on the timing discussed in the roadmap, suggesting that a four or five year time frame would be necessary to successfully implement a change in their financial reporting systems to incorporate IFRSs. Under that assumption, if the SEC determines in 2011 to incorporate IFRSs into the U.S. financial reporting system, the first time that U.S. entities would report under such a system would be no earlier than 2015. This timeline will be further evaluated as part of the work plan. The work plan is included as an appendix at the end of Release No. 33-9109 and also can be found on the SEC's website at www.sec.gov.

**.105** In August 2010, the SEC issued two releases (Release Nos. 33-9133 and 33-9134, *Notice of Solicitation of Public Comment on Consideration of Incorporating IFRS Into the Financial Reporting System for U.S. Issuers*) to solicit public comment on its ongoing consideration of incorporating IFRSs into the financial reporting system for U.S. issuers. The first release contains requests for comment on three topics derived from the work plan that are related to the potential impact on investors. The second release contains requests for comment on three topics, also derived from the work plan, that are related to the potential impact on U.S. issuers. All comments will be available on the SEC's website at www.sec.gov.

### *International Financial Reporting Standard for Small and Medium-sized Entities*

**.106** The IASB issued *International Financial Reporting Standard for Small and Medium-sized Entities* (*IFRS for SMEs*) to be a self-contained global accounting and financial reporting standard applicable to the general purpose financial statements of, and other financial reporting by, entities that are known in many countries as SMEs. *IFRS for SMEs* is intended to be used by entities that publish general purpose financial statements for external users and do not have public accountability.

**.107** The AICPA Governing Council recognizes the IASB as an accounting body for purposes of establishing international financial accounting and reporting principles. This amendment to appendix A of AICPA Rule 202, *Compliance With Standards* (AICPA, *Professional Standards*, vol. 2, ET sec. 202 par. .01), and Rule 203, gives AICPA members the option to use IFRSs as an alternative to U.S. GAAP. As such, a key professional barrier to using IFRSs and, therefore, *IFRS for SMEs* has been removed. CPAs may need to check with their state boards of accountancy to determine the status of reporting on financial statements prepared in accordance with *IFRS for SMEs* within their individual state. Any remaining barriers may come in the form of unwillingness by a private company's financial statement users to accept financial statements prepared under *IFRS for SMEs*, and a private company's expenditure of money,

time and effort to convert to *IFRS for SMEs*. Information about IFRSs and *IFRS for SMEs* can be found at www.ifrs.com.

**.108** Additionally, to help its membership, the AICPA has developed an IFRS for SMEs—U.S. GAAP Comparison Wiki. The purpose of the wiki is to provide a detailed and comprehensive comparison of *IFRS for SMEs* with corresponding requirements of U.S. GAAP. But it is more than just a comparison resource—it is a wiki. That means it is a collaborative, ongoing work in progress for anyone to contribute to and use. The wiki is found at http://wiki.ifrs.com/.

**.109** At approximately 230 pages, *IFRS for SMEs* is a simplified version of full IFRSs. This guidance is the result of the overall cost-benefit analysis by the IASB in considering the needs of nonpublicly accountable entities and their financial reporting users, with the goal of providing a practical alternative to full IFRSs. With this view, the IASB eased certain recognition and measurement requirements by generally allowing only one accounting treatment. The accounting treatment in the standards is generally simpler than that allowed or required by full IFRSs. Also, disclosure requirements are reduced from full IFRSs, and topics not relevant to SMEs have been omitted from the standards. The IASB has further simplified the standards' usability by limiting revisions to *IFRS for SMEs* to once every three years. These simplifications provide a version of IFRSs that is less costly to implement than full IFRSs and perhaps more relevant to the users of SME financial statements.

**.110** Some U.S. private companies may find the simplified *IFRS for SMEs* an attractive alternative to the more complicated and voluminous U.S. GAAP. Those private companies may find *IFRS for SMEs* to be a more relevant and less costly financial accounting and reporting standard than U.S. GAAP. Being based on full IFRSs and missing many accounting topics, *IFRS for SMEs*, therefore, differs from U.S. GAAP in a variety of areas. Some of the key differences under *IFRS for SMEs* are the following:

- Disclosures are simplified in a number of areas, including pensions, leases, and financial instruments.
- Last in, first out (LIFO) is prohibited.
- Goodwill and indefinite life intangible assets are amortized over a period not exceeding 10 years.
- Depreciation is based on a components approach.
- The temporary difference approach to income tax accounting is simplified.
- Reversal of impairment charges, if certain criteria are met, is allowed.
- Accounting for financial assets and liabilities makes greater use of cost.

**.111** Some key challenges that may be present in choosing to use *IFRS for SMEs* include understanding the differences between *IFRS for SMEs* and U.S. GAAP, the willingness of financial statement users to accept financial statements prepared under *IFRS for SMEs*, working with and accepting a more principles-based set of accounting standards compared with the more rules-based U.S. GAAP, the impact on taxes and tax planning strategies, and the impact on financial reporting metrics.

**.112** Entities interested in *IFRS for SMEs*, or possibly adopting the standard, may find it helpful to take the following actions:

- *Monitor the efforts of the AICPA/FAF/NASBA "Blue Ribbon" Panel on Standard Setting for Private Companies*. For more information about the panel, go to www.fasb.org/cs/ContentServer?c=Page&pagename=FASB%2FPage%2FSectionPage&cid=1176156684820.
- *Monitor convergence efforts of FASB and the IASB*.
- *Stay informed on SEC developments*. Public companies will be directly affected by the SEC's decision to adopt IASB standards. The future of private company reporting will also likely be impacted by an SEC mandate to adopt IFRS.
- *Develop a high-level analysis of the potential impact on accounting policies, processes and systems, contracts, legal agreements, and financing and tax structures*.

## Private Company Financial Reporting

**.113** The AICPA and the Financial Accounting Foundation established the "blue-ribbon panel" to address how U.S. accounting standards can best meet the needs of U.S. users of private company financial statements. This panel also is sponsored by the National Association of State Boards of Accountancy. The "blue-ribbon panel" will provide recommendations through an issued report on the future of standard setting for private companies, including whether separate, stand-alone accounting standards for private companies are needed. The panel has discussed how smaller entities are struggling to understand and implement complex standards, which has resulted in entities taking more GAAP exceptions. Other key items include (*a*) whether U.S. GAAP is meeting private company user needs in a cost-beneficial manner for both users and preparers, (*b*) how private company standard setting in the United States compares to standard setting in other countries, and (*c*) possible lessons to be learned from alternatives seen in other countries. The panel's issued report will be made available to the public, and the resulting action plan is expected to be exposed for public comment prior to that plan being finalized. Although no deadline has been set for the panel's work, the recommendations are likely to come in 2010.

**.114** During the July 2010 meeting of the panel, seven alternative models for private company financial reporting were discussed. Models based on IFRSs and a model that would have resulted in no change to private company financial reporting were eliminated. All remaining models would result in differences in GAAP for private and public entities; the main focus of the panel moving forward will be to select a model that is relevant to users of private company financial reports because this has become the overriding issue. The three primary models the panel agreed to focus on going forward are U.S. GAAP with Exclusions for Private Companies—with enhancements; U.S. GAAP—Baseline GAAP with Public Company Add-Ons; and Separate, Stand-Alone GAAP Based on Current U.S. GAAP. Most of the panel members also expressed their discontent with the current make-up of FASB and its heavy, but appropriate, focus on public companies. This led to another key discussion topic: the structure of whatever model is chosen—the current FASB; a restructured FASB (with greater private company representation); or a new, separate Private Company Standards Board under the oversight of the Financial Accounting Foundation.

# Recent Accounting Pronouncements and Related Guidance for Nonpublic Companies

## Recent ASUs

**.115** The following table presents, by codification area, a list of recently issued ASUs, through the issuance of ASU No. 2010-24, *Health Care Entities (Topic 954): Presentation of Insurance Claims and Related Insurance Recoveries (a consensus of the FASB Emerging Issues Task Force)*. However, this table does not include ASUs that are SEC updates (such as ASU No. 2010-19, *Foreign Currency [Topic 830]: Foreign Currency Issues: Multiple Foreign Currency Exchange Rates [SEC Update]*) or ASUs that are technical corrections to various topics. FASB ASC does include SEC content to improve the usefulness of FASB ASC for public companies, but the content labeled as SEC staff guidance does not constitute rules or interpretations of the SEC nor does such guidance bear official SEC approval.

| ***Recent Accounting Standards Updates*** | |
|---|---|
| **Assets Area of Financial Accounting Standards Board *Accounting Standards Codification*** | |
| Accounting Standards Update (ASU) No. 2010-20 (July 2010) | *Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses* |
| ASU No. 2010-18 (April 2010) | *Receivables (Topic 310): Effect of a Loan Modification When the Loan Is Part of a Pool That Is Accounted for as a Single Asset—a consensus of the FASB Emerging Issues Task Force* |
| **Liabilities Area of FASB ASC** | |
| ASU No. 2009-15 (October 2009) | *Accounting for Own-Share Lending Arrangements in Contemplation of Convertible Debt Issuance or Other Financing—a consensus of the FASB Emerging Issues Task Force* |
| **Equity Area of FASB ASC** | |
| ASU No. 2010-01 (January 2010) | *Equity (Topic 505): Accounting for Distributions to Shareholders with Components of Stock and Cash—a consensus of the FASB Emerging Issues Task Force* |
| **Revenue Area of FASB ASC** | |
| ASU No. 2010-17 (April 2010) | *Revenue Recognition—Milestone Method (Topic 605): Milestone Method of Revenue Recognition—a consensus of the FASB Emerging Issues Task Force* |

