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Limited liability entities

Some special considerations

By CPAmerica A&A Technical Consultant
Thomas A. Ratcliffe, Ph.D., CPA

Reporting entities frequently are formed as limited liability entities, particularly limited liability companies and limited liability partnerships.

The accounting literature that particularly relates to these types of entities, herein referred to collectively as LLCs, is found in the FASB *Accounting Standards Codification* (FASB ASC) Topic 272, *Limited Liability Entities*.

LLCs have characteristics of both corporations and partnerships, but these types of entities also are dissimilar in many respects.

LLCs are formed in accordance with laws of the various jurisdictions under which the entities are organized. Given that laws in this arena are not uniform, characteristics of LLCs may likely vary from jurisdiction to jurisdiction.

As clearly delineated in FASB ASC 272-10-05-6, for LLCs to be classified as partnerships for federal income tax purposes, they must lack at least two of the following corporate characteristics:

- Limited liability
- Free transferability of interest
- Centralized management
- Continuity of life

Certain jurisdictions have enacted LLC legislation that includes income tax requirements.

It should be noted that many jurisdictions have adopted similar requirements for LLCs to be classified as partnerships for state income or franchise tax purposes. However, certain jurisdictions have enacted LLC legislation that includes income tax requirements.

LLC Financial Statements

Using the guidance in FASB ASC 272-10-45-1, a complete set of LLC financial statements needs to include all of the following:

- A statement of financial position at the end of the reporting period
- A statement of operations for the reporting period
- A statement of cash flows for the reporting period
- Accompanying notes to the financial statements

In addition to the above-noted financial statements and note disclosures, LLCs need to present information related to changes in member equity for the reporting period. As with entities other than LLCs, this information may be presented as a separate financial statement, combined with the statement of operations or disclosed in the notes to the financial statements.

Statement of Financial Position Equity Section Presentation

From a presentation perspective, financial statements of LLCs are required to be similar to those of partnerships. Since LLC owners are referred to as members, the equity section in statements of financial position is required to be titled "Members' Equity."

Where LLCs are formed so that more than one class of members exist – each having varying rights, preferences and privileges – using

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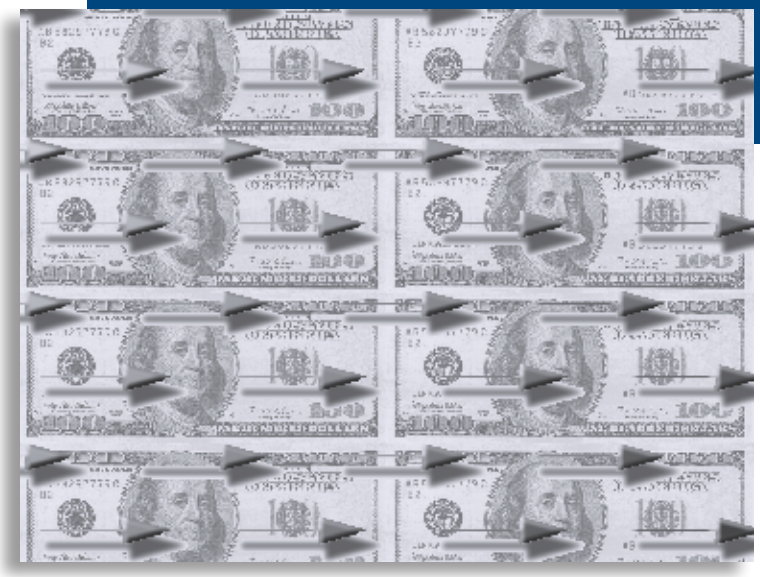
Have you analyzed your company's cash flow lately?

Why it's important

By guest columnist Cesar Mejia, CPA, with Sol Schwartz & Associates, P.C., a CPAmerica International member firm



We've all heard the age-old expression: "Cash is king." No other place is this more true than in business.

Cash is the key component that makes any business function because it's needed to pay banks, vendors, suppliers and employees.

Having sufficient cash on hand may also help keep a company out of debt by removing a motive for taking out loans and by preventing unnecessary expenses such as late payment charges.

In addition, when trying to determine how much a company is worth, one fundamental rule many investors use is to invest in stock that earns a lot of cash year in and year out.

After all, a company is only worth what it can deliver in the form of cash to investors in the long run. Cash is needed for a company to grow and pay out shareholder dividends – both of which appeal to investors.

Statement of cash flows

Unfortunately, many businesses overlook the importance of cash flow analyses (cash flow budget, cash flow statement, etc.) because they believe that all of the essential financial information can be taken from the balance sheet and income statement.

