

# Insights

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## Accounting

### Partial Deferral of Statement No. 157

The Financial Accounting Standards Board (FASB) has issued FASB Staff Position (FSP) No. FAS 157-2, *Effective Date of FASB Statement No. 157*, to partially defer FASB Statement No. 157, *Fair Value Measurements*. This FSP defers the effective date of Statement No. 157 for nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. Nonfinancial assets and nonfinancial liabilities include all assets and liabilities other than those meeting the definition of a financial asset or financial liability as defined in paragraph 6 of Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. Examples of items to which the deferral would apply include, but are not limited to:

- Nonfinancial assets and nonfinancial liabilities initially measured at fair value in a business combination or other new-basis event, but not measured at fair value in subsequent periods
- The following as described in Statement No. 142, *Goodwill and Other Intangible Assets*:
  - ♦ Reporting units measured at fair value in the first step of a goodwill impairment test
  - ♦ Nonfinancial assets and nonfinancial liabilities measured at fair value in the second step of a goodwill impairment test
  - ♦ Indefinite-lived intangible assets measured at fair value for an impairment assessment
- Asset retirement obligations initially measured at fair value under Statement No. 143, *Accounting for Asset Retirement Obligations*
- Nonfinancial long-lived assets (asset groups) measured at fair value for an impairment assessment under Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*
- Nonfinancial liabilities for exit or disposal activities initially measured at fair value under Statement No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*

Examples of items to which the deferral would not apply include, but are not limited to:

- Items within the scope of paragraph 7 of Statement No. 159 that are recognized or disclosed at fair value on a recurring basis
- Items within the scope of Statement No. 107, *Disclosures about Fair Value of Financial Instruments*, whether recognized or not
- Financial and nonfinancial derivatives within the scope of Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*
- Servicing assets and servicing liabilities within the scope of Statement No. 156, *Accounting for Servicing of Financial Assets*, including situations in which an entity has elected the amortization method as the subsequent measurement attribute

- Loans measured for impairment using the practical expedient in Statement No. 114, *Accounting by Creditors for Impairment of a Loan* (based on the fair value of collateral if the loan is collateral dependent), even if the underlying collateral is nonfinancial
- Financial assets and financial liabilities initially measured at fair value in a business combination or other new basis event, regardless of whether measured at fair value during subsequent periods

This FSP does not apply to entities that have issued financial statements that included the adoption of Statement No. 157 in its entirety. Any entity that has early adopted Statement No. 157 may not reverse that adoption. Any entity that has not applied the provisions of Statement No. 157 in interim or annual financial statements is required to make certain financial statement disclosures until Statement No. 157 is applied to all assets and liabilities. Any entity that has not yet adopted Statement No. 157 is encouraged to carefully review each asset and each liability on its balance sheet to determine whether the proposed deferral would apply to each item.

The FSP is available in full at [http://www.fasb.org/pdf/fsp\\_fas157-2.pdf](http://www.fasb.org/pdf/fsp_fas157-2.pdf).

### **FASB Indefinitely Defers Effective Date of SOP 07-1**

The Financial Accounting Standards Board has issued FASB Staff Position (FSP) No. SOP 07-1-1, *Effective Date of AICPA Statement of Position 07-1*, which indefinitely defers the effective date of AICPA Statement of Position (SOP) 07-1, *Clarification of the Scope of the Audit and Accounting Guide, "Investment Companies," and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies*. The deferral is intended to allow the FASB time to consider a number of issues related to the implementation of SOP 07-1. SOP 07-1 provides guidance for determining whether (a) an entity is within the scope of the AICPA Audit and Accounting Guide, *Investment Companies*, and (b) investment company accounting should be retained by a parent company in consolidation or by an equity method investor. Investment company accounting provides that investment companies report their investments at fair value. SOP 07-1 was effective for financial statements issued for years beginning on or after December 15, 2007 and early application was encouraged. The FSP is effective as of December 15, 2007.

An entity that early adopted SOP 07-1 is permitted, but not required, to continue to apply the provisions of the SOP. An entity that did not early adopt SOP 07-1 before December 15, 2007 may not adopt the SOP, with the following exception. If a parent entity that early adopted the SOP chooses not to rescind its early adoption, an entity consolidated by that parent entity that is formed or acquired after that parent entity's adoption of the SOP must apply the provisions of the SOP in its stand-alone financial statements. If an entity that early adopted the provisions of SOP 07-1 voluntarily rescinds its early adoption as permitted by FSP No. SOP 07-1-1, that entity must account for that change according to the provisions of FASB Statement No. 154, *Accounting Changes and Error Corrections*.