*(continued)*

| *Recent Accounting Standards Updates* | |
|---|---|
| **Assets Area of Financial Accounting Standards Board *Accounting Standards Codification*** | |
| **Expenses Area of FASB ASC** | |
| ASU No. 2010-13 (April 2010) | *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* |
| **Broad Transactions Area of FASB ASC** | |
| ASU No. 2010-10 (February 2010) | *Consolidation (Topic 810): Amendments for Certain Investment Funds* |
| ASU No. 2010-02 (January 2010) | *Consolidation (Topic 810): Accounting and Reporting for Decreases in Ownership of a Subsidiary—a Scope Clarification* |
| ASU No. 2009-17 (December 2009) | *Consolidations (Topic 810): Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities* |
| ASU No. 2010-11 (March 2010) | *Derivatives and Hedging (Topic 815): Scope Exception Related to Embedded Credit Derivatives* |
| ASU No. 2010-06 (January 2010) | *Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements* |
| ASU No. 2010-09 (February 2010) | *Subsequent Events (Topic 855): Amendments to Certain Recognition and Disclosure Requirements* |
| ASU No. 2009-16 (December 2009) | *Transfers and Servicing (Topic 860): Accounting for Transfers of Financial Assets* |
| **Industry Area of FASB ASC** | |
| ASU No. 2010-16 (April 2010) | *Entertainment—Casinos (Topic 924): Accruals for Casino Jackpot Liabilities—a consensus of the FASB Emerging Issues Task Force* |
| ASU No. 2010-03 (January 2010) | *Extractive Activities—Oil and Gas (Topic 932): Oil and Gas Reserve Estimation and Disclosures* |
| ASU No. 2010-15 (April 2010) | *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* |

| ***Recent Accounting Standards Updates*** | |
|---|---|
| **Assets Area of Financial Accounting Standards Board *Accounting Standards Codification*** | |
| **Industry Area of FASB ASC—continued** | |
| ASU No. 2010-24 (August 2010) | *Health Care Entities (Topic 954): Presentation of Insurance Claims and Related Insurance Recoveries (a consensus of the FASB Emerging Issues Task Force)* |
| ASU No. 2010-23 (August 2010) | *Health Care Entities (Topic 954): Measuring Charity Care for Disclosure—a consensus of the FASB Emerging Issues Task Force* |
| ASU No. 2010-07 (January 2010) | *Not-for-Profit Entities (Topic 958): Not-for-Profit Entities: Mergers and Acquisitions* |
| ASU No. 2009-14 (October 2009) | *Software (Topic 985): Certain Revenue Arrangements That Include Software Elements—a consensus of the FASB Emerging Issues Task Force* |

## Recently Issued Technical Questions and Answers

**.116** The following table presents a list of nonauthoritative accounting and audit and attest technical questions and answers recently issued by the AICPA. Recently issued questions and answers can be accessed at www.aicpa.org/InterestAreas/AccountingAndAuditing/Resources/Pages/RecentlyIssuedTechnicalQuestionsandAnswers.aspx.

| ***Recently Issued Technical Questions and Answers*** **(AICPA, *Technical Practice Aids*)** | |
|---|---|
| **Accounting** | |
| Technical Questions and Answers (TIS) section 6931.12 (July 2010) | "Accounting and Disclosure Requirements for Health and Welfare Plans Related to the COBRA Premium Subsidy Included in the American Recovery and Reinvestment Act of 2009" |
| TIS section 9070.06 (June 2010) | "Decline in Market Value of Assets Subsequent to the Balance Sheet Date" |
| TIS section 6140.25 (June 2010) | "Multiyear Unconditional Promises to Give—Measurement Objective and the Effect of Changes in Interest Rates" |
| TIS section 6140.24 (June 2010) | "Contributions of Certain Nonfinancial Assets, Such as Fundraising Material, Informational Material, or Advertising, Including Media Time or Space for Public Service Announcements or Other Purposes" |

*(continued)*

| ***Recently Issued Technical Questions and Answers* (AICPA, *Technical Practice Aids*)** | |
|---|---|
| **Accounting—continued** | |
| TIS section 6140.23 (June 2010) | "Changing Net Asset Classifications Reported in a Prior Year" |
| TIS section 6930.02 (June 2010) | "Defined Benefit Plan Measurement of a Life Insurance Policy" |
| TIS section 5250.15 (June 2010) | "Application of Certain FASB Interpretation No. 48 (codified in FASB ASC 740-10) Disclosure Requirements to Nonpublic Entities That Do Not Have Uncertain Tax Positions" |
| TIS section 5250.14 (June 2010) | "Application of Financial Accounting Standards Board (FASB) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (codified in FASB *Accounting Standards Codification* [ASC] 740-10) to Taxes Other Than Income Taxes" |
| TIS section 2240.06 (June 2010) | "Measurement of Cash Value Life Insurance Policy" |
| TIS section 2130.40 (June 2010) | "Certificates of Deposit and FASB ASC 320, *Investments—Debt and Equity Securities*" |
| TIS section 2130.39 (June 2010) | "Balance Sheet Classification of Certificates of Deposit" |
| TIS section 2130.38 (June 2010) | "Certificates of Deposit and Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 820, *Fair Value Measurements and Disclosures*" |
| TIS section 1800.05 (June 2010) | "Applicability of Fair Value Disclosure Requirements and Measurement Principles in Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 820, *Fair Value Measurements and Disclosures*, to Certain Financial Instruments" |
| TIS section 6910.33 (December 2009) | "Certain Financial Reporting, Disclosure, Regulatory, and Tax Considerations When Preparing Financial Statements of Investment Companies Involved in a Business Combination" |
| TIS section 2220.27 (December 2009) | "Determining Fair Value of Investments When the Practical Expedient Is Not Used or Is Not Available" |
| TIS section 2220.26 (December 2009) | "Categorization of Investments for Disclosure Purposes" |

| ***Recently Issued Technical Questions and Answers* (AICPA, *Technical Practice Aids*)** | |
|---|---|
| **Accounting—continued** | |
| TIS section 2220.25 (December 2009) | "Impact of 'Near Term' on Classification Within Fair Value Hierarchy" |
| TIS section 2220.24 (December 2009) | "Disclosures—Ability to Redeem Versus Actual Redemption Request" |
| TIS section 2220.23 (December 2009) | "Adjusting NAV When It Is Not Calculated Consistent With FASB ASC 946" |
| TIS section 2220.22 (December 2009) | "Adjusting NAV When It Is Not as of the Reporting Entity's Measurement Date" |
| TIS section 2220.21 (December 2009) | "Determining Whether an Adjustment to NAV Is Necessary" |
| TIS section 2220.20 (December 2009) | "Determining Whether NAV Is Calculated Consistent With FASB ASC 946, *Financial Services—Investment Companies*" |
| TIS section 2220.19 (December 2009) | "Unit of Account" |
| TIS section 2220.18 (December 2009) | "Applicability of Practical Expedient" |
| TIS section 6910.32 (July 2009) | "Additional Financial Statement Disclosures for Nonregistered Investment Partnerships When the Partnership Has Provided Guarantees Related to the Investee Fund's Debt" |
| TIS section 6910.31 (July 2009) | "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" |
| TIS section 6910.30 (July 2009) | "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" |
| TIS section 1600.04 (June 2009) | "Presentation of Assets at Current Values and Liabilities at Current Amounts in Personal Financial Statements" |
| TIS section 1500.07 (June 2009) | "Disclosure Concerning Subsequent Events in OCBOA Financial Statements" |

*(continued)*

| ***Recently Issued Technical Questions and Answers* (AICPA, *Technical Practice Aids*)** | |
|---|---|
| **Audit and Attest** | |
| TIS section 1400.33 (July 2010) | "Combining Financial Statements Prepared in Accordance With the Income Tax Basis of Accounting" |
| TIS section 1800.06 (July 2010) | "Applicability of Fair Value Disclosure Requirements in Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 820, *Fair Value Measurements and Disclosures*, to Financial Statements Prepared in Conformity With a Comprehensive Basis of Accounting Other Than Generally Accepted Accounting Principles" |
| TIS section 8700.03 (June 2010) | "Auditor's Responsibilities for Subsequent Events Relative to a Conduit Debt Obligor" |
| TIS section 9110.16 (February 2010) | "Example Reports on Federal Deposit Insurance Corporation Loss Sharing Purchase and Assumption Transactions" |
| TIS section 8700.02 (September 2009) | "Auditor Responsibilities for Subsequent Events" |
| TIS section 8700.01 (September 2009) | "Effect of FASB ASC 855 on Accounting Guidance in AU Section 560" |

**.117** The AICPA also recently issued two new questions and answers that specifically apply to compilation and review engagements, as follows.

### *TIS section 9150.26, "The Accountant's Responsibilities for Subsequent Events in Compilation and Review Engagements"*

**.118** This question and answer was issued in response to FASB's 2009 addition of subsequent events into accounting literature, which is now codified in FASB ASC 855. This question and answer discusses how the entity's responsibility to disclose the date through which subsequent events have been evaluated (per FASB ASC 855-10-50-1) affects the accountant's responsibilities for subsequent events in a compilation and review engagement. This question and answer points out that FASB ASC 855 does not change the accountant's responsibilities under SSARSs. TIS section 9150.26 is reprinted in its entirety in appendix D, "The Accountant's Responsibilities for Subsequent Events in Compilation and Review Engagements.'"

### *TIS section 9150.27, "The Accountant's Reporting Responsibility With Respect to Subsequent Discovery of Facts Existing at the Date of the Report"*

**.119** This question and answers clarifies that the term *where applicable*, as discussed in paragraph .79(a) of AR section 100, refers to a situation in

which the accountant has not reported on compiled financial statements not intended for third party use. In the case of a review or compilation in which the accountant has issued a report, then a revised accountant's report should be issued and the reason for the financial statement's revision usually should be described in the revised report, as well as in a note to the revised financial statements. TIS section 9150.27 is reprinted in its entirety in appendix E, "The Accountant's Reporting Responsibility With Respect to Subsequent Discovery of Facts Existing at the Date of the Report.'"

## Recent AICPA Independence and Ethics Developments

**.120** The Audit Risk Alert *Independence and Ethics Developments—2010/11* (product no. 0224710) contains a complete update on new independence and ethics pronouncements. This alert will heighten your awareness of independence and ethics matters likely to affect your practice. Obtain this alert by calling the AICPA at (888) 777-7077 or visiting www.cpa2biz.com.

### Establishing and Maintaining Internal Control

**.121** One of the Professional Ethics Executive Committee's (PEEC's) current projects deals with a possible inconsistency within Interpretation No. 101-3. Interpretation No. 101-3 provides examples of general activities that would impair a member's independence, including establishing or maintaining internal controls, including performing ongoing monitoring activities for a client. PEEC recognizes that some practitioners perceive an inconsistency in Interpretation No. 101-3 because certain bookkeeping services and other nonattest services that are permitted under Interpretation No. 101-3 could be viewed as maintaining internal control for the client. For example, bookkeeping is recognized to be part of the Committee of Sponsoring Organizations of the Treadway Commission's information and communication element of internal control. Additionally, some nonattest activities, such as performing calculations (for example, tax provision, leases, LIFO reserve); maintaining ledgers (for example, fixed asset ledger); performing reconciliations; and identifying adjusting journal entries, have been viewed as maintaining the client's controls, regardless of whether management has met the general requirements of Interpretation No. 101-3 (that is, oversees the service, reviews and approves the work. and makes all significant judgments and decisions).

**.122** To address the possible inconsistency in Interpretation No. 101-3, PEEC is considering possible clarifying revisions to Interpretation No. 101-3. The revisions would provide more descriptive language about management responsibilities, which should help members better distinguish between permissible and prohibited nonattest services. Readers are encouraged to monitor the progress of this project.

**.123** PEEC meeting information, including meeting agendas, discussion materials, and minutes of prior meetings, can be found at www.aicpa.org/InterestAreas/ProfessionalEthics/Community/MeetingMinutesandAgendas/Pages/MeetingInfo.aspx.

