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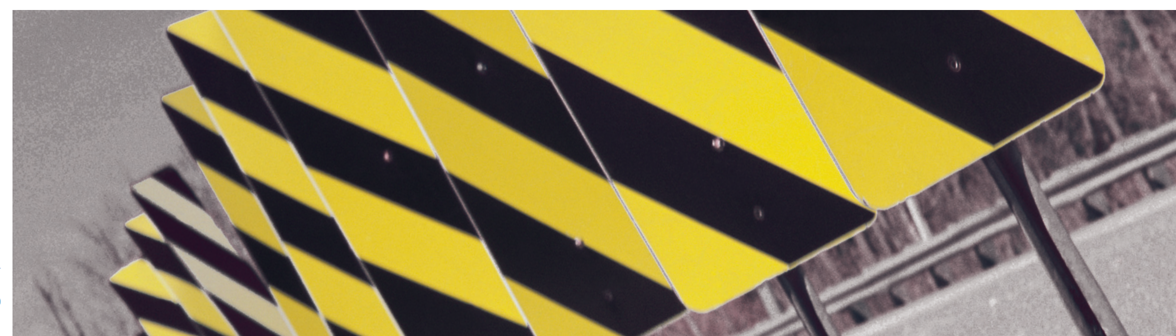
Audit Risk Alert: 2010/11 General Accounting and Auditing Developments

AICPA

2010/11

General Accounting and Auditing Developments

AUDIT RISK ALERT



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2010/11

General Accounting and Auditing Developments

AUDIT RISK ALERT

Strengthening Audit Integrity
Safeguarding Financial Reporting

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Notice to Readers

This Audit Risk Alert replaces *Current Economic Instability: Accounting and Auditing Considerations—2009*.

This Audit Risk Alert is intended to provide auditors of financial statements with an overview of recent economic, industry, technical, regulatory, and professional developments that may affect the audits and other engagements they perform. This Audit Risk Alert also can be used by an entity's internal management to address areas of audit concern.

This publication is an *other auditing publication*, as defined in AU section 150, *Generally Accepted Auditing Standards* (AICPA, *Professional Standards*, vol. 1). Other auditing publications have no authoritative status; however, they may help the auditor understand and apply the Statements on Auditing Standards.

If an auditor applies the auditing guidance included in an other auditing publication, he or she should be satisfied that, in his or her judgment, it is both relevant to the circumstances of the audit and appropriate. The auditing 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 Keira A. Kraft provided in creating this publication.

Feedback

This Audit Risk Alert is published annually. As you encounter audit or accounting issues that you believe warrant discussion in next year's Audit Risk Alert, please feel free to share them with us. Any other comments that you have about the Audit Risk Alert also would be appreciated. You may e-mail these comments to A&APublications@aicpa.org.

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How This Alert Helps You

.01 This Audit Risk Alert (alert) helps you plan and perform your audits and also can be used by an entity's internal management. This alert provides information to assist you in achieving a more robust understanding of the business, economic, and regulatory environments in which your clients operate. This alert is an important tool to help you identify the significant risks that may result in the material misstatement of financial statements and delivers information about emerging practice issues and current accounting, auditing, and regulatory developments. You should refer to the full text of accounting and auditing pronouncements, as well as the full text of any rules or publications that are discussed in this alert.

.02 It is essential that the auditor understand the meaning of audit risk and the interaction of audit risk with the objective of obtaining sufficient appropriate audit evidence. In AU section 312, *Audit Risk and Materiality in Conducting an Audit* (AICPA, *Professional Standards*, vol. 1), *audit risk* is broadly defined as the risk that the auditor may unknowingly fail to appropriately modify his or her opinion on financial statements that are materially misstated. Further, paragraph .04 of AU section 314, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement* (AICPA, *Professional Standards*, vol. 1), explains that the auditor should use professional judgment to determine the extent of the understanding required of the entity and its environment. The auditor's primary consideration is whether the understanding that has been obtained is sufficient to assess risks of material misstatement of the financial statements and to design and perform further audit procedures.

Economic, Legislative, and Regulatory Developments

The Current Economy

.03 When planning and performing audit engagements, an auditor 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.

.04 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 (DJIA) 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 relatively unmoved 5 months later, in mid-August 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. The Chicago Board Options Exchange Volatility

Index (VIX) is a key measure of market expectations of near-term volatility conveyed by S&P 500 stock index options prices and is considered by many to be a barometer of investor sentiment, market volatility, and the best gauge of fear in the market. In 2008, the high closing price of VIX was 80.86; during 2009, the high closing price was 56.65—a substantial decrease from the peak of the financial crisis. Through mid-August 2010, the peak closing price for the year has been 45.79, which occurred in late May (not on the day when the DJIA inexplicably dropped nearly 1,000 points). This demonstrates the uncertainties that still plague investors.

Key Economic Indicators

.05 These key economic indicators further illustrate the severity of the recent recessionary period experienced by the United States. 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 2.4 percent in the second quarter of 2010, 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 July 2010, the rate has remained below 10.0 percent. One reason for the continued high unemployment rate is that more Americans are resuming their search for work. Further, although many entities are doing better financially this year than last year, they are hesitant to hire additional workers due to uncertainties about the strength of the economic recovery and concerns about slipping back into a recessionary environment. Instead, those who are employed either switched from part time to full time or experienced an increase in overtime. To illustrate this trend, the Bureau of Labor Statistics reported that in May 2010, the average weekly hours and overtime of private employees had risen consistently over the last 3 months. The May 2010 average of 34.2 hours per week was last reached in January 2009. The trend in increasing current employees' hours will only meet increasing demands for a finite amount of time; plus, after working too much overtime, employees will lose efficiency. Once employers believe the recovery is sustainable and permanent, more employees will be hired.

.07 June and July 2010 exhibited some downward trends in the economy, which increased concern about the possibility of a "double-dip" recession. In each of those months, over 131,000 jobs were lost nationwide; the dip in unemployment to 9.5 percent from May was mostly attributable to a shrinking of the nation's labor force; financial activities continued to lose jobs; the median duration of unemployment remained high; and the number of buyers who signed contracts to purchase homes fell 30 percent in May. Some offsetting positive signs in June and July 2010 include the increase of jobs in the private sector,

increases in manufacturing jobs, and an increase of jobs in the health care and social assistance industries. In addition, July marked the seventh month of consecutive private-sector job growth. Although, generally speaking, the overall economy is moving in the right direction, how long it will take to fully recover from the economic recession, and how bumpy that will recovery will be, remains to be seen.

.08 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.
- The pace of economic recovery is likely to be more modest in the near term than had been anticipated.

.09 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.

Reporting Trends

Securities and Exchange Commission Comment Letters

.10 As discussed in the May 2010 issue of *CFO* magazine, a list of the top 10 concerns of the Securities and Exchange Commission (SEC) related to U.S. entities' annual and quarterly filings dated between January 1, 2009, and January 1, 2010, was compiled. The data was based upon a comment letter database, as of March 24, 2010, compiled by the research firm Audit Analytics. In general, the topics commented on by the SEC remain consistent over the years. The most commented area in filings is the "Management's Discussion & Analysis (MD&A)" section, which provides an overview of the period's operations, how the entity performed, and management's approach to the coming year. It also discusses the fundamentals of the entity, which include members of management and their management style. Typically, the SEC requests more details in entities' descriptions of their operating results, their liquidity and capital resources, and how they develop critical accounting estimates. The next two most commented areas include executive compensation and fair value measurements, which given the economic climate, is not unexpected. The SEC also continues to remain interested in incentive-pay performance targets, such as

earnings per share. The remaining seven top concerns of the SEC are intangible assets and goodwill; disclosure controls; segment reporting; non-generally accepted accounting principles (GAAP) measures, revenue recognition; debt, warrants, and equity issues; and related-party transactions. These general areas of focus in the financial statements should be considered by all preparers and auditors in order to provide investors and regulators with the most useful and transparent financial information.

Loss Contingency Disclosures

.11 The SEC also focuses on the adequacy of loss contingency disclosures in the financial statements of registrants, particularly regarding litigation. The SEC staff has expressed concern about the lack of timely and transparent disclosures. Further, registrants sometimes fail to disclose the amount or range of possible loss when no amount is accrued because the loss is only reasonably possible (rather than probable). Disclosures on contingencies should be specific rather than generic. Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 450-20-50 discusses disclosures for loss contingencies and explains that in some circumstances, it may be misleading not to disclose the amount accrued in the financial statements for a loss contingency. If an exposure to loss exists in excess of amounts accrued and it is reasonably possible that a loss or additional loss may have been incurred, the estimated possible loss or range of loss or a statement that such estimate cannot be made should be included in the disclosures. The SEC also questioned the following inconsistency: registrants disclose in the footnotes that the outcome of a contingency is not expected to materially affect their financial statements but explain in the "Risk Factors" section that the same contingency's outcome could materially affect their financial results.

.12 Discussion from the SEC about contingencies can be found in the Division of Corporate Finance's *Current Accounting and Disclosures Issues in the Division of Corporate Finance*, which can be accessed at www.sec.gov/divisions/corpfin/cfacctdisclosureissues.pdf. FASB also has a project on its agenda to revise the guidance on disclosure of certain loss contingencies, which is discussed in further detail in the "On the Horizon" section of this alert.

Going Concern

.13 The percentage of audit reports for 2009 containing a going concern qualification is substantially unchanged from the percentage in 2008, according to Audit Analytics and based on fiscal year 2009 SEC filings through the end of April 2010. In 2008, an extremely challenging economic year, approximately 20.3 percent of audit reports had a going concern qualification. Although 2009 was certainly not a year of economic boom, GDP did turn positive by the third quarter and continued on that trend. However, the percentage of going concern qualification reports for 2009 remained high at 19.8 percent. Although this is a slight decrease, the explanation for the decrease appears to be unrelated to the current economic recovery. Instead, it may be attributable to 8.4 percent of the going concern entities from 2008 deregistering with the SEC in 2009; the SEC is estimated to receive 518 fewer audit opinions for 2009 than 2008. In 2009, the most common reason for auditors' concern over their clients' futures and, therefore, a going concern opinion was net operating loss. When examining going concern opinions since 2000, 2003 and 2004 produced the lowest amount and 2007 produced the highest amount; in 2007, there was a 28 percent increase from the number of going concern opinions issued in both 2003 and 2004.

It remains to be seen how the uncertain economic conditions of 2010 will affect entities and their futures and whether going concern opinions will remain high or decrease from a continued economic recovery.

SEC Circuit Breaker Rules

.14 On May 6, 2010, a market disruption occurred whereby the DJIA rapidly fell almost 1,000 points. The reasons for the fall have yet to be confirmed and are thought to have occurred due to a system glitch. Approximately 1 month later, the SEC approved rules that will require the exchanges and the Financial Industry Regulatory Authority to pause trading in certain individual stocks if the price moves 10 percent or more in either direction in a 5 minute period. The pause would only apply to stocks in the S&P 500 and would give the markets the opportunity to attract new trading interest in an affected stock, establish a reasonable market price, and resume trading in a fair and orderly fashion. These rules are in effect on a pilot basis through December 10, 2010. The pilot period will be used to make appropriate adjustments to the parameters or operations of the circuit breakers based on the experience, and the scope of the rules will be expanded to securities beyond the S&P 500 as soon as practicable. Additionally, the SEC is considering recalibrating marketwide circuit breaker rules that were already in effect in May 2010 but were not triggered during the May 6 minicrash. By the end of June, these circuit breakers had been set off twice—both times for erroneous trades.

Legislative and Regulatory Developments

The Dodd-Frank Wall Street Reform and Consumer Protection Act

.15 On July 21, 2010, the president signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) into law in response to weaknesses in the financial services industry that are believed to have contributed to the recent economic recession. The Dodd-Frank Act was approved by the House on June 30, before narrowly clearing the Senate on July 15. As the economy is slowly recovering from the worst economic downturn since the Great Depression, this reform represents the greatest change to financial regulation since that time. It ends the era of hands-off regulation and increased deregulation of the financial services industry. The two main goals of the reform are to lower the systemic risks to the financial system and enhance consumer protections.

.16 The Dodd-Frank Act, among many other changes, will create new regulations for companies that extend credit to customers, exempt small public companies from Section 404(b) of the Sarbanes-Oxley Act of 2002 (SOX), make auditors of broker-dealers subject to Public Company Accounting Oversight Board (PCAOB) oversight, and change the registration requirements for investment advisers. It mandates over 60 different studies and reports by various oversight agencies on a range of issues. Because these new regulations will most likely be produced over the next few years, the timing of the impact of these reforms will be staggered. This will provide opportunities for the financial services industry to respond to the proposed regulations and work with regulators in developing reporting requirements, formats, and timetables that are practical to implement. Additionally, this will enable both regulators and the industry to meet their individual goals, which is important to the efforts to avoid market disruptions and inadvertently increase systemic risk.

Large, complex institutions, in particular, and newly regulated entities with new reporting requirements will be challenged to update their systems and data infrastructures. Although the Dodd-Frank Act contains many provisions, some highlights that may be of particular interest to auditors are summarized in the following sections.

Financial Stability Oversight Council

.17 The Dodd-Frank Act creates a new systemic risk regulator called the Financial Stability Oversight Council (FSOC), which is to be led by the Treasury secretary. The two main goals of the FSOC are to identify risks to the financial stability of the United States and promote market discipline by eliminating the expectation of "too big to fail." To meet these goals, the FSOC has many powers, and it will identify any company, product, or activity that could threaten the financial system. The FSOC has the power to designate nonbank financial entities as systemically important and, through the Office of Financial Research (OFR), may collect reports from any bank holding entity or nonbank financial entity for the purpose of determining whether it poses a threat to U.S. financial stability. The new OFR is targeted to be established and fully operational no later than one year after enactment. The FSOC will be chaired by the Treasury secretary, and members will be heads of regulatory agencies, including the chairmen of the Federal Reserve, the Federal Deposit Insurance Corporation (FDIC), and the SEC, among others. The first meeting of the FSOC will be in October 2010. For those large entities deemed a threat to the U.S. financial system, the FSOC can, under the authority of a new orderly liquidation authority, authorize the FDIC to close such entities under the supervision of the Federal Reserve. Upon enactment of the Dodd-Frank Act, the FSOC, through the Federal Reserve, will also have the power to preemptively require a large, complex entity to divest some of its holdings if it poses a grave threat to the stability of the United States, although this is intended only as a last resort.

.18 The FSOC will make recommendations to the Federal Reserve to increase capital, leverage, liquidity, risk management, and other requirements as entities grow in size and complexity, with significant requirements for entities that pose a risk to the financial system. Final rules must be made by the Federal Reserve no later than 18 months after enactment. The current level of minimum leverage capital requirements is to be the floor for the future capital requirements to be developed. New and stricter capital requirements will have differing effects on financial entities: some may move toward lower-margin businesses that are less capital intensive but others may continue to strive for higher returns. Further, new forms of capital may be considered a possibility, such as contingent capital. This capital would effectively be subordinated, and other forms of debt that convert to common equity under prescribed conditions may be considered. Low interest rates and government support have helped many entities build up their capital. Some rating agencies have said that without this assistance, many entities would have lower credit ratings, and as the new rules are implemented, some may experience downgrades. Entities will likely be considering new ways to build and maintain capital or shed troubled assets. The FSOC has the ability to veto rules created by another new regulator, the Bureau of Consumer Financial Protection, with a two-thirds vote.

.19 The FSOC also has monitoring and reporting responsibilities. It will review and, as appropriate, submit comments to the SEC and any other standard setting body (for example, FASB) with respect to an existing or proposed

accounting rule. Further, the FSOC must annually report to Congress significant financial market and regulatory developments, including accounting and insurance regulations, along with assessing their possible impact on the financial system's stability. Lastly, it will make recommendations on implementation of the Volcker Rule to aid regulators. These recommendations must be issued no later than six months after enactment, with final rulemaking no later than nine months after the FSOC's recommendations.