The FSP is available in full at [http://www.fasb.org/pdf/fsp\\_sop07-1-1.pdf](http://www.fasb.org/pdf/fsp_sop07-1-1.pdf).

### **FASB Statement No. 157 Amended to Exclude Statement No. 13**

The Financial Accounting Standards Board (FASB) has issued FASB Staff Position (FSP) No. FAS 157-1, *Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13*. This FSP amends FASB Statement No. 157, *Fair Value Measurements*, to exclude FASB Statement No. 13, *Accounting for Leases*, and other accounting pronouncements that address fair value measurements for purposes of lease classification or measurement under Statement No. 13. However, this scope exception does not apply to assets acquired and liabilities assumed in a business combination that are required to be measured at fair value under Statement No. 141, *Business Combinations*, or No. 141 (revised 2007), *Business Combinations*, regardless of whether those assets and liabilities are related to leases.

The FASB has issued this FSP because issues stemming from the interaction between the fair value measurement objective in Statement No. 13 and the fair value measurement objective in Statement No 157 may result in a change in lease accounting that requires consideration of lease classification criteria and measurements in leasing transactions that are beyond the scope of Statement No. 157. The FSP restores the original definition of the term "fair value" in Statement No. 13 to "the price for which the property could be sold in an arm's-length transaction between unrelated parties." Statement No. 157 had amended the definition of the term "fair value" in Statement No.

13 to “the price that would be received to sell the property in an orderly transaction between market participants at the measurement date. Market participants are buyers and sellers that are independent of the reporting entity, that is, they are not related parties at the measurement date.” The FASB has on its agenda a project to comprehensively reconsider the lease accounting provisions in Statement No. 13.

The FSP is effective upon the initial adoption of Statement No. 157. Statement No. 157 is effective for years beginning after November 15, 2007. An entity that applied Statement No. 157 in a manner consistent with the provisions of FSP 157-1 would continue to apply the provisions of the FSP from the date of the initial adoption of Statement No. 157. However, an entity that did not apply Statement No. 157 in a manner consistent with the provisions of the FSP must retrospectively apply the provisions in the FSP to the date of the initial adoption of Statement No. 157.

The FSP is available in full at [http://www.fasb.org/pdf/fsp\\_fas157-1.pdf](http://www.fasb.org/pdf/fsp_fas157-1.pdf).

### **Accounting for Transfers of Financial Assets and Repurchase Financing Transactions**

FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, provides accounting and reporting standards for transfers of financial assets. Recently, questions have arisen about whether there are circumstances that would permit a transferor and a transferee to evaluate the accounting for a transfer of a financial asset separately from a repurchase agreement that relates to a previously transferred financial asset (a repurchase financing) when the counterparties to the two transactions are the same. Consequently, the Financial Accounting Standards Board has issued FASB Staff Position (FSP) No. FAS 140-3, *Accounting for Transfers of Financial Assets and Repurchase Financing Transactions*, to address this issue.

The FSP concludes that a transferor and transferee should not separately account for a transfer of a financial asset and a related repurchase financing unless (a) the two transactions have a valid and distinct business or economic purpose for being entered into separately and (b) the repurchase financing does not result in the initial transferor regaining control over the financial asset. The FSP specifies that if the transactions meet all of the following criteria, the repurchase financing should be accounted for separately from the initial transfer, and the initial transferor and initial transferee should analyze the repurchase financing as a repurchase agreement under Statement No. 140:

- The initial transfer and the repurchase financing are not contractually contingent on one another.
- The repurchase financing provides the initial transferor with recourse to the initial transferee upon default.
- The financial asset subject to the initial transfer and repurchase financing is readily obtainable in the marketplace.
- The financial asset and repurchase agreement are not coterminous (i.e., of equal duration). The maturity of the repurchase financing must be before the maturity of the financial asset.

If the transactions do not meet all of the above criteria, the initial transfer and repurchase financing should be evaluated as a linked transaction. The linked transaction should then be evaluated to determine if it meets the requirements for sale accounting under Statement No. 140. If the linked transaction does not meet the requirements for sale accounting, the linked transaction should be accounted for based on the economics of the combined transactions, which generally represent a forward contract that should be evaluated under Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*.

The FSP is effective for financial statements issued for fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. Earlier application is not permitted. The FSP should be applied prospectively to initial transfers and repurchase financings for which the initial transfer is executed on or after the beginning of the fiscal year in which this FSP is initially applied.

The FSP is available in full at [http://www.fasb.org/pdf/fsp\\_fas140-3.pdf](http://www.fasb.org/pdf/fsp_fas140-3.pdf).

