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2009

Accounting Desk Book

The Accountant's Everyday Instant Answer Book

LOIS RUFFNER PLANK
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BRYAN R. PLANK
CHRISTIE PLANK CIRAULO

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ISBN 978-0-8080-1940-4

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Printed in the United States of America

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2009 Accounting Desk Book

by Lois Ruffner Plank, Donald Morris, Bryan R. Plank, and Christie Plank Ciraulo

Highlights

The 2009 Accounting Desk Book is a practical working tool that provides quick, authoritative, and up-to-date answers for CPAs and Financial Services Professionals applying relevant accounting principles and standards as well as tax rules. It contains all of the important pronouncements from the FASB, GASB, PCAOB, and IASB; financial reporting presentation requirements; required and recommended disclosures; and specialized accounting topics needed to field a client's questions, brush up on the proper treatment of a transaction, or consider an engagement in a new area of practice.

Guidelines, illustrations, and step-by-step instructions simplify complex accounting issues and give public and private accountants quick answers to accounting application questions.

2009 Edition

Most chapters have been updated or revised to reflect new guidance or standards on accounting and tax matters. Improvements in coverage have been made throughout.

Both the FASB and GASB have been busy issuing exposure drafts, developing guidance, and adopting new standards as detailed in Chapters 7, 9, and 10. Among the topics covered are insurance and derivatives that are discussed in more detail in Chapters 22 and 37. The FASB is also working on the codification of existing standards and rulings, and identification of a consistent hierarchy for selecting accounting principles to be used in preparing financial statements. Chapters 12 and 13 on international standards have been modified to include new standards as well as revised and/or redrafted pronouncements.

Chapter 11 includes a new section discussing the actions of the IRS and the Justice Department in tracking down money laundering activities by non-profits. Their primary focus has been on the legal requirement for reporting cash received in a trade or business if the amount exceeds $10,000. Whereas the reporting requirements apply to trade or business activities, they do not apply to donations of cash to charities. Charities may, therefore, have the opportunity to avoid detection of certain money-laundering activities if the cash received takes the form of charitable donations.

Use of the Internet continues to be a growing factor, albeit at a slower pace, in all aspects of business, specifically in retail trade as indicated by the updated figures in the chapter on E-Commerce.

In response to the concerns over the expensive and inefficient implementation of the Section 404(b) auditor attestation requirement of the Sarbanes-Oxley Act, the SEC announced approval of a one-year extension of the compliance date for smaller public companies. Also reacting to the problems with implementation of Section 404, the SEC and the PCAOB took major steps to make Section 404 less costly, without lessening its ability to protect the investor. The SEC provided interpretive guidance for management, and the PCAOB replaced Auditing Standard No. 2 with a much improved Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That is Integrated With An Audit of Financial Statements*. These actions and a further study are expected to have much of the problem solved by the end of the extension. These and many other actions by the PCAOB are discussed in Chapter 28.

The year 2009 may not be the best time to consider investing in the stock market, but if the fancy strikes, several options are discussed in the expanded Chapter 31, "Advanced Equity Strategies."

Four major tax bills were signed into law in 2008 with the most recent coming in October as part of the bailout legislation of the banks and the economy in general. Extensions of expiring items are also updated in Chapter 41. Reverse mortgages, discussed in Chapter 40, may not carry the stigma that forward ones do in the present economic climate. Included in that October bill, the *Housing and Economic Recovery Act of 2008*, was a provision that could be of interest to senior citizens who own a higher priced home. It provides for a substantial increase in the FHA's HECM loan limit on a reverse mortgage.

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About the Authors

Lois Ruffner Plank received her B.A. degree in Public Administration and International Relations from Miami University in Oxford, Ohio, with additional work in investments at the University of California at Los Angeles and at the University of Illinois.

Mrs. Plank is the co-editor of the *Encyclopedia of Accounting Systems* and co-author of several of the supplements to the *Accounting Desk Book*. She has been involved in budgeting and financial management with a government agency in Washington, D.C., and instituted a public relations and marketing program for a suburban Chicago school district.

She is an editor of professional publications and books and is a public relations consultant. Additional experience includes newspaper reporting and chief copy consultant for a national magazine.