Bureau of Consumer Financial Protection

.20 The Bureau of Consumer Financial Protection (BCFP) is the new independent watchdog (although it will be housed at the Federal Reserve), and it consolidates most federal regulation of financial services offered to consumers. The BCFP will ensure consumers obtain clear, accurate information to shop for mortgages, credit cards, and other financial products (but not products subject to securities or insurance regulations); provide them with one powerful and dedicated advocate; and protect them from hidden fees and deceptive practices. The BCFP will also oversee the enforcement of federal laws intended to ensure the fair, equitable, and nondiscriminatory access to credit for individuals and communities. The director of the BCFP replaces the director of the Office of Thrift Supervision (OTS) on the FDIC board (the OTS was abolished by the Dodd-Frank Act). The BCFP will be led by an independent director appointed by the president and confirmed by the Senate, with a dedicated budget in the Federal Reserve. Functions currently handled by existing agencies are expected to be transferred to the BCFP, and the BCFP is expected to assume full authority for consumer financial protection no later than one year after enactment.

.21 A significant mortgage reform provision of the Dodd-Frank Act is the creation of a new federal standard applicable to home loans that requires institutions to ensure borrowers can repay the loans they were sold. Lenders and mortgage brokers who do not comply with the new rules prohibiting unfair lending practices will be held accountable through imposed penalties. The mortgage reforms from the Dodd-Frank Act are effective immediately. The Dodd-Frank Act does not address the government-sponsored entities Fannie Mae and Freddie Mac—they will be addressed separately through future legislation.

.22 The BCFP has the authority to examine and enforce regulations for banks and credit unions with assets of over $10 billion and all mortgage-related businesses (lenders, servicers, mortgage brokers, and foreclosure scam operators); providers of payday loans; and student lenders, as well as other nonbank financial entities that are large, such as debt collectors and consumer reporting agencies. Banks and credit unions with assets of $10 billion or less will be examined for consumer complaints by the appropriate regulator. The BCFP also is able to autonomously write rules for consumer protections governing all financial institutions (banks and nonbanks) offering consumer financial services or products. The Dodd-Frank Act recognizes that CPAs providing customary and usual accounting activities (which include accounting, tax, advisory, or other services that are subject to the regulatory authority of a state board of accountancy) and other services incidental to such customary and usual accounting activities are already adequately regulated and, therefore, are not subject to the BCFP's authority.

.23 A national consumer complaint hotline will be created so consumers will have, for the first time, a single toll-free number to report problems with financial products and services.

Financial Planning Study

.24 The Government Accountability Office (GAO) is required to study the effectiveness of regulatory oversight of financial planners and make recommendations on how financial planning should be regulated.

Section 404(b) SOX Exemption

.25 The Dodd-Frank Act amends SOX to make permanent the exemption from its Section 404(b) requirement for nonaccelerated filers (those with less than $75 million in market capitalization) that had temporarily been in effect by order of the SEC. Section 404(b) of SOX requires companies to obtain an auditor's report on management's assessment of the effectiveness of the company's internal control over financial reporting. It is important to note that Section 404(a) of SOX, which requires management's attestation on internal control over financial reporting, is still required for nonaccelerated filers. The Dodd-Frank Act also requires the SEC to complete a study within 9 months of the act's enactment on how to reduce the burden of Section 404(b) SOX compliance for companies with market capitalizations between $75 million and $250 million. The study will consider whether any such methods of reducing the burden, or a complete exemption, would encourage companies to list on U.S. exchanges.

.26 Another study required by the Dodd-Frank Act is for the GAO to evaluate whether issuers that are exempt from Section 404(b) requirements have fewer or more restatements than those that are required to comply, how the cost of capital compares for exempt issuers, whether any difference exists in investor confidence in the integrity of the financial statements of exempt versus complying issuers, and whether exempted entities should be required to disclose to investors the absence of Section 404(b) attestation and the costs and benefits of voluntary compliance. The report of findings from the second study is due to Congress within three years.

The PCAOB

.27 The Dodd-Frank Act also provides for the PCAOB to create a program for registering and inspecting the auditors of broker-dealers, including standard setting and enforcement. Currently, all auditors of broker-dealers must be registered with the PCAOB. Covered auditors will now be required to follow PCAOB guidance, although the Dodd-Frank Act allows the PCAOB, in its inspection rule, to differentiate among broker-dealer classes and to potentially exempt introducing brokers, such as those who do not engage in clearing, carrying, or custody of client assets.

.28 The PCAOB is also now authorized, in certain circumstances, to share information with foreign audit oversight authorities. This will facilitate PCAOB cooperation with its foreign counterparts and PCAOB inspection of non-U.S. firms. When SOX was enacted, few other countries had similar audit oversight bodies, and therefore, no provisions in SOX existed to authorize sharing information with foreign authorities. Since then, many countries have established, or are in the process of establishing, similar audit oversight bodies.

.29 Further, any registered public accounting firm (domestic or foreign) that relies, in whole or in part, on the work of a foreign public accounting firm in issuing an audit report, performing audit work, or conducting an interim review must (*a*) produce the foreign firm's audit work papers and all related

documents if the SEC or PCAOB requests them and (*b*) secure the foreign firm's agreement to produce those documents as a condition of relying on the work of that firm. Any foreign firm that performs work for a domestic registered public accounting firm must provide the domestic firm with written consent and power of attorney designating the domestic firm as an agent on whom the SEC or PCAOB may serve a request for documents. Any foreign firm that performs material services on which a registered public accounting firm relies must designate to the SEC or PCAOB an agent in the United States on whom the SEC or PCAOB may serve a request for documents. The SEC or PCAOB may allow a foreign firm to meet document production obligations through alternate means, such as through the SEC's or PCAOB's foreign counterparts.

Derivatives Trading

.30 The Dodd-Frank Act provides the SEC and the Commodity Futures Trading Commission (CFTC) with the authority to regulate over-the-counter (OTC) derivatives and requires central clearing and exchange trading for derivatives that can be cleared. The SEC will have authority over security-based swaps (including credit default swaps). The CFTC will have authority over all other swaps, including energy-rate swaps, interest-rate swaps, security-based swap agreements, and broad-based security group or index swaps. Standardized swaps will be traded on an exchange or in other centralized trading facilities, which will promote transparency; standardized derivatives will also have to be handled by central clearinghouses. *Cleared* describes when trades are routed through a central clearinghouse that covers losses if a party to the trade is unable to complete the transaction. As a safeguard, many derivative traders will also be required to post margin to ensure all obligations can be paid and to offset the general risks that derivative trading poses to the financial system. Clearing and exchange trading requirements are expected to become effective 360 days following enactment.

.31 The Dodd-Frank Act also provides regulators with the authority to impose capital and margin requirements on swap dealers and major swap participants, not end users. Rules prescribed by the CFTC or the SEC must be promulgated no later than 360 days after enactment. By making the market more transparent, the pricing of common kinds of derivatives from the open marketplace may be reduced and would allow a wider range of entities to hedge their risks; customized derivatives could still have higher prices. The credit exposure from derivative transactions will be added to banks' lending limits. However, the new rules may increase some costs of derivative trading because with the increase in transparency and price competition between securities dealers, the dealers will face decreased profit margins and may charge a higher trading fee. Banks are allowed to continue engaging in principal transactions involving interest-rate, foreign-exchange, gold, silver, and investment-grade credit default swaps, subject to Volcker Rule limitations on proprietary trading. For commodities, most other metals, energy, and equities, banks will have to shift their swap operations to a separately capitalized affiliate within the holding entity. Under an end user exemption, nonfinancial firms can still use derivatives to hedge and manage the commercial risks associated with their business.

Registered Investment Advisers and Hedge Funds

.32 The Dodd-Frank Act will require advisers to hedge funds and private equity funds with over $150 million in assets to register with the SEC and be subject to its oversight. Venture capital funds and family offices will be exempt

from registration with the SEC. The new registration requirement will become effective 1 year after enactment; however, any investment adviser may, at the discretion of the investment adviser, register with the SEC during that 1-year period. This new requirement may cause smaller funds to incur greater costs and possibly force some of them to close or raise fees to investors. Currently, the Investment Advisers Act of 1940 requires investment advisers with over $30 million in assets under management to register with the SEC. Under the new reform, this threshold for federal regulation will be raised to $100 million, with certain exceptions. This change will increase the number of small advisers under state supervision and allow the SEC to focus on newly registered hedge funds. Advisers will provide information about their trades and portfolios necessary to assess their systemic risk. The exemption in the Investment Advisers Act of 1940 for advisers with fewer than 15 clients has also been eliminated.

.33 Investment advisers, now including hedge funds, must take steps to safeguard client assets over which such adviser has custody, including, without limitation, verification of such assets by an independent public accountant, as the commission may, by rule, prescribe. The Dodd-Frank Act also raises the standard for individuals to qualify as accredited investors, a basic threshold for purchasing private investments; these investors must now have $1 million, excluding the value of their primary residence. The prior standard was simply $1 million.

SEC and Investor Protections

.34 Because it lowers the legal standard from "knowing" to "knowing or reckless," the Dodd-Frank Act may make it easier for the SEC to prosecute aiders and abettors of those who commit securities fraud under the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Company Act of 1940, and the Investment Advisers Act of 1940. This change will increase the difficulty for a defendant to fight a civil enforcement action because the SEC does not have to show that the person intended to aid another person's violation but only that reckless conduct furthered the violation. The SEC and the Department of Justice will also now have the authority to bring civil or criminal law enforcement proceedings involving transnational or extraterritorial securities frauds. Additionally, the Dodd-Frank Act authorizes 2 studies on these matters. One of the studies directs the GAO to investigate the impact of authorizing private rights of action for aiding and abetting claims and to release its findings within 1 year. The second study directs the SEC to examine whether private rights of action should be authorized for transnational or extraterritorial claims, and that study is to be completed within 18 months.

.35 The Dodd-Frank Act gives the SEC the authority to impose a fiduciary duty on brokers who give investment advice (that is, the advice must be in the best interest of their customers—currently, this applies to investment advisers). Currently, brokers are only required to recommend investments that are suitable for customers. The SEC must first study this issue and deliver a report to Congress on the costs and benefits. The Office of the Investor Advocate (OIA) will also be created within the SEC to identify areas where investors have significant problems dealing with the SEC and to provide them with assistance. Another responsibility of this office will be to identify areas in which investors would benefit from changes in the regulations of the SEC. The OIA must submit its first annual report to Congress no later than June 30, 2011.

.36 A whistle-blower program, with rewards to encourage securities violations reports, was created by the Dodd-Frank Act. An exception is provided for any whistle-blower who gains information through the performance of an audit of financial statements. Employers are prohibited from retaliating against whistle-blowers. Subsidiaries and affiliates that are consolidated with public companies for financial accounting purposes will become subject to the whistle-blower protections in SOX.

.37 The SEC is permitted to use fee collections to establish a reserve fund of up to $100 million, which can be used to fund special projects. The SEC may submit its annual budget directly to Congress without requiring the prior approval of the White House. The SEC has publicly stated that it will need to hire approximately 800 new people to carry out the new reforms (given the new required enforcement, the 5 offices created within the SEC, and the studies to be carried out) and to develop the specifics of new regulations.

Executive Compensation

.38 The Dodd-Frank Act requires a nonbinding shareholder vote on executive pay and golden parachutes. This is intended to give them the power to hold executives accountable. Although the vote is nonbinding, a "No" vote by shareholders would likely force management to respond in some way and can still have a beneficial effect. At a public company's first shareholder meeting following the end of the six month period after enactment, management must give shareholders the opportunity to vote on how frequently shareholders will have a "say on pay" (that is, annually, every two years, or every three years). The SEC now has the authority to grant shareholders proxy access to nominate directors, which is intended to help shift management's focus from short-term profits to long-term growth and stability. However, shareholders would need to exercise this right for it to have any possibility of an impact. The SEC is allowed to exempt small businesses from this requirement. The SEC issued a proposed proxy access rule last year but has been waiting for the clear legal authority that this act provides prior to moving ahead with a final rule. The SEC is already in the process of drafting proxy access rules for public comment. The Dodd-Frank Act also requires entities to disclose in their annual proxy statement the median of annual total compensation to all employees, other than their CEO; the annual total compensation of the CEO; and the ratio of these two amounts. Disclosure is also required on why the chairman of the board and CEO positions are separate or combined.

.39 Compensation based on financial statements that are restated must be returned for the 3 years preceding the restatement in an amount equal to the excess of what would have been paid under the restated results. This is required regardless of whether the executive was involved in the misconduct that led to the restatement. Listing exchanges will enforce the compensation policies. The Dodd-Frank Act also requires directors of compensation committees to be independent of the entity (*independent* as defined by its exchange) and its management. The members of that committee are required to select consultants, legal counsel, and other advisers only after taking into account independence factors established by the SEC. The SEC will write these rules, and these final rules are required not later than 360 days after enactment. New disclosures regarding compensation will also be required, such as the incentive-based compensation policies. Further, the SEC is required to clarify disclosures on compensation, including requirements to provide information that shows the

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relationship between executive compensation actually paid and the financial performance of the issuer.

.40 Overall, the level and complexity of the relationships that entities have with their regulators will increase because of the passage of the Dodd-Frank Act. Already, many firms have chief risk officers who sit above any risk management structures inside business units and try to manage the firm's overall risk profile. This position is important because it creates a single senior point of contact for regulators seeking a high-level understanding of where a firm may have risk concentrations with possible systemic implications. Entities that don't have this position will likely reconsider the creation of one.

Ending "Too Big to Fail" Bailouts

.41 The Dodd-Frank Act is intended to reduce the risk that large firms will take excessive risk because they believe they are, in effect, guaranteed to be bailed out in the event of failure. Bailouts like this occurred during the recent economic recession. Although that is an intent of the specific changes required by this reform, whether that goal will be achieved can only be determined over time. The goal is that taxpayers will not again be responsible to save a failing financial entity or cover the cost of its liquidation.

.42 Under the new Volcker Rule of the Dodd-Frank Act, a banking entity will now be prohibited from proprietary trading; acquiring or retaining any equity, partnership, or other ownership interest in a hedge fund or private equity fund; and sponsoring a hedge fund or private equity fund. Final rulemaking on the Volcker Act must be no later than nine months after the FSOC's recommendations on implementation considerations. *Proprietary trading* consists of transactions made by an entity that affect the entity's own account but not the accounts of its clients; the entity is using its own money to place directional market bets that are unrelated to serving customers. Some of the benefits to bank entities of proprietary trading, which will now be eliminated, include the following:

- Allows the entity to profit on its own instead of collecting commissions and fees from clients
- Allows the entity build an inventory of securities, which can be useful if a client places a trade in an illiquid market
- Allows the bank to make a market when it is assigned to ensure the liquidity for a given security

.43 A major bank estimated that 10 percent of its revenue came from proprietary trading, but that may vary depending on the size and complexity of the institution. Banks are allowed to make de minimis investments in hedge funds and private equity funds, using no more than 3 percent of their tangible common equity in all such funds combined. Also, a bank's investment in a private fund may not exceed 3 percent of the fund's total ownership interest. Nonbank financial institutions supervised by the Federal Reserve will also have restrictions on proprietary trading, hedge fund investments, and private equity investments.

.44 The Dodd-Frank Act also requires large, complex financial entities to periodically submit plans for their rapid and orderly shutdown should the company go under (a "funeral plan" or "living will"). No later than 18 months after enactment, the Federal Reserve Board and the FDIC must issue final

rules implementing the resolution plan requirement. Entities that fail to submit acceptable plans will have higher capital requirements and restrictions on growth and activity, as well as divestment. This will create an increased focus on entity-level financial and operational concerns for these large, complex entities.

