



FLORIDA  
GULF COAST  
UNIVERSITY

Accounting & Tax Conference  
Oct. 27-28, 2011 • Ft. Myers-Estero

**Soar Higher**



# 2011 Florida Gulf Coast University Accounting & Tax Conference Conference Planning Committee

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## Thursday, October 27, 2011

<b>8:00-8:05 a.m.</b>	<b>Introduction and Opening Remarks</b> Daryl Johnson, Vice Chair
<b>8:05-8:15 a.m.</b>	<b>FGCU Welcome</b> Hudson Rogers, DBA Dean, Lutgert College of Business/Florida Gulf Coast University
<b>8:15am-9:05am</b>	<b><u>Federal Income Tax Consequences of Foreclosures, Short Sales and Debt Modifications .....1</u></b> Mark R. Giallonardo, JD, LL.M. Principal/Hill, Barth & King, LLC
<b>9:05am-9:55am</b>	<b><u>Financial Statement Presentations to Certain Audiences .....40</u></b> Sean E. Dannelly, CPA Founding Partner/Dannelly, Monteleone & Associates LLC and Raymond Monteleone, CPA President and Founding Partner/Paladin Global Partners
<b>10:05am-11:45am</b>	<b><u>A&amp;A Update .....43</u></b> Eugene Ristaino, CPA, ABV, MT Partner/Director A&A Department/Isdaner & Company, LLC
<b>11:45 a.m.-1:00 p.m.</b>	<b>Lunch</b>
<b>12:10pm-1:00pm</b>	<b><u>Using SBA Lending Today to Facilitate Business Succession Planning Tomorrow .....182</u></b> Thomas Maiale Jr, MBA Senior Business Banking Manager/Key Private Bank
<b>1:15pm-2:05pm</b>	<b><u>Impact of the FASB/IASB Lease and the Small and Medium Size Entity GAAP Proposals on Accounting for Leases .....190</u></b> Ara G. Volkan PhD, CPA, Ph.D, CPA Eminent Scholar/ Chair of Accounting/Florida Gulf Coast University

2:05pm-2:55pm	<a href="#"><u>Federal Tax Update .....</u></a>	<a href="#"><u>195</u></a>
	Raymond L. Placid, CPA, JD, LL.M. Associate Professor of Accounting/Florida Gulf Coast University	
3:10pm-4:50pm	<a href="#"><u>Dealing with a Florida Sales/Use Tax Audit-do's and Don'ts .....</u></a>	<a href="#"><u>197</u></a>
	Glenn A. Bedonie, CPA Owner/Glenn A. Bedonie, CPA and Joseph C. Moffa, Esq., CPA Shareholder/Moffa, Gainor & Sutton, PA	

### Friday, October 28, 2011

7:30 – 8:00 a.m.	<b>Continental Breakfast</b>	
8:00am-8:50am	<a href="#"><u>Mortgage Fraud: An Unfortunate Growth Industry .....</u></a>	<a href="#"><u>200</u></a>
	Professor Gary P. Opper, CFP, CPA, MST Managing Member/Levie-Opper, LLC	
8:50am-9:40am	<a href="#"><u>Internal Auditing 2011: It's Time to "Fill the Glass" .....</u></a>	<a href="#"><u>246</u></a>
	Deborah Hoffman Director, Standards and Guidance/ The Institute of Internal Auditors Global Headquarters	
9:55am-10:45am	<a href="#"><u>Employment Law Update .....</u></a>	<a href="#"><u>272</u></a>
	Eduardo A. Suarez-Solar, MMS, MPA, JD, SPHR President and Owner/Integrated Employer Resources	
10:45am-11:35am	<a href="#"><u>The Going Concern: Evaluation and Presentation .....</u></a>	<a href="#"><u>283</u></a>
	Daryl A. Johnson, CPA, CMA Owner/Daryl A. Johnson, CPA	
11:35 a.m.-12:55 p.m.	<b>Lunch</b>	
12:05pm-12:55pm	<a href="#"><u>Lunch Presentation: Blue Ribbon Panel Report.....</u></a>	<a href="#"><u>302</u></a>
	Christopher T. Marrie, Hill, Barth & King, LLC	
1:10pm-2:00pm	<a href="#"><u>CIRA Update .....</u></a>	<a href="#"><u>310</u></a>
	Michael A. Kosinski, CPA Principal/LarsonAllen LLP	
2:00pm-2:50pm	<a href="#"><u>Valuation of Inventory After the Balance Sheet Date But Before the Financials Are Issued - Should the Impaired Inventory Be Written Down? .....</u></a>	<a href="#"><u>326</u></a>
	Daniel Acheampong, CPA Accounting Instructor/Florida Gulf Coast University	

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***Federal Income Tax Consequences  
of Foreclosures, Short Sales and  
Debt Modifications***

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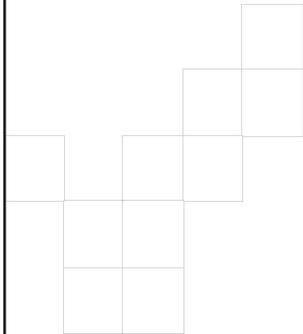
*Mark R. Giallonardo, JD, LLM*

**Mark Giallonardo**  
Principal in the Tax Department  
Hill, Barth & King LLC

Mark Giallonardo became a Principal in the Tax Department of Hill, Barth & King LLC (HBK) as of September 1, 2001. Mark joined HBK in August 1999, after having acquired 13 years of diversified tax accounting experience, split equally among national and regional accounting firms. Mark obtained a Bachelor of Science degree in Mathematics from Westminster College, a law degree from the Duquesne University School of Law, and a Masters of Law in Taxation from the Villanova University School of Law.

Mark now resides in Naples and serves as the director of tax quality control for HBK's Florida offices. Mark's area of tax emphasis is primarily business taxation, with a special emphasis on flow-through entities such as S corporations, partnerships and limited liability companies. Mark has also represented numerous clients before federal, state and local taxing authorities and appellate review boards.

Mark has presented various tax topics for the FICPA and other organizations. He is also involved with HBK's internal tax education program and has taken a particular interest in educating, developing and mentoring the younger staff. Mark is also a former adjunct professor of partnership taxation at the University of Pittsburgh School of Law and the Duquesne University Graduate School of Business.



## COD Income

Presented by: Mark Giallonardo  
October 27, 2011



## Tax Benefit Approach

- No income shall be realized from debt discharge to the extent that payment of the debt would have given rise to a deduction
  - Cash basis payables
  - Contingent liabilities



## Gift vs. COD Income

- If the forgiveness of debt constitutes a gift from the creditor to the debtor (or is in the nature of a bequest), gross income does not result to the debtor
- Donative cancellations are most likely to occur in family or other close personal relationships
- The creditor may have income (i.e., the donative cancellation of an installment obligation is treated as a disposition)



## Acquisition of Debt by Related Party

- 108(e)(4) provides that the acquisition of debt at a discount by a party related to the debtor triggers COD income to the debtor



## Purchase Price Reduction vs. COD Income

- 108(e)(5) provides that the reduction of a purchaser's debt with respect to seller-financed property is treated as a purchase price reduction rather than COD income



## Forgiveness of Shareholder Debt

- Corporate forgiveness of shareholder debt is treated as a distribution rather than COD income (regs. 1.301-1(m))
- The corporation is not entitled to a bad debt deduction



## Forgiveness of Partner / Member Debt

- Partnership / LLC forgiveness of partner / member debt is treated as a distribution rather than COD income
- No bad debt deduction for the partnership / LLC



## Forgiveness of Employee Debt

- Employer forgiveness of employee debt is treated as wages rather than COD income
- Compensation vs. bad debt deduction for the employer



## Forgiveness of Entity Debt by Owner

- The straight-up forgiveness of corporate or partnership debt by a shareholder or partner will generally result in COD income to the entity
- However, most of these situations are handled as contributions of debt to equity



## Contribution of Debt to Equity

- When a corporate shareholder contributes debt to equity, 108(e)(6) provides that the corporation will be treated as having satisfied the debt with an amount of money equal to the shareholder's basis in the debt
  - Thus, if the shareholder's basis in the debt equals its face, there should be no COD income
  - S shareholders with reduced basis debt can ignore reductions attributable to the flow-through of losses



## Contribution of Debt to Equity

- When a non-shareholder creditor contributes debt in exchange for an ownership interest, 108(e)(8) provides that the debtor corporation is treated as having satisfied the debt with an amount of money equal to the FMV of the ownership interest
  - Thus, COD income will result where the value of the ownership interest is less than the face amount of contributed debt



## Contribution of Debt to Equity

- In a partnership context, the general consensus for years was that there was a debt-to-equity exception from COD income
- However, 108(e) (8) was amended to provide that when a creditor contributes debt to a partnership in exchange for a partnership interest, the partnership will be deemed to have satisfied the debt with cash equal to the FMV of the partnership interest issued



## Contribution of Debt to Equity

- Many authors and practitioners felt that the change for partnerships only affected non-partner, third-party creditors that were becoming partners for the first time
- Belief was that existing partners continued to enjoy a debt-to-equity exception from COD



## Contribution of Debt to Equity

- However, proposed regs were issued within the last 5 years that apply the same rules to existing partners, but the regs have yet to be finalized
- Many authors believe that this is a bad result
- Thus, if a partner contributes debt to equity, COD income will result to the partnership unless the equity value transferred to the partner equals the face amount of the debt (at least according to the proposed regs)



## Gain vs. COD Income – Recourse Debt

- A foreclosure (or deed in lieu of foreclosure) transaction may result in debt discharge income to the borrower when recourse debt is involved.
- The taking of the property by the lender in satisfaction of the recourse debt is treated as a deemed sale with proceeds equal to the lesser of FMV at the time of foreclosure or the amount of secured debt.
- If the amount of debt exceeds FMV, the difference is treated as debt discharge income if it is forgiven.



## Gain vs. COD Income – Recourse Debt

- One way to avoid this result is to have the partner contribute additional cash equal to the face amount of debt
- The partnership would then use the cash to repay the debt
- The partner puts cash in and immediately receives it back, but the debt has been effectively converted to equity without triggering 108(e)(8)



## Gain vs. COD Income

- As a result of these rules, it is possible for a foreclosure transaction involving recourse debt to result in both:
  - a gain or loss from the sale of the property (because FMV is more or less than basis) and
  - debt discharge income (because the secured debt is in excess of FMV)
- The character of the gain or loss depends on the character of the property subject to foreclosure
- The bid price in a foreclosure sale is presumed to be the property's FMV unless there is clear and convincing proof to the contrary



## Gain vs. COD Income

- Debt discharge income occurs in a foreclosure transaction only if the lender discharges part or all of any deficiency
- If state law provides a debtor a right of redemption following a property foreclosure, any gain or loss related to the property transfer is not realized until the redemption period expires.
- However, if the right of redemption is abandoned or terminated before its normal expiration, the gain or loss is recognized at that time.



## Example

- Rob bought a commercial building on January 1, 2007 for \$500,000. He financed the purchase with a \$450,000 recourse bank loan and a \$50,000 cash down payment.
- As of December 31, 2010, the outstanding debt principal was \$432,000 and his adjusted basis in the building and land (after depreciation) was \$405,000. Rob transferred the property deed to the bank in lieu of foreclosure on December 31, 2010, and the bank discharged him from any further liability on the loan.
- The FMV of the property on December 31, 2010 was \$425,000. Rob was not bankrupt or insolvent at the time of the transfer and did not make the qualified real property business debt election.

FMV	425,000	Debt Balance	432,000
Adjusted Basis	<u>405,000</u>	FMV	<u>425,000</u>
Gain	20,000	COD Income	7,000



## Gain vs. COD Income – Nonrecourse Debt

- If the debt is nonrecourse, the whole transaction is treated as a sale with the debt the full amount realized
- Therefore no COD



## Example

- Rob bought a commercial building on January 1, 2007 for \$500,000. He financed the purchase with a \$450,000 nonrecourse bank loan and a \$50,000 cash down payment.
- As of December 31, 2010, the outstanding debt principal was \$432,000 and his adjusted basis in the building and land (after depreciation) was \$405,000. Rob transferred the property deed to the bank in lieu of foreclosure on December 31, 2010.
- The FMV of the property on December 31, 2010 was \$425,000. Rob was not bankrupt or insolvent at the time of the transfer and did not make the qualified real property business debt election.

Debt Balance	432,000
Adjusted Basis	<u>405,000</u>
Gain	27,000



## Gain vs. COD Income

- When financial institutions foreclose on property or take property in lieu of foreclosure, they must issue a Form 1099-A.
- A practical problem is where to report items from Form 1099-A on Form 1040:
  - If the property is related to a trade or business, farm, or rental property, the transaction will be reported as a sale on Form 4797.
  - If the property is an investment property, this amount will be reported as a sale on Schedule D.
  - The amount to report as sales proceeds would depend on whether the taxpayer is personally liable for repayment of the debt or the debt is nonrecourse.
  - If the taxpayer is personally liable for the debt, the amount reported as sales proceeds would equal the fair market value at the date the relinquishment occurred.
  - If the debt is nonrecourse, the full principal amount of the debt relieved is treated as the sales price.



## What About Losses?

- The problem we face today is that many properties are being foreclosed upon or sold at substantial losses
- Taxpayers never believe at the time of acquisition that the property will lose value
- Thus properties were positioned to ensure capital gain treatment upon future sale



## What About Losses?

- Now that the property is being sold or foreclosed upon at a loss, is there any way to claim ordinary rather than capital loss treatment, particularly if there will be substantial corresponding COD (ordinary) income?



## What About Losses?

- Can we argue that the property was initially acquired for development, but due to the failed economy no activity has commenced?
- A taxpayer's intent can only be established with clear and convincing evidence
- One major stumbling block is how the property's expenses have been handled during the period of ownership



## Real Estate Transactions

### **Investor**

- Passive owner of property
- Holding property for future appreciation or
- Holding property for present income producing potential

### **Dealer**

- Anyone who holds property primarily for sale to customers in the ordinary course of business.
  - Primarily is defined by Supreme Court to mean "of first importance" or "principally"



## Tax Consequences

### **Investor**

- Capital Gain treatment for gains and losses
  - Losses limited
- Expenses are a reduction of the proceeds of the sale

### **Dealer**

- Ordinary income treatment for gains and losses
- Expenses are ordinary business deductions
- Precluded from using installment method



## Some Examples

### **Investor**

- Intent is to hold until property appreciates to desired level

### **Dealer**

- Intent is to subdivide and sell plots
  - Exception – Code Sec. 1237



## Intent and Motive

- Motive is controlling, absent a change in intent
- Taxpayers status must be interpreted based on his activities in connection with the real estate.
- Look at the facts of each case



## Items to Consider

- Courts usually focus on:
  - The purpose and use for which the property was acquired and held
  - The length of time between purchase and sale
  - The number and frequency of sales made over a period of time
  - The activities of the taxpayer and his agents and the developments and improvements made to put the property in a sale worthy condition



## Items to Consider

- The activity of the taxpayer and his agents in advertising and promoting sales
- The extent and substantiality of the above transactions (i.e.: time and effort devoted)
- The existence of a liquidation intent at the time of sale
- The replacement of property sold with additional real estate
- The activities of the taxpayer in buying, developing, and selling real property before, during and after the years of the sale in question



## Intent Can Change

- Difficult to cross line between dealer and investor
- Requires clear and affirmative evidence that a change took place
  - Courts focus on tangible economic reason that led to the change (profitability, zoning, condemnation, etc.)
    - Purpose of acquisition is considered
    - Determining factor is the purpose for which the property is held at the time of sale



## Dual Status

- Holder of real estate can be dealer and investor
  
- Mark S. Gardner v. Commissioner (Decided just last month)
  - Taxpayer's responsibility to make a clear distinction on books and records of properties held
    - No segregation equals ordinary income tax rates for sales and dispositions of the property



## Choose a Side

### **Investor**

- Intent should be well documented
- Activity should be limited to a land-use study
- Sell to independent developers in few isolated or bulk sales

### **Dealer**

- Intent should be well documented
- Have an active development scheme and sales program



## General Exclusion Rule

- Section 108(a)(1) provides that gross income does not include any amount that would otherwise be included in income if:
  - The discharge occurs in a Title 11 case
  - The discharge occurs when the taxpayer is insolvent
  - The debt discharged is “qualified farm indebtedness”
  - The debt discharged is “qualified real property business indebtedness, or
  - The debt discharged is “qualified principal residence indebtedness” discharged before January 1, 2013
  - The discharge is of a student loan



## Coordination Provisions

- Section 108(a)(2) provides the following:
  - The Title 11 exclusion takes precedence
  - Insolvency exclusion takes precedence over the “qualified farm” and “qualified real property business” exclusions
  - The “principal residence” exclusion takes precedence over the insolvency exclusion unless otherwise elected.



## Bankrupt or Insolvent

- Bankrupt taxpayers
  - Bankrupt taxpayers exclude all debt discharge income under 108(a)(1)(A)
  - Bankruptcy falls under the federal bankruptcy statutes Title 11:
    - Chapter 7 (liquidation)
    - Chapter 11 (business reorganization)
    - Chapter 12 (family farmer and fisherman)
    - Chapter 13 (adjustment of an individuals debts)



## Bankrupt or Insolvent

- In the case of tax partnerships, bankruptcy and insolvency are tested at the partner level.
- Thus, if an LLC files for bankruptcy or is insolvent, the exclusions under these provisions are not available unless the partner is either in bankruptcy or insolvent
- What if a single-member LLC files for bankruptcy, but the member does not?



## Bankrupt or Insolvent

- Insolvent taxpayers
  - Exclude COD income from taxable gross income to the extent of insolvency prior to the cancellation of the debt
  - Any excess is taxable income
  - Extent of insolvency = liabilities – FMV of assets immediately prior to discharge



## Bankrupt or Insolvent

- In a tax partnership context, for purposes of computing insolvency, a partner is entitled to include his/her share of allocable nonrecourse debt to the extent that the debt exceeds the FMV of the property
- This makes sense since the forgiveness of nonrecourse debt will result in COD income to the partner



## Bankrupt or Insolvent

- An allocation of COD income must be made in accordance with the substantial economic effect safe harbor
- Therefore, COD income recognized by a tax partnership will generally be allocated among the partners in a manner consistent with how the debt was allocated for basis purposes



## Bankrupt or Insolvent

- Reduction of tax attributes
  - While bankrupt/insolvent taxpayers can exclude debt discharge income, they must reduce, to the extent possible, certain tax attributes
  - Reduced dollar for dollar or 33 1/3 cents from credits (in following order)



## Bankrupt or Insolvent

### ■ Reduction of tax attributes (cont.)

1. NOLs - any NOL from tax year of discharge or carried into that year
2. General Business Credits (current year or carried into that year)
3. Minimum Tax Credit – beginning of year following discharge
4. Capital loss carryovers (current year or carried into that year)



## Bankrupt or Insolvent

### ■ Reduction of tax attributes (cont.)

5. Basis – depreciable & nondepreciable property of taxpayer – subject to 1017 limits
6. Passive Activity Loss and Credit Carryovers (current year or carried into that year)
7. Foreign Tax Credit Carryovers (current year or carried into that year)



## Basis Reductions Under 1017

- Reduction of depreciable/nondepreciable assets is limited if COD arises from a discharge of indebtedness in a Title 11 or insolvent taxpayer
- Reduction may not exceed excess of:
  - Aggregate of adjusted basis of property held immediately after discharge over the,
  - Aggregate of liabilities immediately after discharge
- Limitation does not apply if basis reduction is due to election to reduce basis of depreciable property first
- Basis reduction is not treated as a disposition



## Bankrupt or Insolvent

- Basis reduction elections
  - Two elections available vs. attribute order
    - First, reduce basis of depreciable assets - 108(b)(5)
      - Excess then follows attribute order
      - Beneficial to those with NOL or credit carryovers to be used in the near future and long lived assets
      - Made on Form 982 with a statement listing the asset basis reduction
    - Second, treat real property inventory as a depreciable asset
      - Made on Form 982
  - Preparation Pointer
    - Please note that Form 982 needs filed whenever there is COD



## Bankrupt or Insolvent

- Ordering rules for basis reduction
  - Real property securing debt
  - Personal property securing debt
  - Any other trade or business property
  - Inventory, receivables
  - Any other property
- Should always run both calculations to determine best option
- Timing of attribute reductions
  - After taxable income for the year of discharge has been determined
    - Can use NOLs and other carryovers against current income



## Example

- Taxpayer has a Schedule C and has the following prior to any COD in 2008:
  - \$500,000 of debt
  - FMV of assets of \$490,000
  - NOL of \$60,000
  - Capital loss carryover of \$5,000
  - Credit of \$1,000
  - Tax basis of:
    - Depreciable Assets of \$120,000
    - Inventory of \$124,000
    - Other \$100,000
  - Taxable income of \$25,000

## Example

- Bank discharges \$150,000 of note
- Therefore:
  - Insolvency = \$10,000 (\$500,000-\$490,000)
  - The \$140,000 remaining is taxable income therefore
    - \$60,000 NOL is used
    - \$1,000 tax credit is used
    - \$3,000 of loss carryover is used
  - \$2,000 of loss carryover attribute is reduced to \$-0-
  - Since debt left over (\$350,000) is greater than remaining asset basis (\$344,000), no other attribute reduction is necessary.
  - The other \$8,000 left over from COD is ignored going forward.
  - See Form 982 attached

<p><b>Form 982</b>          (Rev. January 2005)  <small>Department of the Treasury          Internal Revenue Service</small></p>	<p><b>Reduction of Tax Attributes Due to Discharge of          Indebtedness (and Section 1082 Basis Adjustment)</b></p> <p>► Attach this form to your income tax return.</p>	<p>OMB No. 1545-0048          Attachment          Sequence No. 94</p>
<p>Identify the taxpayer:  <b>Roxanne Bear</b></p>		<p>Identifying number:  <b>123-45-6789</b></p>
<p><b>Part I General Information</b> (see instructions)</p>		
<p>1 Amount excluded is due to (check applicable box(es)):</p> <p>a Discharge of indebtedness in a title 11 case <input type="checkbox"/></p> <p>b Discharge of indebtedness to the extent insolvent (not in a title 11 case) <input checked="" type="checkbox"/></p> <p>c Discharge of qualified farm indebtedness <input type="checkbox"/></p> <p>d Discharge of qualified real property business indebtedness <input type="checkbox"/></p> <p>e Discharge of certain indebtedness of a qualified individual by reason of Hurricane Katrina <input type="checkbox"/></p>		
<p>2 Total amount of discharged indebtedness excluded from gross income: <input type="text" value="12"/> <input type="text" value="10,000"/></p>		
<p>3 Do you elect to treat all real property described in section 1221(a)(1), relating to property held for sale to customers in the ordinary course of a trade or business, as if it were depreciable property? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No</p>		
<p><b>Part II Reduction of Tax Attributes.</b> You must attach a description of any transactions resulting in the reduction in basis under section 1081. See Regulations sections 1.1017-1 and 1.1017-11 for basis reduction ordering rules, and, if applicable, required partnership consent statements. (For additional information, see the instructions for Part II.)</p>		
<p>Enter amount excluded from gross income:</p>		
4 For a discharge of qualified real property business indebtedness, applied to reduce the basis of depreciable real property	4	
5 That you elect under section 1082(b)(5) to apply first to reduce the basis (under section 1017) of depreciable property	5	
6 Applied to reduce any net operating loss that occurred in the tax year of the discharge or carried over to the tax year of the discharge	6	
7 Applied to reduce any general business credit carryover to or from the tax year of the discharge	7	
8 Applied to reduce any minimum tax credit as of the beginning of the tax year immediately after the tax year of the discharge	8	
9 Applied to reduce any net capital loss for the tax year of the discharge including any capital loss carryover to the tax year of the discharge	9	2,000
10 Applied to reduce the basis of nondepreciable and depreciable property if not reduced on line 5. DO NOT use in the case of discharge of qualified farm indebtedness.	10	
11 For a discharge of qualified farm indebtedness, applied to reduce the basis of:		
a Depreciable property used or held for use in a trade or business, or for the production of income, if not reduced on line 5	11a	
b Land used or held for use in a trade or business of farming	11b	
c Other property used or held for use in a trade or business, or for the production of income	11c	
12 Applied to reduce any passive activity loss and credit carryovers from the tax year of the discharge	12	
13 Applied to reduce any foreign tax credit carryover to or from the tax year of the discharge	13	
<p><b>Part III Consent of Corporation to Adjustment of Basis of its Property Under Section 1082(a)(2)</b></p>		
<p>Under section 1081(b), the corporation named above has excluded \$ ..... from its gross income for the tax year beginning ..... and ending .....          Under that section, the corporation consents to have the basis of its property adjusted in accordance with the regulations prescribed under section 1082(b)(2) as effect at the time of filing its income tax return for that year. The corporation is organized under the laws of .....</p>		
<p><b>Note.</b> You must attach a description of the transactions resulting in the nonrecognition of gain under section 1081.</p>		
<p>For Paperwork Reduction Act Notice, see page 3 of this form. <span style="float: right;">Cat. No. 17005E <span style="margin-left: 100px;">Form 982 (Rev. 1-2005)</span></span></p>		



## Qualified Farm Debt

- 108(a)(1)(C)
  - Taxpayer engaged in the business of farming may reduce tax attributes in lieu of recognizing COD income.
  - Two requirements must be met:
    - Debt must be incurred directly in the business of farming
    - 50% or more of the taxpayer's aggregate gross receipts for the three taxable years preceding the year of discharge must have been attributable to the trade or business of farming



## Qualified Real Property Business Debt

- 108(a)(1)(D)
  - Applies to taxpayers other than C corps.
  - Eligible taxpayer not in bankruptcy or insolvent may elect to reduce the basis of depreciable property by the amount of discharge
  - This exclusion can apply after application of the insolvency exclusion renders the taxpayer solvent
  - This exclusion is elective, and in a partnership context is made at the partner level



## Qualified Real Property Business Debt

- Defined as meeting all of the following:
  - Incurred by the taxpayer in connection with real property used in a trade or business and is secured by such property;
  - Incurred before January 1, 1993 or, if after that date, is “qualified acquisition indebtedness”
  - Taxpayer elects to treat the debt as such
  - Qualified farm debt cannot qualify as qualified real property business debt



## Qualified Real Property Business Debt

- Includes debt from refinancing, so long as the refinanced amount does not exceed the amount of the original debt
- Qualified real property business debt does not need to secure depreciable property, only real property used in the business, which can be land



## Qualified Real Property Business Debt

- For debt incurred after January 1, 2003, “qualified acquisition debt” is defined as:
  - Debt secured by the property and incurred to acquire, construct, reconstruct or substantially improve such property



## Qualified Real Property Business Debt

- Exclusion cannot exceed the lesser of
  - FMV Limitation – the excess of the outstanding principal amount (before discharge) over the FMV of the real property securing the debt reduced by the remaining debt securing the property
  - Overall Limitation – the aggregate adjusted basis of all depreciable real property held by the taxpayer
- Importance of qualified appraisals
- Excluded debt discharge income decreases the tax basis in the property



## Example

- Joan owns a building used in her business. Its FMV is \$150,000 (adjusted basis \$175,000)
- The building secures a first mortgage of \$110,000 and a second mortgage of \$90,000
- None of the debt is qualified farm indebtedness
- Joan is not insolvent or bankrupt and owns no other depreciable real property.



## Example continued

- On July 1, 2010, the second mortgagee agrees to reduce its debt from \$90,000 to \$30,000, resulting in debt discharge income of \$60,000
- The FMV rule limits the total amount of debt discharge income that can be excluded to \$50,000, the amount by which the principal of the debt (\$90,000) exceeds the FMV of the collateral property ( $\$150,000 - \$110,000 = \$40,000$ )
- Joan can exclude \$50,000 of debt discharge income if she files an election to do so with her 2010 return
- The remaining \$10,000 of debt discharge income is included in her 2010 income



## Qualified Principal Residence Debt

- 108(a)(1)(E)
  - Taxpayers can exclude from gross income a discharge of qualified principal residence indebtedness before January 1, 2013
  - Applies to restructure and foreclosures
  - Qualified principal residence indebtedness – debt that qualifies under normal acquisition indebtedness interest expense rule, but only for the principal residence under IRC 121 (not second/vacation homes)
  - \$2 million limit



## Qualified Principal Residence Debt

- Operative rules
  - Residential mortgages are usually recourse debt
  - Foreclosure involving recourse debt are treated as deemed sales, proceeds equal the lesser of:
    - FMV at foreclosure or,
    - Amount of secured debt
  - Debt > FMV = COD income, only that portion is subject to the exception
  - Basis is reduced by the COD income
  - Complete Form 982



## Qualified Principal Residence Debt

### ■ Example

- Tim has a principal residence that is subject to a \$300,000 mortgage secured by the house. The home cost \$270,000 and the lender foreclosed on the loan in 2010 when the home was worth \$280,000
- COD is the debt (\$300,000) over the FMV (\$280,000) = \$20,000
- The deemed proceeds are \$280,000 less the basis of \$270,000 for a \$10,000 taxable gain, which could be excluded under IRC 121



## Rev Proc 2009-37 for IRC Sec. 108(i) Elections

### ■ Provides new exception to general COD rules

- May elect to defer the recognition of certain types of COD arising in 2009 & 2010
- COD results from reacquisition
- COD income is then recognized ratably over 5 future tax years
  - For 2009 “recognition” starts at 5th tax year after tax year where COD is realized
  - For 2010 it is the 4th year
  - Recognition takes place in 2014-2018 for calendar year taxpayers



## Rev Proc 2009-37 for IRC Sec. 108(i) Elections

- **Reacquisition –**
  - Acquisition of debt for cash
  - Exchange of debt for debt
  - Exchange of debt for stock/partnership interest
  - Contribution of debt to capital
  - Complete forgiveness of indebtedness
- **The deferral can be accelerated by “acceleration events” such as death, liquidation, business cessation, etc.**



## Rev Proc 2009-37 for IRC Sec. 108(i) Elections

- **Elections are made at the entity level**
- **If election is made, all the other COD exceptions are not allowed for future years pertaining to the debt recognition**



## Rev Proc 2009-37 for IRC Sec. 108(i) Elections

### ■ Elections by Partnerships

- Allocate COD as normal partner distributive share calculated under IRC 704.
  - Each partner receives the gross “COD amount”
  - Partner's share of deferred amount of the above is referred to as “Deferred Amount”
- There is no opt-out of the entity election, but there is a remedy in cases where the election is being applied to an amount less than the total COD:
  - The partnership can allocate the “deferred amount” to specific partners as long as it had a substantial economic effect
  - Partners may use their own exceptions under the other 108 provisions



## Rev Proc 2009-37 for IRC Sec. 108(i) Elections

### ■ Elections by Partnerships

- Decrease in partners' share of liabilities
  - Not treated as current “deemed distribution”, referred to as “deferred 752 amount”
  - This deferral treats the reduction in liabilities as a distribution ratably as the COD income is recognized
- Example Partnership
  - 2 partners (A and B), 50-50
  - Reacquire debt of \$10,000 for \$8,000 (COD of \$2,000)
  - A's basis (including liabilities) = \$4,000
  - B's basis (including liabilities) = \$4,500
  - Assume no other income or loss for 2009



## Rev Proc 2009-37 for IRC Sec. 108(i) Elections

### ■ Example continued

- The deferred amount may not exceed the lesser of
  - The partner's deferred amount of \$1,000 (50% of COD of \$2,000) or
  - The gain that the partner would recognize as a result of the deemed distribution of debt (\$5,000 for A and \$5,000 for B due to the debt reduction)
- A has a basis of \$4,000 less deemed distributions of \$5,000 for a gain of \$1,000 (equal to COD)
- B has a basis of \$4,500 less deemed distributions of \$5,000 for a gain of \$500 (less than the COD)
- Starting in 2014, A gets deemed distributions of \$200 per year for 5 years and B gets distributions of \$200, \$200, and \$100 in years 2014-2016



## Rev Proc 2009-37 for IRC Sec. 108(i) Elections

### ■ Elections by S Corps

- Allocated pro rata to shareholders that are shareholders immediately before the reacquisition transaction



## Rev Proc 2009-37 for IRC Sec. 108(i) Elections

### ■ Elections

- File with timely return (including extensions)
- There is a 12-month extension
- If already filed (for fiscal years), you can amend by November 16 to get election in compliance



## Rev Proc 2009-37 for IRC Sec. 108(i) Elections

### ■ Elections – required information

- “Section 108(i) Election” across top
- Name and TIN of debt issuer
- General description of instrument
- Description of reacquisition
- Total COD income that results
- Total COD electing to defer
- List of partners/shareholders, TIN, COD amount and deferred amount
- New instrument details (if any)



## Rev Proc 2009-37 for IRC Sec. 108(i) Elections

- Partly and fully protective elections
  - Amount of COD can be overstated if not sure what total amount may be determined
  - If not sure taxpayer complies with other IRC 108 Provision, election may be made to follow 108(i) just in case



## Rev Proc 2009-37 for IRC Sec. 108(i) Elections

- Additional requirements for Partnerships/S Corps
  - Report on Schedule K-1, in aggregate, the partners' share of all applicable debt instruments that the 108(i) election is made
  - Information Statement for Partners
    - Keep with Partners' records (not filed)
    - Include the detail (not aggregate) of all the separate instruments
    - If only 1 transaction, this should look the same as the aggregate filed with the tax return



## Rev Proc 2009-37 for IRC Sec. 108(i) Elections

- Required annual information statements
  - Must be filed with each return year after election up until all items have been recognized (2018)
  - Titled “Section 108(i) Information Statement”
    - Deferred COD included in current taxable income
    - Deferred COD included due to acceleration event
    - Deferred COD not yet included in prior or current year income
    - Deferred OID deductions included in current year
    - Deferred OID not yet included in prior or current years
  - For Pass-through Entities this gets attached to K-1’s, as well



## Rev Proc 2009-37 for IRC Sec. 108(i) Elections

- Tiered Pass-through Entities and Foreign Corporations/Partnerships
  - Addressed in the Rev Proc
  - Can review case by case

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***Financial Statement Presentations  
to Certain Audiences***

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*Sean E. Dannelly, CPA  
and  
Raymond Monteleone, CPA*

## **Sean Dannelly**

### **Founding Partner**

### **Paladin Global Partners**

Sean Dannelly is a founding partner of Paladin Global Partners. Dannelly's experience spans multiple industry sectors including Health Care, Banking, Distribution, Construction, and Emerging markets, to name a few. With Paladin Global Partners, Sean provides the critical accounting and financial support for the firm's M&A, turnaround, and strategic development clients. Much of his work is hands-on where he functions in a CFO role; guiding the firm's finance operations. Other recent projects include managing due diligence on several acquisitions, developing succession plans, mentoring finance management, providing audit assistance, and establishing internal controls and infrastructures to maintain audit compliance.

As president of Dannelly, Monteleone & Associates, Sean focuses this full-service CPA firm on meeting the needs of small and medium sized businesses. Utilizing state-of-the-art technology, the firm provides the highest quality of work consistent with those found at larger firms, but with a local firm accessibility. Dannelly, Monteleone & Associates is noted for its personal service, providing clients with meaningful information and creative management advice. Some of the services provided includes tax planning & return preparation, monthly bookkeeping & financial reporting, payroll, business consulting and contract CFO services, financial planning & auditing & attestation.

Prior to co-founding Dannelly, Monteleone & Associates, Sean was president of Dannelly & Company, P.A., where he focused his full-service CPA firm on providing quality, personal services that had a positive impact on the success of his clients.

Before he established his own practice, Sean was Director of Finance for Life Extension, an international vitamin and supplement distributor dedicated to the radical extension of the healthy human lifespan. In addition to distributing products via the web and their state of the art call center, the company also manages a magazine & publication division, a retail store and an international distribution division. Dannelly managed all financial-related operations for both the "for profit" company and the "not-for-profit" foundation, including all accounting, treasury management, tax reporting & inventory control. During his tenure, he directed the installation of corporate financial controls & procedures, negotiated \$5 million line of credit with banking institutions, and implemented the inventory control management system.

Mr. Dannelly's corporate career began with Arthur Andersen, LLP, an international accounting and former "Big 6" firm. At Arthur Andersen, he focused on auditing and consulting to some of the firm's largest publicly traded and private clients. During his tenure, he served on acquisition teams whose efforts resulted in over \$175 million in acquisitions.

Sean proudly served as a Non-Commissioned Officer in the United States Marine Corps. Serving with the 1st Battalion, 7th Marines, he managed the infantry battalion's financial budget, overseeing financial expenditures for the unit relating to asset acquisitions & maintenance supply requests. He was honored with a meritorious promotion to non-commissioned officer within two years, making him the youngest NCO in the 1st Marine Division at that time. Dannelly participated in Operation Restore Hope in Mogadishu, Somalia, serving in-country for five months and receiving a Navy Achievement Medal for management of logistical & supply operations for the Ground Combat Element. He then served two 6-month tours in Okinawa, Japan, receiving his 2nd Navy Achievement Medal from the 3rd Marine Division.

Mr. Dannelly is a member of the American Institute of CPAs as well as Florida Institute of CPAs. He serves on the Board of the Gold Coast Venture Capital Association. He is a graduate of Leadership Broward, Class XXVI and past president of Business Networking International. In addition, Mr. Dannelly is active in several local charities including the Marine Corps League, American Legion, and Leadership Broward, to name a few.

Dannelly, a Certified Public Accountant, graduated from the University of Florida with a Bachelor of Science degree in Accounting and a Masters of Accounting.

# **Raymond C. Monteleone, CPA, MBA**

## **President**

### **Paladin Global Partners**

Ray Monteleone, a founding partner and president of Paladin Global Partners distinguishes himself not only by his professional career but his community involvement as well. Monteleone's depth of expertise spans multiple industries and business functions, successfully navigating the business world. Mr. Monteleone is also a partner with Dannelly, Monteleone & Associates, a full-service CPA firm.

With Paladin Global Partners, Mr. Monteleone provides innovative and unique solutions for a broad range of national and international clients representing an array of business interests. He focuses on services in the areas of strategic management, problem solving, mergers & acquisitions, compensation consulting, growing companies, and senior executive mentoring. Some of the industries he has served include healthcare, high tech, manufacturing, education, financial institutions and not-for-profit organizations. He has held numerous directorships in representative entities of those industries including Interactive Speech Solutions, Rexall Sundown, First American Railways, Durango & Silverton Narrow Gauge Railway, Rush Holdings, and Pointe Financial Corporation, and he currently chairs the Advisory Board of Algy Costumes.

Monteleone's reputation for professionalism and integrity led to a two-year appointment as Deputy Commissioner/Chief Operating Officer for the Florida Department of Education, appointed by Commissioner James Horne and recommended by Governor Jeb Bush. Prior to his stint with the Florida Department of Education, Monteleone served as chairman of the board and co-chief executive officer for Loren Industries Inc., a jewelry manufacturer, in Hollywood, Florida. Previously, Mr. Monteleone was president/COO & member of the board of directors of First American Railways; vice president of corporate development, planning & administration for Sensormatic Electronics Corporation; a consultant with Holland & Knight involved in strategic planning & practice development; and, a South Florida tax & business consulting partner with Arthur Young & Company, ascending to the level of Director of Taxes for all three South Florida offices.

Monteleone serves and has held leadership positions in multiple professional and civic organizations. He is the Past Chair of the Broward Education Foundation and is active with the Leadership Broward Foundation (Past President), National Society of Certified Healthcare Business Consultants, Leadership Florida (Advisory Board), Florida Atlantic University (FAU) Broward Seaside Burrow (Past Chairman), FAU National Alumni Association, FAU Broward President's Community Council, Florida Institute of Certified Public Accountants (Chair of the Industry Section Committee), and American Institute of Certified Public Accountants. He also served with AeA Florida (Past President), South Broward Hospital District Board of Commissioners, Enterprise Development Corporation of South Florida, Association for Corporate Growth Founder, State of Florida Continuing Care Advisory Board, Florida Chairman of the National Association of Manufacturers, Committee of 100, Hollywood Economic Development Board, and Chairman of the Child Care Connection, just to name a few. Ray was honored as a Leader of the Year by Leadership Broward, an Outstanding Broward Alumnus by Florida Atlantic University, and was recently inducted into FAU's Parliament of the Owls.

Monteleone graduated cum laude from New York Institute of Technology, attended graduate courses at North Carolina State and attended the Arthur Young Harvard Business School program. He received his MBA from Florida Atlantic University and has lectured at many universities and business & professional association seminars.

