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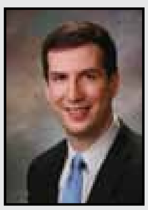
A&A ADVISOR

July 2013

Welcome to our July 2013 edition of the **A&A Advisor**. Our A&A Advisor continues to focus on issues impacting the Commercial, Governmental and Non-Profit Sectors; providing you with insight and guidance on new rules, proposed changes and views of standard setters to assist you in the management of the financial and reporting aspects of your organization. I encourage you to contact us with any comments or questions you may have.



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Comprehensive Income Standard Update

In February 2013, the FASB issued an updated accounting standard on Comprehensive Income "Update no. 2013-02." This update does not change the current requirements for reporting comprehensive income in financial statements. The update, however, requires companies to provide information about the amounts reclassified out of accumulated other comprehensive income by component. A company is required to present, either on the face of the income statement or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items or net income in its entirely in the same reporting period.

This accounting update will be effective prospectively for reporting periods beginning after December 15, 2013. Early adoption is permitted.

Liquidation Standard Update

The FASB has issued FASB update no. 2013-07 "Liquidation Basis of Accounting" which will be effective for annual periods beginning after December 15, 2013, and interim reporting periods therein. The FASB has issued this update to explain when the liquidation basis of accounting should be applied. The FASB has indicated that an entity will be required to apply liquidation basis of accounting when the likelihood is remote that the entity will return from liquidation (i.e., liquidation is imminent) and either of the following occurs:

- a plan for liquidation has been approved by the person or persons with the authority to make such a plan effective and the likelihood is remote that the execution of the plan will be blocked by other parties or the entity will return from liquidation, or
- a plan for liquidation is imposed by other forces, and the likelihood is remote that the entity will return from liquidation.

The common question we have received from our clients is how will the update effect entities which are either incorporated for a specific task or there is an end date other than perpetuity. This is usually seen in specific purpose partnerships or joint ventures that are set up to complete a specific task. The FASB has stated that liquidation accounting would only be imminent if the approved plan for liquidation was different from the plan specified in the entity incorporation or formation documents. In other words, if an entity is set up to complete a task and they are in the last year of completing that specific task, liquidation accounting would not be applicable since, at inception, the entity's formation document specified the purpose and end date of the entity.

Reexamination of Lease Accounting in the Governmental Environment

By David Gannon, Partner

In April 2013, the Governmental Accounting Standards Board added "Lease Accounting – Reexamination of NCGA Statement No. 5 and GASB Statement No. 13" to the current agenda of projects to be further reviewed by the Board. The objective of this project is to reexamine issues related to lease accounting and consider whether improvements to current accounting guidance are necessary.

Accounting guidance related to lease accounting in the public sector environment is currently provided by the following:

- National Council on Governmental Accounting Statement No. 5, *Accounting and Financial Reporting Principles for Lease Agreements of State and Local Governments;*
- GASB Statement No. 13, *Accounting for Operating Leases with Scheduled Rent Increases;*
- GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements;*
- GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*

Interesting to note that GASB Statement No. 62 incorporates the accounting guidance contained in FASB Statement No. 13, *Accounting for Leases,* as amended and interpreted, into the authoritative literature of the Governmental Accounting Standards Board.

In today's environment, governmental entities routinely enter into leases, many of which are considered to be operating leases, and therefore not recorded as long-term debt on a government organization's balance sheets, even though those operating leases represent long-term commitments of the governmental organization. Additionally, governments do not record the assets associated with the operating lease. This project intends to provide a basis for the Board to consider whether an operating lease meets the definitions of an asset or liability as defined in Concepts Statement No. 4, *Elements of the Financial Statements.*

The Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) are currently considering significant revisions to private sector guidance over leases. The GASB believes that adding this project to the current agenda is prudent in order to follow the progress of the FASB and IASB in order to evaluate whether changes should also be adopted for organizations that follow GASB and allow the GASB to consider changes in a timely manner.

This GASB project is considering the following issues:

- What types of leases are entered into by state and local governments?
- What specific user needs exist regarding governmental leases and what decision-useful or accountability information is needed to meet those needs?
- Are current accounting and financial reporting standards appropriate to meet essential user needs?
- Should there be a distinction between operating and capital leases?
- If current standards are not considered to be adequate, what additional potential requirements should be considered?

Who Will Be Affected?

All governmental organizations that follow generally accepted accounting principles would be required to implement any guidance being issued as a result of this project.

Timeline:

Accounting guidance related to this current agenda item is still in the preliminary stages with final adoption of a new pronouncement not estimated until December 2015.

ERISA Section 408(b)(2) (Fee Disclosure Regulation)

By Craig R. Erickson – Partner-in-Charge, Employee Benefit Plan Group

What is Section 408(b)(2)?