.45 Additionally, an orderly liquidation mechanism for the FDIC to unwind failing systemically significant financial entities that pose a risk to the financial system has been created. The mechanism provides that shareholders and unsecured creditors bear losses and management and culpable directors will be removed. The FDIC will only be allowed to borrow funds to liquidate an entity when it expects to be repaid from the assets of the entity being liquidated, and the government will be first in line for repayment. Funds that are not repaid from the sales of the entity's assets will be repaid first through the clawback of any payments to creditors that exceeded liquidation value and then through assessments on large financial entities (with the riskiest ones paying more). Taxpayers will bear no cost for liquidations, and the bailout of an individual entity will become prohibited by the Federal Reserve. To prevent bank runs, the FDIC can guarantee debt of solvent insured banks, but only after meeting serious requirements.

Other Bank and Thrift Regulations

.46 The Dodd-Frank Act abolishes the OTS and transfers authority mainly to the Office of the Comptroller of the Currency, which also regulates federally chartered national banks. However, the thrift charter has been preserved. There will be a permanent increase in deposit insurance for banks, thrifts, and credit unions to $250,000, which is retroactive to January 1, 2008. Cash limits on Securities Investor Protection Corporation protection is also increased from $100,000 to $250,000, subject to periodic adjustments for inflation. The prohibition of banks paying interest on demand deposits has been repealed. Additionally, the Dodd-Frank Act removes a regulatory arbitrage opportunity by prohibiting a bank from converting its charter (unless both the old and new regulator do not object) in order to avoid an enforcement action.

Rating Agencies

.47 Rating agencies became subject to increased scrutiny, given their role in the subprime mortgage crisis. The Dodd-Frank Act creates an Office of Credit Ratings at the SEC that must examine credit ratings agencies at least once per year and make key findings public. These agencies will now be subject to expert liability with the nullification of Rule 436(g), which had provided an exemption for credit ratings provided by credit rating agencies from being considered a part of the registration statement. In order to include a credit rating agency's rating in a registration statement, the registrant must file the credit rating agency's consent along with the registration statement. This will make credit rating agencies vulnerable to lawsuits when underwriters include their assessments in documents used to sell debt; they will now face the same legal risks as accountants and other parties who participate in bond sales. Investors can now bring private rights of action against ratings agencies for a knowing or reckless failure to conduct a reasonable investigation of the facts or to obtain analysis from an independent source. The SEC also has the authority to deregister a credit rating agency for providing bad ratings over time. The SEC will be required to investigate any conflicts of interest involved in financial entities picking the agency they believe will give them the highest ratings.

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Credit rating agencies will be required to disclose their methodology and track record. The SEC will conduct a study on the feasibility of a public or private entity that would be responsible for the assignment of a credit rating to the credit rating agencies.

.48 New rules were also made to help ensure the objectivity and independence of the employees of credit rating agencies. These agencies must conduct a 1-year lookback review when an employee goes to work for an obligor or underwriter of a security or money market instrument subject to rating by that credit rating agency. A report to the SEC is also required when certain employees of a credit rating agency go to work for an entity that the agency has rated in the previous 12 months. Ratings analysts will also be required to pass qualifying exams and take continuing education.

Other Requirements and Additional Information

.49 The Dodd-Frank Act also makes changes to securitization rules. Entities that sell products such as mortgage-backed securities will now be required to retain at least 5 percent of the credit risk, unless the underlying loans meet standards that reduce risk. The federal banking agencies must prescribe final rules for credit risk retention no later than 270 days after enactment. Issuers of these securities will also be required to disclose more information about the underlying assets, including analysis of the quality of the underlying assets. A study is mandated regarding the impacts of the new credit risk retention requirements and FASB Statement No. 166, *Accounting for Transfers of Financial Assets—an amendment of FASB Statement No. 140*, and No. 167, *Amendments to FASB Interpretation No. 46(R)*, on asset-backed securities.

.50 The first ever office in the federal government focused on insurance will be created, which will monitor the insurance industry for systemic risk purposes, among its other responsibilities.

.51 The impact of these new reforms on the capital markets and credit availability is difficult to predict. Although strengthening transparency is an appropriate response to the recent economic recession, the more stringent rules may affect economic recovery. Additionally, with the new capital requirements, regulators are likely to disapprove of any perceived efforts by entities to avoid compliance, and those firms that do so may risk political backlash and reputational harm. A copy of the full Dodd-Frank Act, as signed by the president, can be found at www.gpo.gov/fdsys/pkg/BILLS-111hr4173ENR/pdf/BILLS-111hr4173ENR.pdf. The AICPA is also following any developments related to the Dodd-Frank Act on our website at www.aicpa.org under "Advocacy—Federal Issues."

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

.52 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.

.53 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 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.

.54 After consultation with the 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

.55 As background, FASB 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.

.56 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.

.57 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.

.58 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.

.59 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.

.60 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).

PCAOB Constitutionality

.61 On June 28, 2010, the Supreme Court ruled in the lawsuit challenging the constitutionality of the PCAOB. When the PCAOB was set up under SOX, its board members were appointed by the SEC and could be removed only for cause. The Supreme Court ruled, in a 5-4 vote, that although the manner in which the PCAOB was constituted was constitutionally invalid, SOX itself was not invalidated. Rather, the Supreme Court severed from the rest of SOX the provisions relating to the removal of PCAOB board members. The consequence

of the Supreme Court's decision is that PCAOB board members will now be removable by the SEC at will, instead of only for good cause. Essentially, this decision has no material impact on the workings of the PCAOB, and all PCAOB programs will continue to operate as usual, including registration, enforcement, and standard-setting activities.

Audit and Attestation Issues and Developments

Audit Risks Arising From Current Economic Conditions

.62 The recent economic conditions and regulatory actions described in this alert may cause additional risk factors that had not previously existed or did not have a material effect on audit clients in prior years. Some risks that may affect an entity in the current economic environment are as follows:

- Marginally achieving explicitly stated strategic objectives
- Volatile real estate and business markets
- Significant measurement uncertainty, including accounting estimates and fair value measurements
- Potentially erroneous or fraudulent activity due to decreased staffing and resurgence of business activity
- The continuing evolution of the postrecessionary marketplace

.63 Although many of these risks are not new to businesses, consideration of the ways a client is affected by external forces is part of obtaining an understanding of the entity and its environment and will allow the auditor to plan and perform the audit to address those risks. As noted in paragraph .17 of AU section 312, some possible audit responses to significant risks of material misstatement include increasing the extent of audit procedures, performing procedures closer to year-end, or increasing audit procedures to obtain more persuasive evidence. Additionally, given the constant changing status of economic conditions that could affect your client, auditors should consider modifying audit procedures to ensure that risks are still adequately addressed.

Enterprise Risk Management

.64 To meet the challenges and risks in today's business and economic environment, many entities have turned to enterprise risk management (ERM). Further, the recent economic crisis has led to a renewed focus on how senior executives approach risk management and the role of their boards of directors in risk oversight. The purpose of ERM is to address processes, procedures, and risk on an entity-wide basis to enable management to holistically understand the business risks that the entity faces. Some characteristics of the ERM model include strengthening communication; additional training, including cross-training, process, and internal control improvement; and entity-wide participation.

.65 Once implemented, managers of individual business components can make appropriate decisions based on an understanding of the risks that each business component encounters and how those risks affect other components and the entity as a whole. The purpose of this process is not to reduce business risk but rather to provide the knowledge that management needs to effectively assess risks and to then plan appropriate strategies to achieve the entity's business objectives. A good ERM framework allows the entity to foresee potential

consequences from future events, make necessary changes to minimize risk, manage the negative fallout if an event materializes, and capitalize on the opportunities that it presents for growth.

.66 ERM can help an entity articulate its major risks and identify the nature of those risks, then develop a process for measuring, monitoring, and controlling these risks. ERM can help shape the commentary in MD&A, but not all ERM-related information will be relevant and important enough to warrant mention in the MD&A. The presence and use of an ERM system is something that many entities include in the MD&A section of their financial statements. This provides investors, analysts, and rating agencies with a better picture and more insight into the goals of the entity.

.67 A strong ERM, or the lack thereof, is an important consideration for an external auditor when understanding and assessing the entity's environment, internal control, and corporate governance, in addition to the overall audit risk. Further, the risk-based approach of current auditing has nurtured the concept of an effective financial statement audit being intertwined with business risks and, therefore, ERM. Business risks of any nature ultimately affect the risk of misstatement in the financial statements. In many entities, an internal auditor conducts an audit on the effectiveness of the framework by examining that the risk management practices defined in the framework are in use and operating as expected. In all entities, management is the owner of the ERM framework and surrounding processes.

.68 Additional information about ERM can be obtained from the Committee of Sponsoring Organizations of the Treadway Commission (COSO's) website at www.coso.org.

.69 Although it is impossible to predict and include all accounting, auditing, and attestation issues that may affect your engagements, we cover in this alert the primary areas of concern. Continue to remain alert to economic, legislative, and regulatory developments, as well as the associated accounting, auditing, and attestation issues as you perform your engagements.

PCAOB Auditing Standards on Risk Assessment

.70 In August 2010, the PCAOB adopted a suite of eight auditing standards related to the auditor's assessment of, and response to, risk in an audit. These standards were initially proposed in late 2008 and reproposed in late 2009. These risk assessment standards will benefit investors by setting forth requirements that enhance the effectiveness of the auditor's assessment of, and response to, the risks of material misstatement in the financial statements. They are applicable to audit procedures spanning from the initial planning stages of the audit to the evaluation of the audit results. Improvements in the risk assessment standards should enhance integration of the audit of financial statements with the audit of internal control over financial reporting by articulating a process for identifying and assessing risks of material misstatements that apply to both portions of the integrated audit.

.71 The new auditing standards, with a brief description of each, are as follows:

- Auditing Standard No. 8, *Audit Risk*, discusses the auditor's consideration of audit risk in both an integrated audit and an audit of financial statements only. It describes the components of audit

risk and the auditor's responsibilities for reducing it to an appropriately low level.

- Auditing Standard No. 9, *Audit Planning*, establishes requirements for planning an audit, such as assessing important matters and establishing an appropriate audit strategy.
- Auditing Standard No. 10, *Supervision of the Audit Engagement*, is applicable to the engagement partner and other team members who supervise during the audit. It sets forth requirements for supervision of the audit engagement and the work of other engagement members. Related to this topic, the PCAOB also recently issued a release discussing the provision of SOX that authorizes the PCAOB to impose sanctions on registered public accounting firms and their supervisory personnel for failing to reasonably supervise associated persons.
- Auditing Standard No. 11, *Consideration of Materiality in Planning and Performing an Audit*, describes the auditor's responsibilities for consideration of materiality in planning and performing an audit.
- Auditing Standard No. 12, *Identifying and Assessing Risks of Material Misstatement*, establishes requirements for auditors in identifying and assessing risks of material misstatement, including information-gathering procedures.
- Auditing Standard No. 13, *The Auditor's Responses to the Risks of Material Misstatement*, establishes requirements for responding to those identified risks of material misstatement through general audit procedures. It also includes audit procedures related to significant accounts and disclosures.
- Auditing Standard No. 14, *Evaluating Audit Results*, establishes requirements for evaluating audit results and the sufficiency of appropriate audit evidence.
- Auditing Standard No. 15, *Audit Evidence*, discusses what constitutes audit evidence and how to design and perform audit procedures to support the opinion expressed in the auditor's report.

.72 These risk assessment standards will supersede the following six PCAOB interim standards and related amendments: AU-P section 311, *Planning and Supervision*; AU-P section 312, *Audit Risk and Materiality in Conducting an Audit*; AU-P section 313, *Substantive Tests Prior to the Balance Sheet Date*; AU-P section 319, *Consideration of Internal Control in a Financial Statement Audit*; AU-P section 326, *Evidential Matter*; and AU-P section 431, *Adequacy of Disclosure in Financial Statements* (AICPA, *PCAOB Standards and Related Rules*, Standards). The standards, if approved by the SEC, will be effective for audits of fiscal periods beginning on or after December 15, 2010.

Engagement Quality Review for Issuers

.73 In January 2010, the PCAOB announced that the SEC had approved Auditing Standard No. 7, *Engagement Quality Review* (AICPA, *PCAOB Standards and Related Rules*, Standards, AU-P sec. 162), which was adopted by the PCAOB in July 2009. Auditing Standard No. 7 (AU-P sec. 162) provides a framework for the engagement quality reviewer to objectively evaluate the significant judgments made and related conclusions reached by the engagement team in

forming an overall conclusion about the engagement. Auditing Standard No. 7 (AU-P sec. 162) is expected to increase the likelihood that a registered public accounting firm will catch any significant deficiencies before it issues its audit report. As a result, more work may be necessary under this standard than performed under the existing requirements for concurring partners. However, Auditing Standard No. 7 (AU-P sec. 162) explains that the procedures required by the engagement quality reviewer are different in nature than those required to be performed by the engagement team. Further, if the engagement quality reviewer deems more work is required before giving approval of issuance, the engagement team is responsible for completing that work.

.74 This standard applies to all audit engagements, and engagements to review interim financial information, conducted pursuant to the standards of the PCAOB, and it supersedes the PCAOB's interim concurring partner review requirement. Auditing Standard No. 7 (AU-P sec. 162) is effective for engagement quality reviews of audits and interim reviews for fiscal years that began on or after December 15, 2009. For a public, calendar-year company, this standard is applicable for the quarter ended March 31, 2010. For the full text of the standard, readers are encouraged to visit the PCAOB's website at www.pcaob.org.

Question and Answer on Auditing Standard No. 7

.75 Subsequent to the issuance of Auditing Standard No. 7 (AU-P sec. 162), the PCAOB issued Staff Question and Answer, *Auditing Standard No. 7*, Engagement Quality Review (AICPA, *PCAOB Standards and Related Rules*, PCAOB Staff Guidance, sec. 100.10), to provide further implementation guidance on the documentation requirements of the standard. This guidance focuses on the required documentation of the interactions between the engagement quality reviewer and the engagement team, specifically as it relates to a specific example in Auditing Standard No. 7 (AU-P sec. 162). The question and answer clarifies that the standard does not require documentation of all of the interactions between the engagement quality reviewer and the engagement team. Further, it explains that the example is intended to illustrate how the documentation requirements of the standard should be applied once a reviewer concludes that a significant engagement deficiency exists. This question and answer can be located at http://pcaobus.org/Standards/QandA/2010-02-19_EQR_QA%20_2.pdf.

PCAOB Practice Alert on Using the Work of Others

.76 In July 2010, the PCAOB issued Staff Audit Practice Alert No. 6, *Auditor Considerations Regarding Using the Work of Other Auditors and Engaging Assistants From Outside the Firm* (AICPA, *PCAOB Standards and Related Rules*, PCAOB Staff Guidance, sec. 400.06), because it observed that a number of registered public accounting firms located in the United States have been issuing audit reports on financial statements filed by issuers that have substantially all of their operations outside of the United States. This practice alert contains reminders for registered firms of their obligations when using the work of other firms or using assistants engaged from outside the firm, such as in the aforementioned situation. It also describes the circumstances under which the firm issuing the audit report may use the work and reports of another auditor.

.77 Auditors who engage assistants from outside their firm are governed by the same standards regarding planning the audit and supervising assistants

when audit work is performed by assistants employed by the auditor's firm. Observations from the PCAOB's inspection process suggest that some firms may be issuing audit reports based on the work of another firm, or using the work of assistants engaged from outside the firm, without complying with the relevant PCAOB standards. The practice alert is broken down into two sections:

- Using the work of other auditors. This discussion is based upon AU section 543, *Part of Audit Performed by Other Independent Auditors* (AICPA, *Professional Standards*, vol. 1).
- Engaging assistants from outside the firm. This discussion is based upon numerous sections of auditing guidance.

.78 The full text of this practice alert can be found at http://pcaobus.org/Standards/QandA/2010-07-12_APA_6.pdf.

PCAOB Practice Alert on Significant Unusual Transactions

.79 In April 2010, the PCAOB issued Staff Audit Practice Alert No. 5, *Auditor Considerations Regarding Significant Unusual Transactions* (AICPA, *PCAOB Standards and Related Rules*, PCAOB Staff Guidance, sec. 400.05), which is intended to remind auditors of public companies about their responsibilities to assess and respond to the risk of material misstatement of the financial statements due to error or fraud posed by significant unusual transactions. Practice Alert No. 5 compiles existing requirements from PCAOB standards and groups them into the following categories: identifying and assessing risks of material misstatement, responding to risks of material misstatement, consulting others, evaluating financial statement presentation and disclosure, communicating with audit committees, and reviewing interim financial information. Practice Alert No. 5 can be accessed at http://pcaobus.org/Standards/QandA/04-07-2010_APA_5.pdf.