**.124** Exposure drafts issued by PEEC can be found at www.aicpa.org/InterestAreas/ProfessionalEthics/Community/ExposureDrafts/Pages/ExposureDrafts.aspx.

# New AICPA Products and Publications

**.125** The AICPA has recently developed a brand new guide, *Compilation and Review Engagements*. This guide provides additional information on implementing SSARS No. 19. It includes illustrative engagement and representation letters, sample compilation and review reports, detailed illustrations, and case studies. See www.cpa2biz.com and enter product no. 0128110 for further information. You can also save more than $10 when you purchase both the guide and SSARS No. 19 as a set online using product no. 0129010HI.

# On the Horizon

**.126** Accountants should keep abreast of compilation, review, and accounting developments and upcoming guidance that may affect their engagements. The following sections present brief information about some ongoing projects that have particular significance to your clients or that may result in significant changes. Remember that exposure drafts are nonauthoritative and cannot be used as a basis for changing existing standards.

**.127** Information on, and copies of, outstanding exposure drafts may be obtained from the various standard setters' websites. These websites contain in-depth information about proposed standards and other projects in the pipeline. Many more accounting, compilation, and review projects exist, in addition to those discussed here. Readers should refer to information provided by the various standard setting bodies for further information.

## SSARS Pipeline

### *SSARS Clarity Project*

**.128** In response to growing concerns about the complexity of standards, the ASB commenced a large-scale clarity project to revise all existing auditing standards so they are easier to read and understand. Over the last few years, the ASB has been redrafting all of the existing auditing sections contained in the *Codification of Statements on Auditing Standards* (AU sections of the AICPA's *Professional Standards*) to apply the clarity drafting conventions and converge with the International Standards on Auditing (ISAs) issued by the IAASB. The majority of the clarified standards will be issued in a single SAS codified as AU sections, with each section assigned a section number and title. When the new SAS becomes effective, the SASs issued prior to SAS No. 117, *Compliance Audits* (AICPA, *Professional Standards*, vol. 1, AU sec. 801), will be superseded. The ASB proposes that most redrafted standards become effective at the same time and is working toward completing the project in the first half of 2011.

**.129** In its May 2010 meeting, ARSC agreed to begin working to clarify the current SSARSs literature using the same conventions as the ASB project. The ARSC project is expected to begin in late 2010 and continue through 2011.

### *Codification of Existing SSARSs*

**.130** The issuance of SSARS No. 19 resulted in the separation of the compilation and review engagement framework, compilation standards, and review standards into three new codified sections. These new sections became AR section 60, *Framework for Performing and Reporting on Compilation and Review Engagements*; AR section 80, *Compilation of Financial Statements*; and

AR section 90, *Review of Financial Statements* (AICPA, *Professional Standards*, vol. 2). Once SSARS No. 19 is fully effective, AR section 20, *Defining Professional Requirements in Statements on Standards for Accounting and Review Services*; AR section 50, *Standards for Accounting and Review Services*; and AR section 100 will be removed from *Professional Standards*.

**.131** In addition, those AR sections that were not superseded by SSARS No. 19 will be conformed so that the performance and reporting requirements are consistent with SSARS No. 19. It is expected that the 2011 SSARSs codification will be fully conformed to SSARS No. 19.

### *Consideration of International Compilation and Review Standards*

**.132** The IAASB is currently working on redrafting International Standard on Related Services 4410, *Engagements to Compile Financial Statements*, and International Standard on Review Engagements 2400, *Engagements to Review Financial Statements*.

**.133** The IAASB plans to further deliberate this project at its September 2010 public meeting. ARSC plans to comment on the IAASB proposed standards when such standards are exposed for public comment. Such standards are expected to be exposed by the end of 2010. ARSC will continue to monitor the progress of the IAASB project and consider how any changes to the international compilation and review standards might be converged with the current SSARSs. Further information on the IAASB project is available through the project summary on the IAASB website at www.ifac.org/IAASB.

## Joint FASB and IASB Accounting Pipeline

### *FASB and IASB Memorandum of Understanding*

**.134** FASB expects 2010 to be a pivotal year of progress toward the goal of completing the important projects in the "Memorandum of Understanding" (MoU) during 2011. Since its original issuance in 2006, FASB and the IASB have continued to reaffirm their respective commitments to the development of high quality, compatible accounting standards that could be used for both domestic and cross-border financial reporting. FASB and the IASB agreed that the goal of joint projects is to produce common, principles-based standards, subject to the required due process. Most recently, FASB and the IASB have agreed to intensify their efforts to complete the major joint projects described in the MoU and are committed to developing, and making publicly available, quarterly progress reports on these major projects. The MoU identifies 11 convergence topics:

- Financial instruments
- Consolidations
- Derecognition
- Fair value measurement
- Revenue recognition
- Leases
- Financial instruments with characteristics of equity
- Financial statement presentation
- Other MoU projects
- Other joint projects

**.135** A progress report for the quarter ended March 31, 2010, highlighted the following topics: (*a*) on the financial instruments and insurance contracts topics, the boards have reached different conclusions on significant technical issues that may affect the project timetables of these topics, and (*b*) the boards agreed to explore an alternative approach to lessor accounting that may affect the project timetable of this topic. FASB and the IASB also have several other joint projects in process, including balance sheet—offsetting, emissions trading schemes, and reporting discontinued operations. In March 2010, the exposure draft *Conceptual Framework for Financial Reporting* was published for public comment. In early June 2010, the boards issued a joint statement that discusses the boards' recognition of the challenges that arise from seeking effective global stakeholder feedback. Specifically, the boards were scheduled to expose for comment numerous major exposure drafts during the second quarter of 2010, and stakeholders voiced concern about their ability under those circumstances to provide high-quality input. The boards have developed a modified strategy to accommodate these concerns by prioritizing the major projects in the MoU, staggering the publication of exposure drafts by limiting the number of significant exposure drafts to four per quarter, and issuing a separate consultation document seeking stakeholder input about effective dates and transition methods.

**.136** The priority joint projects are financial instruments, revenue recognition, leases, the presentation of other comprehensive income, and fair value measurements. The boards also decided to issue separate exposure drafts to address differences in the two sets of standards on balance sheet netting of derivative contracts and other financial instruments. The IASB has also made its projects on improved disclosures about derecognized assets and other off balance-sheet risks, consolidations, and insurance contracts priorities. June 2011 or earlier will remain the target completion date for these priority convergence projects; the target completion dates for the nonpriority projects, however, has been extended into the second half of 2011. Additionally, the comments received on exposure drafts will affect the timeline of finalized converged standards. The boards' joint statement states that this action is not expected to negatively impact the SEC's work plan to consider in 2011 whether and how to incorporate IFRSs into the US financial system.

**.137** Readers are encouraged to remain current for the remainder of the exposure draft releases and other developments on convergence through the AICPA's website, www.ifrs.com, in addition to the FASB, IASB, and SEC websites. The growing acceptance of IFRSs as a basis for U.S. financial reporting could represent a fundamental change for the U.S. accounting profession.

### *Comprehensive Income Exposure Draft*

**.138** In May 2010, FASB issued a proposed ASU on comprehensive income that would require an entity to report total comprehensive income in a continuous financial statement in two parts: net income and other comprehensive income. In that financial statement, the components of net income and the components of other comprehensive income should be displayed. The proposed ASU is intended to simplify how comprehensive income is reported by eliminating two options for how items of comprehensive income are displayed. The proposed ASU contains illustrative examples of the revised financial statement. This proposed ASU is the result of a joint project as part of IFRSs and U.S. GAAP convergence, and the IASB has separately issued a similar document. The proposed amendments would be applied on a fully retrospective basis to improve comparability between reporting periods. Further, because compliance

with the proposed amendments is already permitted, early adoption would be permitted. FASB plans to align the effective date with the effective date of the amendments in the proposed ASU on financial instruments. The IASB and FASB aim to finalize an improved and converged standard on other comprehensive income in the fourth quarter of 2010.

### *Financial Instruments Exposure Draft*

**.139** Also, in May 2010, FASB issued a proposed ASU on accounting for financial instruments, derivative instruments, and hedging activities. The main objective of this proposal is to provide financial statement users with a more timely and representative depiction of an entity's involvement in financial instruments while reducing the complexity in accounting for those instruments. It develops a consistent framework for classifying financial instruments, removes the threshold for recognizing credit impairments creating a single credit impairment model for both loans and debt securities, and makes changes to the requirements to qualify for hedge accounting. The main provisions of these amendments are as follows:

- Most financial instruments would be measured at fair value in the statement of financial position each reporting period.
- Hybrid financial instruments containing embedded derivatives that would otherwise have been required to be bifurcated under FASB ASC 815-15 would be classified and measured at fair value in their entirety, with changes accounted for through net income.
- For financial instruments for which an entity's business strategy is to hold for collection or payment(s) of contractual cash flows, a reconciliation from amortized cost to fair value would be required on the statement of position; with the exception of certain liabilities that qualify for the amortized cost option, all other changes in fair value from these instruments would be recognized in other comprehensive income each reporting period. Therefore, net income will remain relatively unchanged because only changes arising from interest accruals, credit impairments, and realized gains and losses would be recognized in net income each reporting period.
- The existing probable threshold for recognizing impairments on loans would be removed. (Currently, FASB ASC 310-10-35-4 states that the concept in U.S. GAAP is that impairment of receivables [including loans] should be recognized when, based on all available information, it is probable that a loss has been incurred based on past events and conditions existing at the date of the financial statements. Probable is defined by FASB ASC 310-10-20 as when the future event or events are likely to occur).
- For changes in value of financial instruments measured through other comprehensive income, an entity is required to determine if a credit impairment is appropriate at the end of each reporting period based on information related to past events and existing economic conditions. An entity would recognize in net income the loss related to the amount of credit impairment for all contractual amounts the entity does not expect to collect.
- Core deposit liabilities would be remeasured each period using a current value method that reflects the economic benefit that an entity receives from this lower cost, stable funding source.

- Interest income would be recognized after considering cash flows that are not expected to be collected, which would better reflect a financial instrument's interest yield.
- Quantitative-based hedging requirements would be replaced with more qualitative-based assessments that would make it easier to qualify for hedge accounting. The shortcut method and critical terms match method would be eliminated. An entity would be able to designate particular risks as the risk being hedged in a hedging relationship, and only the effects of the risks hedged would be reflected in net income.
- Hedge accounting would be discontinued only if the criteria for hedge accounting are no longer met or the hedging instrument expires or is sold, terminated, or exercised. An entity would not be permitted to discontinue hedge accounting by simply removing the designation of a hedging relationship.

