

# CONSOLIDATION OF VARIABLE INTEREST ENTITIES: NOT JUST A PUBLIC COMPANY ISSUE

By Kiersten Alvarado, CPA

Often referred to as off-balance-sheet entities, variable interest entities became the focus of the Financial Accounting Standards Board (FASB) in the aftermath of the Enron accounting scandal. The world had just discovered that the collapse of this Fortune 500 company was in large part attributable to the creation of thousands of off-balance-sheet entities used to hide losses from investors, none of which were ever consolidated or disclosed anywhere in the financial statements of Enron. The FASB, with egg on its face and Congress breathing down its neck, quickly began working on clarifying its accounting standards to ensure something like this never happened again.

In January of 2003, the FASB issued Financial Interpretation No. 46: Consolidation of Variable Interest Entities (FIN 46) that was intended to close the loophole and improve the financial reporting of companies involved with variable interest entities, a term coined by the FASB. Unfortunately, the FASB jumped the gun on the issuance of the interpretation and, later that year, issued Financial Interpretation No. 46, as revised (FIN 46(R)), the current standard on the subject.

## ***How Does this Impact my Business?***

Although these accounting standards were created because of the wrongdoings of a few large public corporations, they have sweeping ramifications for private companies as well. Generally accepted accounting principles (GAAP) do not distinguish between big or small, public or private companies. Many agribusiness owners are surprised to learn that they must evaluate whether they are required to consolidate the assets, liabilities, and activities of variable interest entities in which they are involved in their financial statements.

## ***Accounting Considerations***

GAAP requires a company to consolidate the financial information of any entity in which it has a controlling interest. Prior to the issuance of FIN 46(R), a controlling interest was defined as ownership of more than 50% of an entity's voting interests. FIN 46(R), which became effective for most non-public entities in 2005, expanded the definition of controlling interest to include certain situations when a company should consider factors other than voting rights in determining controlling interest. As a result, GAAP now contains two models for evaluating

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whether or not consolidation is required: the traditional voting interest model and the new risk-and-rewards model found in FIN 46(R).

## ***The Risk-and-Rewards Model***

The risk-and-rewards model in FIN 46(R) outlines three requirements for evaluating whether an entity is a variable interest entity (VIE) and subject to consolidation. The first requirement is that the entity is not self-sustaining. Entities that are not self-sustaining generally do not have sufficient equity to fund the activities of the entity without additional subordinated financial support. Equity is considered to be sufficient under FIN 46(R) if it exceeds expected losses. The second criteria is that the reporting entity has a variable interest in the VIE. A variable interest is defined as a contractual, ownership or other interest in an entity whose fair value changes

*continued on page 2*

with changes in the fair value of the entity's net assets. A common example of a variable interest is a guarantee of debt. The third criteria for evaluating whether a VIE is subject to consolidation is that the entity is the primary beneficiary of the VIE. A primary beneficiary absorbs a majority of an entity's expected losses, receives a majority of the expected returns, or both. If all three requirements are met, an entity is considered a VIE and must be consolidated in the financial statements of the reporting company.

### ***Practical Example***

Here is an example to illustrate the basics of how to identify a VIE and how to determine whether a VIE is required to be consolidated under FIN 46(R). Adam and Bill are brothers and each owns 50% of Vitamin-C, a citrus packing company. Bill is also the sole shareholder of D-Best Farming, which owns 1,000 acres of citrus and is Vitamin-C's largest grower. D-Best Farming was thinly capitalized from inception, and has experienced recurring operating losses. As a result, Vitamin-C has loaned D-Best Farming one million dollars, which is subordinated to D-Best Farming's bank loan (also guaranteed by Vitamin-C).

In this example, D-Best Farming is not considered self-sustaining as it does not have sufficient equity to fund the activities of the company. Vitamin-C has a variable interest in D-Best Farming, due to both the guarantee of debt and the subordinated loan. Finally, Vitamin-C is considered the primary beneficiary of the VIE as D-Best Farming's expected losses would likely be absorbed by the subordinated loan.

Under the new risk-and-rewards model for consolidation, Vitamin-C would need to consolidate the financial information of D-Best Farming in its financial statements. In contrast, under the traditional voting interest model for consolidation, Vitamin-C would not be required to consolidate the financial information of D-Best Farming since Vitamin-C does not have any ownership or voting interests in D-Best Farming.