## **Webcast Regarding Codification of U.S. GAAP**

The Financial Accounting Standards Board (FASB) is hosting a webcast to discuss and demonstrate the use of the FASB Accounting Standards Codification, an on-line research system that organizes all authoritative U.S. GAAP by topic. Panelists Larry Smith, FASB Board member, and Tom Hoey, project director for the FASB codification project, will entertain questions during the event. Jay Hanson, National Director of Accounting for McGladrey & Pullen, LLP, will moderate the program.

The one-hour webcast, *The Move to Codification of U.S. GAAP*, is offered free of charge and is scheduled for Thursday, March 13, 2008, beginning at 1 p.m. EDT. The FASB also will archive the live webcast for access by the public. To register for the live or archived webcast, go to <http://w.on24.com/r.htm?e=104519&s=1&k=BDD7BC6E5BD3B1CC8E9F2631759517DD>

## **Auditing**

### **SSARS No. 17 Issued**

The Accounting and Review Services Committee of the American Institute of Certified Public Accountants has issued Statement on Standards for Accounting and Review Services (SSARS) No. 17, *Omnibus Statement on Standards for Accounting and Review Services - 2008*. Among other provisions, this statement:

- Replaces the term “nonpublic entity” with the term “nonissuer” to conform to the terminology used by other standard setters.
- Clearly indicates the differences between compilation, review, and audit engagements and revises the illustrative arrangement letters for compilation and review engagements accordingly.
- States that, in a review engagement, the accountant must apply analytical procedures to the financial statements; make inquiries of management or other company personnel, or both; and obtain representations from management for all financial statements and periods covered by the accountant’s review report.
- Revises the definition of “third parties” to clarify that the phrase, “who are knowledgeable about the nature of the procedures applied and the basis of accounting and assumptions used in the preparation of financial statements” applies to “members of management,” and also introduces definitions of “those charged with governance” and “management.”
- States that management’s written representations should be made as of the date of the accountant’s review report.
- Provides guidance with respect to an accountant’s consideration of the entity’s ability to continue as a going concern during the performance of compilation or review procedures.
- Provides guidance with respect to an accountant’s consideration of subsequent events in a compilation or review engagement.
- Incorporates guidance with respect to analytical procedures in a review engagement.

SSARS No. 17 is effective for compilations and reviews of financial statements for periods ending on or after December 15, 2008.

## **Public Sector**

### **Guidance Proposed for Net Asset Classification of Donor-Restricted Endowment Funds**

In July 2006, the National Conference of Commissioners on Uniform State Laws approved the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA). This Act is a modernized version of the Uniform Management of Institutional Funds Act of 1972 (UMIFA), the model act on which most states have based their laws governing the investment and management of donor-restricted endowment funds by not-for-profit organizations.

Because the UPMIFA prescribes new guidelines for expenditure of donor-restricted endowment funds, questions have arisen as to the appropriate net asset classification of such funds. To provide guidance on the net asset classification of donor-restricted endowment funds for a not-for-profit organization that is subject to an enacted version of the UPMIFA, the Financial Accounting Standards Board (FASB) has proposed FASB Staff Position (FSP) No. FAS 117-a, Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures. The proposed FSP addresses the following accounting issues resulting from new guidelines in the UPMIFA:

- The UPMIFA shifts its focus from the prudent spending of the net appreciation of the fund to the entirety of a donor-restricted endowment fund. The UPMIFA eliminates UMIFA's historic-dollar-value threshold, an amount below which an organization could not spend from the fund, in favor of a more robust set of guidelines about what constitutes prudent spending, explicitly requiring consideration of the duration and preservation of the fund. The proposed FSP therefore would require a not-for-profit organization that is subject to an enacted version of the UPMIFA to classify all or a portion of a donor-restricted endowment fund of perpetual duration as permanently restricted net assets. The amount classified as permanently restricted is the amount of the fund (a) that must be retained permanently in accordance with explicit donor stipulations, or (b) that in the absence of such stipulations, the organization's governing board determines must be retained permanently, if any, under the relevant law.
- Subsection 4(a) of the UPMIFA provides that "unless stated otherwise in the gift instrument, the assets in an endowment fund are donor-restricted assets until appropriated for expenditure by the institution." Subsection 4(d) includes an optional provision for adding a rebuttable presumption of imprudence for spending over seven percent of the fair market value of the fund (calculated over the period on which the organization bases its endowment spending formula but not less than three years). The proposed FSP concludes that in determining whether provisions in enacted legislation that are based on subsection 4(a) or 4(d) of the UPMIFA impose a temporary (time) restriction on the portion of a donor-restricted endowment fund that otherwise would be classified as unrestricted net assets, an organization should apply the guidance in EITF Topic No. D-49, "Classifying Net Appreciation on Investments of a Donor-Restricted Endowment Fund". Topic D-49 concludes that, in the absence of other relevant law, if the Act has been adopted without modifications that preclude the governing board from exercising its discretion to appropriate some or all of an organization's net appreciation on investments, realized or unrealized, the net appreciation is not donor-restricted, unless the donor has explicitly restricted the use of either income or net appreciation. A legal limitation requiring that a governing board exercise ordinary business care and prudence when appropriating net appreciation is not the equivalent of a law that extends a donor-imposed restriction and, therefore, does not result in classification of net appreciation as donor-restricted, either permanently or temporarily.