**.140** Some specific types of financial instruments, such as pension obligations and leases, would be exempt from the proposed guidance. Additionally, short-term receivables and payables would continue to be measured at amortized cost (plus or minus any fair value hedging adjustments). This proposed ASU was not issued jointly with the IASB and does not contain converged guidance; however, the goal still remains for both boards to issue comprehensive improvements to foster international comparability of financial information about financial instruments. The IASB completed its first phase of classification and measurement with the issuance of IFRS 9, *Financial Instruments*, in November 2009. The IASB also issued two exposure drafts on amortized cost and impairment and fair value option for financial liabilities in late 2009 and mid-2010, respectively; the third topic, hedge accounting, is still being deliberated by the IASB, and an exposure draft is expected in the near term. The boards have stated that they will consider together the comment letters and other feedback received on each boards' exposure drafts in an effort to reconcile their differences in ways that foster improvement and convergence. The effective date of these amendments will be established upon issuance of the final ASU which is expected in the second quarter of 2011; it is estimated to have an effective date in 2013. However, nonpublic entities with less than $1 billion in total consolidated assets would be granted an additional 4 years to implement certain requirements related to loans and core deposits. Upon its application, an entity would apply the proposed guidance by means of a cumulative-effect adjustment to the statement of financial position for the reporting period that immediately precedes the effective date.

### *Revenue Recognition Exposure Draft*

**.141** The revenue recognition project is intended to develop a single, common revenue recognition model that can be applied to a wide range of industries and transaction types. The standards resulting from this project will eliminate weaknesses and inconsistencies between the existing standards. A joint discussion paper issued by the boards proposed a single revenue recognition model. A joint exposure draft, *Revenue from Contracts with Customers*, from the boards was published in June 2010, and the boards aim to issue a final converged standard by the second quarter of 2011. The proposed standard would replace International Accounting Standard (IAS) 18, *Revenue*; IAS 11, *Construction Contracts*; and related interpretations in IFRSs; under U.S. GAAP, it would

supersede most of the guidance contained in FASB ASC 605, *Revenue Recognition*. The core principle of the draft standard is that an entity should recognize revenue from contracts when it transfers goods or services to the customer in the amount of consideration the entity receives, or expects to receive, from the customer.

**.142** In addition to eliminating weaknesses and inconsistencies between IFRSs and U.S. GAAP, this proposal intends to provide a more robust framework for addressing various revenue recognition issues; improve comparability of revenue recognition practices across entities, industries, jurisdictions, and capital markets; and simplify the preparation of financial statements by reducing the number of requirements to which entities must refer. The proposed standard will also amend the existing guidance on recognition of a gain or loss on the sale of some nonfinancial assets that are not an output of the entity's ordinary activities (for example, property, plant, and equipment) to be consistent with the proposed revenue recognition and measurement requirements. To implement the preceding core principle of revenue recognition, an entity would

- identify the contract(s) with the customer.
- identify the separate performance obligations in the contract (*performance obligation* is an enforceable promise [whether explicit or implicit] in a contract with a customer to transfer a good or service to the customer).
- determine the transaction price (*transaction price* is the amount of consideration that an entity receives, or expects to receive, from a customer in exchange for transferring goods or services promised in the contract).
- allocate the transaction price to the separate performance obligations.
- recognize revenue when the entity satisfies each performance obligation by transferring a promised good or service to a customer (a good or service is transferred when the customer obtains control of that good or service).

**.143** The proposal also includes guidance on accounting for some costs. An entity would recognize the costs of obtaining a contract as expenses when incurred. For expenses incurred in fulfilling a contract, if they are ineligible for capitalization in accordance with other guidance, an entity would only be able to recognize an asset if those costs relate directly to a contract (or a specific contract under negotiation); generate or enhance resources of the entity that will be used in satisfying performance obligations in the future; and are expected to be recovered. The proposed guidance would differ from current practice in the following ways: (*a*) recognition of revenue only from the transfer of goods or services, (*b*) identification of separate performance obligations, (*c*) licensing and rights to use, (*d*) effect of credit risk, (*e*) use of estimates, (*f*) accounting for costs, and (*g*) disclosure.

**.144** As discussed previously, because the revenue recognition project is one of many standards the boards expect to issue as converged and final in 2011, the boards plan to invite additional comment through a separate consultation on how best to transition over to the new standards. Therefore, no expected specific effective date is stated at this point. Comments on the exposure draft are due on October 22, 2010. This topic is considered by many to be the most pervasive of any FASB has ever worked on. The reader is encouraged to review

the exposure draft, consider if it is operational to you or your clients' common revenue transactions, and share any resulting concerns with FASB. The boards also anticipate holding public roundtable meetings after the end of the comment period.

## *Fair Value Exposure Draft*

**.145** The fourth and final exposure draft of the second quarter of 2010 was *Fair Value Measurements and Disclosures (Topic 820): Amendments for Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*. The amendments in the exposure draft are intended to result in common fair value measurement and disclosure requirements in financial statements prepared in accordance with U.S. GAAP and IFRSs. Many of the requirements are not intended to result in a change in the application of the requirements in FASB ASC 820; however, some are intended to clarify or change the application of existing fair value guidance. Additionally, some wording changes were made to ensure the guidance is described consistently between U.S. GAAP and IFRSs. The most significant proposed amendments include the following:

- Highest and best use and valuation premise
- Measuring the fair value of an instrument classified in shareholders' equity
- Measuring the fair value of financial instruments that are managed within a portfolio
- Application of blockage factors and other premiums and discounts in a fair value measurement
- Additional disclosures about fair value measurements

**.146** The first two of these significant amendments are intended to clarify the application of existing fair value measurement guidance. The last three of these significant amendments would change a particular principle of fair value guidance.

**.147** The amendments would specify that the concepts of highest and best use and valuation premise in a fair value measurement are relevant only when measuring the fair value of nonfinancial assets, not when measuring the fair value of financial assets or liabilities. The FASB ASC glossary defines *highest and best use* as, in broad terms, the use of an asset by market participants that would maximize the value of the asset or the group of assets within which the asset would be used. The rationale for this proposed change is that the highest and best use concept is irrelevant when measuring the fair value of financial assets or liabilities because these items do not have alternative uses and their fair values do not depend on their use within a group of other assets or liabilities. These changes are not expected to affect the fair value measurement of nonfinancial assets. However, they might affect current practice for reporting entities that apply the in-use valuation premise more broadly.

**.148** The amendments related to measuring the fair value of an instrument classified in shareholders' equity would specify that a reporting entity should measure the fair value of its own equity instrument from the perspective of a market participant who holds the instrument as an asset. An example of an instrument that would be measured at fair value and classified in shareholders' equity is equity interests issued as consideration in a business combination.

Currently, U.S. GAAP does not contain explicit guidance on this topic, and the proposed amendments are expected to increase the comparability among reporting entities applying U.S. GAAP and IFRSs.

**.149** Regarding measuring the fair value of financial instruments that are managed within a portfolio, the proposed amendments would allow an exception to FASB ASC 820 for measuring fair value when a reporting entity manages its net exposure, rather than its gross exposure, to the underlying risks. A reporting entity that holds a group of financial assets and financial liabilities is exposed to interest rate risk, currency risk, or other price risk (market risks) and to the credit risk of each of the counterparties. The proposed guidance is intended to coincide with financial institutions and other similar reporting entities that hold and manage these instruments in that manner. Specifically, a reporting entity could measure the fair value of the financial assets and financial liabilities that are managed in that way on the basis of the price that would be received to sell a net long position (that is, an asset) for a particular risk or to transfer a net short position (that is, a liability) for a particular risk in an orderly transaction between market participants at the measurement date. The proposed amendments would result in U.S. GAAP and IFRSs having the same requirements for measuring the fair value of financial instruments; additionally, these changes would not change how financial assets and financial liabilities that are managed on the basis of a reporting entity's net risk exposure are measured in practice. However, they might affect the current practice for reporting entities that apply the in-use valuation premise more broadly.

**.150** The proposed amendments regarding the application of blockage factors and other premiums and discounts in fair value measurements would make two changes to current guidance. Currently, under U.S. GAAP, use of a blockage factor in fair value measurements is only prohibited when fair value is measured using a quoted price for an asset or a liability (or similar assets or liabilities). This would be level 1 within the fair value hierarchy. The first change from the proposed amendments is that a blockage factor is not relevant and, therefore, also should not be used when fair value is measured using a valuation technique that does not use a quoted price. This would be level 2 or level 3 within the fair value hierarchy. Second, the amendments specify that fair value measurements categorized within level 2 and level 3 take into account other premiums and discounts when market participants would consider those premiums or discounts when pricing an asset or a liability, consistent with the unit of account for that asset or liability. Examples include a control premium or a noncontrolling interest discount. These proposed amendments may affect current practice for any reporting entities applying a blockage factor in fair value measurements that is measured using quoted prices and categorized within level 2 of the fair value hierarchy.

**.151** Lastly, the amendments propose additional disclosures about fair value measurements. More information about the following would be required for disclosure:

- The effect on a fair value measurement of changing one or more unobservable inputs that could have reasonably been used to measure fair value in the circumstances
- Use of an asset in a way that differs from the asset's highest and best use when that asset is recognized at fair value in the statement of financial position on the basis of its highest and best use

- The categorization by level within the fair value hierarchy for items that are not measured at fair value in the statement of financial position but for which the fair value of such items is required to be disclosed

**.152** The effective dates of these proposed amendments would be determined after the feedback from the exposure draft is considered. However, when it is effective, it will be effective as of the beginning of the period of adoption, and an entity would recognize a cumulative effect adjustment in beginning retained earnings in the period of adoption if a difference exists in a fair value measurement of an item recorded at fair value as a result of applying these amendments. Additional disclosures would be required on a prospective basis. These amendments are expected to achieve the objective of developing common fair value measurement and disclosure requirements in U.S. GAAP and IFRSs.

### *Financial Statement Presentation Staff Draft*

**.153** FASB and the IASB are working together to establish a common standard that would improve how information is organized and presented in financial statements. This common standard is intended to address users' concerns that existing requirements permit too many alternative types of presentation and that information in financial statements is highly aggregated and inconsistently presented, making it difficult to fully understand the relationship between an entity's financial statements and its financial results. In 2008, a discussion paper was issued by the boards that outlined the proposed principles for presenting financial statements in a way that portrays a cohesive financial picture of an entity.

**.154** Given the magnitude of this project, the expected implementation costs, and the substantial effects it will have on financial statement presentation for many years to come, the boards decided in May 2010 to modify the strategy for this project. Before finalizing an exposure draft, the boards decided to engage in additional outreach activities that focus on the perceived benefits and costs of the proposals and the implications of the proposals for financial reporting by financial service entities. The boards plan on discussing these two areas of focus with preparers and users of financial statements. This outreach will be based on a rough draft of a proposed standard, known as a *staff draft*, and reflects the cumulative tentative decisions made by the boards, concluding with their joint meeting in April 2010. This staff draft was made publicly available solely for this purpose.