### ***Recent News***

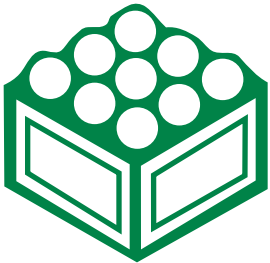
In June 2009, the FASB issued Statement of Financial Accounting Standards No. 167 (FAS 167), which amends certain provisions of FIN 46(R) and will become effective in 2010 for calendar year companies. Although the full ramifications of FAS 167 are not yet known, the statement does require additional evaluation criteria and disclosures to the requirements of FIN 46(R).

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accounting standards are  
applicable to them.***

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We often find that agribusinesses are surprised to learn that these new accounting standards are applicable to them. Please contact Brandon Vance (432-2346 or [brandon@bpfcpa.com](mailto:brandon@bpfcpa.com)) if you would like assistance in evaluating whether your business is subject to consolidation of the activities of any variable interest entities in its financial statements.



**BP&F**  
**Ag Business  
Award**  
**2009**

**T**he Baker, Peterson & Franklin Ag Business Award honors an organization whose achievements and impact have significantly contributed to the ag industry and the community.

**Criteria**

- Any for-profit agribusiness or farming entity based in the central San Joaquin Valley is eligible.
- Prior Baker, Peterson & Franklin Ag Business Award winners are not eligible.
- Self-nominations are encouraged.
- The award is bestowed annually at the Ag Awards Luncheon with the Greater Fresno Area Chamber of Commerce.
- Award recipient is selected by a committee of representatives from the BP&F Ag Department and local agribusiness community.
- Submitted nominations are considered for the following three years.

Complete the form on the reverse side and mail or fax by September 18, 2009.  
For further information, please call:

**Baker, Peterson, & Franklin, CPA, LLP**  
Julie Maldonado  
Ag Business Award Selection Committee  
970 W. Alluvial, Suite 101  
Fresno, CA 93711  
Phone: (559) 432-2346 • FAX: (559) 432-5831  
mail@bpfcpa.com



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**B&F**  
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2009

**Application**

Name of organization: \_\_\_\_\_

Mailing address: \_\_\_\_\_

City: \_\_\_\_\_ Zip: \_\_\_\_\_ County: \_\_\_\_\_

Street address (if different from above): \_\_\_\_\_

City: \_\_\_\_\_ Zip: \_\_\_\_\_ County: \_\_\_\_\_

Phone: \_\_\_\_\_ Fax: \_\_\_\_\_

Chief Executive: \_\_\_\_\_ Title: \_\_\_\_\_

Contact person: \_\_\_\_\_ Title: \_\_\_\_\_

Contact person email: \_\_\_\_\_ Year established: \_\_\_\_\_

Brief description of the company and its products or services: \_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

You may use one sheet of paper to answer the following questions; attach the sheet to this application.  
(Please be specific, list accomplishments, etc.)

1. Describe the organization's growth and success.
2. What are the contributions of the organization to the agricultural industry and our community?

Nominated by: (Optional)

Name: \_\_\_\_\_ Title: \_\_\_\_\_

Email address: \_\_\_\_\_

Name of organization: \_\_\_\_\_

Address: \_\_\_\_\_

City: \_\_\_\_\_ Zip: \_\_\_\_\_

Phone: \_\_\_\_\_ Fax: \_\_\_\_\_

Only the application form and your one-page response to the above questions will be judged.

Deadline September 18, 2009.

# FOOD FOR THOUGHT: HIRING THE UNEMPLOYED

By Nancy Ervin, AVA

**W**e have all read the headlines – California unemployment is at an unprecedented 11.6%.<sup>1</sup> For those companies that are hiring, one would think that the potential pool of qualified candidates would be pretty deep right now...not necessarily.

A year or so ago, when the economy was still humming along, a single ad on *Monster.com* for a controller would net thirty or more applicants, a dozen of whom were qualified, and at least 2 or 3 would be the kind most businesses would be eager to hire. Our biggest challenge was moving fast enough to make an offer to the top candidate before someone else did.

At the time, consumer confidence was strong, as was competition for the best and the brightest. As a result, many of the resumes were from up-and-comers looking to make a vertical move from their current position. They were confident, qualified and willing to take some risks to advance their career.

