



Introduction

Welcome back to the Burt & Company CPAs, LLC Audit & Accounting (A&A) Update. In this document, we will pass on information we feel is important for you and your business, and provide resources for you to find additional information.

We look forward to receiving feedback from you, our clients and community partners, on A&A topics you would find interesting and relevant to your business. For tax-related issues, please read our "Tax Updates" publication from our tax department.

In addition, we encourage you to visit our website regularly for up-to-date tax information, hundreds of financial calculators, and other important tools and information for your business. You can also register on our client portal "File Share" to exchange documents with us in a secure environment.

Thank you for your business and your support!

Ronald Schranz, CPA
 Audit & Accounting Partner

Auditing Standards Board Issues Clarified Statements on Auditing Standards Related to Risk Assessment

As part of its Clarity Project, the Auditing Standards Board has issued six clarified statements on auditing standards related to risk assessment (clarified Risk Assessment Standards). In March 2006, the ASB issued eight SASs (Nos. 104-111), which became effective for audits of financial statements for periods beginning on or after December 15, 2006 (collectively known as the "risk assessment standards"). The clarified Risk Assessment Standards represent the redrafting of SAS Nos. 106-110 to apply the ASB clarity drafting conventions and to converge with International Standards on Auditing. The SASs are effective for audits of financial statements for periods beginning on or after December 15, 2010. The effective date is provisional but will not be earlier.

If you're unsure about this announcement affects your business, please call us at 505-265-6604 and talk to Ron Schranz or Cheryl Silcox.

Merits & Challenges of Having Fewer Rules

The "U.S. Perspective" panel at October's AICPA/IASC Foundation Conference on IFRS, featuring six financial industry heavyweights, evolved into a discussion about the merits and challenges of a principles-based system of accounting. The panel was moderated by Thomas Jones, vice chairman of the International Accounting Standards Board (IASB) from its formation in 2001 until earlier this year.

"Perhaps I'm killing my own job, but I've gone on record in favor of convergence," announced Neri Bukspan, Standard & Poor's chief accountant and its global chief quality officer responsible for overseeing the rating agency's operating standards and ratings quality assurance efforts. "I make my livelihood interpreting accounting, how it departs or not from economic reality," he explained. "Do financial statements currently tell the entire story? No, they certainly do not. I've learned over the years that there are some things financial statements can never convey."

Michael Young, a litigation partner with Willkie Farr & Gallagher LLP, whose practice focuses on securities and financial reporting with a particular emphasis on accounting irregularities, held up two documents as a way to crystallize the discussion about the differences between a principles-based approach and a rules-based one: FAS 133 Accounting for Derivate Instruments and Hedging Activities as a rules-based document and the United States Constitution as a principles-based example.

"FAS 133 and its supporting literature has about 800 pages, while the U.S. Constitu-

tion has six (including the Bill of Rights)," Young declared. "Our Constitution is the supreme law governing all our laws, as well as the interplay with other countries. FAS 133 covers only accounting for derivatives. Anyone who thinks they understand FAS 133 hasn't read it carefully."

Young debunked the notion that adherence to FAS 133 or any other rule under U.S. GAAP offers protection from liability. "Think of all the restatements by well-meaning people trying to adhere to sometimes counterintuitive rules," he said. "Some say we need the protection of the rules, but I've spent 25 years defending accountants and have come to the conclusion that conforming to the rules does not necessarily get you off the hook. You might think you have a great argument, but if it doesn't smell right, you cannot assume technical adherence to the rules will be enough."

"Some people argue that board members and companies need rules because of our culture and history and the fact we are a litigious society," said Young. "But rules lead to more rules. They feed on themselves and you lose sight of the principles. They might even become counterintuitive, at which point they lead to risk. These days in particular, the test is not conformity to the rules. "What's the objective? What are you trying to accomplish? What is the best way to communicate the facts? There is no better protection from liability than that. I think you get to the point where rules made by well-meaning people actually get in the way. You end up with a lot of compliance, but not a lot of useful information."