**.155** The proposals in this project would be applicable to all entities, except a benefit plan within the scope of FASB ASC 960, *Plan Accounting—Defined Benefit Pension Plans*; FASB ASC 962, *Plan Accounting—Defined Contribution Pension Plans*; and FASB ASC 965, *Plan Accounting—Health and Welfare Benefit Plans* or IAS 26, *Accounting and Reporting by Retirement Benefit Plans*. The two core financial statement principles in this proposal are cohesiveness and disaggregation. A common structure for the statements of financial position, comprehensive income, and cash flows would be established in the form of required sections, categories or subcategory, and related subtotals. Some proposed specific changes in the classification and format of financial statements include the following:

- Related information would be displayed in the same sections, categories, and subcategory in each statement so that information is more easily associated.

- Presentation of business and financing activities would be separated as follows:
  - — The business section would include items that are part of an entity's daily operations and other income generating activities.
  - — The financing section would include items that are part of an entity's activities to obtain (or repay) capital.
- Discontinued operations and income taxes would be presented in their own separate sections.
- The statement of changes in equity would not include the sections and categories used in the other statements because that statement presents information solely about changes in items classified in the equity category in the statement of financial position.

**.156** Further, FASB plans to propose some changes that are already required by IAS 1, *Presentation of Financial Statements*. The proposal would define, and provide the requirements for, a complete set of financial statements. Currently, a complete set of financial statements for the period is defined only in the FASB Concepts Statements. An entity would also be required to present one period of comparative information. A *complete set of financial statements* would consist of, at a minimum, statements of financial position, comprehensive income, cash flows and changes in equity, and notes to financial statements for two periods (the current period and the previous period). Also, an opening statement of financial position would be part of a complete set of financial statements if an entity applies an accounting principle retrospectively, restates its financial statements, or reclassifies items in the financial statements.

**.157** The boards' tentative decisions on financial statement presentations do differ in a few ways in relation to minimum line requirements for the statement of financial position, segment reporting, and net debt presentation. Of these three, the differing stance on segment reporting is the only significant difference. The boards now aim to issue an exposure draft in the first quarter of 2011 and a final improved and converged standard in the fourth quarter of 2011. Both the introduction to the staff draft and the staff draft can be accessed from FASB's website at www.fasb.org.

### *Leases Exposure Draft*

**.158** During the third quarter of 2010, the IASB and FASB published for public comment joint proposals to improve the financial reporting of lease contracts. These proposals would result in a consistent approach to lease accounting for both lessees and lessors—a right-of-use approach. This would result in the liability for payments arising under the lease contract and the right to use the underlying asset being included in the lessee's statement of financial position, therefore providing more complete and useful information to investors and other users of financial statements. Currently, the accounting for a lease depends on its classification; an operating lease results in the lessee not recording any assets or liabilities in the statement of financial position under either IFRSs or U.S. GAAP, whereas a capital lease results in the lessee recognizing an asset and obligation. Under the proposed guidance, lessees would only have one method of accounting for leases, which would produce more complete and comparable financial reporting, in addition to reducing the opportunity to structure transactions to achieve a desired accounting outcome.

**.159** The scope of the new lease guidance includes all leases (including leases of right-of-use assets in a sublease) other than leases of biological and intangible assets, leases to explore for or use natural resources, and leases of some investment properties. Under this new guidance, all lessees would use a single method of accounting for all leases: an asset would be recognized representing the lessee's right to use the leased (underlying) asset for the lease term (the right-of-use asset), and a liability at the present value of the expected lease payments would also be recognized.

**.160** A lessor would recognize an asset representing its right to receive lease payments and, depending on its exposure to risks or benefits associated with the underlying asset, would either (*a*) recognize a lease liability while continuing to recognize the underlying asset (a performance obligation approach); or (*b*) derecognize the rights in the underlying asset that it transfers to the lessee and continue to recognize a residual asset representing its rights to the underlying asset at the end of the lease term (a derecognition approach). The assets and liabilities recognized by both lessors and lessees would be measured on the basis that

- assumes the longest possible lease term that is more likely than not to occur, taking into account the effect of any options to extend or terminate the lease.
- uses an expected outcome technique to reflect the lease payments, including contingent rentals and expected payments under term option penalties and residual value guarantees, specified by the lease.
- a remeasurement is triggered when changes in facts or circumstances indicate that there would be a significant change in those assets or liabilities since the previous reporting period.

**.161** For leases of 12 months or less, lessors and lessees would be able to apply simplified requirements. The simplified accounting would allow lessees to ignore the effects of interest on the recorded assets and liabilities and allow the lessee to record the liability for lease payments at the undiscounted amount for lease payments. New disclosures would also be required.

**.162** In early 2009, the boards issued a discussion paper on leases; this exposure draft is the result of extensive deliberations that included consideration of input received from investors, preparers, auditors, regulators, and other interested parties since that discussion paper. The comment period is open until December 15, 2010. During the comment period, the boards will undertake further outreach activities, including public round-table meetings to ensure that the views of all interested parties are taken into consideration before the new standard is completed. Also, the boards will share and jointly consider all comment letters received. A final standard is expected in 2011.

## FASB Accounting Pipeline

### *Disclosure of Certain Loss Contingencies*

**.163** In July 2010, FASB issued an exposure draft on the disclosure of certain loss contingencies in response to concerns from investors and other financial statement users that the current disclosures do not provide adequate and timely information to assess the likelihood, timing, and magnitude of future cash outflows associated with loss contingencies. The objective of these

disclosures would be for an entity to disclose qualitative and quantitative information about loss contingencies to enable financial statement users to understand all of the following: the nature of the loss contingencies, their potential magnitude, and their potential timing (if known). Disclosure of certain remote loss contingencies would be required and, therefore, would expand the population of loss contingencies that are required to be disclosed. An entity would not consider the possibility of recoveries from insurance or other indemnification arrangements when assessing the materiality of loss contingencies to determine whether disclosure is required. Further, current qualitative disclosures would be enhanced by requiring additional disclosures. These additional required qualitative and quantitative disclosures include the following:

- For litigation contingencies, the contentions of the parties and how users can obtain more information about the litigation
- Publicly available quantitative information, such as the claim amount for asserted litigation contingencies; other relevant nonprivileged information; and, in some cases, information about possible recoveries from insurance and other sources
- For public entities, tabular reconciliations, by class, of recognized (accrued) loss contingencies that present the activity in the account during the period

**.164** The amendments in this proposal would affect all entities. The exposure draft noted that FASB will continue to work with the Public Company Accounting Oversight Board, the AICPA, and the American Bar Association (ABA) to identify and address any potential implications of the proposed amendments for auditing literature and the ABA's Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information. The proposed amendments would be effective for fiscal years ending after December 15, 2010, for public entities and in the first annual period beginning after December 15, 2010, for nonpublic entities. The comment period ended in September 2010.

### *Going Concern FASB Project*

**.165** Currently, the accounting guidance with respect to going concern resides in the auditing literature, as well as in SSARSs. This project's intention is to appropriately incorporate going concern guidance into U.S. GAAP. Specifically, this guidance would discuss the following:

- Preparation of financial statements as a going concern
- An entity's responsibility to evaluate its ability to continue as a going concern
- Disclosure requirements when financial statements are not prepared on a going concern basis
- Disclosure requirements when there is a substantial doubt about an entity's ability to continue as a going concern
- The adoption and application of the liquidation basis of accounting

**.166** A revised exposure draft is expected to be issued in the fourth quarter of 2010, with a final ASU expected in the first quarter of 2011. FASB has decided that management should take into account available information about the foreseeable future, which is generally, but not limited to, 12 months from the end of the reporting period. Readers should be alert to developments on this topic.

### Other Accounting Projects

**.167** Additionally, FASB has the following projects underway:

- Troubled debt restructuring
- Disclosure framework
- Investment properties

## Resource Central

**.168** The following are various resources that practitioners performing compilation and review engagements may find beneficial.

## PCPS SSARS No. 19 Toolkit

**.169** The PCPS has developed a SSARS No. 19 toolkit to support practitioners with implementing SSARS No. 19 and communicating SSARS No. 19 within the accounting firm and to clients. The SSARS No. 19 toolkit includes the following components:

- *Comparative overview of compilation, review, and audit brochure (available to all AICPA members)*. The level of service provided in an engagement is generally determined by the needs of the client and the requirements of the client's creditors or investors. This customizable brochure is provided to assist practitioners with educating clients in the differences between compilation, review, and audit engagements and has been updated for SSARS No. 19 guidance.
- *SSARS No. 19 frequently asked questions (FAQs) (available only to PCPS member firms)*. The FAQs are intended to address the most common practitioner questions related to applying SSARS No. 19 and include a side-by-side compilation and review comparison grid, as well as illustrative comparison grids of previous and new reporting elements. In addition, they provide links to additional resources needed to further understand and apply SSARS No. 19.
- *SSARS No. 19 overview PowerPoint presentation (available only to PCPS member firms)*. This PowerPoint presentation is designed for practitioners to educate their staff and clients about SSARS No. 19.
- *SSARS No. 19 educate your client communications (available only to PCPS member firms)*. This template can be used by practitioners in newsletters or website communications to educate clients about the differences between the requirements of compilations, reviews, and audits and to communicate the impact of SSARS No. 19 on the client's engagement.
- *SSARS No. 19 management representation checklist for review engagements (available only to PCPS member firms)*. As part of a practitioner's client's review engagements, client management is required to provide the practitioner a written letter that includes documentation about representations made during the review. This checklist is designed to assist the practitioner in requesting representations required for all financial statements and periods covered by the accountant's review report ending on or after December 15, 2010.

**.170** For additional information on the SSARS No. 19 toolkit, refer to www.aicpa.org/InterestAreas/PrivateCompaniesPracticeSection/Resources/KeepingUp/Pages/SSARSNo19Toolkit–PCPSMembers.aspx.

