Professional Practices Update:

Auditing, Accounting, Compilation & Review

Presented by:

Paul J. Sanchez, CPA, CBA, CFSA
President

Professional Service Associates
150 Main Street
Port Washington, NY 11050

Phone: (516) 883-2390
Fax: (516) 883-8429
E-Mail: SanchezPSA1@yahoo.com
Website: www.sanchez-psa.com

Korean American CPA Association of Greater New York

November 11, 2013 – Monday
8:30am to 4:30pm

Teaneck, New Jersey

Paul J. Sanchez

"Bio"

Paul J. Sanchez, CPA, CBA, CFSA conducts a CPA practice in Port Washington, New York. He is also the owner of Professional Service Associates (PSA), a consulting and professional training and development business servicing corporate clients (auditors, controllers, etc.), CPA firms, professional associations and others. He was an assistant professor at Long Island University - C.W. Post Campus as well as an adjunct lecturer at City University of New York. Prior to starting PSA, he was the Vice President-Professional Development for the Audit Division of a regional bank and Director of Professional Practices and Vice President of a money-center bank, where he directed the professional practice development and training for internal auditors. He was also on the technical staff of the Auditing Standards and Examinations Divisions of the AICPA. He practiced public accounting in the New York office of Deloitte where he also was involved as a firm recruiter and in-house professional development instructor. He was an owner and auditing and financial accounting seminar leader for the Person/Wolinsky CPA Review Courses, a company that prepared candidates to pass the Uniform CPA Examination. He is a frequent lecturer and seminar leader for accounting, auditing, banking, risk assessment and other professional presentations and is the author of the textbook, "Accounting Basics for Community Financial Institutions" (Financial Managers Society, 2nd edition, Chicago, 2009) and the monthly "Ideas an Analysis Letter: The Sanchez Take" (see www.sanchez-psa.com). As a contributing author, his chapter on 'An Auditor's Approach to Risk-Based Auditing: What to Audit and When,' is included in the textbook, "Effective Auditing for Corporates: Key Developments in Practice and Procedures," (Bloomsbury Information, Ltd, London, 2012).

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

<u>**Table of Contents**</u>

Section **Contents**

Accounting

1. Recent ASUs - 2013
   - Accounting Standards Update No. 2013-11—Income Taxes (Topic 740)
   - Accounting Standards Update No. 2013-10—Derivatives and Hedging (Topic 815)
   - Accounting Standards Update No. 2013-09—Fair Value Measurements (Topic 820)
   - Accounting Standards Update No. 2013-08—Investment Companies (Topic 946)
   - Accounting Standards Update No. 2013-07—Presentation of Financial Statements (Topic 205)
   - Accounting Standards Update No. 2013-06—Not-for-Profit Entries (Topic 415)
   - Accounting Standards Update No. 2013-05—Foreign Currency Matters (Topic 830)
   - Accounting Standards Update No. 2013-04—Liabilities (Topic 405)
   - Accounting Standards Update No. 2013-03—Financial Instruments (Topic 825)
   - Accounting Standards Update No. 2013-02—Other Comprehensive Income (Topic 220)
   - Accounting Standards Update No. 2013-01—Balance Sheet (Topic 210)
2. Proposed ASUs – 2013
   - Proposed Accounting Standards Update PCC 13-01A—Business Combinations (Topic 805)
   - Proposed Accounting Standards Update PCC 13-01B—Intangibles-Goodwill and Other (Topic 350)
   - Proposed Accounting Standards Update PCC 13-03—Derivatives and Hedging (Topic 815)
   - Proposed Accounting Standards Update 2013-290—Insurance Contracts (Topic 834)
   - Proposed Accounting Standards Update 2013-300—Presentation of Financial Statements (Topic 205)
   - Proposed Accounting Standards Update 2013-270—Leases (Topic 842)
   - Proposed Accounting Standards Update 2013-240—Technical Corrections and Improvements Related to Glossary Terms
   - Proposed Accounting Standards Update EITF-13B-Investments-Equity Method and Joint Ventures (Topic 323)
   - Proposed Accounting Standards Update 2013-221—Financial Instruments-Overall (Subtopic 825-10)

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

- Proposed Accounting Standards Update 2013-230—Presentation of Financial Statements (Topic 205)
- Proposed Accounting Standards Update 2013-220—Financial Instruments-Overall (Subtopic 825-10)
- Proposed Accounting Standards Update 2013-210—Transfers and Servicing (Topic 860)

3. Proposed ASUs – 2012
   - Proposed Accounting Standards Update 2012-260—Financial Instruments—Credit Losses (Subtopic 825-15)
   - Proposed Accounting Standards Update EITF-12G—Consolidation (Topic 810)
   - Proposed Accounting Standards Update 2012-200—Financial Instruments (Topic 825)
   - Proposed Accounting Standards Update 2012-250—Revenue Recognition (Topic 605)

4. Proposed ASUs – 2011
   - Proposed Accounting Standards Update EITF11A—Consolidation (Topic 810)
   - Proposed Accounting Standards Update 2011-230—Revenue Recognition (Topic 605)
   - Proposed Accounting Standards Update 2011-220—Consolidation (Topic 810)
   - Proposed Accounting Standards Update 2011-210—Real Estate—Investment Property Entities (Topic 973)

5. Proposed ASUs – 2010
   - Proposed Accounting Standards Update 1820-100—Revenue Recognition (Topic 605)
   - Proposed Accounting Standards Update 1810-100—Financial Instruments (Topic 825) and Derivatives and Hedging (Topic 815)

Auditing

6. New Audit Standards
   SAS 127- Omnibus SAS – 2013
   SAS 126 – "Going Concern" SAS

7. Proposed PCAOB Changes to Standard Auditor's Report

Compilation & Review

8. "Clarity" SSARS – Reviews of Financial Statements

9. Decision Re: Compilations

10. New Structure for Private Company Accounting Principles

Section 1

Recent ASUs – 2013

Accounting Standards Update No. 2013-11—Income Taxes (Topic 740)

This ASU eliminates the diversity in practice in the presentation of unrecognized tax benefits in the balance sheet when a net operating loss carryforward or a tax credit carryforward exists.

Under this ASU, an unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the balance sheet as a reduction to a deferred tax asset for a net operating loss carryforward or a tax credit carryforward. If, however, either of those carryforwards is not available under the tax law of the applicable jurisdiction, to settle any additional income taxes that would result from the disallowance of a tax position, the unrecognized tax benefit should be presented in the balance sheet as a liability.

ASU 2013-11 has created a new accounting rule companies must follow when they present unrecognized tax benefits when they also have a new operating loss or a tax credit to carry forward.

An unrecognized tax benefit is a reserve account where companies "park" amounts they expect to recognize in future periods based on unresolved tax issues, such as an audit or litigation. Companies have rules to follow in how they should recognized uncertainty in income taxes, but they don't have explicit rules explaining whether to **net** or **gross** their unrecognized tax benefits with any net operating loss or tax credit carryforward that might also exist.

Some companies used a net presentation to show their unrecognized tax benefits in relation to their carryforwards. Others used a gross presentation.

Now, companies are required to show their unrecognized tax benefit as a reduction to a deferred tax asset except under some specific situations.

Companies can no longer combine an unrecognized tax benefit with a carry forward or other deferred tax asset if the credit or carry forward is not available on the financial statement date under the applicable tax rules, or if the tax law doesn't allow or the entity doesn't intend to use the deferred tax asset in that way.

No new disclosures are required.

This ASU is effective for fiscal years beginning after December 15, 2013. For nonpublic entities, the effective date is for fiscal years beginning after December 15, 2014. Early adoption is permitted.

This ASU finalizes Proposed ASU 2013-EIFT-13C.

Issued: July 18, 2013

See the following box for related information.

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

Net Operating Losses – Brief Accounting Summary

A net operating loss (NOL) occurs for tax purposes in a year when tax-deductible expenses exceed taxable revenues.

Corporations are taxed during profitable periods and receive tax relief during periods of net operating losses.

Under certain circumstances the federal tax laws permit corporate taxpayers to use the losses of one year to offset the profits of other years. This income-averaging provision is accomplished through the carryback and carryforward of net operating losses. This allows a corporation to pay no income taxes for a year in which it incurs a net operating loss. In addition, a corporation may select one of the two options:

Option 1 - Loss Carryback

Through use of a loss carryback, a corporation may carry the net operating loss of a particular year back 2-years and receive refunds for income taxes paid in those years.

The loss must be applied to the earliest year first, and then sequentially to the second year.

Any loss remaining after the 2 year carryback may be carried forward up to 20 years to offset future taxable income.

Option 2 - Loss Carryforward

A company may elect to forgo the loss carryback and use only the loss carryforward option, offsetting future taxable income for up to 20 years.

Illustration

To illustrate the procedures for a NOL carryback, assume that G Corp. experiences the following:

Year	Taxable Income or (Loss)	Tax Rate	Tax Paid
2008	$ 75,000	30%	$22,500
2009	50,000	35%	17,500
2010	100,000	30%	30,000
2011	200,000	40%	80,000
2012	(500,000)	---	- 0 -

In 2012, G incurs a net operating loss that it elects to carryback.

Under the tax law, the carryback must be applied initially to the second year prior to the loss year (i.e. 2010). Therefore, the loss would be carried back first to 2010. Any unused loss would then be carried back to 2011.

Accordingly, G would file amended tax returns for each of the years 2010 and 2011, receiving refunds for $110,000 ($30,000 + $80,000) of taxes paid in those years.

For accounting as well as tax purposes, the $110,000 represents the tax effect (tax benefit) of the loss carryback. This tax effect should be recognized in 2012, the loss year.

Since the tax loss gives rise to a refund that is both measurable and currently realizable, the associated tax benefit should be recognized in this loss period.

G would make the following journal entry for 2012:

Account	Debit	Credit
Income Tax Refund Receivable	$110,000	
Benefit Due to Loss Carryback (Income Tax Expense)		$110,000

The account debited, Income Tax Refund Receivable, is reported on the balance sheet as a current asset at December 31, 2012.

The account credited is displayed on G's income statement for 2012 as follows:

Partial Income Statement for 2012	
Operating loss before income taxes	$(500,000)
Income tax benefit:	
Benefit due to loss carryback	110,000
Net loss	$(390,000)

Loss Carryforward Illustrated

If a NOL is not fully absorbed through a carryback or if the corporation decides not to carry the loss back, then it can be carried forward for up to 20 years.

Since the $500,000 net operating loss for 2012 exceeds the $300,000 total taxable income from the 2 preceding years, the remaining $200,000 loss is carried forward.

Because carryforwards are used to offset future taxable income, the tax effect of a loss carryforward represents future tax savings. Realization of the future tax benefit is dependent upon future earnings, the prospect of which may be highly uncertain.

The key accounting issue is whether there should be different requirements for recognition of a deferred tax asset for (a) deductible temporary differences and (b) operating loss carryforwards. The FASB's position is that in substance these items are the same. Both are amounts that are deductible on tax returns in the future years.

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

The FASB has concluded that there should not be different requirements for recognition of a deferred tax asset from deductible temporary differences and operating loss carryforwards.

Carryforward (Assume No Valuation Allowance is Needed)

To illustrate the accounting for a NOL carryforward, return to the G Corp. example.

If future taxable income will be realized in the year 2012, the company would record the tax effect of the $200,000 loss carryforward as a deferred tax asset of $80,000 ($200,000 X 40%) assuming that the enacted future tax rate is 40%.

The journal entries to record the benefits of the carryback and the carryforward in 2012 would be as follows:

To Recognize Benefit of Loss Carryback

	Debit	Credit
Income Tax Refund Receivable	$110,000	
Benefit due to Loss Carryback (Income Tax Expense)		$110,000

To Recognize Benefit of Loss Carryforward

	Debit	Credit
Deferred Tax Asset	$80,000	
Benefit Due to Loss Carryforward (Income Tax Expense)		$80,000

The income tax refund receivable of $110,000 will be realized immediately as a refund of taxes paid in the past.

A Deferred Tax Asset is established for the benefits of future tax savings.

The two accounts credited are contra income tax expense accounts, which would be displayed in the 2012 income statement as follows:

Partial Income Statement for 2012

Operating loss before income taxes		$(500,000)
Benefit due to loss carryback	$110,000	
Benefit due to loss carryforward	80,000	190,000
Net loss		$(310,000)

The $110,000 current tax benefit is the income tax refundable for the year, which is determined by applying the carryback provisions of the tax law to the taxable loss for 2012. The $80,000 is the deferred tax benefit for the year, which results from an increase in the deferred tax asset account.

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

For 2013, assume that G returns to profitable operations and has taxable income of $300,000 (prior to adjustment for the NOL carryforward) subject to a 40% tax rate.

G would then realize the benefits of the carryforward for tax purposes in 2013 which were recognized for accounting purposes in 2012.

The income tax payable for 2013 is computed as follows:

Taxable income prior to loss carryforward	$ 300,000
Loss carryforward deduction	$(200,000)
Taxable income for 2013	100,000
Tax rate	X 40%
Income tax payable for 2013	$ 40,000

The journal entry to record income taxes in 2013 would be as follows:

Income Tax Expense ($300,000 X 40%)	$120,000	
Deferred Tax Asset ($200,000 X 40%)		$80,000
Income tax payable		40,000

The Deferred Tax Asset account is reduced because the benefits of the NOL carryforward are realized in 2013.

The 2013 income statement that appears below would simply show the current and deferred income tax expense. It would not report the tax effects of either the loss carryback or the loss carryforward because both had been reported previously.

Partial Income Statement for 2013

Income before income taxes		$300,000
Income tax expense		
Current	$ 40,000	
Deferred	$ 80,000	120,000
Net Income		$180,000

ASU 2013-11

Under the ASU 2013-11, an entity **must** present an unrecognized tax benefit, or a portion of an unrecognized tax benefit, in the financial statements as a reduction to a deferred tax asset for an NOL carryforward, a similar tax loss, or a tax credit carryforward **except when**:

- An NOL carryforward, a similar tax loss, or a tax credit carryforward is not available as of the reporting date under the governing tax law to settle taxes that would result from the disallowance of the tax position.
- The entity does not intend to use the deferred tax asset for this purpose (provided that the tax law permits a choice).

If either of these conditions exists, an entity should present an unrecognized tax benefit in the financial statements as a **liability** and should not **net** the unrecognized tax benefit with a deferred tax asset.

Additional recurring disclosures are not required because the ASU does not affect the recognition or measurement of uncertain tax positions under ASC 740-50.

This ASU does not affect the amounts public entities disclose in the tabular reconciliation of the total amounts of unrecognized tax benefits because the tabular reconciliation presents the gross amounts of unrecognized tax benefits.

So, in the G Corp example, assuming it is not MLTN that sufficient taxable income will be realized, the journal entries and partial income statement for 2012 would be as follows:

The journal entry to record the benefit of the loss carryback 2012 would be as follows:

	Debit	Credit
Income Tax Refund Receivable	$110,000	
Benefit due to Loss Carryback (Income Tax Expense)		$110,000

The journal entry to set up the benefit of loss carryforward would be:

	Debit	Credit
Deferred Tax Asset	$80,000	
Benefit Due to Loss Carryforward (Income Tax Expense)		$80,000

The journal entry to set up reserve for unrecognized tax benefits would be:

	Debit	Credit
Benefit Due to Loss Carryforward (Income Tax Expense)	$80,000	
Unrecognized Tax Benefit Reserve Account (Liability Account)		$80,000

Partial Income Statement for 2012

Operating loss before income taxes		$(500,000)
Benefit due to NOL carryback	$110,000	
Benefit due to NOL carryforward	80,000	
Unrecognized Benefit Due to NOL carryforward	$(80,000)	$ 110,000)
Net loss		$(390,000)

Partial Income Statement for 2012

Assets:		
Deferred Tax Asset	$80,000	
Liabilities:		
Unrecognized Tax Benefit Reserve Account (Liability Account)		$80,000

Accounting Standards Update No. 2013-10—Derivatives and Hedging (Topic 815)

This ASU allows the Fed Funds Effective Swap Rate (also known as the Overnight Index Swap Rate or OIS) to be used as a United States benchmark interest rate for hedge accounting purposes, in addition to the interest rates on direct Treasury obligations of the U.S. government (UST) and the London Interbank Offered Rate (LIBOR) swap rate, which were the only benchmark interest rates considered.

This ASU permits use of OIS as a benchmark interest rate for hedge accounting.

Topic 815 provides guidance on the risks that are permitted to be hedged in a fair value or cash flow hedge. Among those risks for financial assets and financial liabilities is the risk of changes in a hedged item's fair value or a hedged transaction's cash flows attributable to changes in the designated benchmark interest rate (referred to as interest rate risk).

An entity is required to designate a benchmark interest rate at the inception of an interest rate risk hedge.

Previous U.S. GAAP permitted only the interest rates on direct Treasury obligations of the U.S. government and, for practical reasons, the LIBOR swap rate to be used as benchmark interest rates.

This ASU permits the use of the Fed Funds Effective Swap Rate (also referred to as the Overnight Index Swap Rate, or OIS) as a benchmark interest rate in such hedges.
In a change from the original proposal, the final ASU permits entities to use different benchmark rates for similar hedges because the FASB was persuaded that companies may have valid business reasons for doing so. Lastly, the ASU does not require any new disclosures.