(<http://www.ifrs.com/merits.html>)

Panel Meets to Discuss Private Company Financial Reporting

BY ALEXANDRA DEFELICE
 APRIL 12, 2010

Members of a blue-ribbon panel established to provide recommendations on the future of accounting standards for private companies met for the first time to discuss their views on the topic, which has been debated for decades.

The key portion of the meeting featured the viewpoints of those panel members who use private company financial statements. Those users included three lenders, a venture capitalist, a private equity manager, a surety, and a business owner. One of the key takeaways was that most members agreed that U.S. GAAP is seen as a gold standard in financial reporting, and that consistency of GAAP is key.

They also said that financial statements are only a part of decision making and that management's character plays an important role in those decisions.

The 18 panel members, including AICPA President and CEO Barry Melancon, and participating observers represent a cross-section of financial reporting constituencies, including lenders, investors and owners, as well as preparers, auditors and regulators.

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It is sponsored by the AICPA; the Financial Accounting Foundation, FASB's parent organization; and the National Association of State Boards of Accountancy.

GAAP is Gold, but Just the Start

Most panel members agreed that GAAP is seen as the "gold standard." "Lenders [and other users of financial statements] want GAAP for validity, reliability and accuracy ... tied to assurance," said James Castellano, who is not a panel member but served as past chairman of the AICPA's Private Company Financial Reporting Task Force and took part in an expert discussion Monday. "The notion that there's a body of knowledge that is [universally] accepted is important."

Panel members said in using financial statements, they make adjustments to fit their own needs and they would be willing to make further changes if GAAP were modified. But having too many exceptions and variances erodes the notion of what is considered to be generally accepted, they said.

"If the standard changed tomorrow, we'd adjust our own underwriting of that," said Dev Striscek, panel member and senior vice president and senior credit policy officer, Corporate Risk Management, SunTrust Banks Inc. "We know we need to speak different languages for private vs. public companies, but one person's flexibility is another person's chaos. We'd prefer field hockey to lacrosse as a standard. Field hockey has boundaries."

Panel members also stressed that while financial statements are an important element in decision-making by the users of those statements, they are a starting point and, after that, many other factors are considered, including the character and integrity of management.

Jason Mendelson, a panel member and managing director and co-founder of Boulder, Colo.-based venture capital firm Foundry Group, pointed to the key role the human element plays in decisions. "This march to character is happening," Mendelson said. "I now have monthly meetings with banks. They want my personal guarantee, my word, that I support this company, despite the fact they have all my financial statements. That said, if you're wrong it may be difficult for you to obtain credit later."

Panel member Michael Menzies, president/CEO of Easton Bank and Trust Company, a small community bank in eastern Maryland, said his bank only lends to relationships, so the borrower plays a bigger role than the financial statements do, though he values GAAP for making industry comparisons. "We lend as if the borrower is going to marry our daughter," Menzies said. "We get key information from walking around the business and kicking the tires."

Several "C" factors come into play when making the analysis on whether to lend, including the capacity to repay debt, capital,

collateral, the right conditions and adequate coverage to transfer out risk, he said.

Next Steps

The group began to talk about the complexities related to standards but that discussion likely will be expanded upon at the panel's meeting next month, when preparers and auditors will share their viewpoints whereas Monday's meeting focused on the viewpoints of the users of financial statements. Also at next month's meeting, representatives from the International Accounting Standards Board and the Canadian Accounting Standards Board will speak with the panel about IFRS for SMEs and Canadian GAAP for Private Enterprises. Judith O'Dell, chairman of FASB's Private Company Financial Reporting Committee, will give a report on Canada's progress with its private company financial reporting standards. The meeting will take place on May 14 at the FAF's office in Norwalk, Conn.

For now, the panel will focus on all organizations that don't report to the SEC, with the exception of nonprofits, though banks and other types of companies may be excluded later.

When asked how this group will differ from others tasked with similar efforts in the past, panelists emphasized that what makes this panel stand out is that it includes representatives of all the key constituents of private company accounting and places a strong emphasis on financial statement user needs and viewpoints. They stress the fact that this panel is not about technical decisions, but process, i.e., getting the right set of standards for users.