Supplementary and Other Information Related to Financial Statements

.80 In February 2010, the AICPA Auditing Standards Board (ASB) issued a trio of auditing standards related to the auditor's responsibility for other information, supplementary information, and required supplementary information. These three standards supersede AU sections 550A, *Other Information in Documents Containing Audited Financial Statements*; 551A, *Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents*; and 558A, *Required Supplementary Information* (AICPA, *Professional Standards*, vol. 1). All three standards are effective for audits of financial statements for periods beginning on or after December 15, 2010. Early application is permitted.

Other Information in Documents Containing Audited Financial Statements

.81 Statement on Auditing Standards (SAS) No. 118, *Other Information in Documents Containing Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1, AU sec. 550), addresses the auditor's responsibility in relation to other information in documents containing audited financial statements and the auditor's report thereon. In this SAS, *other information* is defined as financial and nonfinancial information (other than the financial statements and the auditor's report thereon) that is included in a document containing audited

financial statements and the auditor's report thereon, excluding required supplementary information. *Documents containing audited financial statements* refers to annual reports (or similar documents) that are issued to owners (or similar stakeholders) and annual reports of governments and organizations for charitable or philanthropic purposes that are available to the public that contain audited financial statements and the auditor's report thereon. In the absence of any separate requirement in the particular circumstances of the engagement, the auditor's opinion on the financial statements does not cover other information, and the auditor has no responsibility for determining whether such information is properly stated. This SAS establishes the requirement for the auditor to read the other information of which the auditor is aware because the credibility of the audited financial statements may be undermined by material inconsistencies between the audited financial statements and other information. This SAS also may be applied, adapted as necessary in the circumstances, to other documents to which the auditor, at management's request, devotes attention.

Supplementary Information in Relation to the Financial Statements as a Whole

.82 SAS No. 119, *Supplementary Information in Relation to the Financial Statements as a Whole* (AICPA, *Professional Standards*, vol. 1, AU sec. 551), addresses the auditor's responsibility when engaged to report on whether supplementary information is fairly stated, in all material respects, in relation to the financial statements as a whole. For purposes of generally accepted auditing standards (GAAS), *supplementary information* is defined as information presented outside the basic financial statements, excluding required supplementary information that is not considered necessary for the financial statements to be fairly presented in accordance with the applicable financial reporting framework. Such information may be presented in a document containing the audited financial statements or separate from the financial statements.

.83 The information covered by this SAS is presented outside the basic financial statements and is not considered necessary for the financial statements to be fairly presented in accordance with the applicable financial reporting framework. This SAS also may be applied, with the report wording adapted as necessary, when an auditor has been engaged to report on whether required supplementary information is fairly stated, in all material respects, in relation to the financial statements as a whole.

Required Supplementary Information

.84 SAS No. 120, *Required Supplementary Information* (AICPA, *Professional Standards*, vol. 1, AU sec. 558), addresses the auditor's responsibility with respect to *required supplementary information*. The SAS defines *required supplementary information* as information that a designated accounting standard setter requires to accompany an entity's basic financial statements. Required supplementary information is not part of the basic financial statements; however, a designated accounting standard setter considers the information to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. In addition, authoritative guidelines for the methods of measurement and presentation of the information have been established. In the absence of any separate requirement in the particular circumstances of the engagement, the auditor's opinion on the basic financial statements does not cover required

supplementary information. SAS No. 120 explains that the objectives of the auditor, when a designated accounting standard setter requires information to accompany an entity's basic financial statements, are to perform specified procedures in order to

- describe, in the auditor's report, whether required supplementary information is presented and
- communicate therein when some or all of the required supplementary information has not been presented in accordance with guidelines established by a designated accounting standard setter or when the auditor has identified material modifications that should be made to the required supplementary information for it to be in accordance with guidelines established by the designated accounting standard setter.

Auditing Fair Value Measurements

.85 In addition to understanding the looming questions relative to fair value accounting, auditors should be aware of audit issues involving fair value measurements. Particular assets, liabilities, and components of equity are measured or disclosed at fair value in the financial statements, and it is management's responsibility to make the fair value measurements and disclosures. When auditing these fair values to ensure they are in conformity with U.S. GAAP, auditors should consult AU section 328, *Auditing Fair Value Measurements and Disclosures* (AICPA, *Professional Standards*, vol. 1), which establishes standards and provides guidance for auditors. Specific types of fair value measurements are not covered by AU section 328. For example, when auditing the fair value of derivatives and securities, refer to AU section 332, *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities* (AICPA, *Professional Standards*, vol. 1).

.86 In regard to analyzing the sufficiency of the audit evidence, the strongest audit evidence to support a fair value is an observable market price in an active market. If that is not available, a valuation method should incorporate common market assumptions. If common market assumptions are not available or require significant adjustments, the entity may use its own assumptions. The auditor should obtain an understanding of the entity's process for determining fair values, as well as whether the fair value measurements and disclosures are in accordance with U.S. GAAP. During this testing, the auditor also may identify any possible indicators of impairment. According to paragraph .23 of AU section 328, substantive tests of the fair value measurements may involve (*a*) testing management's significant assumptions, the valuation model, and the underlying data; (*b*) developing independent fair value estimates for corroborative purposes; or (*c*) reviewing subsequent events and transactions. Paragraph .26 also notes that when testing the fair value measurements and disclosures, the auditor should evaluate whether management's assumptions are reasonable and reflect, or are not inconsistent with, market information. According to FASB ASC 820, *Fair Value Measurements and Disclosures*, under U.S. GAAP this may include evaluating the following:

- Whether a significant decrease has occurred in the volume and level of activity for the asset or liability when compared with normal market activity, which may include consideration of the number of recent transactions, the date of the most recent price quotes, consistency among price quotes, increases in implied liquidity risk

premiums, increases in the bid-ask spread, and the amount of publicly available information.

- Whether the transaction was an orderly transaction, which may include consideration of the seller's financial condition, the counterparty credit position, the exposure to the market during the marketing period, and the actual transaction price.
- The reasonableness of the underlying assumptions, which may include consideration of the use of pricing services, the assumptions used by the pricing service, and the extent of testing required to verify the reasonableness of the prices provided. (For example, the auditor should understand whether the fair value measurement was determined using quoted prices from an active market, observable inputs, or fair value measurements based on a model. If the price is not based on quoted prices from an active market or observable inputs, the auditor should obtain an understanding of the model used by the pricing service and evaluate whether the assumptions are reasonable [see the following section for additional information on pricing services].)
- The reasonableness of the determination within the fair value hierarchy of inputs.

Fair Values of Securities

.87 The guidance in AU section 332 relating to auditing the fair value of securities is fairly similar to the guidance in AU section 328; however, there are some items of note for the auditor. As previously mentioned, quoted market prices in active markets are the best available audit evidence to support a fair value; however, when they are unavailable and the valuations of securities are obtained from a broker or dealer or another pricing service based on valuation models, the auditor should understand the underlying valuation method used (such as a cash flow projection). These prices also may be based on quoted prices from an active market or other observable inputs that will be a consideration on the auditor's procedures. The process used by the pricing service in measuring fair value should be evaluated to determine the consistency with the specified valuation method (as discussed in FASB ASC 820-10-35). The auditor also may determine that it is necessary to obtain quotes from more than one pricing source based on circumstances, such as an existing relationship between the entity and the valuing entity, which could inhibit objective pricing or underlying valuation assumptions that are highly subjective. In the context of FASB ASC 820, quoted prices in active markets are considered level 1 inputs.

.88 When an entity performs its own valuation, value testing procedures include the following:

- Assessing the reasonableness
- Comparing the assumptions to industry reports or benchmarks
- Assessing the appropriateness of the model
- Calculating the value using his or her own model
- Comparing the fair value with subsequent or recent transactions

.89 Whether the inputs to the entity's valuation model are observable determines their characterization as level 2 or level 3 inputs, respectively, within FASB ASC 820. When extensive judgment is needed, consider using a specialist

or refer to AU section 342, *Auditing Accounting Estimates* (AICPA, *Professional Standards*, vol. 1). Additionally, when the underlying collateral of a security significantly contributes to its fair value and collectability of the security, evidence of the collateral also should be examined for existence, fair value, transferability, and the investor's right to the collateral.

.90 Paragraph .19 of AU section 328 also notes that the auditor should evaluate whether the entity's method for determining fair value measurements is applied consistently and, if so, whether the consistency is appropriate considering possible changes in the environment or circumstances affecting the entity or changes in accounting principles. The auditor also should evaluate management's conclusions regarding other-than-temporary impairment on its securities. Examples of factors that could cause an other-than-temporary impairment, per paragraph .47 of AU section 332, include the following:

- Fair value is significantly below cost and
  - — the decline is attributable to adverse conditions specifically related to the security or to specific conditions in an industry or in a geographic area.
  - — the decline has existed for an extended period of time.
  - — management does not possess both the intent and the ability to hold the security for a period of time sufficient to allow for any anticipated recovery in fair value.
- The security has been downgraded by a rating agency.
- The financial condition of the issuer has deteriorated.
- Dividends have been reduced or eliminated, or scheduled interest payments have not been made.
- The entity recorded losses from the security subsequent to the end of the reporting period.

.91 Auditors should consider all facts and circumstances when determining if an other-than-temporary impairment has occurred. Additionally, the classification of an entity's securities is based on management's intent and ability. The auditor should obtain an understanding of management's classification process among trading, available-for-sale, and held-to maturity, as well as consider the classifications in light of the entity's current financial position.

Auditing Accounting Estimates

.92 As noted in paragraph .04 of AU section 342, the auditor is responsible for evaluating the reasonableness of accounting estimates made by management in the context of the financial statements as a whole. Although this alert has discussed fair value measurements at length, it is important to remember many types of accounting estimates exist in client financial statements. Some examples include the allowance for uncollectible accounts receivable, impairment analysis and estimated useful lives of long lived assets, valuation allowance for deferred tax assets, and actuarial assumptions in pension and other postretirement benefit costs.

.93 Given the current economic climate, additional skepticism should be exercised when considering management's underlying assumptions used in accounting estimates. When evaluating accounting estimates, the auditor should consider both the subjective and objective factors with professional skepticism.

As discussed in paragraph .09 of AU section 342, key factors and assumptions that the auditor normally concentrates on include the assumptions that are significant to the estimate, sensitive to variations, deviations from historical patterns, or particularly subjective and susceptible to misstatement and bias; however, it is important to consider whether historical patterns are still applicable.

.94 For example, in the current market, new patterns may emerge. In this economic climate, with possible increasing pressure on management to meet earnings, a key aspect of AU section 342 is for an auditor to determine the reasonableness of management's accounting estimates with an extra degree of professional skepticism. As noted by AU section 316, *Consideration of Fraud in a Financial Statement Audit* (AICPA, *Professional Standards*, vol. 1), when assessing audit differences between client estimates and audit estimates, even if they are individually reasonable, an auditor should consider whether these differences are indicative of possible bias by management. If so, the auditor should reconsider the estimates as a whole.

.95 The auditor should obtain an understanding of how management develops estimates and should employ one of the approaches outlined in paragraph .10 of AU section 342 in testing that process. In reviewing and testing management's process, the auditor may consider identifying controls around this process and determining if the underlying data used for the estimate are reliable and used appropriately. An auditor also may develop an estimate and compare it to management's estimate. Lastly, the auditor may review subsequent events or transactions occurring prior to the date of the auditor's report. Further, as noted in AU section 316, hindsight may provide the auditor additional insight into the existence of management bias. For further details on auditing estimates, see AU section 342. The AICPA has released a proposed redrafted SAS, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates and Related Disclosures* (Redrafted), on auditing accounting estimates, including fair value. Readers are encouraged to remain alert for developments on this topic.

Auditor Responsibilities for Subsequent Events

.96 To provide guidance related to the effect of Accounting Standard Update (ASU) No. 2010-09, *Subsequent Events (Topic 855): Amendments to Certain Recognition and Disclosure Requirements*, on the auditor's responsibilities for subsequent events relative to a conduit debt obligor and the date of the auditor's report, the AICPA issued Technical Questions and Answers (TIS) section 8700.03, "Auditor's Responsibilities for Subsequent Events Relative to a Conduit Debt Obligor" (AICPA, *Technical Practice Aids*), in June 2010. TIS section 8700.03, through an example, explains that management of a conduit debt obligor with conduit debt securities that trade in a public market must evaluate subsequent events through the date the financial statements are first widely distributed (that is, issued). Further, the auditor, using professional judgment, needs to evaluate management's assertion about the financial statement issuance date and decide whether the manner in which the entity has made its financial statements available does or does not constitute issuance for purposes of complying with GAAP and completing the auditor's subsequent event procedures. In accordance with AU section 561, *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report* (AICPA, *Professional Standards*, vol. 1), the auditor has no obligation to make any further or continuing inquiry or perform any other auditing procedures, with respect to the audited financial

statements, after the date of the auditor's report, unless new information that may affect the report comes to his or her attention.

.97 In September 2009, the AICPA issued TIS section 8700.02, "Auditor Responsibilities for Subsequent Events" (AICPA, *Technical Practice Aids*), which discusses the effects of the entity's responsibility to disclose the date through which the subsequent events have been evaluated on the auditor's responsibilities for subsequent events. This question and answer was issued in response to FASB's issuance of FASB Statement No. 165, *Subsequent Events* (codified in FASB ASC 855, *Subsequent Events*). Because the auditor is concerned with events occurring through the date of his or her 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 auditor's report. This typically will result in the same date being used for both the auditor's report and the date disclosed by management through which they have evaluated subsequent events. The auditor may consider discussing these dating requirements with management in advance of beginning the audit and including any agreed upon understanding in the engagement letter. Recently issued technical questions and answers can be accessed at www.aicpa.org/InterestAreas/AccountingAndAuditing/Resources/Pages/RecentlyIssuedTechnicalQuestionsandAnswers.aspx.

Communicating Internal Control Related Matters Identified in an Audit

.98 SAS No. 115, *Communicating Internal Control Related Matters Identified in an Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 325), supersedes SAS No. 112, *Communicating Internal Control Related Matters Identified in an Audit*, and further clarifies standards and provides guidance on communicating matters related to an entity's internal control over financial reporting (internal control) identified in an audit of financial statements. SAS No. 115 is effective for audits of financial statements for periods ending on or after December 15, 2009, with early implementation permitted.

.99 SAS No. 115 is applicable whenever an auditor expresses an opinion on financial statements (including a disclaimer of opinion), except when the auditor is performing an integrated audit and will be expressing an opinion on the effectiveness of internal control over financial reporting under AT section 501, *An Examination of an Entity's Internal Control Over Financial Reporting That Is Integrated With an Audit of Its Financial Statements* (AICPA, *Professional Standards*, vol. 1). In general, SAS No. 115 retains many of the provisions of SAS No. 112. The key differences between the two standards lie in the definitions of *material weaknesses* and *significant deficiencies*.

Definitions of Significant Deficiency *and* Material Weakness

.100 A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that a reasonable possibility exists that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. For the purpose of this definition, a reasonable possibility exists when the likelihood of the event is either *reasonably possible* or *probable*, as those terms are defined in the FASB ASC glossary. The FASB ASC glossary defines *reasonably possible* as when the chance of the future event or events occurring is more than remote but less than likely; *probable* is defined as when the future event or events are likely to occur. A *significant deficiency*

is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness yet important enough to merit attention by those charged with governance.