Donald Morris CPA, Ph.D. has extensive accounting and tax experience in both the business and academic worlds. Dr. Morris managed his own accounting firm in Chicago for more than a decade before selling the practice and taking a position as professor of accounting first at Eastern New Mexico University and now at the University of Illinois at Springfield. With publications in accounting, tax, finance, management and business ethics journals Dr. Morris brings a wide perspective to issues relevant to accountants. In addition to being a Certified Public Accountant he is also a Certified Fraud Examiner and Certified Financial Planner. His newest book, *Opportunity: Optimizing Life's Chances* (Prometheus Books) was released in 2006. Dr. Morris has a Masters in Taxation from DePaul University and earned his Ph.D. in philosophy from Southern Illinois University Carbondale. He is a member of the American Institute of CPAs, the American

Accounting Association and both the New Mexico and Illinois CPA Societies. He is also a member of the Society for Business Ethics and the American Philosophical Association. He has received recognition from *Who's Who Among America's Teachers* and *Who's Who in Finance and Industry*.

Bryan R. Plank is a wealth management advisor and resident director at a large securities firm. In addition, he holds numerous licenses, certifications, and credentials in securities, insurance, and real estate. Mr. Plank is serving on the NASD committee for the Los Angeles district.

He has 20 years of experience in training and development in the securities industry and is a frequent guest speaker at many San Diego area colleges and universities. Mr. Plank earned university degrees from the University of Southern California and California State Polytechnic University, Pomona, with additional postgraduate work at Claremont Graduate School.

Christie Plank Ciraulo has a B.S. in journalism and an MPR in Public Relations from the University of Southern California, with additional studies at the University of Geneva, Switzerland, and the University of California, Los Angeles.

Her work experience in writing includes major Los Angeles hospital and healthcare newsletters and annual reports, as well as media appearances. For 12 years she was owner of a graphic design and writing firm that produced professional and trade publications. As research editor and author, she has been instrumental in the development, research, writing, and editing of the *Accounting Desk Book* and *The Encyclopedia of Accounting Systems*.

Preface

Accounting information is complex, mirroring the complexity of the business, government, and non-profit activities it measures. It is difficult for those practicing the profession to be specialists in more than a few limited areas, let a alone understand it all. Overlaying this problem is the growing influence of the international accounting community and its pursuit of convergence of accounting standards, which could lead to uniform reporting around the world. In this complex and changing environment, it is essential that the accounting practitioner have at least a glancing knowledge of many areas, if only to know what he or she does not know or needs to study.

In auditing in particular, but also in tax and other areas of accounting, the accountant must understand the industry in which his or her client operates including its regulatory environment. One of the goals of the *Accounting Desk Book* is to bring together in one source, changes and updates to areas of accounting and tax compliance from across the business spectrum. While it is difficult for anyone to be an expert in all areas of accounting, it is certainly possible to be aware of recent changes across a wide range of accounting and tax issues. From recent FASB pronouncements, to the implementation of Sarbanes-Oxley, to significant recent tax legislation, this book provides information and guidance on what is occurring on the margins. It is not a textbook or a detailed reference on a niche within accounting. Rather, it spans traditional boundaries in accounting providing current information on financial accounting, tax, cost accounting, non-profit, governmental, and international accounting as well as related information on investments, e-commerce, ethics, the Securities and Exchange Commission, insurance accounting and much more.

Because of its breadth of coverage, this work serves to introduce and update many topics. Nevertheless, in the case of other topics, on which comprehensive information is not always available, such as the treatment of independent contractors and tip income, its coverage is substantial. For many practitioners, the book proves most useful by offering a quick background update on an unfamiliar topic or area in which they have not practiced for a number of years.

It is imperative that all accountants and auditors keep pace with new laws, regulations, official pronouncements and industry guidance affecting their practice. The *Accounting Desk Book* assists the accountant in his or her effort to understand and comply with both new and existing accounting rules and regulations. The importance of current information cannot be overemphasized. Coverage of topics, applications, examples, and definitions of terms is the goal of this volume. It avoids abstract theory, technical jargon, complex "legalese" and textbook-type prose, which can needlessly complicate discussion of the rules and procedures. All topics are covered in straightforward, plain English. Discussions throughout the *Accounting Desk Book* are mostly self-contained. A review of the topics does not require reference to other sources. The table of contents clearly sets forth the subjects discussed and the index helps locate needed information rapidly.

Contents

Chapter 1

Principles of Financial Statements, Disclosure, Analysis, and Interpretation

Contents

¶1000 Overview

The general objective of financial reporting is to provide reliable information on resources, obligations and progress. The information should be useful for comparability, completeness and understandability. The basic features involved in financial accounting are the individual accounting entity, the use of approximation and the preparation of fundamentally related financial statements.

The financial statements—balance sheet, income statement, change in stockholders' equity and statement of cash flows, as well as segment reports and interim reports—will summarize a firm's operations and ending financial position. Analysts, investors, creditors and potential investors and creditors will analyze these documents in their decision-making processes.