## Publications

**.171** Practitioners may find the following publications useful. Choose the format best for you—online or print.

- SSARS No. 19, *Compilation and Review Engagements* (product no. 060657 [paperback] or 060657PDF [online])
- Guide *Compilation and Review Engagements* (2010) (product no. 0128110 [paperback] or WRC-XX [online])
- Audit Risk Alert *Independence and Ethics Developments—2010/11* (product no. 0224710 [paperback] or WIA-XX [online])
- *Accounting Trends & Techniques, 63rd Edition* (product no. 0099009 [paperback] or WAT-XX [online])
- *IFRS Accounting Trends & Techniques* (product no. 0099109 [paperback] or WIF-XX [online])
- *Audit and Accounting Manual* (2010) (product no. 0051310 [paperback], WAM-XX [online], or AAM-XX [loose leaf])
- Financial Reporting Alert *Current Economic Instability: Accounting Issues and Risks for Financial Management and Reporting—2010* (product no. 0292010 [paperback])

## AICPA Online Professional Library: Accounting and Auditing Literature

**.172** The AICPA has created your core accounting and auditing library online. The AICPA Online Professional Library is now customizable to suit your preferences or your firm's needs. Or, you can sign up for access to the entire library. Get access—anytime, anywhere—to FASB ASC, the AICPA's latest *Professional Standards*, *Technical Practice Aids*, Audit and Accounting Guides, Audit Risk Alerts, *Accounting Trends & Techniques*, and more. One option is the *AICPA Audit and Accounting Guides with* FASB Accounting Standards Codification™, which contains all audit and accounting guides, all audit risk alerts, and FASB ASC in the Online Professional Library (product no. WFA-XX [online]). To subscribe to this essential online service for accounting professionals, visit www.cpa2biz.com.

## Continuing Professional Education

**.173** The AICPA offers a number of continuing professional education (CPE) courses that are valuable to CPAs working in public practice and industry, including the following:

- *AICPA's Annual Accounting and Auditing Update Workshop (2010–2011 Edition)* (product no. 730096 [text] or 180096 [DVD]). Whether you are in industry or public practice, this course keeps you current and informed and shows you how to apply the most recent standards.
- *Internal Control Essentials for Financial Managers, Accountants and Auditors* (product no. 731856 [text], 181856 [DVD/Manual], or

351856 [Additional Manual for DVD]). This course will provide you with a solid understanding of systems and control documentation at the significant process level.

- *International Versus U.S. Accounting: What in the World is the Difference?* (product no. 731668 [text] or 181661 [DVD]). Understanding the differences between IFRSs and U.S. GAAP is becoming more important for businesses of all sizes. This course outlines the major differences between IFRSs and U.S. GAAP.
- *IFRS Essentials with GAAP Comparison: Building a Strong Foundation* (product no. 741602 [text], 181601 [DVD/Manual], or 351601 [Additional Manual for DVD]). This course provides you with a greater understanding of what you need to know as the acceptance of international standards continues to grow.

**.174** Among the many courses, the following are specifically related to compilation and review engagements:

- *Small Business Audit, Compilation and Review Update* (product no. 734522 [text])
- *Accounting Services, Compilations and Reviews: Effective Risk Management* (product no. 732825 [text])
- *Advanced Update for Compilation, Review and Accounting Services* (product no. 731556 [text])
- *Managing Compilation, Review and Accounting Services* (product no. 733482 [text])
- *Performing Compilation and Review Engagements* (product no. 739700 [CD-ROM])
- *Advanced Issues in Compilation, Review and Accounting Services* (product no. 733383 [text])
- *Compilation and Review Engagement Essentials* (product no. 733881 [text])
- *Compilation, Review and Accounting Service Update* (product no. 733373 [text])
- *Compiling Personal Financial Statements* (product no. 733503 [text])
- *InSight: SSARS 19—The New Compilation and Review Standard* (product no. 154230 [online])

**.175** Visit www.cpa2biz.com for a complete list of CPE courses.

**.176** In fall 2010, the AICPA will release on-demand CPE courses, including case studies, that address how to perform a review under SSARS No. 19.

### Online CPE

**.177** AICPA CPExpress, offered exclusively through CPA2Biz, is the AICPA's flagship online learning product. AICPA members pay $180 for a new subscription and $145 for the annual renewal. Nonmembers pay $435 for a new subscription and $375 for the annual renewal. Divided into 1-credit and 2-credit courses that are available 24 hours a day, 7 days a week, AICPA CPExpress offers hundreds of hours of learning in a wide variety of topics. Some topics

of special interest to those performing compilation and review engagements include the following:

- *2010 Annual A&A Update: Compilation and Review Update*
- *Comp and Review Engagements: Current Practices; Accounting & Reporting Issues; Potential Change*
- *Compilations and Reviews: "Introduction and Background" plus "Engagement Planning and Administration"*
- *Drafting Audit, Review, and Compilation Reports*
- *Comp and Review Engagements: Recent SSARS Developments and Current Practice Issues*
- *Intro to Cash and Tax OCBOAs and Their Effects on Procedures in Audits, Reviews, and Compilations*
- *Compilations and Reviews: Independence Considerations*

**.178** To register or learn more, visit www.cpa2biz.com.

## Webcasts

**.179** Stay plugged in to what is happening and earn CPE credit right from your desktop. AICPA webcasts are high quality, two-hour CPE programs that bring you the latest topics from the profession's leading experts. Broadcast live, they allow you to interact with the presenters and join in the discussion. If you cannot make the live event, each webcast is archived and available on CD-ROM. For additional details on available webcasts, please visit www.cpa2biz.com/AST/AICPA_CPA2BIZ_Browse/Store/Webcasts.jsp.

## Member Service Center

**.180** To order AICPA products, receive information about AICPA activities, and get help with your membership questions, call the AICPA Service Operations Center at (888) 777-7077.

## Hotlines

### *Accounting and Auditing Technical Hotline*

**.181** Do you have a complex technical question about review, compilation, accounting, or other technical matters? If so, use the AICPA's Accounting and Auditing Technical Hotline. AICPA staff will research your question and call you back with the answer. The hotline is available from 9 a.m. to 8 p.m. EST on weekdays. You can reach the Technical Hotline at (877) 242-7212 by e-mail at aahotline@aicpa.org, or online at www.aicpa.org/Research/TechnicalHotline/Pages/TechnicalHotline.aspx. Additionally, members can submit questions by completing a Technical Inquiry form found on the same website.

### *Ethics Hotline*

**.182** In addition to the Technical Hotline, the AICPA also offers an Ethics Hotline. Members of the AICPA's Professional Ethics Team answer inquiries concerning independence and other behavioral issues related to the application of the AICPA Code of Professional Conduct. You can reach the Ethics Hotline at (888) 777-7077 or by e-mail at ethics@aicpa.org.

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## Appendix A—Additional Internet Resources

Here are some useful websites that may provide valuable information to accountants.

| *Website Name* | *Content* | *Website* |
|---|---|---|
| AICPA | Summaries of recent auditing and other professional standards, as well as other AICPA activities | www.aicpa.org www.cpa2biz.com www.ifrs.com |
| AICPA Financial Reporting Executive Committee (formerly known as Accounting Standards Executive Committee [AcSEC]) | Summaries of recently issued guides, technical questions and answers, and practice bulletins containing financial, accounting, and reporting recommendations, among other things | www.aicpa.org/InterestAreas/AccountingAndAuditing/Community/FINREC/Pages/FinREC.aspx |
| AICPA Accounting and Review Services Committee | Summaries of review and compilation standards and interpretations | www.aicpa.org/InterestAreas/AccountingAndAuditing/Community/AccountingReviewServicesCommittee/Pages/ARSC.aspx |
| AICPA Professional Issues Task Force | Summaries of practice issues that appear to present concerns for practitioners and disseminate information or guidance, as appropriate, in the form of practice alerts | www.aicpa.org/InterestAreas/AccountingAndAuditing/Resources/AudAttest/AudAttestGuidance/Pages/PITFPracticeAlerts.aspx |
| Economy.com | Source for analyses, data, forecasts, and information on the U.S. and world economies | www.economy.com |
| The Federal Reserve Board | Source of key interest rates | www.federalreserve.gov |
| Financial Accounting Standards Board (FASB) | Summaries of recent accounting pronouncements and other FASB activities | www.fasb.org |

| *Website Name* | *Content* | *Website* |
|---|---|---|
| USA.gov | Portal through which all government agencies can be accessed | www.usa.gov |
| Government Accountability Office | Policy and guidance materials and reports on federal agency major rules | www.gao.gov |
| Governmental Accounting Standards Board (GASB) | Summaries of recent accounting pronouncements and other GASB activities | www.gasb.org |
| International Accounting Standards Board | Summaries of International Financial Reporting Standards and International Accounting Standards | www.iasb.org |
| International Auditing and Assurance Standards Board | Summaries of International Standards on Auditing | www.iaasb.org |
| International Federation of Accountants | Information on standards setting activities in the international arena | www.ifac.org |
| Private Company Financial Reporting Committee | Information on the initiative to further improve FASB's standard setting process to consider needs of private companies and their constituents of financial reporting | www.pcfr.org |

**.184**

## Appendix B—Significant Change to Compilation Reporting Requirements When Independence Is Impaired

During its November 2009 meeting, the AICPA's Accounting and Review Services Committee (ARSC) removed, at the urging of many local and smaller firm CPAs and certain user groups, a prohibition against stating the reasons why an accountant was not independent when performing a compilation service.

Many accountants are finding that their independence with respect to a compilation client is impaired for a number of reasons. Examples of impairments include the performance of certain nonattest services, ownership in the client's business, or having certain relationships with the client. Prior to the issuance of Statement on Standards for Accounting and Review Services (SSARS) No. 19, *Compilation and Review Engagements* (AICPA, *Professional Standards*, vol. 2), an accountant was prohibited from including in his or her compilation report the reasons for an impairment of independence. An accountant could only state that he or she was not independent. Consequently, users who wanted to understand the reasons for an independence impairment needed to contact the client or the accountant for more information. Because of this interest on the part of users and to improve the overall transparency in the compilation report, ARSC decided to remove the prohibition and allow an accountant, if he or she chooses, to state the reasons for an independence impairment in the compilation report.

Although most provisions of SSARS No. 19 will not be effective until on or after December 15, 2010, ARSC felt that it was important to permit accountants to disclose the reasons for an independence impairment in the compilation report as soon as practicable. Therefore, the standard has an exception that this specific provision (set forth in paragraph 2.21 [AR sec. 80 par. .21] of SSARS No. 19) may be implemented early. This appendix discusses, in a question and answer format, this specific paragraph and the alternatives that will now be available to accountants.

*Question*—To what compilation engagements does SSARS No. 19 apply?

*Answer*—SSARS No. 19 applies to compilations of financial statements and other specified elements, accounts, or items of a financial statement and pro forma financial information performed in accordance with SSARSs. SSARS No. 19 does not apply to engagements to compile prospective financial information. Such engagements would be performed in accordance with AT section 301, *Financial Forecasts and Projections* (AICPA, *Professional Standards*, vol. 1). Paragraph .23 of AT section 301 states that the reason for a lack of independence should not be described in the compilation report.[1]

*Question*—When may I start describing the reasons for lack of independence in my compilation report?

*Answer*—SSARS No. 19 was issued in December 2009. Therefore, you may begin using the provision in paragraph 2.21 (AR sec. 80 par. .21).