The Evaluation Process

.101 Although the auditor is not required to perform procedures specifically to identify deficiencies in internal control, during the course of the audit, the auditor may become aware of deficiencies in the design or operation of the entity's internal control. The auditor should evaluate the severity of each deficiency in internal control identified during the audit and determine whether the deficiency, individually or in combination with other deficiencies in internal control, rise to the level of significant deficiencies or material weaknesses. Further, the severity of a deficiency does not depend on whether a misstatement actually occurred.

.102 The AICPA published the Audit Risk Alert *Communicating Internal Control Related Matters in an Audit—Understanding SAS No. 115* (product no. 022539) to assist in understanding the requirements of this SAS. This Audit Risk Alert provides specific case studies to help determine whether identified control weaknesses would constitute a significant deficiency or material weakness; it can be obtained by calling the AICPA at (888) 777-7077 or visiting www.cpa2biz.com.

Consideration of an Entity's Ability to Continue as a Going Concern

.103 The consideration of an entity's ability to continue as a going concern is required in every audit performed under GAAS and continues to be an especially important consideration in the current state of the economy, as discussed in the "Reporting Trends" section of this alert. An entity's ability to continue as a going concern is affected by many factors, such as the industry and geographic area in which it operates, the financial health of its customers and suppliers, and its accessibility to financing.

.104 As explained by paragraph .02 of AU section 341, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern* (AICPA, *Professional Standards*, vol. 1), the auditor's evaluation is based on his or her knowledge of relevant conditions and events that exist at, or have occurred prior to, the date of the auditor's report. Therefore, this is an ongoing evaluation that extends through the date of the auditor's report.

.105 The auditor has a responsibility to evaluate whether there is a substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time. AU section 341 notes that is a period not to exceed one year beyond the date of the financial statements being audited. Audit teams may find it useful to have preliminary discussions about going concern considerations during engagement planning meetings; however, as noted in AU section 341, it is not necessary to design audit procedures around specifically identifying the possibility of a going concern issue because results of typical audit procedures should illuminate any indicators. These procedures may consist of analytical procedures, review of subsequent events, review of compliance with financing agreements, review of board minutes, inquiry of legal counsel, and confirmation with related third parties of the details of arrangements to provide or maintain financial support.

.106 If the auditor believes that a substantial doubt about the entity's ability to continue as a going concern exists, the next steps are to obtain management's plans to mitigate the effect of such conditions and then assess the likelihood that these plans can be implemented effectively. If, after considering management's plan, an auditor determines that a substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time remains, the auditor should communicate with those charged with governance of the entity, in accordance with AU section 341. In that instance, the auditor also should consider the effects on the entity's financial statements and the adequacy of the related disclosure, and an explanatory paragraph should be added to the audit report following the opinion paragraph. Alternatively, if management's plan mitigates the risk of the entity's inability to continue as a going concern, the auditor should consider disclosing the primary conditions that gave rise to the initial doubt and management's plans. These disclosures are especially important for financial statement users to fully comprehend the entity's financial strength and ability to continue as a going concern.

.107 The auditor's assessment of whether an entity's ability to continue as a going concern may have a significant impact on an entity's business, either if it is a going concern or if it is not. Because the auditor's professional judgment is frequently the basis for whether a going concern issue exists, it is important that the auditor carefully consider the impact of his or her judgment on the users of the client's financial statements and to what extent management's plans may have alleviated the substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time. Further, a premature going concern paragraph may have detrimental effects on an entity and become a self-fulfilling prophecy.

.108 FASB has undertaken a project that will incorporate going concern guidance into accounting literature. One of the expected major changes is regarding the going concern time frame. FASB 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. The time frame beyond 12 months is limited to a practical amount of time thereafter in which significant events or conditions that may affect the evaluation can be identified. An exposure draft is expected in the fourth quarter of 2010; readers should be alert for its issuance.

Service Organizations

.109 Since 1992, SAS No. 70, *Service Organizations* (AICPA, *Professional Standards*, vol. 1, AU sec. 324), has been the authoritative standard on requirements and guidance for reporting on controls at service organizations and auditing the financial statements of entities that use service organizations to accomplish tasks that may affect their financial statements. This guidance has now been split into an attest standard and an auditing standard to better reflect the nature of the work being performed. Statement on Standards for Attestation Engagements (SSAE) No. 16, *Reporting on Controls at a Service Organization* (AICPA, *Professional Standards*, vol. 1, AT sec. 801), contains the requirements for reporting on controls at service organizations that are relevant to user entities' internal control over financial reporting. A finalized clarified SAS on service organizations, *Audit Considerations Relating to an Entity Using a Service Organization*, will supersede SAS No. 70 and addresses the user auditor's responsibility for obtaining sufficient appropriate audit evidence in an audit of the financial statements of a user entity that uses one or more service

organizations. This SAS will be effective for audits of financial statements for periods ending on or after December 15, 2012. SSAE No. 16 is effective for service auditor's reports for periods ending on or after June 15, 2011. Until the new SAS is effective, user auditors will still use the guidance currently contained in AU sec. 324. Once the new SAS becomes effective, it will replace the guidance for user auditors currently in AU sec. 324. SSAE No. 16 is based on the International Auditing and Assurance Standards Board's (IAASB's) International Standard on Assurance Engagements No. 3402, *Assurance Reports on Controls at a Service Organization*, and the new SAS is based on the IAASB's International Standard on Auditing (ISA) 402, *Audit Considerations Relating to an Entity Using a Service Organization*.

.110 SSAE No. 16 is applicable when an entity outsources a business task or function to another entity (usually one that specializes in that task or function) and the data resulting from that task or function is incorporated in the outsourcer's financial statements. The SSAE defines a *service organization* as an organization or segment of an organization that provides services to user entities, which are likely to be relevant to those user entities' internal control over financial reporting; a *user entity* is defined as an entity that uses a service organization; and a *service auditor* is defined as a practitioner who reports on controls at a service organization. Some examples of service organizations are an entity that processes medical claims for health insurance companies, an investment adviser that maintains accountability for those assets and provides statements to user entities, and a data center that provides applications and technology that enable user entities to process financial transactions.

.111 SSAE No. 16 discusses the requirements and guidance for a service auditor reporting on a service organization's controls. Among the changes made to the guidance, two major changes would affect a service auditor's engagement: (*a*) management of the service organization will now be required to provide the service auditor with a written assertion about the fairness of the presentation of the description of the system and about the suitability of the design and, in a type 2 engagement, the operating effectiveness of controls, and (*b*) in a type 2 engagement, the description of the service organization's system and the service auditor's opinion on the description will cover a period (the same period as the period covered by the service auditor's tests of the operating effectiveness of controls). SSAE No. 16 enables a service auditor to perform two types of engagements:

- A *type 1 engagement* is when the service auditor reports on the fairness of the presentation of management's description of the service organization's system and the suitability of the design of the controls to achieve the related control objectives included in the description as of a specified date.
- A *type 2 engagement* is when the service auditor reports on the fairness of the presentation of management's description of the service organization's system and the suitability of the design and operating effectiveness of the controls to achieve the related control objectives included in the description throughout a specified period.

.112 A service auditor's report provides useful information only to a user organization that actually uses those services and needs that information to make decisions about its own internal control over financial reporting. Therefore, use of an SSAE No. 16 report is restricted to user entities that are

customers of the service organization and user auditors (this restriction was also present for a SAS No. 70 report). An SSAE No. 16 report is not intended to be used as a marketing or sales tool by the client. As with SAS No. 70 reports, there is no such thing as being "SSAE No. 16 certified." It is a popular misconception that a service organization can become "certified" as compliant after undergoing a service auditor's engagement. An SSAE No. 16 report is primarily an auditor-to-auditor communication. Further, SSAE No. 16 (as well as SAS No. 70), does not apply to examinations of controls over subject matter other than financial reporting. These engagements would be performed under AT section 101, *Attest Engagements* (AICPA, *Professional Standards*, vol. 1).

.113 The AICPA is in the process of overhauling and rewriting the Audit Guide *Service Organizations: Applying SAS No. 70, as Amended* (commonly known as the SAS 70 guide). Also, to address reporting on a service provider's controls over subject matter other than financial reporting, the AICPA is developing a new Audit Guide, *Reporting on Controls at a Service Provider Relevant to Security, Availability, Processing Integrity, Confidentiality, or Privacy*. Both guides are expected to be available for sale in early 2011. The AICPA is also in the process of drafting communication materials that will help auditors, clients, and users understand the three types of service organization control (SOC) reports (formerly SAS No. 70 reports) to be used for reporting on these engagements.

	Title	***Description***
SOC 1	*Report on Controls at a Service Organization Relevant to User Entities' Internal Control over Financial Reporting*	To be used only in circumstances when the service organization's services and controls affect the internal control over financial reporting for the entities that use the service.
SOC 2	*Report on Controls at a Service Organization relevant to Security, Availability, Processing Integrity, Confidentiality, and Privacy*	The purpose is to convey trust and assurance to users of the system that the service organization has deployed an effective control system to effectively mitigate operational and compliance risks that the system may represent to its users.
SOC 3	*Trust Services Report*	These reports are designed to meet the needs of users who want assurance on the controls at a service organization related to security, availability, processing integrity, confidentiality, or privacy of a system but do not have the need for the level of detail provided in an SOC 2 report. These reports are general use reports and can be freely distributed or posted on a website as a seal.

Compilation and Review Engagements

.114 The AICPA developed a brand new guide, *Compilation and Review Engagements*, which provides additional information on implementing Statement on Standards for Accounting and Review Services No. 19, *Compilation and Review Engagements* (AICPA, *Professional Standards*, vol. 2). It also includes illustrative engagement and representation letters, sample compilation and review reports, detailed illustrations, and case studies. This guide is now available electronically and in paperback on www.cpa2biz.com.

Accounting Issues and Developments

Accounting for Certain Distributions to Shareholders

.115 In January 2010, FASB issued ASU No. 2010-01, *Equity (Topic 505): Accounting for Distributions to Shareholders with Components of Stock and Cash—a consensus of the FASB Emerging Issues Task Force*. This ASU affects entities that declare dividends to shareholders that may be paid in cash or shares at the election of the shareholders, with a potential limitation on the total amount of cash that all shareholders can elect to receive in the aggregate. The amendments in this ASU clarify that the stock portion of the distribution that allows the shareholders to elect or receive cash or shares, with a potential limitation on the total amount of cash that all shareholders can elect to receive in the aggregate, is considered a share issuance. The intent is to eliminate the current diversity in practice. These amendments are effective for interim and annual periods ending on or after December 15, 2009, and should be applied on a retrospective basis.

Accounting for Uncertainty in Income Taxes

.116 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]).

.117 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.

.118 In June 2010, to clarify some practice issues related to FASB ASC 740-10, the AICPA issued TIS section 5250.14, "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," and TIS section 5250.15 "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" (AICPA, *Technical Practice Aids*). TIS section 5250.14 explains that the scope of FASB ASC 740-10 applies to income taxes only (not sales, payroll, and other taxes). Entities should follow the guidance contained in FASB ASC 450, *Contingencies*, to account for uncertainties in taxes other than income taxes. TIS section 5250.15 clarifies that the disclosure requirements in paragraph 15(c)–(e) of FASB ASC 740-10-50 remain in effect (if applicable), regardless of whether an entity has any uncertain tax positions. Those disclosure requirements include the following:

- The total amounts of interest and penalties recognized in both the statement of operations and the statement of financial position
- For positions for which it is reasonably possible that the total amounts of unrecognized tax benefits will significantly increase or decrease within 12 months of the reporting date, the nature of the uncertainty, the nature of the event that could occur in the next 12 months that would cause the change, and an estimate of the range of the reasonably possible change or a statement that an estimate of the range cannot be made
- A description of tax years that remain subject to examination by major tax jurisdictions

.119 Recently issued technical questions and answers of the AICPA can be accessed at www.aicpa.org/InterestAreas/AccountingAndAuditing/Resources/Pages/RecentlyIssuedTechnicalQuestionsandAnswers.aspx.

Decreases in Ownership of a Subsidiary

.120 In January 2010, FASB issued 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*). FASB ASC 810-10 requires an entity to deconsolidate a subsidiary when the entity ceases to have a controlling financial interest in the subsidiary. Upon deconsolidation, an entity recognizes a gain or loss on the transaction and measures any retained investment in the subsidiary at fair value. That gain or loss includes any gain or loss associated with the difference between the fair value of the retained investment in the subsidiary and its

carrying amount at the date the subsidiary is deconsolidated. This guidance aligns the accounting for both business combinations and dispositions by recognizing any preexisting interest or retained investment in a subsidiary at its fair value. In contrast, an entity is required to account for a decrease in its ownership interest of a subsidiary that does not result in a change of control as an equity transaction.

.121 These amendments affect any entity that experiences a decrease in ownership in a subsidiary that is a business or nonprofit activity, plus any entity that exchanges a group of assets that constitutes a business or nonprofit activity for an equity interest in another entity. These amendments clarify that the scope of the decrease in ownership provisions of FASB ASC 810-10 and related guidance apply to the following:

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

.122 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
- Conveyances of oil and gas mineral rights

.123 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.

Consolidation of Variable Interest Entities

.124 For calendar year entities, 2010 is the first year of application of FASB Statement No. 167, 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 FASB 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. As explained by FASB ASC 810-10-65-2(i), this guidance may be applied retrospectively in previously issued financial statements for one or more years, with a cumulative-effect adjustment to retained earnings as of the beginning of the first year restated. FASB Statement No. 167 retains the scope of previous variable interest entities (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, which was incorporated into FASB ASC by ASU No. 2009-16, *Transfers and Servicing (Topic 860): Accounting for Transfers of Financial Assets*. As a result of including qualifying special purpose entities, transferors, sponsors, and investors in those entities must now consider the consolidation and disclosure provisions in FASB Statement No. 167.

.125 FASB Statement No. 167 states that 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 consolidation of VIE guidance to eliminate the quantitative approach previously required for determining the primary beneficiary of a VIE, which was based on determining which company absorbs the majority of the entity's expected losses, receives a majority of the entity's expected residual returns, or both. In the new guidance, kickout rights and participating rights are ignored both in the determination of whether an entity is a VIE and in the identification of the VIE's primary beneficiary, unless the rights are held by a single reporting entity.

.126 Under the new guidance, a reporting entity must now continually reconsider which variable interest holder is the VIE's primary beneficiary. Additionally, if equity interest holders lose the power from the voting rights of those investments to direct the entity's most significant activities, the reporting entity must reconsider an entity's VIE status. Also, a reporting entity must meet six conditions to make the determination that fees paid to a decision maker or service provider do not represent a variable interest. Fees paid to an enterprise that acts solely as a fiduciary or agent should typically not represent a variable interest in a VIE because those fees would meet all of the conditions. A primary beneficiary must present separately, on the face of the balance sheet, assets of consolidated VIEs that can only be used to settle obligations of those VIEs and liabilities of consolidated VIEs for which creditors do not have recourse to the general credit of the primary beneficiary. Power is only considered shared (and no party consolidates) if two or more unrelated parties together have the power to direct the VIE's most significant activities and decisions about those activities require the consent of each of the parties sharing power.

.127 Only substantive terms, transactions, and arrangements, whether contractual or noncontractual, should be considered when applying this guidance. Any term, transaction, or arrangement that does not have a substantive effect on an entity's status as a VIE, an enterprise's power over a VIE, or an enterprise's obligation to absorb losses or its right to receive benefits of the entity should be disregarded when applying the provisions of this guidance. Judgment, based on all facts and circumstances, is needed to make this determination.

.128 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

SEC Considerations on FASB Statement No. 167

.129 The SEC staff shared with the Center for Audit Quality (CAQ) SEC Regulations Committee its FASB Statement No. 167 views regarding transition questions for SEC registrants and the internal control over financial reporting requirements for an entity newly consolidated pursuant to this guidance.

.130 The SEC staff indicated that if an entity has elected to adopt FASB Statement No. 167 retrospectively and has filed interim financial statements for a period that includes the date of adoption, that registrant must recast its prior period annual financial statements that are incorporated by reference to reflect a material retrospective application of FASB Statement No. 167. Conversely, if a registrant elects to adopt FASB Statement No. 167 only on a prospective basis, or if the retrospective application of the guidance is not material, its registration statement may incorporate by reference its most recent Form 10-K, which would include its historical annual financial statements of periods prior to the adoption of FASB Statement No. 167 (assuming that the prior financial statements do not require revision for other purposes).

