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Heads Up

In This Issue:

Members of the following Deloitte teams contributed to this issue of *Heads Up*: Accounting Standards and Communications, Audit and Assurance Services, Independence, and SEC Services.
To our colleagues at Deloitte, our clients, and our other friends, we wish each of you a joyous and peace-filled holiday season and a happy new year.

Dateless in Washington

Highlights of the 2009 AICPA National Conference on Current SEC and PCAOB Developments

by Deloitte & Touche LLP's National Office Departments of Professional Practice

Darn. It is almost New Year's Eve and still no date.

If you are like many of us observing the actions of the SEC, you are wondering what date the Commission will set (and whether it will set a date at all) for public companies in the United States to make the switch from U.S. GAAP to International Financial Reporting Standards (IFRSs). Well, if you are reading this publication for clues about that magical date, you will be disappointed. At this year's conference, the SEC did not provide much information on a new IFRS roadmap. However, the SEC and other presenters had a lot to say on a host of other topics. In the Executive Summary below, we cover the major themes discussed at the conference; later sections outline speeches in more detail by subject matter. We think there is something of interest within for everyone.

Organized by topic, this *Heads Up* extracts key insights from nearly 26 hours of material discussed at the 2009 Conference. It focuses on experts' views on topics such as the impact of the economic crisis on financial reporting, accounting and disclosure issues, and accounting and auditing standard setting. This publication also includes links to information available elsewhere — for example, details on new or proposed accounting guidance are on the FASB's Web site at www.fasb.org. Links to publicly available speeches and presentations from the conference are available in Appendix B.

Executive Summary

Last year's conference was held during the heat of the economic crisis; many speakers discussed the pressure on multiple aspects of the financial reporting system. This year, many of the themes were similar, but the speakers had greater opportunity to reflect on the implications of the crisis for financial reporting and regulation, discuss actions taken, and consider future improvements to financial reporting.

Conference Themes

Globalization of Accounting and Reporting Standards and Regulations

In his remarks, James L. Kroeker, chief accountant in the SEC's Office of the Chief Accountant, noted, "An important area highlighted by the financial crisis is the potential for arbitrage or mischief that can result from differential regulatory standards when you cross national borders. The crisis has shown that accounting standards are not immune to this issue. Thus, the crisis has highlighted the importance of developing, implementing and enforcing high-quality and consistent accounting standards around the world." Throughout the three-day conference, the IASB and FASB updated attendees on numerous standard-setting projects focused on converging and jointly improving accounting standards, including those on financial instruments, fair value, consolidations, revenue, and leasing. In addition, in various panel discussions, preparers provided their insights into fair value, consolidations, and revenue.

Of course, much has been said about moving to a single set of high-quality global accounting standards. Thus, many attendees were anxiously awaiting news from SEC representatives about the status of its deliberations on the "Roadmap," the Commission's proposed approach to use of IFRSs by entities in the United States. SEC staff members and SEC Commissioner Elisse B. Walter noted that although feedback on the Roadmap indicated widespread support for a single set of high-quality global accounting standards, views differed on what approach should be taken. Commenters highlighted numerous operational, structural, and transitional challenges. Commissioner Walter stated that "we should move forward with further incorporating IFRS into the U.S. capital markets if, and only if, it is the right thing to do for U.S. investors." The SEC staff and commissioners are currently evaluating the comments received on the Roadmap, particularly those on the impact of IFRSs on U.S. capital markets and investors.

In short, we don't have a date yet. SEC representatives indicated that the SEC will take further action in early 2010.

Globalization of Auditing Standards and Regulations

Operating in a global environment presents challenges for those charged with regulating auditors as well. Daniel L. Goelzer, acting chairman of the Public Company Accounting Oversight Board, addressed some lessons that the PCAOB has learned from performing its inspections of non-U.S. audit firms involved in the audits of U.S. registrants. He noted that the audit environment varies from country to country and that understanding these differences is important to planning and conducting a non-U.S. inspection. The PCAOB must understand, among other things, what the local risks are, how audits are conducted in the particular jurisdiction, the local audit oversight, securities law enforcement, and the mindset regarding business and financial reporting. Mr. Goelzer commented that when the PCAOB visits another country for an inspection, it seeks the cooperation of local audit oversight authorities. Interaction with the local authorities can range from simply informing the home-country regulator that the PCAOB will be conducting an inspection of the audit firm to working side by side with the regulator in a simultaneous inspection of the firm. Mr. Goelzer noted that the PCAOB sometimes finds it difficult to reach an agreement with its foreign counterparts and discussed a specific example related to inspections in the European Union. The major obstacle to reaching agreement in some of these cases relates to the PCAOB's inability to share inspections information because of the confidentiality provisions in the Sarbanes-Oxley Act.