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[1] In June 2010, the Accounting and Review Services Committee released a proposed Statement on Standards for Attestation Engagements (SSAE), *Reporting on Compiled Prospective Financial Statements When the Practitioner's Independence Is Impaired*. This proposed SSAE would revise the attestation standards to permit the disclosure of the reasons for an independence impairment in such compilation reports. For the current status of this project, visit www.aicpa.org.

*Question*—May I disclose the reasons for the lack of independence only for December 2009 compilations and subsequent periods, or may I use it for earlier compilations (for example, November 2009 compilations)?

*Answer*—You may disclose the reasons for a lack of independence in a November (or earlier) compilation report as long as your report is released (or reissued) after December 30, 2009, which was the official issuance date of SSARS No. 19.

*Question*—May I start using the new standard compilation report illustrated in SSARS No. 19 now?

*Answer*—No. The effective date of SSARS No. 19 is for compilations and reviews of financial statements for periods ending on or after December 15, 2010. Early implementation of the new standard is not permitted, except for the one paragraph permitting disclosure of the reasons for a lack of independence in the compilation report. Therefore, you cannot use the new standard compilation report until SSARS No. 19 becomes effective.

*Question*—Does SSARS No. 19 require me to state the reasons why I'm not independent with respect to a compilation client?

*Answer*—No. SSARS No. 19 permits, but does not require, the accountant to disclose the reasons. You may simply state that you are not independent with respect to the client without disclosing the reasons.

*Question*—May I disclose the reasons for the lack of independence in one period and then not disclose the reasons in a subsequent period for the same client?

*Answer*—Yes. Each period for which a compilation report is issued for a client is treated as a separate compilation. For example, you may decide to disclose the reasons in a compilation report on financial statements for the period ended March 31, 2010, and then decide to not disclose the reasons in a compilation report on financial statements for the period ended June 30, 2010, or vice versa.

*Question*—Are there factors that I should consider before deciding to disclose the reason(s) for the impairment?

*Answer*—An accountant should exercise his or her professional judgment in making that decision. That judgment might include consideration of such factors as the number of reasons for independence impairment or the ability of the user of the compiled financial statements to understand the nature of the impairments.

Paragraph 2.21 (AR sec. 80 par. .21) of SSARS No. 19 states in part, "If the accountant elects to disclose a description about the reasons his or her independence is impaired, the accountant should ensure that all reasons are included in the description." Therefore, if the accountant's independence is impaired for three reasons (for example, ownership, nonattest services, and family relationships), the accountant may decide that describing all three would make the report too lengthy or too confusing. Consequently, the accountant might decide to stay with the extant language and merely say that he or she is not independent. On the other hand, an accountant who is providing a nonattest service that impairs independence may feel that this information would be beneficial for users to know. Therefore, that accountant may decide to disclose the reason.

*Question*—Are there any limitations on what the report may say?

*Answer*—No. ARSC did not prescribe any requirements except that if an election is made to describe, then all the reasons for the impairment must be described. That means that an accountant could, if he or she chooses, write a paragraph three pages long to describe the reasons for the impairment. Although that

P1: PjU
ACPA165-CRA ACPA165.cls October 7, 2010 21:34



length certainly isn't expected, ARSC anticipates and expects that some accountants will go into far greater detail than will others.

*Question*—Assuming an accountant is not independent for two reasons (for example, a family relationship and ownership) does each reason need to be in a separate paragraph?

*Answer*—No. An accountant may combine the reasons into a single paragraph. For example, assuming the accountant held an ownership interest in the client and the accountant's spouse was the CFO of the company, a description paragraph may be drafted, such as the following:

> I am not independent with respect to XYZ Company as of and for the year ended December 31, 2010, because I am a minority shareholder in XYZ Company and my spouse is an officer of XYZ Company.

*Question*—Assuming an accountant's independence is impaired because the accountant maintains a number of controls for the client, does each area of internal control need to be listed by the accountant, or may the accountant merely say that his or her independence is impaired because he or she maintained internal controls?

*Answer*—The provision is flexible and allows an accountant to provide as much detail as he or she feels appropriate in the circumstances. Therefore, the accountant may either state the areas of internal control maintained by the accountant or provide a general description of the reason or give no reason at all and merely say that he or she is not independent. In making this decision, the accountant should make sure that his or her description is not misleading. For example, if the accountant is maintaining only small aspects of internal control over financial reporting, the accountant would not want to describe the reason by saying that he or she is maintaining all controls for the client. Such a statement would be misleading and inaccurate.

*Question*—May this provision be used for review reports as described in the exposure draft?

*Answer*—No. Although the exposure draft did include a situation whereby an accountant could design or operate aspects of internal control over financial reporting for a client and also perform a review, this provision was not included in the final standard. Paragraph 3.2 (AR sec. 90 par. .02) of SSARS No. 19 states that the accountant is precluded from performing a review engagement if the accountant's independence is impaired for any reason.

*Question*—Where should I go if I have additional questions?

*Answer*—Members having additional questions regarding any of the provisions of SSARS No. 19 should contact the AICPA's accounting and auditing hotline at 1-877-242-7212, through e-mail at aahotline@aicpa.org, or through the following website: www.aicpa.org/Research/TechnicalHotline/Pages/Accounting AuditingTechnicalHelpQA.aspx.

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## Appendix C—"Changes on Tap for Compilation and Review Standards"

Significant changes to the standards for compilation and review engagements will soon take effect. The AICPA's Accounting and Review Services Committee (ARSC) issued Statement on Standards for Accounting and Review Services [SSARS] No. 19, *Compilation and Review Engagements* [(AICPA, *Professional Standards*, vol. 2)], in December [2009]. The standard's effective date is for compilations and reviews of financial statements for periods ending on or after Dec. 15, 2010, with early implementation permitted for the new reporting option for compilation engagements when the accountant's independence is impaired. This article discusses the major changes made by the standard.

### Disclosure of Reasons for Lack of Independence

SSARS No. 19 contains the most significant changes to the professional literature for compilation and review engagements since SSARS No. 1, *Compilation and Review of Financial Statements* [(AICPA, *Professional Standards*, vol. 2, AR sec. 100)], was issued in December 1978. For more than 30 years, accountants have been required to disclose in the compilation report if they are not independent but have been prohibited from disclosing the reasons. It was thought that while it was important for users to know whether the accountant was independent, the reasons were not relevant and, in fact, could cause confusion among financial statement users.

However, with the increasing complexity of new accounting standards, many smaller companies are asking for their accountant's assistance in preparing high-quality, reliable financial statements. This assistance, which often includes preparing and posting payroll and payroll reports, maintaining the general ledger, and preparing and recording journal entries, may cause the accountant to impair his or her independence.

As a result, members advised ARSC that third-party users (primarily bankers) wanted to know and understand the reasons for the impairment. What ARSC found out is that many bankers view a technical impairment caused by the accountant's involvement in a client's system of internal control different from an impairment caused by a financial interest or a relationship with the client.

After studying the issue, ARSC developed the new standard so that the accountant has the option, but is not required, to disclose the reasons for an independence impairment in a compilation report. The only caveat is that, if the accountant does decide to disclose the reasons for an independence impairment, *all* reasons must be disclosed. The result will be reports that are more transparent and useful to users of compiled financial statements.

### Separating Compilation Guidance From Review Guidance

Another significant change is the separation of the compilation guidance from the review guidance. SSARS No. 19 supersedes AR sections 20, *Defining Professional Requirements in Statements on Standards for Accounting and Review Services*; 50, *Standards for Accounting and Review Services*; and 100, *Compilation and Review of Financial Statements* [(AICPA, *Professional Standards*,

P1: PjU
ACPA165-CRA ACPA165.cls October 7, 2010 21:34



vol. 2)]. In the place of those AR sections, the requirements and guidance will be separated into the following sections:

- Framework for Performing and Reporting on Compilation and Review Engagements
- Compilation of Financial Statements
- Review of Financial Statements

This change was in direct response to member comments that they had difficulty in researching the existing literature since the requirements and guidance for compilation and review engagements were presented together. For example, under the pre-SSARS No. 19 standards, an accountant looking to understand the compilation standards would have to sort through both compilation and review guidance because they were presented together. Now, the framework and compilation sections contain all the necessary requirements and guidance. In fact, an accountant who just performs compilations can rip the framework and compilation sections out of the [*Codification of Statements on Standards for Accounting and Review Services*] and have all of the professional literature that he or she needs.

## Clarification of Review Performance Procedures

Another important change was made in the review standards where ARSC felt more guidance around the planning of review procedures was needed. ARSC noted that, to properly plan the nature and extent of review procedures, an accountant cannot merely use a canned list of analytical and inquiry procedures. Rather, an accountant should tailor those procedures, taking into consideration those areas where the accountant believes there are increased risks of misstatements. In that respect, a review engagement is not simply a compilation engagement with a few additional procedures layered on top. A review is an assurance engagement and needs to be planned and performed to obtain a limited level of assurance that the financial statements are free of material misstatement.

A review engagement requires the accumulation of *review evidence* that will provide the accountant with a reasonable basis for obtaining *limited assurance* that there are no material modifications that should be made to the financial statements for the statements to be in accordance with the applicable financial reporting framework.[1] That compares to an auditor's objective, which is to accumulate greater evidence to obtain a reasonable or high level of assurance. Limited assurance can generally be obtained by performing analytical and inquiry procedures whereas an audit contemplates much greater testing through inspection, observation, confirmation, and the examination of source documents.

While SSARS No. 19 does not require the accountant to ordinarily perform procedures beyond analytical procedures and inquiries, it does require the accountant to use professional judgment in determining the specific procedures

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[1] [The *applicable financial reporting framework* is the financial reporting framework adopted by management and, when appropriate, those charged with governance in the preparation of the financial statements that is acceptable in view of the nature of the entity and the objective of the financial statements, or that is required by law or regulation. They include, for example, accounting principles generally accepted in the United States, the cash basis of accounting, or the income tax basis of accounting.]

and tailor those procedures accordingly. A trend analysis may be an appropriate analytical procedure for client A; however, that same analysis may not be appropriate for client B. Additionally, the inquiries that are made to management should be tailored. The accountant should tailor his or her analytical procedures and inquiries to that specific client based on an understanding of the industry, knowledge of the client, and awareness of the risk that the accountant may unknowingly fail to modify his or her review report on financial statements that are materially misstated.

SSARS No. 19 also attempts to clear up the misconception that a review engagement is always limited to analytical procedures and inquiries. If the accountant performs a trend analysis and the results indicate that accounts receivable increased by an unexpected amount and the client's response to the accountant's inquiry does not satisfy the accountant, other procedures should be performed. Such other procedures may include making additional inquiries of client management or personnel, performing additional analyses, or confirming certain receivables. A mistaken assumption is that once an "audit-type" procedure is performed, the accountant is required to perform an audit. Although certain procedures are ordinarily performed in an audit and not in a review, the accountant should perform additional procedures he or she believes necessary to obtain limited assurance that the financial statements are free of material misstatement when the accountant becomes aware that there may be a material misstatement.

