

Insights

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A biweekly audit and accounting publication

Accounting

More Accounting Changes Coming – July Update

Currently, the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) have at least a dozen joint projects in process. The goal of each project is to replace the existing FASB and IASB guidance on the topic with a common standard. In May, McGladrey & Pullen's National Professional Standards Group published a summary discussing six of the projects that will have the biggest impact on virtually all companies, plus the planned changes to the guidance on how to measure fair value. These projects are:

- Financial statement presentation
- Revenue recognition
- Financial instruments
- Leases
- Financial instruments with characteristics of equity
- Consolidation
- Fair value measurements

The updated summary, *More Accounting Changes Coming*, was published on July 19 and is available on our Web site at http://mcgladreypullen.com/Resource_Center/more_accounting_changes_coming.pdf.

Other recent accounting-related publications available on the McGladrey & Pullen Web site include:

- Significant Accounting and Regulatory Implications to Accounting for Loan Participation and Other Partial Loan Sales
- Determination of Reporting Units when Testing Goodwill for Impairment
- Guidance on Fundamentals of Debt Modifications and Restructurings
- Quick Reference Guide to the FASB Codification
- Fair Value Disclosures for Business Combinations and Other Accounting Events

Auditing

Proposed Amendment to and Redrafting of SAS No. 116

In February 2009, the AICPA Auditing Standards Board (ASB) issued Statement on Auditing Standards (SAS) No. 116, Interim Financial Information, which revised the applicability of AU Section 722, Interim Financial Information, such that the SAS does not apply when the provisions of Statements on Standards for Accounting and Review Services (SSARS) apply. SAS No. 116 is applicable when an auditor performs the audit of the latest annual financial statements of a nonpublic company and expects to be engaged to audit the current-year financial statements. SAS No. 116 is not applicable when the auditor expects that a new auditor may be engaged for the current year. To allow for an appropriate transition between auditors when an auditor change is anticipated, the ASB recently proposed to revise the applicability of SAS No. 116 to include engagements when the auditor expects that a new auditor may be appointed for the current year, but such appointment is not effective prior to the beginning of the period covered by the review. The proposed amendment would be effective for interim reviews of interim financial information for periods beginning after December 15, 2011, with early implementation permitted. The proposed SAS, Revised Applicability of Statement on Auditing Standards No. 116, "Interim Financial Information", is available for comment until October 8, 2010 at http://www.aicpa.org/Research/ExposureDrafts/AccountingandAuditing/DownloadableDocuments/20100708a_ED_Applicability.pdf.

In addition, in conjunction with its efforts to clarify generally accepted auditing standards for audits of nonpublic companies, the ASB recently issued a proposed SAS, Interim Financial Information (Redrafted). The redrafted standard reflects the proposed revision discussed above, together with the following proposed changes, among others:

- AU Section 722 notes that an accountant is not required to issue a written report on a review of interim financial information, except under certain conditions. The proposed SAS requires 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 that the auditor performing the interim review issue a written review report. However, the proposed SAS permits 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 Public Company Accounting Oversight Board AU Section 722, Interim Financial Information.
- The proposed SAS requires the auditor, before accepting the engagement, (i) to review the interim financial information to determine whether the financial reporting framework to be applied in the preparation of the interim financial information is acceptable and (ii) to obtain the agreement of management that it acknowledges and understands its responsibility for certain specified matters.

- AU Section 722 requires that the review report include a statement that the review of interim financial information was conducted in accordance with standards established by the AICPA. To differentiate between the proposed standard and other standards established by the AICPA, such as SSARs, the proposed SAS requires a statement that the review of interim financial information was conducted in accordance with auditing standards generally accepted in the United States of America.

If finalized, the proposed SAS would be effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2012. The proposed SAS is available for comment until October 8, 2010 at http://www.aicpa.org/Research/ExposureDrafts/AccountingandAuditing/DownloadableDocuments/20100708b_ED_Interim_Financial_Information.pdf.

SEC

PCAOB Staff Audit Practice Alert Issued

The Public Company Accounting Oversight Board (PCAOB) recently published Staff Audit Practice Alert No.6, Auditor Considerations Regarding Using the Work of Other Auditors and Engaging Assistants from Outside the Firm. The Alert reminds registered firms of their obligations when using the work of other firms or using assistants engaged from outside the firm. It describes the circumstances under which the firm issuing the audit report may use the work and reports of another auditor. The Alert also notes that auditors who engage assistants from outside the firm are governed by the same standards regarding planning the audit and supervising assistants that apply when audit work is performed by assistants who are partners of, or employed by, the auditor's firm. The Alert covers the following topics, among others:

- Using the work of other auditors
 - o Identifying circumstances in which PCAOB AU Section 543, Part of Audit Performed by Other Independent Auditors, applies
 - o Determining whether to serve as principal auditor
 - o Responsibilities of the principal auditor
 - o Language considerations
- Engaging assistants from outside the firm
 - o Knowledge, skill, ability, and independence
 - o Planning and supervision
 - o Audit documentation
 - o Engagement quality review

Staff Audit Practice Alert No. 6 is available in full at http://pcaobus.org/Standards/QandA/2010-07-12_APA_6.pdf.