The proposed FSP also would require improved disclosures about an organization's endowment (both donor-restricted and board-designated funds), whether or not the organization is subject to the UPMIFA. The proposed FSP requires a not-for-profit organization to disclose information to enable financial statement users to understand the net asset classification, net asset composition, changes in net asset composition, spending policies, and related investment policies about its endowment funds (both donor-restricted and board-designated).

If finalized, the provisions of the proposed FSP would be effective for fiscal years ending after June 15, 2008. The proposed FSP is available for comment until April 18, 2008 at [http://www.fasb.org/fasb\\_staff\\_positions/prop\\_fsp\\_fas117-a.pdf](http://www.fasb.org/fasb_staff_positions/prop_fsp_fas117-a.pdf).

## SEC

### SEC Proposes Delay of SOX 404 Audit Requirement

The SEC has proposed a one-year delay in the requirement for an audit of internal controls over financial reporting for smaller public companies (i.e., those that are not required to file annual and quarterly reports on an accelerated basis). Currently, the auditor's attestation report on internal control over financial reporting is required when a smaller public company (i.e., non-accelerated filer) files an annual report for a fiscal year ending on or after December 15, 2008. It should be noted that a one-year grace period, if finalized, would not relieve smaller public companies of the

obligation to provide management's report on internal control over financial reporting for annual reports for fiscal years ending on or after December 15, 2007.

We want to emphasize that this proposed delay in the requirement for an audit of internal controls over financial reporting for smaller public companies has not yet been finalized by the SEC. You should monitor the SEC's Web site for updates.

### **Disclosures for Smaller Reporting Companies**

Effective February 4, 2008, the SEC adopted a new system of disclosure rules for smaller reporting companies filing periodic reports and registration statements with the SEC. The "smaller reporting company" category includes companies that qualified as "small business issuers" before the new rules, as well as most companies that qualify as "non-accelerated filers." In general, companies with less than \$75 million in common equity public float qualify as smaller reporting companies. Companies unable to calculate the public float typically qualify if they have less than \$50 million in annual revenues.

Under the new disclosure rules, a company that formerly qualified as a small business issuer will have the option to file their next annual report for a fiscal year ending after December 15, 2007 on Form 10-KSB or the standard Form 10-K. If a company formerly qualified as a small business issuer and this year opts to file a standard Form 10-K under the new disclosure rules for smaller reporting companies, the Form 10-K and financial statement disclosure requirements will not change from the prior year, except that the smaller reporting company disclosure rules require two years of balance sheets, instead of a balance sheet for only one year. Also, companies qualifying as smaller reporting companies are required to check the "Smaller Reporting Company" box on the cover page of Form 10-K.

A non-accelerated filer that now qualifies as a smaller reporting company may opt to file its Form 10-K under the new disclosure rules for smaller reporting companies. Such a company should be aware of the following scaled reporting requirements, among others, that are available for smaller reporting companies, as compared with those that are required of large accelerated filers and accelerated filers:

- Financial statements – Two years of balance sheets and statements of income, cash flow, comprehensive income, and shareholders' equity; smaller reporting companies previously following Regulation S-X can now follow the disclosure requirements that generally applied to S-B filers under Regulation S-B Item 310
- Item 101 – Less detailed description of the business
- Item 301 – Five-year selected financial data not required
- Item 302 – Selected quarterly financial data not required
- Item 303 – Management's discussion and analysis of financial condition and results of operations only required to cover two years; contractual obligations table not required
- Item 305 – Information regarding market risk factors not required
- Item 402 – More limited disclosures of executive compensation

Final Rule 33-8876, Smaller Reporting Company Regulatory Relief and Simplification, is available at <http://www.sec.gov/rules/final/2007/33-8876.pdf>. Also, Changeover to the SEC's New Smaller Reporting Company System by Small Business Issuers and Non-Accelerated Filer Companies - A Small Entity Compliance Guide is available at <http://www.sec.gov/info/smallbus/secg/smrepcosysguid.pdf>.