However, the Securities and Exchange Commission considers the information presented on a cash flow statement so important that it requires all publicly traded companies to have their cash flow statement, along with their balance sheet and income statement, audited each year.

A business owner may ask, "If there's cash at the end of the day, why do I need to categorize the cash inflows and outflows?"

The statement of cash flows is important because it helps to properly assess the incoming and outgoing flow of cash.

It also gives insight into a company's operating, investing and financing activities. By categorizing cash flow activity into these three categories, one can see if company operations are *providing* or *using* cash.

Operating activities must be the primary long-term cash source of a company. That is, operations must eventually pay for the company's debts, dividends and growth. Otherwise, a business owner will have to continue making capital contributions or take out new loans to keep the company running.

All publicly traded companies must have their cash flow statement, along with their balance sheet and income statement, audited each year.

For example, a $2 million net increase in cash may sound great initially, but it may not be a good thing if cash used by operations was $100 million and cash from loan proceeds was $102 million.

It should be noted that net increases in cash shouldn't always be expected since new or growing companies may expect to see a decrease in cash flow.

Cash flow budget

By using cash flow budgets, management can ensure sufficient funds to keep operations running smoothly. A cash flow budget projects your sources and uses of cash for future periods. With this budget, you can detect future cash shortages in advance and take corrective actions ahead of time.

This may involve shifting the timing of certain transactions – such as vendor payments or purchase of inventory. It may also determine whether money needs to be borrowed, when it needs to be borrowed and how much should be borrowed.

With a cash flow budget, you can detect future cash shortages in advance and take corrective actions ahead of time.

Periods of excess cash may also be noted. This information can be used to direct excess cash into interest-bearing assets, where additional revenue can be generated, or to scheduled loan payments.

Steps to help improve cash flow

For a business to stay afloat, it must maintain an adequate level of cash. In addition to the everyday goal of increasing sales, the following tips can help improve your cash flow:

Keep an eye on your receivables.

- Check customer credit histories because late or no payments slow down your cash flow and require collection costs.
- Let your customers know the repayment terms, and offer a cash discount for early payment or cash payments.
- Review an accounts receivable aging report frequently and follow up on past due amounts. The longer receivables

See ***Cash Flow*** *next page*

Update addresses impairment of certain intangible assets

By CPAmerica A&A Technical Consultant
Thomas A. Ratcliffe, Ph.D., CPA

The Financial Accounting Standards Board issued guidance in July 2012 that applies to all reporting entities – public, private and not-for-profit – for testing impairment of indefinite-lived intangible assets.

Some examples of intangible assets that will be subject to the new "optional" qualitative impairment testing guidance include indefinite-lived trademarks, licenses and distribution rights.

The guidance, Accounting Standards Update (ASU) 2012-02, *Testing Indefinite-Lived Intangible Assets for Impairment,* amends requirements in FASB *Accounting Standards Codification (ASC)* Topic 350, *Intangibles – Goodwill and Other.* It builds upon the guidance in ASU 2011-08, *Testing Goodwill for Impairment*, which was issued by the FASB in September 2011.

Before being amended by ASU 2012-02, the guidance in FASB ASC 350 requires reporting entities to test indefinite-lived intangible assets for impairment on at least an annual basis by comparing the fair value of the assets with their carrying amounts. When the carrying amounts exceed fair value, impairment losses need to be recognized in an amount equal to the difference.

Intangible assets that will be subject to the new 'optional' testing guidance include indefinite-lived trademarks, licenses and distribution rights.

Importantly, the amended guidance in FASB ASC 350 still includes the requirement for these assets to be tested for impairment on at least an annual basis.

In assessing whether it is more likely than not that indefinite-lived intangible assets are impaired, financial statement preparers need to assess all relevant events and circumstances that could affect the significant inputs used in determining fair value of the assets.

Examples of these types of events and circumstances include, but are not limited to, the following:

- Cost factors (e.g., increase in materials costs, etc.)
- Financial performance (e.g., declining cash flows, etc.)
- Legal, regulatory, contractual, political, business or other factors (e.g., asset-specific factors that could affect fair value)
- Other relevant entity-specific events (e.g., changes in management, contemplation of bankruptcy)
- Industry and market considerations (e.g., deterioration in the environment in which the entity operates)
- Macroeconomic conditions (e.g., deterioration in general economic conditions, limitations on accessing capital)

Financial statement preparers also should consider:

- Positive and mitigating events and circumstances that could affect the significant inputs used to determine fair value
- Where recent fair value calculations have been made, the difference between the fair value amounts and carrying amounts of these assets
- Any changes to the carrying amounts of the assets

None of the individual examples noted above are intended to represent standalone events and circumstances that necessarily require preparers to calculate the fair value of the indefinite-lived intangible assets. Also, the existence of positive and mitigating events and circumstances is *not* intended to represent a rebuttable presumption that preparers should not perform the quantitative impairment test to discern whether the indefinite-lived intangible assets are impaired.