Mr. Kroeker commented that he was encouraged by reports from PCAOB board members about their many positive experiences in working jointly with their non-U.S. counterparts to accomplish this mutually important mission. Mr. Kroeker also recognized that although coordination with non-U.S. counterparts can sometimes be complicated, he believes that it is in the best interest of all parties to act jointly to increase efficiency and reduce the regulatory burden. He also noted that the inspection process is an important tool for maintaining and enhancing the quality of audits of entities that choose to participate in the U.S. capital markets. The House and Senate are currently considering legislation that would allow the PCAOB to share certain information with non-U.S. audit oversight bodies.

Speakers at the conference also emphasized the global convergence of auditing standards and the need for the PCAOB to take the work of other standard setters into account as it develops auditing standards for auditors of U.S. registrants. Allison M. Patti, a professional accounting fellow in the SEC's Office of the Chief Accountant, indicated that "auditing standards play a critical role in the protection of investors within each country's securities market and are an important part of supporting investor confidence in financial reporting." She described her "sense is that there is broad agreement among securities regulators, as well as among capital market participants, on the benefits of high quality international [auditing] standards utilized for financial reporting" and remarked on how securities regulators (including the SEC through its membership in the International Organization of Securities Commissions (IOSCO)) and other relevant authorities are engaging in the international auditing standards arena.

The Importance of an Independent Accounting Standard-Setting Body

Many keynote speakers addressed the political pressure on accounting standard setting in the United States and internationally, emphasizing that the financial information entities provide to investors should be unbiased and transparent so that investors can make appropriate investment decisions. Mr. Kroeker noted that "accounting standards must not be designed to: portray an artificial stability; mute the impacts of real business cycles; mask a lack of adequate risk management or supervision; or favor one industry or business practice over another."

Commissioner Walter discussed the need to "protect the independence of the standard-setting process" and to remain focused on "full and fair disclosure" to investors. She believes that regulators should leave the independence of the standard-setting process intact and that our accounting standards should be "fair and objective, based on expert analysis and judgment, and free of undue influence, both political and commercial."

In addition, Commissioner Walter pointed out that the independence of the standard-setting process should not be set aside when extraordinary events occur and called alternative approaches to the independent standard-setting process "unwise and short-sighted." She further indicated that (1) standard setters must continue to ensure broad applicability of accounting guidance, must be accountable, and must stay current with the real world and (2) the body of accounting standards must be high-quality and relevant.

FASB Chairman Robert H. Herz addressed the interplay of accounting standards and the regulation of financial institutions. He noted that as the financial crisis evolved, some parties sought to change "the objectives of financial reporting and the approach to accounting standard setting in the U.S." One of Mr. Herz's key points was that "[m]uch of the discussion about the role of accounting standards in the economic crisis seems to confuse our role of helping to provide investors and the capital markets with relevant and transparent information on the performance and financial condition of financial institutions (along with other companies) with the regulatory need to ensure the safety and soundness of financial institutions and stability of the financial system. While these tasks often overlap, they are not the same and the setting of accounting standards (i.e., GAAP) and the setting of regulatory capital and reserves should be decoupled so that one does not drive the other."

Fair Value and Financial Instruments

Paul A. Beswick, deputy chief accountant in the SEC's Office of the Chief Accountant, remarked on the joint FASB and IASB financial instruments project, indicating that the following two aspects of the project are "proving to be vexing for some":

- When an entity should recognize changes in fair value in the financial statements.
- Whether it is necessary to improve how the provision for loan losses is determined.

Mr. Beswick focused on the second of these aspects, dividing his discussion of the current loan loss provisioning model into "The Good, the Bad and the Ugly."

In terms of the good, Mr. Beswick applauded the FASB and IASB for working together to form an expert advisory panel to address impairments. He stressed that such efforts will help improve the transparency of information provided to investors.

Regarding the bad, Mr. Beswick acknowledged that certain "groups and individuals" have been voicing concerns that the two boards "currently are exposing differing models." However, he reminded conference participants that these are only exposure drafts, not final standards.

As for the ugly, Mr. Beswick has heard a number of comments indicating that the FASB and the IASB "did not go far enough in providing management discretion in their proposed models." However, he remarked that the objectives of the individuals making these comments appear to differ from the boards' goals of providing "investors with credible, transparent, and comparable financial information they can rely on to make sound investment and credit decisions."