This ASU finalizes Proposed ASU 2013 EITF-13A

Issued: July 17, 2013

Accounting Standards Update No. 2013-09—Fair Value Measurements (Topic 820)

This ASU **defers** indefinitely the effective date of certain quantitative disclosures contained in FASB Accounting Standards Update No. 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*, for investments held by a nonpublic employee benefit plan **in its plan sponsor's own nonpublic entity equity securities**, including equity securities of its plan sponsor's nonpublic affiliated entities.

The quantitative disclosures that are **deferred** are about the following:

1. For recurring and nonrecurring fair value measurements categorized within Level 2 and 3 of the fair value hierarchy, a description of the valuation technique(s) and the inputs used in the fair value measurement. If there has been a change in valuation technique (for example, changing from market approach to an income approach or the use of an additional valuation technique), the reporting entity shall disclosure that change and the reasons(s) for making it.

2. For fair value measurements categorized within Level 3 of the fair value hierarchy, a reporting unit shall provide quantitative information about the significant unobservable inputs used in the fair value measurement. A reporting entity is not required to create quantitative information to comply with this disclosure requirement if quantitative unobservable inputs are not developed by the reporting entity when measuring fair value (for example, when a reporting entity uses prices from prior transactions or third-party pricing information without adjustment). However, when providing this disclosure, are porting entity cannot ignore quantitative unobservable inputs that are significant to the fair value measurement and are reasonably available to the reporting entity.

This ASU is applicable for employer benefit plans other than plans that are subject to SEC filing requirements.

This ASU does not defer the effective date for those certain quantitative disclosures for other nonpublic entity equity securities held in the nonpublic employee benefit plan or any qualitative disclosures.

This ASU is designed to ease and improve private company reporting.

This ASU is the final version of Proposed ASU 2013-260—Fair Value Measurement (Topic 820).

This ASU became effective immediately for all financial statements not yet issued.

Issued: July 8, 2013

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

Accounting Standards Update No. 2013-08—Investment Companies (Topic 946)

This ASU changes the approach to determining whether an entity is an investment company within the scope of Topic 946 and provides comprehensive implementation guidance for that assessment.

It also modifies measurement and disclosure requirements for investment companies within the scope of Topic 946.

In ASU 2013-08, the FASB has:

- Developed converged guidance for assessing whether an entity is an investment company, and
- Provided measurement requirements for an investment company's investments.

ASU 2013-08 addresses, among other things, how an investment company should record a noncontrolling interest in another investment company, and whether a noninvestment company parent should retain the specialized accounting used by an investment company subsidiary in its consolidated financial statements.

ASU 2013-08 also mandates several new financial statement disclosures, including additional disclosures on the financial support provided by an investment company to its investees and detailed disclosures regarding an entity's status as an investment company.

Definition of Investment Company

Under ASU 2013-08, an entity must determine whether it qualifies as an investment company based on a two-tiered assessment, which requires an entity to possess certain fundamental characteristics while allowing judgment in assessing other typical characteristics. An entity should also consider its purpose and design when making this assessment.

An investment company has the following fundamental characteristics:

- It is an entity that does **both** of the following:
  - Obtains funds from one or more investors and provides the investor(s) with investment management services.
  - Commits to its investor(s) that its business purpose and only substantive activities are investing the funds solely for returns from capital appreciation, investment income or both.
- The entity or its affiliates do not obtain, or have the? objective of obtaining, returns or benefits from an investee or its affiliates that are:
  - Not normally attributable to ownership interests, or
  - Other than capital appreciation or investment income.

An entity that does not have all of the above characteristics would not qualify as an investment company.

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

Furthermore, the FASB has clarified that an entity could be, but does not need to be, a legal entity to be an investment company. The economic substance of the entity, rather than its legal form, should be evaluated to determine whether the entity is a reporting entity that provides investors with periodic financial results about its investment activities. For example, a separately managed account that does not have the form of a legal entity might still qualify as an investment company under ASU 2013-08.

Typical Characteristics of an Investment Company

Under ASU 2013-08, an investment company also has the following typical characteristics:

- It has more than one investment.
- It has more than one investor.
- It has investors that are not related parties of the parent (if there is a parent) or the investment manager.
- It has ownership interests in the form of equity or partnership interests.
- It manages substantially all of its investments on a fair value basis.

Not having one or more of these typical characteristics may not necessarily preclude an entity from being an investment company. However, an entity that does not have one or more of the typical characteristics is required to justify how its activities continue to be consistent with that of an investment company.

The FASB also decided that an entity registered as an investment company under the SEC's Investment Company Act of 1940 (1940 Act Company) is an investment company for accounting purposes. Therefore, a 1940 Act Company is not required to assess whether it meets the fundamental characteristics and the typical characteristics of an investment company under ASC Topic 946.

Initial Determination

Under ASU 2013-08, the initial determination of whether an entity is an investment company must be made upon the formation of the entity. An entity is required to reassess whether it meets – or does not meet – the criteria only if:

- There is a subsequent change in its purpose and design, or
- It is no longer regulated under the Investment Company Act of 1940.

Any change in status must be accounted for prospectively as of the date of the change.

This ASU is the final version of Proposed ASU 2011-200—Financial Services—Investment Companies (Topic 946).

ASU 2013-08 is effective for the interim and annual reporting periods in fiscal years that begin after December 15, 2013. Therefore, the effective date for a calendar year private investment company is January 1, 2014. Earlier applicable is prohibited.

Issued: June 7, 2013

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

Accounting Standards Update No. 2013-07—Presentation of Financial Statements (Topic 205)

This ASU on Liquidation Basis of Accounting replaces Proposed ASU 2013-210.

ASU 2013-07 proves guidance on financial statements for entities ceasing operations and selling assets to settle with creditors. Such financial statements should show what value will be remaining after all debts have been paid off.

1. There is little guidance in authoritative literature about liquidation accounting.

2. ASU 2013-07 provides guidance re:

   - When to use liquidation accounting (when liquidation is imminent).
   - Principles for recognition and measurement of assets and liabilities.

3. Imminent = Plan exists and is approved by person of authority, and execution of the plan is likely; plan is imposed by outside parties.

4. Assets presented at amounts of expected cash proceeds (from collection or sale of assets).

5. Liabilities presented at amounts required by US GAAP. Can not anticipate forgiveness of some or all of liability.

6. Accured assets (income) and accrued liabilities (expense) are required.

7. Must disclose the plan and assumptions used for measurement and the expected duration of the liquidation process.

8. If a basis for liquidating is specified in governing documents (limited life entity) use the specified basis; if current plan differs from the specified plan, use the liquidation basis outlined in ASU 2013-07.

9. Effective date:

   - 2013-07 is effective for entities that determined liquidation is imminent during annual reporting periods beginning after 12/15/13 and interim reporting periods therein. If using another basis (other than 2013-07 basis) for liquidation, continue using that other basis.

See the following box for examples of liquidation basis financial statements.

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

DCW Corporation
Unaudited Statement of Net Assets as of December 31, 2012
and
Unaudited Statement of Changes in Net Assets for the Three Month Period ended December 31, 2012

On October 29, 2012, DCW Corporation ("the Company") filed a Form 15 with the SEC, certifying that the Company had as of that date only 128 holders of record of the outstanding shares of its Common Stock and notifying the United States Securities and Exchange Commission (the "SEC") of termination of registration of the Common Stock under section 12(g) of the Exchange Act and suspension of the Company's duty to file reports under sections 13 and 15(d) of the Exchange Act. The Company's duty to file periodic, current and other reports with the SEC under the Exchange Act was suspended effective upon filing of the Form 15 with the SEC. The Company's final Annual Report on Form 10-K was filed with the SEC on December 14, 2012.

Although the Company is no longer filing reports with the SEC, the Company intends to post on its website on a quarterly basis an unaudited statement of net assets and an unaudited statement of changes in net assets. The Company will also post on its website from time to time information about any material developments with respect to any significant transactions for disposing of the Company's remaining assets, any significant developments in claims, litigation, investigations and any other future events that could materially impact the timing or amount of future liquidating distributions, if any, to be made to the Company's stockholders of record as of September 21,2012, which was the date the Company filed a Certificate of Dissolution with the Secretary of State of Delaware.

The Company's unaudited interim consolidated financial statements as of December 31, 2012 and for the three month period ended December 31, 2012 have been prepared in accordance with accounting principles generally accepted in the United States of America ("generally accepted accounting principles"). These unaudited interim consolidated financial statements reflect, in the opinion of management, all material adjustments necessary to fairly present the Company's assets in liquidation and its changes in net assets in liquidation. All intercompany transactions and balances have been eliminated. The unaudited interim consolidated financial statements are presented on the liquidation basis of accounting. Under this basis of accounting, assets are valued at their net realizable values and liabilities are stated at their estimated settlement amounts.

The interim consolidated financial statements have not been audited or reviewed by an independent accountant. The Company has elected to omit substantially all of the disclosures required by generally accepted accounting principles. If the omitted disclosures were included in the interim consolidated financial statements, they might influence the user's conclusions about the Company's assets in liquidation and its changes in net assets in liquidation. Accordingly, these interim consolidated financial statements are not designed for those who are not informed about such matters. The unaudited interim consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2012. During the three months ended December 31, 2012, the Company has not made any material changes in the selection or application of its critical accounting policies that were set forth in its Annual Report on Form 10-K for the fiscal year ended September 30, 2012.

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

The Company’s activities are now limited to winding down its affairs, including but not limited to, seeking to realize the value of its remaining assets; making tax and regulatory filings; winding down its remaining business activities and satisfying its remaining liabilities.

DCW Corporation
Consolidated Statement of Net Assets in Liquidation as of December 31, 2012
Unaudited
(Liquidation Basis)
(In thousands)

	December 31, 2012
Assets:	
Cash and cash equivalents	$ 70,500
Accounts receivable, net	2,200
Income tax receivable	14,300
Prepaid expenses and other current assets	1,200
Deferred income tax assets	1,400
Total assets	$ 89,600
Liabilities:	
Accounts payable	$ 1,600
Accrued compensation and benefits	1,600
Other accrued liabilities	9,300
Total liabilities	12,500
Noncontrolling interest at estimated value	5,000
Total liabilites and noncontrolling interest	17,500
Net Assets in Liquidation	$ 72,100

DCW Corporation
Unaudited
Consolidated Statement of Net Assets in Liquidation
(Liquidation Basis)
(In thousands)

	For the three month period ended December 31, 2012
Net Assets in liquidation September 30, 2012	$ 72,700
Liquidation basis adjustments:	
Net operations	200
Adjustment to net realizable value of assets	(400)
Adjustment to accrued liquidation costs	(400)
Net assets in liquidation as of December 31, 2012	$ 72,100

Issued: April 22, 2013

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

Accounting Standards Update No. 2013-06—Not-for-Profit Entries (Topic 415)

This ASU on Services Received from Personnel of an Affiliate Replaces Proposed ASU-EITF 12B.

1. ASU 2013-06 applies to NFP entities, including NFP business oriented health care entities that receive services from personnel of an affiliate. The services directly benefit the recipient entity and they are for "free" – no charge.

2. The recipient entity should book services received at the cost recognized by the affiliate giving the service. If that cost significantly overstates or understates the value of services given, the recipient can choose:

   A. Cost recognized by the affiliate or
   B. Fair value of the services given

3. If the recipient uses performance indicators (e.g. "income from continuing operations") "book" as an increase in net asset and an equity transfer. If no indicators, do whatever is best but do not "book" the services as a contra expense or contra asset.

4. Effective prospectively for fiscal years beginning after June 15, 2014 and interim and annual periods thereafter.

Issued: April 19, 2013

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

Accounting Standards Update No. 2013-05—Foreign Currency Matters (Topic 830)

This ASU resolves the diversity in practice about whether Subtopic 810-10, Consolidation—Overall, or Subtopic 830-30, Foreign Currency Matters—Translation of Financial Statements, applies to the release of the cumulative translation adjustment into net income when a parent either sells a part or all of its investment *in* a foreign entity or no longer holds a controlling financial interest in a subsidiary or group of assets that is a nonprofit activity or a business (other than a sale of in substance real estate or conveyance of oil and gas mineral rights) *within* a foreign entity.

This ASU makes it clear that the cumulative translation adjustment should be released into net income **only** if the sale or transfer results in the complete or substantially complete liquidation of the foreign entity in which the subsidiary or group or assets had resided.

In addition, this ASU resolves the diversity in practice for the treatment of business combinations achieved in stages (sometimes also referred to as **step acquisitions**) involving a foreign entity.

See the following box for background and effective date information.

Subtopic 810-10, as amended by *ASU 2010-02, Consolidation (Topic 810): Accounting and Reporting for Decreases in Ownership of a Subsidiary—a Scope Clarification*, requires that a parent deconsolidate a subsidiary or derecognize a group of assets that is a nonprofit activity or a business (other than a sale of in substance real estate or conveyance of oil and gas mineral rights) if the parent ceases to have a controlling financial interest in that group of assets.

The derecognition guidance in Subtopic 810-10 supports releasing the cumulative translation adjustment into net income upon the loss of a controlling financial interest in such a subsidiary or group of assets. That guidance does not distinguish between sales or transfers pertaining to an investment in a foreign entity (as defined in Topic 830) and those pertaining to a subsidiary or group of assets within a foreign entity.

Subtopic 830-30, however, provides for the release of the cumulative translation adjustment into net income only if a sale or transfer represents a sale or complete or substantially complete liquidation of an investment in a foreign entity.

In addition, diversity in practice has existed regarding the treatment of business combinations achieved in stages (sometimes also referred to as step acquisitions) involving a foreign entity. Some entities view step acquisitions as being composed of two events, the disposition of an equity method investment and simultaneous acquisition of a controlling financial interest.

Those entities generally release the cumulative translation adjustment related to the equity method investment. Those entities that view step acquisitions as being composed of a single event (increasing an investment) generally do not release the cumulative translation adjustment in practice.

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

Under the provisions of ASU 2013-05, when a reporting entity (parent) ceases to have a controlling financial interest in a subsidiary or group of assets that is a nonprofit activity or a business (other than a sale of in substance real estate or conveyance of oil and gas mineral rights) within a consolidated foreign entity, the parent would be required to apply the guidance in Subtopic 830-30 to release any related cumulative translation adjustment into net income.

Accordingly, the cumulative translation adjustment would be released into net income only if the sale or transfer results in the complete or substantially complete liquidation of the foreign entity in which the subsidiary or group of assets had resided.

For an equity method investment that is a foreign entity, the partial sale guidance in Section 830-30-40 still applies. As such, a pro rata portion of the cumulative translation adjustment would be released into net income upon a partial sale of such an equity method investment.

However, this treatment would not apply to an equity method investment that is not a foreign entity. In those instances, the partial sale would have to represent the complete or substantially complete liquidation of the foreign entity that contains the equity method investment in order for the cumulative translation adjustment to be released into net income.

Additionally, the amendments in ASU 2013-05 would clarify that the sale of an investment in a foreign entity includes both

1. Events that result in the loss of a controlling financial interest in a foreign entity (that is, irrespective of any retained investment), and
2. Events that result in an acquirer obtaining control of an acquiree in which it held an equity interest immediately before the acquisition date (sometimes also referred to as a step acquisition).

Accordingly, the cumulative translation adjustment would be released into net income upon the occurrence of those events.

<u>Effective Dates</u>
For nonpublic entities, ASU 2013-05 is effective prospectively for reporting periods beginning after December 15, 2014. It is effective prospectively for reporting periods beginning after December 15, 2013 for public entities.

The ASU should be applied prospectively to derecognition events occurring after the effective date. Early adoption is permitted.

This ASU replaces Proposed ASU 2011-EITF 11A (issued December 8, 2011).

Issued: March 4, 2013

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

Accounting Standards Update No. 2013-04—Liabilities (Topic 405)

This ASU provides guidance for the recognition, measurement, and disclosure of obligations resulting from **joint and several liability arrangements** for which the total amount of the obligation is fixed at the reporting date.

The guidance in this ASU requires an entity to measure those joint and several obligations as the sum of the amount the reporting entity agreed to pay on the basis of its arrangement among its co-obligors and any additional amount the reporting entity expects to pay on behalf of its co-obligors.

The guidance in this ASU also requires an entity to disclose the nature and amount of the obligation as well as other information about the obligation.

This ASU is the final version of Proposed ASU EITF12D - Liabilities (Topic 405).

See the following box for background and effective date information.

Because of the lack of specific authoritative guidance, some reporting entities have recorded the entire amount under joint and several liability arrangements on the basis of the concept of a liability and the guidance that must be met to extinguish the liability.

Other reporting entities have recorded less than the total amount of the obligation [e.g., an allocated amount], an amount corresponding to proceeds received, or the portion of the amount the reporting entity agreed to pay among co-obligors, on the basis of the guidance used in accounting for contingent liabilities.

ASU 2013-04 applies to all reporting entities, whether public or nonpublic, having obligations resulting from joint and several liability arrangements for which the total amount of the obligation is fixed as of the reporting date and for which no specific guidance exists.

Under ASU 2013-04, reporting entities are now required to measure obligations resulting from certain joint and several liability arrangements where the total amount of the obligation is fixed as of the reporting date, as the sum of the following:

- The amount the reporting entity agreed to pay on the basis of its arrangement among co-obligors.
- Any additional amounts the reporting entity expects to pay on behalf of its co-obligors.