## Documenting the Understanding With Management

SSARS No. 19 does not change the accountant's requirement to establish an understanding with the client's management regarding the services to be performed with respect to both compilation and review engagements. However, whereas previous standards stated that it is preferable that the understanding be in writing, SSARS No. 19 *requires* that the understanding be in writing. For accountants who have established the understanding verbally with their clients in the past, this will be a change in practice and may necessitate discussions with the client.

Accountants should be aware that SSARS No. 19 leaves open the "engagement" that the written understanding should cover. For example, if the accountant is to compile monthly financial statements and then review the year-end financial statements, the accountant can obtain one engagement letter. That letter would cover the entire year. Therefore, SSARS No. 19 does not require a separate engagement letter for the compilation and another letter for the year-end review.

The accountant can even obtain an engagement letter that covers multiple years; however, such documentation is discouraged since the understanding would be less clear as time goes on. It is recommended that the accountant document the understanding with the client's management regarding the services to be performed at least annually.

## Enhanced Requirements for Compilation Documentation

Prior to SSARS No. 19, in a compilation engagement, the accountant was only required to document the understanding with the client's management regarding the services to be performed if the accountant availed himself or herself of the nonreporting option provided for compiled financial statements not intended for third-party use and any communications to the appropriate level of

management with respect to suspected fraud or illegal acts. SSARS No. 19 expands the documentation requirements for compilation engagements, requiring documentation of the understanding with the client's management regarding the services to be performed for all engagements and any findings or issues that, in the accountant's judgment, are significant. The accountant is still required to document any communications to the appropriate level of management regarding fraud or illegal acts.

A compilation is limited to assisting management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements for the statements to conform to the applicable financial reporting framework. In the cleanest of compilations, the accountant simply takes the client's data and puts it in the form of financial statements. However, if during the process, the accountant questions whether some of the amounts in the financial statements may be misstated, then those questions and how they're resolved are likely to be significant issues that should be documented. The documentation could be the issue that the accountant raised and management's response to the accountant's inquiry. . . .

## Review Documentation Changes

The documentation procedures for a review engagement are likewise enhanced and expanded. The accountant is now required to document the establishment of an understanding with the client's management regarding the services to be performed for all review engagements.

The accountant is now also required to document management's responses to inquiries regarding fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount. The accountant is required to document the significant matters covered in his or her inquiry procedures and the responses received. This may be accomplished by using a memorandum, checklist, or other means. Any findings or issues that, in the accountant's judgment, are significant must be documented, such as the results of review procedures that indicate the financial statements could be materially misstated, including actions taken to address such findings, and the basis for the final conclusions reached. . . .

## New Compilation and Review Reports

SSARS No. 19 revises the reporting requirements for compilation and review engagements to make the reports clearer as to management's responsibilities and the accountant's responsibility. In addition to the new compilation reporting option when the accountant's independence is impaired, the compilation reporting requirements require a title that clearly indicates that it is the accountant's compilation report. The accountant may indicate that he or she is independent in the title, if appropriate. Examples of appropriate titles would be "Accountant's Compilation Report" or "Independent Accountant's Compilation Report." The report is also required to be addressed as appropriate in the circumstances.

The revised illustrative compilation report splits the report into three clear paragraphs. The introductory paragraph identifies the entity whose financial statements have been compiled; states that the financial statements have been compiled; identifies the financial statements that have been compiled; specifies the date or period covered by the financial statements; and includes a

statement that the accountant has not audited or reviewed the financial statements and, accordingly, does not express an opinion or provide any assurance about whether the financial statements are in accordance with the applicable financial reporting framework.

The second paragraph states management's responsibility for the financial statements and for internal control over financial reporting. The third paragraph states the accountant's responsibility to conduct the compilation in accordance with SSARSs issued by the AICPA and the objective of the compilation. [Refer to the "New Reports for Compilations and Reviews of Financial Statements Ending on or After December 15, 2010" section of this alert to see a comparison of the pre-SSARS No. 19 compilation report and the new report.]

With respect to the review report, SSARS No. 19 requires that the accountant's review report have a title that clearly indicates that it is the accountant's review report and includes the word "independent." An appropriate title would be "Independent Accountant's Review Report." In addition, the accountant's report should be addressed as required by the circumstances of the engagement.

The illustrated review report is separated into four paragraphs. The introductory paragraph identifies the entity whose financial statements have been reviewed, states that the financial statements have been reviewed, identifies the financial statements that have been reviewed, specifies the date or period covered by the financial statements, and includes a statement that a review consists of primarily applying analytical procedures to management's financial data and making inquiries of company management. It also includes a statement that a review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole, and that, accordingly, the accountant does not express such an opinion.

The second paragraph states management's responsibility for the financial statements and for internal control over financial reporting. The third paragraph states that the accountant's responsibility is to conduct the review in accordance with SSARSs issued by the AICPA, that those standards require the accountant to perform the procedures to obtain limited assurance that there are no material modifications that should be made to the financial statements, and that the accountant believes that the results of his or her procedures provide a reasonable basis for his or her report.

The fourth paragraph states that, based upon his or her review, the accountant is not aware of any material modifications that should be made to the financial statements for them to be in conformity with the applicable financial reporting framework, other than those modifications, if any, indicated in the report. [Refer to the "New Reports for Compilations and Reviews of Financial Statements Ending on or After December 15, 2010" section of this alert to see a comparison of the pre-SSARS No. 19 review report and the new report.]

## Changes From April 2009 Exposure Draft

In April 2009, ARSC exposed for public comment a trio of proposed standards that eventually became SSARS No. 19. During the comment period, the committee received 169 comment letters.

SSARS No. 19 differs from the exposure draft in two major ways. First, ARSC decided to retain the concept of *limited assurance* rather than *moderate assurance* as proposed in the exposure draft. ARSC had proposed using the term *moderate assurance* to describe the level of assurance that the accountant aims to obtain in a review engagement in order to harmonize with the terminology

used in the international review standards. However, after the exposure draft was issued, the International Audit and Assurance Standards Board began a project to revise the international review standards. ARSC determined that it would be inappropriate to conform to a document currently under revision and, accordingly, tabled the proposed change.

The other major difference is that the proposed nonindependent review is not part of the final standard. ARSC received a number of comments on this proposal, both for and against. As a result of the great interest in this topic, ARSC decided to defer this issue so it could hold additional meetings with key stakeholders. These additional meetings will be used to further discuss with stakeholders the issues that many smaller firm accountants face in trying to serve their small business clients.

At issue is whether performing a nonattest service to help smaller businesses establish or maintain aspects of their internal control over financial reporting, the purpose of which is to improve the reliability of the client's financial statements, impairs an accountant's independence. ARSC will revisit the topic during its public meetings in 2010 but remains committed to allowing practitioners to review financial statements when they also perform services that are intended to assist the client in preparing reliable, high-quality financial statements.

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**.186**

## Appendix D—"The Accountant's Responsibilities for Subsequent Events in Compilation and Review Engagements"

*Inquiry*—FASB *Accounting Standards Codification* (ASC) 855-10-50-1 states, "An entity shall disclose the date through which subsequent events have been evaluated, as well as whether that date is the date the financial statements were issued or the date the financial statements were available to be issued." How does the entity's responsibility to disclose the date through which subsequent events have been evaluated affect the accountant's responsibilities for subsequent events in a compilation or review engagement?

*Reply*—FASB ASC 855, *Subsequent Events*, does not change the accountant's responsibilities under AR section 100, *Compilation and Review of Financial Statements* (AICPA, *Professional Standards*, vol. 2), which states that an accountant performing a review engagement should inquire of members of management who have responsibility for financial and accounting matters concerning events subsequent to the date of the financial statements that could have a material effect on the financial statements. In a compilation engagement, the accountant does not have any responsibility with respect to subsequent events unless evidence or information comes to the accountant's attention that a subsequent event that has a material effect on the financial statements has occurred. When such evidence or information comes to an accountant's attention during a compilation or review engagement, the accountant should request that management consider the possible effects on the financial statements, including the adequacy of any related disclosure. If the accountant determines that a subsequent event is not appropriately accounted for in the financial statements or disclosed in the notes, he or she should follow the guidance in paragraphs .56–.58 of AR section 100 regarding departures from generally accepted accounting principles.

Because the accountant's compilation or review report should be dated as of the completion of the compilation or review procedures, the date of the accountant's compilation or review report can never be earlier than management's subsequent event note date.

In a review engagement, because the accountant is concerned with events occurring through the date of the review report that may require adjustment to, or disclosure in, the financial statements, the specific management representations relating to information concerning subsequent events should be made as of the date of the accountant's review report.

In most cases, the date that management discloses as the date through which they have evaluated subsequent events (in the notes to the financial statements and, in a review engagement, in the management representation letter) will be the same date as the accountant's compilation or review report. In order to coordinate that these dates (the note date, the representation letter date [in a review engagement], and the accountant's compilation or review report date) are the same, the accountant may want to discuss these dating requirements with management in advance of beginning the compilation or review engagement. The accountant also may want to include, in the accountant's understanding

with the client regarding the services to be performed (engagement letter), that management will not date the subsequent event note earlier than the date of management's representations (in a review engagement) and the date of the accountant's compilation or review report.

**.187**

## Appendix E—"The Accountant's Reporting Responsibility With Respect to Subsequent Discovery of Facts Existing at the Date of the Report"

*Inquiry*—Paragraphs .77–.82 of AR section 100, *Compilation and Review of Financial Statements* (AICPA, *Professional Standards*, vol. 2), provide requirements and guidance when the accountant becomes aware that facts may have existed at the date of the accountant's compilation or review report (or the date of submission of compiled financial statements not intended for third party use in which the accountant does not report) that might have caused him or her to believe that information supplied by the entity was incorrect, incomplete, or otherwise unsatisfactory had the accountant then been aware of such facts.

Paragraph .79(a) states that when the accountant has concluded that action should be taken to prevent further use of the accountant's report or the financial statements, and the effect on the accountant's report or the financial statements of the subsequently discovered information can promptly be determined,

> disclosure should consist of issuing, as soon as practicable, revised financial statements and, where applicable, the accountant's report. The reasons for the revision usually should be described in a note to the financial statements and, where applicable, referred to in the accountant's report. Generally, only the most recently-issued compiled or reviewed financial statements would need to be revised, even though the revision resulted from events that had occurred in prior years.

What does the term where applicable refer to in paragraph .79(a)?

*Reply*—The use of the term where applicable refers to a situation in which the accountant has not reported on compiled financial statements not intended for third party use. In the case of a review or a compilation in which the accountant has issued a report, then a revised accountant's report should be issued and the reason for the financial statement's revision usually should be described in the accountant's revised report as well as in a note to the revised financial statements.