### **Guide for Use of Form S-3 by Smaller Companies**

Recently, the SEC issued a compliance guide that provides information on the extension of Form S-3 availability to issuers with less than \$75 million in public float. Although the guide is not a substitute for the SEC's rules, it summarizes and explains the conditions under which a company with less than \$75 million in public float is allowed

to register primary offerings of its securities on Form S-3 and Form F-3. The guide also discusses how a company calculates how much capital it can raise through an offering on Form S-3 or F-3, and provides links to related resources.

Eligibility of Smaller Companies to Use Form S-3 or F-3 for Primary Securities Offerings is available in full at <http://www.sec.gov/info/smallbus/secg/s3f3-secg.htm>.

## International

### Two International Standards on Review Engagements Clarified

International Standard on Review Engagements (ISRE) 2410, *Review of Interim Financial Information Performed by the Independent Auditor of the Entity*, was originally written to be applicable for reviews of interim financial information conducted by an entity's auditor, under the premise that the entity's auditor is able to use audit-based knowledge of the entity when carrying out such reviews. The International Auditing and Assurance Standards Board (IAASB) did not intend to eliminate auditor's reviews of historical financial information (other than interim financial information) from the scope of this ISRE, and therefore recently amended ISRE 2410 so that it also applies to reviews of historical financial information other than interim financial information conducted by an entity's auditor.

ISRE 2400, *Engagements to Review Financial Statements*, applies to all reviews of historical financial information excluding those conducted by the entity's auditor, but may be applied "to the extent practicable" to engagements to review other information. To align the application of ISRE 2400, ISRE 2410, and International Standard on Assurance Engagements 3000, *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*, the IAASB has amended ISRE 2400 to restrict its application to a review of any historical financial information performed by a practitioner who is not the entity's auditor.

The amendments are effective immediately, and are available in full at <http://www.ifac.org/store>.

### IAS 32 Amended

International Accounting Standard (IAS) 32, *Financial Instruments: Presentation*, requires a financial instrument to be classified as a liability if the holder of that instrument can require the issuer to redeem it for cash. Many instruments, including some ordinary shares and partnership interests, include provisions that allow the holder to "put" the instrument (to require the issuer to redeem it) for cash. Such instruments, which would otherwise be considered as equity, must be classified as liabilities under the provisions of IAS 32.

The International Accounting Standards Board (IASB) believes that there are many legitimate reasons for put features that should not necessarily cause the related instruments to be classified as liabilities. Therefore the IASB has amended IAS 32 to require the following types of financial instruments to be classified as equity rather than as liabilities, provided they have particular features and meet specific conditions:

- Puttable financial instruments (for example, some shares issued by co-operative entities)
- Instruments, or components of instruments, that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation (for example, some partnership interests and some shares issued by limited-life entities).

Additional disclosures are required about the instruments affected by the amendments. The amendments are set out in Amendments to IAS 32, "Financial Instruments: Presentation" and IAS 1, "Presentation of Financial Statements" – Puttable Financial Instruments and Obligations Arising on Liquidation.

The amendments are effective for annual periods beginning on or after January 1, 2009, with earlier adoption permitted. If entities adopt the amendments for a period beginning before January 1, 2009, consequential amendments to IFRS 7, *Financial Instruments: Disclosures*; IAS 39, *Financial Instruments: Recognition and Measurement*; and IFRIC 2, *Members' Shares in Co-operative Entities and Similar Instruments*, should be adopted from the same earlier date. Also, the fact that the amendments have been adopted in advance of their effective date should be disclosed. In the absence of specific transitional provisions, the amendments should be applied retrospectively in accordance with IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*.

## Revised Standard for Auditing Accounting Estimates

The International Auditing and Assurance Standards Board (IAASB) has released International Standard on Auditing (ISA) 540 (Revised and Redrafted), *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*. This revised standard adopts a risk-based approach to the audit of accounting estimates. It addresses the auditor's evaluation of the effect of estimation uncertainty on risk assessments, management's methods for making estimates, the reasonableness of assumptions used by management, and the adequacy of disclosures. ISA 540 (Revised and Redrafted) also expands the guidance on the use of models in valuations.

The revised standard combines ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures (Other Than Those Involving Fair Value Measurements and Disclosures)*, and ISA 545, *Auditing Fair Value Measurements and Disclosures*. ISA 540 (Revised and Redrafted) is effective for audits of financial periods beginning on or after December 15, 2009, and is available in full at <http://www.ifac.org/store>.

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