Reporting entities are required to disclose the nature and amount of obligations under joint and several liability arrangements, as well as other information about those obligations.

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

Effective Dates

While early adoption of ASU 2013-04 is permitted, for public companies, ASU 2013-04 is required to be implemented in fiscal years, and interim periods within those years, beginning after December 15, 2013.

For nonpublic entities, the ASU is effective for fiscal years ending after December 15, 2014, and interim periods and annual periods thereafter.

ASU 2013-04 must be implemented retrospectively to all prior periods presented for obligations resulting from joint and several liability arrangements that exist at the beginning of the year of adoption.

In determining the effects of retrospective application, reporting entities may use hindsight for comparative periods if the accounting approach used changes as a result of implementing ASU 2013-04.

If a hindsight approach is used, that fact must be disclosed.

Issued: February 28, 2013

Accounting Standards Update No. 2013-03—Financial Instruments (Topic 825)

This ASU clarifies the scope and applicability of a disclosure exemption that resulted from the issuance of ASU No. 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*.

This ASU makes it clear that the requirement to disclose the level of the fair value hierarchy within which the fair value measurements are categorized in their entirety (Level 1, 2, or 3) **does not apply to nonpublic entities for items that are not measured at fair value in the statement of financial position, but for which fair value is only disclosed.**

This ASU is the final version of Proposed ASU 2013-200—Financial Instruments (Topic 825).

This ASU was effective upon issuance.

Issued: February 7, 2013

<u>Accounting Standards Update No. 2013-02—Other Comprehensive Income (Topic 220)</u>

This ASU supersedes and replaces the presentation requirements for reclassifications out of accumulated other comprehensive income (OCI) in ASUs 2011-05 (issued in June 2011) and 2011-12 (issued in December 2011) for all public and private organizations.

This ASU requires the disclosure of additional information about reclassifications out of accumulated OCI. It requires an entity to provide information about the amounts reclassified out of accumulated OCI by component. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated OCI by the respective line items of net income but **<u>only</u>** if the amount reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures required under U.S. GAAP that provide additional detail about those amounts.

Substantially all of the information that this ASU requires already is required to be disclosed elsewhere in the financial statements under U.S. GAAP. However, the new requirement about presenting information about amounts reclassified out of accumulated OCI and their corresponding effect on net income will present, in one place, information about significant amounts reclassified and, in some cases, cross-references to related footnote disclosures. Currently, this information is presented in different places throughout the financial statements.

This ASU is the final version of Proposed ASU 2012-240—Comprehensive Income (Topic 220).

This ASU applies to all entities that issue financial statements that are presented in conformity with U.S. GAAP and that report items of other comprehensive income.

Public companies are required to comply with ASU 2013-02 for all reporting periods presented, including interim period.

Nonpublic entities are required to comply with all the requirements of ASU 2013-02 for annual reporting periods.

For interim reporting periods, nonpublic entities are not required to report the effects of reclassifications on net income but are required to report information about the amounts reclassified out of accumulated other comprehensive income by component for each reporting period.

Non-for-Profit Entities that report under the requirements of Subtopic 985-205, Non-for-Profit Entities—Presentation of Financial Statements, are excluded from the scope of these amendments.

What follows are two examples of a financial statements disclosure that might be used to comply with ASU 2013-02.

Issued February 5, 2013

Example – Effects of OCI Transfers on Net Income

Entity XYZ
Statement of Income
For the Period Ended December 31, 20XX

Revenues (includes $12,000 accumulated other comprehensive income reclassifications For net gains on cash flow hedges)	$ 350,000
Expenses (includes $6,000 accumulated other comprehensive income reclassifications for net losses on cash flow hedges)	(80,000)
Gain on sales of securities (includes $10,000 accumulated other comprehensive income reclassifications for net gains on available-for-sale securities	10,000
Other gains and losses	20,000
Income from operations before taxes	$ 300,000
Income tax expense (includes ($5,000) income tax expense from reclassification items)	(98,000)
Net income	$ 202,000

This type of information could be disclosed either in a footnote to the financial statements or parenthetically on the face of the financial statements.

The only requirement is that all of the required information be presented in a single location.

Example – Reclassifications from AOCI

Entity XYZ
Notes to Financial Statements
Changes in Accumulated Other comprehensive Income by Component
For the Period ended December 31, 20XX

Details About Accumulated Other Comprehensive Income Components		Amount Reclassified From Accumulated Other Comprehensive Income	Affected Line Items in the Statement Where Net Income is Presented
Gains and losses on cash flow hedges			
Interest rate contracts	$	5,700	Interest income/expense
Credit derivatives		(1,400)	Other income/expense
Foreign exchange contracts		5,900	Sales/revenue
Commodity contracts		(3,700)	Cost of sales
		6,500	Total before tax
		(4,500)	Tax (expense) or benefit
	$	2,000	Net of Tax
Unrealized gains and losses on available-for-sale securities			
	$	11,120	Realized gain (loss) on sale of securities
		(1,120)	Impairment expense
		10,000	Total before tax
		(2,600)	Tax (expense) or benefit
	$	7,400	Net of Tax
Amortization of defined benefit pension items			
Prior service costs	$	(2,900)	(a)
Transition obligation		(7,200)	(a)
Actuarial gains/losses)		(1,500)	(a)
		(11,600)	Total before tax
		2,000	Tax (expense) or benefit
	$	(9,600)	Net of Tax
Total reclassifications out of accumulated other comprehensive income for the period	$	(200)	

(a) These components are included in the computation of net periodic pension cost and are presented in the pension footnote

Accounting Standards Update No. 2013-01—Balance Sheet (Topic 210)

This ASU clarifies that the scope of ASU No. 2011-11, *Disclosures about Offsetting Assets and Liabilities*, would apply to derivatives including bifurcated embedded derivatives, repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions that are either offset in accordance with Section 210-20-45 or Section 815-10-45 or are subject to a master netting arrangement or **similar agreement.** (Standard commercial provisions of many contracts often equate to a master netting arrangement).

This ASU is the final version of Proposed ASU 2012-250—Balance Sheet (Topic 210).

It is effective for fiscal years beginning on or after January 1, 2013, and interim periods therein.

Background for ASU 2013-01

Many companies, particularly financial services companies have receivables and payables from the same counter party at the same time.

The receivables and payables are often called "Due from (receivables) and "Due to" (payables) accounts.

Reciprocal "due to" and "due from" balances should be offset for balance sheet presentation if they may legally be netted in the process of collection or payment.

Right of Setoff. GAAP prohibits the offsetting of assets and liabilities in the balance sheet except where a "right of setoff" exists.

A right of setoff is a debtor's legal right, by contract or otherwise, to discharge all or a portion of the debt owed to another party by applying against the debt an amount that the other party owes to the debtor. A right of setoff exists when all of the following conditions are met:

a. Each of two parties owes the other determinable amounts.
b. The reporting party has the right to set off the amount owed with the amount owed by the other party.
c. The reporting party intends to set off.
d. The right of setoff is enforceable at law.

A debtor having a valid right of setoff may offset the related asset and liability and report the net amount.

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

Generally, debts may be set off if they exist between mutual debtors who act in the capacity of both debtor and creditor. In some cases, State laws about the right of setoff are different from common law. Also, the U.S. Bankruptcy Code imposes restrictions on or prohibitions against the right of setoff in bankruptcy under certain circumstances. Legal constraints must be considered to determine whether the right of setoff is enforceable. Appropriate disclosures are required.

ASU 2013-01 limits the scope of the offsetting disclosures to the following instruments or transactions:

- Recognized derivative instruments accounted for in accordance with ASC 815, including bifurcated embedded derivatives, repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions that are offset in accordance with either ASC 210-20-45 or ASC 815-10-45.
- Recognized derivative instruments accounted for in accordance with ASC 815, including bifurcated embedded derivatives, repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions that are subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are offset in accordance with either ASC 210-20-45 or ASC 815-10-45.

This removes trade payables and receivables from the scope of the offsetting disclosure requirements. Receivables and payables of broker-dealers resulting from their unsettled regular-way trades are also outside the scope of the disclosure requirements.

ASU 2013-01 also clarifies that only derivatives accounted for in accordance with ASC 815, including bifurcated embedded derivatives, are within the scope of the disclosure requirements. Instruments that meet the definition of a derivative in ASC 815 but that are subject to one of the scope exceptions in ASC 815 are outside the scope of the offsetting disclosure requirements.

ASU 2013-01 retains the language from ASU 2011-11 that specified instruments "that are subject to an enforceable master netting arrangement or similar agreement" are within the scope of the offsetting disclosures, even if those instruments are not actually offset in the balance sheet. ASU 2013-01 does not, however, specify the characteristics that would make an agreement similar to a master netting arrangement (MNA).

Entities that hold instruments that may be subject to the offsetting disclosure requirements but that are not offset in the statement of financial position (i.e., derivatives, repurchase and reverse repurchase agreements, or securities lending or borrowing transactions) should review any agreements underlying those instruments (e.g., ISDA, exchange or central clearing agreements) to assess whether such agreements are an MNA or similar agreement. Entities and their advisers will need to exercise professional judgment when determining whether an agreement is similar to an MNA.

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

Although ASU 2013-01 does not explicitly specify what characteristics make an agreement similar to an MNA, any agreement with provisions that allow either party to net in the event of default should be examined carefully.

When entities analyze such agreements, it is important that they assess whether the reporting entity has the right to offset its positions should the counterparty default.

For example, some entities enter into one-sided master netting arrangements that grant a right of offset to the counterparty but do not give the reporting entity a mirror right of offset. Because the reporting entity does not, from its perspective, have an MNA (i.e., it has no right of offset under the arrangement), instruments subject to that arrangement would not be within the scope of the offsetting disclosure requirements for the reporting entity.

Entities also need to assess the enforceability of their MNAs or similar agreements. An entity and its advisers will most likely need to perform some level of legal analysis to determine whether an arrangement is enforceable in a given jurisdiction.

Under ASU 2013-01, an entity is also permitted to include in the tabular offsetting disclosures all other recognized derivatives accounted for in accordance with ASC 815, repurchase and reverse repurchase agreements, and securities borrowing and lending transactions to facilitate reconciliation to individual line item amounts in the statement of financial position.

ASU 2013-01 does not change the requirement to reconcile amounts from the tabular disclosures to the statement of financial position. The narrower scope of the disclosures, along with the clarification that bifurcated embedded derivatives accounted for in accordance with ASC 815 are within the scope of the offsetting disclosure requirements, could pose reconciliation challenges for some reporting entities depending on how they aggregate positions in their statement of financial position. Such entities should consider whether it is necessary to provide supplemental disclosures to comply with the reconciliation requirement.

Issued: January 31, 2013

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

Section 2

Proposal ASUs – 2013

Proposed Accounting Standards Update PCC-13-01A—Business Combinations (Topic 805) – PCC Issue

This Proposed ASU addresses the concerns of private company stakeholders that the benefits of the current accounting for identifiable intangible assets acquired in a business combination do not justify the related costs.

The Proposed ASU would provide guidance about an accounting alternative for the recognition, measurement, and disclosure of identifiable intangible assets acquired in a business combination.

Private companies could elect to recognize separately from goodwill only those identifiable intangible assets that arise from **contractual rights** with noncancelable contractual terms, or that arise from other legal rights, whether or not those intangible assets are transferable or separable. An entity would be required to disclose qualitatively the nature of identifiable intangible assets acquired but not recognized.

Identifiable intangible assets that arise from contractual rights would be measured using the fair value measurement principles of Topic 820 except that the measurement only would consider market participant assumptions about the remaining noncancelable terms. Identifiable intangible assets that arise from other legal rights but that are not contractual would continue to be measured at fair value in accordance with Topic 820, Fair Value Measurement, incorporating all market participant expectations.

This Proposed ASU generally would result in entities recognizing fewer intangible assets in a business combination because not all identifiable intangible assets would be recognized separately, as currently required under Topic 805.

Topic 805 requires an acquirer to recognize assets acquired and liabilities assumed in a business combination at their acquisition-date fair values, including all intangible assets that are identifiable.

An intangible asset is identifiable if it meets either one of the following criteria:

1. It arises from **contractual** or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.
2. It is **separable**, that is, capable of being separated or divided from the entity and sold, transferred, licensed, rented, or exchanged, either individually or together with a related contract, identifiable asset, or liability, regardless of whether the entity intends to do so.

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

The Proposed ASU would continue to provide decision-useful information to the users of private company financial statements, while providing a reduction in the cost and complexity associated with the valuation of certain identifiable intangible assets.

Generally, intangible assets are organized as follows:

1. Marketing-related intangible assets
2. Customer-related intangible assets
3. Artistic-related intangible assets
4. Contract-based intangible assets
5. Technology-based intangible assets.

- Marketing-related include trademarks, trade names, service marks, trade dress, newspaper mastheads, internet domain names, non-compete agreements, etc.

- Customer-related include customer lists, order or production backlog, customer relationships, etc.

- Artistic-related include plays, operas, ballets, books, magazines, newspapers, musical marks, song lyrics, advertising singles, pictures, photographs, motion pictures, music videos, television programs, etc.

- Contract-based include licensing or royalty agreement; advertising, construction, management or supply contracts; construction permits; franchise agreements; broadcasting rights; mortgage servicing rights; employment contracts; drilling rights; water rights, etc.

- Technology-based include computer software, patented or unpatented technology, databases, trade secrets, trade formulas, trade processing, trade recipes, etc.

Currently, those intangible assets that arise from contract rights must be separate from goodwill and should be measured at fair value based on market participants' assumptions. This Proposed ASU would make that an election.

Issued: July 1, 2013

Comments Due: August 23, 2013

Proposed Accounting Standards Update PCC-13-01B—Intangibles—Goodwill and Other (Topic 350) – PCC Issue

This Proposed ASU addresses the concerns of private company stakeholders that the benefits of the current accounting for goodwill do not justify the related costs.

The Proposed ASU provides guidance about an accounting alternative for the subsequent measurement of goodwill.

The alternative would allow a private company to amortize goodwill on a straight-line basis over the useful life of the **primary asset** acquired in a business combination, not to exceed 10 years. A primary asset is the long-lived asset that is the most significant asset of the acquired entity.

Goodwill would be tested for impairment only when a triggering event occurs that would indicate that the fair value of an entity may be below its carrying amount. Moreover, goodwill would be tested for impairment at the entity-wide level rather than at the reporting until level.

The goodwill impairment loss, if any, would represent the excess of an entity's carrying amount of goodwill.

Issued: July 1, 2013

Comments Due: August 23, 2013

Proposed Accounting Standards Update PCC-13-03—Derivatives and Hedging (Topic 815) – PCC Issued

This Proposed ASU addresses the concerns of private companies that, because of limited resources and/or the complexity of understanding and applying hedge accounting, lack the expertise to comply with the requirements to qualify for **cash flow hedge accounting**.

Generally, private companies do not apply hedge accounting, which results in income statement volatility.

This Proposed ASU would provide two alternative approaches, the *combined instruments approach* and the *simplified hedge accounting approach*, to account for swaps that are entered into for the purposes of economically converting variable-rate borrowing to fixed-rate borrowing.

The details underlying the two alternatives are beyond the scope of this text.

Issued: July 1, 2013

Comments Due: August 23, 2013

Proposed Accounting Standards Update 2013-290—Insurance Contracts (Topic 834)

This Proposed ASU increases the decision usefulness of the information about an entity's (insurance company or other) insurance liabilities, including the nature, amount, timing, and uncertainty of cash flows related to those liabilities, and the related effect on the statement of comprehensive income. It also provides comparability, regardless of the type of entity issuing the contract.

The guidance would require an entity to measure its insurance contracts under one of two measurement models, referred to as the *building block approach* and the *premium allocation approach*.

Contracts accounted for using the **building block approach** generally would be measured in a way that portrays a current assessment of the insurance contract. That measurement has the following two components:

1. The present value of the unbiased probability-weighted mean of the future net cash flows (expected value) that the entity expects in fulfilling the contract
2. A margin representing profit at risk, which is deferred and recognized as income as the uncertainty in the cash flows decreases.

An entity applying the **premium allocation approach** would initially measure its liability for remaining coverage as the contractual premiums that are within the boundary of the existing contract. In subsequent periods, the entity would reduce the measurement of the liability for remaining coverage on the basis of the expected timing of incurred claims and benefits and would recognize the amount of that reduction as insurance contract revenue. When insured events occur, an entity generally would measure a separate liability for incurred claims as the expected value of future cash flows to settle the claims and related expenses.

This Proposed ASU would require an entity to present the following in net income:

1. Insurance contract revenue:
   (a) For the building block approach—over the coverage and settlement periods as the obligation to provide coverage and other services is satisfied.
   (b) For the premium allocation approach—over the coverage period on the basis of the expected timing of incurred claims.
2. Claims and expenses as they are incurred, and for contracts measured using the building block approach, changes in assumptions regarding expected cash flows.
3. Interest expense using the discount rates determined when the contract was initially recognized. Those rates would be periodically reset for insurance contracts with discretionary participation features that change the expected cash flows.

Issued: June 27, 2013

Comments Due: October 25, 2013

Proposed Accounting Standards Update 2013-300—Presentation of Financial Statements (Topic 205)

This Proposed ASU would provide guidance in U.S. GAAP on management's responsibilities in evaluating an entity's **going concern uncertainties** and on the timing and content of related footnote disclosures.