Paralleling the amendments in ASU 2011-08 for goodwill, the 2012-02 amendments to FASB ASC 350 "allow" financial statement preparers to make a qualitative evaluation about the likelihood of impairment of indefinite-lived intangible assets. The qualitative evaluation would be used to determine whether it is necessary to apply the quantitative evaluation and calculate the fair value of the indefinite-lived intangible assets.

Essentially, preparers of financial statements now will have the option to first assess qualitative factors – events and circumstances – that could have affected the significant inputs used in determining the fair value of the indefinite-lived intangible assets to determine whether it is more likely than not (a likelihood of greater than 50 percent) that the indefinite-lived intangible assets have been impaired.

The FASB ASC 350 amendments in ASU 2012-02 are effective for annual and interim impairment tests performed in fiscal years beginning after Sept. 15, 2012. Earlier implementation is permitted. ■

Cash Flow *continued from previous page*

remain outstanding, the lower the chances are that they will be collected.

Extend your timetable for making cash payments

- Pay bills on time, and take advantage of discounts offered.
- Don't pay bills earlier than they are due.

Improve inventory management

- Avoid excess inventory, which creates storage costs and cash outflow.
- Eliminate obsolete inventory by marking it down and selling it. Obsolete inventory creates storage costs, and the longer it goes unsold, the less likely that it will sell. ■

LLCs *continued from page 1*

the guidance in FASB ASC 272-10-45-3, LLCs are encouraged to report each class separately within the equity section. In circumstances in which LLCs do not report amounts for each class separately within the equity section of statements of financial position, they are required to disclose those amounts in notes to the financial statements.

Using the guidance in FASB ASC 272-10-45-4, even though LLC member liability may be limited, if the total balance of the members' equity account or accounts falls below zero, LLCs are required to report the deficits in statements of financial position.

Using the guidance in FASB ASC 272-10-45-5, when LLCs record amounts due from members for capital contributions, those amounts are required to be presented as deductions from members' equity. Presenting these amounts as assets is considered to be inappropriate except in very limited circumstances where there is substantial evidence of ability and intent to pay within a reasonable period of time.

Financial Statement Note Disclosures

LLCs should ensure that both of the following disclosures are included in notes to the financial statements:

- A description of any limitation associated with member liability
- The different classes of member interests and respective rights, preferences and privileges of each class; also, in circumstances where LLCs do not report separately amounts for each class in the equity section of statements of financial position, disclosure of those amounts

In circumstances where LLCs have finite lives, the dates associated with when they will cease to exist need to be disclosed.

As discussed previously, LLCs must lack at least two characteristics typically associated with corporate forms of entities, where one of those characteristics relates to continuity of life. If this is one of the characteristics LLCs lack, that fact needs to be disclosed since it may be of significant interest to users of financial statements entering into transactions with the LLCs.

Related to income taxes, while LLCs generally are classified as partnerships for federal income tax purposes and, as such, are exempt from taxes in that tax liabilities flow through to LLC members, the disclosure requirements in FASB ASC 740, *Income Taxes*, need to be followed. In addition, the recognition and measurement provisions within FASB ASC 740 might be applicable in certain circumstances where LLCs have income generated that is subject to income tax. ■

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WEC is an independently owned and operated member firm of CPAmerica International, one of the largest associations of CPA firms in the United States. Through our affiliation, we have instant access to the expertise and resources of more than 2,500 professionals across America. WEC clients benefit from the resources, experience and professional knowledge base of a national firm while still receiving the personalized service and attention that only a locally-owned, independent accounting firm can offer.

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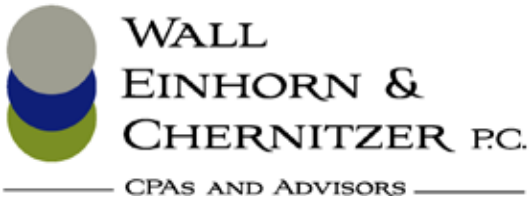
For more information, please visit us online at www.wec-cpa.com.



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