.131 An SEC registrant must present in its Form 10-K three years of comparative income statements and two years of comparative balance sheets (two years of comparative income statements and balance sheets for a smaller reporting company). The Form 10-K of an SEC registrant that is not a smaller reporting company also must include a table of selected financial data for the past five years (or a longer period at the registrant's option). This creates another issue addressed by the SEC staff, which is whether an SEC registrant that retrospectively applies FASB Statement No. 167 to all periods presented in its financial statements would be permitted to retrospectively apply the effects of the guidance to any additional periods presented in the table of selected financial data. The SEC staff indicated that it expects there to be consistency between the application of FASB Statement No. 167 in the financial statements and in the table of selected financial data. In all cases, the SEC staff expects a registrant to disclose to which periods it has retrospectively applied FASB Statement No. 167 and, if necessary, the fact that certain periods are not comparable to the periods for which the audited financial statements are provided. For example, if a calendar year-end entity adopts FASB Statement No. 167 on January 1, 2010, and elects to retrospectively apply it to fiscal years 2009 and 2008, the entity will record a cumulative effect adjustment to retained earnings as of January 1, 2008. The registrant may decide whether it will also apply FASB Statement No. 167 to fiscal years 2006 and 2007 within the selected financial data table.

.132 The SEC staff also commented on the internal control over financial reporting considerations related to FASB Statement No. 167. The SEC staff stated that VIEs consolidated upon adoption of the guidance should be

included in management's reports on internal control over financial reporting. Because the criteria for consolidation of a VIE are now based upon control, a registrant will no longer be able to justify excluding consolidated VIEs from the scope of its internal controls assessment because it will likely have the right or authority to assess the internal controls of those VIEs. Further, because the consolidation of VIEs will occur as of the first day of the registrant's fiscal year, the registrant will have sufficient time to perform that assessment and would be unable to rely on the temporary relief provided under the SEC staff's third question in *Management's Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports: Frequently Asked Questions* (Section 4310.11 of the Division of Corporation Finance *Financial Reporting Manual*). However, the SEC staff did explain that after adoption of FASB Statement No. 167, an SEC registrant may apply the guidance in the third question when considering whether it would be appropriate to exclude a VIE that is newly consolidated due to events or changes in circumstances from the scope of its internal control assessment in the fiscal year consolidation first occurs, if an internal control assessment is not possible.

.133 Additionally, the guidance contained in the first question continues to apply only in the rare circumstance in which the VIE was in existence prior to December 15, 2003, and the registrant, despite having control, does not possess the right or authority to assess the VIE's internal controls and lacks the ability, in practice, to make that assessment. Registrants may continue to follow the guidance in the first question in this rare circumstance.

.134 In early June 2010, a speech given by a member of the Office of the Chief Accountant at the SEC discussed the issue of structuring transactions to achieve an accounting result, specifically in regard to FASB Statement No. 167. The speech reinforces the guidance in the new standard, specifically that the substance of an arrangement should be considered, not just the form; further, nonsubstantive terms should be disregarded when determining who makes the key decisions that most significantly impact an entity's economic performance. The speech also discusses the SEC's thoughts with regard to certain strategies that entities may use to avoid consolidation. The overarching themes were that significant judgment is required in determining whether a controlling financial interest exists in complex fact patterns and that the Office of the Chief Accountant is available if a registrant would like to consult regarding its accounting for unusual transactions when it believes the application of GAAP is unclear. The full text of the speech can be accessed at www.sec.gov/news/speech/2010/spch060310pab.htm.

Application of Consolidation Requirements for Certain Investment Funds

.135 In February 2010, FASB issued ASU No. 2010-10, *Consolidation (Topic 810): Amendments for Certain Investment Funds*. This ASU defers the amendments to consolidation guidance from FASB Statement No. 167 for a reporting entity's interest in an entity that has all the attributes of an investment company, as specified in FASB ASC 946, *Financial Services—Investment Companies*, or for which it is industry practice to apply measurement principles for financial reporting that are consistent with those in FASB ASC 946. The deferral also applies to a reporting entity's interest in an entity that is required to comply with or operate in accordance with requirements that are similar to those included in Rule 2a-7 of the Investment Company Act of 1940 for registered money market funds. ASU No. 2010-10 does not defer the disclosure

requirements in FASB Statement No. 167. For further details, including to whom the deferral does not apply, readers are encouraged to review the full text of ASU No. 2010-10, which can be found on FASB's website.

Accounting for Transfers of Financial Assets

.136 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 FASB 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.

.137 Historically, accounting for transfers in which the transferor has no continuing involvement with the transferred financial assets or transferee has not been controversial. However, transfers of financial assets with continuing involvement raise questions about the circumstances under which the transfers should be accounted for as sales or secured borrowings and about how transferors and transferees should account for sales and secured borrowings. This guidance 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.

.138 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. All transferees, including VIEs, must now be evaluated for consolidation, unless another exception is available. This aspect of the new guidance is considered by many to have the most profound effect. Additionally, the special provisions for guaranteed mortgage securitizations have been removed, and those securitizations will be treated the same as any other transfer of financial assets within FASB ASC 860. If such securitizations do not meet the requirements for sale treatment accounting, the securitized mortgage loans will continue to be classified as loans in the transferor's statement of financial position. The transferor also would not separately recognize a servicing asset or servicing liability.

.139 The amendments also modify the financial components approach and limit the circumstances in which a transferor derecognizes a portion or

component of a financial asset when the transferor has not transferred the original financial asset or when the transferor has continuing involvement with the financial asset. The unit of account eligible for sale accounting is limited to an entire financial asset, a group of entire financial assets, or a participating interest in an entire financial asset (as defined in "Pending Content" of FASB ASC 860-10-40-6A). Inherent in this requirement is that an entire financial asset cannot be divided into components prior to a transfer, with those components being eligible for derecognition upon transfer, unless all of the components meet the definition of a participating interest. The legal isolation analysis is clarified in the new guidance to ensure that the financial asset has been put beyond the reach of the transferor, its consolidated affiliates (affiliates that are not entities designed to make remote the possibility that they would enter bankruptcy or other receivership) included in the financial statements being presented, and its creditors.

.140 The principle of effective control is also clarified so that the transferor must evaluate whether it, its consolidated affiliates included in the financial statements being presented, or its agents effectively control the transferred financial asset(s) directly or indirectly. Further, when evaluating transfers of financial assets for derecognition, an entity must consider all arrangements or agreements made contemporaneously with, or in contemplation of, a transfer, even if not entered into at the time of the transfer. Also, the practicability exception from measuring the proceeds received by a transferor in a transfer that qualifies for sale accounting at fair value has been removed.

.141 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

.142 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

.143 FASB Statement No. 165, which has been codified in FASB ASC 855, became effective for interim and annual periods ending after June 15, 2009, and establishes 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. In September 2009, the AICPA issued 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.

.144 In February 2010, FASB issued ASU No. 2010-09 to address questions that arose in practice about potential conflicts between FASB ASC 855 and SEC guidance—specifically, the requirements to disclose the date that the financial statements are issued. This ASU also addresses the intended breadth of the reissuance disclosure provision related to subsequent events.

.145 ASU No. 2010-09 requires an entity that is an SEC filer or a conduit bond obligor for conduit debt securities that are traded in a public market to evaluate subsequent events through the date the financial statements are issued. As stated in the definition of *financial statements are issued* in the FASB ASC glossary, financial statements are considered issued when they are widely distributed to shareholders and other financial statement users for general use and reliance in a form and format that complies with GAAP. All other entities must evaluate subsequent events through the date the *financial statements are available to be issued*; as defined by the FASB ASC glossary, this is when they are complete in a form and format that complies with GAAP and all approvals necessary for issuance have been obtained (for example from management, the board of directors, or significant shareholders). Further, an entity that is an SEC filer is not required to disclose the date through which subsequent events have been evaluated. Lastly, only non-SEC filers should disclose in the revised financial statements the dates through which subsequent events have been evaluated in both the issued or available-to-be-issued financial statements and the revised financial statements. Revised financial statements are considered reissued financial statements. The amendments in ASU No. 2010-09 are effective upon issuance, except for the use of the issued date for conduit bond obligors. That amendment is effective for interim or annual periods ending after June 15, 2010. TIS section 8700.03 was issued by the AICPA in June 2010 to provide guidance on the application of ASU No. 2010-09, relative to a conduit debt obligor, and is discussed in the "Auditor Responsibilities for Subsequent Events" section of this alert.

Fair Value

.146 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.

Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)

.147 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.

.148 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 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.

.149 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.

.150 These amendments are effective for interim and annual periods ending after December 15, 2009, and are included in FASB ASC 820-10. An AICPA

practice aid, *Alternative Investments—Audit Considerations*, also is available and is a useful tool for auditors. It focuses on the existence and valuation assertions associated with alternative investments.

.151 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.

.152 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

.153 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

.154 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.

.155 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).

.156 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.

.157 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.

.158 In June 2010, the AICPA issued TIS section 1800.05, "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" (AICPA, *Technical Practice Aids*). TIS section 1800.05 explains that the measurement principles of FASB ASC 820 do apply to financial instruments that are not recognized at fair value in the statement of financial position but for which fair value is required to be disclosed in the financial statement notes in accordance with paragraphs 10–19 of FASB ASC 825-10-50. On the other hand, the fair value disclosure requirements of FASB ASC 820-10-50 do not apply to financial instruments that are not recognized at fair value in the statement of financial position. For the complete discussion of these conclusions, readers are encouraged to refer to the full text of the question and answer. Recently issued technical questions and answers can be located on the AICPA's website at www.aicpa.org/InterestAreas/AccountingAndAuditing/Resources/Pages/RecentlyIssuedTechnicalQuestionsandAnswers.aspx.

Subsequent Declines in Market Value

.159 The AICPA issued TIS section 9070.06, "Decline in Market Value of Assets Subsequent to the Balance Sheet Date" (AICPA, *Technical Practice*

Aids), in June 2010 to provide guidance to accountants on the appropriate treatment of declines in the market value of an asset subsequent to the balance sheet date. Through references to FASB ASC 855-10, TIS section 9070.06 clarifies that an entity should only recognize the effects of conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. Changes in the fair value of assets or liabilities (financial or nonfinancial) after the balance sheet date, but before financial statements are issued or are available to be issued, are specifically identified as an example of a nonrecognized subsequent event.

Disclosures About Credit Quality and Allowance for Credit Losses

.160 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.

.161 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

.162 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.

.163 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.

.164 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.

Embedded Credit Derivatives

.165 FASB issued ASU No. 2010-11, *Derivatives and Hedging (Topic 815): Scope Exception Related to Embedded Credit Derivatives*, in March 2010 to address questions that have arisen in practice about the intended breadth of the embedded credit scope exception discussed in paragraphs 8–9 of FASB ASC 815-15-15. ASU No. 2010-11 clarifies the aforementioned scope exception for embedded credit derivative features related to the transfer of credit risk in the form of subordination of one financial instrument to another. This ASU addresses how to determine which credit derivative features, including those in collateralized debt obligations and synthetic collateralized debt obligations, are considered to be embedded derivatives that should not be analyzed under FASB ASC 815-15-25 for potential bifurcation and separate accounting. Further, the ASU explains that upon initial adoption of its amendments, an entity may elect the fair value option for any investment in a beneficial interest in a securitized financial asset. The amendments in this ASU are effective for each reporting entity at the beginning of its first fiscal quarter beginning after June 15, 2010. Early adoption is permitted at the beginning of each entity's first fiscal quarter beginning after the issuance of this ASU.

Share-Based Payment Awards Denominated in a Different Currency

.166 In April 2010, FASB issued ASU No. 2010-13, *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*. This ASU clarifies that an employee share-based payment award with an exercise price denominated in the currency of a market in which a substantial portion of the entity's equity securities trades should not be considered to contain a condition that is not a market, performance, or service condition. Therefore, such an award should not be classified as a liability if it otherwise qualifies as equity. A share-based payment award that contains a condition that is not a market, performance, or service condition is required to be classified as a liability.

.167 This ASU affects entities that issue employee share-based payment awards with an exercise price denominated in the currency of a market in which a substantial portion of the entity's equity securities trades that differs from the functional currency of the employer entity or payroll currency of the employee. This will also affect any entities that have previously considered

such awards to be liabilities because of their exercise price. For example, a parent entity whose functional currency is the Canadian dollar grants equity share options with an exercise price denominated in U.S. dollars to employees of a Canadian entity with the functional and payroll currency of the Canadian dollar. If a substantial portion of the parent entity's equity securities trades on a U.S. dollar denominated exchange, the options are not precluded from equity classification.

.168 The amendments in this ASU are effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2010; early adoption is permitted. These amendments should be applied by recording a cumulative-effect adjustment to the opening balance of retained earnings. The cumulative-effect adjustment should be calculated for all awards outstanding as of the beginning of the fiscal year in which the amendments are initially applied as if the amendments had been applied consistently since the inception of the awards; the adjustment should also be presented separately.

Certificates of Deposit

.169 To provide additional guidance to constituents on the accounting and reporting on certificates of deposit, the AICPA staff issued three technical questions and answers in June 2010. TIS section 2130.40, "Certificates of Deposit and FASB ASC 320, *Investments—Debt and Equity Securities*" (AICPA, *Technical Practice Aids*), explains that, in accordance with the definition of *security* as stated by FASB ASC 320-10-20, certificates of deposit are typically not within the scope of FASB ASC 320, *Investments—Debt and Equity Securities*. That definition states that a *security* is a share, participation, or other interest in property or an entity of the issuer or an obligation of the issuer that has all of the following characteristics: (*a*) it is either represented by an instrument issued in bearer or registered form or, if not represented by an instrument, is registered in books maintained to record transfers by or on behalf of the issuer; (*b*) it is of a type commonly dealt in on securities exchanges or markets or, when represented by an instrument, is commonly recognized in any area in which it is issued or dealt in as a medium for investment; and (*c*) it either is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations. However, certain negotiable certificates of deposit may meet that definition and, therefore, may be subject to FASB ASC 320.

.170 Further, TIS section 2130.38, "Certificates of Deposit and Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 820, *Fair Value Measurements and Disclosures*" (AICPA, *Technical Practice Aids*), explains that certificates of deposit that do not meet the aforementioned definition of a security are not subject to the disclosure requirements of FASB ASC 820-10-50. Negotiable certificates of deposit that do meet that definition will be required to make those disclosures if they are not classified as held to maturity.

.171 Regarding classification on the balance sheet, TIS section 2130.39, "Balance Sheet Classification of Certificates of Deposit" (AICPA, *Technical Practice Aids*), states that certificates of deposit with original maturities of 90 days or less are commonly considered cash and cash equivalents under FASB ASC 305, *Cash and Cash Equivalents*. Those with greater original maturities and not defined as a security (in accordance with FASB ASC 320-10-20) could

be included in the line item "investments—other." An example policy and procedures note disclosure is included in TIS section 2130.39.

FASB Statement No. 168

.172 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 Documentation

.173 You should consider how your entity will reference FASB ASC in your documentation (policy and procedures, technical memorandums, financial statements and filings, engagement working papers, and so on). It is only prudent to reflect current U.S. GAAP in your documentation. The FASB Notice to Constituents (NTC) 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 working papers, articles, textbooks, and related items.

.174 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 audit, attest, or compilation and review working papers 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.

.175 However, if your entity will continue to follow grandfathered guidance not included in FASB ASC, it would still be appropriate to reference those standards (and not FASB ASC). A listing of examples of grandfathered guidance can be found in FASB Statement No. 168.

.176 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

.177 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)

.178 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 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).

.179 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.

.180 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

.181 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.

.182 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.

.183 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.

.184 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.

.185 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."

.186 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.