(<http://www.journalofaccountancy.com/Web/20102816.htm>)

Troubled Banking Industry Sharply Reduced Lending in 2009

By Binyamin Appelbaum

Lending by the banking industry fell by \$587 billion, or 7.5 percent, in 2009, the largest annual decline since the 1940s, as the number of troubled financial institutions rose sharply, the Federal Deposit Insurance Corp. reported Tuesday.

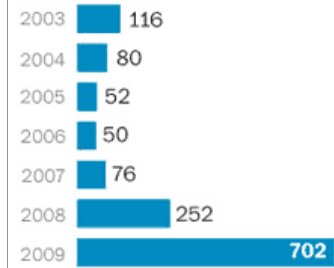
FDIC Chairman Sheila C. Bair said that some small banks have reduced lending because of financial weakness, a problem the Obama administration aims to address with a proposal to pump \$30 billion in new federal aid into community banks.

The FDIC considered 702 banks to be in some danger of failing as of the end of 2009, more than double the number at the beginning of the year.

But Bair said that the vast majority of the lending decline was the result of cutbacks by the nation's largest banks, which have tightened qualification standards for borrowers and increased the proportion of money that they hold in reserve against unexpected losses.

In danger

The number of banks considered by the Federal Deposit Insurance Corp. to be at risk of failure jumped in 2009.



SOURCE: FDIC The Washington Post

"Large banks do need to do a better job of stepping up to the plate here," Bair said.

The decline in lending is a looming issue as the economy begins to recover. Companies start by returning to full capacity, filling open desks with new workers or running equipment more hours each day. But for the recovery to continue, for businesses to expand and employment to grow, lending must begin to expand, too. The decline also has become a major political issue amid broad public anger that the federal rescue of the banking industry has restored profitability but not the flow of loans.

The FDIC, which reports every three months on the health of the banking industry, said Tuesday that the nation's 8,012 banks posted an aggregate profit of \$12.5 billion in 2009, up from the depths of 2008 but far below the profits recorded during the golden age of the mid-2000s.

The largest banks accounted for most of those profits as a growing number of smaller banks have struggled to survive losses on commercial real estate loans. Almost 30 percent of all banks lost money in 2009, the largest share of losers in the 26 years of available data.

Regulators closed 140 banks in 2009, and Bair said she expected the number to rise this year.

There were modest signs of better days ahead. The FDIC continues to project that loan delinquencies will peak this year. But the industry's health tends to lag behind that of the broader economy as banks absorb losses from lending mistakes, and Bair said banks would continue to convalesce through 2010.

"We're still bumping along the bottom of the credit cycle," she said.

As you make your way through the funding process, keep in mind that your CPA, as your professional business adviser, can be an important ally in evaluating all the available options and helping you choose the one that best meets your needs.

Reasonable and Necessary

The following is an excerpt from the new self-study course on Cost Principles written by Sefton Boyars and Bill Allen:

While not specifically stated, the cost principles recognize this conundrum and set out some basic criteria related to determining the reasonableness of costs incurred in the performance of federal projects.

Basketball Tickets

In the 1970s, we conducted many audits of the U.S. Department of Education's Title I program. This program is designed to help children who are functioning below average to perform at their grade level. During these audits, we found numerous instances of schools conducting activities, particularly field trips, which did not seem designed to improve educational achievement. Schools had taken kids to Disneyland, to Knott's Berry Farm, and to roller rinks under the Title I program. One school district even paid for the junior high prom dinner with Title I funds. Another district took about 30 children to a professional basketball game and charged the tickets to the Title I program. They classified the activity as part of the reading program. I wondered if they were teaching the children to read defenses. As a side note, after we reported on a number of these abusive practices, the audit reports became public. The districts were severely criticized in the newspapers. After the publicity, those charges reduced significantly.

The Prudent Person Rule

Appendix A of both 2 CFR 225 and 2 CFR 230 clarifies that to be reasonable, a cost may not be more than a "prudent person" would spend in its nature and amount at the time of the decision.

Appendix A to Title 2, Part 225 (State and Local Governments) - Reasonable costs. ... A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the cost. ...

Appendix A to Title 2, Part 230 (Non-Profits) - Reasonable costs. A cost is reasonable if, in its nature or amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the costs....