An entity would evaluate going concern uncertainties by assessing the likelihood that the entity would be unable to meet its obligations as they become due within 24 months after the financial statement date.

An entity would evaluate going concern uncertainties at each annual and interim reporting period and start providing footnote disclosures when it is either:

(1) **more-likely-than not** that the entity will be unable to meet its obligations within 12 months after the financial statement date without taking actions outside the ordinary course of business or
(2) **known-or-probable that** the entity will be unable to meet its obligations within 24 months after the financial statement date without taking actions outside the ordinary course of business.

In determining whether disclosures are necessary, an entity would assess information about conditions and events that exist at the date the financial statements are issued (or for a nonpublic entity the date that the financial statements are available to be issued) – not the balance sheet date.

In determining whether disclosures are necessary, an entity would not consider the potential mitigating effect of management's plans that are outside the ordinary course of business. An effective plan to assure survival and continuity would not negate the need for disclosure of going concern issues.

An entity would disclose in the footnotes a description of:

(1) the principal conditions and events that give rise to the entity's potential inability to meet its obligations,
(2) the possible effects those conditions and events could have on the entity,
(3) management's evaluation of the significance of those conditions and events,
(4) mitigating conditions and events, and
(5) management's plans that are intended to address the entity's potential inability to meet its obligations.

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

Disclosures may be less extensive in earlier going concern uncertainty periods because available information may be limited.

In subsequent reporting periods, disclosures may become more extensive as additional information becomes available about conditions and events and about management's plans.

The Proposed ASU also would require an entity that is an SEC filer to evaluate whether there is substantial doubt about its going concern presumption. If there is substantial doubt, the entity would disclose that determination in the footnotes.

Substantial doubt would exist if, after assessing existing conditions and events and after considering all of management's plans (including those outside the ordinary course of business), the entity concludes that it is known or probable that it will be unable to meet its obligations within 24 months after the financial statement date.

An entity that is not an SEC filer would not be required to evaluate or disclose whether there is substantial doubt about its going concern presumption but would be required to apply all of the other disclosure requirements within the proposed amendments

Issued: June 26, 2013

Comments Due: September 24, 2013

<u>Proposed Accounting Standards Update 2013-270—Leases (Topic 842)</u>

This **revised** Proposed ASU includes a new approach to lease accounting with an objective to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and by disclosing key information.

The core principle of this Proposed ASU is that an entity should recognize assets and liabilities arising from a lease.

A lessee would recognize assets and liabilities for leases with a maximum possible term of more than 12 months. A lessee would recognize a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the leased asset (the underlying asset) for the lease term.

The recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee would depend on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset.

For most leases of assets other than property (for example, equipment, aircraft, cars, trucks), a lessee would classify the lease as a **Type A lease** and would do the following:

1. Recognize a right-of-use asset and a lease liability, initially measured at the present value of lease payments
2. Recognize the unwinding of the discount on the lease liability as interest separately from the amortization of the right-of-use asset.

For most leases of property (that is, land and/or a building or part of a building), a lessee would classify the lease as a **Type B lease** and would do the following:

1. Recognize a right-of-use asset and a lease liability, initially measured at the present value of lease payments
2. Recognize a single lease cost, combining the unwinding of the discount on the lease liability with the amortization of the right-of-use asset, on a straight-line basis.

The accounting applied by a lessor would depend on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset. For practical purposes, this assessment often would depend on the nature of the underlying asset.

For most leases of assets other than property, a **lessor** would classify the lease as **a Type A lease** and would do the following:

1. Derecognize the underlying asset and recognize a right to receive lease payments (the lease receivable) and a residual asset
2. Recognize the unwinding of the discount on both the lease receivable and the residual asset as interest income over the lease term
3. Recognize any profit relating to the lease at the commencement date.

For most leases of property, a **lessor** would classify the lease as a **Type B lease** and would apply an approach similar to existing operating lease accounting in which the lessor would do the following:

1. Continue to recognize the underlying asset
2. Recognize lease income over the lease term typically on a straight-line basis.

For leases with a maximum possible term (including any options to extend) of 12 months or less, a lessee and a lessor would be permitted to make an accounting policy election, by class of underlying asset, to apply simplified requirements that would be similar to existing operating lease accounting.

An entity would provide disclosures to meet the objective of enabling users of financial statements to understand the amount, timing, and uncertainty of cash flows arising from leases.

Issued: May 16, 2013

Comments Due: September 13, 2013

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

Proposed Accounting Standards Update 2013-240—Technical Corrections and Improvements Related to Glossary Terms

This Proposed ASU relates to glossary terms and covers a wide range of Topics in the Codification.

It represents changes to clarify the Master Glossary of the Codification, consolidate multiple instances of the same term into a single definition, or make minor improvements to the Master Glossary that are not expected to have a significant effect on current accounting practice or create a significant administrative cost to most entities.

Additionally, the Proposed ASU will make the Master Glossary easier to understand, as well as reduce the number of terms appearing in the Master Glossary.

Issued: May 6, 2013

Comments Due: August 5, 2013

Proposed Accounting Standards Update 2013-EITF-13B—Investments—Equity Method and Joint Ventures (Topic 323)

This Proposed ASU provides guidance on accounting for investments in affordable housing projects that qualify for the low income housing tax credit.

The low income housing tax credit program is designed to encourage investment of private capital for use in the construction and rehabilitation of low income housing. This program is an indirect tax subsidy that allows investors in a flow-through limited liability entity, such as a limited partnership or limited liability company that manages or invests in a qualified affordable housing project, to receive the benefits of the tax credits allocated to the entity that owns the qualified affordable housing project.

Currently, under U.S. GAAP, a reporting entity that invests in a qualified affordable housing project may elect to account for that investment using the effective yield method if all the conditions in paragraph 323-740-25-1 are met. For those investments that are not accounted for using the effective yield method, paragraph 323-740-25-2 requires that those investments be accounted for in accordance with Subtopic 970-323, Real Estate—General—Investments—Equity Method and Joint Ventures, which results in the investments being accounted for under either the equity method or the cost method.

This Proposed ASU would modify the conditions that an entity must meet to elect to use the effective yield method for qualified affordable housing project investments and would allow the entity to use both cash flows from the tax credits and other tax benefits for the calculation of the investor's projected yield. Additionally, it would require recurring disclosures about investments in qualified affordable housing projects. The proposed amendments would enable more entities to qualify to elect the effective yield method to account for investments in qualified affordable housing projects, which provides a presentation of the investment's performance net of taxes.

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

In addition, this Proposed ASU would help financial statement users understand the nature of qualified affordable housing project investments and their effect on the financial position and results of operations of the reporting entity.

This Proposed ASU would permit reporting entities that invest in a qualified affordable housing project through a limited liability entity to elect to account for the investment using the effective yield method if all of the following conditions are met:

1. It is probable that the tax credits allocable to the investor will be available.
2. The investor retains no operational influence over the investment other than protective rights, and substantially all of the projected benefits are from tax credits and other tax benefits (for example, tax benefits generated from the operating losses of the investment).
3. The investor's projected yield based solely on the cash flows from the tax credits and other tax benefits is positive.
4. The investor is a limited liability investor in the affordable housing project for both legal and tax purposes, and the investor's liability is limited to its capital investment.

For those investments in qualified affordable housing projects not accounted for using the effective yield method, the investment would be accounted for as an equity method investment or cost method investment in accordance with Subtopic 970-323.

The decision to apply the effective yield method of accounting will continue to be an accounting policy decision rather than a decision to be applied to individual investments that qualify for use of the effective yield method.

Issued: April 17 2013

Comments Due: June 17, 2013

Proposed Accounting Standards Update 2013-221—Financial Instruments—Overall (Subtopic 825-10)

This is a companion document to the Exposure Draft of Proposed ASU 2013-220, Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities (proposed update on financial instruments), which was issued on February 14, 2013.

The Proposed ASU eliminates the fair value option for:

- guarantees and other contingencies accounted for in accordance with Topic 460, Contingencies.
- rights and obligations under an insurance contract and obligations under a warranty that is accounted for under Topic 944, Financial Services - Insurance or the current Proposed ASU 2013-290

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

- rights under a warranty accounted for in accordance with the guidance in the revenue recognition Proposed ASU.
- written loan commitments
- firm commitments

Issued: April 12, 2013

Comments Due: May 15, 2013

Proposed Accounting Standards Update 2013-230—Presentation of Financial Statements (Topic 205)

This Proposed ASU would change the criteria for reporting discontinued operations.

Under this Proposed ASU, the **definition of discontinued operation would be changed** as follows:

1. Only those components of an entity that represent a separate major line of business or major geographic area of operations would be eligible for discontinued operations presentation in the financial statements. Currently, a component of an entity that is a reportable segment, an operating segment, a reporting unit, a subsidiary, or an asset group is eligible for discontinued operations presentation.

2. The following conditions in the current definition of discontinued operation would not have to be met:

    a. The operations and cash flows of the component have been (or will be) eliminated from the ongoing operations of the entity as a result of the disposal transaction.
    b. The entity will not have any significant continuing involvement in the operations of the component after the disposal transaction.

3. A business that, on acquisition, meets the criteria to be classified as held for sale would be a discontinued operation.

4. Disposals of equity method investments that meet the definition of a discontinued operation would be eligible for discontinued operations presentation.

Too many disposals of assets currently qualify for discontinued operations presentation. Only disposals representing a significant strategic shift in operations should be presented in discontinued operations. The current continuing involvement criterion is difficult to apply and does not result in consistent application. The Proposed ASU addresses these issues.

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

This Proposed ASU would require expanded disclosures for discontinued operations and for disposals of individually material components of an entity that do not qualify for discontinued operations presentation.

The new disclosures would provide users of financial statements with more information about the financial results of discontinued operations and disposals of individually material components of an entity. For example, disclosures about the operating, investing, and financing cash flows would be required for a discontinued operation.

This Proposed ASU also would require certain additional disclosures about discontinued operations, including:

A **public entity** would now provide disclosures about a disposal of an individually material component of an entity that does not qualify for discontinued operations presentation in the financial statements, including:

1. The pretax profit or loss attributable to the component of an entity for the period in which it is sold or is classified as held for sale and for all prior periods that are presented in the statement where net income is reported.
2. If the component of an entity includes a noncontrolling interest, the pretax profit or loss attributable to the parent for the period in which it is sold or is classified as held for sale and for all prior periods that are presented in the statement where net income is reported.
3. A reconciliation of the major classes of assets and liabilities of the component of an entity classified as held for sale that are disclosed in the notes to the financial statements to total assets and total liabilities of the disposal group classified as held for sale that are presented separately on the face of the statement of financial position for the initial period in which the disposal group is classified as held for sale.

A **nonpublic entity** would now provide disclosures about a disposal of an individually material component of an entity that does not qualify for discontinued operations presentation in the financial statements, including:

1. The pretax profit or loss attributable to the component of an entity for the period in which it is sold or is classified as held for sale
2. If the component of an entity includes a noncontrolling interest, the pretax profit or loss attributable to the parent for the period in which it is sold or is classified as held for sale.

The Proposed ASU would expand the disclosures about an entity's continuing involvement with a discontinued operation, including:

1. The amount of any cash inflows (outflows) from (to) the discontinued operation
2. Disclosures about a discontinued operation in which an entity retains an equity method investment after the disposal transaction.

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

Those disclosures would be required until the results of operations of the discontinued operation in which an entity retains continuing involvement are no longer separately presented in the statement where net income is reported.

Issued: April 2, 2013

Comments Due: August 30, 2013

Proposed Accounting Standards Update 2013-220—Financial Instruments—Overall (Subtopic 825-10)

This Proposed ASU would improve financial reporting for financial instruments by developing a consistent, comprehensive framework for classifying those instruments.

That framework would link the measurement of financial assets to the way in which the company expects to benefit from the cash flows embedded in those assets, while the measurement of financial liabilities would be consistent with how the entity expects to settle those liabilities.

Additionally, the proposal would improve the clarity and organization of much of the guidance on financial instruments, which in turn improves its accessibility and understandability.

The Proposed ASU would affect all entities that hold financial assets or owe financial liabilities.

The extent of the effect on an individual entity would depend on the significance of financial instruments to the entity's operations and financial position. For example, traditional banking-type institutions and insurance companies would be affected to varying degrees depending on their asset mix and the business models within which they manage their financial assets. The effect likely would be less significant for many commercial and industrial entities and many not-for-profit entities.

An entity would classify its financial assets by applying both a contractual cash flow characteristics criterion and a business model criterion. The business model assessment would require an entity to classify and measure a financial asset that meets the contractual cash flow characteristics criterion on the basis of how the entity would manage that financial asset together with other financial assets within a distinct business model.

An entity also would no longer be able to classify an equity instrument with a readily determinable fair value as available for sale, and the cost method of accounting would be eliminated.

The Proposed ASU would provide a practicability exception for an equity investment without a readily determinable fair value that does not qualify for the practical expedient

to estimate fair value in accordance with paragraph 820-10-35-59 (that is, the net asset value per share expedient).

In addition, the Proposed ASU also would eliminate the other-than-temporary impairment model for equity investments under existing U.S. GAAP and replace it with a one-step impairment model based on assessment of qualitative factors to determine when it is more likely than not that the fair value of the equity investment is below its carrying amount.

The proposed guidance would reduce alternative accounting methods, thereby improving comparability, by replacing the existing unconditional fair value option for financial instruments (within the scope of this proposed guidance) with limited fair value options.

Hybrid financial assets that do not give rise to cash flows that are solely payments of principal and interest on the principal amount outstanding would no longer be eligible for separate accounting for the derivative and nonderivative components and would be measured in their entirety at fair value with all changes in fair value recognized in net income. That provision would simplify the accounting for those instruments in addition to increasing the relevance of the information in financial statements by including in net income the change in fair value of a financial asset that has more than insignificant cash flow variability.

The proposed guidance would eliminate the need for bifurcation and separate accounting for hybrid nonfinancial assets by requiring the hybrid contract to be measured at fair value (with changes in fair value recognized in net income) if the hybrid nonfinancial asset contains an embedded derivative that would have required bifurcation and separate accounting under Subtopic 815-15.

Under current U.S. GAAP, changes in the fair value of a financial liability designated under the fair value option that result from a change in the instrument-specific credit risk are included in net income. The proposed guidance would require the portion of a change in the fair value of a financial liability resulting from a change in instrument-specific credit risk to be recognized in OCI and presented separately. That treatment would improve the relevance of the information about financial liabilities measured at fair value by excluding from net income gains or losses that the entity may not realize because those financial liabilities designated under the fair value option are not usually settled at their fair value before maturity.

Issued: February 14, 2013

Comments Due: May 15, 2013

See also ASU 2013-03 (Issued February 7, 2013); Proposed ASU 2013-221 (Issued April 12, 2013): Proposed ASU 2012-260 (Issued December 20, 2012); and Proposed ASU 2012-200 (Issued June 27, 2012)

Proposed Accounting Standards Update 2013-210—Transfers and Servicing (Topic 860)

The Proposed ASU would require that a transfer of an existing financial asset with an agreement that both entitles and obligates a transferor to repurchase or redeem the transferred asset from the transferee that meet certain criteria maintain the transferor's effective control over the transferred financial asset and, therefore, are required to be accounted for as a secured borrowing transaction.

In addition, the Proposed ASU also would clarify the characteristics of financial assets that may be considered "substantially the same", and the effect of the proposed guidance on the accounting for repurchase financing transactions.

Under current U.S. GAAP, agreements that both entitle and obligate a transferor to repurchase a transferred financial asset from the transferee at the maturity of the transferred asset do not maintain the transferor’s effective control. If the remaining conditions for derecognition are satisfied (that is, isolation and the transferee’s right to pledge or exchange the asset), such transfers of financial assets currently would be accounted for as a sale and forward repurchase agreement (generally, a derivative under Topic 815, Derivatives and Hedging).

The Proposed ASU would change the current accounting outcome by requiring secured borrowing accounting for such transactions.

These transactions should be considered to maintain the transferor’s effective control over the transferred financial assets during the term of the agreement.

In addition, under current U.S. GAAP, an initial transfer and related repurchase financing are required to be assessed to determine if they should be accounted for as a linked transaction, resulting in the combined transaction being accounted for by the initial transferor as a forward sale agreement and by the initial transferee as a forward purchase agreement, which is generally treated as a derivative.

The proposed guidance would require a repurchase financing to be accounted for separately from the initial transfer on the basis of the proposed amendments to the guidance on effective control. Such transactions would no longer be accounted for on a linked basis with the initial transfer.

Secured borrowing accounting for a repurchase agreement executed as a repurchase financing transaction best reflects its economics as a financing transaction and most faithfully represents the position of the parties to the transaction as a lender and borrower of funds.

Issued: January 15, 2013

Comments Due: March 29, 2013

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

Section 3

Proposed ASUs – 2012

Proposed Accounting Standards Update 2012-260—Financial Instruments—Credit Losses (Subtopic 825-15)

This Proposed ASU would require an entity to recognize an allowance for expected credit losses that reflects management's current estimate of the contractual cash flows that the company does not expect to collect, based on its assessment of credit risk as of the reporting date.

The Proposed ASU would remove the existing "probable" threshold in U.S. GAAP for recognizing credit losses and broaden the range of information that must be considered in measuring the allowance for expected credit losses.