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# ***A&A Update***

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*Eugene Ristaino, CPA, ABV, MT*

**EUGENE J. RISTAINO, CPA, ABV, CFF, MT**  
Partner & Director of Accounting & Auditing  
Isdaner & Company, LLC

Gene Ristaino is a partner/member of Isdaner & Company, LLC, a local firm of 65 people in Bala Cynwyd PA and is the director of accounting and auditing. Gene manages a diversified accounting practice specializing in the construction and real estate industries. He also provides services for developers and contractors in cost certification and analysis, claim support and documentation, expert witness, business valuation and job cost system implementation and improvement.

Gene's diversified background includes a concentration in the governmental and not-for-profit auditing sectors, including HUD, Circular A-133 and the Single Audit, as well as healthcare, manufacturing, transportation, retail and service organizations.

Gene has a Masters in Taxation (MT), concentrating in corporate taxation, with a specialization in the real estate and construction industries.

Gene is Accredited in Business Valuation (ABV), and Certified in Financial Forensics (CFF) by the American Institute of Certified Public Accountants (AICPA).

Gene is a national instructor for the American Institute of Certified Public Accountants (AICPA) and many state societies. He also lectures for many industry associations, and has authored several professional education programs and one-day seminars.

Gene is a former adjunct professor of tax law for the Masters in Taxation Programs for Villanova University and the Philadelphia University. He received his undergraduate BS degree in accounting from Drexel University, and earned his Masters in Taxation from Villanova University.

Gene is a member of the American and Pennsylvania Institutes of Certified Public Accountants and currently serves on the Peer Review Committee for the Pennsylvania Institute of Certified Public Accountants. He is a team captain for the AICPA Peer Review Program.

# ***ACCOUNTING AND AUDITING UPDATE***



***PRESENTED BY  
GENE RISTAINO, CPA, ABV, CFF, MT***

***FICPA FCGU CONFERENCE  
OCTOBER 27, 2011***

## ***AGENDA***

- NEWS UPDATE***
- ETHICS EXPOSURE DRAFT***
- FINANCIAL REPORTING***
- FASB US STANDARDS UPDATE***
- OCBOA UPDATE***
- US AUDITING AND ATTEST UPDATE***





## ***NEWS UPDATE***

**UPDATED**

## **CPA PROFESSION**



- ***CPA WAS THE 9<sup>TH</sup> BEST CAREER OUT OF MONEY MAGAZINE'S 100 TOP CAREERS***
- ***BASED ON PROJECTED PAY AND GROWTH OVER NEXT 10 YEARS***
- ***22% JOB GROWTH PROJECTED FOR CPAS***

# **AICPA MEMBERSHIP**



- **81.4 % VOTED TO CHANGE AICPA ADMISSION REQUIREMENTS**
- **50% OF MEMBERS ARE IN INDUSTRY, GOVERNMENT AND ACADEMIA**
- **AICPA MEMBERSHIP CRITERIA IS NOW CONSISTENT WITH CPA CERTIFICATION IN UAA**

# **AICPA CRITERIA**



## **MEET ONE OF FOLLOWING CRITERIA**

- **HOLD A VALID UNREVOKED CPA CERTIFICATE**
- **AT ANY TIME POSSESSED A VALID CPA CERTIFICATE THAT WAS NOT REVOKED AS A RESULT OF A DISCIPLINARY ACTION**
- **PASSED THE CPA EXAM, FULFILLED THE EDUCATION AND EXPERIENCE REQUIREMENTS OF THE UAA FOR CPA CERTIFICATION (150 HOURS AND 1 YEAR RELEVANT EXPERIENCE)**

## **BENEFITS OF AUDIT**



***WALL STREET JOURNAL STUDY SHOWS THAT SMALL BUSINESSES WHOSE BOOKS ARE AUDITED BUY A CPA IMPROVE THEIR CHANCES OF GETTING A LOAN AT FAR BETTER TERMS***

***BANKERS FEEL THE BENEFITS OUTWEIGH THE EXTRA COSTS OF THE AUDIT***

## **BENEFITS OF AUDIT**



***A JOINT STUDY BY MICHIGAN STATE UNIVERSITY AND INDIANA UNIVERSITY FOUND SMALL BUSINESSES WITH AUDITED FINANCIAL STATEMENTS WERE "SIGNIFICANTLY LESS LIKELY" TO BE DENIED CREDIT FROM BANKS***

## **WSJ PERSPECTIVE**



***A SMALL BUSINESS AUDIT COSTS ANYWHERE FROM \$5,000 TO \$75,000 DEPENDING ON THE SIZE OF THE COMPANY AND THE COMPLEXITY OF THE DATA AND OTHER FACTORS OR (2X THE COST OF A REVIEW)***

## **WSJ PERSPECTIVE**



***→ AN AUDIT PROVIDES THIRD PARTY ASSURANCE THAT A COMPANY'S FINANCIAL STATEMENTS ARE CORRECTLY PREPARED AND BASED ON VERIFIABLE BUSINESS DATA***

***→ WHILE A REVIEW SHOWS THE STATEMENTS ARE AT LEAST INTERNALLY CONSISTENT WITH DATA PROVIDED BY MANAGEMENT***

# **AUDITOR ROTATION**



***PCAOB IS  
CONSIDERING A  
MANDATORY AUDITOR  
ROTATION FOR ALL  
PUBLIC AUDITEES***

# **AUDITOR'S REPORT**



***PROFESSION IS PREPARING  
FOR CHANGES TO THE  
STANDARD AUDIT REPORT***

- EMPHASIS OF MATTER***
- ATTENTION TO SPECIFIC AREAS  
OF AUDIT WORK***
- INFORMATION ON CRITICAL  
ACCOUNTING ESTIMATES***
- AUDITOR MDA***

## **IASB FUNDING**



- *THE INTERNATIONAL ACCOUNTING STANDARDS BOARD DISCLOSED AN OPERATING DEFICIT OF £1.3 MILLION (\$2.1 MILLION) FOR 2010*
- *THE FINANCIAL ACCOUNTING FOUNDATION, (FAF) WHICH FUNDS AND OVERSEES THE U.S. FINANCIAL ACCOUNTING STANDARDS BOARD, FORWARDED \$500,000 TO THE IFRS FOUNDATION, WHICH OVERSEES THE IASB*
- *THE IFRS FOUNDATION BUDGET FOR 2011 IS £26 MILLION, BUT ITS TRUSTEES BELIEVE IT MAY NEED TO GROW TO ABOUT £40 MILLION TO £45 MILLION AND HAVE BEEN HOPING TO COME UP WITH A LONG-TERM GLOBAL FUNDING SYSTEM, ACCORDING TO A STRATEGY REVIEW RELEASED EARLIER THIS YEAR*

## **IASB FUNDING**



*WHILE THE IASB EXPECTS TO HAVE A BALANCED BUDGET IN 2011, THE DEFICIT IS A BIT OF A PROBLEM, AS U.S. REGULATORS ARE SET TO DECIDE LATER THIS YEAR WHETHER THEY CAN REALLY USE INTERNATIONAL FINANCIAL REPORTING STANDARDS. BEFORE DOING SO, THEY WANT TO BE ASSURED THAT THE BOARD IS FINANCIALLY SUPPORTED*

## **IASB FUNDING**



- ***UNDER SARBANES-OXLEY, THE U.S. ACCOUNTING STANDARD SETTER IS REQUIRED TO HAVE A STABLE FUNDING SOURCE, WHICH COMPLICATES THE ABILITY OF U.S. COMPANIES TO USE IFRS***
- ***MORE THAN A THIRD OF THE IFRS FOUNDATION'S REVENUE IS STILL DERIVED FROM DONATIONS. THE ACCOUNTING BOARDS EARN MILLIONS FROM SELLING SUBSCRIPTIONS AND PUBLICATIONS, BUT THAT'S NOT ENOUGH TO SUPPORT THEIR OPERATIONS ALONE.***
- ***THE IASB HAS BEEN WORKING SINCE 2006 TO TRY TO STABILIZE ITS FINANCES AND HAS SUCCESSFULLY COME UP WITH FEE SUPPORT STRUCTURES FROM SEVERAL COUNTRIES IN ASIA AND EUROPE***

## **US FUNDING**



- ***SINCE 2002, FASB HAS BEEN LARGELY FUNDED THROUGH ACCOUNTING SUPPORT FEES, WHICH WERE LEVIED ON COMPANIES AS PART OF THE SARBANES-OXLEY ACT. IT RECEIVED ABOUT \$34 MILLION IN SUCH FEES LAST YEAR.***
- ***THE GOVERNMENT ACCOUNTING STANDARDS BOARD, WHICH IS ALSO OVERSEEN BY THE FAF, IS SET TO GET MORE STABLE FUNDING FOR THE FIRST TIME LATER THIS YEAR UNDER NEW LEGISLATION IN THE DODD-FRANK ACT.***

## **SEC COMMENTS**



### **CHAIRMAN MARY SCHAPIRO**

*"The IASB lacks an independent and assured source of funding, as the IFRS Foundation has no authority to impose funding requirements. The threats of interference during the financial crisis serve as a continued reminder of the importance of financial independence for the IFRS Foundation and the IASB."*

## **SEC COMMENTS**



### **CHAIRMAN MARY SCHAPIRO**

*"I know from my role as a member of the Monitoring Board that the trustees of the IFRS Foundation are working closely with regulatory and other public authorities and key stakeholder groups to explore more stable funding mechanisms. Until then, however, funding for the IASB will remain a challenge."*

# **IFRS ADOPTION**



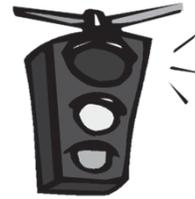
- **SEC "CONDORSEMENT" PAPER**
- **ALTERNATIVE APPROACH TO INCORPORATING IFRS INTO US GAAP**
- **SOLICITS COMMENTS – JULY 31**
- **COMMENTS CAN BE MADE THROUGH THE SEC WEBSITE**
- **SHOULD NOT BE CONSIDERED AS SEC DETERMINATION TO ADOPT IFRS**
- **SHOULD NOT BE CONSIDERED THE PREFERRED APPROACH OR THE ONLY APPROACH**

# **SEC PAPER**



***"The focus of this Staff Paper is to outline a possible approach for incorporation of IFRS into the U.S. financial reporting system, if the Commission were to decide that incorporation of IFRS is in the best interest of U.S. investors," OCA reported. "This [paper] does not provide an extensive discussion of a potential timeline of incorporation."***

## **SEC PAPER**



*"The Staff's discussion in this Staff Paper is not intended to suggest that the Commission has determined to incorporate IFRS," the paper says, "or that the discussed framework is the preferred approach or would be the only possible approach."*

## **SEC PAPER**



*The paper summarizes other jurisdictions' approaches and outlines condorsement as another possible option, elaborating on the concept introduced in December by a member of the OCA staff at the AICPA National Conference on Current SEC and PCAOB Developments. The paper was published as an update on the SEC staff's Work Plan for global accounting standards.*

## **SEC PAPER**



*“Importantly, the framework would retain a U.S. standard setter and would facilitate the transition process by incorporating IFRS into U.S. GAAP over some defined period of time (e.g., five to seven years),” the paper notes. “At the end of this period, the objective would be that a U.S. issuer compliant with U.S. GAAP should also be able to represent that it is compliant with IFRS as issued by the IASB.”*

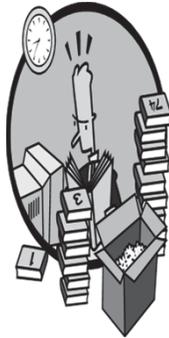
■

## **CONVERGENCE**



***IASB AND FASB HAVE AGREED TO EXTEND THE TIMETABLE FOR THE REMAINING PRIORITY CONVERGENCE PROJECTS BEYOND JUNE 2011. THE CONVERGENCE PROJECTS ARE TARGETED FOR COMPLETION IN SECOND HALF OF 2011, BUT THE INSURANCE STANDARD TARGETED FOR FIRST HALF OF 2012.***

## ***REGULATOR CONCERNS***



- ***ANTICIPATED SIGNIFICANT COSTS TO MODIFY INTERNAL PROCESSES AND TO EVALUATE AND MODIFY FINANCIAL METRICS CURRENTLY USED TO EVALUATE REGULATED INDUSTRIES***
- ***GENERAL LACK OF INDUSTRY-SPECIFIC GUIDANCE UNDER IFRS, INCLUDING GUIDANCE FOR RATE-REGULATED INDUSTRIES***
- ***DIMINISHED ABILITY TO INFLUENCE THE STANDARD SETTING PROCESS***

## ***SEC REPORT***



- ***IS IFRS COMPREHENSIBLE, AUDITABLE AND ENFORCEABLE?***
- ***DOES IFRS ALLOW FOR COMPARABILITY "WITHIN AND ACROSS JURISDICTIONS" DUE TO LESS PRESCRIPTIVE GUIDANCE, LACK OF GUIDANCE, OR ACCOUNTING POLICY OPTIONS?***
- ***WILL THE USE OF IFRS IMPAIR AUDITOR AND REGULATOR EFFORTS?***

# ***SEC REPORT***



***IF THE LEGAL OBSTACLES TO RECOGNIZING IFRS AS GENERALLY ACCEPTED UNDER US SECURITIES LAW CANNOT BE OVERCOME, THE SEC MAY NOT BE ABLE TO MANDATE THE USE OF IFRS AS ISSUED BY THE IASB WITHOUT SOME FORM OF NATIONAL INCORPORATION PROCESS.***

# ***PRIVATE GAAP***



- FAF FORMING A WORKING GROUP TO REVIEW THE ADEQUACY AND EFFECTIVENESS OF FASB EFFORTS IN SETTING STANDARDS FOR PRIVATE COMPANIES AND NOT FOR PROFITS***
- INTENT TO ISSUE AN ACTION PLAN IN 6 TO 8 MONTHS ON WHETHER OR HOW TO DEVISE RULES THAT DIFFER FORM THOSE OF PUBLIC COMPANIES***



## ***ETHICS EXPOSURE DRAFT***

## **PEEC PROPOSAL**



- ***FEBRUARY 2011 PROPOSAL (ED) - OMNIBUS PROPOSAL AICPA PROFESSIONAL ETHICS DIVISION INTERPRETATIONS AND RULINGS***
- ***PARTIALLY, TO REVISE INTERPRETATION #101-3 (PERFORMANCE OF NONATTEST SERVICES, UNDER RULE 101), INDEPENDENCE***
- ***COMMENT PERIOD ENDS MAY 31, 2011***
- ***NON-INDEPENDENT REVIEWS TABLED AT THIS TIME***

# **GUIDANCE**



***AMONG OTHER REVISIONS, THE PEEC ED WOULD CHANGE THE SECTION OF THE INTERPRETATION THAT LISTS GENERAL ACTIVITIES THAT IMPAIR A CPA'S INDEPENDENCE TO A LIST OF EXAMPLES OF ACTIVITIES THAT WOULD BE CONSIDERED MANAGEMENT'S RESPONSIBILITY AND, THEREFORE IMPAIR A CPA'S INDEPENDENCE WHEN PERFORMED FOR AN ATTEST CLIENT.***

# **CHANGE**

## **EXISTING**

***ESTABLISHING OR MAINTAINING INTERNAL CONTROLS, INCLUDING PERFORMING ONGOING MONITORING ACTIVITIES, FOR A CLIENT***



## **PROPOSED**

***ACCEPTING RESPONSIBILITY FOR DESIGNING, IMPLEMENTING, OR MAINTAINING INTERNAL CONTROLS FOR A CLIENT***

# **CHANGE**



**AS A RESULT OF THIS CHANGE, IF MANAGEMENT ACCEPTS RESPONSIBILITY FOR THE RESULTS OF THE ACCOUNTANT'S SERVICES, AND THE ACCOUNTANT MEETS THE OTHER GENERAL REQUIREMENTS OF INTERPRETATION 101-3, THE ACCOUNTANT'S INDEPENDENCE WOULD NOT BE IMPAIRED AND THE ACCOUNTANT WOULD NOT BE PRECLUDED FROM PERFORMING THE SERVICES THAT THE ARSC HAD PREVIOUSLY DEFINED AS INTERNAL CONTROL SERVICES.**



# **FASB STANDARDS**

**UPDATED**

## **FASB ASU UPDATES**

***2011-08 – TOPIC 715 – COMPENSATION:  
DISCLOSURES ABOUT AN EMPLOYER'S  
PARTICIPATION IN A MULTIEMPLOYER  
PLAN***

***2011-08 – TOPIC 350 – GOODWILL:  
TESTING FOR IMPAIRMENT***

## **FASB ASU UPDATES**

***2011-04 – TOPIC 820 – FAIR VALUE:  
AMENDMENTS TO ACHIEVE COMMON FAIR  
VALUE MEASUREMENT AND DISCLOSURE  
REQUIREMENTS IN US GAAP AND IFRS***

***2011-05 – TOPIC 220 – COMPREHENSIVE  
INCOME: PRESENTATION OF  
COMPREHENSIVE INCOME***

***2011-06 – TOPIC 720 – OTHER EXPENSES:  
FEES PAID TO THE FEDERAL GOVT BY  
HEALTH INSURERS***

***2011-07 – TOPIC 954 – HEALTH CARE  
ENTITIES: PRESENTATION AND  
DISCLOSURE REVENUE AND BAD DEBTS***

## **FASB ASU UPDATES**

***2011-03 – TOPIC 860 – TRANSFERS:  
RECONSIDERATION OF CONTROL***

***2011-02 – TOPIC 310 – RECEIVABLES:  
TROUBLED DEBT RESTRUCTURINGS***

***2011-01 – TOPIC 310 – RECEIVABLES:  
DEFERRAL OF ASU 2010-20***

***2010-29 – TOPIC 805 – BUSINESS  
COMBINATIONS: PRO FORMA INFO***

***2010-28 – TOPIC 350 – GOODWILL:  
IMPAIRMENT TESTING WITH NEGATIVE  
EQUITY***

## **FASB ASU UPDATES**

***2010-27 – TOPIC 720 – FEES PAID TO  
FEDERAL GOVT BY PHARMACEUTICAL MFG***

***2010-26 – TOPIC 944 – FINANCIAL SERVICES  
– INSURANCE: COSTS ASSOCIATED WITH  
INSURANCE CONTRACTS***

***2010-25 – TOPIC 962 – PLAN ACCOUNTING:  
REPORTING LOANS TO PARTICIPANTS***

***2010-24 – TOPIC 954 – HEALTH CARE  
ENTITIES: INSURANCE CLAIMS AND  
RECOVERIES***

# **FASB ASU UPDATES**

**2010-23 – TOPIC 954 – HEALTH CARE ENTITIES: MEASURING CHARITY CARE FOR DISCLOSURE**

**2010-22 – SEC UPDATE – TECHNICAL CORRECTIONS TO SEC PARAGRAPHS**

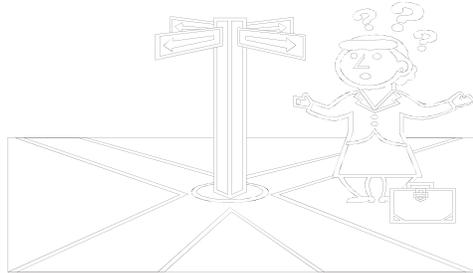
**2010-21 – SEC UPDATE – TECHNICAL AMENDMENTS TO RULES, CODIFICATION OF FINANCIAL REPORTING POLICIES**

**2010-20 – TOPIC 310 – RECEIVABLES – DISCLOSURE OF CREDIT QUALITY**

# **STANDARDS UPDATE**

- **SUBSEQUENT EVENTS**  
**ASU 2010-09 (FASB #165)**
- **PARTICIPANT LOANS**  
**ASU 2010-25**
- **GOODWILL IMPAIRMENT**  
**ASU 2010-28**  
**ASU 2011-08**
- **DEBT RESTRUCTURING**  
**ASU 2011-02**
- **FAIR VALUE**  
**ASU 2011-04**





***SUBSEQUENT EVENTS***  
***ASU 2010-09 (FASB #165)***

***SUBSEQUENT EVENTS***

***TOPIC 855***

***FASB #165 SHOULD NOT RESULT  
IN SIGNIFICANT CHANGES IN  
RECOGNITION OR DISCLOSURE  
OF SUBSEQUENT EVENTS***



# **SUBSEQUENT EVENTS**



***REQUIRES DISCLOSURE OF THE DATE THROUGH WHICH AN ENTITY HAS EVALUATED SUBSEQUENT EVENTS, AND THE BASIS FOR THAT DATE***

***SHOULD ALERT ALL USERS THAT AN ENTITY HAS NOT EVALUATED SUBSEQUENT EVENTS AFTER THAT DATE***

# **SUBSEQUENT EVENTS**



***PUBLIC ENTITIES SHALL EVALUATE SUBSEQUENT EVENTS THROUGH THE DATE THE FINANCIAL STATEMENTS ARE ISSUED***

***ALL OTHER ENTITIES SHALL EVALUATE SUBSEQUENT EVENTS THROUGH THE DATE THE FINANCIAL STATEMENTS ARE AVAILABLE TO BE ISSUED***

## **ISSUED**



***FINANCIAL STATEMENTS ARE  
CONSIDERED ISSUED WHEN THEY  
ARE WIDELY DISTRIBUTED TO  
SHAREHOLDERS AND OTHER  
FINANCIAL STATEMENT USERS FOR  
GENERAL USE AND RELIANCE, IN A  
FORM AND FORMAT THAT COMPLIES  
WITH GAAP***

## **AVAILABLE TO BE ISSUED**



***FINANCIAL STATEMENTS ARE  
CONSIDERED AVAILABLE TO  
BE ISSUED WHEN THEY ARE  
COMPLETE IN A FORM AND  
FORMAT THAT COMPLIES  
WITH GAAP, AND ALL  
NECESSARY APPROVALS  
HAVE BEEN OBTAINED***

# **RECOGNIZED**



***EVENTS OR TRANSACTIONS THAT PROVIDE ADDITIONAL EVIDENCE ABOUT CONDITIONS THAT EXISTED AT THE BALANCE SHEET DATE, INCLUDING ESTIMATES INHERENT IN THE PROCESS OF PREPARING FINANCIAL STATEMENTS***

# **EVENTS**



**AFTER THE BALANCE SHEET DATE BUT BEFORE THE STATEMENTS ARE ISSUED OR AVAILABLE TO BE ISSUED**

- LITIGATION SETTLEMENT AND/OR OFFERS TO SETTLE AT AMOUNT DIFFERENT FROM ESTIMATES AT THE BALANCE SHEET DATE**
- EVENTS AFFECTING THE REALIZATION OF ASSETS RECORDED AT THE BALANCE SHEET DATE, SUCH AS RECEIVABLES, INVENTORY, INVESTMENTS**

# **NOT RECOGNIZED**

***EVENTS THAT PROVIDE EVIDENCE ABOUT CONDITIONS THAT DID NOT EXIST AT THE BALANCE SHEET DATE, BUT AROSE AFTER THAT DATE***



# **EVENTS**



**AFTER THE BALANCE SHEET DATE BUT BEFORE THE STATEMENTS ARE ISSUED OR AVAILABLE TO BE ISSUED**

- SALE OF BONDS OR STOCK
- BUSINESS COMBINATION
- LITIGATION SETTLEMENT WHERE THE EVENT GIVING RISE TO THE LITIGATION TOOK PLACE AFTER THE BALANCE SHEET DATE
- FIRE OR NATURAL DISASTER
- ENTERING INTO SIGNIFICANT COMMITMENTS

# **DISCLOSURE**



***MANY SUBSEQUENT EVENTS NOT  
RECOGNIZED MUST BE DISCLOSED TO  
KEEP THE FINANCIAL STATEMENTS  
FROM BEING MISLEADING***

- EFFECT, OR A STATEMENT THAT  
DESCRIBES THE NATURE OF THE  
EVENT***
- AN ESTIMATE OF ITS FINANCIAL  
IMPACT OR A STATEMENT THAT SUCH  
AN ESTIMATE CANNOT BE MADE***



***PARTICIPANTS'  
LOANS  
ASU 2010-25***

# **LOANS**



- ***PARTICIPANT LOANS SHOULD BE CLASSIFIED AS NOTES RECEIVABLE FROM PARTICIPANTS IN THE FINANCIAL STATEMENTS OF A DEFINED CONTRIBUTION PLAN, MEASURED AT THE OUTSTANDING PRINCIPAL AMOUNT PLUS ACCRUED BUT UNPAID INTEREST***
- ***FV DISCLOSURE REQUIREMENTS IN 825-10-50-10 THROUGH 50-16 ARE NOT APPLICABLE FOR PARTICIPANT LOANS***

# **LOANS**



- ***PARTICIPANT LOANS ARE EXEMPT FROM CREDIT QUALITY DISCLOSURES REQUIRED BY TOPIC 310 UPDATE ASC 2010-10***
- ***A PLAN SHALL APPLY THE PROPOSED CLASSIFICATION GUIDANCE RETROSPECTIVELY TO ALL PRIOR PERIODS PRESENTED***
- ***GUIDANCE IS EFFECTIVE FOR FISCAL YEARS ENDING AFTER DECEMBER 15, 2010 WITH EARLY ADOPTION PERMITTED FOR 2009 STATEMENTS YET TO BE ISSUED***

# **DOL REQUIREMENTS**



→ **THE DOL HAS NOT ACCEPTED THIS CHANGE AND STILL TREATS PARTICIPANT LOANS AS INVESTMENTS**

→ **CERTAIN DOL REQUIRED DISCLOSURES AND SCHEDULES PRESENTED IN THE NOTES TO THE FINANCIAL STATEMENTS (AND THE TAX RETURN) NEED TO INCLUDE THE PARTICIPANT LOANS AS INVESTMENTS**



**GOODWILL  
IMPAIRMENT  
ASU 2010-28**

## **EXISTING GAAP**

### **IMPAIRMENT IS TESTED IN A TWO-STEP PROCESS**



- 1) ASSESS WHETHER THE CARRYING AMOUNT OF A REPORTING UNIT EXCEEDS ITS FAIR VALUE**
- 2) ADDITIONAL TEST TO DETERMINE WHETHER GOODWILL HAS BEEN IMPAIRED AND CALCULATE THE AMOUNT OF THE IMPAIRMENT**

## **REPORTING UNIT**

### **CARRYING AMOUNT OF REPORTING UNIT**



- ENTERPRISE PREMISE – ALL ASSETS LESS LIABILITIES OTHER THAN THOSE THAT ARE PART OF THE CAPITAL STRUCTURE (DEBT)**
- EQUITY PREMISE – ALL ASSETS LESS ALL LIABILITIES**

## **CHANGE**



***IF THE CARRYING AMOUNT OF A REPORTING UNIT (NET EQUITY) IS ZERO OR NEGATIVE, THE SECOND STEP OF THE IMPAIRMENT TEST SHALL BE PERFORMED TO MEASURE THE AMOUNT OF IMPAIRMENT LOSS, IF ANY, WHEN IT IS MORE LIKELY THAN NOT THAT A GOODWILL IMPAIRMENT EXISTS.***

## **CHANGE**



***IN CONSIDERING WHETHER IT IS MORE LIKELY THAN NOT THAT A GOODWILL IMPAIRMENT EXISTS, AN ENTITY SHALL EVALUATE WHETHER THERE ARE ADVERSE QUALITATIVE FACTORS, INCLUDING THE EXAMPLES PROVIDED IN PARAGRAPH 350-20-35-30(A) THROUGH (G).***

# **FACTORS**

## **CAUTION**

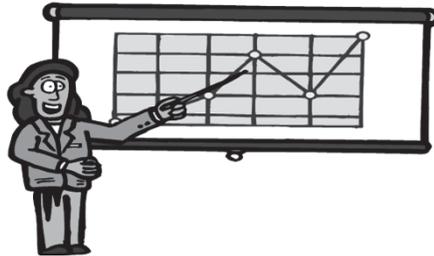
**SEE ASU 2011-08 ON  
GOODWILL IMPAIRMENT  
TESTING FOR QUALITATIVE  
FACTORS THAT WILL  
REPLACE THESE FACTORS**



# **FACTORS**



- a) **ADVERSE CHANGE IN LEGAL FACTORS OR BUSINESS CLIMATE**
- b) **ADVERSE ACTION OR ASSESSMENT BY A REGULATOR**
- c) **UNANTICIPATED COMPETITION**
- d) **LOSS OF KEY PERSONNEL**
- e) **A MORE-LIKELY-THAN-NOT EXPECTATION THAT A REPORTING UNIT WILL BE SOLD OR DISPOSED OF**
- f) **IMPAIRMENT OF A LONG-LIVED ASSET**
- g) **GOODWILL IMPAIRMENT OF A SUBSIDIARY**



# ***GOODWILL IMPAIRMENT ASU 2011-08***

## ***IMPAIRMENT TEST***



***ENTITIES TESTING GOODWILL FOR  
IMPAIRMENT HAVE THE OPTION OF  
PERFORMING A QUALITATIVE  
ASSESSMENT (STEP ZERO?) BEFORE  
CALCULATING THE FAIR VALUE OF  
THE REPORTING UNIT (I.E., STEP 1  
OF THE GOODWILL IMPAIRMENT  
TEST).***

## **IMPAIRMENT TEST**



***IF ENTITIES DETERMINE, ON THE BASIS OF QUALITATIVE FACTORS, THAT THE FAIR VALUE OF THE REPORTING UNIT IS MORE LIKELY THAN NOT GREATER THAN THE CARRYING AMOUNT, A QUANTITATIVE CALCULATION WOULD NOT BE NEEDED***

## **IMPAIRMENT TEST**



- THE QUALITATIVE ASSESSMENT IS OPTIONAL — ENTITIES MAY, AT THEIR DISCRETION, BYPASS IT FOR ANY REPORTING UNIT IN ANY PERIOD AND BEGIN THEIR IMPAIRMENT ANALYSIS WITH THE QUANTITATIVE CALCULATION IN STEP 1***
- ENTITY MAY RESUME PERFORMING THE QUALITATIVE ASSESSMENT IN ANY SUBSEQUENT PERIOD***

# **TESTING**



## **STEP ZERO?**

- **QUALITATIVE ANALYSIS TO DETERMINE WHETHER IT IS "MORE LIKELY THAN NOT" THE FAIR VALUE OF THE REPORTING UNIT IS LESS THAN ITS CARRYING AMOUNT, INCLUDING GOODWILL. IF SO, PROCEED TO STEP 1.**
- **IF THE DETERMINATION IS THAT BASED ON THE QUALITATIVE ANALYSIS THE FAIR VALUE OF THE REPORTING UNIT IS GREATER THAN THE CARRYING AMOUNT, NO FURTHER TESTING OF GOODWILL FOR IMPAIRMENT IS PERFORMED**

# **TESTING**



## **STEP 1**

- **DETERMINE WHETHER THE FAIR VALUE OF THE REPORTING UNIT IS LESS THAN ITS CARRYING AMOUNT, INCLUDING GOODWILL. IF SO, PROCEED TO STEP 2.**
- **IF THE FAIR VALUE OF THE REPORTING UNIT IS GREATER THAN THE CARRYING AMOUNT, FURTHER TESTING OF GOODWILL FOR IMPAIRMENT IS NOT PERFORMED**

# **TESTING**



## **STEP 2**

- ***DETERMINE THE IMPLIED VALUE OF THE GOODWILL OF THE REPORTING UNIT BY ASSIGNING THE FAIR VALUE OF THE REPORTING UNIT USED IN STEP 1 TO ALL THE ASSETS AND LIABILITIES OF THAT REPORTING UNIT (INCLUDING ANY UNRECOGNIZED INTANGIBLE ASSETS) AS IF THE REPORTING UNIT HAD BEEN ACQUIRED IN A BUSINESS COMBINATION***
- ***COMPARE THE IMPLIED FAIR VALUE OF GOODWILL WITH THE CARRYING AMOUNT OF GOODWILL TO DETERMINE WHETHER GOODWILL IS IMPAIRED***

# **FACTORS**



***AMENDS THE EXAMPLES OF QUALITATIVE FACTORS FOR INTERIM TESTING AND ANNUAL TESTING FOR ENTITIES WITH ZERO OR NEGATIVE EQUITY TO THOSE FACTORS NOW CONSIDERED IN THE QUALITATIVE ASSESSMENT (STEP ZERO)***

***THE QUALITATIVE FACTORS ARE NOT MEANT TO BE ALL INCLUSIVE OR STAND ALONE FACTORS***

# **FACTORS**



## **MACROECONOMIC CONDITIONS**

- ***DETERIORATION OF GENERAL ECONOMIC CONDITIONS***
- ***LIMITATIONS ON ACCESSING CAPITAL***
- ***FLUCTUATIONS IN FOREIGN EXCHANGE RATES***
- ***OTHER DEVELOPMENTS IN CREDIT OR EQUITY MARKETS***

# **FACTORS**



## **INDUSTRY CONSIDERATIONS**

- ***DETERIORATION IN THE ENVIRONMENT IN WHICH THE ENTITY OPERATES***
- ***INCREASED COMPETITION***
- ***DECLINE IN MARKET DEPENDENT MULTIPLES OR METRICS***
- ***CHANGE IN THE MARKET OR DEMAND FOR THE ENTITY'S PRODUCTS OR SERVICES***
- ***REGULATORY OR POLITICAL DEVELOPMENTS***

# **FACTORS**



## **INCREASED COST FACTORS**

- MATERIAL PRICES
- LABOR COSTS
- OTHER COSTS THAT HAVE A NEGATIVE EFFECT ON EARNINGS AND CASH FLOWS

# **FACTORS**



## **OVERALL FINANCIAL PERFORMANCE**

- NEGATIVE OR DECLINING CASH FLOWS
- ACTUAL DECLINE IN REVENUES OR PROFITS

# **FACTORS**



## **ENTITY SPECIFIC EVENTS**

- **MANAGEMENT CHANGES**
- **LOSS OF KEY PERSONNEL**
- **CHANGES IN STRATEGIES**
- **MAJOR CUSTOMER SHIFTS OR LOSS**
- **BANKRUPTCY**
- **LITIGATION**

# **FACTORS**



## **EVENTS AFFECTING A REPORTING UNIT**

- **CHANGE IN COMPOSITION OF ASSETS**
- **CARRYING VALUE OF ASSETS**
- **DISPOSAL OF A REPORTING UNIT**
- **ASSET RECOVERY TESTS**
- **ASSET IMPAIRMENT OF A UNIT**

# **FACTORS**



***A SUSTAINED DECREASE IN SHARE PRICE BOTH ABSOLUTELY AND IN RELATION TO PEERS***

# **CONSIDER**



- ***SIGNIFICANCE AND ADVERSITY OF EACH FACTOR TO FAIR VALUE OF REPORTING UNIT***
- ***POSITIVE FACTORS AND MITIGATING CIRCUMSTANCES THAT MAY AFFECT THE ANALYSIS***
- ***EXISTENCE OF POSITIVE AND MITIGATING EVENTS AND CIRCUMSTANCES SHOULD NOT BE REBUTTABLE PRESUMPTION NOT TO PERFORM STEP ONE TEST***
- ***RECENT FV CALCULATIONS***
- ***FACTORS IN THEIR TOTALITY – NO ONE FACTOR IS MEANT TO BE A DETERMINATIVE EVENT***

# **CARRYFORWARD**



- ***CURRENTLY, UNDER ASC 350-20-25-29, AN ENTITY'S DETAILED CALCULATION OF THE FAIR VALUE OF THE REPORTING UNIT MAY BE CARRIED FORWARD FROM ONE YEAR TO THE NEXT IF CERTAIN CONDITIONS ARE MET***
- ***THE ASU DELETES THE CARRYFORWARD GUIDANCE IN ASC 350-20. THEREFORE, ENTITIES CURRENTLY USING THIS OPTION WOULD NEED TO ASSESS WHETHER TO PERFORM THE QUALITATIVE ASSESSMENT OR MOVE STRAIGHT TO THE QUANTITATIVE STEP 1 CALCULATION.***

# **SCOPE**



- ***WOULD APPLY TO ALL ENTITIES, BOTH PUBLIC AND PRIVATE, THAT HAVE GOODWILL RECORDED IN THEIR FINANCIAL STATEMENTS***
- ***WOULD NOT AMEND THE ANNUAL TESTING REQUIREMENTS FOR OTHER INDEFINITE-LIVED INTANGIBLE ASSETS (TRADE NAMES, FRANCHISES, ETC)***
- ***NEW PROJECT TO TEST INDEFINITE-LIVED INTANGIBLE ASSETS***
- ***PICPA A&A COMMITTEE SENT FASB A LETTER RECOMMENDING TO EXTEND THE QUALITATIVE ANALYSIS TO OTHER INDEFINITE-LIVED INTANGIBLES***

# **EFFECTIVE DATE**



- **THE AMENDMENTS WOULD BE EFFECTIVE FOR ANNUAL AND INTERIM GOODWILL IMPAIRMENT TESTS PERFORMED IN FISCAL YEARS BEGINNING AFTER DECEMBER 15, 2011**
- **EARLY ADOPTION WOULD BE PERMITTED**



# **TROUBLED RESTRUCTURINGS ASU 2011-02**

# **RESTRUCTURINGS**



- **CLARIFICATION WHEN A LOAN MODIFICATION OR RESTRUCTURING IS CONSIDERED A TROUBLED DEBT RESTRUCTURING (TDR)**
- **EFFECTIVE FOR INTERIM AND ANNUAL PERIODS ENDING ON OR AFTER JUNE 15, 2011**
- **RETROSPECTIVE APPLICATION TO MODIFICATIONS OCCURRING ON OR AFTER THE EARLIEST PERIOD PRESENTED**

# **MODIFICATIONS**

## **DETERMINATION**



- **IS THE DEBTOR EXPERIENCING FINANCIAL DIFFICULTY?**
- **HAS THE LENDER GRANTED A CONCESSION TO THE BORROWER?**

# **TDR**



- **A TDR IS DEFINED AS A RESTRUCTURING OF DEBT IN WHICH THE LENDER, "FOR ECONOMIC OR LEGAL REASONS RELATED TO THE BORROWER'S FINANCIAL DIFFICULTIES GRANTS A CONCESSION THAT IT WOULD NOT OTHERWISE CONSIDER"**
- **PROPOSED ASU CLARIFIES THAT A BORROWER COULD BE EXPERIENCING FINANCIAL DIFFICULTY EVEN IF IT IS NOT CURRENTLY IN DEFAULT BUT DEFAULT IS "PROBABLE IN THE FORESEEABLE FUTURE"**



# **FINANCIAL DIFFICULTY**

- **EXISTING GAAP - CURRENTLY IN DEFAULT ON ANY OF ITS DEBT – INSIGNIFICANT DELAYS IGNORED**
- **PROPOSED ASU - NOT CURRENTLY IN DEFAULT, BUT DEFAULT IS "PROBABLE IN THE FORESEEABLE FUTURE" – INSIGNIFICANT DELAYS NOT IGNORED**
- **EXAMPLE - INTEREST ONLY LOAN THAT BECOMES AMORTIZING IN THE NEAR FUTURE**



## **CONCESSION**



- **LENDER IS PRECLUDED FROM PERFORMING EFFECTIVE RATE TEST**
- **BORROWER'S INABILITY TO ACCESS FUNDS AT A MARKET RATE FOR THE NEW LOAN**
- **PERMANENT OR TEMPORARY INCREASES TO RATES CAN STILL BE A TDR IF THE RATE IS STILL BELOW MARKET**
- **INSIGNIFICANT DELAY IN PAYMENT**

## **DEBTORS**



- **DESCRIPTION OF PRINCIPAL CHANGES AND FEATURES OF THE SETTLEMENT**
- **AGGREGATE GAIN ON RESTRUCTURING, NET OF TAX EFFECT (EPS AFTER TAX)**
- **GAIN OR LOSS ON ASSETS TRANSFERRED TO SETTLE DEBTS**
- **FOR SUBSEQUENT PERIODS:**
  - **AMOUNTS CONTINGENTLY PAYABLE**
  - **CONDITIONS UNDER WHICH THE CONTINGENT AMOUNTS WOULD BECOME DUE OR FORGIVEN**

# **CREDITORS**



- **AGGREGATE AMOUNT OF THE INVESTMENT**
- **GROSS AMOUNT OF INTEREST INCOME THAT WOULD HAVE BEEN RECORDED IN EACH PERIOD IF THE RECEIVABLES HAD BEEN CURRENT WITH THEIR ORIGINAL TERMS**
- **AMOUNT OF INTEREST INCOME ON THE RELATED RECEIVABLES INCLUDED IN NET INCOME**
- **AMOUNT OF ANY ADDITIONAL FUNDS COMMITTED TO DEBTORS OWNING RESTRUCTURED RECEIVABLES**