Convergence With International Financial Reporting Standards

.187 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

.188 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.

.189 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

.190 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.

.191 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.

International Financial Reporting Standard for Small and Medium-sized Entities

.192 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.

.193 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, *Accounting Principles* (AICPA, *Professional Standards*, vol. 2, ET sec. 203 par. .01), 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.

Private Company Financial Reporting

.194 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.

.195 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 Pronouncements

.196 AICPA auditing and attestation standards are applicable only to audits and attestation engagements of nonissuers. The PCAOB establishes auditing and attestation standards for audits of issuers. For information on pronouncements issued subsequent to the writing of this alert, please refer to the AICPA website at www.aicpa.org, the FASB website at www.fasb.org, and the PCAOB website at www.pcaob.org. You also may look for announcements of newly issued accounting standards in the *CPA Letter Daily* and the *Journal of Accountancy*.

Recent Auditing and Attestation Pronouncements and Related Guidance

.197 The following table presents a list of recently issued audit and attestation pronouncements and related guidance.

Recent Auditing and Attestation Pronouncements and Related Guidance	
Statement on Auditing Standards (SAS) No. 120, *Required Supplementary Information* (AICPA, *Professional Standards*, vol. 1, AU sec. 558) Issue Date: February 2010 (Applicable to audits conducted in accordance with generally accepted auditing standards [GAAS])	This standard addresses the auditor's responsibility with respect to information that a designated accounting standard setter requires to accompany an entity's basic financial statements. In the absence of any separate requirement in the particular circumstances of the engagement, the auditor's opinion on the basic financial statements does not cover required supplementary information. It also supersedes AU section 558A, *Required Supplementary Information* (AICPA, *Professional Standards*, vol. 1). This SAS is effective for periods beginning on or after December 15, 2010. Early application is permitted.
SAS No. 119, *Supplementary Information in Relation to the Financial Statements as a Whole* (AICPA, *Professional Standards*, vol. 1, AU sec. 551) Issue Date: February 2010 (Applicable to audits conducted in accordance with GAAS)	This SAS addresses the auditor's responsibility when engaged to report on whether supplementary information is fairly stated, in all material respects, in relation to the financial statements as a whole. The information covered by this SAS is presented outside the basic financial statements and is not considered necessary for the financial statements to be fairly presented in accordance with the applicable financial reporting framework. Along with SAS No. 118, *Other Information in Documents Containing Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1, AU sec. 550), this SAS also supersedes AU section 551A, *Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents* (AICPA, *Professional Standards*, vol. 1). This SAS is effective for periods beginning on or after December 15, 2010. Early application is permitted.

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Recent Auditing and Attestation Pronouncements and Related Guidance	
SAS No. 118, *Other Information in Documents Containing Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1, AU sec. 550) Issue Date: February 2010 (Applicable to audits conducted in accordance with GAAS)	This SAS addresses the auditor's responsibility in relation to other information in documents containing audited financial statements and the auditor's report thereon. In the absence of any separate requirement in the particular circumstances of the engagement, the auditor's opinion on the financial statements does not cover other information, and the auditor has no responsibility for determining whether such information is properly stated. This SAS establishes the requirement for the auditor to read the other information of which the auditor is aware because the credibility of the audited financial statements may be undermined by material inconsistencies between the audited financial statements and other information. This SAS supersedes AU section 550A, *Other Information in Documents Containing Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1), and along with SAS No. 119 supersedes AU section 551A. This SAS is effective for periods beginning on or after December 15, 2010. Early application is permitted.
SAS No. 117, *Compliance Audits* (AICPA, *Professional Standards*, vol. 1, AU sec. 801) Issue Date: December 2009 (Applicable to audits conducted in accordance with GAAS)	This standard amends AU section 801 to reflect changes in the compliance audit environment and incorporates the risk assessment standards. It requires the auditor to adapt and apply the AU sections of the AICPA's *Professional Standards* to compliance audits and provides guidance on how to do so. It is effective for compliance audits for fiscal periods ending on or after June 15, 2010. Earlier application is permitted.
Statement on Standards for Attestation Engagements (SSAE) No. 16, *Reporting on Controls at a Service Organization* (AICPA, *Professional Standards*, vol. 1, AT sec. 801) Issue Date: April 2010	SSAE No. 16 supersedes the guidance for service auditors in AU section 324, *Service Organizations* (AICPA, *Professional Standards*, vol. 1), and addresses examination engagements undertaken by a service auditor to report on controls at organizations that provide services to user entities when those controls are likely to be relevant to user entities' internal control over financial reporting. Reports prepared in accordance with SSAE No. 16 may provide

Recent Auditing and Attestation Pronouncements and Related Guidance	
	appropriate evidence under AU section 324. It is effective for service auditors' reports for periods ending on or after June 15, 2011. Earlier implementation is permitted.
Public Company Accounting Oversight Board (PCAOB) Auditing Standard No. 15, *Audit Evidence* (subject to approval by the Securities and Exchange Commission [SEC]) Issue Date: August 2010 (Applicable to audits conducted in accordance with PCAOB standards)	This standard explains what constitutes audit evidence and establishes requirements for designing and performing audit procedures to obtain sufficient appropriate audit evidence to support the opinion expressed in the auditor's report.
PCAOB Auditing Standard No. 14, *Evaluating Audit Results* (subject to approval by the SEC) Issue Date: August 2010 (Applicable to audits conducted in accordance with PCAOB standards)	This standard establishes requirements regarding the auditor's evaluation of audit results and determination of whether the auditor has obtained sufficient appropriate audit evidence. The evaluation process set forth in this standard includes, among other things, evaluation of misstatements identified during the audit; the overall presentation of the financial statements, including disclosures; and the potential for management bias in the financial statements.
PCAOB Auditing Standard No. 13, *The Auditor's Responses to the Risks of Material Misstatement* (subject to approval by the SEC) Issue Date: August 2010 (Applicable to audits conducted in accordance with PCAOB standards)	This standard establishes requirements for responding to the risks of material misstatement in financial statements through the general conduct of the audit and performing audit procedures regarding significant accounts and disclosures.
PCAOB Auditing Standard No. 12, *Identifying and Assessing Risks of Material Misstatement* (subject to approval by the SEC) Issue Date: August 2010 (Applicable to audits conducted in accordance with PCAOB standards)	This standard establishes requirements regarding the process of identifying and assessing risks of material misstatement of the financial statements. The risk assessment process discussed in the standard includes information-gathering procedures to identify risks and an analysis of the identified risks.

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Recent Auditing and Attestation Pronouncements and Related Guidance	
PCAOB Auditing Standard No. 11, *Consideration of Materiality in Planning and Performing an Audit* (subject to approval by the SEC) Issue Date: August 2010 (Applicable to audits conducted in accordance with PCAOB standards)	This standard describes the auditor's responsibilities for consideration of materiality in planning and performing an audit.
PCAOB Auditing Standard No. 10, *Supervision of the Audit Engagement* (subject to approval by the SEC) Issue Date: August 2010 (Applicable to audits conducted in accordance with PCAOB standards)	This standard sets forth requirements for supervision of the audit engagement, including, in particular, supervising the work of engagement team members. It applies to the engagement partner and other engagement team members who assist the engagement partner with supervision.
PCAOB Auditing Standard No. 9, *Audit Planning* (subject to approval by the SEC) Issue Date: August 2010 (Applicable to audits conducted in accordance with PCAOB standards)	This standard establishes requirements regarding planning an audit, including assessing matters that are important to the audit, and establishing an appropriate audit strategy and audit plan.
PCAOB Auditing Standard No. 8, *Audit Risk* (subject to approval by the SEC) Issue Date: August 2010 (Applicable to audits conducted in accordance with PCAOB standards)	This standard discusses the auditor's consideration of audit risk in an audit of financial statements as part of an integrated audit or an audit of financial statements only. It describes the components of audit risk and the auditor's responsibilities for reducing audit risk to an appropriately low level in order to obtain reasonable assurance that the financial statements are free of material misstatement.
PCAOB Auditing Standard No. 7, *Engagement Quality Review* (AICPA, *PCAOB Standards and Related Rules*, Standards, AU-P sec. 162) Issue Date: January 2010 (Applicable to audits conducted in accordance with PCAOB standards)	This standard and its related amendments supersede the interim concurring partner review requirements and update the interim quality control standards. An engagement quality review and concurring approval of issuance are required for each audit engagement and for each engagement to review interim financial information conducted pursuant to the standards of the PCAOB. The standard provides a framework for the engagement quality reviewer to objectively evaluate the

Recent Auditing and Attestation Pronouncements and Related Guidance	
	significant judgments made and related conclusions reached by the engagement team in forming an overall conclusion about the engagement. It is effective for engagement quality reviews of audits and interim reviews for fiscal years that began on or after December 15, 2009.
PCAOB Staff Question and Answer, *Auditing Standard No. 7*, Engagement Quality Review (AICPA, *PCAOB Standards and Related Rules*, PCAOB Staff Guidance, sec. 100.10) Issue Date: February 2010 (Applicable to audits conducted in accordance with PCAOB standards)	This staff question and answer provides further implementation guidance on the documentation requirements of Auditing Standard No. 7 (AU-P sec. 162) in light of comments the SEC received during its comment period.
PCAOB Staff Audit Practice Alert (PA) No. 6, *Auditor Considerations Regarding Using the Work of Other Auditors and Engaging Assistants from Outside the Firm* (AICPA, *PCAOB Standards and Related Rules*, PCAOB Staff Guidance, sec. 400.06) Issue Date: July 2010 (Applicable to audits conducted in accordance with PCAOB standards)	This alert is intended to remind registered public accounting firms of their obligations when using the work of other firms or using assistants engaged from outside the firm. The alert was prompted by observations by the PCAOB that a number of registered public accounting firms located within the United States have been issuing reports on financial statements filed by issuers that have substantially all of their operations outside of the United States, and some of these firms may not be conducting those audits in accordance with PCAOB standards.
PCAOB Staff Audit PA No. 5, *Auditor Considerations Regarding Significant Unusual Transactions* (AICPA, *PCAOB Standards and Related Rules*, PCAOB Staff Guidance, sec. 400.05) Issue Date: April 2010 (Applicable to audits conducted in accordance with PCAOB standards)	This alert explains that significant unusual transactions, especially those close to period-end that pose difficult substance over form questions, can provide opportunities for entities to engage in fraudulent financial reporting. This staff audit practice alert is designed to remind auditors of public companies about their responsibilities to assess and respond to the risk of material misstatement of the financial statements due to error or fraud posed by significant unusual transactions.

Recent ASUs

.198 The following table presents, by codification area, a list of recently issued ASUs, through the issuance of ASU No. 2010-22, *Accounting for Various Topics—Technical Corrections to SEC Paragraphs (SEC Update)*. 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*
ASU No. 2009-13 (October 2009)	*Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements—a consensus of the FASB Emerging Issues Task Force*

Recent Accounting Standards Updates	
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. 2009-12 (September 2009)	*Fair Value Measurements and Disclosures (Topic 820): Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*
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*

(continued)

Recent Accounting Standards Updates	
Industry Area of FASB ASC—continued	
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*
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*

Recent Technical Questions and Answers

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

Recent Technical Questions and Answers (AICPA, *Technical Practice Aids*)	
Technical Questions and Answers (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 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 8700.03 June 2010	"Auditor's Responsibilities for Subsequent Events Relative to a Conduit Debt Obligor"

Recent Technical Questions and Answers (AICPA, *Technical Practice Aids*)	
TIS section 9070.06 June 2010	"Decline in Market Value of Assets Subsequent to the Balance Sheet Date"
TIS section 6140.23 June 2010	"Changing Net Asset Classifications Reported in a Prior Year"
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"
TIS section 6140.25 June 2010	"Multiyear Unconditional Promises to Give—Measurement Objective and the Effect of Changes in Interest Rates"
TIS section 6930.02 June 2010	"Defined Benefit Plan Measurement of a Life Insurance Policy"
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 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 2240.06 June 2010	"Measurement of Cash Value Life Insurance Policy"
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 2130.39 June 2010	"Balance Sheet Classification of Certificates of Deposit"
TIS section 2130.40 June 2010	"Certificates of Deposit and FASB ASC 320, *Investments—Debt and Equity Securities*"
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"

(continued)

Recent Technical Questions and Answers (AICPA, *Technical Practice Aids*)	
TIS section 9110.16 February 2010	"Example Reports on Federal Deposit Insurance Corporation Loss Sharing Purchase and Assumption Transactions"
TIS section 9150.26 December 2009	"The Accountant's Responsibilities for Subsequent Events in Compilation and Review Engagements"
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 2220.18 December 2009	"Applicability of Practical Expedient"
TIS section 2220.19 December 2009	"Unit of Account"
TIS section 2220.20 December 2009	"Determining Whether NAV Is Calculated Consistent With FASB ASC 946, *Financial Services—Investment Companies*"
TIS section 2220.21 December 2009	"Determining Whether an Adjustment to NAV Is Necessary"
TIS section 2220.22 December 2009	"Adjusting NAV When It Is Not as of the Reporting Entity's Measurement Date"
TIS section 2220.23 December 2009	"Adjusting NAV When It Is Not Calculated Consistent With FASB ASC 946"
TIS section 2220.24 December 2009	"Disclosures—Ability to Redeem Versus Actual Redemption Request"
TIS section 2220.25 December 2009	"Impact of 'Near Term' on Classification Within Fair Value Hierarchy"
TIS section 2220.26 December 2009	"Categorization of Investments for Disclosure Purposes"
TIS section 2220.27 December 2009	"Determining Fair Value of Investments When the Practical Expedient Is Not Used or Is Not Available"
TIS section 8700.01 September 2009	"Effect of FASB ASC 855 on Accounting Guidance in AU Section 560"
TIS section 8700.02 September 2009	"Auditor Responsibilities for Subsequent Events"

Recent AICPA Independence and Ethics Developments

.200 The Audit Risk Alert *Independence and Ethics Developments—2009* (product no. 0224709) 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

.201 One of the Professional Ethics Executive Committee's (PEEC's) current projects deals with a possible inconsistency within Interpretation No. 101-3, "Performance of Nonattest Services." under Rule 101, *Independence* (AICPA, *Professional Standards*, vol. 2, ET sec. 101 par. .05). 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. The 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 COSO's information and communication element of internal control. Additionally, some nonattest activities, such as performing calculations (for example, tax provision, leases, last in first out [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).

.202 To address the possible inconsistency in Interpretation No. 101-3, the PEEC is considering possible clarifying revisions to Interpretation No. 101-3, and accordingly, readers are encouraged to monitor the progress of this project.

.203 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.

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

On the Horizon

.205 Auditors should keep abreast of auditing and accounting developments and upcoming guidance that may affect their engagements. The following sections present brief information about some ongoing projects that are of particular significance or that may result in significant changes. Remember that exposure drafts are nonauthoritative and cannot be used as a basis for changing existing standards.

.206 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 and auditing projects exist in addition to those discussed

here. Readers should refer to information provided by the various standard setting bodies for further information.

Auditing and Attestation Pipeline—Nonissuers

ASB Clarity Project

.207 In response to growing concerns about the complexity of standards, the ASB has 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 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. Two possible exceptions to that timeframe include the clarity redrafts of AU sections 341 and 532, *Restricting the Use of an Auditor's Report* (AICPA, *Professional Standards*, vol. 1).

.208 In May 2010, the expected effective date of the clarified standards was revised to be applicable for audits of financial statements for periods ending on or after December 15, 2012. The standards recently issued in clarified format (SAS Nos. 117–120) have different effective dates. The ASB believes that having a single effective date for most of the clarified standards will ease the transition to, and implementation of, the redrafted standards. The effective date will be long enough after all redrafted statements are finalized to allow sufficient time for training and updating of firm audit methodologies. This expected date depends on satisfactory progress being made and will be amended, if necessary. Further, early adoption of the new SAS will not be appropriate. The SAS that will encompass all clarified AU sections will be issued with the next consecutive number that is available. See the explanatory memorandum "Clarification and Convergence," the discussion paper *Improving the Clarity of ASB Standards*, and *Clarity Project: Questions and Answers* at www.aicpa.org/InterestAreas/AccountingAndAuditing/Resources/AudAttest/AudAttestStndrds/ASBClarity/Pages/ImprovingClarityASBStandards.aspx. All clarified SASs that have been finalized by the ASB but are not yet issued as authoritative can be found at www.aicpa.org/InterestAreas/AccountingAndAuditing/Resources/AudAttest/AudAttestStndrds/ASBClarity/Pages/Final%20Clarified%20Statements%20on%20Auditing%20Standards.aspx.