Today, the hiring scene is quite different. The vast majority of resumes we receive today are from people who have been laid off, or otherwise “downsized” from their current positions, while the “best and the brightest” are staying put.

If you are currently looking for new employees, there are a few things you should keep in mind:

**Compassion** – Some of these candidates are desperate to work. Oftentimes they have been let go from a long-term position and unwillingly thrown into the job search arena. Their

confidence shattered, they may not interview as well as you would normally expect. Show some compassion. Ask them questions about things they have done well in the past, rather than focus on the reasons for losing their job. Give them an opportunity to shine and look for that sparkle in their eye, even if it is only a glimmer.

**Communication** – This follows closely with compassion. Don't leave a candidate hanging. Communicate your decisions as soon as you have made them.

**Caution** – Because of the large number of layoffs, it can be difficult to determine who has been a victim of downsizing and who might have been let go for performance reasons. Keep this in mind during the interview process, and be sure to ask specific questions about what they did on a daily basis. Don't assume that the resume is entirely accurate, and be certain to do a thorough reference check.

**Creativity** – The upside is that there are some very good people available today, some of whom are willing to stretch themselves into new and challenging areas. Be creative when considering a candidate's experience. They may not have exactly what you are looking for, but they might be able to draw from a vastly different background and find new and creative solutions to your business needs.

We offer a variety of personnel search services, from interviewing to accounting and personality testing. If you need any assistance with evaluating potential accounting candidates, please contact Nancy Ervin at 432-2346 or [nancye@bpfcpa.com](mailto:nancye@bpfcpa.com).

*The vast majority of resumes we receive today are from people who have been laid off.*

*Be creative when considering a candidate's experience.*

<sup>1</sup> *United States Department of Labor – Bureau of Labor Statistics: California seasonally adjusted unemployment rate as of June 2009. [www.bls.gov/laumstrk.htm](http://www.bls.gov/laumstrk.htm)*

# RESEARCH AND DEVELOPMENT TAX INCENTIVES FOR THE FOOD & CONSUMER PACKAGED GOODS INDUSTRY

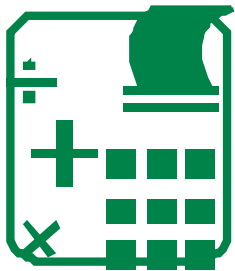
Many companies in the food manufacturing and processing industries are unaware that the government offers generous research and development (R&D) incentive programs. Even those that are aware often fail to capture the full extent of R&D tax credits to which they are entitled. For example, many companies may be capturing relevant expenses from their R&D cost centers, but not all qualifying R&D activities take place in traditional R&D departments. In many companies, prototyping, process development, and testing happen in the plant or on the shop floor and thus may be overlooked for purposes of the R&D tax credit. If you think you have to have a Ph.D. and a state-of-the-art laboratory to be conducting qualified activities as defined by the Internal Revenue Code, think again.

Scientists, nutritionists, dieticians, technologists, and process engineers who work for food manufacturing and processing companies have the responsibility and challenge of developing a wide variety of food, beverage, and consumer products and processes to satisfy continuously evolving customer expectations and preferences. These efforts to create better tasting or more nutritious products typically involve extensive experimentation and testing of new formulations, recipes, process parameters, and packaging methods.

Has your company introduced product line extensions recently? Have you modified product formulations and/or manufacturing processes to create food products that taste better, are more nutritious, have better consistency, or have longer shelf lives? If the answer is yes, then there is a strong chance that your company could benefit from an R&D Tax Credit Study.

Examples of food science innovations eligible for R&D tax incentives include the following:

- Developing recipe formulations for new food products and flavorings
- Improving existing food product formulations to extend product shelf life
- Developing new or improved agricultural or chemical materials that go into the food products
- Improving existing food product formulations to enhance sensory qualities including flavor, appearance, and texture
- Improving existing food product formulations to achieve specified nutritional requirements, including sodium content and caloric value
- Improving existing food product formulations to achieve specified analytical requirements, including those related to pH level, brix level, acid content, and product viscosity
- Developing new production process specifications and techniques for the production of new food products, including mixing times, batching sequences, and cooking temperatures and durations
- Improving existing production processes to improve efficiency or reduce manpower, lead time, and waste
- Developing new machinery and equipment for the production and testing of food products
- Developing new packaging designed to provide enhanced functionality or increased shelf life



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# DEPRECIATION OPPORTUNITIES AND STRATEGIES

By Dennis Veeh, CPA,

During 2009 there are many opportunities to take advantage of increased depreciation deductions for taxpayers who may want to acquire machinery, equipment and other assets in their farming business. Planning for asset acquisitions is important to take advantage of the maximum amount of depreciation deductions that may be available.