***FAIR VALUE***  
***ASU 2011-04***

# **TOPIC 820**

## **FAIR VALUE**

***"THE PRICE THAT WOULD BE RECEIVED TO SELL AN ASSET OR PAID TO TRANSFER A LIABILITY IN AN ORDERLY TRANSACTION BETWEEN MARKET PARTICIPANTS AT THE MEASUREMENT DATE"***



## **FAIR VALUE**



- EXCHANGE PRICE OF ASSET IS BASED ON ITS PRINCIPAL OR MOST ADVANTAGEOUS MARKET***
- MARKET-BASED NOT ENTITY-SPECIFIC***
- FAIR VALUE OF A LIABILITY REFLECTS ITS NON-PERFORMANCE RISK***

# **INPUTS**



## **LEVEL 1**

- **INPUTS TO VALUE ARE "QUOTED PRICES IN ACTIVE MARKETS FOR IDENTICAL ASSETS AND LIABILITIES"**
- **MUST HAVE ACCESS TO THE MARKET**
- **DIRECT OBSERVATIONS**
- **UNCOMMON FOR PHYSICAL ASSETS**

# **INPUTS**



## **LEVEL 2**

- **LESS ACTIVE MARKETS FOR IDENTICAL ASSETS AND LIABILITIES**
- **ASSETS THAT ARE SIMILAR TO, BUT NOT THE SAME AS, THOSE TRADED**
- **NO ACTIVE MARKET EXISTS, BUT SOME OBSERVABLE MARKET DATA IS AVAILABLE**

# **INPUTS**



## **LEVEL 3**

- ***UNOBSERVABLE INPUTS ARE NOT BASED ON INDEPENDENT SOURCES BUT ON THE "REPORTING ENTITY'S OWN ASSUMPTIONS OF WHAT MARKET PARTICIPANTS WOULD USE"***
- ***BEST INFORMATION AVAILABLE IN THE CIRCUMSTANCES***
- ***LITTLE , IF ANY, MARKET ACTIVITY EXISTS***

# **CONVERGENCE**



- ***THE BOARDS WORKED TOGETHER TO ENSURE THAT FAIR VALUE HAS THE SAME MEANING IN U.S. GAAP AND IN IFRS AND THAT THEIR RESPECTIVE FAIR VALUE MEASUREMENT AND DISCLOSURE REQUIREMENTS ARE THE SAME (EXCEPT FOR MINOR DIFFERENCES IN WORDING AND STYLE)***
- ***THE BOARDS CONCLUDED THAT THE AMENDMENTS IN THIS UPDATE WILL IMPROVE THE COMPARABILITY OF FAIR VALUE MEASUREMENTS PRESENTED AND DISCLOSED IN FINANCIAL STATEMENTS PREPARED IN ACCORDANCE WITH U.S. GAAP AND IFRS***

# **TRANSITION**



- ***THE AMENDMENTS IN THIS UPDATE ARE TO BE APPLIED PROSPECTIVELY***
- ***FOR PUBLIC ENTITIES, THE AMENDMENTS ARE EFFECTIVE DURING INTERIM AND ANNUAL PERIODS BEGINNING AFTER DECEMBER 15, 2011***
- ***FOR NONPUBLIC ENTITIES, THE AMENDMENTS ARE EFFECTIVE FOR ANNUAL PERIODS BEGINNING AFTER DECEMBER 15, 2011***
- ***EARLY APPLICATION BY PUBLIC ENTITIES IS NOT PERMITTED***
- ***NONPUBLIC ENTITIES MAY APPLY THE AMENDMENTS IN THIS UPDATE EARLY, BUT NO EARLIER THAN FOR INTERIM PERIODS BEGINNING AFTER DECEMBER 15, 2011***

# **GUIDANCE**



***THE REQUIREMENTS DO NOT EXTEND THE USE OF FAIR VALUE MEASUREMENT. INSTEAD, THE BOARDS INTENDED TO IMPROVE GUIDANCE ON HOW FAIR VALUE MEASUREMENT SHOULD BE APPLIED IN SITUATIONS WHERE FAIR VALUE MEASUREMENTS ARE ALREADY REQUIRED OR PERMITTED***

# **CLARIFICATIONS**



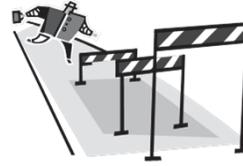
- **THE CONCEPT OF HIGHEST AND BEST USE APPLIES ONLY TO NON-FINANCIAL ASSETS**
- **THE FAIR VALUE OF AN ENTITY'S EQUITY INTEREST SHOULD BE MEASURED FROM THE PERSPECTIVE OF A MARKET PARTICIPANT WHO HOLDS THAT EQUITY INSTRUMENT AS AN ASSET**
- **REPORTING ENTITIES SHOULD DISCLOSE QUANTITATIVE INFORMATION ABOUT UNOBSERVABLE INPUTS CATEGORIZED AS LEVEL 3 INPUTS**

# **CHANGES**



- **FINANCIAL INSTRUMENT PORTFOLIOS**
  - RISK MANAGEMENT
  - GROSS VS NET BASIS
- **APPLICATION OF PREMIUMS AND DISCOUNTS**
  - ABSENCE OF LEVEL 1 INPUT
  - APPLY IF A MARKET PARTICIPANT WOULD

# **DISCLOSURES**



## **LEVEL 3 VALUE MEASUREMENTS**

- *THE VALUATION PROCESS USED BY THE REPORTING ENTITY*
- *THE SENSITIVITY OF FAIR VALUE MEASUREMENTS TO CHANGES IN UNOBSERVABLE INPUTS*
- *THE INTERRELATIONSHIPS BETWEEN OBSERVABLE INPUTS, IF ANY*

# **DISCLOSURES**



- *WHETHER THE USE OF A NON-FINANCIAL ASSET DIFFERS FROM THE HIGHEST AND BEST USE ASSUMED IN THE FAIR VALUE MEASUREMENT OR DISCLOSURE OF THAT ASSET*
- *THE FAIR VALUE HIERARCHY LEVEL APPLICABLE TO BALANCE SHEET ITEMS DISCLOSED, BUT NOT MEASURED AT FAIR VALUE*

# **PRIVATE ENTITIES**



## **DISCLOSURES NOT REQUIRED**

- 1) *TRANSFERS BETWEEN LEVEL 1 AND LEVEL 2 MEASUREMENTS*
- 2) *THE SENSITIVITY OF LEVEL 3 MEASUREMENTS TO CHANGES IN UNOBSERVABLE INPUTS*
- 3) *INTERRELATIONSHIPS BETWEEN UNOBSERVABLE LEVEL 3 INPUTS*
- 4) *FAIR VALUE HIERARCHY LEVEL APPLICABLE TO BALANCE SHEET ITEMS DISCLOSED, BUT NOT MEASURED AT FAIR VALUE*



# ***PROPOSED STANDARDS***

# **PROPOSED ASUs**



- **REVENUE RECOGNITION**
- **LEASES**
- **CONTINGENCIES**



# **REVENUE RECOGNITION**

## **OBJECTIVES**



- REMOVE INCONSISTENCIES AND WEAKNESSES IN EXISTING STANDARDS
- PROVIDE A STRONGER AND MORE STREAMLINED FRAMEWORK FOR ADDRESSING REVENUE RECOGNITION ISSUES
- IMPROVE THE COMPARABILITY ACROSS ENTITIES, JURISDICTIONS AND CAPITAL MARKETS
- SIMPLIFY FINANCIAL STATEMENT PREPARATION BY REDUCING THE NUMBER OF REQUIREMENTS

## **CORE PRINCIPLE**



**AN ENTITY SHALL RECOGNIZE REVENUE TO DEPICT THE TRANSFER OF GOODS OR SERVICES TO CUSTOMERS IN AN AMOUNT THAT REFLECTS THE CONSIDERATION THE ENTITY RECEIVES, OR EXPECTS TO RECEIVE, IN EXCHANGE FOR THOSE GOODS OR SERVICES**

# **APPLICATION**



- **IDENTIFY CONTRACTS WITH A CUSTOMER**
- **IDENTIFY THE SEPARATE PERFORMANCE OBLIGATIONS IN THE CONTRACT**
- **DETERMINE THE TRANSACTION PRICE**
- **ALLOCATE THE TRANSACTION PRICE TO THE SEPARATE PERFORMANCE OBLIGATIONS**
- **RECOGNIZE REVENUE WHEN THE ENTITY SATISFIES EACH PERFORMANCE OBLIGATION**

# **EXCEPTIONS**



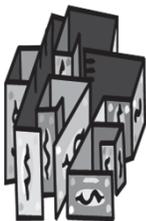
- **LEASE CONTRACTS**
- **INSURANCE CONTRACTS**
- **CERTAIN CONTRACTUAL RIGHTS OR OBLIGATIONS**
- **GUARANTEES**
- **NON-MONETARY EXCHANGES BETWEEN ENTITIES IN THE SAME LINE OF BUSINESS TO FACILITATE SALES TO CUSTOMERS**

# **THE CONTRACT**



- *NEITHER PARTY COULD TERMINATE A WHOLLY UNPERFORMED CONTRACT WITHOUT PENALTY*
- *CONTRACT HAS COMMERCIAL SUBSTANCE*
- *THE PARTIES HAVE APPROVED THE CONTRACT AND ARE COMMITTED TO SATISFYING THEIR RESPECTIVE OBLIGATIONS*
- *EACH PARTY'S ENFORCEABLE RIGHTS IN RESPECT OF THE GOODS OR SERVICES TO BE TRANSFERRED CAN BE IDENTIFIED*
- *THE TERMS AND MANNER OF PAYMENT CAN BE IDENTIFIED*

# **THE CONTRACT**



*TWO OR MORE CONTRACTS WOULD HAVE TO BE COMBINED AND ACCOUNTED FOR AS A SINGLE CONTRACT IF THE AMOUNT OF CONSIDERATION IN ONE CONTRACT IS DEPENDENT ON THE AMOUNT IN ANOTHER CONTRACT*

# **THE CONTRACT**



## **CONTRACT INTERDEPENDENCE**

- **CONTRACTS ARE ENTERED INTO AT OR NEAR THE SAME TIME**
- **CONTRACTS ARE NEGOTIATED AS A PACKAGE WITH A SINGLE COMMERCIAL OBJECTIVE**
- **PERFORMANCE OF THE CONTRACTS IS ACCOMPLISHED EITHER CONCURRENTLY OR CONSECUTIVELY**

# **THE CONTRACT**



**CONVERSELY, A SINGLE CONTRACT WOULD HAVE TO BE SEGMENTED AND ACCOUNTED FOR AS TWO OR MORE SEPARATE CONTRACTS IF THE PRICE OF SOME GOODS OR SERVICES IN THE CONTRACT IS INDEPENDENT OF THE PRICE OF OTHER GOODS OR SERVICES IN THE SAME CONTRACT**

# **THE CONTRACT**



## **INDEPENDENT PRICING**

- ***THE ENTITY (OR ANOTHER ENTITY) REGULARLY SELLS IDENTICAL OR SIMILAR GOODS OR SERVICES SEPARATELY***
- ***THE CUSTOMER DOES NOT RECEIVE A SIGNIFICANT DISCOUNT FOR BUYING SOME GOODS OR SERVICES TOGETHER WITH OTHER GOODS OR SERVICES IN THE CONTRACT***

# **THE CONTRACT**



***A CONTRACT MODIFICATION WOULD BE ACCOUNTED FOR TOGETHER WITH THE EXISTING CONTRACT ITSELF IF THE PRICES OF THE MODIFICATION AND THE EXISTING CONTRACT ARE INTERDEPENDENT (I.E., THE CUMULATIVE EFFECT OF THE CONTRACT MODIFICATION WOULD BE RECOGNIZED IN THE PERIOD THE CONTRACT MODIFICATION OCCURS).***

# **OBLIGATIONS**



**IF AN ENTITY PROMISES TO TRANSFER MORE THAN ONE DISTINCT GOOD OR SERVICE, EACH PROMISE TO TRANSFER WOULD BE ACCOUNTED FOR AS A SEPARATE OBLIGATION**

## **DISTINCT GOOD OR SERVICE**

- ENTITY SELLS AN IDENTICAL GOOD OR SERVICE
- HAS A DISTINCT FUNCTION AND A DISTINCT PROFIT MARGIN

# **PERFORMANCE**



## **REVENUE WOULD BE RECOGNIZED WHEN**

- AN IDENTIFIED PERFORMANCE OBLIGATION IS SATISFIED - PROMISED GOODS OR SERVICES ARE TRANSFERRED TO A CUSTOMER, AND
- WHEN THE CUSTOMER OBTAINS CONTROL OF SUCH GOODS OR SERVICES

# **CONTROL**



- ***CUSTOMER HAS THE ABILITY TO DIRECT THE USE OF AND RECEIVE BENEFIT FROM THE GOODS OR SERVICES***
- ***ABILITY TO PREVENT OTHER ENTITIES FROM DIRECTING THE USE OF AND RECEIVING THE BENEFITS FROM THE GOODS OR SERVICES***
- ***CUSTOMER'S PRESENT RIGHT TO USE THE ASSET FOR ITS REMAINING ECONOMIC LIFE OR TO CONSUME IT IN THE CUSTOMER'S ACTIVITIES***
- ***OBTAIN THE CASH FLOWS FROM THE ASSET***

# **CONTROL**



- ***CUSTOMER'S UNCONDITIONAL OBLIGATION TO PAY***
- ***CUSTOMER HAS LEGAL TITLE TO THE GOODS OR SERVICES***
- ***THE CUSTOMER HOLDS PHYSICAL POSSESSION OF THE GOODS***
- ***THE DESIGN OR FUNCTION OF THE GOODS OR SERVICES IS CUSTOMER-SPECIFIC***

# **CONTINUOUS** **TRANSFER**



***WHEN THE PROMISED GOODS OR SERVICES UNDERLYING A SEPARATE PERFORMANCE OBLIGATION ARE TRANSFERRED CONTINUOUSLY TO A CUSTOMER, TRANSFER IS DEPICTED BY ONE OF THE FOLLOWING METHODS:***

# **CONTINUOUS** **TRANSFER**



## **OUTPUT METHOD**

- UNITS PRODUCED OR DELIVERED***
- CONTRACT MILESTONES***
- GOODS OR SERVICES TRANSFERRED TO DATE RELATIVE TO TOTAL GOODS OR SERVICES TO BE TRANSFERRED***

***IS INFORMATION AVAILABLE FOR CONSTRUCTION CONTRACTS??***

# **CONTINUOUS** **TRANSFER**

## **INPUT METHOD**

***EFFORTS EXPENDED TO DATE  
RELATIVE TO TOTAL EFFORTS  
INTENDED TO BE EXPENDED***

- COSTS OF REVENUES CONSUMED***
- LABOR HOURS WORKED***
- MACHINE HOURS USED***



# **CONTINUOUS** **TRANSFER**

## ***PASSAGE OF TIME –***

***E.G., ON A STRAIGHT LINE BASIS  
OVER THE EXPECTED DURATION  
OF THE CONTRACT IF SERVICES  
ARE TRANSFERRED EVENLY OVER  
TIME – UNLIKELY FOR  
CONSTRUCTION CONTRACTS***



# **PRICE**



***WHEN A PERFORMANCE OBLIGATION IS SATISFIED, REVENUE WOULD BE RECOGNIZED IN THE AMOUNT OF THE TRANSACTION PRICE ALLOCATED TO THAT SPECIFIC PERFORMANCE OBLIGATION***

***TRANSACTION PRICE WOULD REFLECT THE PROBABILITY-WEIGHTED AMOUNT OF CONSIDERATION EXPECTED TO BE RECEIVED FROM THE CUSTOMER IN EXCHANGE FOR TRANSFERRING GOODS OR SERVICES***

# **PRICE**



***A REASONABLY ESTIMATED TRANSACTION PRICE WOULD REQUIRE THE FOLLOWING CONDITIONS TO BE PRESENT:***

- THE ENTITY HAS EXPERIENCE WITH SIMILAR TYPES OF CONTRACTS (OR ACCESS TO THE EXPERIENCE OF OTHER ENTITIES)***
- THE ENTITY DOES NOT EXPECT THERE TO BE SIGNIFICANT CHANGES IN CIRCUMSTANCES FROM PREVIOUS EXPERIENCE***

# **PRICE**



***IF ONLY A PORTION OF THE CONSIDERATION CAN BE REASONABLY ESTIMATED (E.G., THE FIXED AMOUNT), THE TRANSACTION PRICE WOULD INCLUDE ONLY SUCH AMOUNT***

***IF SOME OR ALL OF THE CONSIDERATION RECEIVED IS EXPECTED TO BE REFUNDED TO THE CUSTOMER, A REFUND LIABILITY WOULD HAVE TO BE ESTABLISHED***

# **REFUND LIABILITY**



- UPDATED EACH REPORTING PERIOD***
- MEASURED AT THE PROBABILITY-WEIGHTED AMOUNT OF CONSIDERATION EXPECTED TO BE REFUNDED***
- INCLUDES DISCOUNTS AND REBATES, CREDITS, REFUNDS, INCENTIVES***
- MOST LIKELY A REDUCTION OF THE TRANSACTION PRICE AS OPPOSED TO AN EXPENSE***

# **PRICE**



***IN DETERMINING THE TRANSACTION PRICE CONSIDERATION WOULD HAVE TO BE GIVEN TO THE FOLLOWING:***

- COLLECTIBILITY***
- TIME VALUE OF MONEY***
- NON-CASH CONSIDERATION***
- CONSIDERATION PAYABLE TO THE CUSTOMER***

# **COLLECTIBILITY**



- CUSTOMER'S CREDIT RISK***
- AMOUNT OF PROMISED CONSIDERATION WOULD BE REDUCED TO REFLECT THE CUSTOMER'S ABILITY TO PAY***
- SUBSEQUENT CHANGES IN THE CUSTOMER'S CREDIT RISK WOULD BE RECOGNIZED AS OTHER INCOME OR EXPENSE RATHER THAN AS AN ADJUSTMENT TO REVENUE***

# **TIME VALUE**



- **IF SIGNIFICANT, THE TIME VALUE OF MONEY WOULD BE REFLECTED BY DISCOUNTING THE AMOUNT OF PROMISED CONSIDERATION**
- **DISCOUNT RATE WOULD BE A RATE USED IN A SEPARATE FINANCING TRANSACTION**
- **SINCE DISCOUNT RATE TAKES INTO CONSIDERATION THE CUSTOMER'S CREDIT RISK, THE AMOUNT OF PROMISED CONSIDERATION WOULD NOT ALSO BE ADJUSTED**

# **NON-CASH**



**NON-CASH CONSIDERATION RECEIVED WOULD BE MEASURED AT FAIR VALUE IF FV CAN BE REASONABLY ESTIMATED**

**IF FV CANNOT BE REASONABLY ESTIMATED – THE NON-CASH TRANSACTION WOULD BE MEASURED INDIRECTLY BY REFERENCE TO THE STANDALONE SELLING PRICE OF THE GOODS OR SERVICES TRANSFERRED**

## **PAYABLE TO CUSTOMER**



- **CASH OR CREDIT THAT CAN BE APPLIED AGAINST AMOUNTS OWNED BY THE CUSTOMER**
- **IF SUCH CONSIDERATION IS DEEMED TO BE A REDUCTION OF THE TRANSACTION PRICE – RECOGNIZED AS A REDUCTION OF REVENUE UPON THE LATER OF:**
  - **TRANSFER OF THE GOODS OR SERVICES**
  - **ENTITY PROMISES TO PAY THE CONSIDERATION TO THE CUSTOMER**

## **ALLOCATION**



- **THE TRANSACTION PRICE WOULD HAVE TO BE ALLOCATED TO ALL SEPARATE PERFORMANCE OBLIGATIONS ON A RELATIVE BASIS IN PROPORTION TO THE STANDALONE PRICE OF THE GOODS OR SERVICES AT THE CONTRACT INCEPTION**
- **BEST EVIDENCE OF A STANDALONE SELLING PRICE WOULD BE THE OBSERVABLE PRICE OF GOODS OR SERVICES SOLD SEPARATELY BY THE ENTITY**

# **ALLOCATION**



***IF A STAND ALONE SELLING PRICE IS NOT OBSERVABLE (I.E., A CONTRACTUALLY STATED PRICE CAN NOT BE PRESUMED TO REPRESENT STANDALONE PRICE) IT WOULD HAVE TO BE ESTIMATED***

# **PRICE ESTIMATION**



***EXPECTED COST PLUS MARGIN APPROACH - INVOLVES FORECASTING COSTS OF SATISFYING A PERFORMANCE OBLIGATION AND THEN ADDING TO SUCH COSTS THE MARGIN THE ENTITY WOULD REQUIRE FOR THE SPECIFIC GOODS OR SERVICES***

# **PRICE ESTIMATION**

## **ADJUSTED MARKET ASSESSMENT APPROACH –**



- **EVALUATION OF THE MARKET IN WHICH THE ENTITY SELLS THE GOODS OR SERVICES FOR PRICES OF A WILLING BUYER**
- **REFERENCE TO PRICES FROM COMPETITORS FOR SIMILAR GOODS, ADJUSTING THE PRICES FOR THE ENTITY'S COSTS AND MARGINS**

# **PRICE**



- **SUBSEQUENT CHANGES TO THE TRANSACTION PRICE WOULD BE ALLOCATED TO ALL PERFORMANCE OBLIGATIONS ON THE SAME BASIS THAT ALLOCATION WAS MADE AT CONTRACT INCEPTION**
- **ANY CHANGES ALLOCATED TO AN OBLIGATION ALREADY SATISFIED WOULD BE RECOGNIZED AS REVENUE (OR A REDUCTION OF REVENUE) IN THEN PERIOD OF THE CHANGE**

# **LOSS OBLIGATIONS**

***IF A PERFORMANCE OBLIGATION IS DEEMED TO BE ONEROUS, A LIABILITY AND EXPENSE WOULD BE ESTABLISHED***



***AN ONEROUS PERFORMANCE OBLIGATION IS WHEN THE PRESENT VALUE OF THE PROBABILITY-WEIGHTED COSTS TO SATISFY THE OBLIGATION EXCEEDS THE AMOUNT OF THE ALLOCATED TRANSACTION PRICE***

# **LOSS OBLIGATIONS**

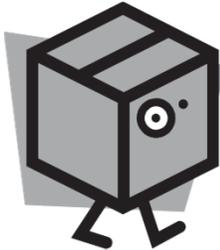


- NEED TO RECOGNIZE ANY IMPAIRMENT LOSS ON THE CONTRACT'S RELATED ASSET – (I.E., INVENTORY, PROPERTY AND EQUIPMENT, OR SOFTWARE)***
- OBLIGATION NEEDS TO BE REMEASURED AT EACH SUBSEQUENT REPORTING DATE AND RECOGNIZED AS AN EXPENSE OR REDUCTION TO AN EXPENSE***

# **CONTRACT COSTS**

## **CAPITALIZATION**

***COSTS GIVE RISE TO AN ASSET  
ELIGIBLE FOR RECOGNITION***



- INVENTORY***
- PROPERTY AND EQUIPMENT***
- SOFTWARE***

# **CONTRACT COSTS**

## **OTHER CONDITIONS FOR RECOGNIZING AN ASSET**



- COSTS DIRECTLY RELATE TO A  
CONTRACT***
- COSTS GENERATE OR ENHANCE  
RESOURCES OF THE ENTITY THAT  
WILL BE USED IN SATISFYING  
PERFORMANCE OBLIGATIONS***
- COSTS ARE RECOVERABLE***

# **CONTRACT COSTS**



## **DIRECT CONTRACT COSTS**

- *DIRECT LABOR*
- *DIRECT MATERIALS*
- *ALLOCATED COSTS (CONTRACT MANAGEMENT)*
- *COSTS EXPLICITLY CHARGEABLE TO THE CUSTOMER UNDER THE TERMS OF THE CONTRACT*
- *OTHER COSTS INCURRED SOLELY BECAUSE THE ENTITY ENTERED INTO THE CONTRACT*

# **ASSETS**



- *ASSETS WOULD BE CLASSIFIED ACCORDING TO THEIR NATURE OR FUNCTION*
- *ASSETS WOULD HAVE TO BE AMORTIZED ON A SYSTEMATIC BASIS CONSISTENT WITH THE PATTERN OF TRANSFER OF THE GOODS OR SERVICES*
- *IMPAIRMENT LOSS RECOGNIZED WHEN CARRYING VALUE IS GREATER THAN THE TRANSACTION PRICE ALLOCATED TO THE REMAINING PERFORMANCE OBLIGATIONS*

# **CURRENT EXPENSE**

- *COSTS OF OBTAINING A CONTRACT – INCLUDING BID AND PROPOSAL COSTS*
- *COSTS RELATING TO ALREADY SATISFIED PERFORMANCE OBLIGATIONS*
- *COSTS OF AN ABNORMAL AMOUNT OF WASTED MATERIALS, LABOR OR OTHER RESOURCES USED TO FULFILL THE CONTRACT*
- *COSTS THAT ARE INDISTINGUISHABLE REGARDING WHETHER THEY RELATE TO FUTURE OR PAST PERFORMANCE*

DON'T  
EVEN  
THINK OF  
PARKING  
HERE



# **LEASE ACCOUNTING**

## **CORE PRINCIPLES**



- **ELIMINATE THE OPERATING LEASE**
- **LESSEES - RECOGNITION OF AN ASSET AND LIABILITY**
- **LESSORS - ACCOUNT FOR LEASE ARRANGEMENTS ON THE BASIS OF WHETHER THE LESSOR RETAINS SIGNIFICANT RISKS OR BENEFITS ASSOCIATED WITH THE UNDERLYING ASSET**
- **EXPANDED DISCLOSURES**

## **EXCEPTIONS**



### **LEASES FOR:**

- **INTANGIBLE ASSETS**
- **TO EXPLORE FOR THE USE OF OIL, MINERALS, NATURAL GAS, ETC**
- **BIOLOGICAL ASSETS**

# **LESSEE**



- **RECOGNIZE AN ASSET REPRESENTING ITS RIGHT TO USE AN UNDERLYING ASSET**
- **ASSET TO BE AMORTIZED OVER THE SHORTER OF:**
  - **EXPECTED LEASE TERM OR**
  - **ASSET'S USEFUL LIFE**
- **RECOGNIZE A LIABILITY REPRESENTING THE PRESENT VALUE OF THE OBLIGATION TO MAKE LEASE PAYMENTS**
- **INTEREST EXPENSE WOULD BE RECOGNIZED ON THE LIABILITY**

# **LESSORS**



- **RECOGNIZE AN ASSET REPRESENTING THE RIGHT TO RECEIVE LEASE PAYMENTS**
- **RECOGNIZE A LEASE LIABILITY**
- **DEPENDING ON LESSORS EXPOSURE TO RISKS OR BENEFITS ASSOCIATED WITH THE UNDERLYING ASSET:**
  - **CONTINUE TO RECOGNIZE THE UNDERLYING ASSET**
  - **DERECOGNIZE THE UNDERLYING ASSET FOR ALL RIGHTS TRANSFERRED, AND CONTINUE TO CARRY THE RESIDUAL ASSET RIGHTS RETAINED**

# **SHORT-TERM LEASES**



## **MAXIMUM POSSIBLE LEASE TERM IS 12 MONTHS OR LESS**

- **LESSEE CAN MEASURE THE ASSET AND LIABILITY AT THE UNDISCOUNTED AMOUNTS OF THE PAYMENTS**
- **LESSOR CAN ELECT NOT TO RECOGNIZE AN ASSET OR A LIABILITY OR DERECOGNIZE THE UNDERLYING ASSET**

# **LEASE TERM**



- **LONGEST POSSIBLE TERM DEEMED MORE LIKELY THAN NOT TO OCCUR**
- **APPLY ESTIMATES OF THE PROBABILITY OF OCCURRENCE OF EACH POSSIBLE TERM**
- **CONSIDER EFFECTS OF OPTIONS TO EXTEND OR TERMINATE**

# **LEASE TERM**

## **FACTORS TO CONSIDER**



- **EXPLICIT CONTRACT TERMS**
- **LEGAL AND FINANCIAL CONSEQUENCES OF DECISION TO EXTEND OR TERMINATE**
- **EXTENT TO WHICH UNDERLYING ASSET IS SPECIALIZED OR CRITICAL TO ENTITY'S OPERATIONS**
- **ENTITY'S PAST PRACTICES AND INTENTIONS**

# **LEASE PAYMENTS**



## **PRESENT VALUE OF PAYMENTS OVER LEASE TERM WOULD INCLUDE:**

- **CONTINGENT RENTALS**
- **RESIDUAL VALUE GUARANTEES**
- **EXPECTED PAYMENTS UNDER TERM OPTION PENALTIES – BASED ON THE PV OF PROBABILITY-WEIGHTED CASH FLOWS FOR A REASONABLE NUMBER OF OUTCOMES**
- **DOES NOT INCLUDE THE EXERCISE OF A PURCHASE OPTION**



# ***CONTINGENCIES***

## ***CONTINGENCIES***



→ ***ORIGINAL EFFECTIVE DATE  
OF 2010 DELAYED***

→ ***AMENDS FASB ASC 450-20***

## **CORE PRINCIPLES**

### **REQUIRED TO BE DISCLOSED**



- **QUALITATIVE INFORMATION ENABLING USERS TO UNDERSTAND THE CONTINGENCY'S NATURE AND RISKS**
- **PUBLICALLY AVAILABLE QUANTITATIVE AND OTHER NON-PRIVILEGED INFORMATION**

## **CORE PRINCIPLES**



- **ADDITIONAL INFORMATION TO BE DISCLOSED CONCERNING ALL REASONABLY POSSIBLE LOSS CONTINGENCIES**
- **THRESHOLD WOULD BE LOWERED TO INCLUDE REMOTE CONTINGENCIES**
- **PUBLIC COMPANIES WOULD BE REQUIRED TO PROVIDE A TABULAR RECONCILIATION OF**

# **DISCLOSURE**



- **EARLY STAGES – INFORMATION AVAILABLE TO THE PUBLIC ENABLING USERS TO UNDERSTAND THE CONTINGENCY'S NATURE, POTENTIAL MAGNITUDE, AND POTENTIAL TIMING**
- **SUBSEQUENT PERIODS – MORE EXTENSIVE DISCLOSURE AS ADDITIONAL INFORMATION ABOUT AN UNFAVORABLE OUTCOME BECOMES AVAILABLE**
- **SIMILAR CONTINGENCIES CAN BE AGGREGATED**

# **DISCLOSURE**



## **EARLY STAGES**

- **THE CONTENTIONS OF THE PARTIES INVOLVED**
- **THE AMOUNT OF DAMAGES CLAIMED**
- **THE BASIS OF THE ENTITY'S DEFENSE**

# **DISCLOSURE**



## **SUBSEQUENT PERIODS**

- AN INCREASE IN THE LIKELIHOOD OR MAGNITUDE OF THE LOSS
- IF KNOWN, THE ANTICIPATED TIMING OF THE RESOLUTION OF THE INDIVIDUALLY ASSERTED CONTINGENCIES

# **DISCLOSURE**



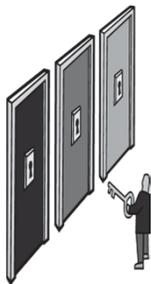
- NAME OF THE COURT OR AGENCY
- DATE INSTITUTED
- IDENTIFICATION OF THE PRINCIPAL PARTIES
- DESCRIPTION OF THE FACTUAL BASIS ALLEGED TO UNDERLIE THE PROCEEDINGS
- CONTINGENCY'S CURRENT STATUS
- BASIS OF AGGREGATION, IF APPLICABLE

**SPECIAL  
OFFER!**

## ***OCBOA UPDATE***

**UPDATED**

## **CONSOLIDATED FS**



***NOTHING IN AU SECTION 623  
PROHIBITS AN AUDITOR FROM  
REPORTING ON A INCOME TAX  
BASIS COMBINING PRESENTATION  
OF BROTHER-SISTER  
CORPORATIONS AS LONG AS THE  
BASIS OF ACCOUNTING FOR EACH  
OF THE ENTITIES PRESENTED IS  
THE BASIS THEY USE, OR EXPECT TO  
USE, TO FILE THEIR INCOME TAX  
RETURNS – TIS SECTION 1400***

## **FIN #48**



***ORDINARILY, THE RECOGNITION AND MEASUREMENT PROVISIONS OF FASB ASC 740-10 (PREVIOUSLY FIN #48) WOULD NOT APPLY TO OCBOA FINANCIAL STATEMENTS BECAUSE A LIABILITY FOR AN UNCERTAIN TAX POSITION WOULD NOT BE REPORTED ON AN ENTITY'S TAX RETURN, NOR IS IT BASED ON RECEIPTS AND DISBURSEMENTS – TIS SECTION 9110***

## **OCBOA DISCLOSURES**

***INTERPRETATION #14 OF AU SECTION 623 (PARAGRAPH 90–95)***

***IF OCBOA FINANCIAL STATEMENTS CONTAIN ELEMENTS, ACCOUNTS, OR ITEMS FOR WHICH GAAP WOULD REQUIRE DISCLOSURE, THE STATEMENTS SHOULD EITHER PROVIDE THE RELEVANT DISCLOSURE THAT WOULD BE REQUIRED OR PROVIDE INFORMATION THAT COMMUNICATES THE SUBSTANCE OF THAT DISCLOSURE. THAT MAY RESULT IN SUBSTITUTING QUALITATIVE INFORMATION FOR SOME OF THE QUANTITATIVE INFORMATION REQUIRED FOR GAAP DISCLOSURE***



# **FAIR VALUE**



***IF OCBOA FINANCIAL STATEMENTS REFLECT ASSETS OR LIABILITIES MEASURED AT FAIR VALUE IN ACCORDANCE WITH FASB ASC 820 (FV MEASUREMENTS AND DISCLOSURES), THE AUDITOR SHOULD CONSIDER WHETHER THE FINANCIAL STATEMENTS AND NOTES INCLUDE THE FAIR VALUE DISCLOSURE REQUIREMENTS OF FASB ASC 820 AS APPROPRIATE FOR THE BASIS OF ACCOUNTING USED***



# ***AUDIT AND ATTEST STANDARDS***

***UPDATED***

## **AICPA CLARITY**



- **ALL AUDITING STANDARDS ARE BEING REWRITTEN TO A NEW FORMAT**
- **RISK ASSESSMENT STANDARDS HAVE BEEN REDRAFTED**
- **THE EFFECTIVE DATE FOR ALL OTHER CLARIFIED SAS IS FOR AUDITS OF FINANCIAL STATEMENTS FOR PERIODS ENDING ON OR AFTER DECEMBER 15, 2012.**

## **AICPA CLARITY**



- **UPON THE FINALIZATION OF ALL CLARIFIED SAS, ONE SAS WILL BE ISSUED CONTAINING ALL CLARIFIED SAS IN CODIFIED FORMAT**
- **WHEN "SAS #12X" BECOMES EFFECTIVE, ALL SAS ISSUED PRIOR TO SAS NO. 117 WILL BE SUPERSEDED. HOWEVER, THE SUPERSEDED AU SECTIONS ARE EXPECTED TO BE RETAINED UNTIL JANUARY 2014, AT WHICH TIME "SAS NO. 12X" WILL BE FULLY EFFECTIVE**

# **AICPA CLARITY**



## ***STRUCTURAL IMPROVEMENTS TO MAKE STANDARDS EASIER TO UNDERSTAND***

- ▶ ***OBJECTIVES AND REQUIREMENTS***
- ▶ ***APPLICATION***
- ▶ ***EXPLANATORY MATERIAL***
- ▶ ***GLOSSARY OF TERMS AND  
DEFINITIONS***

# **PCAOB REPORT**



***“The Board is issuing this report to inform the public concerning the audit risks and challenges that it has identified through its inspection program as a result of the disruption in credit and financial markets and the broader economic downturn (“the economic crisis”). This report covers aspects of the Board’s work during the 2007, 2008, and 2009 inspection cycles relating to domestic registered firms (“firms” or “registered firms”).***

# **PCAOB REPORT**



*The audit deficiencies described in this report have been communicated to the firms involved through PCAOB comment forms or inspection reports for the years in question, and, in many cases, the deficiencies are described in the public portion of those inspection reports. This report collects and summarizes, in a single document, audit deficiencies in areas that were significantly affected by the economic crisis..."*

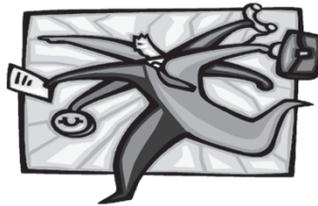
## **DEFICIENCIES**



- **FAIR VALUE MEASUREMENTS**
- **ASSET IMPAIRMENT:**
  - **GOODWILL**
  - **INDEFINITE-LIVED INTANGIBLE ASSETS**
  - **LONG-LIVED ASSETS**
- **ALLOWANCE FOR LOAN LOSSES,**
- **OFF-BALANCE SHEET STRUCTURES**
- **REVENUE RECOGNITION**
- **INVENTORY**
- **INCOME TAXES**

# **SAS #118**

## ***OTHER INFORMATION***



# **SAS #118**



- ***REQUIREMENTS REGARDING OTHER INFORMATION IN DOCUMENTS CONTAINING AUDITED FINANCIAL STATEMENTS***
- ***EFFECTIVE FOR AUDITS OF FINANCIAL STATEMENTS FOR PERIODS BEGINNING ON OR AFTER DECEMBER 15, 2010 (2011)***
- ***EARLY APPLICATION IS PERMITTED***

# **REQUIREMENT**



***ESTABLISHES REQUIREMENT FOR THE AUDITOR TO READ THE OTHER INFORMATION OF WHICH THE AUDITOR IS AWARE BECAUSE THE CREDIBILITY OF THE AUDITED FINANCIAL STATEMENTS MAY BE UNDERMINED BY MATERIAL INCONSISTENCIES BETWEEN THE AUDITED FINANCIAL STATEMENTS AND THE OTHER INFORMATION***

# **INCONSISTENCIES**



***IF, ON READING THE OTHER INFORMATION, THE AUDITOR IDENTIFIES A MATERIAL INCONSISTENCY, THE AUDITOR SHOULD DETERMINE WHETHER THE AUDITED FINANCIAL STATEMENTS OR THE OTHER INFORMATION NEEDS TO BE REVISED***

## **OTHER** **INFORMATION**



- ▶ *A REPORT BY MANAGEMENT OR THOSE CHARGED WITH GOVERNANCE ON OPERATIONS*
- ▶ *FINANCIAL SUMMARIES OR HIGHLIGHTS*
- ▶ *FINANCIAL RATIOS*
- ▶ *SELECTED QUARTERLY DATA*
- ▶ *PLANNED CAPITAL EXPENDITURES*
- ▶ *NAMES OF OFFICERS AND DIRECTORS*
- ▶ *EMPLOYMENT DATA*

## **EXCLUDED** **INFORMATION**



- ▶ *A PRESS RELEASE OR SIMILAR MEMORANDUM OR COVER LETTER ACCOMPANYING THE DOCUMENT CONTAINING AUDITED FINANCIAL STATEMENTS AND THE AUDITOR'S REPORT THEREON*
- ▶ *INFORMATION CONTAINED IN ANALYST BRIEFINGS*
- ▶ *INFORMATION CONTAINED ON THE ENTITY'S WEB SITE*

**SAS #119**  
**SUPPLEMENTARY  
INFORMATION**



**SAS #119**



- **REPORTING ON SUPPLEMENTARY INFORMATION**
- **EFFECTIVE FOR AUDITS OF FINANCIAL STATEMENTS FOR PERIODS BEGINNING ON OR AFTER DECEMBER 15, 2010**
- **EARLY APPLICATION PERMITTED**

## **SAS #119**



***ADDRESSES THE AUDITOR'S RESPONSIBILITY WHEN ENGAGED TO REPORT ON WHETHER SUPPLEMENTARY INFORMATION IS FAIRLY STATED, IN ALL MATERIAL RESPECTS, IN RELATION TO THE FINANCIAL STATEMENTS AS A WHOLE***

## **SUPPLEMENTARY INFORMATION**



***SUPPLEMENTARY INFORMATION IS DEFINED AS INFORMATION PRESENTED OUTSIDE THE BASIC FINANCIAL STATEMENTS, EXCLUDING REQUIRED SUPPLEMENTARY INFORMATION THAT IS NOT CONSIDERED NECESSARY FOR THE FINANCIAL STATEMENTS TO BE FAIRLY PRESENTED IN ACCORDANCE WITH THE APPLICABLE FINANCIAL REPORTING FRAMEWORK***

