

Auditing a Publicly Traded Company

Name

ACC/541

Date

Instructor Name

MEMORANDUM

TO: Senior Management
FROM: Staff I - Team A
DATE:
SUBJECT: Audit of a Publicly Traded Company

Ensuring a company's accounting treatment of the share-based payment and accounting consolidation theory abides the Generally Accepted Accounting Principles (GAAP) is vital to their success. Through proper research and understanding of the rules the company will be on their way to a profitable business.

In this memo, Team A will assess the share-based payment reporting and the special purpose entities (SPE) reporting for 'Company 123.' During the investigation Team A have paid close attention to the accounting treatment of the share-based payment and accounting consolidation theory as it relates to special purpose entities.

A share-based payment transaction occurs when the entity obtains goods/services by two methods:

1. Through a share-based payment agreement with the company or person,
2. They acquire the commitment to resolve the debt through a share-based payment agreement when another company obtains goods.

A share-based payment transaction can be settled by the following:

1. Equity,
2. Cash,
3. Equity/cash

There are requirements with a share-based payment transaction when reporting on the company's financial reports:

1. When shares increase the equity component must increase,
2. If the payment for the goods/services does not symbolize an asset, the debit entry needs to be expensed,
3. When the goods/services are used, the expense needs to be documented at that time (Summaries of International Financial Reporting Standards, 2012)

According to *Summaries of International Financial Reporting Standards (2012)*, "the required disclosures include:

1. The nature and extent of share-based payment arrangements that existed during the period,

2. How the fair value of the goods or services received, or the fair value of the equity instruments granted, during the period was determined,
3. The effect of share-based payment transactions on the entity's profit or loss for the period and on its financial position" (par. 14).

A special purpose entity (SPE) refers to a business interest formed for a specific task but restrained by limited life and limited activities. SPEs are set up to benefit a company by isolating financial risk and providing less expensive financing; the most common SPEs are liability corporations (LLCs) or trusts. A company often creates an SPE to

1. Finance certain assets or services and keeping the associated debt off the balance sheet of the sponsors,
2. Transform certain financial assets, such as trade receivables, loans, or mortgages, into liquid securities,
3. Engage in tax-free exchanges (Soroosh & Ciesielski, 2009, par. 3).

The main factor for most SPEs is off-balance sheet financing to keep large expenditures off a company's balance sheet. Under FASB interpretation Number 46, there are a complex set of rules guiding SPE consolidation. In layman's terms, if an SPE is consolidated, the fair market value of assets is reported on the balance sheet as an asset. However, the fair value for the liability is recorded on the other side of the balance sheet along with the fair market value of the minority interests in the SPE (Accounting, Financial & Tax, 2009, par. 6) .

Additionally, according to SFAS Number 140, an SPE can qualify for nonconsolidation only when the transferor has surrendered complete control over the transferred assets through the following conditions:

1. The transferred assets are isolated from the transferor even in bankruptcy,
2. Each transferee, or holder of beneficial interests (if the transferee is considered a "Qualified Special Purposes Entity") has the right to pledge or exchange the assets;
3. The transferor does not maintain effective control over the assets (Financial Accounting Standards Board, 2011).

Despite recent corporate abuses, special-purpose entities are often a legitimate option for a company to segregate a certain activity to remove potential risk of that activity from ongoing operations. Used correctly, SPEs can be powerful structured finance tools.

As stated above SPEs are entities established to achieve a narrow and definite objective, such as to facilitate a research and development activities, a securitization of financial assets, or a lease. Under FASB 140, SPEs should be perceptibly separate from the transferor, its activities be considerably limited and should hold only certain kinds of financial properties. If the FASB 140 conditions are met, such kind of SPE is not consolidated by the transferor of assets to the SPE (Soroosh & Ciesielski, 2009).