The estimate of expected credit losses would be based on relevant information about past events, including historical loss experience with similar assets, current conditions, and reasonable and supportable forecasts that affect the expected collectability of the assets' remaining cash flows. An estimate of expected credit losses would always reflect both the possibility that there is a credit loss and the possibility that there is no credit loss. Accordingly, the Proposed ASU would prohibit an entity from estimating expected credit losses solely on the basis of the most likely outcome (that is, the statistical mode).

As a result of the Proposed ASU, financial assets carried at amortized cost less an allowance would reflect the current estimate of the cash flows expected to be collected at the reporting date, and the income statement would reflect credit deterioration (or improvement) that has taken place during the period.

For financial assets measured at fair value with changes in fair value recognized through OCI, the balance sheet would reflect the fair value, but the income statement would reflect credit deterioration (or improvement) that has taken place during the period.

An entity, may choose to not recognize expected credit losses on financial assets measured at fair value, with changes in fair value recognized through OCI if both:

(1) the fair value of the financial asset is greater than (or equal to) the amortized cost basis and
(2) expected credit losses on the financial asset are insignificant.

Issued: December 20, 2012

Comments Due: April 30, 2013

Proposed Accounting Standards Update 2012-EITF-12G—Consolidation (Topic 810)

This Proposed ASU will resolve the diversity in practice when accounting for the difference between the fair value of the financial assets and the fair value of the financial liabilities of a consolidated collateralized financing entity.

Topic 810 Consolidation, requires a reporting entity to consolidate a variable interest entity (VIE) if it is determined to be the **primary beneficiary** of the VIE. As a result, a reporting entity may be **required to consolidate** a collateralized financing entity, which is a VIE that holds debt instruments and issues beneficial interests in those financial assets. The beneficial interests are financial liabilities that only have recourse to the related financial assets of the collateralized financing entity.

In some instances, the reporting entity may not own any of the beneficial interests but may consolidate the collateralized financing entity for other reasons, including a subordinated fee structure.

Upon initial consolidation, many reporting entities elect the fair value option to account for the financial assets and financial liabilities of the consolidated collateralized financing entities.

This Proposed ASU would require a reporting entity that measures the financial assets and financial liabilities of a collateralized financing entity at fair value to determine the fair value of the collateralized financing entity's financial assets and financial liabilities consistently with how market participants would prince the reporting entity's net risk exposure at the measurement date. The reporting entity would allocate the fair value of the portfolio to the individual financial assets or financial liabilities on a reasonable and consistent basis using a methodology appropriate in the circumstances.

Issued: October 11, 2012

Comments Due: December 10, 2012

Proposed Accounting Standards Update 2012-200—Financial Instruments (Topic 825)

This Proposed ASU is to improve financial reporting about certain risks inherent in financial instruments and how they contribute to broader risks to which the reporting organization is exposed.

The Proposed ASU addresses many stakeholders' concerns about how organizations disclose their exposures to **liquidity risk** and **interest rate risk**, two risks that were prominent during the recent financial crisis and that continue to be relevant to reporting organizations on an ongoing basis.

It also proposes to require expanded and standardized disclosures about these risks.

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

Liquidity Risk Disclosures. The proposed liquidity risk disclosures would provide information about the risks and uncertainties that a reporting entity might encounter in meeting its financial obligations. For a financial institution the proposed amendments would require tabular disclosure of the carrying amounts of classes of financial assets and financial liabilities segregated by their expected maturities, including off-balance-sheet financial commitments and obligations.

The Proposed ASU also would require a **financial institution** to disclose in a table its available liquid funds, which include any unencumbered cash and highly liquid assets and any available borrowings such as loan commitments, unpledged securities, and lines of credit.

An entity that is **not a financial institution** would disclose in a table its expected cash flow obligations disaggregated by their expected maturities. Furthermore, in a separate table, an entity that is not a financial institution would be required to disclose its available liquid funds.

The Proposed ASU would require a depository institution to disclose information about its time deposit liabilities. Specifically, a depository institution would be required to disclose in a table the cost of funding from the issuance of time deposits and acquisition of brokered deposits during the previous four fiscal quarters.

The Proposed ASU would require all reporting entities to provide additional quantitative or narrative disclosure to the extent necessary so that users of financial statements can understand an entity's exposure to liquidity risk.

Interest Rate Risk Disclosures. An entity that is **not a financial institution** would not be required to provide any of the interest rate risk disclosures in this Proposed ASU.

The proposed interest rate risk disclosures would provide information about the exposure of a financial institution's financial assets and financial liabilities to fluctuations in market interest rates. The Proposed ASU would require a financial institution to disclose the carrying amounts of classes of financial assets and financial liabilities segregated according to **time intervals** based on the contractual **repricing** of the financial instruments. Such a disclosure also would include the weighted-average contractual yield by class of financial instrument and **time interval** as well as the duration for each class of financial instrument, if applicable.

The Proposed ASU would require a **financial institution** to disclosure in an interest rate sensitivity table the effects on net income and shareholders' equity of specified hypothetical, instantaneous shifts of interest rate curves as of the measurement date.

Issued: June 27, 2012

Comments Due: September 25, 2012

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

Proposed Accounting Standards Update 2011-250—Revenue Recognition (Topic 605): Codification Amendments

This is a companion document to the Exposure Draft of Proposed ASU, *Revenue Recognition (Topic 605): Revenue from Contracts with Customers* (proposed update on revenue recognition), which was issued November 14, 2011. (Issued on November 14, 2011)

This document includes the proposed amendments that codify the guidance in the proposed update (2012-230) on revenue recognition. .

Proposed ASU 2011-250 would affect any entity that enters into contracts with customers unless those contracts are in the scope of other standards (for example, insurance contracts or lease contracts).

The guidance would supersede most of the revenue recognition requirements in Topic 605 (and related guidance).

The core principle of this Proposed ASU is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

To achieve that core principle, an entity would apply all of the following steps:

Step 1: Identify the contract with a customer
Step 2: Identify the separate performance obligations in the contract.
Step 3: Determine the transaction price.
Step 4: Allocate the transaction price to the separate performance obligations in the contract.
Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation.

Issued: January 4, 2012

Companion document: Proposed ASU 2011-230 (Issued November 14, 2011)

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

Section 4

Proposed ASUs – 2011

Proposed Accounting Standards Update EITF11A—Consolidation (Topic 810)

This Proposed ASU was issued as ASU 2013-05 (March 4, 2013)

Issued: December 8, 2011

Comments Due: February 6, 2012

Proposed Accounting Standards Update 2011-230—Revenue Recognition (Topic 605)

This Proposed ASU specifies the principles that an entity would apply to report useful information about the amount, timing, and uncertainty of revenue and cash flows arising from its contracts to provide goods or services to customers.

In summary, the core principle would require an entity to recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the amount of consideration to which the entity expects to be entitled in exchange for those goods or services.

Issued: November 14, 2011; See also Proposed ASU 2011-250 (Issued January 4, 2012) and Proposed ASU 1820-100 (Issued June 24, 2010)

Proposed Accounting Standards Update 2011-220—Consolidation (Topic 810)

This Proposed ASU would change the analysis that a reporting entity must perform to determine whether it should consolidate another entity.

Specifically, the proposed amendments would:

- Provide criteria to evaluate whether an entity's decision maker is using its decision-making authority as a principal or an agent. This would affect the determination of whether an entity is a variable interest entity (VIE) and which party is the VIE's primary beneficiary.

- Amend the requirements for evaluating kick-out and participating rights in the various Subsections of Subtopic 810-10 to be more closely aligned.

- Amend the requirements for evaluating whether a general partner controls a limited partnership.

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

Variable Interest Entities. A reporting entity must determine whether it has a variable interest in the entity being evaluated for consolidation and whether that entity is a variable interest entity.

Subtopic 810-10 currently provides criteria that must be evaluated to assess whether a decision-making arrangement represents a variable interest in an entity. Under the current requirements if a reporting entity concludes that a decision-making arrangement represents a variable interest, then the decision maker is not an agent. This could affect the conclusion as to whether the entity is a variable interest entity. Specifically, the analysis of whether a decision-making arrangement represents a variable interest could affect the assessment of whether the equity investment holders, as a group, lack the characteristics of a controlling financial interest.

In addition, if the decision-making arrangement is determined to be a variable interest and the entity is a variable interest entity, current U.S. GAAP would require the decision maker to **consolidate the variable interest entity if it has the power to direct the activities that most significantly impact the entity's economic performance and the obligation to absorb losses or the right to receive benefits of the variable interest entity that potentially could be significant to the variable interest entity**.

The Proposed ASU would continue to require an evaluation to determine whether a decision maker has a variable interest in an entity. However, it would introduce a separate qualitative analysis to determine whether the decision maker is using its power in a principal or an agent capacity. Generally, a decision maker who is a principal is usually a primary beneficiary. Accordingly, a decision maker with a variable interest in an entity would need to determine its capacity on the basis of the amendments in this Proposed ASU.

Principal versus Agent Analysis. Under the Proposed ASU, the evaluation to assess whether a decision maker is using its power as a principal or an agent would focus on:

1. The rights held by other parties
2. The compensation to which the decision maker is entitled in accordance with its compensation agreement(s)
3. The decision maker's exposure to variability of returns from other interests that it holds in the entity.

Comments Due: January 17, 2012

Proposed Accounting Standards Update 2011-210—Real Estate—Investment Property Entities (Topic 973)

This Proposed ASU would provide accounting guidance for an entity that meets the criteria to be an investment property entity.

An entity in which substantially all of its business activities are investing in a real estate property of properties for total return, including an objective to realize capital appreciation (for example, certain real estate investment trusts and real estate funds) is an *investment property entity*.

An entity that meets all of the following criteria would be an investment property entity under the Proposed ASU:

1. *Nature of the business activities*. Substantially all of the entity's bsiness activities are investment in a real estate property or properties.

2. *Express business purpose*. The express business purpose of the entity is to invest in a real estate property or properties for total return including an objective to realize capital appreciation, for example through disposal of its real estate property or properties. Real estate properties held by an entity for either of the following purposes do not meet this criterion:

    a. The entity's own use in the production or supply of goods or services or for administrative purposes
    b. Development for sale in the ordinary course of business upon completion.

3. *Unit Ownership*. Ownership in the entity is represented by units of investments, in the form of equity

4. *Pooling of funds*. The funds of the entity's investors are pooled to avil the investors of professional investment management. The entity has investors that are not related to the parent (if thee is a parent) and those investors, in aggregate, hold a significant ownership interest in the entity.

5. *Reporting entity*. The entity provides financial results about its investing activities to its investors. The entity can be but does not need to be a legal entity.

The Proposed ASU would introduce presentation and disclosure requirements for an investment property entity.

Real Estate Properties. Investment properties acquired by an investment property entity would initially be measured at transaction price, including transaction costs. Subsequent measurement is at fair value with all changes in fair value recognized in net income. Real estate properties other than investment properties would be measured in accordance with other relevant U.S. GAAP.

Controlling Financial Interests. The Proposed ASU would require an investment property entity to account for a controlling financial interest in the following entities in accordance with Topic 810, Consolidation:

1. Another investment property entity.
2. An investment company as defined in Topic 946.
3. An operating entity that provides services to the investment property entity.

An investment property entity would measure a controlling financial interest in any other entity at fair value with all changes in fair value recognized in net income.

Equity Method Investments. The Proposed ASU would require an investment property entity to account for an investment in an operating company that provides services to the investment property entity in accordance with Topic 323, Investments-Equity Method and Joint Ventures, if the investment property entity can exercise significant influence over the operating company. An investment property entity would measure all other investments that would otherwise qualify for the equity method of accounting (including investments in another investment property entity or an investment company) at fair value with all changes in fair value recognized in net income.

Other Financial Interests. Investments in entities in which the investment property entity does not have a controlling financial interest or cannot exercise significant influence would be measured in accordance with other relevant U.S. GAAP. For example, an investment property entity would account for a debt security issued by another investment property entity in accordance with Topic 320, Investment—Debt and Equity Securities.

Issued: October 21, 2011

Comments Due: January 5, 2012

Section 5

Proposed ASUs – 2010

Proposed Accounting Standards Update 1820-100—Revenue Recognition (Topic 605)

This Proposed ASU specifies the principles that an entity would apply to report useful information about the amount, timing, and uncertainty of revenue and cash flows arising from its contracts to provide goods or services to customers.

In summary, the core principle would require an entity to recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration that it receives, or expects to receive, in exchange for those goods or services.

Issued: June 24, 2010

See also: Proposed ASU 2011-250 (Issued January 4, 2012) and Proposed ASU 2011-230 (Issued November 14, 2011)

Proposed Accounting Standards Update 1810-100—Financial Instruments (Topic 825) and Derivatives and Hedging (Topic 815)

This Proposed ASU focuses on providing the most useful, transparent, and timely information to financial statement users about an entity's involvement in financial instruments, while reducing the complexity in accounting for those financial instruments.

This Proposed ASU simplifies and improves financial reporting for financial instruments by:

- developing a consistent, comprehensive model for classifying and measuring financial instruments
- removing the "probable" threshold for recognizing credit impairments to enable timely recognition of credit losses
- amending the requirements to qualify for hedge accounting to allow for more consistent and transparent reporting of hedging activities.

Issued: May 26, 2010

See also 2013-03 (Issued July 1, 2013); Proposed ASU 2013-22 (Issued April 12, 2013); Proposed ASU 2013-220 (Issued February 14, 2013); Proposed ASU 2012-210 (issued December 20, 2012); and Proposed ASU 2012-200 (Issued June 27, 2012)

Section 6

New Audit Standards

SAS 127 - Omnibus SAS – 2013

SAS127 amends the following sections of SAS 122, "Clarification and Recodification."

- Section 600 – Special Considerations – Audits of Group Financial Statements
- Section 800 – Special Considerations – Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks

SAS 122 Section 600

Section 600 Paragraph .25*a* of SAS 122 precludes making reference to the audit of a component auditor in the auditor's report on the group financial statements unless the component's financial statements are prepared using the same financial reporting framework as that used for the group financial statements.

When a different framework is used in group financials the amendments in SAS 127 allow the auditor to refer to that fact in the auditor's report on the group financial statements.

SAS 127 requires the auditor's report on the group financial statements to disclose that the auditor of the group financial statements is taking responsibility for evaluating the appropriateness of the adjustments made to convert the component's financial statements framework to the group's financial reporting framework.

Section 600 Paragraph .25*b* of SAS 122 precludes making reference to the audit of a component auditor in the auditor's report on the group financial statements unless the component auditor has performed an audit that meets the relevant requirements of generally accepted auditing standards (GAAS).

Section 600 Paragraph .A54 of SAS No. 122 provides guidance on how the group engagement partner may determine that the audit performed by the component auditor meets the relevant requirements of GAAS.

When the auditor of the group financial statements is making reference to the audit of a component auditor and has determined that the component auditor performed additional audit procedures in order to meet the relevant requirements of GAAS, the group auditor's report (on the group financial statements) should indicate the set of auditing standards used by the component auditor and should state that additional audit procedures were performed by the component auditor to meet the relevant requirements of GAAS.

The amendments in SAS 127 also clarify that the group engagement team is required to determine component materiality for those components on which the group engagement

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

team will assume responsibility for the work of a component auditor who performs an audit or a review.

SAS 122 Section 800

Section 800 of SAS 122 introduced the term *special purpose framework*, which is a cash, tax, regulatory, or contractual basis of accounting.

The amendments in SAS 127 add an other basis of accounting that uses a definite set of logical, reasonable criteria that is applied to all material items appearing in financial statements to the bases of accounting defined as special purpose frameworks.

Effective Dates

The amendments in SAS 127 Section 600 and 800 are effective for audits of group financial statements for periods ending on or after December 15, 2012.

SAS 126 – The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern

Continuation of an entity as a going concern is assumed in financial reporting in the absence of information to the contrary.

Ordinarily, information that significantly contradicts the going concern assumption relates to the entity's inability to continue to meet its obligations as they become due without substantial disposition of assets outside the ordinary course of business, restructuring of debt, externally enforced revisions of its operations, or similar actions.

The auditor's responsibility is to evaluate whether there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time.

The auditor's evaluation is based on the auditor's knowledge of relevant conditions or events that exist at, or occurred prior to, the date of the auditor's report.

Auditors should consider all facts and circumstance in evaluating the ability of an entity to continue as going concern.

Factors that affect the ability of an entity to endure increasing hardships caused by the slowly recovering economy include the following:

- recurring operating losses
- working capital deficiencies
- loan defaults
- tightening credit
- loss of key customers and/or suppliers
- litigation proceedings

SAS 126 is effective for audits of financial statements for periods ending on or after December 15, 2012.

The substantial changes will be as follows:

1. The auditor will now have to obtain a written representation from management indicating there could be substantial doubts about the entity's ability to continue as a going concern.
2. The auditors will now be required to re-asses going concern ability by performing certain procedures that will help the auditors determine whether to eliminate the going-concern paragraph.

The approach in the "old" SAS 59 still remains.

1. The auditor is responsible on every audit for determining whether there are substantial doubts about the continued existence of the entity.
2. Evidence must support the auditor's "call" about going concern (identify going concern conditions).
3. The auditor must assess the possible financial affects of uncertainties (including going concern issues) and must assess the adequacy of disclosure.
4. The auditor must evaluate management's plans designed to mitigate adverse affects of the conditions raising doubt about continued existence.
5. The auditor must consider effects on the auditor's report.