In July of 2012, the final service provider disclosure regulation became effective, and was issued under ERISA Section 408(b)(2). This regulation requires covered service providers (CSPs) to provide plan fiduciaries with the appropriate disclosures in regards to the services that are being performed for the Plan as well as all the costs, both direct and indirect, that will be charged for those services. The regulation applies to CSPs who expect to receive at least $1,000 in compensation for services rendered to a covered plan and applies to the following service providers:

- ERISA fiduciary service providers to a covered plan or to a plan asset vehicle in which such plan invests
- Investment advisers registered under Federal or State law
- Record-keepers or brokers who make designated investment alternatives available to the covered plan
- Providers of one or more of the following services to the covered plan who receive or expect to receive indirect compensation (that is compensation received from any source other than the plan sponsor, the plan service provider, an affiliate or a subcontractor) in connection with their services such as:
  - Accounting, auditing, actuarial, banking, consulting, custodial, insurance, investment advisory, legal, recordkeeping, securities brokerage, third party administration or valuation services.

Once CSPs provide the necessary disclosures to plan fiduciaries, it is incumbent upon the Plan Sponsor to assess that the fees being charged for the services being rendered are reasonable. This regulation provides an exemption for reasonable contracts and arrangements for plan services that would have been considered prohibited transactions. The fee disclosures must be made by CSPs in order for the fees and services to be considered reasonable. In any circumstance where a CSP has not made the required disclosures, a possible prohibited transaction may have occurred.

Now What Do I Do?

Plan sponsors and the plan's fiduciaries should identify all CSPs and determine whether the appropriate disclosures were made for all covered plans and that the disclosures are complete and understandable. While this sounds simple, there can be complications to identifying these providers, assuring the disclosures are complete and understandable. As a general rule of thumb, if you cannot do the math to recalculate the fees being charged or the disclosure is unclear and confusing, go back to the CSP and ask questions. It is important to understand that this regulation puts the satisfaction of the completed disclosures on the shoulders of the plan sponsor and its fiduciaries. If the disclosures are incomplete this could lead to a fiduciary breach and potentially a prohibited transaction.

Once this is done, the plan sponsor and its fiduciaries must now assess that the fees are reasonable. While the fee reasonableness evaluation process may be undertaken without assistance, a best practice of working with a knowledgeable and independent adviser to assist in this process would offer the best evaluation. Many sponsors use independent benchmarking services to aid in the assessment of fee reasonableness, while others use an RFP process for all service providers performing services to the plan and still others use a combination of the two. Either way documenting the process and its results is the best way to assist you with assessing fee reasonableness. The evaluation process should answer the following, but not limited to:

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Did You Know?

The FASB has issued an updated (FASB update 2013-4) accounting standard on "obligations resulting from joint and several liabilities arrangements for which the total amount of the obligation is fixed at the reporting date." In the past, FASB remained silent on the accounting and the disclosures needed for this type of obligation. This resulted in inconsistencies on how companies were accounting and disclosing such obligations. This new FASB update will bring consistency between companies on the accounting and disclosures of obligations resulting from joint and several liabilities.

The result of this update: The FASB will now require companies to measure and disclose obligations resulting from joint and several liability arrangements that are fixed at the reporting date. Companies will be required to account and disclosure their portion of the obligation and any additional amount the company expects to pay on behave of its co-obligators. Additionally, the update will require certain disclosures such as the nature and other information about those obligations.

Effective date: The amendments will be effective for nonpublic entities for fiscal years ending after December 15, 2014, and interim periods and annual periods thereafter.

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ERISA Section 408(b)(2) Continued from page 3

- Are all sources of compensation, not just the fees paid directly by the plan or the sponsor being assessed? Revenue sharing from mutual funds and other forms of compensation eventually come from the plan and are tied into the participants' investment returns.
- Are the services appropriate for the plan?
- Do the services meet the needs of the participants?
- Are there any conflicts of interest that could affect the participant's best interest? If so can they be managed appropriately?
- Does the arrangement provide for termination on reasonably short notice and without great penalty to the plan?

What's on the horizon?

Section 408(b)(2) creates a two-way street for the advisor and sponsor. Information must be properly given to the sponsor and that information must be assessed by the sponsor for reasonableness. While testing for reasonableness can be a subjective exercise, someone will be keeping an eye out to make sure excessive fees are being curtailed. On May 17, 2013, the Director of the Philadelphia Region of the Employee Benefits Security Administration noted that one ERISA violation that the EBSA plans to focus on in the coming months is cases where retirement plan participants appear to be paying higher aggregate fees than other plans. The focus will be on what the disclosures look like, what did the fiduciaries look at to assess reasonableness, were the fees being charged documented for reasonableness.

Plan sponsors should prepare for the difficulties that Section 408(b)(2) presents. The duty of the plan sponsor and its fiduciaries is to exercise prudence when it comes to these new fee disclosure regulations.

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