# **SUPPLEMENTARY** **INFORMATION**



***SUCH INFORMATION MAY BE PRESENTED IN A DOCUMENT CONTAINING THE AUDITED FINANCIAL STATEMENTS OR SEPARATE FROM THE FINANCIAL STATEMENTS***

# **REQUIREMENTS**



***IN ORDER TO OPINE ON WHETHER SUPPLEMENTARY INFORMATION (SI) IS FAIRLY STATED, IN ALL MATERIAL RESPECTS, IN RELATION TO THE FINANCIAL STATEMENTS AS A WHOLE, THE AUDITOR SHOULD DETERMINE THAT ALL OF THE FOLLOWING CONDITIONS ARE MET:***

## **REQUIREMENTS**



- a) ***SI WAS DERIVED FROM THE UNDERLYING ACCOUNTING RECORDS USED TO PREPARE THE FINANCIAL STATEMENTS***
- b) ***SI RELATES TO THE SAME PERIOD AS THE FINANCIAL STATEMENTS***
- c) ***THE FINANCIAL STATEMENTS WERE AUDITED, AND THE AUDITOR SERVED AS THE PRINCIPAL AUDITOR ON THAT ENGAGEMENT***

## **REQUIREMENTS**



- d) ***NEITHER AN ADVERSE OPINION OR A DISCLAIMER OF OPINION WAS ISSUED ON THE FINANCIAL STATEMENTS***
- e) ***SI WILL ACCOMPANY THE ENTITY'S AUDITED FINANCIAL STATEMENTS, OR SUCH AUDITED FINANCIAL STATEMENTS WILL BE MADE READILY AVAILABLE BY THE ENTITY***

# **PROCEDURES**



- a) ***INQUIRE AS TO PURPOSE OF SI AND CRITERIA USED TO PREPARE (REGULATOR, CONTRACT)***
- b) ***DETERMINE WHETHER FORM AND CONTENT OF SI COMPLIES WITH CRITERIA***
- c) ***OBTAIN AN UNDERSTANDING OF METHODS USED IN PREPARING SI AND DETERMINE IF CONSISTENT***
- d) ***COMPARE AND RECONCILE SI TO UNDERLYING ACCOUNTING RECORDS OR FINANCIAL STATEMENTS***

# **PROCEDURES**



- e) ***INQUIRE ABOUT ANY SIGNIFICANT ASSUMPTIONS UNDERLYING MEASUREMENT OR PRESENTATION OF SI***
- f) ***EVALUATE THE APPROPRIATENESS AND COMPLETENESS OF SI***
- g) ***OBTAIN WRITTEN REPRESENTATIONS FROM MANAGEMENT REGARDING SI***

# **PROCEDURES**



***THE AUDITOR HAS NO RESPONSIBILITY FOR THE CONSIDERATION OF SUBSEQUENT EVENTS WITH RESPECT TO SI HOWEVER, IF INFORMATION COMES TO THE AUDITOR'S ATTENTION PRIOR TO THE RELEASE OF THE REPORT, AUDITOR SHOULD APPLY REQUIREMENTS OF SUBSEQUENT EVENTS IN AU 560***

# **REPRESENTATIONS**



- i. RESPONSIBILITY FOR PRESENTATION OF SI IN ACCORDANCE WITH APPLICABLE CRITERIA***
- ii. SI IS FAIRLY PRESENTED IN ACCORDANCE WITH THE APPLICABLE CRITERIA***
- iii. CONSISTENT METHODS OF MEASUREMENT AND PRESENTATION OF SI, OR REASONS FOR CHANGES***

# **REPRESENTATIONS**



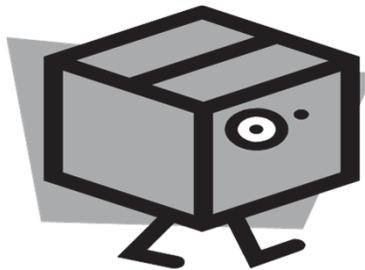
- iv. **SIGNIFICANT ASSUMPTIONS UNDERLYING MEASUREMENT OR PRESENTATION OF SI**
- v. **WHEN SI IS NOT PRESENTED WITH AUDITED FINANCIAL STATEMENTS, MANAGEMENT WILL MAKE AUDITED FINANCIAL STATEMENTS READILY AVAILABLE NO LATER THAN THE DATE OF ISSUANCE OF SI AND REPORT THEREON**

# **REPORT**



*Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The (identify accompanying supplementary information) is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.*

**SAS #120**  
**REQUIRED**  
**SUPPLEMENTARY**  
**INFORMATION**



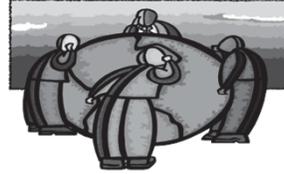
**SAS #120**



**AUDITOR RESPONSIBILITY REGARDING  
REQUIRED SUPPLEMENTARY  
INFORMATION (RSI)**

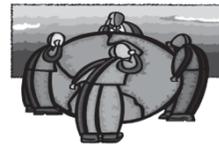
**EFFECTIVE FOR AUDITS OF FINANCIAL  
STATEMENTS FOR PERIODS BEGINNING  
ON OR AFTER DECEMBER 15, 2010  
EARLY APPLICATION IS PERMITTED**

# **SCOPE**



***ADDRESSES THE AUDITOR'S RESPONSIBILITY WITH RESPECT TO INFORMATION THAT A DESIGNATED ACCOUNTING SETTER REQUIRES TO ACCOMPANY AN ENTITY'S BASIC FINANCIAL STATEMENTS – REFERRED TO AS REQUIRED SUPPLEMENTARY INFORMATION (RSI)***

# **SCOPE**



***IN THE ABSENCE OF ANY SEPARATE REQUIREMENT IN THE PARTICULAR CIRCUMSTANCES OF THE ENGAGEMENT, THE AUDITOR'S OPINION ON THE BASIC FINANCIAL STATEMENTS DOES NOT COVER REQUIRED SUPPLEMENTARY INFORMATION***

# **PROCEDURES**



## ***MANAGEMENT INQUIRIES REGARDING METHODS OF PREPARATION OF RSI***

- 1) MEASURED AND PRESENTED IN ACCORDANCE  
WITH PRESCRIBED GUIDELINES***
- 2) CONSISTENT APPLICATION OF GUIDELINES OR  
REASONS FOR CHANGES***
- 3) SIGNIFICANT ASSUMPTIONS OR  
INTERPRETATIONS UNDERLYING  
MEASUREMENT OR PRESENTATION***

# **PROCEDURES**



## ***COMPARE INFORMATION FOR CONSISTENCY:***

- 1) MANAGEMENT'S RESPONSE TO FOREGOING  
INQUIRIES***
- 2) BASIC FINANCIAL STATEMENTS***
- 3) OTHER KNOWLEDGE OBTAINED DURING THE  
AUDIT OF THE BASIC FINANCIAL STATEMENTS***

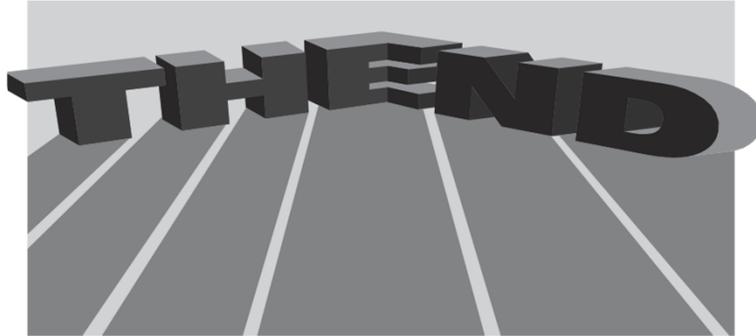
# **REPORT**



*(Identify the applicable financial reporting framework - for example, accounting principles generally accepted in the United States of America) require that the (identify the required supplementary information) on page XX be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by (identify designated accounting standard 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.*

# **REPORT**

*We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.*



***THANK YOU***

# ***SSARS UPDATE***



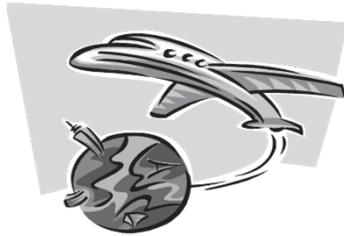
*PRESENTED BY  
GENE RISTAINO, CPA, ABV, MT*

*FICPA FGCU CONFERENCE  
OCTOBER 27, 2011*

## ***AGENDA***



- OVERVIEW***
- INTERPRETATIONS***
- RECENT STANDARDS***
  - ◆ SSARS #18***
  - ◆ SSARS #19***
  - ◆ SSARS #20***



# *OVERVIEW*

## *ASSURANCE CONTINUUM*

### Assurance Continuum



# COMPILATIONS



*IN A COMPILATION ENGAGEMENT, THE ACCOUNTANT'S PROCEDURES ARE LIMITED TO ASSISTING THE CLIENT IN PRESENTING FINANCIAL INFORMATION IN THE FORM OF FINANCIAL STATEMENTS. THE ACCOUNTANT GENERALLY PREPARES THE FINANCIAL STATEMENTS AND THEN READS THEM TO MAKE SURE THAT THEY APPEAR APPROPRIATE IN FORM AND CONTENT. BECAUSE THE ACCOUNTANT DOES NOT PERFORM ANY OTHER PROCEDURES, THE ACCOUNTANT DOES NOT OBTAIN ANY ASSURANCE THAT THE FINANCIAL STATEMENTS ARE FREE OF MATERIAL MISSTATEMENT.*

# REVIEWS

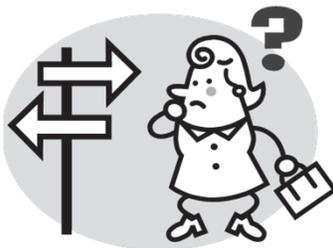


*IN CONTRAST, IN A REVIEW ENGAGEMENT, THE ACCOUNTANT PERFORMS ANALYTICAL AND INQUIRY PROCEDURES IN ORDER TO OBTAIN A LIMITED LEVEL OF ASSURANCE THAT THE FINANCIAL STATEMENTS ARE FREE OF MATERIAL MISSTATEMENT.*

# **REVIEWS**



***MANY ACCOUNTANTS MAKE THE MISTAKE OF VIEWING THE REVIEW ENGAGEMENT AS A COMPILATION ENGAGEMENT WITH ONLY A FEW PROCEDURES ADDED ON. HOWEVER, A REVIEW ENGAGEMENT HAS ELEMENTS IN COMMON WITH AN AUDIT ENGAGEMENT IN THAT BOTH ENGAGEMENTS ARE PERFORMED WITH AN OBJECTIVE OF OBTAINING A LEVEL OF ASSURANCE ABOUT WHETHER THE FINANCIAL STATEMENTS ARE FREE OF MATERIAL MISSTATEMENT.***



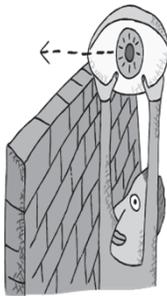
# ***INTERPRETATIONS***

## **SUBSEQUENT EVENTS**



***HOW DOES THE ENTITY'S RESPONSIBILITY TO DISCLOSE THE DATE THROUGH WHICH SUBSEQUENT EVENTS HAVE BEEN EVALUATED AFFECT THE ACCOUNTANT'S RESPONSIBILITIES FOR SUBSEQUENT EVENTS IN A COMPILATION OR REVIEW ENGAGEMENT?***

## **COMPILATIONS**



***IN A COMPILATION ENGAGEMENT, THE ACCOUNTANT DOES NOT HAVE ANY RESPONSIBILITY WITH RESPECT TO SUBSEQUENT EVENTS (INQUIRIES, ETC) UNLESS EVIDENCE OR INFORMATION COMES TO THE ACCOUNTANT'S ATTENTION THAT A SUBSEQUENT EVENT THAT HAS A MATERIAL EFFECT ON THE FINANCIAL STATEMENTS HAS OCCURRED***

## **REVIEWS & COMPILATIONS**



***WHEN SUCH EVIDENCE OR INFORMATION COMES TO AN ACCOUNTANT'S ATTENTION DURING A COMPILATION OR REVIEW ENGAGEMENT, THE ACCOUNTANT SHOULD REQUEST THAT MANAGEMENT CONSIDER THE POSSIBLE EFFECTS ON THE FINANCIAL STATEMENTS, INCLUDING THE ADEQUACY OF ANY RELATED DISCLOSURE.***

## **REVIEWS & COMPILATIONS**



***IF THE ACCOUNTANT DETERMINES THAT A SUBSEQUENT EVENT IS NOT APPROPRIATELY ACCOUNTED FOR IN THE FINANCIAL STATEMENTS OR DISCLOSED IN THE NOTES, THE ACCOUNTANT SHOULD FOLLOW THE GUIDANCE REGARDING DEPARTURES FROM GAAP***

# **REPORT DATING**

*BECAUSE THE ACCOUNTANT'S  
COMPILATION OR REVIEW REPORT  
SHOULD BE DATED AS OF THE  
COMPLETION OF THE  
PROCEDURES, THE DATE OF THE  
ACCOUNTANT'S COMPILATION OR  
REVIEW REPORT CAN NEVER BE  
EARLIER THAN MANAGEMENT'S  
SUBSEQUENT EVENT NOTE DATE*



# **REPORT DATING**

## **SAME DATE**



- *AVAILABLE TO BE ISSUED –  
COMPLETION OF PROCEDURES*
- *REPORT DATE*
- *SUBSEQUENT EVENT NOTE DATE*
- *MANAGEMENT REPRESENTATIONS*

## **IFRS REPORTING**



***MAY AN ACCOUNTANT APPLY  
THE REPORTING GUIDANCE IN  
AR SECTION 100 WHEN  
ENGAGED TO REPORT ON  
FINANCIAL STATEMENTS  
PRESENTED IN ACCORDANCE  
WITH IFRS?***

## **IFRS REPORTING**



- YES***
- IASB IS A BODY DESIGNATED BY  
THE AICPA TO ESTABLISH  
INTERNATIONAL FINANCIAL  
REPORTING STANDARDS***
- MAY ADD EMPHASIS OF MATTER  
PARAGRAPH***

## **COMPILATIONS**



*As disclosed in note x, the accompanying financial statements were prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB).*

## **COMPILATIONS**



*Management has elected to omit substantially all disclosures (and the statement of cash flows) required by International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB). If the omitted disclosures and statement were included in the financial statements, they might influence the user's conclusions about the company's financial position, results of operations, and cash flows. Accordingly, these financial statements are not designed for those who are not informed about such matters.*

## **REVIEWS**



*Based on my (our) reviews, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB).*



## **STANDARDS**

# CLARITY



*THE ARSC IS CURRENTLY UNDERGOING A PROJECT TO CLARIFY THE SSARS LITERATURE IN ACCORDANCE WITH THE ASB CLARITY DRAFTING CONVENTIONS. DURING THE CLARITY PROCESS, THE ARSC WILL REEXAMINE THE SSARS LITERATURE AND REFINE THE SSARS AS NEEDED. THE ARSC HAS DEFERRED CONVERGING ITS STANDARDS WITH THE IAASB'S INTERNATIONAL COMPILATION AND REVIEW LITERATURE UNTIL THE IAASB COMPLETES ITS ONGOING REVISION OF THAT LITERATURE.*



## SSARS #18

**UPDATED**

# APPLICATION



- ▶ *APPLIES TO NON-ISSUERS*
- ▶ *SSARS IS NOT APPLIED WHEN THE PROVISIONS OF SAS #116, INTERIM FINANCIAL INFORMATION, APPLY*
- ▶ *EFFECTIVE FOR REVIEWS OF INTERIM FINANCIAL INFORMATION FOR INTERIM PERIODS WITHIN FISCAL YEARS BEGINNING AFTER 12/15/2009 (2010)*

## SAS #116



- ▶ *INTERIM INFORMATION IS DEFINED AS FINANCIAL INFORMATION OR STATEMENTS COVERING A PERIOD LESS THAN A FULL YEAR OR A 12-MONTH PERIOD ENDING ON A DATE OTHER THAN THE ENTITY'S FISCAL YEAR END*
- ▶ *CAN BE A FULL SET OF FINANCIAL STATEMENTS OR CONDENSED*
- ▶ *REQUIRES UNDERSTANDING WITH CLIENT IN WRITING*

## **REQUIREMENTS**



- ◆ ***THE AUDITOR OR PREDECESSOR HAS AUDITED THE ENTITY' LATEST FINANCIAL STATEMENTS***
- ◆ ***THE AUDITOR HAS AN EXPECTATION TO AUDIT THE ENTITY'S CURRENT YEAR FINANCIAL STATEMENTS***
- ◆ ***INTERIM INFORMATION HAS BEEN PREPARED ON THE SAME FINANCIAL REPORTING FRAMEWORK***

## **REQUIREMENTS**



- ◆ ***THE INTERIM FINANCIAL INFORMATION ACCOMPANIES THE ENTITY'S LATEST ANNUAL AUDITED FINANCIAL STATEMENTS***
- ◆ ***THE INTERIM FINANCIAL INFORMATION INCLUDES A NOTE THAT THE FINANCIAL INFORMATION DOES NOT REPRESENT COMPLETE FINANCIAL STATEMENTS AND SHOULD BE READ IN CONJUNCTION WITH THE ENTITY'S LATEST ANNUAL FINANCIAL STATEMENTS***

## **APPLICATION**



- a) *IF THERE IS AN AUDIT BASE AND THE INTERIM INFORMATION IS ESSENTIALLY AN UPDATE OF THE ANNUAL FINANCIAL STATEMENTS*
- b) *THE ENTITY HAS CONTROLS IN PLACE THAT ARE SUFFICIENT TO PROVIDE A REASONABLE BASIS FOR THE PREPARATION OF RELIABLE INTERIM INFORMATION*

## **REPORTING**



*A REPORT IS NOT REQUIRED UNLESS THE ENTITY STATES THAT THE INTERIM FINANCIAL INFORMATION HAS BEEN REVIEWED AN INDEPENDENT PUBLIC ACCOUNTANT*

## REPORTING



*We have reviewed the accompanying interim financial statements (or describe the interim financial information reviewed) of ABC Company as of June 30, 2010, and for the three-month and six-month periods then ended. This interim information is the responsibility of the Company's management.*

## REPORTING

*We conducted our review in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.*

## **REPORTING**



*Based on our review, we are not aware of any material modifications that should be made to the accompanying interim financial information for it to be in conformity with accounting principles generally accepted in the United States.*

## **REPORTING**



*The balance sheet as of December 31, 2009 was audited by us and we expressed an unqualified opinion on it in our report dated March 10, 2010, but we have not performed any auditing procedures since that date.*



# SSARS #19

**UPDATED**

## **RESTRUCTURING**

### **CHANGES TO COMPILATION AND REVIEW STANDARDS**

- **RESTRUCTURING OF SSARS #1**
- **EFFECTIVE FOR STATEMENTS FOR PERIODS ENDING ON OR AFTER DECEMBER 15, 2010 – CALENDAR 2010**
- **EARLY IMPLEMENTATION PROHIBITED; EXCEPT FOR REPORTING IMPAIRMENTS OF INDEPENDENCE IN COMPILATIONS**



# **RESTRUCTURING**

***RECODIFIES THE SSARS  
LITERATURE INTO  
SEPARATE SECTIONS FOR  
COMPILATION AND REVIEW  
ENGAGEMENTS***



# **MAJOR PROVISIONS**



- ***MUST BE INDEPENDENT TO  
PROVIDE REVIEW SERVICES***
- ***MAINTAINS LIMITED LEVEL OF  
ASSURANCE FOR REVIEWS AS  
OPPOSED TO MODERATE ASSURANCE***
- ***ENHANCED DOCUMENTATION  
REQUIREMENTS ESTABLISHED FOR  
ALL COMPILATION AND REVIEW  
ENGAGEMENTS***

# **REPORTING**



**EARLY ADOPTION AVAILABLE FOR  
PARAGRAPH 2.21 - ... THE  
ACCOUNTANT IS NOT PRECLUDED  
FROM DISCLOSING A DESCRIPTION  
ABOUT THE REASONS THAT HIS OR  
HER INDEPENDENCE IS IMPAIRED  
IN THEIR COMPILATION REPORT  
CAN EITHER CONTINUE TO MERELY  
SAY NOT INDEPENDENT, OR  
DESCRIBE THE REASONS FOR THE  
LACK OF INDEPENDENCE**

# **IMPLEMENTATION**



- ▶ **MATERIALITY**
- ▶ **ENGAGEMENT LETTERS**
- ▶ **PERFORMANCE**
- ▶ **DOCUMENTATION**
- ▶ **INDEPENDENCE**
- ▶ **REPORTING**

# **MATERIALITY**



- **EXPECTED TO INFLUENCE USERS OF THE STATEMENTS**
- **CONSIDERATION OF CLIENT'S FACTS AND CIRCUMSTANCES**
- **NATURE AND AMOUNT OF ACTUAL OR POTENTIAL MISSTATEMENT**
- **BASED ON NEEDS OF USER GROUP**
- **USER GROUP EXPECTED TO UNDERSTAND CLIENT'S BUSINESS ACTIVITY AND UNCERTAINTIES**

# **ENGAGEMENT LETTERS**



**ENGAGEMENT LETTERS ARE REQUIRED FOR ALL COMPILATION AND REVIEW ENGAGEMENTS**

**LETTER IS NOT REQUIRED TO BE SIGNED BY CLIENT**

# **ENGAGEMENT LETTERS**



- ➔ ***OBJECTIVES AND NATURE OF ENGAGEMENT***
- ➔ ***MANAGEMENT RESPONSIBILITIES***
- ➔ ***ENGAGEMENT LIMITATIONS***
- ➔ ***FRAUD AND ILLEGAL ACTS***
- ➔ ***INDEPENDENCE IMPAIRMENTS FOR COMPILATION ENGAGEMENTS***
- ➔ ***REPRESENTATIONS LETTER FOR REVIEW ENGAGEMENTS***

# **MANAGEMENT RESPONSIBILITIES**



- ▶ ***FINANCIAL STATEMENTS***
- ▶ ***INTERNAL CONTROL***
- ▶ ***PREVENTING/DETECTING FRAUD***
- ▶ ***COMPLIANCE WITH LAWS AND REGULATIONS***
- ▶ ***MAKE RECORDS AVAILABLE***

# PERFORMANCE

## COMPILATION



- ▶ *UNDERSTAND THE INDUSTRY*
- ▶ *KNOWLEDGE OF THE CLIENT*
- ▶ *READ THE FINANCIAL STATEMENTS*
- ▶ *NOT REQUIRED TO MAKE INQUIRIES*
- ▶ *NOT REQUIRED TO VERIFY, CORROBORATE, OR REVIEW INFORMATION SUPPLIED BY THE ENTITY*

# PERFORMANCE



*IN A COMPILATION ENGAGEMENT THE ACCOUNTANT SHOULD CONSIDER THE EFFECT OF MANAGEMENT'S CONCLUSIONS REGARDING INCOMPLETE INFORMATION, FRAUD, OR MISSTATEMENTS IN THE FINANCIAL STATEMENTS, AND WHERE THE ACCOUNTANT BELIEVES THE FINANCIAL STATEMENTS ARE OR COULD BE MATERIALLY MISSTATED, THE ACCOUNTANT SHOULD OBTAIN ADDITIONAL OR REVISED INFORMATION.*

# **PERFORMANCE**

## **REVIEW**



- ▶ ***UNDERSTAND THE INDUSTRY***
- ▶ ***KNOWLEDGE OF THE CLIENT***
- ▶ ***ASSESS RISK OF FAILING TO MODIFY REPORT FOR FINANCIAL STATEMENTS THAT ARE MATERIALLY MISSTATED***
- ▶ ***DESIGN AND PERFORM ANALYTICAL PROCEDURES***
- ▶ ***MAKE INQUIRIES***
- ▶ ***PERFORM OTHER PROCEDURES AS APPROPRIATE***
- ▶ ***ACCUMULATE REVIEW EVIDENCE***

# **INQUIRIES**



- ◆ ***FINANCIAL STATEMENTS PREPARED IN CONFORMITY WITH FRAMEWORK***
- ◆ ***ACCOUNTING PRINCIPLES AND PRACTICES EMPLOYED***
- ◆ ***COMPLEX SITUATIONS***
- ◆ ***SIGNIFICANT TRANSACTIONS***
- ◆ ***STATUS OF PRIOR UNCORRECTED MISSTATEMENTS***
- ◆ ***SHAREHOLDER MINUTES/ACTIONS***

# **INQUIRIES**



- ◆ **QUESTIONS ARISING FROM OTHER PROCEDURES AND/OR ANALYTICAL PROCEDURES**
- ◆ **SUBSEQUENT EVENTS**
- ◆ **KNOWLEDGE OF FRAUD OR SUSPECTED FRAUD**
- ◆ **SIGNIFICANT JOURNAL ENTRIES AND ADJUSTMENTS**
- ◆ **COMMUNICATIONS FROM REGULATORY AGENCIES**

# **INQUIRIES**



***THE ACCOUNTANT IS NOT ORDINARILY REQUIRED TO CORROBORATE MANAGEMENT'S RESPONSES WITH OTHER EVIDENCE; HOWEVER, THE ACCOUNTANT SHOULD CONSIDER THE REASONABLENESS AND CONSISTENCY OF MANAGEMENT'S RESPONSES IN LIGHT OF THE RESULTS OF OTHER REVIEW PROCEDURES AND THE ACCOUNTANT'S KNOWLEDGE OF THE CLIENT'S BUSINESS AND THE INDUSTRY IN WHICH IT OPERATES.***

# *ANALYTICAL PROCEDURES*



*ANALYTICAL PROCEDURES INVOLVE COMPARISONS OF EXPECTATIONS DEVELOPED BY THE ACCOUNTANT TO RECORDED AMOUNTS OR RATIOS DEVELOPED FROM RECORDED AMOUNTS.*

# *ANALYTICAL PROCEDURES*



*THE ACCOUNTANT DEVELOPS SUCH EXPECTATIONS BY IDENTIFYING AND USING PLAUSIBLE RELATIONSHIPS THAT ARE REASONABLY EXPECTED TO EXIST BASED ON THE ACCOUNTANT'S UNDERSTANDING OF THE INDUSTRY IN WHICH THE CLIENT OPERATES AND KNOWLEDGE OF THE CLIENT.*

# **ANALYTICAL PROCEDURES**



## **DEVELOPING EXPECTATIONS**

- ▶ **PRIOR PERIODS**
- ▶ **ANTICIPATED RESULTS (BUDGETS)**
- ▶ **EXTRAPOLATED INTERIM RESULTS**
- ▶ **FINANCIAL RELATIONSHIPS**
- ▶ **INDUSTRY BENCHMARKS**
- ▶ **NONFINANCIAL RELATIONSHIPS**

# **ANALYTICAL PROCEDURES**



**IF ANALYTICAL PROCEDURES PERFORMED IDENTIFY FLUCTUATIONS OR RELATIONSHIPS THAT ARE INCONSISTENT WITH OTHER RELEVANT INFORMATION, THE ACCOUNTANT SHOULD INVESTIGATE THESE DIFFERENCES BY INQUIRING OF MANAGEMENT AND PERFORMING OTHER PROCEDURES AS CONSIDERED NECESSARY IN THE CIRCUMSTANCES.**

# **DOCUMENTATION**

## **COMPILATION**



- **SUFFICIENT DETAIL TO PROVIDE A CLEAR UNDERSTANDING OF THE WORK PERFORMED (CHECKLIST)**
- **ENGAGEMENT LETTER**
- **SIGNIFICANT ISSUES AND FINDINGS**
- **ACTIONS AND RESOLUTIONS**
- **COMMUNICATION REGARDING FRAUD OR ILLEGAL ACTS**

# **DOCUMENTATION**

## **REVIEW**



- **SUFFICIENT DETAIL TO PROVIDE A CLEAR UNDERSTANDING OF THE WORK PERFORMED**
- **ENGAGEMENT LETTER**
- **SIGNIFICANT ISSUES COVERED IN MANAGEMENT INQUIRIES (CHECKLIST)**
- **SIGNIFICANT ISSUES AND FINDINGS**
- **SIGNIFICANT UNUSUAL MATTERS**
- **COMMUNICATION REGARDING FRAUD OR ILLEGAL ACTS**
- **REPRESENTATION LETTER**

# **DOCUMENTATION**

## **REVIEW**

### **➤ ANALYTICAL PROCEDURES PERFORMED**



- ◆ **EXPECTATIONS - INCLUDING THE FACTORS CONSIDERED IN DEVELOPING THE EXPECTATIONS**
- ◆ **RESULTS OF COMPARISON OF THE EXPECTATIONS TO RECORDED AMOUNTS OR RATIOS**
- ◆ **MANAGEMENT RESPONSES TO INQUIRIES REGARDING FLUCTUATIONS OR INCONSISTENT RELATIONSHIPS**

# **INDEPENDENCE**

## **COMPILATIONS**



- ▶ **NOT REQUIRED**
- ▶ **DISCLOSURE IN REPORT**
- ▶ **SSARS #19 REMOVES THE PROHIBITION AGAINST ALLOWING THE ACCOUNTANT TO INCLUDE A DESCRIPTION IN THE ACCOUNTANT'S REPORT REGARDING THE REASON FOR AN INDEPENDENCE IMPAIRMENT**

# **INDEPENDENCE**

## **REVIEWS**

- ▶ **REQUIRED**
- ▶ **SSARS #19 - REQUIREMENT FOR INDEPENDENCE REMAINS UNCHANGED**
- ▶ **PROPOSAL TO ALLOW THE ACCOUNTANT TO PERFORM REVIEW SERVICES WHEN INDEPENDENCE IS IMPAIRED AS A RESULT OF ALSO PROVIDING INTERNAL CONTROL SERVICES WAS NOT MADE – SEE INT. 101-3**



# ***ETHICS INTERPRETATION***

## ***101-3***



- ➔ **ACCOUNTANT CANNOT PERFORM MANAGEMENT FUNCTIONS**
- ➔ **RESPONSIBILITIES OF MANAGEMENT MUST BE OUTLINED**
- ➔ **UNDERSTANDING WITH CLIENT MUST BE DOCUMENTED**

# MANAGEMENT RESPONSIBILITIES



- *MAKE ALL MANAGEMENT DECISIONS*
- *DESIGNATE A COMPETENT PERSON TO OVERSEE ALL NON-ATTEST SERVICES PERFORMED BY ACCOUNTANT*
- *EVALUATE ADEQUACY OF SERVICES PROVIDED BY THE ACCOUNTANT*
- *ACCEPT RESPONSIBILITY FOR THE RESULTS*

# MANAGEMENT ACTIVITIES

**WRONG  
WAY**



- ◆ *AUTHORIZING OR EXECUTING CLIENT TRANSACTIONS*
- ◆ *PREPARING SOURCE DOCUMENTS*
- ◆ *HAVING CUSTODY OF ASSETS*
- ◆ *SUPERVISING CLIENT EMPLOYEES*
- ◆ *ESTABLISHING OR MAINTAINING INTERNAL CONTROLS*
- ◆ *PERFORMING ONGOING MONITORING ACTIVITIES*

# EXAMPLES



- *REVIEW AND APPROVE TRANSACTION CLASSIFICATIONS PRIOR TO POSTING TO LEDGER*
- *RECONCILIATION OF SUBSIDIARY LEDGERS TO GENERAL LEDGER*
- *SIGNING PAYROLL CHECKS*
- *PREPARING CASH RECONCILIATIONS TO PROVIDE SEGREGATION OF DUTIES*
- *BACKUP OF DATA SYSTEMS*
- *COUNTING INVENTORY AND COMPARING TO PERPETUAL RECORDS*

# REPORTING

## COMPILATION

- ◆ *WRITTEN REPORT WHEN EXPECTED TO BE USED BY THIRD PARTY*
- ◆ *NO REPORT REQUIRED FOR "INTERNAL USE ONLY" STATEMENTS*
- ◆ *CAN OMIT SUBSTANTIALLY ALL DISCLOSURES – NEED TO DISCLOSE IN ACCOUNTANT'S REPORT*
- ◆ *LACK OF INDEPENDENCE NEEDS TO BE DISCLOSED IN ACCOUNTANT'S REPORT*



# REPORTING



- ▶ *REVISED STANDARD COMPILATION AND REVIEW REPORTS*
- ▶ *REPORTS ON OCBOA*
- ▶ *EMPHASIS OF MATTER*
- ▶ *DEPARTURES FROM REPORTING FRAMEWORK*
- ▶ *RESTRICTING USE OF REPORT*
- ▶ *ABILITY TO CONTINUE AS A GOING CONCERN*
- ▶ *SUBSEQUENT EVENTS*
- ▶ *SUBSEQUENT DISCOVERY OF FACTS*
- ▶ *SUPPLEMENTARY INFORMATION*
- ▶ *CHANGE IN ENGAGEMENT*

# LACK OF INDEPENDENCE



*WE ARE NOT INDEPENDENT WITH RESPECT TO ABC COMPANY AS, DURING THE YEAR ENDED DECEMBER 31, 2010, A MEMBER OF THE ENGAGEMENT TEAM HAD A DIRECT FINANCIAL INTEREST IN THE COMPANY*

**LACK OF**  
**INDEPENDENCE**



*WE ARE NOT INDEPENDENT WITH  
RESPECT TO ABC COMPANY AS, DURING  
THE YEAR ENDED DECEMBER 31, 2010  
WE PERFORMED CERTAIN INTERNAL  
CONTROL AND/OR ACCOUNTING  
SERVICES (ACCOUNTANT MAY INCLUDE  
A DESCRIPTION OF THE SERVICES  
PROVIDED) THAT IMPAIRED OUR  
INDEPENDENCE*



***SSARS #20***

# **SSARS APPLICABILITY**



- ***EFFECTIVE FOR REVIEWS OF FINANCIAL STATEMENTS FOR PERIODS BEGINNING AFTER DECEMBER 15, 2011 (2012)***
- ***EARLY APPLICATION IS PERMITTED***
- ***AMENDS SSARS #19 REVIEWS OF FINANCIAL STATEMENTS***

# **SSARS APPLICABILITY**



***AMENDS PARAGRAPH .01 OF AR SECTION 90, REVIEW OF FINANCIAL STATEMENTS, IN AICPA PROFESSIONAL STANDARDS SO THAT SSARS DO NOT APPLY WHEN THE PROVISIONS OF SAS #100, (INTERIM FINANCIAL INFORMATION), AS AMENDED BY SAS #116, (INTERIM FINANCIAL INFORMATION), AND SAS #121, (REVISED APPLICABILITY OF STATEMENT ON AUDITING STANDARDS #100) APPLY.***

**THANK YOU**



**GENERISTAINO**

***GRISTAINO@ISDANERLLC.COM***

---

***Using SBA Lending Today to  
Facilitate Business Succession  
Planning Tomorrow***

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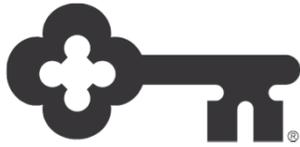
*Thomas Maiale Jr, MBA*

**Thomas Maiale**  
**Vice President, Senior Business Banking**  
**Relationship Manager**  
**KeyBank**

Tom has 12 years of experience in the financial service industry. He specializes in SBA and small business healthcare lending. Tom has the right tools, insights, and resources to make sure his clients' plans are constantly working for them.

Tom joined KeyBank in 2004. He received his BS in finance from the State University of New York (SUNY) Buffalo and MBA from St. Bonaventure University, Buffalo, New York.

Tom is an active member of the community and serves on the Board of Directors for Immokolee Childcare Center and Medical Managers Association of Collier County. Tom also is a Steering Committee Member and founding member of Bonita Springs Area Chamber of Commerce Young Professionals Group. He currently resides in Fort Myers, Florida.



## SBA Solutions For Client Financing

**Prepared For  
Florida Institute of  
Certified Public Accountants**



Presented by  
Thomas J. Maiale, Jr.

Business Banking Relationship Manager

October 27, 2011



KeyCorp Public

### 7(a) Product Highlights

- With the 7(a) loan program, Key is providing the financing and the government is providing a guarantee
- The guarantee is:
  - 85% for loans less than \$150,000
  - 75% for loans greater than \$150,000 up to a \$5,000,000
- Max. Loan of \$5,000,000
- SBA Express Loans - Maximum loan size is \$1,000,000

KeyCorp Public

## How can an SBA loan meet your clients needs?

- Construct new commercial buildings (owner user)
- Purchase existing land and buildings (owner user)
- Purchase machinery, equipment, fixtures, or inventory
- Leasehold Improvements
- Business Acquisitions including Goodwill
  - Asset Purchase (Preferred)
  - Stock Purchase
- Business and Real Estate Acquisition Combined
- Finance increased receivables and augment working capital
  
- SBA Requires Owner Occupancy
  - Existing real estate – must occupy 51% of the available square footage
  - New construction – must occupy 60% of available square footage with plans to use 100%

KeyCorp Public

## Benefits to the Clients:

- Longer terms –
  - Owner-User Real Estate Acquisitions 25 year term.
  - 10 to 15 years for equipment
  - 10 years for Business Acquisitions
- Interest rates - variable-rate 1.5% - 2.75% over the Wall Street Journal Prime
- Flexible repayment options -
  - monthly installments of principal and interest, not fixed principal and interest
  - no balloon payments
  - no pre-payment penalties on loans less than 15 years
- Minimal costs
  - Packaging fee of \$250 to \$2,500
  - No Points/Origination Fees
  - SBA guarantee fee (based on the amount of the guaranteed portion of the SBA loan) which can be financed into the loan amount (eliminated until funds are depleted or 12/31/2010)

KeyCorp Public

## 7(a) Underwriting Highlights

Debt Service Coverage (Cash flow divided by Annual Debt Service ) Equals

Cash Flow Available to Cover Annual Debt Service

- 1.2 : 1 debt service coverage ratio
- 1.4:1 for restaurants & hospitality
- For business expansions, historical debt service coverage must provide a minimum of .8:1 coverage with reasonable projections in line with industry standards meeting/exceeding the 1.2:1 coverage ratio

KeyCorp Public

## 7(a) Underwriting Highlights

Business Acquisitions

- 1.2 : 1 debt service coverage ratio based on historical net income
- Addbacks should be limited to material changes, i.e., significant change in owner's salary/draws, significant change in rent paid, significant one-time expenses, etc.
- Significant addbacks resulting from operating efficiencies can not be allowed unless audited results are provided.
- Seller Notes are subordinate to Bank Financing and placed on Stand-By

KeyCorp Public

## Financing Goodwill

- If Goodwill is less than \$500,000, buyer injection of equity can be 10%.
- When Goodwill exceeds \$500,000, buyer must inject 25% equity.
- Seller assistance in meeting 25% buyer equity: Seller must agree to take back financing and place on full standby for 2 years. Buyer needs to inject 5% to 10% as a minimum.

KeyCorp Public

## U.S. Small Business Administration 504 Loan Program (SBA 504)

This program provides small businesses an opportunity to acquire fixed assets needed to foster growth.