Written Representations

If conditions or events have been identified that indicate there could be substantial doubt about the entity's ability to continue as a going concern, the auditor should obtain the following written representations from management:

- Management's plans that are intended to mitigate the adverse effects of conditions and events that indicate there could be substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time and the likelihood that those plans can be effectively implemented,
- Management's assertion that the financial statements disclose all of the matters of which management is aware that are relevant to the entity's ability to continue as a going concern.

Comparative Presentations

If substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time existed at the date of prior period financial statements that are presented on a comparative basis, and that **doubt has been removed** in the current period, the emphasis-of-matter paragraph included in the auditor's report on the financial statements of the prior period **should not be repeated**.

Eliminating a Going-Concern Emphasis-of-Matter Paragraph From a Reissued Report

An auditor has no obligation to reissue any the report. However, an auditor may be requested to do so to eliminate a going-concern emphasis-of-matter paragraph .

If the auditor decides to reissue the report, the auditor should re-assess the going-concern status of the entity by performing the following procedures:

a. Audit the event or transaction that prompted the request to reissue the report without the going-concern emphasis-of-matter paragraph.
b. Perform the times tested procedures listed in SAS AU-C section 560, Subsequent Events and Subsequently Discovered Facts, at or near the date of reissuance.
c. Based on the conditions and circumstances at the date of reissuance consider the following:

1. Did the audit procedures performed during the audit identify conditions and events that, when considered in the aggregate, indicate there could be substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time?
2. Did the auditor consider the need to obtain additional information about such conditions and events, as well as the appropriate audit evidence to support information that mitigates the auditor's doubt?.
3. If, after considering the identified conditions and events in the aggregate, does the auditor believe there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time?
4. Did the auditor obtain information about management's plans that are intended to mitigate the adverse effects of such conditions and events?
5. Did the auditor identify those elements of management's plans that are particularly significant to overcoming the adverse effects of the conditions and events and did the auditor plan and perform procedures to obtain audit evidence about them including, when applicable, considering the adequacy of support regarding the ability to obtain additional financing or the planned disposal of assets?
6. Did the auditor assess whether it is likely that such plans can be effectively implemented.
7. When necessary, did the auditor request management to provide prospective information and did the auditor consider the adequacy of support for significant assumptions underlying that information? Did the auditor give particular attention to assumptions that are:

    - material to the prospective financial information.
    - especially sensitive or susceptible to change.
    - inconsistent with historical trends.

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

> The auditor's consideration should be based on knowledge of the entity, its business, and its management and should include (*a*) reading the prospective financial information and the underlying assumptions and (*b*) comparing prospective financial information from prior periods with actual results and comparing prospective information for the current period with results achieved to date. If the auditor becomes aware of factors, the effects of which are not reflected in such prospective financial information, the auditor should discuss those factors with management and, if necessary, request revision of the prospective financial information.

<u>Proper Emphasis-of- Matter Paragraph</u>

The inclusion of an emphasis-of-matter paragraph in the auditor's report is sufficient to inform the users of the financial statements.

An illustration of an emphasis-of-matter paragraph when the auditor concludes that there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time follows.

> The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note X to the financial statements, the Company has suffered recurring losses from operations and has a net capital deficiency that raise substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also described in Note X. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to this matter.

<u>Inappropriate Wording in the Emphasis-of-Matter Paragraph</u>

Auditors should be careful to avoid the following inappropriate language:

> "If the Company continues to suffer recurring losses from operations and continues to have a net capital deficiency, there may be substantial doubt about its ability to continue as a going concern"

> "The Company has been unable to renegotiate its expiring credit agreements. Unless the Company is able to obtain financial support, there is substantial doubt about its ability to continue as a going concern."

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

Reissued Report that Eliminates a Previously Issued Going-Concern Emphasis-of-Matter Paragraph

After the auditor has issued the auditor's report containing a going-concern emphasis-of-matter paragraph, the auditor may be asked to reissue the auditor's report on the financial statements and eliminate the going-concern emphasis-of-matter paragraph that appeared in the original report.

Such requests ordinarily occur after the conditions that gave rise to substantial doubt about the entity's ability to continue as a going concern have been resolved

For example, subsequent to the date of the auditor's original report, an entity might obtain needed financing.

Documentation

When the auditor believes there is substantial doubt about the ability of the entity to continue as a going concern for a reasonable period of time, or that disclosure in the financial statements is needed even though substantial doubt has been alleviated, the auditor should document the following:

a. The conditions or events that led the auditor to believe that there is substantial doubt
b. The elements of management's plans that the auditor considered to be particularly significant to overcoming the adverse effects of the conditions or events
c. The audit procedures used and evidence reviewed to evaluate management's plans
d. The auditor's conclusion as to whether substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time remains or is alleviated.

    If substantial doubt remains, the auditor also should document the possible effects of the conditions or events on the financial statements and the adequacy of the related disclosures. If substantial doubt is alleviated, the auditor also should document the auditor's conclusion as to the need for, and if applicable, the adequacy of disclosure of the principal conditions and events that initially caused the auditor to believe there was substantial doubt

e. The auditor's conclusion with respect to the effects on the auditor's report

Section 7

Proposed PCAOB Changes to the Standard Audit Report

The PCAOB is considering ways to change the auditor's report in regulatory filings.

For decades, the reports have consisted of a pass/fail format that investors complain gives them too little information.

Many investors want an auditor's discussion and analysis (AD&A) modeled on the management's discussion and analysis (MD&A) section of quarterly and annual SEC filings as a supplement to the auditor's report.

The AD&A would provide the auditor's views about significant matters and it could include information about the audit.

The AD&A could also include a discussion of the auditor's views on the company's financial statements, and management's decisions on financial issues and accounting policies.

Generally, auditors oppose the lengthy AD&A requirement but would back a limited change, such as expanding the emphasis paragraph to highlight the most significant matters in the financial statements and identify where the matters are disclosed.

The "new" report project on audited financial statements initially was based on:

1. The PCAOB's June 21, 2011 Release No. 2011-003, "Concept Release on Possible Revisions to PCAOB Standards Related to Reports on Audited Financial Statements" – Docket 034.

2. Input provided during a public roundtable meeting in 2011.

In additional there have been 155 comment letters submitted about the project.

The Goal of the PCAOB Audit Report Process

The PCAOB believe investors should be provided with:

1. More transparency about the audit process and

2. More insight into the company's financial statement of other information outside the financial statements.

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

The PCAOB **ALTERNATIVES** to the current standard pass/fail auditors report are:

1. An Auditor's Discussion & Analysis (AD&A)
2. Expanded use of emphasis paragraphs
3. Auditor assurance about information outside the basic financial statements
4. Clarification of language in the standard auditor's report.

AD&A

The intent of an AD&A would be to provide the auditor with the ability to discuss in a narrative format his or her views regarding significant matters.

The AD&A could include information about the audit, such as:

1. audit risk identified in the audit
2. audit procedures and results,
3. auditor independence.

It also could include a discussion of the auditor's views regarding the company's financial statements, such as:

1. management's judgments and estimates
2. accounting policies and practices
3. difficult or contentious issues, including "close calls."

Additionally, an AD&A could provide the auditor with discretion to comment on those material matters that might be in technical compliance with the applicable financial reporting framework, but in the auditor's view, the disclosure of such matters could be enhanced to provide the investor with an improved understanding of the matters and their impact on the financial statements.

An AD&A could also highlight those areas where the auditor believes management, in its preparation and presentation of the financial statements, could have applied different accounting or disclosures.

An AD&A would not be intended to provide separate assurance on individual balances, disclosures, transactions, or any other matters discussed. Rather, an AD&A would be intended to facilitate an understanding of the auditor's opinion on the financial statements taken as a whole.

An AD&A could give the auditor greater leverage to effect change and enhance management disclosure in the financial statements, thus increasing transparency to investors.

An AD&A could provide further context to an investor's understanding of a company's financial statements and management's related discussion and analysis, and provide the

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

auditor with the ability to communicate to investors and other users of financial statements the auditor's significant judgments in forming the audit opinion.

An AD&A also could provide the auditor with an adaptable report that he or she can **tailor** to a company's specific risks, facts, and circumstances.

The perspectives in the AD&A on certain matters could differ from those that management has provided in the MD&A. As a result, additional time might be incurred by management, the audit committee, and auditors to seek to resolve such differences before any views are reflected in the AD&A or MD&A. If the AD&A and the MD&A expressed different views on certain matters, the financial statement user might need to reconcile these differing views. Further, there is a risk that the language in an AD&A might become boilerplate in nature over time.

An AD&A would be the most expansive form of "new" reporting since it would provide auditor commentary on significant matters to the users of financial statements. An AD&A also could require the auditor to communicate some of the same information that the auditor communicates to the audit committee. Many of the matters that could be discussed in an AD&A are part of the audit performed pursuant to current auditing standards.

The PCAOB, in collaboration with the SEC, would likely need to develop new auditing standards to provide standard, objective criteria to the auditor regarding the appropriate content and level of detail to be reported in an AD&A. For example, reporting on difficult or contentious issues, including "close calls" would require additional direction to auditors in identifying and reporting on such matters.

The following box illustrates a potential framework for an AD&A Report including the types of potential criteria that help the auditor prepare an AD&A Report.

The following illustration does not include the following matters:

A. Materiality Levels
B. Engagement Statistics
C. Information Communicated to the Audit Committee

These three areas and others could be included in the AD&A.

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

Illustration of Possible Revised Standard Auditor's Report and Auditor's Discussion and Analysis AD&A

Report of Independent Registered Public Accounting Firm

[Standard Introductory Paragraph]

[Standard Scope Paragraph]

[Standard Opinion Paragraph]

Our audits were conducted for the purpose of forming an opinion on the financial statements, including related disclosures, taken as a whole. The accompanying Auditor's Discussion and Analysis provides additional analysis.

[Signature]
[City and State or Country]
[Date]

Auditor's Discussion and Analysis

This discussion should be read in conjunction with the accompanying auditor's report on the financial statements. We considered the matters discussed below in rendering our opinion on the financial statements taken as a whole. This discussion does not represent separate assurance on individual account balances, disclosures, transactions, or any other matters discussed below. It is not a substitute for the user's full reading and review of such financial statements, including related disclosures, and the auditor's report.

[Auditor discussion concerning the audit or the company's financial statements could be included under headings or in sections of an AD&A such as those set out below. Following each heading is the concept for a possible instruction for drafting the discussion. The potential drafting instructions are intended only to illustrate the possible content of each section. If the Board pursues an AD&A approach, complete requirements would be proposed for public comment.]

Information About the Audit

Audit Risk

[Provide a discussion of significant risks identified by the auditor. This discussion should include the factors the auditor evaluated in determining which risks are significant (see paragraphs 70-71 of Auditing Standard No. 12, *Identifying and Assessing Risks of Material Misstatement*). Describe why the risks are considered significant to the company's financial statements.]

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

Audit Procedures and Results

[Provide a discussion of the audit procedures responsive to the significant risks discussed in the audit risk section above, why the procedures are responsive to such significant risks, and the results of those procedures (see Auditing Standard No. 13, *The Auditor's Responses to the Risks of Material Misstatement)*.]

Auditor Independence

[Provide a discussion of matters that were reported and discussed with the audit committee concerning independence under PCAOB Rule 3526, *Communication With Audit Committees Concerning Independence,* and the related resolution of those matters. Provide affirmation of auditor independence.]

<u>Information About the Company's Financial Statements</u>

Management's Judgments and Estimates

[Provide a discussion of the critical accounting estimates that were communicated to the audit committee and assumptions underlying the critical accounting estimates.

The discussion also should address how the critical accounting estimates are susceptible to change.]

Accounting Policies and Practices

[Provide a discussion of the company's critical accounting policies and practices, including significant unusual transactions that were communicated to the audit committee. This discussion should include the reasons the auditor considers certain policies and practices to be critical, including those that management does not consider critical. Also, provide a discussion of alternative accounting treatments permissible under the applicable financial reporting framework for policies and practices related to material items that have been discussed with management, including the ramifications of the use of such alternative disclosures and treatments, and the treatment preferred by the auditor.]

Difficult or Contentious Issues, Including "Close Calls"

[Provide a discussion of the difficult or contentious issues or "close calls" that arose during the audit and the final resolution of the issue. These issues might include, among other things, the following –

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

- Those accounting matters that required significant deliberation by the auditor and management before being deemed acceptable within the applicable financial reporting framework.

- Those matters related to internal control over financial reporting that required significant deliberation by the auditor and management.

- A financial statement issue that had a potential material impact to the financial statements and was corrected prior to the end of the period.]

Material Matters

[Describe those material matters that are in technical compliance with the applicable financial reporting framework, but in the auditor's view, the disclosure of such matters could be enhanced to provide the investor with an improved understanding of the matters and their effect on the financial statements, or those areas where the auditor believes management, in its preparation and presentation of the financial statements, could have applied different accounting or disclosures.]

Expanded Use of Emphasis Paragraphs

Emphasis paragraphs currently are not required. They can be added at the option of the auditor.

As an alternative to AD&A, an emphasis paragraph may suffice.

Examples of Emphasis

The current auditing literature includes the following items that are appropriate for an emphasis paragraph:

- The entity is a component of a larger business enterprise

- The entity has had significant transactions with related parties

- Unusually important subsequent events have occurred

- Accounting matters, other than those involving a change or changes in accounting principles, affecting the comparability of the financial statements with those of the preceding period.

An illustration of a potential auditor's report with required emphasis paragraphs follows.

Illustration of Possible Revised Standard Auditor's Report with Required Emphasis Paragraphs

Report of Independent Registered Public Accounting Firm

[Standard Introductory Paragraph]

[Standard Scope Paragraph]

[Standard Opinion Paragraph]
Required Emphasis Paragraph[s]

[Emphasize those matters that are important in understanding the financial statement presentation, including significant management judgments and estimates and areas with significant measurement uncertainty. Discuss the audit procedures performed on these significant matters. This discussion should not include matters that the company has not disclosed in the financial statements and should make reference to the notes in the financial statements that disclose each matter.]

[Signature]
[City and State or Country]
[Date]

Auditor Assurance on Other Information Outside the Basic Financial Statements

Another alternative to enhance the auditor's reporting model could be to require auditors to provide assurance on information outside the financial statements, such as MD&A or other information (for example, non-GAAP information or earnings releases).

An auditor providing assurance on information outside of the financial statements could improve the quality, completeness, and reliability of such information, providing investors and other users of financial statements with a higher level of confidence in information about the company that is provided by management.

Many investors and other financial statement users often comment that information outside the financial statements is important to their decision making. Their view is that investors use and rely on MD&A and other financial information (e.g., non-GAAP information and earnings releases) for their investing decisions, in addition to historical audited financial statements. Therefore, this additional reporting could make an audit and auditor reporting more relevant to investors and other users of financial statements. Providing assurance on information outside the financial statements would increase the scope of the auditor's responsibilities, require the development of new auditing standards, and might result in projects separate from the auditor's reporting model project.

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

Additionally, to provide a basis for auditor assurance on information outside the financial statements, a reporting framework would likely need to be developed for management's presentation of such information in collaboration with the SEC.

The SEC maintains disclosure and reporting requirements for MD&A, which may need to be changed, including filing requirements to include the auditor's reporting on MD&A.

Also, if auditors were required to provide assurance on non-GAAP information, the SEC would likely need to develop new management reporting requirements.

Currently, there is no requirement for the auditor to provide assurance on earnings releases, non-GAAP information, or MD&A.

Although the company has the ability to retain the auditor to provide some level of assurance under PCAOB standards, the auditor is rarely retained to provide any assurance on such information.

Current auditing standards describe the auditor's responsibilities regarding other information outside the financial statements in documents containing audited financial statements (e.g., MD&A). These responsibilities include reading and considering whether such information or the manner of its presentation is materially inconsistent with the financial statements or represents a material misstatement of fact.

The **additional reporting** by the auditor on earnings releases, non-GAAP information, the entire MD&A, or portions thereof, could be based on certain aspects of the current attest standard and report, which is **illustrated below.**

Independent Accountant's Report

[Introductory paragraph]

We have examined XYZ Company's Management's Discussion and Analysis taken as a whole, included [incorporated by reference] in the Company's [insert description of registration statement or document]. Management is responsible for the preparation of the Company's Management's Discussion and Analysis pursuant to the rules and regulations adopted by the Securities and Exchange Commission. Our responsibility is to express an opinion on the presentation based on our examination. We have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the financial statements of XYZ Company as of December 31, 20X5 and 20X4, and for each of the years in the three-year period ended December 31, 20X5, and in our report dated [Month] XX, 20X6, we expressed an unqualified opinion on those financial statements.

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

[Scope paragraph]

Our examination of Management's Discussion and Analysis was conducted in accordance with attestation standards established by the Public Company Accounting Oversight Board (United States) and, accordingly, included examining, on a test basis, evidence supporting the historical amounts and disclosures in the presentation. An examination also includes assessing the significant determinations made by management as to the relevancy of information to be included and the estimates and assumptions that affect reported information. We believe that our examination provides a reasonable basis for our opinion.