¶1001 Fair Presentation in Conformity with GAAP

Fair presentation in conformity with GAAP requires that the following four criteria be met:

1. GAAP applicable in the circumstances have been applied in accumulating and processing the accounting information.
2. Changes from period to period in GAAP have been properly disclosed.
3. The information in the *underlying* records is properly *reflected* and *described* in the financial statements in conformity with GAAP.
4. A proper balance has been achieved between the conflicting needs to:
    a. Disclose the important aspects of financial position and results of operation in conformity with conventional concepts, and
    b. Summarize the voluminous underlying data with a limited number of financial statement captions and supporting notes.

¶1003 12 Principles of Financial Statement Presentation

1. *Basic Financial Statements*. At minimum, these statements must include:
    a. Balance Sheet
    b. Statement of Income
    c. Statement of Changes in Stockholders' Equity
    d. Statement of Cash Flows
    e. Disclosure of Accounting Policies
    f. Full Disclosure in Related Notes

    Information is usually presented for two or more periods. Other information also may be presented, and in some cases required, as supplemental information (e.g., price-level statements, information about operations in different industries, foreign operations and export sales, and major customers (segment reporting)).

2. *The Balance Sheet*. A complete balance sheet must include:
   a. All assets
   b. All liabilities
   c. All classes of stockholders' equity
3. *The Income Statement*. A complete income statement must include:
   a. All revenues
   b. All expenses
4. *The Statement of Cash Flow*. A complete statement of cash flow includes and describes all important aspects of the company's operating, financing and investing activities.
5. *Accounting Period*. The basic time period is one year. An interim statement is for less than one year.
6. *Consolidated Financial Statements*. In the context of a parent company and its subsidiaries statements are presumed to be more meaningful than separate statements of the component legal entities. They are usually necessary when one of the group owns (directly or indirectly) over 50 percent of the outstanding voting stock. The information is presented as if it were a single enterprise.
7. *The Equity Basis*. For unconsolidated subsidiaries (consolidated is used where over 50 percent is owned) where ownership is between 20 percent and 50 percent of the voting stock and the investor has significant influence over investees, the equity method is used to report the amount of the investment on the investor's balance sheet. The investor's share of the net income reported by the investee is picked up (debited if income, credited if loss) and shown as investment income and an adjustment of the investment account is made for all earnings subsequent to the acquisition. Dividends are treated as an adjustment (credit) to the investment account.
8. *Translation of Foreign Branches*. Data are translated into U.S. Dollars by conventional translation procedures involving foreign exchange rates.
9. *Classification and Segregation*. These important components must be disclosed separately:
   a. Income Statement—Sales (or other source of revenue); Cost of Sales; Depreciation; Selling Administration Expenses; Interest Expense; Income Taxes.
   b. Balance Sheet—Cash; Receivables; Inventories; Plant and Equipment; Payables; and Categories of Stockholder's Equity:
      - Par or stated amount of capital stock; Additional paid-in capital
      - Retained earnings affected by:

— Net income or loss,
— Prior period adjustments,
— Dividends, or
— Transfers to other categories of equity.

- Working capital—current assets and current liabilities should be classified as such to be able to determine working capital—useful for enterprises in manufacturing, trading and some service enterprises.
- Current assets—cash and other that can reasonably be expected to be realized in cash in one year or a shorter business cycle.
- Current liabilities—liabilities expected to be satisfied by the use of those assets shown as current; by the creation of other current liabilities; or in one year.
- Assets and liabilities—should *not* be offset against each other unless a legal right to do so exists, which is a rare exception.
- Gains and losses—arise from disposals of other than products or services and may be combined and shown as one item. Examples are the sale of equipment used in operations, gains and losses on temporary investments, non-monetary transactions and currency devaluations.
- Extraordinary items or gain or loss—should be shown separately under its own title. Items distinguished by unusual nature and infrequent occurrence should be shown net of taxes.
- Net income—should be separately disclosed and clearly identified on the income statement.
- Earnings per share information is shown for net income and for individual components of net income.

10. *Other disclosures (Accounting policies and notes)*. These include:
    a. Customary or routine disclosures:
        - Measurement bases of important assets
        - Restrictions on assets
        - Restriction on owners' equity
        - Contingent liabilities
        - Contingent assets
        - Important long-term commitments not in the body of the statements
        - Information on terms of equity of owners
        - Information on terms of long-term debt
        - Other disclosures required by the AICPA
    b. Disclosure of changes in accounting policies
    c. Disclosure of important subsequent events—between balance sheet date and date of the opinion