*Borrower must not have a tangible net worth in excess of \$15 million, and does not have an average net income after Federal income taxes (excluding any carry-over losses) for the preceding two years in excess of \$5 million*



KeyCorp Public

## Use of Loan Proceeds

- Acquisition of land, buildings and equipment Building expansion
- New construction
- Limited refinancing in conjunction with the acquisition, expansion or renovation of a building
- For profit businesses
- Owner-occupied real estate
  - 51% of existing space
  - 60% of newly constructed space

KeyCorp Public

## \$4 Million 504

### Uses of Funds:

Building	\$10,000,000
Equipment	<u>300,000</u>
<b>Total</b>	<b>\$10,300,000</b>

### Sources of Funds:

Bank 1 <sup>st</sup> Mtg.	\$5,150,000	(50%)
ESCDC 504 2 <sup>nd</sup> Mtg.	4,000,000	(40%)
Equity	<u>1,150,000</u>	(10%)
<b>Total</b>	<b>\$10,300,000</b>	<b>(100%)</b>

KeyCorp Public

## Checklist for a Complete Financial Package

- Three Years Corporate Tax Returns
- Three Years Personal Tax Returns for all guarantors with 20% ownership
- Interim Financial Statements dated within 60 days of application
- Accounts Receivable and Aging Report (if applicable)
- Personal Financial Statement Completed SBA Application
- Copy of Business Debt Schedule
- Completed SBA Application (if applicable)
- **Affiliates: (to determine eligibility for SBA loans)**
- **Any owner/guarantor who has 20% or more ownership in other entities MUST supply the following information**
- Three Years Corporate Returns for all affiliates (including EPC Entities)
- Interim Financial Statements dated within 60 days of application
- Matching Date to Interims Accts Receivable & Aging Report (if applicable)

### Items if applicable

- Copy of Purchase Agreement/Letter of Intent
- Franchise Agreement
- Uniform Franchise Offering Circular (UFOC)
- Copy of Notes to be refinanced
- Copy of Original Settlement Statement (to show equity injection)
- Copy of Lease
- Projections for Expansion(1 year) or Start Up businesses (3 years)
- Cost Breakdown for Improvements/Equipment Purchase

KeyCorp Public

## Contact Information

<b>Tom Maiale</b>	<b>Business Banking Relationship Manager</b>	<b>239-466-2510 <u><a href="mailto:Thomas.Maiale.Jr@keybank.com">Thomas Maiale Jr@keybank.com</a></u></b>
<b>Joe Ariola</b>	<b>Business Banking Sales Leader</b>	<b>239-466-2519 <u><a href="mailto:Joseph.A.Ariola@keybank.com">Joseph A Ariola@keybank.com</a></u></b>
<b>Renee Porter-Medley, CFP</b>	<b>Senior Financial Planner</b>	<b>239-659-8814 <u><a href="mailto:Renee.Porter-Medley@keybank.com">Renee Porter-Medley@keybank.com</a></u></b>

KeyCorp Public

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***Impact of the FASB/IASB Lease  
and the Small and Medium Size  
Entity GAAP Proposals on  
Accounting for Leases***

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*Ara G. Volkan PhD, CPA, Ph.D, CPA*

**Ara Volkan, Ph.D., CPA**  
Chair of the Accounting Department  
Lutgert College of Business, Florida Gulf Coast University

Ara G. Volkan, Ph.D., CPA, is the Chair of the Accounting Department at Lutgert College of Business, Florida Gulf Coast University. During the past two years, he also served as the Associate Dean and Interim Dean of LCOB. Dr. Volkan joined the FGCU faculty in August 2004 as Eminent Scholar and Moorings Park Chair of Managerial Accounting. He received his doctorate in accounting from the University of Alabama in 1979. He holds a CPA certificate in Florida (1989). Following his teaching engagements at Syracuse University (1979-1985) and at University of South Alabama (1986-1989), Dr. Volkan chaired the Accounting and Finance Department at University of West Georgia (1989-2003). Prior to joining the faculty at FGCU, he was Interim Dean at the Richards College of Business at West Georgia (2003-2004) and directed the Banking and Finance in New York and London Program (1991 – 2003).

In addition to his academic positions, Dr. Volkan had several consulting engagements with local CPA firms and other companies. He is a member of the board of directors Moorings Park, Inc. and its Finance Committee and the chair of the MPI Audit Committee in Naples, FL. He served as a visiting team member for the AACSB accreditation processes. In addition, he was SACS accreditation director at U. of West Georgia (2000-2004).

Dr. Volkan is a member of the AICPA, FICPA, IMA (member of the board of the SWFL chapter), AAA, as well as other academic and professional organizations. He has been recognized for his outstanding teaching at Syracuse and West Georgia. Also, the local chapters of the IMA and state CPA societies, along with several student associations at Syracuse, NY, Mobile, AL, and Carrollton, GA have recognized him for outstanding service. He serves as reviewer for several journals. He has authored numerous articles in academic and professional accounting journals and in other publication outlets.

# **Accounting for SMEs and the New Lease Accounting Proposals by the FASB and IASB - A Continuing Professional Education Presentation to the Southwest Chapter of the FICPA**

October 27, 2011

Ara G. Volkan, Ph.D., C.P.A.  
Chair, Department of Accounting  
Eminent Scholar and Moorings Park Chair of Accounting  
Florida Gulf Coast University  
Lutgert College of Business  
10501 FGCU Blvd. S.  
Fort Myers, FL 33965-6565  
([avolkan@fgcu.edu](mailto:avolkan@fgcu.edu))

## **I. Introduction -**

After receiving input from constituents for nearly a year, the FASB and IASB decided to revise and re-expose their joint proposal on lease accounting. This exposure draft may lead to substantial changes in accounting for leases for companies under the jurisdiction of these two standard setting bodies.

However, the outcome of the U.S. debate on providing separate accounting standards for small and medium size entities (SMEs) will impact how and if these new lease accounting rules will have any impact on our SME clients.

During this 50-minute presentation, we will first examine the similarities and differences between current and proposed lease accounting rules. Next, we will discuss the current status of proposals to provide differential GAAP for SMEs. Finally, we will illustrate how the proposed lease accounting rules will impact the SMEs under each SME GAAP scenario that is currently being considered by the FAF.

The 2010/11 season was a very busy period for the FASB and IASB. Among the controversies addressed were the final report issued by the Blue-Ribbon Panel for Private Company Financial Reporting. In addition, a revised exposure draft is being issued for the FASB/IASB joint project on lease accounting.

Four general reasons drove the tremendous volume of official pronouncements issued by the accounting standard setters:

1. The drive and desire for international convergence.
2. Principles based standards – 1940s all over again.
3. Updating the FASB’s conceptual framework – redefining liabilities and equities.
4. Move to fair value accounting on the liability side.

## II. Recommendations for Accounting for SMEs -

There are many models to follow when we want to implement separate GAAP for SMEs:

- a) Canadian model – Same conceptual framework to support IFRS for public entities and a separate GAAP for private entities, with differences justified with a cost/benefit analyses.
- b) IASB model – Simplified and modified IFRS that eliminates EPS, segment reporting, insurance accounting complexities, interim reporting. While not entirely eliminated, some areas are greatly simplified such as accounting for stock options, warrants, and convertible debt; goodwill impairments and business combinations; investments in associated firms; impairments of intangibles; R&D; and uncertain tax positions.
- c) Other models – In the UK, the Financial Reporting Standards for Smaller Entities was first released in 1981. Ireland followed suit a few years later. Meanwhile, New Zealand has been using two sets of accounting standards since 1997. Finally, Australia has one set of standards but grants exemptions to SMEs from some of the requirements.
- d) Current alternatives – Separate board with SME rulemaking authority with separate GAAP; separate GAAP created by the FASB and revised as needed; current GAAP, but SMEs are exempted from certain requirements; and current GAAP.
- e) Blue-Ribbon Panel recommendation – Establish a separate board (the successor to PCFRC) which will start with separate, stand-alone private GAAP derived from current, public GAAP. The latter will evolve from this base as the new board makes changes. This new board will be autonomous (a third board under FAF). All private (i.e., changed) GAAP will reside in the FASB Codification. Currently, Trustee Working Group will address the needs of financial reporting for nonpublic entities and report to the FAF. **One question remains** – what is wrong with the current FASB practice of making modifications on a case-by-case basis?

**Pros** – 1) current GAAP is too complex; 2) current GAAP does not address the needs of the users of the SME financials (not relevant); 3) current GAAP is too costly to implement for SMEs; 4) the FASB does not address the needs of the SMEs; and 5) users have other means to obtain SME information.

**Cons** – 1) different standards increase borrowing costs; 2) GAAP for SMEs will be viewed as second class (dilution of information quality); 3) a financial statement is either right or wrong – if it is wrong for SMEs perhaps it is time to revise the standard involved, not to create another version (acceptability); 4) market place should decide on a case-by-case basis which GAAP exceptions would be acceptable (relevance – not comparability); and 5) Impact on education will be negative.

### **III. Lease Accounting Update –**

Current rules allow for off-balance sheet financing. Similar leases can be structured to be either operating or capital leases, destroying the comparability of financial information. FASB believes that IAS 17 is a superior standard since it is based on principles and not rules.

a) In March 2009 both Boards issued a joint discussion paper where the right-to-use (RTU) doctrine was explained. In short, it means that all leases that are longer than one year will be capitalized. However, the RTU model is very complex and will be costly to implement.

b) In August 2010 an exposure draft was released. Under the proposal, lessees would no longer classify leases either capital or operating leases. Instead, all leases would be brought into the balance sheet. Lessors will use either the performance obligation approach (lessor retains significant risk in the asset) or the derecognition approach (essentially, a sale is assumed).

c) If the doctrine is applied in its pure form, the increases in the debt-to-equity and decreases in the return-on-assets ratios will be more than 10 percent in transportations, retail, and service industries. The performance approach has many complexities such as varying income and loss recognition by lessor as the lease term is used up, having a balance sheet asset and a liability in addition to the leased asset, and others. Also, it may result in net lease assets exceeding the PV of net cash flows, resulting in excess profits. This may require the use of impairment accounting.

d) Under the derecognition approach, the portion of the asset equal to the PV of lease payments will be written off and the remainder will be shown as a residual on the balance sheet. The PV of rentals would include all possible contingent rentals and extensions and would use the longest possible time period. Lessor may book gain or loss for the difference of the PV of rentals and the carrying amount derecognized. These amounts would be reassessed at every balance sheet date. Changes for past amounts would be recognized as gain or loss but the future amounts would be adjusted to the asset.

e) The proposal met severe criticism and will be revised and released again this quarter. The dual accounting for lessors will be replaced with a single one.

The conclusion of many standard setting bodies is that more leases will be capitalized and accounting will be costly. However, consistency and transparency will be improved.

### **IV. How the SME Accounting Issue Is Resolved Impacts How SME Lease Accounting Changes (or, does not change) –**

If the Blue Ribbon Committee recommendations are approved by the FAF, lease accounting will be much different than if the FASB continued to promulgate GAAP for all entities, with exemptions for SMEs. We can speculate the extent and degrees of change and differences between public and SME lease accounting depending on how the SME standard setting is resolved.

### **V. Further Discussion and Q&A.**

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# ***Federal Tax Update***

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*Raymond L. Placid, CPA, JD, LL.M.*

**Raymond Placid, J.D.**  
Associate Professor of Accounting  
Florida Gulf Coast University

RAYMOND PLACID, Associate Professor of Accounting, J.D.,  
University of Miami (1990). CPA from the University of Florida in 1980.  
Previously at the University of Miami School of Business and School of  
Law LLM Estate Planning Tax Program.

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***Dealing with a Florida Sales/Use  
Tax Audit-do's and Don'ts***

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*Glenn A. Bedonie, CPA  
and  
Joseph C. Moffa, Esq., CPA*

## **Glenn A. Bedonie CPA**

President.

Glenn A. Bedonie CPA, PA

GLENN A. BEDONIE is the former Director of Technical Assistance and Dispute Resolution for the Department of Revenue, having retired after thirty years of distinguished service. He previously served as Program Director of Compliance and Education for the General Tax Administration Program. He served as the Director and Assistant Division Director for Audits; Chief, Bureau of Technical Assistance and was an auditor with the Department. Other professional experiences include public and private accounting and teaching college accounting courses. He received his B.A. in accounting from the University of West Florida. Mr. Bedonie has provided numerous state tax presentations to various professional organizations and has co-chaired the annual meeting of the State Tax Committee of the Florida Institute of Certified Public Accountants and representatives of the Department of Revenue for many years. He has also provided testimony to the National Commission on Restructuring the Internal Revenue Service. As co-chair for the Electronic Business Processes Working Group of the Federation of Tax Administrators Task Force on EDI, Audit and Legal Issues for Tax Administration, he reviewed emerging business practices and technology issues. He has received the Certified in Florida Sales Tax designation. Mr. Bedonie is a member of the American Institute of Certified Public Accountants and the Florida Institute of Certified Public Accountants. He served on the Board of Governors for the Florida Institute of Certified Public Accountants for ten years.

He served as Of Counsel with Thomas Howell Ferguson, a well respected local firm of Certified Public Accountants in Tallahassee, Florida and was a Special Consultant to Ryan & Company, a National State and Local Tax Consulting firm, based in Dallas, Texas.

He was also employed by Ryan, Inc. as Director, State & Local Tax based in Tallahassee, Florida.

He currently is the owner of Glenn A. Bedonie CPA, PA, specializing in State & Local tax matters and regularly consults with other professional practitioners.

## **Joseph C. Moffa, Esquire**

Law Office of Moffa & Gainor, PA

Joseph C. Moffa is an Attorney with The Law Offices of Moffa and Gainor, P.A. in Fort Lauderdale, Florida where he concentrates in the area of state taxation. Mr. Moffa is a frequent lecturer and author on state tax topics for various professional groups and organizations. Mr. Moffa has been actively involved in various professional organizations including: The Florida Bar, The Florida Institute of Certified Public Accountants, The Greater Ft. Lauderdale Tax Counsel (President 1998), FICPA State Tax Committee (Chairman 1998), and a member of the Executive Council of the Florida Bar Tax Section. (1998)

Mr. Moffa received his B.B.A. Degree in accounting (1980) and his M.B.A. Degree (1982) from Florida Atlantic University. He received his J.D. Degree from the University of Miami - School of Law (1984). Mr. Moffa is a licensed Florida CPA; and prior to practicing law, worked with national public accounting firms for over 10 years, the last 4 years of which he headed up the firm's Florida State And Local Tax (SALT) practice.

Mr. Moffa has authored the following articles on state taxation issues for the Florida CPA Today Magazine: Form Over Substance, (September 1994); Drop Shipments, (September 1993); Florida Corporation Income Tax, (August 1990). In addition, Mr. Moffa has authored and lectured on sales tax professional education seminars for such groups as the FICPA, Lorman Education Services, National Business Institute and Professional Education Systems, Inc.

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# ***Mortgage Fraud: An Unfortunate Growth Industry***

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*Professor Gary P. Opper, CFP, CPA, MST*

**Gary P. Opper, CPA**  
Managing Member  
Levie-Opper, LLC

Gary Opper has more than 30 years of accounting, business, financial and mortgage experience. He is a proven leader in the accounting and mortgage professions. He has received numerous awards for excellence in leadership, communication and writing abilities. He has published over 500 articles and has led over 80 seminars, lectures and courses on various topics.

# Mortgage Fraud

## An Unfortunate Growth Industry

Gary Opper, CPA, CFP  
George R. Levie, CPA/ABV  
Levie-Opper, LLC



## Mortgage Fraud Statistics

An indication  
of the  
magnitude of  
fraud is:

Between January and June of 2010, more than 500 people were arrested for alleged mortgage crimes.

The CoreLogic Fraud Index revealed fraud losses for 2010 to be estimated at \$11 billion.

Pending mortgage fraud investigations through the end of February 2011 were 3,020 with 72% involving losses of more than \$1 million.

In the 2011 fiscal year, there have been 245 cases of mortgage fraud opened as of February.

## Fraud Enforcement and Recovery Act

- Purpose: Attack and contain mortgage fraud
- Provide Funding of \$522 million for 2010 and 2011 to combat mortgage fraud
- Establishment of bipartisan Financial Crisis Inquiry Commission to explore financial practices that caused the current economic crisis

Under the Act, the following amounts have been allocated to combat mortgage fraud:

Fiscal Year	Total
	(in millions of dollars)
FBI	\$140
US Attorney Offices	\$100
DOJ- Criminal Division	\$40
DOJ- Civil Division	\$30
DOJ - Tax Division	\$10
Postal Inspection Service	\$60
HUD Inspector General	\$60
Secret Service	\$40
SEC	<u>\$42</u>
Totals	<u>\$522</u>

## Adding Mortgage Fraud Cases to Your Practice

- Civil
  - Lenders suing mortgage “un”professionals, appraisers, title companies, and private mortgage insurance companies
- Criminal
  - Government’s commitment to pursue mortgage fraud due to money committed to FBI, Attorney General, Department of Justice and other government agencies

## How Mortgage Fraud is Committed

- Application Fraud
- Real Estate Fraud
  - Real Estate Title Fraud
- Transaction Fraud

## Types of Fraud

- Fraud for Housing-to obtain a loan and therefore a home
- Fraud for Profit-to deceive a lender to make a profit with one of several schemes:
  - A straw buyer
  - Land Flip
  - Equity Skim

## Straw Buyer

- Definition of Straw buyer-person whose profile is used to serve as a cover for a transaction
- Willing straw buyer-participant in fraud
- Unwilling straw buyer-victim of identify theft

## Examine Mortgage Loan Files

- Mortgage Application- Form 1003
  - Summary of assets and liabilities
  - Sources of Income
  - Description of property purchase or refinanced
  - Signature of borrower
- Tax returns
  - Form 4506 – request for transcript from IRS

## Examine Mortgage Loan Files

- |   |   |
|---|---|
| • Credit Report   | • Appraisal   |
| – Correct name  | – Credentials of appraiser  |
| – FICO Score  | – Notation on appraisal-property values, addresses, date of appraisal |
| – Agreement of names and social security number and address |   |

## Minimizing Sentencing Time

- Sentencing Guidelines
- Economic loss directly related to sentencing time
- Determine amount of economic loss

## Case Study

- Investor uses government to go after criminal that tricked them into the loan application process
- Mortgage broker convicted of mortgage fraud
- Plea bargain rejected
- Criminal defense attorney hires expert
- Determination of actual economic loss by analysis of loan files and tracing of history of loan and property

## Case Study

- Economic loss presented at sentencing hearing to reflect minimal loss
- Prosecution sought 12 years
- Judge orders sentence of 3 years

## Conclusion

- Mortgage Fraud – An Unfortunate Growth Industry
  - Estimated Life 5-7 years
  - Opportunity for criminal defense and forensic professional support personnel, such as accountants, to capitalize during this window of opportunity

 Thank you 

- Levie-Opper, LLC
- Weston, Florida
- Tel. 954-384-4557
- Fax. 954-384-5483
- Email: [george@levie-opper.com](mailto:george@levie-opper.com)
- Email: [gary@levie-opper.com](mailto:gary@levie-opper.com)

# HOW TO BE A SUCCESSFUL FORENSIC ACCOUNTANT

By Gary Opper, Managing Member, Levie-Opper, LLC  
954-384-4557 Fax 954-384-5483

There is an increased need for forensic accountants due to added benefits of expert testimony and litigation support for forensic accounting. With mortgage fraud being such a hot topic, more and more attorneys are beginning to add the defense of this white collar crime to their practice. With this addition, more and more forensic accountants are needed to assist in exploration of these cases. In order to be chosen for the position, there are steps you can take to put your best foot forward and show your success.

## YOUR FEE

With the state of the economy, many attorneys and law firms are going to consider the cost factor before choosing a forensic accountant. Therefore, many firms will choose to seek out a forensic accountant with a specialized expertise in the area they need assistance. Try and focus your practice on a few specialized areas within the forensic field. Also, keep your fees reasonable.

A successful forensic accountant knows to collect a retainer in advance. Collecting a retainer will establish the job as “real” for both parties. Make sure this is indicated when you first meet with the client so it is not a surprise to them when they view the retainer in the engagement letter.

## REPUTATION

The first place someone will go when they have a position they need filled is to a colleague or friend/family member to seek a referral. A good reputation amongst your peers will open many doors to a successful career. Make sure to inform your friends, family and network of business contacts that you are open to referrals and that you are available to consult on any projects that may be available. Be sure to also keep them all abreast of your current business ventures and activities.

## GET INVOLVED

Potential clients will thoroughly review your resume and curriculum vitae. Having something that sets you apart from your competition is key. During your interview, be sure to indicate the professional associations and industry groups that you participate in. This will note that you have gone the extra mile in your professional life so you are sure to go the extra mile for their case, as well. Creating and teaching various seminars will also show your proactivity and that you are working to educate others in your field. Being active will also keep your name at the forefront of associations when they are asked for recommendations. Forensic accountants with extra credentials will surely be moved to

the top pile for consideration since they have shown an interest and desire for achieving high results for themselves.

## COMMUNICATION

Within your pitch meeting, communication will be a topic of great concern. The attorney or law firm will want to be sure that you will be able to speak to them on their level and in terms that can be easily understood. That way, they can in turn explain to their clients (and possibly a judge) exactly how you arrived at the specific figures. With a better understanding of your approach, it will give your potential client a greater confidence in your representation.

Furthermore, it is also important to reassure your potential clients that you will maintain an open line of communication with them. They will explain exactly what they would like to be kept apprised of during your investigation and how often they anticipate hearing from you.

## BE DIFFERENT

To set yourself apart from your competition, know what you have as a business that is different and unique. Be clear with exactly what results you can deliver and how that makes you distinctive amongst your peers. Be known for what you do and also specialize in offering clients consistent results.

Also, set yourself apart through your marketing skills. Actively submit articles that you've written on various forensic accounting topics to industry related magazines and newspapers in order to get your name out there. The more your name and firm get seen in these venues, the more readers will align you as an "expert" in your field. Of course, that is sure to give you greater accolades and set you ahead of your colleagues.

## TIME MANAGEMENT

Expectations will be set for you ahead of time so you will need to be able to estimate a potential timeline for your work. Let your clients know that when you make them a commitment, you follow through and that you will stick to the timeline as close as possible. Furthermore, give them a greater confidence in your services by asserting to clients that when you say you will have something completed by Thursday that it will be ready on Thursday.

## ETHICS

When working with a client, honesty is always the best policy. There will be an appreciation of your candor that you are being upfront with them by simply telling them, "We have a problem. Here's the issue..." By being honest with your client, there is likely to be a greater understanding should you not be able to meet a deadline that you

previously indicated. They will also have a greater respect for you and will likely gain additional trust in your work.

Having high ethics will also keep you out of harm's way. There are some jobs you will instinctively know not to take on so as not to feel pressured by anyone for results. All of your conclusions and reports need to be independent of demand from any party.

## POSITIVITY

Carry on with your work by keeping yourself focused on your goals and achieving your dreams. You need to maintain a positive attitude so that nothing can stop you! Stay on track with your tasks at hand and create the right atmosphere for you to accomplish them. A positive attitude is sure to lead you towards a successful business.

## CONSISTENCY

Consistency is a main indication of success. If you are consistently able to deliver the results your clients need, there will be faith in your work, which then creates return business. Should you need to testify your results; the judge will have a greater trust in your findings. Being consistent will give you the edge you need over your competition and provide you with a sound footing in the industry.

## CONCLUSION

There are many steps you can take to become a successful forensic accountant. Utilize the above tips to make an even greater impact on the industry and increase your business. Be sure to put your best foot forward because happy clients mean a steady income.

*Gary Opper, CPA is the Managing Member of Levie-Opper, LLC, Weston, Florida. He is a member of the American Institute of CPAs and the Florida Institute of CPAs. He has written over 500 published articles in over 20 magazines. Mr. Opper has been the National Association of Mortgage Broker's "Writer of the Year" and "Featured Writer of the Year." He has spoken to many groups including the Florida Bar Association, the Florida Institute of CPAs, the Mortgage Bankers Association and Northern Trust Bank. He has lectured at four colleges including University of Florida and Florida International University. Opper has an Accounting degree from UF and a Master of Science in Taxation from FIU. Opper is Past President of the Florida Association of Mortgage Professionals - Miami Chapter and the FICPA - Gold Coast Chapter. Levie-Opper, LLC focuses on forensic accounting and fraud auditing. They handle state and federal cases including civil, commercial and criminal. Mr. Opper is available to speak to your group. He may be reached at (954) 384-4557, fax: (954) 384-5483, or e-mail: [Gary@Levie-Opper.com](mailto:Gary@Levie-Opper.com).*

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## LICENSING CHART FOR CHAPTER 494 UPDATE

### LICENSE EXPIRATION DATE

	<u>Mortgage Broker</u>	<u>Mortgage Brokerage Business</u>	<u>Mortgage Lender</u>	<u>Correspondent Mortgage Lender</u>
New license type	Loan Originator	Mortgage Broker	Mortgage Lender	Mortgage Broker, Mortgage Lender with/without Service Endorsement
Licenses issued before October 1, 2010 - All old licenses issued before October 1 2010, expire on December 31, 2010.	x	x	x	x
Any old license does not expire until the Office of Financial Services approves or denies the new license application, if the following requirements are met:	x	x	x	x
1. The person holds an active old license issued before October 1, 2010				
2. The person applies for a new license through the Nationwide Mortgage Licensing System and Registry between October 1, 2010 and December 31, 2010				

### Initial Applications

	<u>Mortgage Originator</u>	<u>Mortgage Broker</u>	<u>Mortgage Lender</u>
Must be 18 years old or older and have a high school diploma or equivalent	x		
Complete a 20-hour registry's preclicensing class	x		
Pass a written test	x		
Submit a completed application	x \$195 application, \$20 MGTF	x \$425 application, \$100 MGTF	x \$500 application, \$100 MGTF
Submit fees			
Submit fingerprints	x	x (1)	x (1)
Authorize the registry to obtain a credit report at the applicant's cost	x	x (1)	x (1)
Submit any additional information required by the office to help determine eligibility	x	x	x
Submit any additional information required by the registry	x	x	x
Designate a qualified principal loan originator		x	x
Indicate whether the mortgage lender is seeking a servicing endorsement			x
Submit audited financial statements with adequate net worth			x

(1) submit for each control person

### License Renewals

	<u>Mortgage Originator</u>	<u>Mortgage Broker</u>	<u>Mortgage Lender</u>
Submit a completed license renewal form	x	x \$375	x \$475
Submit a nonrefundable fee, the Mortgage Guarantee Trust Fund fee and, if required, a fingerprint fee	\$150 renewal, \$20 MGTF	\$100 MGTF	\$100 MGTF
Complete an 8 hour continuing education class	x		
Authorize the registry to obtain a credit report at the applicant's cost	x	x (1)	
Submit any additional information required by the office to help determine renewal eligibility	x	x	
Continue to meet the requirements for the initial license (F.S 494.0313)	x		
Submit fingerprints for a new control person		x	x
Annual renewal period	x	x	x

(1) Submit for each control person

# ***FREQUENTLY ASKED QUESTIONS:*** **WHAT ISN'T NEW WITH FLORIDA STATUTES CHAPTER 494 – MORTGAGE LAW?**

By Gary Oppen, Approved Financial Corporation 954-384-4557 – Fax 954-384-5483 –Oppen@ApprovedFinancial.com

*Sometimes the questions are complicated and the answers are simple.*  
*-Dr. Seuss (1904 - 1991)*

This is a summary of the law. Many of the changes are discussed here; however, not every changed is discussed. I hope this helps you wade your way through the Florida Chapter 494 swamp! Don't forget your boots!

This article was written to provide accurate and authoritative information in regard to the subject matter covered. It is printed with the understanding that the author is not offering any legal, accounting or professional service and the information stated should not be applied to any specific factual instance. If you are unsure about a particular situation, you should consult an attorney. Gary Oppen addressed the Miami Chapter of Florida Association of Mortgage Brokers with this presentation.

*Gary Oppen is President of Approved Financial Corporation, Weston, Florida. Approved Financial Corporation is a licensed mortgage lender. Mr. Oppen has been a Mortgage Lender and Note Buyer since 1984. He is president of Levie-Oppen, a mortgage fraud litigation support firm. Also, he does mortgage consulting. He has a CPA and a CFP license. Oppen is past President of the FAMB - Miami Chapter and the FICPA - Gold Coast Chapter. Oppen is a member of the NAMB, FAMB, AICPA and the FICPA. Mr. Oppen has been the NAMB's Writer of the Year and Featured Writer of the Year. Mr. Oppen was the FAMB's Broker of the Year. Mr. Oppen is available to speak to your group. Please contact him to arrange a speech for your event. He may be reached at (954) 384-4557, fax: (954) 384-5483, or e-mail: [oppen@approvedfinancial.com](mailto:oppen@approvedfinancial.com).*

The new mortgage law is 121 pages long. Now is the time to be up to date with the new Florida mortgage act. At first glance it appears ominous and voluminous; however, upon closer inspection many of the changes only substitute a single or a few word changes. For example, "shall" is changed to "must" or "mortgage broker" is changed to "loan originator." Other changes just clean up and clarify the current Chapter 494. Part II of Chapter 494 is changed from "Mortgage Brokers" to "Loan Originators and Mortgage Brokers." A lot of the pages are just the current law or the writing with words stricken, which indicate deletions in the law.

Looking at the underlined sections, which are the new additions, there are less than 60 pages to review. Additionally, in some cases, the new mortgage broker and mortgage lender laws basically mirror each other. Also, the requirements for each new license type mirror each other.

A business will be licensed as a mortgage lender or a mortgage broker; there will be no more mortgage brokerage businesses. Individuals will be licensed as mortgage originators; no longer mortgage brokers. The correspondent mortgage lender license is eliminated. Most of the previous laws concerning mortgage brokerage businesses will apply to mortgage

brokers. Most of the laws that applied to mortgage brokers will apply to mortgage originators.

Florida Governor Charlie Crist approved the bill on June 29, 2009. A PDF copy of the bill is located at: <http://www.myfloridahouse.gov/Sections/Bills/billsdetail.aspx?BillId=41471>  
Click "Enrolled" under "Bill Text." You can search the bill for a particular word. If you wanted to know everything about a "loan originator," just type loan originator in as a search and all the matches will be located.

Chapter 494 is located at:  
<http://www.leg.state.fl.us/Statutes/index.cfm?Mode=View%20Statutes&Submenu=1&Tab=statutes&CFID=94151113&CFTOKEN=42281529>  
or just type in Florida Statutes Chapter 494 in the search section and then click on Statutes & Constitution: View Statutes: Online Sunshine. This is also searchable.

**THESE STATUTES ARE EFFECTIVE JULY 1, 2009 –**

## **What are the new advertising rules?**

Effective July 1, 2009, it is an advertising violation to engage in unfair, deceptive or misleading advertising regarding mortgage loans, brokering services or lending services. 494. (F.S. 494.00165(e)) The

previous violations and the requirement to keep a record of advertisements are still in effect. (F.S. 494.00165)

**THESE STATUTES ARE EFFECTIVE  
SEPTEMBER 30, 2010 -**

**When do mortgage business school permits expire?**

All mortgage business school permits expire on September 30, 2010. (SB2226, Section 70(1)) All future educational classes will be approved by the Nationwide Mortgage Licensing System and Registry. (S.A.F.E. Mortgage Licensing Act 1505(e)(2) & 1506(b)(2))

**THESE STATUTES ARE EFFECTIVE OCTOBER  
1, 2010 -**

**What is the definition of a “loan originator?”**

A “loan originator” means an individual who, directly or indirectly:

1. Solicits or offers to solicit a mortgage
2. Accepts or offers to accept an application for a mortgage
3. Negotiates or offers to negotiate the terms or conditions of a new or existing mortgage on behalf of a borrower or lender
4. Processes a mortgage application
5. Negotiates or offers to negotiate the sale of an existing mortgage to a noninstitutional investor for compensation or gain

The term includes the activities of a loan originator as defined in the S.A.F.E Mortgage Licensing Act of 2008. Also, an individual acting as a loan originator pursuant to that definition is acting as a loan originator for the purposes of this definition.

The term does not include an employee of a mortgage broker or mortgage lender who performs only administrative or clerical tasks, including quoting available interest rates, physically handling a completed application form or transmitting a completed form to a lender on behalf of a prospective borrower. (F.S. 494.001(14))

**What is the definition of a “mortgage broker?”**

A “mortgage broker” means a person conducting loan origination activities through one or more licensed loan originators employed by the mortgage broker or as independent contractors to the mortgage broker. This was a mortgage brokerage business in the old law. (F.S. 494.001(18))

**What is the definition of “mortgage lender?”**

“Mortgage lender” means a person making a mortgage or servicing a mortgage for others, or, for compensation or gain, directly or indirectly, selling or

offering to sell a mortgage to a noninstitutional investor (F.S. 494.001(19))

**When do mortgage brokerage business licenses expire?**

See the chart. The pre-act mortgage broker business is applying for a new mortgage broker license.

**When do mortgage broker licenses expire?**

See the chart. The pre-act mortgage broker is applying for a new loan originator license.

**When do mortgage lender licenses expire?**

See the chart. The mortgage lender is applying for a mortgage lender license (the equivalent license) or a mortgage broker license.

**When do correspondent mortgage lender licenses expire?**

See the chart. The pre-act correspondent mortgage lender is applying for a new mortgage broker or a mortgage lender license.

**How long does the Office of Financial Services (“OFR”) have to approve a mortgage broker or loan originator application?**

Mortgage broker applications submitted between July 1, 2009, and December 31, 2009, or loan origination applications submitted between October 1, 2010 and December 31, 2010, the OFR has 60 days to notify the applicant of any errors or omissions and request any additional information. The OFR has 180 days to approve or deny a completed application. (SB2226, Sec. 70(3))

**What is the definition of the “registry?”**

The “Registry” means the Nationwide Mortgage Licensing System and Registry, which is the mortgage licensing system developed and maintained by the Conference of State Bank Supervisors and the American Association of Residential Mortgage Regulators for licensing and registration of loan originators. (F.S. 494.001(29))

The OFR shall participate in the registry and shall regularly report to the registry violations of Chapter 494, disciplinary actions and other information deemed relevant by the OFR.

**What are the requirements for a mortgage originator’s license?**

See chart.

**What are some of the new requirements of mortgage originators?**

The mortgage originator shall notify the OFR of any conviction or nolo contendere plea for any felony or any crime or administrative violation that involves fraud, dishonesty, breach of trust, money laundering or moral turpitude. (F.S. 494.004(1) (a))

**What are grounds for denial of a mortgage originator?**

If the applicant has:

- a) Committed any violation of Chapter 494
- b) Has a pending felony, criminal prosecution or an administrative enforcement prosecution which involves fraud, dishonesty, breach of trust, money laundering or moral turpitude
- c) Has failed to demonstrate the character, general fitness and financial responsibility to command the confidence of the community and warrant a determination that the applicant will operate honestly, fairly and efficiently. (F.S. 494.00312(4)(b)(1))

**What are grounds for denial of a mortgage broker or a mortgage lender?**

If the applicant or the applicant’s control person has done any of the above three items they are grounds for denial of mortgage originator. F.S. 494.00611(4) & 494.00321(4))

**What is the definition of a “control person?”**

A “control person” means an individual, partnership, corporation, trust or other organization that possesses the power, directly or indirectly, to direct the management or policies of a company, whether through ownership or securities, by contract or otherwise. The term includes, but is not limited to:

- (a) A company’s executive officers, including the President, Chief Executive Officer, Chief Financial Officer, Chief Operations Officer, Chief Legal Officer, Chief Compliance Officer, Director and other individuals having similar status or functions
- (b) For a corporation, each shareholder that, directly or indirectly, owns 10 percent or more or that has the power to vote 10 percent or more, of a class of voting securities unless the applicant is a publicly traded company
- (c) For a partnership, all general partners and limited or special partners that have contributed 10 percent or more or that have the right to receive, upon dissolution, 10 percent or more of the partnership’s capital

- (d) For a trust, each trustee
- (e) For a limited liability company, all elected managers and those members that have contributed 10 percent or more or that have the right to receive, upon dissolution, 10 percent or more of the partnership’s capital
- (f) A principal loan originator (F.S. 494.001(5))

**What is the definition of a “credit score?”**

A “credit score” means a score, grade or value that is derived by using data from a credit report in any type of model, method or program, whether electronically, in an algorithm, in a computer software or program, or by any other process for the purpose of grading or ranking credit report data. (F.S. 494.001(7))

**How is the credit report evaluated?**

If there is adverse information in a credit report of any applicant, the information must be considered within the totality of the circumstances. The adverse items may have resulted from factors that do not necessarily reflect negatively upon the applicant’s character, general fitness or financial responsibility. (F.S. 494.00312(4)(b)(2))

The OFR may not use a credit score or the absence of insufficient credit history information to determine character, general fitness or financial responsibility. (F.S. 494.00312(4)(b)(3))

If the credit report is used as basis to deny a license, the OFR shall provide the applicant the grounds or basis for denial. The use of the terms “poor credit history,” “poor credit rating” or similar language cannot be used by the OFR. (F.S. 494.00312(4)(b)(3))

**How long is a mortgage originator’s license good?**

All mortgage loan originator licenses must be renewed annually by December 31. (F. S. 494.00312(4)(b)(3))

**What are the requirements to renew a mortgage originator’s license?**

See the chart.

**How many mortgage employers can a mortgage originator work for at one time?**

A mortgage originator must be an employee or an independent contractor for one mortgage broker or mortgage lender only. They may not be an employee or contract with more than one mortgage entity. (F.S. 494.00331)

**What is the definition of a “branch manager?”**

A “branch manager” means the licensed loan originator in charge of, and responsible for, the

operation of the branch office of a mortgage broker or mortgage lender. (F.S. 494.001(2))

#### **What if there are branch offices?**

Each branch office of a mortgage entity must be licensed (F.S. 494.0036(1) & F.S. 494.0066(1)) and must designate a branch manager. (F.S. 494.0035(2) & F.S. 494.0065(2)) The branch manager shall have full charge, control and supervision of the mortgage entity. (F.S. 494.0066(2) & F.S. 494.0035(2))

The initial fee and the annual renewal fee for a branch office is \$225.00. (F.S. 494.0036(2) & (3) & F.S. 494.0066(2) & (3))

#### **What if the branch manager or principal loan originator designation is deemed inaccurate?**

If the PLO or branch manager designation is deemed inaccurate then the business shall be deemed to be operated under the control of each officer, director, ultimate equitable owner of 10% or greater or any person in similar capacity. (F.S. 494.0035(2) & 494.00665(1))

#### **Is a mortgage broker or mortgage lender license assignable?**

Neither a mortgage broker or mortgage lender license is assignable or transferable. (F.S. 494.004(4) & 94.0611(7))

#### **NOW THAT WE FINALLY HAVE LICENCES, WHAT IS A MORTGAGE APPLICATION AND MORTGAGE LOAN?**

##### **What is the definition of a “mortgage application?”**

A “mortgage loan application” means the submission of a borrower’s financial information in anticipation of a credit decision, which includes:

1. The borrower’s name
2. The borrower’s monthly income
3. The borrower’s social security number to obtain a credit report
4. The property address
5. An estimate of the value of the property
6. The mortgage loan amount sought
7. Any other information deemed necessary by the loan originator

An application may be in writing or electronically submitted, including a written record of an oral application. (F.S. 494.001(21))

##### **What is the definition of a “borrower?”**

A “borrower” means a person obligated to repay a mortgage and includes, but is not limited to, a co-borrower, cosigner or guarantor. (F.S. 494.001(1))

##### **What is a definition of a “mortgage loan?”**

“Mortgage loan” means any:

- (a) Residential loan primarily for personal, family or household use which is secured by a mortgage, deed of trust or other equivalent consensual security interest on a dwelling, as defined in s. 103(v) of the Federal Truth in Lending Act, or for the purchase of residential real estate upon which a dwelling is to be constructed
- (b) Loan on commercial real property or improved real property consisting of five or more dwelling units if, either apply:
  1. The borrower is an individual
  2. The lender is a noninstitutional investor (F.S. 494.001(20))

##### **What is new with the mortgage broker agreement with the borrower?**

In order to earn a loan origination fee, the written mortgage broker agreement between the mortgage broker and the borrower must be signed and dated by the Principal Loan Officer (“PLO”) or branch manager and the borrower. The PLO is explained below. The unique registry identifier of each loan originator responsible for the loan must be on the agreement. (F.S. 494.0038)

Except for application and third-party fees, all fees received by the mortgage broker from a borrower must be called a loan origination fee. (F.S. 494.0038(1))

All fees must be disclosed in dollar amounts. (F.S. 494.0038(2))

All loan origination fees must be paid to the mortgage broker. (F.S. 494.0038(3))

A mortgage broker may not pay a commission to an unlicensed person. (F.S. 494.0038(8))

##### **What is a “loan origination fee?”**

A “loan origination fee” means the total compensation from any source received by a mortgage broker acting as a loan originator. (F.S. 494.001(13))

##### **Is a separate fee allowed for third party mortgage processing?**

No, any payment for processing mortgage loan applications must be included in the fee and must be paid to the mortgage broker. (F.S. 494.001(13))

##### **What are net worth requirements of a mortgage lender?**

The mortgage lender must submit annually its audited financial statement. The mortgage lender’s net worth

must be at least \$63,000 if the applicant is not seeking a servicing endorsement and at least \$250,000 if it is seeking a servicing endorsement. The net worth requirement must continually be maintained.

**What are net worth requirements for a mortgage lender under the saving clause and for a mortgage lender who is seeking a servicing endorsement?**

The net worth requirement until September 30, 2011 is \$63,000. The net worth requirement from October 1, 2011 to September 30, 2012 will be \$125,000. On or after October 1, 2012, the net worth requirement will be \$250,000. (F.S. 494.0061(2)(f))

**What is the definition of “servicing endorsement?”**

“Servicing endorsement” means authorizing a mortgage lender to service a loan for more than 4 months. (F.S. 494.001(31))

**Is a broker or mortgage lender license transferable or assignable?**

No, the license is not transferable or assignable. (F.S. 494.0061(7))

**What is the definition of a “principal loan originator (“PLO”)?”**

A “principal loan originator” means the licensed loan originator in charge of, and responsible for, the operation of a mortgage lender or mortgage broker. It includes all of the activities of the mortgage lender’s or mortgage broker’s loan originators and branch managers, whether employees or independent contractors. (F.S. 494.001(26))

**What does a principal loan originator do?**

Each mortgage broker and mortgage lender must have a principal loan originator. The PLO shall have full charge, control and supervision of the mortgage entity.