**Farm Machinery & Equipment** – In years prior to 2009, machinery and equipment used in a farming business was classified as 7-year property and was required to be depreciated over that statutory life. For 2009 only, new machinery and equipment which is acquired and used in a farming business is allowed a shorter 5-year depreciable life.

**Bonus Depreciation** – For 2008 and 2009, a taxpayer can claim a 50% additional first-year depreciation deduction (bonus depreciation) for qualified property. Qualified property is generally defined as new property with a depreciation life of not longer than 20 years. This would allow new machinery and equipment acquisitions to qualify for the 50% bonus depreciation. New pumps and irrigation systems would also qualify because the depreciation life on these assets is less than 20 years.

**Section 179, Expensing Election** – Taxpayers may elect to expense the cost of qualifying asset purchases. The maximum amount of qualifying asset purchases that can be expensed for 2008 and 2009 is \$250,000. Qualifying property is generally tangible personal property that is acquired for use in an active trade or business. The property acquired can be used or new. Real property, such as buildings and their structural components, do not qualify. Therefore, all machinery, equipment, pumps and irrigation systems qualify for this expensing election. The otherwise allowable expense deduction is limited to the aggregate amount of

taxable income from any of the taxpayer's active trades or businesses. The maximum expense election (\$250,000) is reduced dollar for dollar for qualifying property placed in service during 2008 or 2009 in excess of \$800,000. Therefore, it is important to plan your purchases to avoid exceeding the \$800,000 threshold.

**Example** – Let us assume a farmer acquired \$800,000 of new machinery and equipment in 2009. The farmer could initially claim \$400,000 of bonus depreciation utilizing the 50% additional depreciation provision in the first year. The remaining basis of \$400,000 would qualify for the expensing election under Section 179 up to the maximum deduction of \$250,000. The balance of the basis not depreciated of \$150,000 (\$800,000 - \$400,000 - \$250,000) could be depreciated over a 5-year life at a 150% rate, resulting in a depreciation deduction of \$22,500. The total first year depreciation deductions would amount to \$672,500, which is 84% of the original cost of the machinery and equipment.

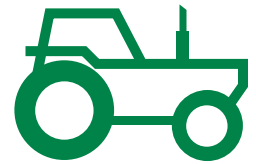
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*Research and Development – continued*

- Producing prototype product samples for testing and validation of new recipe formulations
- Testing prototype samples for analytical and microbiological qualities
- Conducting sensory evaluations of prototype samples

If you would like further information or have questions, please contact Dennis Veeh ([dennis@bpfcpa.com](mailto:dennis@bpfcpa.com)) or Bill Fink ([bill@bpfcpa.com](mailto:bill@bpfcpa.com)) at Baker, Peterson & Franklin, (559) 432-2346.

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***For 2009 only, new machinery and equipment which is acquired and used in a farming business is allowed a shorter 5-year depreciable life.***

# CALENDAR

- September 7** Labor Day. BP&F office closed.
- September 13** 32<sup>nd</sup> Annual Ag Boosters BBQ, Rancho Vista del Rio, Madera. Contact Ag One, 559-278-4266.
- September 15** Deadline to file entity income tax returns on extension for calendar year taxpayers.
- September 18** Deadline for Baker, Peterson & Franklin Ag Business Award nominations.
- October 15** Deadline to file individual income tax returns on extension.
- October 25** 5<sup>th</sup> Annual Fall Wine Cornucopia, Chukchansi Park, [www.idrinkwine.net](http://www.idrinkwine.net).
- November 18** Ag Awards Luncheon honoring BP&F Ag Business Award & Greater Fresno Chamber of Commerce Agriculturist of the Year recipients, Holiday Inn Downtown. Contact Chamber, 559-495-4800.
- November 26 & 27** Thanksgiving (observed). BP&F office closed.

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