Updated Financial Reporting Manual Available

The SEC's Division of Corporation Finance Financial Reporting Manual, which is intended only to provide general guidance to Division staff, contains helpful information to auditors and preparers of issuer financial statements. The Manual was recently updated for the following issues, among others:

- Presentation of predecessor financial statements (Section 1170)
- Financial statement requirements for businesses recently acquired by equity-method investees of a target (Section 2005.5)
- Financial statement requirements in an initial public offering when a merger of entities under common control occurs at the closing date (Sections 2015.2 and 13400)
- Treatment of transaction costs and contingent consideration in the S-X significance tests for the purchase of an investment accounted for under the equity method (Section 2015.5) • Computing the aggregate significance of individually insignificant acquired businesses (Section 2035.4)
- Assessing the age of financial statement requirements relating to an acquired or to-be-acquired business when the registrant and the acquiree have different fiscal year-ends (Section 2045.5)
- Significance testing and reporting upon adoption of FAS 141R and FAS 160 for a disposition of an equity interest that results in loss of control (Section 2100)
- Preparing pro forma financial information following a registrant's change in its fiscal year end (Section 3230.1)
- Impacts of FAS 141R and 160 on existing SEC filing and disclosure requirements and presentation of pro forma income statements (Section 3250.1)
- Presentation of discontinued operations in predecessor financial statements (Section 13210.2)

The updated Financial Reporting Manual is available in full at <http://www.sec.gov/divisions/corpfm/cffinancialreportingmanual.pdf>.

PCAOB Proposes Auditing Standard on Confirmation

The Public Company Accounting Oversight Board (PCAOB) recently approved for public comment a proposed auditing standard, Confirmation. The proposed standard would modernize and strengthen the requirements under the current auditing standard, AU Section 330, The Confirmation Process, which it would replace. The proposed standard carries forward some of the requirements in AU Section 330. In addition, for certain matters, the proposed standard adds to the existing requirements by requiring the auditor to perform additional procedures.

For example, the proposed standard more explicitly incorporates consideration of the risk of material misstatement due to error or fraud into the selection, design, and performance of confirmation procedures. The proposed standard applies this approach to the confirmation process by requiring the auditor to perform confirmation procedures in response to significant risks that relate to the relevant assertions that can be adequately

addressed by confirmation procedures. In addition, the proposed standard includes other procedures that address the risk of material misstatement, such as in the areas of investigating exceptions reflected on confirmation responses and evaluating non-responses to confirmation requests.

The proposed standard enhances requirements when confirmation responses include disclaimers and restrictive language. The proposed standard requires the auditor to evaluate disclaimers and restrictive language included in confirmation responses to determine whether such disclaimers or restrictive language affect the reliability of those responses. The proposed standard further provides that if such language precludes the auditor from treating the response as a confirmation response, the auditor should perform alternative procedures to obtain relevant and reliable audit evidence or assess the implications, if any, for the audit report.

The proposed new standard requires confirmation procedures for specific accounts. The PCAOB is retaining the requirement for the auditor to perform confirmation procedures for receivables, but also is proposing to expand the requirement to receivables that arise from credit sales, loans, or other transactions. The PCAOB is proposing to require the auditor to perform confirmation procedures for cash and other relationships with financial institutions.

The proposed standard reflects significant advances in technology, including increased use of electronic communication methods. The proposed standard includes requirements addressing the risks that are applicable to confirmation in an electronic environment and includes requirements to assess the reliability of electronic confirmation responses. A confirmation response would be defined as “audit evidence obtained as a direct communication to the auditor from a third party, either in paper form or by electronic or other medium.”

Any new auditing standard that is adopted by the PCAOB must be submitted to the SEC for approval. The PCAOB anticipates that the proposed standard would be effective, subject to approval by the SEC, for audits for fiscal years ending on or after December 15, 2011. The proposed standard is available for comment until September 13, 2010 at http://pcaobus.org/Rules/Rulemaking/Docket%20028/2010-07-13_Release_2010-003.pdf.

Public Sector

Suggested Guidelines for Voluntary Reporting

An important component of public sector financial reporting is information about service efforts and accomplishments (SEA). Such information provides insight into how effectively and efficiently state and local governments utilize resources to achieve their missions on behalf of their citizens. Recently the Governmental Accounting Standards Board issued Suggested Guidelines for Voluntary Reporting - SEA Performance Information to provide state and local governments with suggested guidelines for voluntary reporting of SEA performance information to users. The suggested guidelines are intended to provide a common framework for the effective external communication of SEA performance information. The suggested guidelines for voluntary SEA reporting are composed of:

- The four essential components of an effective SEA report:
 - o Purpose and scope;
 - o Major goals and objectives;
 - o Key measures of SEA performance; and
 - o Discussion and analysis of results and challenges;
- The six qualitative characteristics representing the attributes SEA performance information needs to possess as set forth in Concepts Statement No. 1, Objectives of Financial Reporting:
 - o Relevance;
 - o Understandability;
 - o Comparability;
 - o Timeliness;
 - o Consistency; and
 - o Reliability; and
- A discussion of the three keys to effective communication of SEA performance information:
 - o Intended audiences;
 - o Multiple levels of reporting; and
 - o Forms of communication.

International

Proposed Standard Addresses Using the Work of Internal Auditors

The International Auditing and Assurance Standards Board (IAASB) recently released a proposed revised standard that addresses the external auditor's responsibilities relating to using internal auditors' work during an audit. Proposed International Standard on Auditing (ISA) 610 (Revised), Using the Work of Internal Auditors, responds to developments in the internal audit environment and audit practices that are not currently addressed in the extant ISA. For example, in many entities there have been changes in the organizational status of the internal audit function, the activities performed by internal auditors, and the manner of interaction between internal auditors and external auditors. Also, as a result of the revision of ISA 610, changes are being proposed to ISA 315, Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment. The IAASB's objective in revising ISA 315 and ISA 610 is to enhance the performance of external auditors by (a) enabling them to better consider and leverage, as appropriate, the knowledge and findings of an entity's internal audit function in making risk assessments in the external audit, and (b) strengthening the framework for the evaluation and, where appropriate, use of the work of internal auditors in obtaining audit evidence.

The Exposure Draft is available for comment until November 15, 2010 at <http://www.ifac.org/Guidance/EXD-Download.php?EDFID=00339>.

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