**What are the PLO qualifications?**

The individual must be a loan originator for at least one year before becoming the PLO or show that he or she has been in a mortgage broker-related business for at least one year. The entity must keep the OFR informed of any changes to the PLO.

**Can a loan originator be a PLO for more than one mortgage entity?**

No, a loan originator can be a PLO for only one mortgage entity. F.S. 494.0035(1)

**What if the PLO designation is deemed inaccurate?**

The business shall be deemed to be operated under the control of each officer, director, ultimate equitable

owner of 10% or greater or any person in a similar capacity. (F.S. 494.0035(1)). The same is true for a branch manager. F.S. 494.0035(2)

**What about certain changes in the business?**

A mortgage entity shall report any changes to the OFR for the following:

- a) Principal loan originator
- b) Control person
- c) Or, any change in the business organization form (F.S. 494.004(1)(f) & F.S. 494.0067(4)(b))

**What if the OFR does not approve of a new control person?**

If the OFR determines that the mortgage business does not meet the licensing requirements it may take administrative action. F.S. 494.004(1)(e) & F.S. 494.0067(4)

Any change in the PLO or a control person must be reported. (F.S. 494.004(5)(a))

The licensee shall report any addition of a control person who has not previously filed a Uniform Mortgage Biographical Statement & Consent Form, Form MU2, or has not previously complied with the fingerprinting and credit report requirements.

**What rules may the Financial Service Commission (“commission”) adopt under the new laws?**

The legislation has left many of the rule making for the laws up to the commission.

**What if a mortgage entity or loan originator is involved in a crime or administrative violation?**

The citations for these laws F.S. 494.0067(5) are for mortgage lenders and 494.004(a) for mortgage broker and loan originators. The laws are very similar, but not exactly the same. A technical correction act will probably fix the difference so that the laws will match. The law applies to a loan originator, a mortgage broker, a mortgage lender or a control person of either mortgage entity.

The person or entity shall report any indictment, information, charge, conviction or plea of guilty or nolo contendere, regardless of adjudication, to any felony, or any crime or administrative violation that involves fraud, dishonesty, breach of trust, money laundering or moral turpitude, in any jurisdictions within 30 days.

**What is “moral turpitude?”**

West's Encyclopedia of American Law, edition 2 states, “Crimes involving moral turpitude have an inherent quality of baseness, vileness or depravity with

respect to a person's duty to another or to society in general." Examples include rape, forgery, robbery and solicitation of prostitutes. Many jurisdictions impose penalties, such as deportation of aliens and disbarment of attorneys, following convictions of crimes involving moral turpitude.

#### **How long can a mortgage lender service a loan?**

Mortgage brokers and loan originators cannot service a loan. A mortgage lender may close a loan in its own name, but may not service the loan for more than 4 months unless the mortgage lender has a servicing endorsement.

#### **What is the definition of a "material change?"**

"Material change" means a change that would be important to a reasonable borrower in making a borrowing decision, and includes:

1. A change in the interest rate previously offered to a borrower
2. A change in the type of loan offered to a borrower
3. A change in fees to be charged to a borrower resulting in total fees greater than \$100. (F.S. 494.001(17))

#### **What must you do if there is a material change?**

These are not new in the law; however, combined with the definition of material change they bring new meaning to the statute.

A mortgage entity must notify a borrower of any material change in a mortgage loan transaction within 3 business days after being made aware of the changes by a mortgage lender and at least 3 days before the signing of the settlement statement. The licensee bears the burden of proving the notification was provided and accepted by the borrower. A borrower may waive the right to receive notice of the loan if it is needed to meet a bona fide personal financial emergency. (F.S. 494.004(2) & 494.0067(10))

#### **What action constitutes a ground for disciplinary action?**

Each of the following acts constitutes a ground for which the disciplinary actions under F. S. 494.00255 apply:

- a) Escrow - Failure to immediately place upon a receipt, and maintain until authorized to disburse, any money entrusted to the licensee as a licensee in a bank account
- b) Retain Property - Failure to account or deliver to any person any property that is not the licensee's, or that the licensee is not entitled to retain, under the circumstances and at the time that has been agreed upon or

as required by law or, in the absence of a fixed time, upon demand of the person entitled to such accounting and delivery

- c) Retain Funds - Failure to disburse funds in accordance with agreements
- d) Property Misuse- The misuse, misapplication or misappropriation of personal property entrusted to the licensee's care to which the licensee had no current property right at the time of entrustment
- e) Mortgage Fraud - Fraud, misrepresentation, deceit, negligence or incompetence in any mortgage financing transaction
- f) Appraisal Pressure - Requesting a specific valuation, from an appraiser, implying that a specific valuation is needed or conditioning the order on the appraisal meeting a specific valuation. The numeric value need not be stated, but rather the mere statement that a specific valuation is sought, violates this section
- g) Understanding Costs - Consistently and materially underestimating maximum closing costs
- h) Mortgage Guarantee Trust Fund ("MGTF") Disbursement - Disbursement, or an act which has caused or will cause disbursement, to any person in any amount from the MGTF, the Securities Guaranty Fund or the Florida Real Estate Recovery fund, regardless of any repayment or restitution to the disbursed fund by the licensee or any person acting on behalf of the licensee
- i) General Fraud - Commission of fraud, misrepresentation, concealment or dishonest dealing by trick, scheme or device; culpable negligence; breach of trust in any business transaction in any state, nation or territory; or aiding, assisting, or conspiring with any other person engaged in any such misconduct and in furtherance thereof
- j) Crime - Being convicted of, or entering a plea of guilty or nolo contendere to, regardless of adjudication, any felony or any crime involving fraud, dishonesty, breach of trust, money laundering or act of moral turpitude.
- k) Civil Fraud Judgment - Having a final judgment entered against the licensee in a civil action upon grounds of fraud, embezzlement, misrepresentation or deceit

- l) SEC violations - Violating security or commodity laws records, or refusal to comply with an office subpoena or subpoena duces tecum
  - m) RESPA/TIL Violations - Violating the Real Estate Settlement Procedure Act or the Federal Truth in Lending Act. Having a loan originator, mortgage broker, or mortgage lender license, or the equivalent of such license, revoked in any jurisdiction
    - x) Dead Beat - Failure to timely pay any fee, charge or fine imposed or assessed pursuant to ss. 494.001-494.0077 or related rules
- The state has broad subpoena powers.
- What are the penalties for a violation of the above?**
- If the OFR finds a person in violation of the act specified in this section, it may enter an order imposing one or more of the following penalties:
- (a) Issuance of a reprimand
  - (b) Suspension of a license, subject to reinstatement upon satisfying all reasonable conditions imposed by the office
  - (c) Revocation of a license
  - (d) Denial of a license
  - (e) Imposition of a fine in an amount up to \$25,000 for each count or separate offense
  - (f) An administrative fine of up to \$1,000 per day, but not to exceed \$25,000 cumulatively, for each day that:
    1. A Mortgage broker or mortgage lender conducts business at an unlicensed branch office
    2. An unlicensed person acts as a loan originator, mortgage broker or a mortgage lender
- Can the mortgage entity be responsible for the action of a control person or a loan originator?**
- A mortgage broker or mortgage lender is subject to the disciplinary actions for a violation by either:
- a) A control person of the mortgage entity
  - b) A loan originator of the mortgage entity
- Can the PLO, control person or the branch manager be held responsible for the actions of a loan originator?**
- A principal loan originator or branch manager is subject to the disciplinary actions for violations by a loan originator if there is a pattern of repeated violations by the loan originator or if the principal loan originator has knowledge of the violations. (F.S.494.00255(4) & (6).
- An individual who is associated with the mortgage entity is subject to the disciplinary actions for a violation with respect to an action in which such person was involved.
- n) Mortgage License Revocation – Having a any mortgage license revoked in anywhere
  - o) Any License Revocation - Having a license, or the equivalent of such license, to practice any profession or occupation revoked, suspended, or otherwise acted against, including the denial of licensure by a licensing authority of this state or another state, territory, or country
  - p) Unlicensed Practice - Acting as a loan originator, mortgage broker or mortgage lender (without a current license issued under part II or part III of this chapter
  - q) Unlicensed Practice - Operating a mortgage broker or mortgage lender branch office without a current license issued under part II or part III of this chapter
  - r) No PLO or branch manager designation - Conducting any mortgage brokering or mortgage lending activities in the absence of a property designated principal loan originator or mortgage brokering or mortgage lending activities at any particular branch office without a properly designated branch manager
  - s) License mistake - A material misstatement or omission of fact on an initial or renewal license application
  - t) Bad Check - Payment to the office for a license or permit with a check or electronic transmission of funds, which is dishonored by the applicant's or licensees financial institution
  - u) Mortgage Law Breaker - Failure to comply with, or violations of, any provision or rule under Chapter 494
  - v) Maintain Records - Failure to maintain, preserve and keep available for examination all books, accounts or other documents required by ss. 494.001-494.0077 and the rules of the commission
  - w) Investigation Refusal - Refusal to permit an investigation or examination of books and

### **When can the OFR suspend a license?**

Pursuant to F.S. 120.60(6), the OFR may summarily suspend the license of a loan originator, mortgage broker or mortgage lender if the office has reason to believe that a licensee poses an immediate, serious danger to the public's health, safety or welfare. The arrest of the licensee, the mortgage broker or the mortgage lender's control person for any felony or any crime involving fraud, dishonesty, breach of trust, money laundering or any other act of moral turpitude is deemed sufficient to constitute an immediate danger to the public's health, safety or welfare. Any proceeding for the summary suspension of a license must be conducted by the commissioner of the office, or designee, who shall issue the final summary order.

### **What is the Mortgage Guaranty Trust Fund ("MGTF")?**

The MGTF was set up to compensate borrowers who have final judgments against a licensee for damages caused by Chapter 494 violations and the borrower has not been able to collect from the licensee.

A nonrefundable initial and renewal fee is imposed as follows:

- 1) Mortgage Originators - \$20.00
- 2) Mortgage Brokers and Lenders - \$100.00

This fee is in addition to the application fee. The amount is deposited into the Mortgage Guaranty Trust Fund for the payment of claims. (F.S. 494.00172)

When the fund reaches \$5,000,000, the additional fee will be discontinued until the fund is below \$1,000,000.

### **How is borrower eligible for the MGTF?**

A borrower is eligible to seek a recovery from the trust fund if all the following conditions are met:

- a) The borrower has a recorded final judgment issued by a state court based on violation of Chapter 494 and damages were the result of that violation
- b) There is a writ of execution on the judgment and there is no debtor property that can be found or sale of the debtor's property is insufficient to satisfy the judgment
- c) The borrower has searched for the debtor's property and has discovered no property or the amount of the debtor's property is insufficient to satisfy the judgment
- d) The borrower has applied all amounts received from the debtor to the judgment amount
- e) At the time that the action was instituted, the borrower gave notice by certified mail the OFR; this may be waived with good cause

- f) The debtor's act occurred on or after January 1, 2011 (F.S. 494.00172 (a)-(f))

Any person who meets all the conditions above may apply to the OFR for compensation from the MGTF for the unpaid portion of the licensee's judgment or \$50,000, whichever is less. They can request the actual or compensatory damages, attorney's fees and cost awarded by court and documented collection fees. The amount cannot include postjudgment interest. The attorney's fee may not exceed \$5,000 or 20% of the damages, whichever is less. A borrower may not collect more than \$50,000 regardless of the number of licensees involved. (F.S. 494.00172)

Payments for claims are limited to \$250,000 per licensee regardless of total claims. If the claims exceed \$250,000, the amount due each claimant will be prorated. (F.S. 494.0172 (4)(b))

Payments shall be made to all claimants two years after the first complete and valid notice is received by the OFR. Claimants who give notice after two years and comply with the conditions precedent may recover any remaining portion of the \$250,000. The claims will be paid in the order received. F.S. 494.00172 (4)(c)

A claimant may assign their right to recovery from the MGTF. (F.S. 494.00172(d))

If there is insufficient money in the MGTF for any claim, the OFR will satisfy the claim as soon as enough money is available. The claims shall be satisfied in the order they are received. (F.S. 494.00172(4)(e))

### **Can a borrower still get compensated by the MGTF if the licensee files bankruptcy?**

The above does not have to be done if the subject licensee filed for bankruptcy or has been adjudicated bankrupt. The borrower must file a proof of claim and notify the OFR of the proof of claim by certified mail. (F.S. 494.00172(3))

### **When a payment is made for a judgment what is the licensee's status?**

The MGTF payments constitute prima facie grounds for the revocation of the license. (F.S. 494.00172(4)(f)) Prima facie is Latin for "on its face." Lectric Law Library states, "a prima facie case is one that at first glance presents sufficient evidence for the plaintiff to win. Such a case must be refuted in some way by the defendant for him to have a chance of prevailing at trial."

### **When does a licensee have a conflicting interest?**

A conflicting interest occurs when:

1. The licensee or the licensee's relative provides the borrower with additional products or services
2. The licensee or the licensee's relative owns, controls or holds voting power or proxies of 1% or more of any equity or beneficial interest in the entity providing the product or service
3. The provider owns, controls or holds voting power or proxies of 1% or more of any equity or beneficial interest in the licensee
4. A holding company owns, controls or holds voting power or proxies of 1% or more of any equity or beneficial interest or licensee and the provider of the product or service
5. One or more person or person's relative is an officer, director or performs similar function for both the licensee and the provider
6. The licensee or the licensee's relative is an officer, director or performs similar function for the additional provider (F.S. 494.4940023(2))

**What is the definition of a “relative?”**

A “relative” means any of the following, whether by the full or half blood or by adoption:

- (a) A person's spouse, father, mother, children, brothers and sisters
- (b) The father, mother, brothers and sisters of the person's spouse
- (c) The spouses of person's children, brothers or sisters (F.S. 494.001(30))

**What must the licensee do if there is a conflicting interest?**

At a minimum, the licensee shall provide the following written disclosures:

- a) The relationship between the licensee and the provider of the product or service
- b) An estimated charge or range of charges
- c) That the licensee may receive a financial benefit
- d) That alternative sources may be chosen by the borrower for the product or service (F.S. 494.0023(1))

**What practices are prohibited?**

It is prohibited to act as loan originator, mortgage broker or mortgage lender without a current active license. (F.S. 494.0025)

It is prohibited to knowingly alter, withhold, conceal or destroy any information related to a person's mortgage activity. (F.S. 494.0025(10))

**What are some of the changes in the mortgage lender laws?**

A mortgage lender shall report any changes in the principal loan originator, control person or any change in business organization by written amendment in such form and at such time that Financial Services Commission specifies by rule. (F. S. 494.0067(4))

Any addition of a control person who has not previously filed a Uniform Mortgage Biographical Statement & Consent Form, Form MU2, or has not previously complied with the fingerprinting and credit report requirements of mortgage lender license is subject to the mortgage lender requirements. (F.S. 494.0067(4)(b))

If after the addition of a control person the OFR determines that the licensee does not continue to meet the licensure requirements, the OFR may bring administrative actions to enforce the mortgage lender requirements. . (F.S. 494.0067(4)(b))

Each mortgage lender shall report any indictment, information, charge, conviction or plea of guilty or nolo contendere, regardless of adjudication, to any felony or any crime or administrative violation that involves fraud, dishonesty, breach of trust, money laundering or another act of moral turpitude, in any jurisdiction, by the licensee or any principal officer, director or ultimate equitable owner of 10% or more of the licensed corporation, within 30 business days after the incidence. (F.S. 494.0067(5))

Each mortgage lender must mail or deliver to the applicant a good faith estimate of costs within three business days after the lender receives a written loan application from the applicant. (F.S. 494.0067(8))

A mortgage lender may close loans in its own name, but may not service the loan for more than 4 months unless the lender has a servicing endorsement. Only a lender with net worth of at least \$250,000 may obtain a servicing endorsement. (F.S. 494.0067(11))

A servicing endorsement means authorizing a mortgage lender to service a loan from more than 4 months. (F.S. 494.001(31))

A mortgage lender must report to the OFR within two days after the mortgagee knows or should have known that the \$250,000 net worth requirement is not meet. (F.S. 494.0067(12))

**What is the definition of a “loan modification?”**

“Loan modification” means a modification to an existing loan. The term does not include a refinancing transaction. (F.S. 494.001(12)) Effective January 1, 2010, new rules regarding loan modification will take effect.

**What must a loan modification services agreement have to avoid a prohibited act?**

F.S 494.00296 is stated negatively. Here is how the agreement must be structured:

- a) Before any services are performed, a written loan modification service agreement with the borrower must be executed
- b) Before executing a loan modification, the borrower must be aware of each modified term and consent to each term
- c) Before receiving payment, all the services included in the loan modification service agreement must be completed. A fee may only be charged if there is a material benefit to the borrower. The commission may adopt rules as to what is a material benefit to the borrower.(F.S 494.00296(1)(a),(b) and (c))

**What must the loan modification agreement contain?**

The loan modification service agreement must:

- 1. Be at least 12-point uppercase type
- 2. Be signed by both parties
- 3. Include the names and addresses of the person providing the loan modification services
- 4. State the exact nature and specific detail of each service to be provided
- 5. Include the total amount and terms of the charges
- 6. Include the date of the agreement

The date of the agreement cannot be earlier than the date the borrower signed the agreement. The mortgage entity must give the borrower a copy of the agreement to review at least one business day before the borrower signs the agreement. (F.S 494.00296(2)(a))

The borrower has the right to cancel the agreement without penalty or obligation if they cancel within three business days of signing the agreement. The right to cancel may not be waived or limited by the borrower or the mortgage entity. (F.S 494.00296(2)(b)) A mortgage entity can give a borrower more time to cancel. (F.S 494.00296(2)(d)) If the borrower cancels, any payments must be returned to the borrower within ten business days after the mortgage entity receives the cancellation notice. (F.S 494.00296(2)(b))

Additionally, immediately above the signature line, a 12 –point uppercase four paragraph statement concerning the borrower’s right of cancellation must be included. (F.S 494.00296(2)(c))

The borrower must receive a signed copy of the agreement within three hours after the borrower signs the agreement. (F.S 494.00296(2)(e))

**What are some the requirements relating to the SAFE Mortgage Licensing Act of 2008?**

Under Section 494.0011(2)(c) the commission shall adopt rules that comply with the following:

- 1. Require loan originators, mortgage brokers, mortgage lenders, and branch offices to register through the registry.
- 2. Require the use of uniform forms that have been approved by the registry and any subsequent amendments to such forms if the forms are substantially in compliance with the provisions of this chapter - Uniform forms that the commission adopts include, but are not limited to:
  - a. Uniform Mortgage Lender/Mortgage Broker Form, Form MU1
  - b. Uniform Mortgage Biographical Statement & Consent Form, Form MU2
  - c. Uniform Mortgage Branch Office Form, Form MU3
  - d. Uniform Individual Mortgage License/Registration & Consent Form, Form MU4
- 3. Require the filing of forms, documents and fees in accordance with the requirements of the registry
- 4. Prescribe requirements for amending or surrendering a license or other activities as the commission deems necessary for the office’s participation in the registry
- 5. Prescribe procedures that allow a licensee to challenge information contained in the registry
- 6. Prescribe procedures for reporting violations of this chapter and disciplinary actions on the licensees to Registry

**Who did the legislature exempt from this new statue?**

Effective January 1, 2010, everybody, but you! The folks who are exempt from Part I (General Provisions), II (Mortgage Brokers) and III (Mortgage Lenders) of Chapter 494, are not exempt from Part IV (Florida Fair Lending) and V (Loans under Florida Uniform Land Sales Practices Law). (F. S. 494.00115) The following entities are exempt:

- a) Any person operating exclusively as a registered loan originator in accordance with

the S.A.F.E. Mortgage Licensing Act of 2008

- b) Depository institutions like banks and credit unions
- c) The Federal National Mortgage Association (“FNMA”), the Federal Home Loan Mortgage Corporation (“FHLMC”), any Federal Government agency, any state, county or municipal government; or any quasi-governmental agency that acts in such capacity under specific authority of the laws of any state or the United States
- d) A licensed attorney who negotiates mortgage terms for a client as an ancillary matter to the representation of a client
- e) A person involved solely in timeshare plan financing

Effective January 1, 2010, the following are exempt under Part III (Mortgage Lending) (F.S. 494.00115(2)) :

- a) A fiduciary under court authority
- b) A real estate seller who receives one or more mortgages in a purchase money transaction
- c) A mortgage servicer for federal, state or municipal agencies
- d) A person who makes nonresidential mortgages and sells loans only to institutional investors
- e) Individuals who:
  - 1. Makes or acquires mortgage loans
  - 2. Uses his or her own funds for his or her own investment
  - 3. Does not hold himself or herself out to the public as being in the mortgage lending business
- f) An individual who sells a mortgage that was purchased with that individual’s funds and who does not hold himself or herself out to the public as being in the mortgage lending business

The burden of establishing the exempt right is on the party claiming the exempt.

**What is the definition of a “registered loan originator?”**

“Registered loan originator” means a loan originator who is employed by a depository institution, by a subsidiary that is owned and controlled by a depository institution and regulated by a federal banking agency, or by an institution regulated by the Farm Credit Administration and who is registered with and maintains a unique identifier through the registry. (F.S. 494.001(28))

**What is the definition of a “depository institution?”**

“Depository institution” has the same meaning as in s. (3)(c) of Federal Deposit Insurance Act and includes any credit union. (F.S. 494.001(8))

# **LENDER LESSONS: *Surviving the Declining Housing Market***

By Gary Opper, Managing Member, Levie-Opper, LLC  
954-384-4557 Fax 954-384-5483

## ***THE ROAD TO RUIN***

The road to ruin always starts as a path of daisies when borrowers are facing foreclosure. The loan process starts off pleasant. Borrowers are easy to contact and communications are always positive. Then, the path of daisies starts to get bumpy when the loan gets 10 days late followed by 30 days, 60 days and eventually 90 days late. The once smooth road has now become the road to ruin with foreclosure lurking in the shadows.

## ***READ THE ROAD SIGNS***

When the borrower gets behind in their payments, lenders should encourage the borrower to keep the lines of communication open. Contacting borrowers can be complicated because borrowers may be feeling embarrassed, overwhelmed and even confused by the circumstances they are facing. Depending on the type of situation they are in, they may not be willing to speak to the lender. Borrowers are easier to speak to when they are less than 30 days late. Once the account goes past 30 days late, the borrowers often avoid the calls.

Ask your borrower to explain their situation to you in a hardship letter. You may want to ask them to provide you with their current financial information so you have a better understanding where they are financially. Knowing where your borrower stands financially can help you determine which solution to offer the borrower when they are facing foreclosure.

## ***USE THE CAUTION LANE***

Once you have contacted the borrower you should have an idea of what their intentions are. Are they financially able to make the payments? Are they willing to work out an agreement? Are they willing to turn over the house because they are unable to make future payments? Are they willing to talk to

you at all? The questions could go on and on but what's important is the answer.

A borrower may be able to afford the payment financially but are just facing a personal dilemma that has caused them to miss a month or two of payments. Another borrower may have heard that others have gotten their rate and/or payment changed so they have decided to stop making payments on purpose, just to see if the lender will lower their rate and payment.

There are a multitude of solutions for borrowers that want to keep their home. Some solutions may include:

- A stipulation for the borrower(s) that they can make their regular monthly payments as well as payments towards the arrearage.
- Allowing the borrower to suspend or reduce their monthly mortgage payments for a specific amount of time. The arrearage would be collected at a later date. (similar to a stipulation)
- A mortgage modification with adjustments to rate, term and/or maturity dates.
- Referring the borrower to their federal, state or local agencies to see if they have programs that may be able to help the borrower.
- Applying the default payments to the back of the loan and continue to let the borrower make their existing monthly payment. The arrearage would be collected at the time of payoff.
- Offering a principal reduction at the time of payoff, if the borrower maintains the account in a satisfactory manner.

There are also solutions for borrowers that want to give up their home. A Deed-In-Lieu of foreclosure is one example. Sometimes a borrower wants to leave but needs a little more time. A lender may agree to a Deed-In-Lieu of foreclosure and allow the borrower the extra time needed to move out. A lender may also agree to a Deed-In-Lieu of foreclosure and offer the borrower "Cash for keys" if they move out by a specific date. "Cash for keys" is when the lender gives a borrower a cash incentive to deed a property to the lender and vacate it in reasonable condition. This financial motivation gives the borrower a little extra money in their pocket to put towards a down payment on a more affordable home or rental. Both of these solutions save time and money and the property is less likely to be damaged or vandalized.

Borrowers and lenders both want the same thing. They both want the borrowers to remain in their homes and they both want the payments to be made on time. Foreclosures are the last thing that either party wants to happen.

Sometimes a borrower has the financial ability to pay a mortgage, but refuses to pay the current amount. Lenders should work with the borrower to find a solution rather than take the position, “You can pay; we are not negotiating.” The borrower will default, the lender will foreclose and the property will deteriorate. Instead, a lender should negotiate. Waiting until the borrower is three months behind only makes the situation financially worse for the lender. Do the following analysis: What is the most the borrower will pay? What is the property worth now? (It doesn’t matter what the property was worth or the current mortgage balance. What matters is at what price the property can be sold.) Determine if the yield is satisfactory. Here is an example:

The bank average yield on portfolios	=	5.32%
The original appraisal price for the property	=	\$200,000
Mortgage balance	=	\$180,000
Current property value	=	\$100,000
Monthly amount borrower willing to pay (Principal and Interest)	=	\$800.00
Monthly amount annualized	=	\$9,600
Reality yield to bank:		
<u>Annual PI Payment</u>	=	<u>\$9,600</u>
Current Property Value	=	\$100,000
		= <b>9.6%</b>

Since the reality yield on the bank’s investment is 9.6%, which is substantially higher than the bank’s average portfolio yield, the bank should consider approving the modified payment. The alternative is a potentially long and costly foreclosure. The borrower will probably be agreeable

because this is market rate to buying a similar home in the current mortgage market. Obviously, this is a simple example. Tax and insurance payments and other factors may need to be addressed.

### ***THE FAST LANE***

On the other hand, borrowers avoiding calls, emails and refusing certified mail may be an indication that they do not have the means of working something out with the lender. If all roads lead to foreclosure and you have exhausted all other avenues of working things out with the borrower, you may want to move over into the fast lane and proceed forward without delay.

Maintain accurate records and gather your documentation. Gather the property values and contact your attorney to set a trial date as soon as possible. Foreclosures should not be postponed and any borrower communication should be directed to the attorney to avoid any delays.

### ***CONCLUSION***

There are many reasons why borrowers get behind. All borrowers can not be handled the same. What works for one may not work for the next. Lenders should stay focused and stay up to date on the options they have available for borrowers. Keep yourself educated on the laws, property values and your rights as a lender. Keeping the lines of communication open and maintaining accurate records can keep you miles ahead of the traffic jams that you may encounter along the way.

*Gary Opper is President of Approved Financial Corporation, Weston, Florida. Approved Financial Corporation is a licensed mortgage lender. Mr. Opper has been a Mortgage Lender and Note Buyer since 1984. He is the Managing Member of Levie-Opper, LLC, a mortgage fraud litigation support firm. Also, he does mortgage consulting. He has a CPA and a CFP license. Opper is Past President of the Florida Association of Mortgage Professionals - Miami Chapter and the Florida Institute of CPAs - Gold Coast Chapter. Opper is a member of the National Association of Mortgage Brokers, American Institute of CPAs, the FAMP and the FICPA. Mr. Opper was named the NAMB's "Writer of the Year" and "Featured Writer of the Year" and the FAMP's "Broker of the Year." Opper is president of the FIU's School of Accounting Alumni Affinity Council. Mr. Opper is available to speak to your group. Please contact him to arrange a speech for your event. He may be reached at (954) 384-4557, fax: (954) 384-5483, or e-mail: Opper@ApprovedFinancial.com.*

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## **GARY OPPER'S COMMENTS TO THE FLORIDA SUPREME COURT**

### **MORTGAGE REFORM: *ADDRESSING THE LARGER ISSUES***

I applaud the efforts of the Supreme Court of Florida to address a major state problem. The Florida Supreme Court Task Force on Residential Mortgage Foreclosure Cases addresses the problem of the enormous increase in foreclosure filings that has overwhelmed the resources of many circuit courts. This crisis in the court system is part of a larger national problem, an international problem. Finding a solution to the court crisis will obviously help return the courts to an effective and efficient system; however, the underlying problem that caused the financial fiasco needs to be addressed at both a macro and a micro level.

No matter how many times you try and shake them off, some problems still rear their ugly heads. In fact, the same issues are continuing to arise in the mortgage industry. They may be hidden now, but they have not gone away. Unfortunately, the problems and causes of the mortgage meltdown are not necessarily being fixed. Many of the same mortgage un-professionals (lenders, Wall Street bankers, mortgage brokers, appraisers, etc.) are still involved in the industry either working or, even worse, making mortgage decisions. The following will explore the areas that are still of the gravest concerns. They create a ripe recipe for more mortgage misfortunes.

#### **ELIMINATING THE "BAD ORANGES"**

Unfortunately, mortgage fraud has become a pandemic and not just an epidemic. It is, sadly, pervasive in our society to the point that it has become the "hot topic" as lead articles in newspapers and magazines. The city, state and federal governments have begun devoting tremendous resources to fight mortgage fraud. It has brought down top businesses and banks in America. It has changed the way that people act and think for the next generation. With the growing cases of fraud, the government is seriously and aggressively pursuing guilty parties. Thankfully, with the passage of the Fraud Enforcement and Recovery Act of 2009, \$522 million is being provided to the FBI, the Attorney General, the Department of Justice and other governmental agencies over the next two years in order to work towards tracking down fraud and punishing the guilty parties.

To our dismay, many appraisers, title agents, mortgage brokers, processors, underwriters, bankers and real estate agents that were dishonest are still in place. In order to fix this injustice, many individuals need to be removed from their positions; some may need to be retrained to fully understand their obligations and some may need prison time.

The removal of many un-professionals will reduce the hyper-competition among the remaining professionals, which will foster a more ethical professional industry. Many of the un-professionals that created the exotic products are still holding positions with major mortgage lenders. They created and touted products that made no financial, economic or mortgage sense; other than to provide tremendous incomes and bonuses for these un-professionals. These lender's

companies need to be cleaned of these dangerous people. They need to be permanently expelled from the mortgage industry. They are not mortgage leaders, they are mortgage leaches.

## SIMPLIFYING MORTGAGE PRODUCTS AND DISCLOSURES

The mortgage process is too complicated. Former Secretary of HUD Mel Martinez stated that his home purchase was complicated even for him. We do not need to return to the days of hundreds of mortgage products. We need enough mortgage products to satisfy Main Street, not Wall Street. The products must be simple enough for the average consumer to understand and make a prudent decision on which mortgage product to choose.

The disclosures are voluminous. Many do not truly explain anything. The main purpose of the numerous disclosures has evolved into simply creating defenses for foreclosures. Most borrowers simply sign the documents and never completely read them, even though they have a three day right of rescission. Understandably, the documents must protect the lender's interest; however, many documents can be eliminated or combined. The remaining documents can be written in simple English and in short paragraphs.

## FIXING A FLAWED SYSTEM

The mortgage system, as it is now, creates the opportunity for fraud. Ultimately, the lender usually has no contact with the borrower and may not even see the loan until after it closes and funds. The ultimate lender's underwriting decision has been delegated to a mortgage company that processes and underwrites the loan or the loan processing may be done by a mortgage broker. The group of people responsible for making sure the documents is complete, correct and valid are the same individuals who are paid a commission only if the loan closes.

A person who earns a commission from a loan should never be allowed to handle the processing of a loan, the ordering of a real estate appraisal or title policy. The pressure is too great to do what is best financially for the un-professional than what is honest and ethical. The ultimate lender should ultimately be responsible for the integrity of the loan by directly supervising the processing and underwriting of the loan.

Also, the mortgage industry is currently filled with complex mortgage buy-back agreements. Under certain circumstances, the ultimate lender may require a downstream lender to buy back a mortgage. A downstream lender may require a mortgage broker to buy back the loan. The ultimate lender has the deep pocket; no one down stream usually has the money to buy back a loan much less a portfolio of loans. Making each lender responsible will eliminate this false sense of financial security.

## EDUCATING CONSUMERS IN MORTGAGE MATTERS

Through the shady dealings of un-professionals, there has been the creation of a class of uneducated borrowers. Education is needed that clearly explains the important financial obligation a borrower is undertaking when borrowing money. Un-professionals are allowing these borrowers to sign on the dotted line on mortgages, all the while knowing these people may not be able to afford their payments. Independent consumer education must be a major base from which the housing market will recover. Plus, without the complete explanation of rate and terms, these new homeowners cannot truly understand the risk and rewards of homeownership. Also, the advantages of renting versus owning must be explained. The entire mortgage process must be explained to prospective borrowers AND understood by prospective borrowers.

## RAISING THE REQUIREMENTS TO ENTER INTO THE REAL ESTATE AND MORTGAGE FIELDS AND MAINTAIN A LICENSE

Florida Statute Chapter 494 has increased the requirements to become a mortgage originator. The requirements to become and to continue to be a mortgage originator, real estate agent, title agent and appraiser should be raised. This would serve many purposes.

First, there would be enough professionals to have healthy competition, but not too much competition to drive people to commit fraud in order to obtain business. The following table shows the tremendous increase in mortgage brokers in Florida:

Year	Active Mortgage Brokers
2001	28,140
2002	30,282
2003	41,211
2004	46,092
2005	59,896
2006	67,266
2007	81,895
2008	63,993
2009	65,692

These 65,672 mortgages represent one mortgage broker for approximately every 110 Florida households. This does not include mortgage originators that work for mortgage lenders and banks. Assuming there are between 100,000 to 150,000 total mortgage professionals soliciting the 7.3 million Florida households then there is 1 mortgage professional for every 49 to 73 Florida households. This is an oversaturated mortgage professional market.

Second, the regulatory authorities would be able to investigate and monitor licensees more efficiently with a more manageable number of licensees.

Third, increasing the continuing educational requirements would create truly professional individuals.

## GIVING FIRST TIME HELP FOR FIRST-TIME HOME BUYERS

A lot of people in the real estate industry have put their recovery hopes on first time homebuyers. In fact, there is a first-time home buyer tax credit for 2009, but there is no requirement that the first-time home buyers have any understanding of what homeownership entails. All first-time home buyers, whether they receive a tax credit or not, should attend a home ownership educational seminar.

## RETHINKING THE AMERICAN DREAM

The program of the American government and the government sponsored entities highly promotes homeownership. Clearly, homeownership provides the basis for strong neighborhoods and cities hence, this will create a strong citizenry. Homeownership is not for everyone, though; however, it is blindly promoted as the “American Dream.” In some cases, the dream can be a nightmare. Homeownership can be a heavy financial burden on an individual. Other factors may indicate that homeownership is not the proper choice in a scenario. Renting provides more flexibility to move than homeownership.

## MODIFYING A LOAN MODIFICATION

Where to start with the issues of loan modifications? There are honest, ethical and conscientious loan modification professionals; however, this industry has grown from zero to overpopulated with unethical people. Reviewing of Florida’s Attorney General Bill McCollum’s website will provide ample examples of individual loan modification companies.

The loan modification industry is dominated by mortgage brokers. These same mortgage brokers were pushing borrowers into the mortgages that they could not afford. Many times an attorney appears to be handling a case, but the case is actually managed by a loan modification company, unbeknownst to borrowers. This illegally circumvents the law that allows attorneys to receive loan modification payments up front, but prevents a loan modification company from collecting a fee prior to performance. This hurts everyone: the borrower, ethical attorneys and

home loan modification companies. Also, a loan modification specialist needs no specialized training. In Florida, they need to be an attorney or simply have a mortgage broker license.

## BANKING THE FUTURE AWAY

Lenders take way too long to make a decision. Many times, lenders make decisions based on the impact on their financial statements. This is only “smoke and mirrors.” A bank unwilling to address what a property’s actual market value and a borrower’s real ability to pay only prolongs the mortgage monster. Rather than make the right decision and recognize the loss, currently the bank tries not to recognize the loss. If banks were to financially recognize and address the problem, the problem would be over sooner. The bank’s net worth would be reduced or eliminated. This would force the FDIC to take over or find buyers for many banks. The shareholders would suffer, but we would be further down the road to recovery. Additionally, decisions made by bank employees are in the best interest for the employee’s need for continued employment and not in the best interest of the bank, the borrower, the state or the national economy.

## FINDING STRONGER BUYERS FOR A STRONGER RECOVERY

The mortgage market has dried up except for government programs and limited portfolio products. Most of the government products provide loans with less than 5% down- payments and some allow the seller to pay up to 6% of the closing costs. A borrow who is only putting 5% down and paying very little closing costs usually is not a strong borrower. There is very little financial incentive to continue to make payments in case of a financial set back. Many low down payment borrowers do not have the financial ability to even make payments if they were to have a small financial set back. By allowing such low down payments, we may be sowing the sour seeds of a second mortgage collapse.

## UNCLOGGING THE COURTS BY PUNISHING COURT ABUSERS

When a borrower receives word that their home is in jeopardy of being foreclosed, often times they will step up and try to make an agreement with their current lender. If no terms can be agreed on, in order to fight back against the lender, many times a borrower will hire an attorney to assist in saving their home. The attorney may honestly have the ability to challenge the validity of the debt. To the borrower’s benefit, during the time the legal fight is occurring, they are allowed to continue to stay in their home without paying their mortgage.

Unfortunately, some unethical attorneys have filed frivolous and deceitful defenses. Their only objective is to delay the foreclosure because the borrower has no intention or ability to pay the mortgage. The lender has done nothing wrong, but the lender has to spend an inordinate amount

of time and money pursuing the meritless defendant cases. This clogs the state's courts system needlessly.

Additionally, immediately before the courthouse foreclosure sale, a bankruptcy attorney may file a bankruptcy on behalf of the borrower. In the majority of cases, the borrower's case is dismissed and no payments are ever made during the bankruptcy. This clogs the federal courts needlessly.

Many times the borrowers cannot pay yet the system allows for delays. The current system promotes this abuse of the courts. Cases that unnecessarily clog the court system should be promptly dismissed. Attorneys that have a practice and a pattern of abuse in the court system should be firmly reprimanded, sanctioned or disbarred. Lawyers have an obligation to be honest and ethical officers of the court.

## SUMMARY

The mortgage industry will continue to flounder if no action is taken to solve the festering problems. Persistent and rapid efforts to correct and address these issues created by mortgage unprofessionals will aid in the national recovery.

Respectfully Submitted,

Gary Opper, CPA, Managing Member  
Levie-Opper, LLC  
1304 SW 160<sup>th</sup> Ave., Suite 355  
Weston, Florida 33326

954-384-4557  
Fax 954-384-5483  
Gary@Levie-Opper.com

# **THE MORTGAGE FRAUD TRIANGLE:** *Pressure, Opportunity and Rationalization*

By Gary Opper, Managing Member, Levie-Opper, LLC  
954-384-4557 Fax 954-384-5483

Fraud has become a rampant occurrence in the mortgage industry. It has become such a common practice that many people are getting away with it. There are numerous reasons why an individual would commit this illegal act. By utilizing the mortgage fraud triangle, we can explore the pressure, opportunity and rationalization.

## **COMITTING FRAUD**

Unfortunately, many mortgage companies create a corporate culture that allows for corruption to occur. Techniques to commit fraud were taught to their new employees as part of instructing them in mortgage processing. Lenders have also created programs on how to detect fraud, which were then used by dishonest brokers as ways to actually conduct it. Through the combination of financial pressures, employer pressures and a lack of ethics there was too great a temptation created and brokers have begun to take the risk and commit fraud.

## **CRESSEY'S THEORY**

In 1953, Donald R. Cressey theorized that there were two components needed to commit a crime: general information and technical skill. According to Cressey, general information is the knowledge that fraud could be committed. In a mortgage fraud circumstance, the information could be derived from hearing that other mortgage brokers (either in the same mortgage entity or another mortgage entity) are committing fraud. It could also come from observing fraudulent behavior or even supervisors, managers and employers. Even the newspapers provide information on fraudulent behavior by mortgage brokers.