[Explanatory paragraph]

The preparation of Management's Discussion and Analysis requires management to interpret the criteria, make determinations as to the relevancy of information to be included, and make estimates and assumptions that affect reported information. Management's Discussion and Analysis includes information regarding the estimated future impact of transactions and events that have occurred or are expected to occur, expected sources of liquidity and capital resources, operating trends, commitments, and uncertainties. Actual results in the future may differ materially from management's present assessment of this information because events and circumstances frequently do not occur as expected.

[Opinion paragraph]

In our opinion, the Company's presentation of Management's Discussion and Analysis includes, in all material respects, the required elements of the rules and regulations adopted by the Securities and Exchange Commission; the historical financial amounts included therein have been accurately derived, in all material respects, from the Company's financial statements; and the underlying information, determinations, estimates, and assumptions of the Company provide a reasonable basis for the disclosures contained therein.

[Signature]
[City and State or Country]
[Date]

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

Clarification of Language in the Standards

Another potential enhancement of the auditor's reporting model could involve clarifying language in the existing standard auditor's report.

While this alternative would not significantly expand the content of the auditor's report, it could provide additional explanation about what an audit currently represents and the related auditor responsibilities.

Possible language that could be clarified in the auditor's report includes –

- *Reasonable Assurance* – The standard auditor's report explicitly asserts that the audit was conducted in accordance with auditing standards and states that "those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement." The auditing standards describe reasonable assurance as being a "high level of assurance, but not absolute assurance." Such language could be added to the auditor's report or reasonable assurance could be further explained.

- *Auditor's Responsibility for Fraud* – The standard auditor's report does not mention "fraud" and is silent about the auditor's responsibility to detect fraud. The auditing standards require the auditor to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. Such language could be added to the auditor's report or the auditor's responsibility could be further explained.

- *Auditor's Responsibility for Financial Statement Disclosures* – The auditor's report identifies the balance sheets, related statements of operations, stockholders' equity and cash flows as the financial statements. As it relates to financial statements under Regulation S-X, the SEC's rules provide that "financial statements" include all notes to the financial statements and all related schedules. The auditing standards require auditors to perform procedures to test the financial statement disclosures and to evaluate whether the financial statements contain the information essential for fair presentation of the financial statements in conformity with the applicable financial reporting framework. Auditing standards also require auditors to perform procedures to assess the risk of omitted, incomplete, or inaccurate disclosures, whether intentional or unintentional; to identify and test significant disclosures; and, in integrated audits, to test controls over significant disclosures. The auditor's report could be revised to provide clarification regarding the auditor's responsibility for financial statement disclosures.

- *Management's Responsibility for the Preparation of the Financial Statements* – The auditor's report includes a statement that the financial statements are the responsibility of the company's management and that the auditor's responsibility is to express an opinion on the financial statements based on his or her audit.

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

Corporate officers are required to certify in periodic filings with the SEC that "based on such officer's knowledge, the financial statements, and other financial information included in the report, fairly present in all material respects the financial condition and results of operations of the issuer, as of, and for, the periods presented in the report. The auditor's report could be further clarified to state that management prepares the financial statements and has responsibility for the fair presentation of the financial statements.

- *Auditor's Responsibility for Information Outside the Financial Statements* – The auditor has a responsibility to read the other information in documents containing audited financial statements and consider whether such information, or the manner of its presentation, is materially inconsistent with the financial statements or represents a material misstatement of fact. Such information might be financial or non-financial information and includes the Chairman's or CEO's letter to shareholders, risk disclosures, MD&A, and the other portions of documents containing audited financial statements. The auditor's report could be clarified to describe the auditor's responsibility with respect to such other information.

Auditor Independence – The title of the standard auditor's report is "Report of Independent Registered Public Accounting Firm." Aside from the title, the auditor provides no further information regarding the auditor's independence or otherwise provides assurance that the auditor has complied with the applicable independence requirements of the PCAOB and SEC. The auditor's report could be clarified to include a statement in the auditor's report, in addition to the title, that the auditor has a responsibility to be independent of the company and has complied with applicable independence requirements of the PCAOB and SEC.

Massive Project Will Create New Role for CPAs

The PCAOB new audit report project is extensive. Currently, it is focusing on using PCAOB Auditing Standard (AS) 16, "Communications with Audit Committees," to more specifically identify what topics should be addressed in the audit reports.

It will result in a massive change in the role of the auditor and what is expected from the auditor.

Some believe the current standard report has outlived its usefulness.

Investors want more assurances.

If they do not get the assurances they seek from the CPAs, another profession, industry or group will provide the assurances desired by investors.

Auditors must change to survive.

Section 8

Proposed Clarity SSARS - Review of Financial Statements

The proposed SSARS, *Review of Financial Statements, is* divided into two parts"

1. Review of Financial Statements (AR Section 90)
2. Review of Financial Statements – Special Considerations (AR Section 95)

This proposed SSARS will be easier to use, understand and implement. AR Section 90 will address typical, basic review engagement issues (Section 1). AR Section 95 will address less frequently-encountered, more-
complicated review situations (Section 2).

The ARSC wants to put the SSARS literature into the same format as the SAS literature.

SSARS will have the same conventions as those used for the "clarified" auditing standards.

The clarified SSARS will address the following:

- Establish Objectives for each clarified section
- Include definitions in each AR section
- Separate requirements for application from other explanatory material
- Number "Application and Explanatory Materials" as A1, A2, A3 etc.
- Use formatting techniques such as bullets

The proposed SSARS will be effective for reviews of financial statements for periods ending on or after December 15, 2014.

Significant Changes

The existing literature and existing practice will change in the following areas:

Other Financial Information

The new guidance specifically applies to:

- Specified elements, accounts or items of a financial statement
- Supplementary information
- Required supplementary information (RSI)
- Financial information included in a tax return

Engagement Letter

There **must** be an engagement letter or other suitable form of written communication signed by:

- The accountant or the accountant's firm
- The management or, if applicable, those charged with governance (e.g. audit committee)

Headings

Headings (such as "Management's Responsibility for the Financial Statements," "Accountant's Responsibility," "Accountant's Conclusion," "Known Departure from GAAP, (if applicable)" must be shown throughout the accountant's review report.

When applicable, the city and state of the issuing office of the accounting firm must be shown on the review report.

Special Purpose Framework

The proposed SSARS uses the term "special purpose framework," which includes the cash-, tax-, regulatory-, and other bases of accounting that have traditionally been referred to as other comprehensive bases of accounting (OCBOA) as well as the contractual basis of accounting.

The proposed SSARS includes the following **new requirements** for reporting on financial statements prepared in accordance with a special purpose framework:

- The accountant **must** consider whether the financial statements

    1. are suitably titled
    2. include a summary of significant accounting policies
    3. adequately describe how the special purpose framework differs from generally accepted accounting principles (GAAP)

- The accountant **must** consider whether the financial statements include informative disclosures for items that are the same as, or similar to, those in GAAP financial statements

- In the case of financial statements prepared in accordance with a contractual basis of accounting, the accountant **must** consider whether the financial statements adequately describe any significant interpretations of the contract on which the financial statements are based

- When management has a choice of financial reporting frameworks, the accountant's review report **must** make reference to management's responsibility for determining that the applicable financial reporting framework is acceptable in the circumstances

- The accountant's review report on financial statements prepared in accordance with a regulatory or contractual basis of accounting (which s is a special purpose framework) must describe the purpose for which the financial statements are prepared or refer to a note in the financial statements that contains that information

- The accountant's review report on financial statements prepared in accordance with a special purpose framework **must**:

    1. include an emphasis-of-matter paragraph under an appropriate heading, that indicates that the financial statements are prepared in accordance with the applicable financial reporting framework
    2. refer to the note to the financial statements that describes the framework
    3. state that the special purpose framework is a basis of accounting other than GAAP

- The accountant's review report on special purpose financial statements on a contractual basis or regulatory basis of accounting **must** include an other-matter paragraph under an appropriate heading that restricts the use of the accountant's review report solely to

    1. those within the entity
    2. the parties to the contract or agreement
    3. the regulatory agencies to whose jurisdiction the entity is subject

Emphasis of Matter or Other-Matter Paragraphs

The accountant **must** include an emphasis-of-matter or other-matter paragraph in the review report when reporting on:

- Financial statements prepared in accordance with a special purpose framework

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

- Revised financial statements when management revises financial statements for a subsequently discovered fact that became known to the accountant after the report release date, and the accountant's review report on the revised financial statements differs from the accountant's review report on the original financial statements

The accountant **must** include an emphasis-of-matter paragraph in the accountant's review report when:

- The accountant considers it necessary to draw users' attention to a matter appropriately presented or disclosed in the financial statements that, in the accountant's professional judgment, is of such importance that it is fundamental to the user's understanding of the financial statements, provided that the accountant does not believe that the financial statements may be materially misstated.

The accountant **must** include an other-matter paragraph in the accountant's review report when:

- the accountant considers it necessary to communicate a matter not presented or disclosed in the financial statements that, in the accountant's professional judgment, is relevant to the users' understanding of the review, the accountant's responsibilities, or the accountant's review report.

If the accountant expects to include an emphasis-of-matter or other-matter paragraph in the accountant's review report, the accountant **must** communicate with management regarding this expectation and the proposed wording of this paragraph.

RSI

Required Supplementary Information (RSI) is information that a designated accounting standard setter requires to accompany an entity's basic financial statements.

RSI is not part of the basic financial statements. A designated accounting standard setter, however, 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.

A designated accounting standard setter is a body designated by the AICPA Council to promulgate GAAP (e.g., the FASB).

The new proposed SSARS requires that the accountant include an ther-matter paragraph in the accountant's review report on the financial statements to refer to the RSI.

Special Considerations

The following special considerations must be addressed by the accountant in a review engagement:

- The need to draw users' attention, when required or when in the accountant's judgment it is necessary to do so, by way of an **emphasis-of-matter** paragraph or an **other-matter** paragraph

- To express kn**own departures** from the applicable financial reporting framework in the accountant's review report

- To include an **alert that restricts the use** of the accountant's review report when the potential exists for the accountant's review report to be misunderstood if taken out of the context in which it is intended to be used

- The accountant's consideration of an entity's ability to continue as a **going concern**

- The accountant's consideration of **subsequent events** and **subsequent discovery of facts**

- The accountant decides to **reference the work of other accountants** who audited or reviewed the financial statements of significant components in an accountant's review report

- Information is presented for **supplementary analysis purposes** that accompanies reviewed financial statements

- Request to **change the engagement** from an audit to a review

Comments about these special considerations follow.

Emphasis-of-Matter Paragraphs

When the accountant includes an emphasis-of-matter paragraph in the accountant's review report, the accountant should:

- include it immediately after the accountant's conclusion paragraph in the accountant's review report

- use the heading — "Emphasis of a Matter" or other appropriate heading

- include in the paragraph a clear reference to the matter being emphasized and to where relevant disclosures that fully describe the matter can be found in the financial statements

- indicate that the accountant's conclusion is not modified with respect to the matter emphasized.

Other-Matter Paragraphs

If the accountant considers it necessary to communicate matters other than those that are presented or disclosed in the financial statements that, in the accountant's professional judgment, is relevant to the users' understanding of the review, the accountant's responsibilities, or the accountant's review report, the accountant should do so in a paragraph in the accountant's review report with the heading ―"Other Matter" or other appropriate heading.

The accountant should include this "other-matter" paragraph immediately after the accountant's conclusion other-matter paragraph and any emphasis-of-matter paragraph

Known Departures From the Applicable Financial Reporting Framework

When the accountant becomes aware of a material departure from the applicable financial reporting framework (including inadequate disclosure) and, if the financial statements are not revised, the accountant must consider whether modification of the standard report is adequate to disclose the departure.

Disclosure the Departure and Effects. If the accountant concludes that modification of the standard report is appropriate, the departure should be disclosed in an emphasis-of-matter or an other-matter paragraph of the report under the heading ―"Known Departures From the [*identity the applicable financial reporting framework*]," including disclosure of the effects of the departure on the financial statements if such effects have been determined by management or are known to the accountant as the result of the accountant's procedures.

Effects Not Determined. If the effects of the departure have not been determined by management or are not known to the accountant as a result of the accountant's procedures, the accountant is not required to determine the effects of a departure. In such circumstances the accountant should state in the report that such determination has not been made.

Modification Not Adequate. If the accountant believes that modification of the standard report is not adequate to indicate the deficiencies in the financial statements as a whole, the accountant should withdraw from the review engagement and provide no further services with respect to those financial statements.

No Opinion. The accountant should not modify the standard report to include a statement that the financial statements are not in accordance with the applicable financial reporting framework because such a statement would be tantamount to expressing an adverse opinion on the financial statements as a whole. Such an opinion can be expressed only in the context of an audit engagement.

Alert That Restricts the Use of the Accountant's Review Report

An accountant's review report should include an alert, in a separate paragraph, that restricts its use when the subject matter of the accountant's review report is based on:

- measurement or disclosure criteria that are determined by the accountant to be suitable only for a limited number of users who can be presumed to have an adequate understanding of the criteria, or

- measurement or disclosure criteria that are available only to the specified parties.

The alert that restricts the use of the accountant's review report should:

- state that the accountant's review report is intended solely for the information and use of the specified parties.

- identify the specified parties for whom use is intended.

- state that the accountant's review report is not intended to be and should not be used by anyone other than the specified parties.

Add Other Parties. When the accountant includes an alert that restricts the use of the accountant's review report to certain specified parties and the accountant is requested to add other specified parties, the accountant should determine whether to agree to add the other specified parties.

If the other parties are added after the release of the accountant's review report, the accountant should take one of the following actions:

- Amend the accountant's review report to add the other parties. In such circumstances, the accountant should not change the original date of the accountant's review report.

- Provide a written acknowledgment to management and the other parties that such parties have been added as specified parties. The accountant should state in the acknowledgment that no procedures were performed subsequent to the original date of the accountant's review report.

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

Going Concern Matters

The accountant should consider whether, during the performance of review procedures, evidence or information came to the accountant's attention indicating that there **could be an uncertainty** about the entity's ability to continue as a going concern for a reasonable period of time, not to exceed one year beyond the date of the financial statements being reviewed.

There is an Uncertainty. If, after considering the evidence or information, the accountant believes that **there is an uncertainty** about the entity's ability to continue as a going concern for a reasonable period of time, the accountant should request that management consider the possible effects of the going concern uncertainty on the financial statements, including the need for related disclosure.

Management's Conclusion. After management communicates to the accountant the results of its consideration of the possible effects on the financial statements, the accountant should consider the reasonableness of management's conclusions, including the adequacy of the related disclosure.

Inadequate Management Conclusion. If the accountant determines that the entity's disclosures with respect to the entity's ability to continue as a going concern for a reasonable period of time are inadequate, a departure from the applicable financial reporting framework exists and the accountant should follow the guidance under the caption "Known Departures from the Applicable Reporting Framework."

Subsequent Events and Subsequently Discovered Facts

Subsequent Events. When evidence or information that subsequent events that require adjustment of, or disclosure in, the financial statements comes to the accountant's attention, the accountant should request that management consider whether each such event is appropriately reflected in the financial statements in accordance with the applicable financial reporting framework.

Subsequently Discovered Facts. The accountant is not required to perform any review procedures regarding the financial statements after the date of the accountant's review report. However, if a subsequently discovered fact becomes known to the accountant before the report release date, the accountant should:

- discuss the matter with management and, when appropriate, those charged with governance

- determine whether the financial statements need revision and, if so, inquire how management intends to address the matter in the financial statements

Before Report Release. If **management revises the financial statements**, the accountant should perform the review procedures necessary in the circumstances on the revision. The accountant also should either:

- date the accountant's review report as of a later date or
- include an additional date in the accountant's review report on the revised financial statements that is limited to the revision (that is, **dual-date** the accountant's review report for that revision), thereby indicating that the accountant's review procedures subsequent to the original date of the accountant's review report are limited solely to the revision of the financial statements described in the relevant note to the financial statements.

If **management does not revise the financial statements** in circumstances when the accountant believes they need to be revised, the accountant should modify the accountant's review report, as appropriate.

After Report Release Date. If a subsequently discovered fact becomes known to the accountant after the report release date, the accountant should:

- discuss the matter with management and, when appropriate, those charged with governance
- determine whether the financial statements need revision and, if so, inquire how management intends to address the matter in the financial statements.

If **management revises the financial statements**, the accountant should

- date the accountant's review report as of a later date or
- include an additional date in the accountant's review report on the revised financial statements that is limited to the revision (that is, **dual-date** the accountant's review report for that revision), thereby indicating that the accountant's review procedures subsequent to the original date of the accountant's review report are limited solely to the revision of the financial statements described in the relevant note to the financial statements.
- if the reviewed financial statements (before revision) have been made available to third parties, assess whether the steps taken by management are timely and appropriate to ensure that anyone in receipt of those financial statements is informed of the situation, including that the reviewed financial statements are not to be used. If management does not take the necessary steps, the accountant should notify management and those charged with governance that the accountant will seek to prevent future use of the accountant's review report.

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

- if the accountant's review report on the revised financial statements differs from accountant's review report on the original financial statements, disclose in an emphasis-of-matter paragraph

  - the date of the accountant's previous report,
  - a description of the revisions, and
  - the substantive reasons for the revisions.