Interim Financial Information

.209 In July 2010, the ASB issued two proposed SASs on interim financial information. The first, *Revised Applicability of Statement on Auditing Standards No. 116*, Interim Financial Information, is intended to revise paragraph 5 of SAS No. 116, *Interim Financial Information* (AICPA, *Professional Standards*, vol. 1, AU sec. 722), so that the guidance in SAS No. 116 would be applicable when the auditor audited the entity's latest annual financial statements and the appointment of another auditor to audit the current year financial statements is not effective prior to the beginning of the period covered by the review. Currently, the guidance in SAS No. 116 is applicable when the auditor

performs the audit of the latest annual financial statements and expects to be engaged to audit the current year financial statements (and, therefore, is not applicable when the auditor expects that a new auditor may be engaged for the current year). This proposed amendment would be effective for interim reviews of interim financial information for periods beginning after December 15, 2011, with early implementation permitted. Comments are due by October 8, 2010.

.210 The second proposal on interim financial information, *Interim Financial Information* (Redrafted), would supersede SAS No. 116 and represents the redrafting of the guidance to apply clarity drafting conventions. The main changes to existing standards are as follows:

- Replacement of the term *accountant* with *auditor*
- The change to paragraph 5 discussed in the prior paragraph
- Requirement of the auditor to issue a written report unless the review of the interim financial information is required by a third party and the third party does not require a written review report
- Allowance of oral reports for entities that are subject to external requirements to report in a manner that is substantially similar to the reporting required of issuers, pursuant to PCAOB standards
- Requirement for the auditor to perform procedures consistent with those required for acceptance of an engagement to audit financial statements
- Requirement for the review report to include a statement that the review of interim financial information was conducted in accordance with auditing standards generally accepted in the United States of America

.211 This proposed SAS would be effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2012. Comments for this proposed SAS are also due by October 8, 2010.

Finalized Clarified SAS on Service Organizations

.212 As discussed in the "Service Organizations" section of this alert, the ASB released the finalized clarified SAS on service organizations, *Audit Considerations Relating to an Entity Using a Service Organization*, which will supersede SAS No. 70 upon its effective date. This SAS, along with the majority of other clarified auditing standards, will be effective for periods ending on or after December 15, 2012. This SAS addresses the user auditor's responsibility for obtaining sufficient appropriate audit evidence in an audit of the financial statements of a user entity that uses one or more service organizations. The SAS defines a *service auditor* as a practitioner who reports on controls at a service organization and a *user auditor* as an auditor who audits and reports on the financial statements of a user entity. Services provided by a service organization are relevant to the audit of a user entity's financial statements when those services and the controls over them affect the user entity's information system, including related business processes, relevant to financial reporting. The nature and extent of work to be performed by the user auditor regarding the services provided by a service organization depend on the nature and significance of those services to the user entity and the relevance of those services

to the audit. The objectives of the user auditor, when the user entity uses the services of a service organization, are to

- obtain an understanding of the nature and significance of the services provided by the service organization and their effect on the user entity's internal control relevant to the audit, sufficient to identify and assess the risks of material misstatement.
- design and perform audit procedures responsive to those risks.

.213 If the user auditor is unable to obtain a sufficient understanding of the service organization from the user entity, among other options, the auditor may obtain that understanding by obtaining and reading a type 1 or type 2 report, if available. A type 1 report is also referred to as a *report on management's description of a service organization's system and the suitability of the design of controls* and comprises the following: (*a*) management's description of the service organization's system; (*b*) a written assertion by management of the service organization about whether, in all material respects and based on suitable criteria, management's description of the service organization's system fairly presents the service organization's system that was designed and implemented as of a specified date and the controls related to the control objectives stated in management's description of the service organization's system were suitably designed to achieve those control objectives as of the specified date; and (*c*) a service auditor's report that expresses an opinion on the matters in (*b*).

.214 A type 2 report is referred to as a *report on management's description of a service organization's system and the suitability of the design and operating effectiveness of controls*. A type 2 report contains all the same information as a type 1 report except that in the assertion by management of the service organization, the description of the system and its related controls cover a specified period (as opposed to a specified date). A type 2 report also requires management of the service organization to include in their assertion whether the controls related to the control objectives stated in management's description of the service organization's system operated effectively throughout the specified period to achieve those control objectives. Lastly, in a type 2 report, the service auditor's report includes an opinion on the same matters in a type 1 report, plus whether the controls related to the control objectives operated effectively throughout the specified period and a description of the service auditor's tests of controls and the results thereof.

.215 All final clarified SASs can be accessed through the AICPA's website at www.aicpa.org/InterestAreas/AccountingAndAuditing/Resources/AudAttest/AudAttestStndrds/ASBClarity/Pages/Final%20Clarified%20Statements%20on%20Auditing%20Standards.aspx. Guidance for service auditors is contained in the recently issued SSAE No. 16.

Exposure Drafts on Auditor's Reports

.216 The ASB issued three proposed SASs related to auditor's reports: *Forming an Opinion and Reporting on Financial Statements*, *Modifications to the Opinion in the Independent Auditor's Report*, and *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*. These proposed standards are drafted with the ASB's clarity drafting conventions and are intended to converge with ISAs. The intent of issuing three separate SASs is to assist practitioners in identifying and applying the reporting requirements and guidance. The ASB has made various changes to the related

ISAs to tailor them to the United States; however, these changes have not been substantial in nature.

.217 The comment period for the proposed SASs ended in December 2009. The proposed SASs are expected to be effective for audits of financial statements for periods ending on or after December 15, 2012. Auditors are encouraged to review the exposure draft and be alert for developments on this topic.

Exposure Drafts on Special Considerations Audits

.218 Another exposure draft issued by the ASB contains two proposed SASs: *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks* and *Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement*. These proposed standards have been drafted with the clarity drafting conventions and are intended to converge with the equivalent ISAs. No meaningful differences exist between these proposed standards and the ISAs. *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks* addresses the application of GAAS to financial statements prepared under the cash, tax, regulatory, or contractual bases of accounting. It also replaces the term *other comprehensive basis of accounting* with *special purpose framework*.

.219 *Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement* introduces new planning, performance, and reporting requirements for these engagements. The proposed SAS also clarifies that a single financial statement and a specific element of a financial statement include the related notes.

.220 The comment period for the proposed SASs ended in December 2009. The proposed SASs are expected to be effective for audits of financial statements for periods ending on or after December 15, 2012. Auditors are encouraged to review the exposure draft and be alert for developments on this topic.

Auditing and Attestation Pipeline—Issuers

Confirmations

.221 The PCAOB has proposed a draft of an auditing standard on confirmations. A concept release was originally issued in April 2009 and received 24 comment letters. This proposed auditing standard, issued in July 2010, would strengthen the requirements under the current auditing standard, AU-P section 330, *The Confirmation Process* (AICPA, *PCAOB Standards and Related Rules*, Standards), and replace it, upon final issuance of a standard and approval from the SEC. The proposed new standard

- requires confirmation procedures for specific accounts, such as receivables that arise from credit sales, loans, or other transactions, and also in response to significant risks that relate to the relevant assertions that can be adequately addressed by confirmation procedures.
- incorporates procedures in response to the risk of material misstatement, such as in the areas of investigating exceptions reflected on confirmation responses and evaluating nonresponses to confirmation requests.

- updates the confirmation guidance to reflect significant advances in technology and explains that confirmation responses received electronically (for example, by fax e-mail, through an intermediary, or direct access) might involve additional risks relating to reliability. Therefore, the auditor must perform additional requirements.
- defines a confirmation response to include electronic or other medium.
- enhances requirements when confirmation responses include disclaimers and restrictive language by requiring the auditor to evaluate the effect on the reliability of a confirmation response. Further, if the disclaimer or restrictive language causes doubts about the reliability of a confirmation response, the auditor should obtain additional appropriate audit evidence.

.222 In drafting this proposed standard, the PCAOB considered the guidance contained in ISA 505, *External Confirmations*, and the AICPA's proposed guidance on confirmations. This standard is anticipated to be effective for auditors for fiscal years ending on or after December 15, 2011.

Communications With Audit Committees

.223 In March 2010, the PCAOB proposed for comment an auditing standard on *Communications with Audit Committees* and a series of related amendments to its interim standards that are intended to (*a*) enhance the relevance and effectiveness of the communications between the auditor and the audit committee and (*b*) emphasize the importance of effective, two-way communications between the auditor and the audit committee to better achieve the objectives of the audit. Two of the new requirements would be for the auditor (*a*) to establish a mutual understanding of the terms of the audit engagement with the audit committee and to document that understanding in the engagement letter and (*b*) to evaluate the adequacy of two-way communication between the auditor and audit committee. Additionally, the proposal also includes requirements for the auditor to communicate with the audit committee regarding the following:

- An overview of the audit strategy and timing of the audit, including a discussion of significant risks; the use of the internal audit function; and the roles, responsibilities, and location of firms participating in the audit
- Critical accounting policies, practices, and estimates
- The auditor's evaluation of the entity's ability to continue as a going concern

.224 The proposed standard would become effective, subject to SEC approval, for audits of fiscal years beginning after December 15, 2010.

Joint FASB and IASB Accounting Pipeline

FASB and IASB Memorandum of Understanding

.225 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

.226 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.

.227 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, have 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 affect

the SEC's work plan to consider in 2011 whether and how to incorporate IFRSs into the U.S. financial system.

.228 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

.229 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

.230 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.
- Changes in fair value of equity securities, certain hybrid instruments, and financial instruments that can be prepaid in such a way that the holder would not recover substantially all of its investment would be recognized in net income each reporting period regardless of an entity's business strategy for those financial instruments.
- 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 the 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.

.231 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. A comparison of FASB and IASB proposed models for financial instruments as of May 2010 can be found on FASB's website. 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

.232 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.

.233 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).

.234 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.

.235 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

.236 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

.237 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.

.238 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.

.239 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.

.240 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.

.241 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.

.242 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

.243 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

.244 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 understand fully the relationship

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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.

.245 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.

.246 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*, 962, *Plan Accounting—Defined Contribution Pension Plans*, and 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.

.247 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.

.248 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

.249 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 an 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.

.250 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.

.251 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, the lessor 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.

.252 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.

.253 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 roundtable 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.

Auditing Considerations of Accounting Convergence

.254 Although the future of convergence between IASB and FASB accounting standards remains an unknown, discussions have already begun about the potential impact on auditors. Although auditors are accustomed to new standards, the nature and volume of these changes will likely pose new challenges. Among others, some of these potential challenges include the following:

- Training audit staff on a large amount of new accounting guidance that is based on an accounting approach (that is, principles based versus rules based)
- Developing, as necessary, any new internal audit guidance, such as firm methodology
- Implementing any new resulting auditing rules
- Creating a new framework for documenting audit conclusions on a principles-based accounting approach
- Audit committees learning new accounting guidance to effectively perform their function

.255 In addition to the challenges auditors will face, the effects on preparers will also be great. At the time of this writing, it appears that the transition timeline to convergence will be relatively short; this will divert resources during the preparation of financial statements as entities focus on implementing the new principles, which may result in increased audit risk. Auditors, in addition to preparers, are also encouraged to remain current on developments of international accounting convergence.

FASB Accounting Pipeline

Disclosure of Certain Loss Contingencies

.256 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

.257 The amendments in this proposal would affect all entities. The exposure draft noted that FASB will continue to work with the PCAOB, 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

.258 Currently, the only guidance on going concern resides in the auditing literature, and this project's intention is to 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

.259 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

.260 Additionally, FASB has the following projects underway:

- Troubled debt restructuring
- Disclosure framework
- Investment properties

Resource Central

.261 The following are various resources that practitioners may find beneficial.

Publications

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

- Audit Guide *Analytical Procedures* (2008) (product no. 012558 [paperback] or WAN-XX [online])
- Audit Guide *Assessing and Responding to Audit Risk in a Financial Statement Audit* (2009) (product no. 012459 [paperback] or WRA-XX [online])
- Audit Guide *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities* (2010) (product no. 0125210 [paperback] or WDI-XX [online])
- Guide *Compilation and Review Engagements* (2010) (product no. 0128110 [paperback] or WRC-XX [online])
- Audit Guide *Auditing Revenue in Certain Industries* (2010) (product no. 0125110 [paperback] or WAR-XX [online])
- Audit Guide *Audit Sampling* (2008) (product no. 012538 [paperback] or WAS-XX [online])
- Audit Risk Alert *Compilation and Review Developments—2010/11* (product no. 0223010 [paperback])
- Audit Risk Alert *Independence and Ethics Developments—2009* (product no. 0224709 [paperback] or WIA-XX [online])
- *Independence Library* featuring the Audit Risk Alert *Independence and Ethics Developments—2009* and two independence practice aids (product no. WIL-XX [online])
- *Checklists and Illustrative Financial Statements for Corporations* (product no. 008939 [paperback] or WCP-CL [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])
- Audit and Accounting Practice Aid *Independence Compliance: Checklists and Tools for Complying With AICPA and GAO Independence Requirements* (product no. 006661 [paperback] or WGO-XX [online])
- Audit and Accounting Practice Aid *Independence Compliance: Checklists and Tools for Complying With AICPA, SEC, and PCAOB Independence Requirements* (product no. 006660 [paperback] or WSC-XX [online])
- Financial Reporting Alert *Current Economic Crisis: Accounting Issues and Risks for Financial Management and Reporting—2010* (product no. 0292010 [paperback])

AICPA Online Professional Library: Accounting and Auditing Literature

.263 The AICPA has created your core accounting and auditing library online. 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 on 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

.264 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.

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

Online CPE

.266 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 include the following:

- Accounting and Auditing Update
- Small Business Accounting and Auditing Update
- Fair Value Accounting
- Accounting for Goodwill and Other Intangibles
- Uncertainty in Income Taxes
- Revenue Recognition in Today's Business Climate
- International Versus US Accounting
- Fraud and the Financial Statement Audit
- Public Company Update
- SEC Reporting

.267 To register or learn more, visit www.cpa2biz.com.

Webcasts

.268 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

.269 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

.270 Do you have a complex technical question about GAAP, other comprehensive bases of 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

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from 9 a.m. to 8 p.m. EST on weekdays. You can reach the Technical Hotline at (877) 242-7212 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

.271 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.

The CAQ

.272 The CAQ, which is affiliated with the AICPA, was created to serve investors, public company auditors, and the markets. The CAQ's mission is to foster confidence in the audit process and aid investors and the capital markets by advancing constructive suggestions for change rooted in the profession's core values of integrity, objectivity, honesty, and trust.

.273 To accomplish this mission, the CAQ works to make public company audits even more reliable and relevant for investors in a time of growing financial complexity and market globalization. The CAQ also undertakes research, offers recommendations to enhance investor confidence and the vitality of the capital markets, issues technical support for public company auditing professionals, and helps facilitate the public discussion about modernizing business reporting. The CAQ is a voluntary membership center that provides education, communication, representation, and other means to member firms that audit or are interested in auditing public companies. To learn more about the CAQ, visit http://thecaq.aicpa.org.

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Appendix—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	http://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***
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
Public Company Accounting Oversight Board (PCAOB)	Information on accounting and auditing activities of the PCAOB and other matters	www.pcaob.org
Securities and Exchange Commission (SEC)	Information on current SEC rulemaking and the Electronic Data Gathering, Analysis, and Retrieval database	www.sec.gov
USA.gov	Portal through which all government agencies can be accessed	www.usa.gov