With technical skill, it is the abilities needed in order to commit fraud. Dishonest mortgage brokers have many cohorts. These individuals can include colleagues, managers and lender's account representatives. They are then abusing the trust that is placed in them.

In Cressey's theory, the three components of fraud then form a triangle made up of opportunity, means and motive. Here, the points of the fraud triangle consist of a perceived financial need (pressure), perceived opportunity and rationalization. It

was his belief that these three issues are present to some extent in all white collar criminal cases.



## PRESSURE

There are many pressures in today's society thanks to the recession that is currently taking place in our economy. Many people are suffering financially with such issues as debts or high medical bills. There is also a perceived financial need when you are surrounded by numerous individuals rich in material goods. In the mortgage industry, there is pressure put on brokers from the system. Managers will place tremendous pressure for production on their brokers to close. Therefore, there is additional pressure to compete, keep up with fellow brokers and earn. Unfortunately, these were great enough incentives for fraud to establish itself and grow.

Brokers have that pressure to close put on them by their supervisors, but they also feel it coming from their borrowers. They are looking to quickly close a file to benefit their borrowers. So, some individuals cave and commit fraud in order to get their clients into a home as fast as possible. Other brokers might also commit fraud in order to get their clients a lower rate in a refinance.

## OPPORTUNITY

The opportunity to commit and conceal fraud exists when employees are given access to assets and information. These individuals are given access to firm records and valuables that are ordinary aspects of their jobs. Unfortunately, it is this access that permits them the ability to commit fraud. To these "unprofessionals," committing fraud is available and easy.

These individuals feel that they are unlikely to be caught. Therefore, they think of all the opportunities that will arise for them to handle money at their business. Many lenders easily provide the many ramps needed for brokers and others to commit fraud due to little monitoring and sloppy business practices. These individuals are also provided the knowledge needed to commit fraud through seminars and various educational programs. This readily gives them technical skills that can be utilized to commit fraud.

## RATIONALIZATION

Of course, in the broker's mind, he is not seeing himself as a criminal. He feels like he was simply allowing a borrower to realize the American dream of homeownership. Yes, the broker financially benefited from the transaction; however, he feels he is entitled to the compensation for his technical skill in closing the loan.

After fraud has been committed on a frequent basis, it becomes easier. The individual is no longer bothered by their ethics or morals. It just becomes a continuous activity and feels normal. In fact, it may become enjoyable for them to find new ways to close loans and defraud their employers. They may even rationalize things by believing that if they weren't the ones to do it then it would simply have been done by another broker. It then becomes an expectation to them.

## CONCLUSION

Mortgage fraud can be viewed in a triangular pattern. Through pressure, the broker feels like there is the opportunity to commit fraud because it is a necessary action. Due to the frequency of the commission of fraud, a greater number of avenues must be explored to put an end to this terrible plague.

*Gary Opper, CPA is the Managing Member of Levie-Opper, LLC, Weston, Florida. He is a member of the American Institute of CPAs and the Florida Institute of CPAs. He has written over 500 published articles in over 20 magazines. Mr. Opper has been the National Association of Mortgage Broker's "Writer of the Year" and "Featured Writer of the Year." He has spoken to many groups including the Florida Bar Association, the Florida Institute of CPAs, the Mortgage Bankers Association and Northern Trust Bank. He has lectured at four colleges including University of Florida and Florida International University. Opper has an Accounting degree from UF and a Master of Science in Taxation from FIU. Opper is Past President of the Florida Association of Mortgage Professionals - Miami Chapter and the FICPA - Gold Coast Chapter. Levie-Opper, LLC focuses on forensic accounting and fraud auditing. They handle state and federal cases including civil, commercial and criminal. Mr. Opper is available to speak to your group. He may be reached at (954) 384-4557, fax: (954) 384-5483, or e-mail: [Gary@Levie-Opper.com](mailto:Gary@Levie-Opper.com).*

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# **MORTGAGE FRAUD: *THE UNFORTUNATE GROWTH INDUSTRY***

By Gary Opper, Managing Member, Levie-Opper, LLC  
954-384-4557 Fax 954-384-5483

## **MORTGAGE FRAUD STATISTICS**

Former Acting U. S. Attorney Jeff Sloman indicted forty-one “un-professionals” on mortgage fraud. These un-professionals face a variety of mortgage fraud charges involving \$40 million in loans. The six separate cases epitomize the insidious nature of mortgage fraud from purchasers to mortgage brokers to real estate agents to lawyers, said Sloman.

Congress has appropriated \$522 million in order to work towards higher mortgage standards. The money is being spent in fiscal year 2010 and 2011 that is from October 1, 2009 to September 30, 2011. The majority of the money is for investigating and prosecuting mortgage fraud.

An indication of the magnitude of fraud is:

- Between January and June of 2010, more than 500 people were arrested for alleged mortgage crimes.
- The CoreLogic Fraud Index revealed fraud losses for 2010 to be estimated at \$11 billion.
- The total suspicious activity reports in the fiscal year of 2010 were 70,533 with more than \$3.2 billion in losses.
- Pending mortgage fraud investigations through the end of February 2011 were 3,020 with 72% involving losses of more than \$1 million.
- In the 2011 fiscal year, there have been 245 cases of mortgage fraud opened as of February.
- There were 1,531 successful indictments and 970 convictions of mortgage fraud in 2010.
- According to Acting U.S. Attorney Nora D. Dannehy, most mortgage fraud cases involve false representations on mortgage loan applications and inflated property appraisals. In fact, appraisal and mortgage fraud cause an estimated 83% of all mortgages to be legally problematic.

- Bank America, Wells Fargo & Co., JP Morgan Chase & Co. and Citigroup Inc – some of the biggest players in the servicing industry – are all facing litigation.
- In February of this year, Miami’s highest-ranking female firefighter was charged along with four others by a federal grand jury with taking part in an \$11 million mortgage fraud scheme in which prosecutors say she acted as a straw buyer in the purchase of two luxury Aventura condominiums.
- While Taylor, Bean & Whitaker Mortgage Corp. (TB&W), headquartered in Ocala, Florida was attempting to give a capital infusion to Colonial Bank of \$300 million, federal and state officials raided both entities. TB&W’s website states they are “... a top 10 national wholesale mortgage lender.” The Wall Street Journal says they are the third-largest underwriter of FHA loans. Colonial Bank is the sixth largest bank in Florida. Their relationship was incestuous. TB&W was trying to give Colonial Bank a \$300 million capital infusion at the same time that Colonial Bank was a major funder of TB&W.
- The Mortgage Fraud Index from MortgageDaily.com has fallen 69% over the past year to the lowest level since early 2008, while the dollar volume of associated loans was off by more than half.
- According to CNN, the top ten states with the most significant mortgage fraud problems in 2009 were Florida, New York, California, Arizona, Michigan, Maryland, New Jersey, Georgia, Illinois and Virginia (in that order). In 2009, the fraud index for Florida was 292, which is at least a huge improvement over 2008, when it was 430.
- Mortgage fraud may be pandemic and not just epidemic. It is pervasive in our society. As previously stated, Congress has devoted \$522 million to prosecute mortgage fraud. The city, state and federal governments have devoted tremendous resources to fight mortgage fraud. It has brought down top companies and banks in America. It has changed the way that people act and think for the next generation.

## **FRAUD ENFORCEMENT AND RECOVERY ACT**

Fraud is a significant cause behind the U.S. subprime mortgage collapse and the international economic downturn. It is for this reason that the Fraud Enforcement and Recovery Act of 2009 (FERA) was created. FERA was designed to improve enforcing the mortgage fraud statutes. It will also assist in the recovery of funds that were lost during these fraudulent incidents and other related reasons.

FERA also offers the government additional tools needed in order to crack down on the occurrences of fraud that, unfortunately, have put numerous families at risk for losing their homes. Additionally, FERA expands the abilities of the Department of Justice to

prosecute individuals and/or corporations responsible for predatory lending. Furthermore, through the passing of FERA, a bipartisan Financial Crisis Inquiry Commission has been established in order to explore the financial practices that have created our current economic crisis.

Under the Act, the following amounts have been allocated to combat mortgage fraud:

Fiscal Year 2010-2011	Total
(in millions of dollars)	
FBI	\$140
US Attorney Offices	\$100
Dept. of Justice (DOJ)-	
Criminal Division	\$40
DOJ- Civil Division	\$30
DOJ - Tax Division	\$10
Postal Inspection Service	\$60
HUD Inspector General	\$60
Secret Service	\$40
SEC	\$42
 Totals	 \$522

According to the U.S. Attorney’s office, they are attempting to fast track cases. In a case where the mortgage fraud is in the high millions, they may decide just to prove one to five million dollars of fraud and get a conviction with prison time instead of spending two years investigating to the get the maximum penalty.

## **ADDING MORTGAGE FRAUD CASES TO YOUR PRACTICE**

Now is the right time to add mortgage fraud to your law practice. It has become the “hot topic.” It is usually the lead article of magazines and newspapers. With the growing cases of fraud, the government is seriously and aggressively pursuing guilty parties. A vast amount of money is being provided to the FBI, the Attorney General, the Department of Justice and other governmental agencies are working towards tracking down fraud and punishing the guilty parties. Because of the rampant outbreaks of mortgage fraud, it is a productive, worthwhile and rewarding area of exploration.

According to noted criminal defense attorney Brian H. Bieber, “The mortgage fraud industry has exploded to depths no one could fathom. On the state and federal levels, prosecutors are scrambling to find sufficient resources to arrest, to indict and to convict individuals. The targets are not just mortgagees, but are mortgage companies, low, mid and high level executives. Many cases; however, are defensible. Experienced criminal defense lawyers know which questions to ask, which documents to look at and they can

assist in pinpointing where the fraud began and who is responsible under the law.” Forensic mortgage fraud accounting can assist lawyers to determine the proper questions and documents.

Fraud cases can be both criminal and civil. Civil cases can involve lenders suing mortgage un-professionals, appraisers, title companies and private mortgage insurance companies.

## **DEFINITIONS AND TYPES OF MORTGAGE FRAUD**

The word "fraud" traces its origin from Latin to a Sanskrit word that means, "He bends injures." The Black Law dictionary defines fraud as “the intentional perversion of truth for the purpose of inducing another in reliance upon it to part with some valuable thing belonging to him or surrendering a legal right.”

Mortgage fraud can be committed by:

1. Application Fraud is the intentional misrepresentation of an applicant's income, assets, liabilities, credit history, credit scores or job information.
2. Real Estate Value Fraud is the intentional misrepresentation of the real property value by a real estate appraiser or other professional.
3. Real Estate Title Fraud is the intentional misrepresentation of the liens, judgments, lis pendens, survey problems or other "clouds on the title" by a title company.
4. Transaction Fraud is the participation in a real estate scheme to obtain a loan through misrepresentation of facts.

There are two types of fraud:

1. Fraud for Housing
2. Fraud for Profit

Freddie Mac and Fannie Mae do not distinguish between Fraud for Housing and Fraud for Profit.

Frauds for Housing - The borrower and/or other parties in a real estate transaction can misrepresent facts to a lender to help a borrower obtain a loan and, therefore, a home. Other parties to the transaction include real estate brokers, mortgage brokers, appraisers, title companies, closing agents, lenders' account representatives, accountants, etc.

It is still fraud, no matter how admirable the idea sounds that a "professional" is helping a customer obtain a loan and hence a home. The lender should have the right to all the facts

and they should make the decision whether or not to loan to the applicant. "This is not a noble cause, this hurts our reputation," states Jack Nunnery, Chase Manhattan's National Customer Risk Manager. Obviously, un-professionals profit from this fraud.

Fraud for Profit - An investor deceives a lender into making a loan so that the investor makes a profit. The investor may or may not have the help of other parties in the transaction. Investor fraud includes the following schemes:

1. A Straw Buyer
2. Land Flips
3. Equity Skim

A Straw Buyer is a person is used to buy property to conceal the actual owner. A Straw Buyer is the person whose profile is used to serve as the cover for the transaction. The Straw Buyer's income and credit is used to fraudulently obtain the loan. The Straw Buyer, the actual property owner and anyone else involved in the scheme are guilty of fraud. Straw Buyers are sometimes used in the following occasions:

- Investors who want the more favorable interest rate, loan-to-value and other terms available on owner occupied property
- Builders who want to obtain working capital
- Sellers who want to illegally get money from their property
- Borrowers who could not obtain a mortgage on the subject property

Check to see if the property is in the borrower's name or does the loan file reveal the existence of a straw buyer. Straw Buyers can be willing participants in the scheme, who are paid for providing their names and credit information to make a false purchase. Straw Buyers can also be victims whose identity is being used without their permission (such as in Identity (ID) theft.)

Answer the following questions:

- Does the loan file contain a credit report?
- Is the credit report in the name of the borrower or of a straw buyer?
- Do the social security number reconcile with the various documents?
- Is the FICO score high for the borrower's income and debt?
- Was there an appraisal in the file?
- Was the appraiser credentialed and associated with a large organization?
- Do the names and addresses on the appraisal agree with the loan documents?
- How recent is the appraisal?
- Are values increasing or decreasing in the area?
- Are the comparables real?

A Land Flip is when real property is bought at or below market price and is resold at a price higher than market value. The higher sales price is used to obtain an illegal higher mortgage loan amount. The cooperation of at least a dishonest real estate appraiser is necessary.

An Equity Skim example is as follows: The real property owner obtains a high loan-to-value mortgage on tenant occupied property. The owner collects rent from the tenant(s), but does not pay the mortgage. The owner skims equity from the property during the prolonged collections and foreclosure proceedings.

Fraud can be committed by misrepresentations on the following types of documents:

- Application Documents
- Appraisal Documents
- Credit Reporting Documents
- Income Documents
- Asset Documents

The red flags in these documents are numerous. The most prevalent fraud is income documentation.

Unfortunately, the computer has been a "double-edge" sword in the mortgage industry. On one side, it has provided technology to speed up and automate mortgage processes. On the dark side, with scanners, laser printers and graphic programs, high quality fraudulent documents have been easier to create.

## **DEFENDING MORTGAGE FRAUD DEFENDANTS**

To help in the defense of mortgage fraud charges, there needs to be a thorough understanding of the loan documents that are the subject of the allegations. Therefore, each subject mortgage loan file must be analyzed.

The various documents that will appear in the loan file include the mortgage application or Form 1003. This should be an attestation of the borrower's assets and liabilities, the borrower's income, a description of the property to be purchased or refinanced and the signature of the borrower. The expert needs to determine what supporting documents actually exist in the files. Questions such as "Did the borrower actually sign the Form 1003?" or "Did the loan officer prepare it and sign for the borrower?" need to be asked and answered.

There should be federal income tax returns in the file if it was a fully documented loan. Confirm that the borrower signed IRS Form 4506 agreeing to the release of signed filed copies of tax returns and transcripts from the IRS. This is to validate the tax returns submitted.

In defense of the defendants, it is vitally important to understand the loan file, its contents and what each document means. Just as important is to know who prepared each of the documents within the mortgage fraud organization. The expert for the defense will need to know the role of mortgage defendants and what part they played in each of the loan documents, as well as what happened to the loan after it was funded. The propriety of the mortgage loan documents must be known in order to assist the defense. As there are voluminous documents associated with each mortgage loan file, the validity and accuracy of each document must be determined. The defense cannot just accept a plaintiff's submission of documents in loan files.

## **MINIMIZING SENTENCING TIME**

Once mortgage fraud liability has been concluded, the economic damages as a result of the fraud must be calculated. This is critical since the fine for mortgage fraud in criminal matters is based on guidelines. So, the amount of the loss will be a factor in determining the sentence. The economic loss or damage must be determined through the culmination of the loan transaction. Therefore, tracing is required from the inception of the loan through the ultimate sale of the property. The net assets need to be computed in the calculation of damages. Net assets (as referred to in federal sentencing guidelines) are the "assets remaining after payment of all legitimate claims against assets by known innocent bona fide creditors."

In order to reduce sentencing time, the expert needs to be able to minimize the economic loss, as the two are directly related. I will share an actual case in which the computation of damages was key in the judge's determination of the sentence:

The defendant was convicted of mortgage fraud in the origination of approximately 50 loans. These loans were fully documented so that there were credit reports, appraisals, loan applications and tax returns in the loan files. The loans were purportedly suitable to be purchased by Fannie Mae. In fact, Fannie Mae did purchase them from the lender. The fraud occurred in the quality of the documents, which were altered so that they would qualify to meet Fannie Mae standards.

Upon conviction, the defendant was offered a plea bargain of a sentence of 5 years, which was turned down. The criminal defense attorney did not accept the alleged loss by the prosecution. Instead, he chose to have an expert compute the actual loss, which is critical in a mortgage fraud case. The value of the homes that have been foreclosed must be evaluated extensively to determine whether the bank/lender/investor is actually damaged by the amount they alleged. Remember the bank/lender/investor is using the government to go after what it believes is the criminal that tricked them into the loan application process. A federal criminal defense attorney will have the ability to hire experts, accountants and investigators to get the monetary loss down to a minimum. The lower the monetary loss the lower the exposure to prison time under United States Sentencing Guidelines.

In advance of the sentencing hearing, I was hired by the defendant's attorney to compute the loss and to testify at the sentencing hearing. I attempted to compute the actual loss on each loan and used an Excel spreadsheet to summarize the findings. Factors used in the computation were the principal amount of the loans; interest rates promised to the investor, time period from the purchase of the loan to the date of foreclosure, appraised values at time of loan and appraised values of each property after the foreclosure or what the properties ultimately realized.

In some cases, there were actual gains to the investor in the foreclosures as property values had increased which more than offset any loss in interest or principal. The loan losses were summarized on a net basis to arrive at a total economic loss, which was testified to and presented, to the Court. While the prosecution had its own expert to compute the loss, the final ruling was a much lower loss than alleged. Whereas the prosecution was seeking a sentence of 12 years, the judge ultimately ruled for a sentence of three years. The criminal defense attorney and the client were pleased since the sentence was less than that which was offered in a plea bargain.

## CONCLUSION

This scenario will play out more and more as the indictments continue in mortgage fraud cases. Trials will naturally follow. As the federal government has earmarked millions of dollars in the prosecution of mortgage fraud, the defense of those charged is creating an unfortunate growth industry.

This is the beginning of a five to seven year window of unfortunate opportunity for the criminal defense attorney to provide capable legal services to white-collar defendants along with expert litigation support from forensic mortgage fraud accountants. Take the time to explore the idea of adding mortgage fraud to your practice.

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*Gary Opper, CPA is the Managing Member of Levie-Opper, LLC, Weston, Florida. He is a member of the American Institute of CPAs and the Florida Institute of CPAs. He has written over 500 published articles in over 20 magazines. Mr. Opper has been the National Association of Mortgage Broker's "Writer of the Year" and "Featured Writer of the Year." He has spoken to many groups including the Florida Bar Association, the Florida Institute of CPAs, the Mortgage Bankers Association and Northern Trust Bank. He has lectured at eight colleges including University of Florida, Florida International University and Florida Gulf Coast University. Opper has an Accounting degree from UF and a Master of Science in Taxation from FIU. Opper is president of the FIU's School of Accounting Alumni Affinity Council. Opper is Past President of the Florida Association of Mortgage Professionals - Miami Chapter and the FICPA - Gold Coast Chapter. Levie-Opper, LLC focuses on forensic accounting and fraud auditing. They handle state and federal cases including civil, commercial and criminal. Mr. Opper is available to speak to your group. He may be reached at (954) 384-4557, fax: (954) 384-5483, or e-mail: [Gary@Levie-Opper.com](mailto:Gary@Levie-Opper.com).*

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***Internal Auditing 2011:  
It's Time to "Fill the Glass"***

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*Deborah Hoffman*

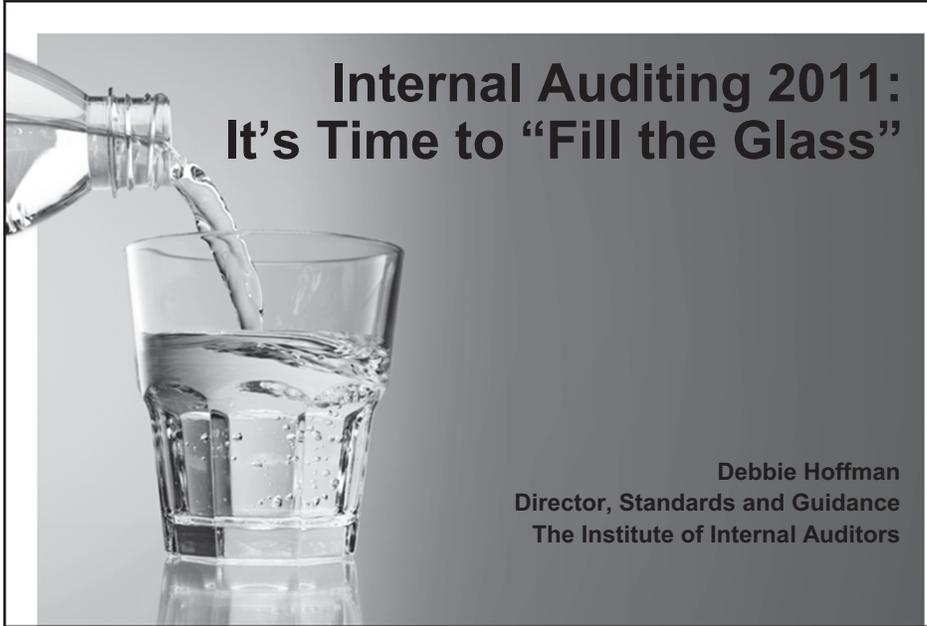
**Deborah (Debbie) Hoffman**  
Director, Standards and Guidance  
Institute of Internal Auditors as Director, Standards and  
Guidance

Deborah (Debbie) Hoffman recently joined the Institute of Internal Auditors as Director, Standards and Guidance. The IIA is a professional society representing 170,000 members globally in 165 countries.

In her role, Debbie is the liaison with the Global Ethics Committee and is responsible for updating the IIA Code of Ethics and monitoring compliance with the Code. Debbie promotes the International Professional Practice Framework, the IIA's authoritative guidance on the internal audit profession, and assists in the development of new internal audit guidance.

Prior to coming to the IIA, Debbie served as Vice President, Audit Services and Chief Compliance Officer for UIL Holdings Corporation, an investor-owned utility based in New Haven, Connecticut. She has also held internal audit leadership positions in the financial services industry.

She has a Bachelors' degree in Economics-Accounting from the College of the Holy Cross in Worcester, Massachusetts, and her MBA from the University of Connecticut.



# Internal Auditing 2011: It's Time to "Fill the Glass"

Debbie Hoffman  
Director, Standards and Guidance  
The Institute of Internal Auditors

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## Internal Auditor magazine quotes

- "There is no simple checklist showing everything internal auditors can do to add value, because, at times, techniques for adding value are as unique and personalized as the organizations for which we work."
- "Gathering knowledge and information about the nature of business risks that face the organization, how those risks are managed, and to what extent they impact the organization's business processes and strategic goals is an inherent competency for most internal audit functions."

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December 1996

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## Presentation Overview

- Dynamic change continues
- Emerging gaps in stakeholder expectations
- Key imperatives for 2011 and beyond
  - Assess and align with key stakeholder expectations
  - “Step up to the plate” in risk management
  - Enhance Internal Auditing’s knowledge of the business
  - Streamline internal audit processes and operations
  - Coordinate and align with other risk, control and compliance functions

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## Dynamic Change is Continuing

### Shifting priorities

- Moving beyond the economic downturn to cautious growth
- Considering mergers/acquisitions; new products; new markets; new employees
- While keeping an eye on short term financial health

**What is the impact on Internal Audit's plans and associated resources and budgets?**

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## Where Do We Find Ourselves in 2011: Impacts On Internal Audit Budgets

### The Past Three Years

	Increased	Stable	Decrease
2008	36%	50%	14%
2009	27%	44%	29%
2010	32%	40%	28%

### The Situation Today

	Increased	Stable	Decrease
Overall	33%	48%	19%
F500	41%	43%	16%



Source: The Institute of Internal Auditors, Audit Executive Network

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## The Global Economic Crisis: Impact on Internal Audit Since 2007

### Internal Audit Budgets

	Increased	Stable	Decrease
Overall	37%	26%	37%
Fortune 500	31%	18%	51%

### Internal Audit Staffing

	Increased	Stable	Decrease
Overall	30%	42%	28%
Fortune 500	25%	34%	41%

Source: The IIA Audit Executive Center – August 30, 2010

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## Realigning Internal Audit Coverage

2011 Audit Plan	Increased
Operational risks	56%
Compliance risks	55%
Fraud risks	44%
Effectiveness of risk management	43%
Financial risks	29%
Cost/expense reduction or containment	28%
Reputational risks	24%

Source: *Emerging Trends and Leading Practices Spring 2011*,  
The Institute of Internal Auditors – Audit Executive Network

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## There is Reason to Be Proud!

- We have weathered the storm well
- Our stature remains strong
- Ample resources remain
- We are recognized, trusted and valued in many organizations
- The glass is at least “half full”



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However ...  
Maybe, it's time to stop  
celebrating

and

Fill the Glass!



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## Meeting Stakeholder Expectations: Are we Being Honest With Ourselves?

"If surveyed today on how well internal auditing is meeting its needs and expectations, my audit committee/executive management would probably rate their overall satisfaction..."

	Audit Committee	Executive Mgt
Unacceptable	0.0%	0.4%
Poor	0.4%	1.9%
Acceptable	16.1%	25.9%
Good	57.6%	57.8%
Outstanding	25.9%	14.0%

Source: *Emerging Trends and Leading Practices Spring 2011*,  
The Institute of Internal Auditors – Audit Executive Network

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## Good News / Bad News

- Recent IIA survey of North American stakeholders found general agreement that **internal audit provides insights and knowledge** (91% positive) and is **knowledgeable of new laws and regulations** (87% positive)
- But were less certain of internal audit's success in assessing **strategic risk** (27% disagree/strongly disagree) and **corporate governance** (19% disagree/strongly disagree)

Source: IIA Stakeholder Expectations and Perceptions Study, January 2011

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## The View from the Other Side?:

### Background

- May 2010
- 547 C-Suite and Audit Committee members
- 26 Industry Sectors
- Revenues greater than \$1 billion

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## The View from the Other Side?:

- Does strong risk management efforts have a positive impact on long term earnings performance? 96% = YES
- Does internal audit have a positive impact on risk management efforts? 94% = YES
- How effective was internal audit in helping the company navigate the financial crisis? 89% Very/Some

Source: Forbes Insight Survey on behalf of Ernst and Young, May 2010

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## The View from the Other Side?:

However...

- IA helps the organization achieve business objectives? 44%
- There's a strong link between IA and enterprise risk functions? 43%
- IA plays an important role in gathering business intelligence and sharing leading practices? 38%
- IA acts as a business advisor as evidenced by requests from the business for assistance? 36%
- IA attracts future leaders and high potential talent from the business? 32%

Source: Forbes Insight Survey on behalf of Ernst and Young, May 2010

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## The View from the Other Side?:

But wait, there's more ...

- Is Internal Audit being asked to improve risk coverage or service? **77% YES, with the same or lower budget**
- Do you believe there is an opportunity to improve your organization's internal audit function? **74% YES**
- How pressing is your need improve your internal audit function? **60%, need to make improvements within the next 12 months**

Source: Forbes Insight Survey on behalf of Ernst and Young, May 2010

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## New Stakeholder Expectations

- **Traditional expectations**

- Regular assurance on financial controls, possibly compliance as well
- “No surprises”
- Reliable execution of internal audit plans
- Demonstrate cost effectiveness of IA function
- Tight coordination with external audit

- **New expectations**

- CAE with executive presence, strong communications
- Ongoing relationship versus periodic communication
- Focus internal audit effort on what is most important; agility to identify and address emerging issues and risks
- Effective fraud/corruption prevention and detection program
- **Actionable and effective business focused recommendations; providing assurance, objectivity and insight**

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Again, maybe – it is  
time to stop celebrating

and

**Fill the Glass!**



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## Five Key Imperatives for 2011 & Beyond

1. Assess - and align with - key stakeholder expectations
2. “Step up to the plate” in risk management
3. Deploy a strategy for internal audit business knowledge acquisition
4. Streamline internal audit processes and operations to enhance value
5. Coordinate and align with other risk, control and compliance functions

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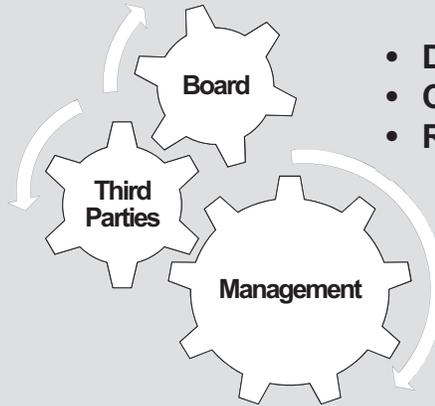


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## Assess and Align With Key Stakeholder Expectations



## Internal Auditing's Stakeholders



- Dynamic
- Cyclical
- Rarely aligned

← Assurance -- *The Audit Continuum* -- Consulting →

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## Current Events

- How's this for an example of being in a "tough spot" ...
    - HEADLINE: "BoFA Kept Executives In Dark on Dividend" – WSJ, April 12, 2011
      - "(BoFA) **internal auditors** are reviewing why two top finance and accounting executives weren't consulted before the bank disclosed to investors that a dividend increase had been rejected by regulators ..."
      - "This is a review that Brian (Moynihan, CEO) asked for ... to understand what happened ..."
- Would you be asked to do this?**
- "The report was ordered by up by Mr. Moynihan ... it will go to the board's audit committee ..."
  - "General corporate auditor ... who reports to the audit committee ... is leading an internal review of the matter ... expected to generate recommendations for procedural change."

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## Stakeholder Concerns

### Directors

- Executive compensation
- Governance and compliance
- Mergers and acquisitions
- Investor relations
- Operational risk
- Liquidity
- Internal controls
- Media relations and business reputation
- Outside legal fees
- Proxy and director election issues

### Audit Committee

- Risk, risk and risk!
- Increased focus on enforcement
- Regulatory changes
- Substantial changes to acct. stds.
- Ongoing economic uncertainty
- Key changes to the business
- Complex transactions
- Complexities of multinational operations
- Audit committee effectiveness

**How does IA effectively address these concerns?**

Source: Corporate Board Member magazine, August 2010

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## Stakeholder Concerns

- Current events ...
  - When asked “what issues pose the greatest concern for your audit committee in 2011?”
    1. Risk management and crisis response
    2. Financial communications/disclosures and new accounting standards/convergence
    3. Legal/regulatory compliance
    4. Uncertainty: economy and government regulation
    5. Leadership/culture/tone at the top
    6. IT/emerging technologies (cloud computing)
    7. Audit committee effectiveness
    8. Globalization

Source: KPMG Audit Committee Institute audience poll: Audit Committee Issues Conference 2011 as published in April/May edition of NACD Directorship

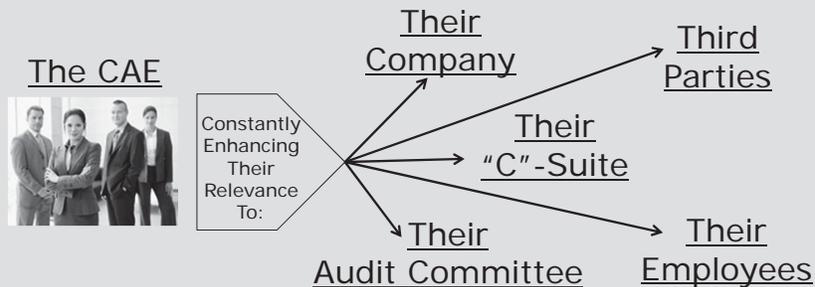
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# It's All About Being Relevant

It's all about being relevant to each of your constituents.



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## Assessing and Aligning with Stakeholder Expectations:

1. Define/revalidate your stakeholders – not the same in every organization
2. Gain a clear understanding of their current expectations
  - Communicate, communicate, communicate
  - Create awareness of internal audit's potential
  - Identify and reconcile stakeholder alignment challenges
3. Assess internal audit's current capabilities and identify "gaps"
4. Formulate a strategic plan to address gaps and achieve continuous alignment
5. Continuously recalibrate



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## Step Up to The Plate in Risk Management



## Risk Management

- Risk management failures were key factors in the financial crisis
- Growing pressure on management to strengthen risk management
- Growing pressure on boards to demonstrate RM oversight
- Internal auditing should play a critical role:
  - Natural experts on risk management
  - Champion or facilitate ERM
  - Maintain a continuous focus on risks
  - Be capable of addressing the full “portfolio of risks” in audit coverage
  - Provide assurance on the effectiveness of risk management

## Embracing a Risk-Centric Strategy: Internal Audit Role in Risk Management

<b>Activities Internal Audit Supports</b>	
Provides (written) assurance over RM process	50%
Provides consulting reports to improve/implement RM process	40%
Facilitates the identification and evaluation of key risks	65%
Participates in the identification of emerging risks	68%
Coaches management in responding to risks	50%
Has accountability for the risk management program	10%

Source: The IIA Audit Executive Center – August 30, 2010

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## Embracing a Risk-Centric Strategy: Responding to Emerging Risks

<b>Increased Focus On:</b>	<b>All</b>	<b>F500</b>
Catastrophic Risks	16%	23%
Reputational Risks	24%	30%
Crisis Management Capabilities	18%	22%



Source: The IIA Audit Executive Center – August 30, 2010

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## Embracing a Risk-Centric Strategy: Responding to Emerging Risks

Increased Focus On:	All	F500
Healthcare Reform (Laws/Regs)	24%	33%
Financial Reform (Laws/Regs)	25%	32%



Source: The IIA Audit Executive Center – August 30, 2010

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## Deploy a Strategy for Acquiring and Cultivating Knowledge of the Business



## The Emerging “Knowledge Gap”

- Collective knowledge must be capable of addressing the full portfolio of risks
- The 2000’s were the decade of “financial auditing expertise”
- Diversification of internal auditing’s focus has exposed knowledge gaps:
  - Knowledge of the business/industry
  - Fraud investigation/audit capabilities
  - Understanding how to audit operating, strategic and business risks



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## CBOK 2010: Competencies

Top Competencies in Internal Auditors

- Communication Skills
- Problem Identification AND Solution Skills
- Keeping up-to-date with Industry and Regulatory Changes

Most Important Skill (2006 and 2010 CBOK):

***Solid Understanding of the Business***

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## Acquire and Cultivate Knowledge

Strategies to Acquire/Maintain Business Knowledge	All	F500
Rotational program in which experienced professionals from the business rotate into internal auditing on an ongoing basis	16%	36%
Active recruitment of experienced professionals with industry experience or knowledge	43%	51%
Co-sourcing relationship with a third-party provider to leverage industry experience	32%	41%
Internal development of existing personnel	87%	94%
Other	13%	12%
I do not consider acquisition of business/industry knowledge to be a priority	1%	0%

Source: *Emerging Trends and Leading Practices Spring 2011*,  
The Institute of Internal Auditors – Audit Executive Network

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## Acquire and Cultivate Knowledge

Strategies to Enhance/Maintain Business Knowledge	All	F500
Partnering inexperienced staff with more experienced staff	67%	96%
Hosting regular all-staff training events	32%	69%
CAE participation in industry focused CAE groups or events	55%	78%
CAE frequently, but informally, benchmarks/networks with peers	49%	69%
Staff receive training focused on industry risks or issues	69%	71%
Staff subscribe to industry periodicals or other literature	75%	76%
Extensive knowledge management framework used to acquire/enhance/maintain knowledge of the business	21%	24%
Other	6%	8%

Source: *Emerging Trends and Leading Practices Spring 2011*,  
The Institute of Internal Auditors – Audit Executive Network

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## Skill Sets Being Recruited in 2011

	All	F500
Business and industry-specific knowledge	44%	60%
IT (general)	45%	57%
Data mining and analytics	38%	61%
Cybersecurity and privacy	12%	11%
Risk management	20%	19%
Risk assessment activities	20%	17%
Report writing	20%	20%

Source: *Emerging Trends and Leading Practices Spring 2011*,  
The Institute of Internal Auditors – Audit Executive Network

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## Streamline Internal Audit Processes And Operations To Enhance Value



## Enhance Capacity Through Innovation

- Sourcing solutions that are:
  - Strategic
  - Innovative
  - Efficient
- Reengineer processes
  - Risk assessment
  - Engagement planning
  - Reporting
- Leverage technology



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## Effectively Leveraging Technology How CAE's See It

### Importance

Not important at all	Somewhat important	Important	Very important	Extremely important
4%	19%	37%	31%	9%

### Current Performance

Inadequate	Limited/developing	Adequate	Above average	Exceptional
8%	40%	38%	12%	2%

Source: *Emerging Trends and Leading Practices Spring 2011*,  
The Institute of Internal Auditors – Audit Executive Network

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## Streamlining Internal Audit

- Adoption of risk-based methodologies
- Enhanced integration of IT and non-IT audit
- Enhanced use of technology tools/services
- Stronger alignment and enhanced stature
- Enhanced emphasis on quality
- More strategic approach to staffing

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## Streamlined Audit Processes

Assuring Efficiency and Effectiveness

- **Compliance**
  - 30% still do not have a “formal” quality assurance and improvement program
  - Up to 60% still have not undergone an external quality assessment

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## Coordinate and Align With Other Risk, Control and Compliance Functions



## Alignment of Risk, Control, and Compliance Functions

### How We See It

#### Importance

Not important at all	Somewhat important	Important	Very important	Extremely important
2%	11%	32%	41%	15%

#### Current Performance

Inadequate	Limited/developing	Adequate	Above average	Exceptional
4%	22%	46%	24%	4%

Source: *Emerging Trends and Leading Practices Spring 2011*,  
The Institute of Internal Auditors – Audit Executive Network

## Key Imperatives for the Coming Decade: Enhance Coordination Internally

- Internal audit co-exists with:
  - Compliance
  - Risk management
  - Corporate investigations
  - Internal controls
  - Environmental or other audit functions
- Gaps or redundancy present risks
- Formal and informal communication
- Cooperate in developing and communicating risk assessments, plans, etc



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# Questions?



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# ***Employment Law Update***

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*Eduardo A. Suarez-Solar, MMS, MPA, JD, SPHR*

**Mr. Eduardo Suarez-Solar, MMS, MPA, JD, SPHR**  
Owner / President  
Integrated Employer Resources

Mr. Suarez has extensive experience in advising employers regarding business development, human resource management and legal compliance issues as well as traditional labor matters. He has provided strategic business development advice to hundreds of companies over the past twenty years. Mr. Suarez formerly practiced with two nationally prominent labor and employment boutique law firms, one in the Southeast and one in the Midwest before purchasing West Coast Employers Association, now known as Integrated Employer Resources. Eduardo has dedicated the majority of his career in assisting organizations in the prevention of labor and employment litigation, the training and development of management personnel, and strategic business development for member and non-member organizations.

Prior to entering private practice, Mr. Suarez was a Federal Attorney with the National Labor Relations Board in Denver, Colorado and worked with the Bibb County District Attorney in Macon, Georgia. Mr. Suarez is a member of the State Bar of Florida as well as the Hillsborough County Bar Association and participates in the Labor and Employment and Workers' Compensation sections of both. Mr. Suarez is admitted to practice before U.S. District for the Middle District for Florida. Mr. Suarez earned his law degree from Mercer University School of Law in Macon, Georgia. In addition, he earned a Master of Public Administration from Georgia College and State University, a Bachelor of Science in Personnel and Industrial Relations, and a Master of Management Science in Operational Management from St. Louis University.