If **management does not revise the financial statements** in circumstances when the accountant believes they need to be revised, then

- if the reviewed financial statements **have not been made available** to third parties, the accountant should notify management and those charged with governance, not to make the reviewed financial statements available to third parties before the necessary revisions have been made and a new accountant's review report on the revised financial statements has been provided.

- if the reviewed financial statements **have been made available** to third parties, the accountant should assess whether the steps taken by management are timely and appropriate to ensure that anyone in receipt of the reviewed financial statements is informed of the situation, including that the reviewed financial statements are not to be used. If management does not take the necessary steps, the accountant should notify management and those charged with governance that the accountant will seek to prevent future use of the accountant's review report.

Reference to the Work of Other Accountants in an Accountant's Review Report

If other accountants audited or reviewed the financial statements of significant components, such as consolidated and unconsolidated subsidiaries and investees, and the accountant of the reporting entity decides not to assume responsibility for the audit or review performed by the other accountants, the accountant of the reporting entity should make reference to the review or audit of such other accountants in the accountant's review report.

In that instance, the accountant should clearly indicate in the accountant's review report that the accountant used the work of other accountants and should include the magnitude of the portion of the financial statements audited or reviewed by the other accountants.

Whether (or not) the accountant of the reporting entity decides to make reference to the review or audit of other accountants, the accountant of the reporting entity should communicate with the other accountants and ascertain:

- that the other accountants are aware that the financial statements of the component which the other accountants have audited or reviewed are to be included in the financial statements on which the accountant of the reporting

entity will report and that the other accountants' report thereon will be relied upon (and, where applicable, referred to) by the accountant of the reporting entity.

- that the other accountants are familiar with the applicable financial reporting framework and with SSARSs or auditing standards generally accepted in the United States of America, as applicable and will conduct the review or audit in accordance therewith.

- that a review will be made of matters affecting elimination of intercompany transactions and accounts and, if appropriate in the circumstances, the uniformity of accounting practices among the components included in the financial statements.

Supplementary Information

When information presented for supplementary analysis purposes accompanies reviewed financial statements, the accountant should include an other-matter paragraph in the accountant's review report on the financial statements to clearly indicate the degree of responsibility, if any, the accountant is taking with respect to such information.

When the accountant has reviewed both the financial statements and the information presented for supplementary analysis purposes, the accountant should report on such information in either:

- an other-matter paragraph in the accountant's review report on the financial statements, or
- a separate report on the information presented for supplementary analysis purposes.

The other-matter paragraph in the accountant's review report on the financial statements or the separate report on the information presented for supplementary analysis purposes should state that:

- the information is presented for purposes of additional analysis and is not a required part of the financial statements, and

- the information has been reviewed from information that is the representation of management, and the accountant has not audited the information and, accordingly, does not express an opinion on such information.

Required Supplementary Information (RSI)

With respect to RSI, the other-matter paragraph should include language to explain the following circumstances, as applicable:

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

a. The RSI is included, and the accountant compiled the RSI.

b. The RSI is included, and the accountant reviewed the RSI.

c. The RSI is included, and the accountant did not compile, review, or audit the RSI.

d. The RSI is omitted.

e. Some RSI is missing, and some is presented in accordance with the prescribed guidelines.

f. The accountant has identified departures from the prescribed guidelines.

g. The accountant has unresolved doubts about whether the RSI is presented in accordance with prescribed guidelines.

<u>All or Some RSI Presented.</u> If the entity has presented all or some of the RSI and the accountant did not compile or review the RSI, the other-matter paragraph should include the following elements:

1. A statement that the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America) require that the RSI be presented to supplement the basic financial statements

2. A statement that such information, although not a part of the basic financial statements, is required by [identify designated accounting standards setter], who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context

3. A statement that the accountant did not compile, review, or audit the RSI and, accordingly, does not express an opinion or provide any assurance on the RSI

4. If some of the RSI is omitted,

    a. a statement that management has omitted the missing RSI that the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America) require to be presented to supplement the basic financial statements

    b. a statement that such missing RSI, although not a part of the basic financial statements, is required by [identify designated accounting standards setter], who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context.

5. If the measurement or presentation of the RSI departs materially from the prescribed guidelines, a statement that material departures from prescribed guidelines exist [describe the material departures from the applicable financial reporting framework]

6. If the accountant has unresolved doubts about whether the RSI is measured or presented in accordance with prescribed guidelines, a statement that the accountant has doubts about whether material modifications should be made to the RSI for it to be presented in accordance with guidelines established by [identify designated accounting standards setter]

All RSI Omitted. If all of the RSI is omitted, the other paragraph should include the following elements:

1. A statement that management has omitted of the missing RSI] that the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America) require to be presented to supplement the basic financial statements

2. A statement that such missing information, although not a part of the basic financial statements, is required by [identify designated accounting standards setter], who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context

Change in Engagement From Audit to Review

Sometimes, the accountant is engaged to perform an audit in accordance with GAAS. The accountant starts the audit and before completion is requested to change the engagement to a review engagement.

The accountant must consider the following before deciding whether to agree to the change:

- The reason given for the client's request (particularly, the implications of a restriction on the scope of the audit engagement, whether imposed by the client or by circumstances).

- The additional audit effort required to complete the audit engagement and the estimated additional cost to complete the audit engagement.

In all circumstances, if the audit procedures are substantially complete or the cost to complete such procedures is relatively insignificant, the accountant should consider the propriety of accepting a change in the engagement from audit to review.

If the accountant concludes, based upon the accountant's professional judgment, that reasonable justification exists to change the engagement, and if the accountant complies with the standards applicable to a review engagement, the accountant should issue an appropriate review report.

The report should **not** include reference to:

- the original engagement

- any audit procedures that may have been performed

- scope limitations that resulted in the changed engagement.

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

When the accountant has been engaged to audit an entity's financial statements and has been prohibited by the client from corresponding with the entity's legal counsel, the accountant, except in rare circumstances, is **precluded from issuing a review report** on the financial statements. In effect, this is an audit scope limitation.

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

Section 9

Decision Re: Compilations

The Accounting and Review Services Committee (ARSC) decided to undertake a SSARS clarity project similar to the recently completed (October 2012) Auditing Standards Board (ASB) SAS clarity project.

This ARSC SSARS project would serve the public interest by having all of the professional literature for audits, reviews, and compilations drafted using the same conventions.

The resulting clarified compilation and review standards would then be easier to read, understand, and apply.

In May 2010, the ARSC approved the project to revise all existing compilation and review standards in the Codification of Statements on Standards for Accounting and Review Services substantially using the drafting conventions adopted by the ASB in clarifying the auditing literature.

In January 2013, the ARSC voted to **withdraw the exposure draft** of the proposed SSARSs, *Association With Unaudited Financial Statements; Compilation of Financial Statements; and Compilation of Financial Statements – Special Considerations*.

The decision to withdraw the exposure draft was in response to comments contained in the ninety-two (92) comment letters that were received on the exposure draft.

The compilation proposal would have revised the applicability of the compilation standard but would have retained the compilation service as an **attest service**.

The timeline indicates that the clarified SSARSs would be effective for compilations and reviews of financial statements for periods ending on or after **December 15, 2014** (that is, for engagements performed for calendar year 2014 financial statements).

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

Section 10

New Structure for Private Company Accounting Principles

In late May 2012 the trustees of the Financial Accounting Foundation (FAF) voted for a new Private Company Council (PCC).

The PCC will determine whether exceptions or modifications to US GAAP for privately held companies are necessary. It will replace the Private Company Financial Reporting Committee and it will have the ability to identify, deliberate and vote on any proposed FASB accounting changes before they are incorporated into GAAP.

The PCC will be the primary advisor to the FASB on the appropriate private company treatment for all items under active consideration by the FASB.

Background

Separate or differential standards for private companies has been debated as far back as the early 1970s.

The culmination of the debate about how to go forward with a structure on determining differential accounting (a/k/a "Big GAAP; Little GAAP") was the establishment of a Blue Ribbon Panel on Standard-Setting for Private Companies. That panel was set up by the FAF, the AICPA and the National Association of State Boards of Accountancy (NASBA) in late 2009.

The Blue Ribbon Panel's report was issued in January 2011. It called for a separate standard-setting board to be set up under the auspices of the FAF.

The FAF, however, issued a proposal in October 2011 calling for the establishment of a Private Company Standards Improvement Council, whose recommendations would still be subject to approval by FASB and which would be chaired by a member of FASB.

The AICPA said that the October proposal did not go far enough in separating the council from FASB control and organized a letter-writing campaign that generated thousands of comments to the FAF from CPAs. The AICPA even suggested that it would create its own standard-setting board.

NASBA was more supportive of the FAF proposal.

The Compromise

The new PCC arrangement is a long-time-coming compromise. It avoids deciding on one or the other of the following alternatives:

1. One GAAP for all

2. Different GAAP for public and private entities

At this point, accounting standards for private companies will still be in the hands of FASB. However, it is now agreed that the PCC will determine whether exceptions or modifications to existing nongovernmental US GAAP are necessary to address the needs of users of private company financial statements.

The new arrangement strikes an important balance. It recognizes that the needs of public and private company financial statement users, preparers and auditors are not always aligned. At the same time, it ensures comparability of financial reporting among disparate companies by putting in place a system for recognizing differences that will avoid creation of a 'two-GAAP' system.

The PCC will meet to discuss the impact of all FASB proposals on private company financial statements. FASB members will be expected to attend the deliberative meetings of the PCC but the PCC could meet with or without FASB members present for educational or administrative meetings.

Endorsement Not Ratification

The new arrangement will be an endorsement process not a ratification process.

There will be a more collaborative relationship between FASB and the PCC.

Having the FASB at the table for the deliberations by the PCC should enable a mutual understanding of views.

The FASB must endorse all proposals from the PCC within 60 days, or it must produce a public report as to why a simple majority didn't endorse the proposal, and it must produce explanations of what must be changed so they can endorse it.

There should be only a small number of disagreements between FASB and the PCC over any recommendations for changes in the standards for private companies. The endorsement process is not going to be a surprise. If FASB disagrees vehemently with where the PCC is going, the PCC will know about the disagreement early in the process.

For independence purposes none of the FASB members will be members of the PCC. However, there will be a FASB member assigned as a liaison to the PCC.

FASB and the PCC will mutually agree on a set of decision criteria that will be their guidebook for determining when exceptions or changes are appropriate for private company standards.

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

Other Activity

AICPA. The AICPA issued a statement of support for the new PCC. Surprisingly, it also announced plans to develop an "other comprehensive basis of accounting" (OCBOA) financial reporting framework to meet the needs of some privately held small- and medium-sized enterprises, as well as the users of the financial statements of these entities.

The enhanced and simplified financial reporting framework will be a cost-beneficial solution for smaller privately held entities that do not need to comply with US GAAP.

Apparently, the AICPA has concluded that one-size U.S. GAAP does **not** fit all companies, especially smaller privately held businesses.

The AICPA believes that the FAF has moved in the right direction and the AICPA will continue to be fully engaged with the FAF and the PCC.

Competitive Rule Making. In July 2013, the AICPA released the much anticipated Financial Reporting Framework for Small- and Medium-Sized Entities (FRF for SME), which is aimed at providing an alternative reporting option for small businesses that aren't required to use GAAP.

The FRF for SMEs takes what the AICPA describes as a "common-sense" approach to financial reporting, based on traditional accounting methods, with the goal of making reporting simpler for small, private business.

Shortly after the framework's release, NASBA advised private companies not to use it, saying that the new Private Company Council (PCC) was making progress on making GAAP more suitable for private companies.

The AICPA countered with a letter to state CPA societies explaining that FRF for SMEs was not meant to replace GAAP, but rather to serve as a next-generation Other Comprehensive Basis of Accounting.

The party line is that the AICPA's OCBOA plan is an important and complementary undertaking to the PCC arrangement. Taken together, these actions demonstrate the commitment of both organizations to the private company financial reporting constituency.

The Institute of Management Accountants (IMA). The IMA supports the new PCC arrangement and has expressed its confidence in that the arrangement. Further, IMA applauds FAFs continued efforts to reduce the complexity of financial reporting.

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

Final Report Available

The FAFs final report on establishing the PCC is available at the FAF's Web site. It includes an executive summary and sections devoted to topics such as background and key events for standard-setting for private companies, key discussion issues, and responsibilities and operating procedures of the PCC. It also contains summaries of the comment letters received on the original proposal.

Specific projects that the new PCC will tackle will be decided after appointments of personnel and other organizing efforts are completed. However, topics that surely will get early attention include:

- Financial Interpretation (FIN) 48, Accounting for Uncertainty in Income Taxes
- Fair Value Measurement
- Consolidation of Variable Interest Entities. (VIEs)

The PCC will control its own agenda. PCC will get input from FASB and from stakeholders to determine what should be put on the PCC agenda

Nuts and Bolts

The PCC plan generally follows the outline of the initial trustee proposal announced last October. The following significant changes from that proposal were made based on input from interested parties.

Work Process

Working jointly, the PCC and FASB will mutually agree on criteria for determining whether and when exceptions or modifications to GAAP are warranted for private companies.

Using the agreed-upon criteria, the PCC will determine which elements of existing GAAP to consider for possible exceptions or modifications by a vote of two thirds of all sitting members, in consultation with FASB and with input from stakeholders.

If endorsed by a simple majority of FASB members, proposed exceptions or modifications to GAAP will be exposed for public comment.

At the conclusion of the comment process, the PCC will re-deliberate the proposed exceptions or modifications and forward them to FASB, which will make a final decision on endorsement, generally within 60 days.

If FASB endorses the proposals, they will be incorporated into GAAP.

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

If FASB does not endorse the proposals, the FASB chairman will provide the PCC chair with a written explanation, including possible changes for the PCC to consider that could result in FASB endorsement.

Membership

The PCC will have between nine and 12 members, including a chair, all of whom will be selected and appointed by the FAF trustees.

The PCC chair will not be a FASB member.

PCC members will be appointed for a three-year term and may be re-appointed for an additional term of two years.

Membership tenure may be staggered to establish an orderly rotation.

The PCC chair and members will serve without remuneration but will be reimbursed for expenses.

One FASB member will be assigned as a liaison to the PCC.

FASB technical and administrative staff will be assigned to support and work closely with the PCC.

Schedule

During its first three years of operation, the PCC will hold at least five meetings each year, with additional meetings if determined necessary by the PCC chair.

Deliberative meetings of the PCC will be open to the public, although the council may hold closed educational and administrative sessions.

Most of the meetings will be held at the FAF's offices in Norwalk, but up to two meetings each year may be held elsewhere.

Oversight and Reporting

The FAF trustees will create a special-purpose committee of trustees, the Private Company Review Committee, which will have primary oversight responsibilities for the PCC.

The Review Committee will hold both the PCC and FASB accountable for achieving the objective of ensuring adequate consideration of private company issues in the standard-setting process.

© 2013 Paul J. Sanchez, CPA / Professional Service Associates

The PCC will provide quarterly written reports to the FAF Board of Trustees. The trustees will conduct an overall assessment of the PCC following its first three years of operation to determine whether its mission is being met and whether further changes to the standard-setting process for private companies are warranted.

The Desired Result

If all work in accordance to plan there still will be one set of US GAAP.

However, where necessary, for private companies, the US GAAP will be modified or exceptions will be granted when the particular accounting principle does not fit the private company situation and/or circumstances.

The private company financial statements that may incorporate the particular modifications and/or exceptions would still be said to "present fairly in accordance with GAAP."

Progress to Date

he Financial Accounting Standards Board (FASB) voted to endorse three alternatives within U.S. GAAP proposed by PCC to address concerns raised about the relevance and complexity of certain aspects of GAAP for private company stakeholders. Initially, the FASB will issue three Exposure Drafts for public comment.

The proposals involve:

(1) accounting for intangible assets acquired in business combination,
(2) goodwill, and
(3) certain types of interest rate swaps.

The first proposal - derived from PCC Issue No. 13-01A, *Accounting for Identifiable Intangible Assets in a Business Combination* - would not require private companies to separately recognize certain intangible assets acquired in a business combination.

The proposal enables private companies that elect the alternative within U.S. GAAP to recognize only those intangible assets arising from noncancelable contractual terms or those arising from other legal rights. Otherwise, an intangible asset would not be recognized separately from goodwill even if it is separable.

The second proposal - derived from PCC Issue No. 13-01B, *Accounting for Goodwill Subsequent to a Business Combination* - would allow for amortization of goodwill and a simplified goodwill impairment model.

This would enable private companies that elect the alternative within U.S. GAAP to amortize goodwill over the useful life of the primary asset acquired in a business combination, not to exceed 10 years.

Goodwill would be tested for impairment only when a triggering event occurs that would more likely than not reduce the fair value of a company below its carrying amount. Moreover, goodwill would be tested for impairment at the company-wide level as compared to the current requirement to test goodwill impairment at the reporting–unit level.

The third proposal - derived from PCC Issue No. 13-03, *Accounting for Certain receive-Variable, Pay-Fixed Interest Rate Swaps* - would allow private companies the option to use two simpler approaches to accounting for certain types of interest rate swaps that are entered into by a private company for the purposes of economically converting its variable-rate borrowing to a fix-rate borrowing.

Under both approaches, the periodic income statement charge for interest would be similar to the amount that would result if the private company were to have entered into fixed-rate borrowing instead of variable rate borrowing.

The two approaches would apply to all private companies, except for financial institutions.