The prudent person rule is also used in the Government Auditing Standards (also known as the Yellow Book) to define abuse. Under GAGAS 4.12, "Abuse involves behavior that is deficient or improper when compared with behavior that a prudent person would consider reasonable and necessary business practice given the facts and circumstances."

Then, to determine whether a cost is reasonable in a given situation, we must consider whether each cost would have been expended by a "prudent person." Who is this prudent person? I don't personally know one, and the determination of what is reasonable is quite subjective. The cost principles fail to define this vague term, but they do the best possible job

defining what is OK and what is not OK to charge to the program.

Subfactors Used to Determine Reasonableness

The determination of whether a cost is reasonable requires the application of the following sub-criteria:

1. The cost generally would be recognized as ordinary and necessary for the operation of the governmental unit or the performance of the federal award.
2. The cost conforms to:
 - o Sound business practices,
 - o Arm's length bargaining,
 - o Laws and regulations, and
 - o Terms and conditions of the federal award.
3. The cost was incurred using the organization's established practices. (Significant deviations from established organizational practices of the governmental unit may unjustifiably increase the federal award's cost.)

Appendix A to Title 2, Part 225 (State and Local Governments) - Reasonable costs. ... The question of reasonableness is particularly important when governmental units or components are predominately federally-funded. In determining reasonableness of a given cost, consideration shall be given to: a) Whether the cost is of a type generally recognized as ordinary and necessary for the operation of the governmental unit or the performance of the Federal award. b) The restraints or requirements imposed by such factors as: Sound business practices; arm's length bargaining; Federal, State and other laws and regulations; and, terms and conditions of the Federal award. c) Market prices for comparable goods or services. d) Whether the individuals concerned acted with prudence in the circumstances considering their responsibilities to the governmental unit, its employees, the public at large, and the Federal Government. e) Significant deviations from the established practices of the governmental unit which may unjustifiably increase the Federal award's cost.

Appendix A to Title 2, Part 230 (Non-Profits) - Reasonable costs. ... The question of the reasonableness of specific costs must be scrutinized with particular care in connection with organizations or separate divisions thereof which receive the preponderance of their support from awards made by Federal agencies. In determining the reasonableness of a given cost, consideration shall be given to: a) Whether the cost is of a type generally recognized as ordinary and necessary for the operation of the organization or the performance of the award. b) The restraints or requirements imposed by such factors as generally accepted sound business practices, arms length bargaining, Federal and State laws and regulations, and terms and conditions of the award. c) Whether the individuals concerned acted with prudence in the circumstances, considering their responsibilities to the organization, its members, employees, and clients, the public at large, and the Federal Government. d) Significant deviations from the established practices of the organization which may unjustifiably increase the award costs.

If employees of an organization normally do not travel first class, they do not have permission to fly first class simply because

a federal award is paying the tab. In general, the rules do not permit flying first-class. However, suppose that your boss informs you that you need to fly across the continent immediately. The only coach seats available are on a red-eye that makes two stops and arrives around noon the next day. Since such a trip would be considered unreasonable, you may very well justify flying first-class.

What about charging the costs of an out-of-town meeting for the staff of an organization to a grant? Let us assume, for purposes of this example, that the meeting is necessary for the efficient delivery of grant services. It could be argued that, to assure uninterrupted training, holding the meeting at a location other than the grantee's place of business is necessary. But, if a federal reviewer finds that the costs or the location selected is inappropriate (e.g., a mainland organization holds a meeting in Honolulu or in a five-star hotel), then the costs may be disallowed as unreasonable and not necessary to properly administer the federal award.

The rules do not expect grantees to suffer the use of poor quality equipment, beg for supplies on the street corner, or work for food. The rules simply require the wise use of federal award funds by grantees. The delivery of grant services should always be paramount but within the constraints of the cost principles.

One guideline that is often used is the "Washington Post" test (or substitute the name of your local newspaper). If the paper found out what you were doing, would they report it on one of the first three pages? They don't put the good news on those pages. If the newspaper were to consider it reportable, it doesn't consider the cost to be reasonable.

The Giggle Test

There are other similar tests. The "red-face" test asks if you can explain the cost without blushing. The "giggle" test asks if people start to giggle as you explain why the cost is acceptable.

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