# 2011 LEGISLATIVE UPDATE

Eduardo A Suarez-Solar, MPA, MMS, JD, SPHR



## Genetic Information Nondiscrimination Act (GINA)

- Law took effect November 21, 2009; final regulations effective January 10, 2011
- Prohibits use of genetic information in making employment decisions
- Restricts acquisition of genetic information by employers and other covered entities, and strictly limits disclosure of such information
- Prohibits retaliation against employees who complain about genetic discrimination
- Impacts wellness programs



## Final Regulations Under the ADAAA

- 1. Broad construction of “disability”; not a demanding standard
- 2. Significant/severe restriction in “major life activity” not required
- 3. Substantial limitation on a major life activity should not be primary object of attention



## Final Regulations Under the ADAAA

- 4. Individualized assessment still required, but with lower standard than before
- 5. Scientific, medical or statistical analysis not required to compare individual with “most people in the general population”
- 6. No more consideration of helpful mitigating measures



## Final Regulations Under the ADAAA

- 7. Impairments that are episodic or in remission are viewed when they are active
- 8. Substantial limitation in only one major life activity is enough
- 9. Effects of an impairment can be substantially limiting even if duration is under six months



## Final Regulations Under the ADAAA

- Forces employers to follow accommodations process in most instances
- Underscores prior wisdom of never assuming individual will not be protected



## Final Regulations Under the ADAAA

- More individuals likely to file charges and suits
- More plaintiff's attorneys likely to take cases
- Less threshold hump of establishing protection
- Many more "regarded as" claims



## National Labor Relations Board

- NLRB Required Posting - NLRB has recently ruled that effective November 14, 2011 all employers are to post a Notice of Employee Rights under the NLRA

(Previously, only federal government contractors  
have been required to post such notice)



## National Labor Relations Board

- On 10/27/10, the NLRB issued a complaint against America Medical Response
- NLRB alleged that AMR suspended then terminated the employee due to negative remarks she posted about her supervisor on her Facebook page from her home computer!
- AMR had policy prohibiting employees from making disparaging, discriminatory or defamatory comments about the company, its managers, employees or clients
- NLRB argues this policy overbroad and interferes with employee's right to engage in protected concerted activity



## National Labor Relations Board

- Case settled in February 2011
- Under settlement, AMR will revise its Internet policy to allow employees to discuss wages, hours, and working conditions with co-workers outside of the workplace
- Company will not apply or construe this policy in a manner that improperly interferes with employees' rights under the NLRA



## National Labor Relations Board

- The NLRB lodged a complaint in April against Boeing over its decision to open a production line at a South Carolina nonunion facility, alleging the move was retaliation for strikes by unionized Washington state employees. In the complaint, the NLRB seeks to stop Boeing from building airplanes at the nonunion facility.



## Department of Labor Division of Wage & Hour

“The Department of Labor is back in the  
business of enforcement.” –  
Secretary of Labor, Hilda Solis



## Department of Labor Division of Wage & Hour

- “We Can Help” campaign launched in April 2010 to educate and assist workers
- “Plan/Prevent/Protect” initiative announced in May 2010 as the “beginning of a broader regulatory and enforcement strategy”
- “Find and Fix” strategy to encourage employers to take responsibility to find and fix problems before a DOL investigator arrives on their doorstep to inspect, discover problems, and enforce the law
- “Bridge to Justice” program which provides referrals to plaintiffs’ attorneys and documentary support for lawsuits they may bring.



## Department of Labor Division of Wage & Hour

- **Decreased cooperation with employers**
  - No more opinion letters
  - No more partnership agreements with employers
  - No more supervision of back wage payments
- **Free Apps for iPhones and coming soon for Androids**
  - Tracks hours (tips, commissions coming soon)
  - Explains Exempt/Non-Exempt Classifications
  - Assistance in filing claims



Department of Labor  
Division of Wage & Hour

- **Exempt misclassifications**
  - Exempt v. Nonexempt
  - Employee v. Independent Contractor (IRS also)
  - Paid employee vs. Unpaid Interns?
- **Regular rate miscalculations**
- **Rounding time**
- **Auto deductions for meal periods**
- **Missed/short meal and rest breaks**



Department of Labor  
Division of Wage & Hour

- **Off-the-clock work**
- **Improperly calculating overtime**
  - Remote work
  - Pre- and post work activities
- **Improper wage deductions**
- **Untimely wage payments**



Thank you



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Eduardo A Suarez-Solar, MPA, MMS, JD, SPHR  
14115 Stilton Street  
Tampa, Florida 33626  
813-433-9003  
**Ed@SuarezGriffin.com**

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***The Going Concern:  
Evaluation and Presentation***

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*Daryl A. Johnson, CPA, CMA*

# **DARYL JOHNSON**

Owner

Daryl A. Johnson, CPA

Mr. Daryl Johnson is a licensed Florida certified public accountant with over thirty years of practical accounting experience. He is currently professionally engaged as a sole practitioner in Lakeland, Florida, where he has lived and worked since 1982. He also is a Certified Management Accountant. Prior to moving to Lakeland, he lived and worked in the Tampa Bay area in public accounting.

Mr. Johnson opened his accounting office in Lakeland in 1984. The scope of his current practice encompasses attest and non-attest accounting services as well as income tax preparation and business consulting.

In addition to his accounting practice, he occasionally fills his spare time teaching accounting as an adjunct instructor. Most recently, he taught cost accounting at Florida Southern College.

A native of Indian Rocks Beach and a multi-generation Floridian, Mr. Johnson earned a BSBA in accounting from The University of Florida in 1976. While there, he participated in numerous campus activities, including the Gator Band. Now as an alumnus, he serves on the committee that oversees the University of Florida Accounting Conference that is held each fall during Homecoming week. Recently, he earned an MBA at the University of South Florida Polytechnic here in Lakeland.

Mr. Johnson is a member of the American Institute of Certified Public Accountants, Florida Institute of Certified Public Accountants and the Institute of Management Accountants. He currently serves on the board of the Polk Chapter of the F.I.C.P.A.

In addition to his professional activities, he also participates in other church and community activities and recently retired as a commissioner on the Lakeland Housing Authority after sixteen years of service.

Daryl and his wife, Kathy, have been happily married for over thirty years. They are the proud parents of four sons ranging in age from twenty-seven to seventeen. Kathy teaches instrumental music at Lakeland Christian School.

**A & A WORKSHOP  
“THE GOING CONCERN”  
ANALYSIS AND PRESENTATION**

Daryl A. Johnson, CPA  
October 28, 2011  
Florida Gulf Coast University  
Accounting Conference

**AGENDA**

- Introduction
- Going Concern – a broad perspective
- Going Concern – technical perspective
- Presentation Issues
- Reporting and Disclosure Issues

## Let's talk about it .....

What's going on out there .....

This has got to be a bad dream .....

Is it really a nightmare .....

Is It getting any better .....

### Accounting and Auditing Considerations in Difficult Economic Times

- Smaller operating margins
- Difficult credit conditions
- Trade receivable collection issues
- Lower inventory turnover
- Cash flow issues
- Management difficulties
- **More business failures**

## AU Section 341

- *“Continuation of an entity as a going concern is assumed in financial reporting in absence of significant information to the contrary.”*

## AU Section 341

- *“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 forced revisions of its operations, or similar actions.”*

## **Going Concern – Basic Concept**

- One of the most basic accounting assumptions is that a business is a going concern
- A specific business enterprise will continue to operate for an indefinite period
- Or the “foreseeable future” – long enough to meet its objectives and fulfill its obligations
- 12 month period looking forward

## **Going Concern Considerations**

- Conditions and events
- Management’ s plan
- Financial statement effects
- Reporting effects

## Conditions and Events

- Negative trends  
*operating losses, negative cash flows*
- Other indications of financial difficulties  
*loan default or denial of credit*
- Internal matters  
*labor issues , bad contract*
- External matters  
*legal or legislative issues, loss of franchise*

## Management's Plans

- Disposal of assets
- Borrow money or restructure debt
- Reduce or delay expenditures
- Increasing ownership equity

## Standards Viewpoint

- Exposure Draft – Going Concern
- Issued in October, 2008
- Comments closed in December, 2008
- No final standard issued at the date

## F.A. S. B. Issues

- *Disclosures about Risks and Uncertainties and the Liquidation Basis of Accounting*
- *Guidance regarding required disclosures*
- *Adoption and application of liquidation basis of accounting*

## **Financial Statement Effects**

- Discontinuance of operations
- Recoverability of assets
- Reclassification of liabilities
- Liquidation basis reporting

## **Reporting Effects**

- Departure from applicable financial reporting framework
- Disclosure in the notes to the financial statements
- Explanatory paragraph included the accountant's report

## **Disclosure Requirements**

- Pertinent conditions and events giving rise to the assessment, including an estimation the timing of the anticipated conditions or events
- Possible effects of these conditions and events
- Possible discontinuance of operations
- Management's evaluation of the significance of these events and any mitigating factors

## **Disclosure Requirements**

- Management's plans to mitigate the effects or conditions, including whether those plans can be effectively implemented as well as the likelihood of success
- Information about the recoverability or classification of recorded amounts or the amounts and classification of liabilities

## Compilation Reporting

- With disclosures ?  
*Adequate disclosure in the footnotes, or  
Modify the report*
- Without disclosure ?  
*Lack of disclosure is not misleading  
Selected disclosure  
Modify the report*

## Review Reporting

- Adequate disclosure
- Modify the report

*“As discussed in Note X, certain conditions indicate that the Company may be unable to continue as a going concern. The accompanying financial statements do not include any adjustments to the financial statements that might be necessary should the Company be unable to continue as a going concern”*

## What are those “modifications” ?

- The liquidation basis of accounting
- To be used only if liquidation is “imminent”  
*a plan of liquidation has been approved by ownership*  
*liquidation plan is being imposed by other forces and avoidance of such is remote*

## Now, lets fill a little time

- *How was your summer?*
- *Any birthdays in the crowd today?*
- *Does everyone have a birth certificate?*
- *Are the basketballers going to play?*

# Case Study

- Entity: Solyndra, LLC
- Location: Fremont, CA
- Employees: 1,100
- Started: 2005
- Business: design and production of solar panels
- Auditor: PriceWaterhouseCoopers, LLP
- Audit circumstances: Initial Public Offering
- Other considerations: \$535 million government guaranteed loan

## Solyndra Balance Sheet

SOLYNDRA, INC.  
CONSOLIDATED BALANCE SHEETS  
(in thousands, except share and per share data)

	January 3, 2009	January 2, 2010 Actual	January 2, 2010 Pro Forma (unaudited)
<b>Assets</b>			
<b>Current assets:</b>			
Cash and cash equivalents	\$ 82,223	\$ 50,285	
Accounts receivable, net	2,835	33,986	
Inventories	3,932	8,737	
Prepaid expenses and other current assets	3,648	9,452	
<b>Total current assets</b>	<b>91,738</b>	<b>102,420</b>	
Property, plant and equipment, net	204,340	375,873	
Restricted cash	3,938	151,307	
Other assets	19,079	53,616	
<b>Total assets</b>	<b>\$ 319,095</b>	<b>\$ 683,216</b>	
<b>Liabilities, Redeemable Convertible Preferred Stock and Stockholders' Equity (Deficit)</b>			
<b>Current liabilities:</b>			
Accounts payable	\$ 20,537	\$ 54,201	
Accrued and other liabilities	30,490	50,977	
<b>Total current liabilities</b>	<b>51,027</b>	<b>105,178</b>	
Deferred rent	3,613	5,901	
Long-term debt	—	140,856	
Preferred stock, warrants	2,083	2,306	
<b>Total liabilities</b>	<b>56,723</b>	<b>254,241</b>	<b>\$ 251,935</b>
<b>Commitments and contingencies (Note 5)</b>			
Redeemable convertible preferred stock: \$0.00001 par value; 171,409,952 shares authorized, 93,576,573, and 170,091,525 shares issued and outstanding at January 3, 2009, and January 2, 2010, respectively, and 241,397,435 shares issued and outstanding pro forma (unaudited) (aggregate liquidation value at January 2, 2010 of \$970,393)			
	630,859	961,270	—
<b>Stockholders' equity (deficit):</b>			
Common stock: \$0.00001 par value; 300,000,000 shares authorized; 14,653,685 and 14,869,622 shares issued and outstanding at January 3, 2009, and January 2, 2010, respectively, and 241,397,435 shares issued and outstanding pro forma (unaudited)			
	—	—	2
Additional paid-in capital	16,707	25,455	989,029
Notes receivable from stockholders	(6)	—	—
Accumulated other comprehensive income (loss)	7	(6)	(6)
Accumulated deficit	(385,141)	(557,744)	(557,744)
<b>Total stockholders' equity (deficit)</b>	<b>(368,487)</b>	<b>(532,295)</b>	<b>\$ 431,281</b>
<b>Total liabilities, redeemable convertible preferred stock, and stockholders' equity (deficit)</b>	<b>\$ 319,095</b>	<b>\$ 683,216</b>	

The accompanying notes are an integral part of these consolidated financial statements.

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## Solyndra Income Statement

SOLYNDRA, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS  
(in thousands, except per share data)

	Fiscal Years ended		
	December 29, 2007	January 3, 2009	January 2, 2010
Revenue	\$ -	\$ 6,005	\$ 100,465
Cost of revenue	-	44,435	162,166
Gross profit (loss)	-	(38,430)	(61,701)
Operating expenses:			
Research and development	85,859	125,499	84,591
Sales and marketing	2,677	4,838	9,317
General and administrative	23,279	21,221	21,541
Asset impairment charges	-	31,610	-
Total operating expenses	111,815	183,168	115,449
Loss from operations	(111,815)	(221,598)	(177,150)
Interest expense	(6,906)	(12,444)	(1,576)
Interest income	2,829	1,870	282
Other income (expense), net	1,764	107	5,949
Net loss	<u>\$ (114,128)</u>	<u>\$ (232,065)</u>	<u>\$ (172,495)</u>
Deemed dividend on preferred stock	-	(10,452)	-
Net loss attributable to common stockholders	<u>\$ (114,128)</u>	<u>\$ (242,517)</u>	<u>\$ (172,495)</u>
Net loss per share:			
Basic and Diluted	<u>\$ (16.55)</u>	<u>\$ (23.85)</u>	<u>\$ (13.30)</u>
Weighted average number of shares used in per share calculations:			
Basic and Diluted	<u>6.898</u>	<u>10.167</u>	<u>12.972</u>
Pro forma loss per share (unaudited):			
Basic and Diluted			<u>\$ (0.90)</u>
Weighted average number of shares used in pro forma per share calculations (unaudited):			
Basic and Diluted			<u>190,766</u>

The accompanying notes are an integral part of these consolidated financial statements.

F-4

## Solyndra :Conditions and Events

- Negative trends  
*operating losses, negative cash flows*
- Other indications of financial difficulties  
*loan default or denial of credit*
- Internal matters  
*labor issues , bad contract*
- External matters  
*legal or legislative issues, loss of franchise*

## Solyndra: Management's Plans

- Disposal of assets
- Borrow money or restructure debt
- Reduce or delay expenditures
- Increasing ownership equity

## Independent Auditor's Opinion

To To the Board of Directors and Stockholders  
of Solyndra, Inc.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, of redeemable convertible preferred stock and stockholders' equity (deficit) and of cash flows present fairly, in all material respects, the financial position of Solyndra, Inc. and its subsidiaries at December 29, 2007 and January 3, 2009, and the results of their operations and their cash flows for each of the three years in the period ended January 3, 2009 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

/s/ PricewaterhouseCoopers LLP

## Disclosure

Management believes that its available cash and cash equivalents and restricted cash, combined with the DOE guaranteed loan facility and Argonaut revolving line of credit facility, will be sufficient to fund operations and capital expenditures for the next 12 months. However, given the history of losses and future capital commitments, the Company may be required to raise additional capital through equity or debt financing if the Company is not able to achieve and sustain positive cash flow from operations. Additionally, future capital requirements will depend on many factors, including the rate of revenue growth, the expansion of manufacturing capacity as well as sales and marketing activities, timing and extent of spending on research and development efforts and the continuing market acceptance of the Company's product. Management believes that the Company will be successful in raising additional financing from its stockholders or from other sources of capital funding, expanding operations and gaining market share. Should forecasted revenues and customer orders not materialize as expected, management may reduce expenditures on production capacity and other operating expenditures until such forecasted revenues are realized. There can be no assurance that, in the event the Company requires additional financing, such financing will be available on terms which are favorable or at all. **Failure to generate sufficient cash flows from operations, raise additional capital, reduce certain discretionary spending or to remain in compliance with the covenants contained in the DOE guaranteed loan facility or the Argonaut revolving credit facility, could have a material adverse effect on the Company's ability to achieve its intended business objectives. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.**

## Amendment to I.P.O.

### ■ REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

- To the Board of Directors and Stockholders
- of Solyndra, Inc.
- In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, consolidated statements of redeemable convertible preferred stock and stockholders' equity (deficit) and consolidated statements of cash flows present fairly, in all material respects, the financial position of Solyndra, Inc. and its subsidiaries at January 3, 2009 and January 2, 2010, and the results of their operations and their cash flows for each of the three years in the period ended January 2, 2010 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.
- The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 1 to the consolidated financial statements, the Company has suffered recurring losses from operations, negative cash flows since inception and has a net stockholders' deficit that, among other factors, raise substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are described in Note 1. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.
- As discussed in Note 13 of Notes to Consolidated Financial Statements, the Company changed the manner in which it accounts for warrants to acquire common stock in fiscal 2009.
- /s/ PricewaterhouseCoopers LLP
- San Jose, California
- March 16, 2010

## Accounts Receivable

- Proper valuation of trade accounts receivable under GAAP requires establishing a reserve for uncollectable accounts
- Two methods for determining the amount of this reserve are:
  - percentage of credit sales*
  - percentage of year end accounts receivable*

## Receivables in “*difficult times*”

- What is the ability of the customer to pay?
- What is the ability of the client to “wait out” the customer?
- Is factoring a consideration?

## Calculation of Allowance

- Data used to calculate the reserve percentage
  - Company historical data*
  - Industry data / trends*
- Example:
  - AR @ 12/31/10 - \$3,600,000*
  - Company historical data – 3.74% of AR is uncollectable*
  - Allowance @ 12/31/10 - \$136,640*

## Potential Issues?

- Shrinking sales
- Increasing AR
- Greater % in over 90 days
- Bankruptcy or insolvency of customer
- Unwillingness of client to face reality

**The End**

---

# ***Blue Ribbon Panel Report***

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*Christopher T. Marrie, CPA*

**Christopher T. Marrie**  
**Assurance Manager**  
Hill, Barth & King LLC

**Areas of Expertise**

Not-for-Profit Organizations  
Construction and Real Estate  
Health Care Organizations

**Experience**

Chris is a Manager in the Naples, Florida office of Hill, Barth & King LLC (HBK) and has been with the firm since 1998.

Christ has extensive experience in auditing and business consulting. Chris provides a variety of accounting and assurance services to clients ranging from individuals to small to medium size businesses and not-for-profit organizations.

**Education**

BS Degree in Accounting and Business Administration  
Youngstown State University

**Professional Organizations**

Member, American Institute of Certified Public Accountants (AICPA)  
Member, Florida Institute of Certified Public Accountants (FICPA)  
Member, Economic Development Council of Collier County



# Standard Setting for Private Companies

BLUE-RIBBON PANEL RECOMMENDATIONS

Presented by Chris Marrie

## The Problem Statement

- 28 million private companies vs. 14,000 public companies in the United States
- Private companies (PCs) preparing GAAP financial statements often times do not have the resources available to their public counterparts

# The Problem Statement

## RECENT ACCOUNTING STANDARDS

- Variable Interest Entities
- Uncertain Tax Positions
- Fair Value Measurements
- Goodwill Impairment

# The Problem Statement

## ACCOUNTING STANDARDS

- The MOST complex are often the LEAST relevant for users of private company financial statements (PCFS)
- Growing number of GAAP exception in reports – are standards still “generally accepted”?
- Growing use of OCBOA statements

# The Problem Statement

## USERS OF PCFS

- Lenders
- Sureties
- Owners
- Venture Capital Investors

# Background

## BLUE-RIBBON PANEL (BRP)

- Joint effort of AICPA, FAF, FASB and NASBA
- How standards can best meet needs of U.S. PCFS
- 18 members

# Background

## ISSUES

- Understanding what information users of PCFS consider **DECISION USEFUL**
- How needs differ from users of public company financial statements
- Cost vs. benefits of GAAP for use in private company financial reporting

# Recommended Model

## U.S. GAAP WITH EXCEPTIONS/MODIFICATIONS FOR PCS

- Based on U.S. GAAP with potential differences in measurement, presentation, disclosure and recognition
- Cost-Benefit
  - \*Cost – reduced to prepare, report on and use?
  - \*Benefit – users able to make appropriate decision with information provided?

# Recommended Structure

## SEPARATE PRIVATE COMPANY STANDARDS BOARD

- Establish appropriate exceptions and modifications to GAAP for PCs
- All differences will reside in one GAAP codification
- Ultimate authority to approve exceptions and modifications will reside with new board

# Pros

- Can be implemented quickly
- Maintains significant consistency and comparability
- Minimizes cost to private companies that choose to "go public"
- Lower education and training costs

## Cons

- May not be considered sufficiently responsive to complexity and cost to private companies
- Depending on level of exceptions / modification considered could reduce comparability with public companies
- Having 2 boards responsible for a single framework is unproven and could be problematic

## Recent Developments

AS OF OCTOBER 4, 2011

- FAF plans to establish Private Company Standards Improvement Council (PCSIC)
- Overseen by board of Trustees of FAF
- Seeking public comment through January 2012

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# ***CIRA Update***

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*Michael A. Kosinski, CPA*

# **Michael Kosinski, CPA**

Principal  
LarsonAllen

## **Profile**

Michael Kosinski is a principal with LarsonAllen specializing in assurance and tax services for commercial businesses. Michael Kosinski has been with LarsonAllen (including acquired practices) since 2002, and has 12 years of experience in both public accounting and private industry.

## **Experience in serving clients**

Michael primarily works with assurance, tax, and business planning aspects of closely held for-profit businesses and their owners as well as employee benefit plans. He has significant experience with clients in the manufacturing, real estate, and construction industries. Michael has worked with many companies in aspects such as indirect cost allocations, job cost allocations, cost capitalization, and complex lease and financing issues. Michael has also worked in a consulting capacity to many companies restructuring or streamlining accounting operations and financial reporting.

## **Educational/professional involvement**

Michael graduated with honors from Florida Gulf Coast University, Fort Myers, Florida, with a Bachelor of Business Administration with a degree in accounting. Michael is a member of the American Institute of Certified Public Accountants (AICPA), the Florida Institute of Certified Public Accountants (FICPA), and the Institute of Management Accountants (IMA). Michael is licensed by the State of Florida as a Certified Public Accountant.

## CIRA Audit and Accounting Update 2011



Michael Kosinski, CPA  
LarsonAllen  
Mkosinski@larsonallen.com

**LarsonAllen**  
LLP  
CPAs, Consultants & Advisors

### Objectives

- At the end of this session you will be able to
  - Identify potential audit and accounting issues related to CIRA's
  - Apply the proper accounting treatment these issues
  - Identify potential issues that may require outside counsel
  - Apply Florida State Statutes to the financial statement audit



## What is a CIRA?

Common Interest Realty Association

Is a non taxable corporation... not tax exempt

Forms of CIRAs

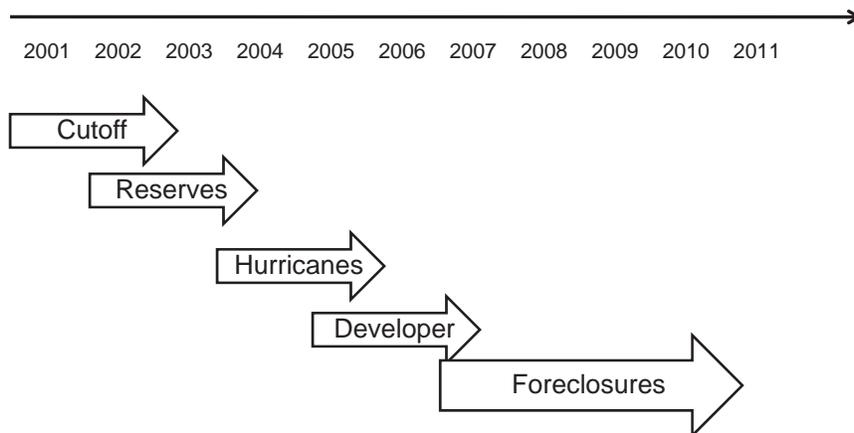
Governed in large part by Florida Statutes

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## Brief History

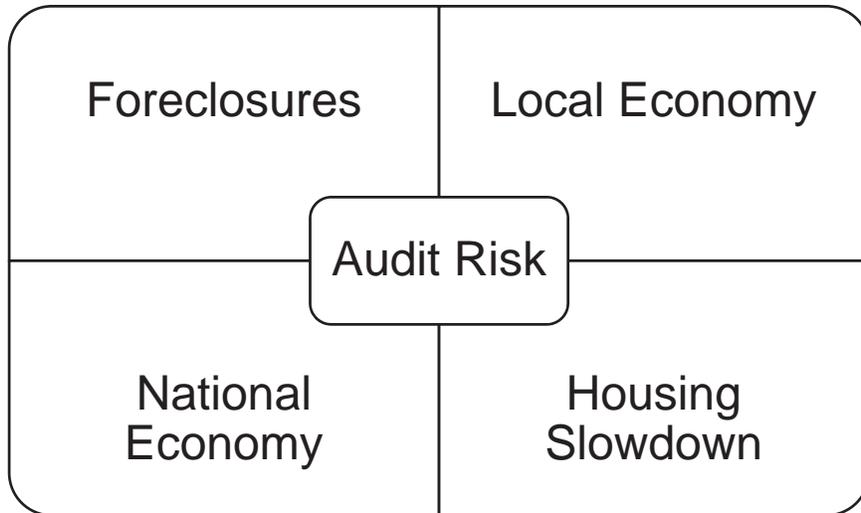


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## Operating Environment



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## Statutes - 2011 Changes

- Changes to provisions to liabilities to master associations during foreclosure
- Changes to bulk purchaser requirements
- Assignment of rents to the association

Consult an attorney...



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# Wiki for CIRA

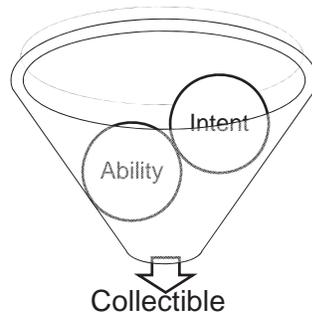
The screenshot shows the homepage of the AICPA Common Interest Realty Association Wiki. At the top, there is a navigation bar with 'Log In' or 'Register' links and a search box. The main heading reads 'Welcome to the AICPA's Common Interest Realty Association Wiki'. Below this, a section titled 'A Collaborative Tool for Financial Statement Preparers and Practitioners' explains the purpose of the wiki. To the right, a 'Content Pages' sidebar lists various topics such as 'Industry Background and Unique Characteristics' and 'Financial Statement Presentation'. The footer includes the text 'NOTICEABLY DIFFERENT' and a copyright notice for 2011 LarsonAllen LLP.

## Statutes - Important Thresholds

Compiled	<ul style="list-style-type: none"><li>• \$100,000</li><li>• \$199,999</li></ul>
Reviewed	<ul style="list-style-type: none"><li>• \$200,000</li><li>• \$399,999</li></ul>
Audited	<ul style="list-style-type: none"><li>• \$400,000</li><li>• And Over</li></ul>

## Bad Debt

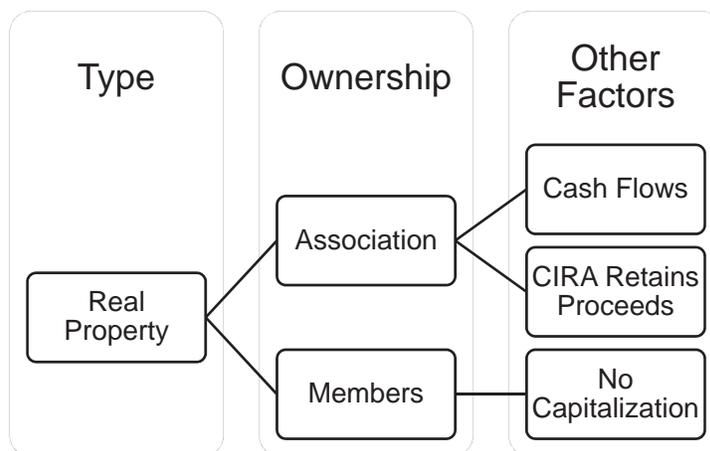
“Management considers all assessments receivable to be fully collectible; therefore, no allowance for uncollectible amounts is deemed necessary.”



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## Common Property



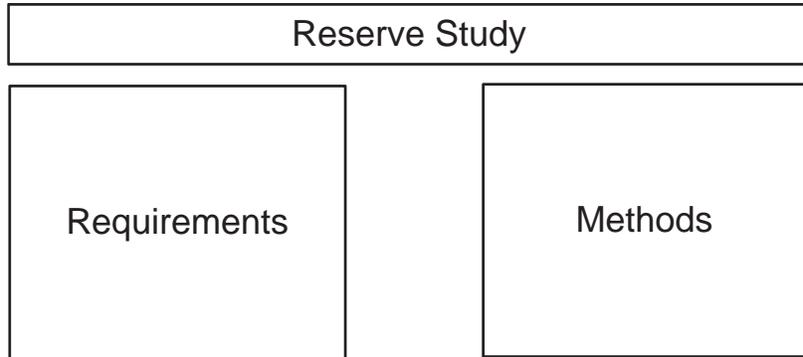
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## Reserves

“We can evade reality, but we cannot evade the consequences of evading reality”

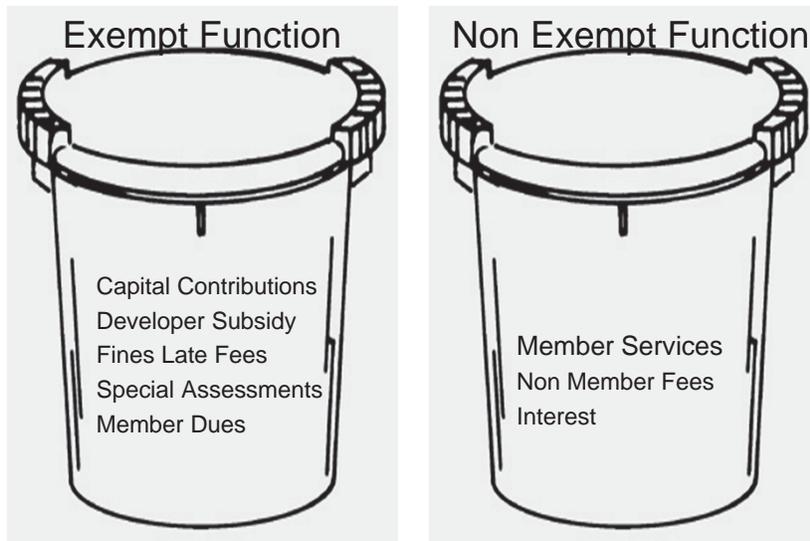
-Ayn Rand



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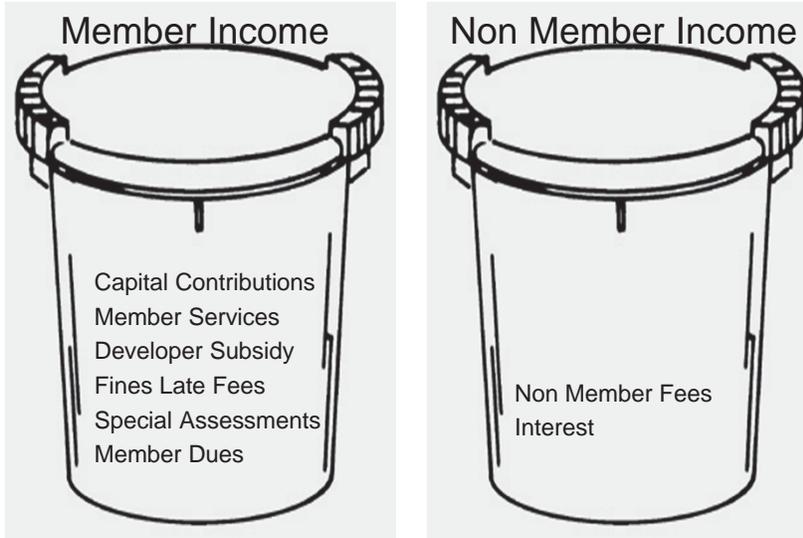
## Income Taxes - 1120H



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## Income Taxes - 1120



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## Income Taxes - Apportioned Expenses

- Interest – accounting, audit, tax prep, fidelity bond, management
- Guest Suite Income – property insurance, management, utilities, repairs, security, janitorial, housekeeping
- Apportionment methods
- Keep in mind the 90% test



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## Developer Subsidy - Condominiums

- Examine subsidy requirements
  - Non-assessment Revenues and Expenses
  - Interest Earned
  - Bad debt and Depreciation

*“only regular periodic assessments for common expenses as provided for in the declaration and prospectus and disclosed in the estimated operating budget shall be used for payment of common expenses during any period in which the developer is excused”*



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## Developer Subsidy – HOA

- Developer Subsidy – HOA – Post October 1, 1995
- Must be in the documents
- Examine for expirations and maximums
- Non assessment revenue expenses

*“the guarantor shall pay any deficits that exceed the guaranteed amount, less the total regular periodic assessments earned by the association from the members other than the guarantor during the guarantee period regardless of whether the actual level charged was less than the maximum guaranteed amount.” 708.308*

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## Developer Subsidy - Reserves

- Do not use reserve funds in place of deficit subsidy
- **61B-20.006 Enforcement Resolution and Civil Penalties – Major Violations**

*-Not providing sufficient cash/resources to provide payment on a timely basis of all common expenses including full funding of reserves.*

*-Comingling reserve funds with operating funds*



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## Successor Developer Issues

Was Turnover Triggered?

Will you be the  
successor developer?

What liability are you  
assuming?

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## Other Associations

Timeshares

Cooperatives

Commercial  
Associations

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## Timeshares

- Capitalization of Interior Furniture
- Property Taxes
- Foreclosed Unit Weeks
- Tax Considerations



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## Cooperatives

- Have title to the property
- Owners are stockholders
- Transfer of interest requires approval of the board
- Real property is capitalized more frequently
- Must file 1120-C

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## Commercial Associations

- Can Not File 1120H
- Much of the same requirements
- Question as to whether Rev Ruling 70-604 applies



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## Fraud Risks

- Incentives – Changes in management companies, auditors, reserve study preparers, pressures to keep assessments low, employees underpaid, economic conditions
- Attitudes – adverse relationships between CIRA and employees, personal difficulties of employees

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## Fraud Risks

- Opportunities – Lack of board oversight, management has access to several associations bank accounts, lack of financial knowledge, weak management company internal controls, little segregation of duties at the management company, board members may not closely review expenditures

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## Some Responses

- Confirm cash
- Journal entry testing
- Data extraction software
- Expenditure vouching
- Scanning the general ledger detail
- Review of vendor lists

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## Conclusion

- Dealing with issues early prevents unwanted surprises
- Know when to obtain an outside opinion
- Be aware of unique developer issues
- And  
    of  
    course

Thank you for your time!!!

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Questions???

???

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***Valuation of Inventory After the  
Balance Sheet Date But Before the  
Financials Are Issued –  
Should the Impaired Inventory  
Be Written Down?***

---

*Daniel Acheampong, CPA*

**Daniel Acheampong**  
Instructor I in Accounting  
University of South Florida

Daniel Acheampong, Instructor I in Accounting. MAcc, University of South Florida (2006), Is a CPA(the State of Florida) and a member of the IIA, ACFE, National Regulatory Research Institute (NRRI), and UNDP (Anti-Corruption Practitioners Network). Research interests in Utility Ratemaking, Internal controls, and Forensic Accounting (preventive controls).

## **Valuation of Inventory After the Balance Sheet Date But Before the Financials are Issued - Should the Impaired Inventory Be Written Down?**

Daniel Acheampong MAcc., C.P.A.  
Accounting Instructor  
Florida Gulf Coast University  
Lutgert College of Business  
10501 FGCU Blvd. S.  
Fort Myers, FL 33965-6565

## **Required Entities-ASU 855**

- **Securities & Exchange Commission filer**
  - Filing Date (Date the Financial Statements are issued)
  - No need to disclose the evaluation date
- **Entity is a conduit bond obligor and bond is publically traded**
  - Filing Date (Date the Financial Statements are issued)
  - Disclose the date of evaluation and the date the financial statement was issued

## Required Entities-ASU 855

- Entities that do not meet the above Criteria
  - Evaluate subsequent events through the date that the financial statements are available to be issued
  - Disclose the evaluation date

## Accounting for Contingencies-FAS 5

- A **loss contingency** - potential loss depends on whether some future event occurs
  - a pending lawsuit at year-end with no known outcome
- Contingency is accrued and reported as a liability depending on:
  - Likelihood that the confirming event will occur:
    - probable
    - reasonably possible
    - remote

## Accounting for Contingencies-FAS 5

- Contingency is accrued and reported as a liability depending on:
  - what can be determined about the amount of loss.
    - Known
    - Can be reasonably estimated
    - Cannot be reasonably estimated
- A contingent liability is recorded if loss is probable and the amount of loss can be at least reasonably estimated.

## SAS No. 1 Section 560 Subsequent Events

- Events or transactions occurring subsequent to the balance-sheet date, but prior to the issuance of the financial statements
- Material effect on the financial statements
- Require adjustment or disclosure in the financial statements

## SAS No. 1 Section 560

### Subsequent Events- Type 1/Recognized

- Events existed at the date of the balance sheet
  - Judgment and knowledge of the evidence and circumstances exist
  - The financial statement should be adjusted
- Example: loss on inventory due to obsolescence (expiration of medication with Dec 31 Expiring Date) subsequent to the balance-sheet date would be suggestive of conditions existing at the balance-sheet date
- Financial statement need to be adjusted before issuance

## SAS No. 1 Section 560

### Subsequent Events-Type 2 / Unrecognized

- Events that provide evidence with respect to conditions that did not exist at the date of the balance sheet being reported on but arose subsequent to that date.
- No adjustment of the financial statements is needed.
- Disclosure of these events is required if material

**SAS No. 1 Section 560**  
**Subsequent Events-Type 2 / Unrecognized**

Subsequent events such as changes in the quoted market prices reflect a concurrent evaluation of new conditions

Pharmaceutical inventory-unsuccessful defense of patent, leading to a drop in inventory price by the Balance sheet date

**SAS No. 1 Section 560**  
**Subsequent Events-Type 2 / Unrecognized**

- Loss of inventory due to fire or flood (December 31) subsequent to the balance-sheet date would not be suggestive of conditions existing at the balance-sheet date
- Adjustment of the financial statements would not be appropriate.
- Events affecting the realization of inventories will require adjustment of the financial statements

## SAS No. 1 Section 560

### Subsequent Events-Type 2 / Unrecognized

- Occasionally, a subsequent event of type 2 may have such a material impact on the entity that the auditor may wish to include in his report an explanatory paragraph directing the reader's attention to the event and its effects (AU section 508)
- E.g.: Pending defense of patent right
  - Medication after patent expiration –generic medication may lead to substantial price reduction

## References

- FASB. (2008). *Statement of financial accounting standards no. 5: Accounting for contingencies*. Retrieved from <http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175820904701&blobheader=application%2Fpdf>
- FASB. (2010). *Amendments to certain recognition and disclosure requirements*. (No. ASU2010-09.)
- McGladrey, & Pullen. (2010). *Subsequent events : new standards apply*. Retrieved from Accounting Insights.
- PCAOB. (2002, September 1). *AU section 560: Subsequent events [Auditing Procedures in the Subsequent Period]*. Retrieved from <http://pcaobus.org/Standards/Auditing/Pages/AU560.aspx>

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Cherry, Bekaert & Holland, LLP  
Coral Gables  
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Ray Monteleone, CPA  
President, Paladin Global Partners  
Fort Lauderdale  
Member since 1979



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David White, CPA  
Carr Riggs & Ingram LLC  
Tallahassee  
Member since 2010



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### **FOR MORE INFORMATION**

Contact Carol Kearney at (800) 342-3197  
(in Florida) or (850) 224-2727, Ext. 271  
or e-mail [kearneyc@ficpa.org](mailto:kearneyc@ficpa.org).



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**(MEMBER'S NAME), CPA, Completes course  
on (SUBJECT AREA)**

**(MEMBER'S CITY), (DATE), 2011** -- (MEMBER'S FULL NAME),  
CPA, of (FIRM NAME) in (CITY), completed a course,  
“(COURSE TITLE),” on (DATE). This continuing-education course covered  
the topic of (SUBJECT AREA).

(MEMBER'S LAST NAME) is a (POSITION TITLE) practicing in the  
area of (MEMBER'S AREA OF PRACTICE – TAS, AUDIT, ETC.) with the firm.

In addition to (MEMBER'S LAST NAME)'S professional responsibilities, HE/SHE is also active in (LIST ANY OTHER PROFESSIONAL/CIVIC/ VOLUNTEER/COMMUNITY ACTIVITIES – OPTIONAL). HE/SHE is an active member of the Florida Institute of Certified Public Accountants, the professional association representing the interests of more than 18,400 CPAs with over 4,400 offices throughout Florida.

(MEMBER NAME) can be reached by telephone at (PHONE NUMBER), or via e-mail at  
(E-MAIL ADDRESS).

###