Enforcement of SEC Regulations

During the past year, there has been a changing of the guard at the SEC's Enforcement Division. Robert Khuzami was named director of enforcement in February 2009. Historically, enforcement personnel have primarily focused their remarks at the conference on actions taken in connection with preparer and auditor activities. At this year's conference, Mr. Khuzami also addressed the division's expectations regarding the duties and responsibilities of boards of directors and audit committees.

He noted that during the SEC's investigations of significant financial fraud, members of the Enforcement Division evaluate whether directors and audit committees properly discharged their duties. This evaluation includes determining whether these individuals recklessly ignored red flags and other information that may have identified the fraud; asked for information and required thorough answers to their requests; delved into key accounting issues; and understood the registrant's financial reporting. Further emphasizing this point, Mr. Khuzami noted that enforcement personnel focus on whether (1) board members have exercised due care and diligence and (2) audit committees are active in accounting and audit issues and have set the appropriate "tone at the top" regarding misconduct and the need to produce accurate financial statements.

Enhanced Disclosures in SEC Filings

Representatives from the Commission, particularly those in the Division of Corporation Finance, emphasized the importance of (1) their core disclosure project and (2) embracing simplification and consistency in communications with investors in the upcoming reporting season. The SEC's core disclosure project will comprise a comprehensive review of the current disclosure requirements, with goals to modernize disclosures and eliminate redundancy. Meredith Cross, director of the Division of Corporation Finance, stated that the focus is on obtaining "the right disclosure, not more disclosure," and that it "imposes a huge burden on investors to wade through [disclosure] to see what's important. It's also a waste of time and money to prepare that type of disclosure."

Ms. Cross indicated that, in keeping with the SEC staff's focus on enhancing disclosures for the benefit of investors, the staff is conducting a review of the current interpretations on non-GAAP measures. The goal of the staff's review is to ensure the interpretations are not read "in a fashion that causes companies to keep key information out of their filings, which they are otherwise using to tell investors their story [through communications such as earnings calls and press releases] and which they believe is the most meaningful indicator of how they are doing." The staff has noted an inconsistency between (1) the focus of information on company Web sites, earnings releases, and presentations to analysts and (2) disclosures in their filings. She also noted that registrants may be omitting non-GAAP measures from their filing because of concerns about future SEC staff comments. However, she explained that she is not suggesting that companies throw caution to the wind and go back to some of the practices that existed before Regulation G was issued and "led to the crackdown on non-GAAP measures." The staff plans to revise the guidance before year-end so that calendar-year-end companies can consider it in preparing their annual filings.

SEC staff representatives also gave their thoughts on accounting and disclosure for areas such as consolidations, goodwill impairment, business combinations and joint ventures, fair value, and segment reporting.

Use of Assumptions

At this year's conference, the SEC staff discussed management's use of assumptions from two different perspectives: (1) integrity lapses that have led to enforcement actions and (2) transparent and meaningful disclosure.

Jason S. Flemmons, associate chief accountant in the SEC's Division of Enforcement, noted accounting estimates as one key area in which integrity lapses occur, particularly when such estimates are more subjective and when there is a risk of "unintentional bias and intentional manipulation." He recommended that when developing its estimates, management employ "sincere efforts to get to the right answer" and provide support for its accounting estimates, including documentation of its analyses or independent valuations. Mr. Flemmons also noted that the SEC has often taken enforcement actions when a registrant lacks documentation to support accounting estimates or has manipulated data to achieve desired accounting results.

Mr. Beswick offered some advice to entities regarding the use of assumptions in the current market environment. First, he noted that entities should ensure the use of well-reasoned assumptions by incorporating "current market data, consideration of what the experts in the industry are forecasting, and an evaluation of what others in the industry are doing." Mr. Beswick also stated that an entity's assumptions should be "reasonable and consistent with the objectives of the accounting standard" to which they are applied.

Second, Mr. Beswick advised entities to "step back and consider the implications" of their assumptions. He emphasized that before rationalizing their assumptions, entities should ensure that they have considered the requirements of the accounting standards. Specifically, he noted that the SEC has recently "heard that some companies may be inappropriately resetting the health care cost trend rate every year to 'manage their retirement liabilities.'"

Use of Reasonable Accounting Judgments

Mr. Beswick also addressed management judgments. He highlighted the importance of using reasonable judgments in accounting and reiterated the SEC's willingness to accept those judgments. However, he pointed out that entities should fully expect the SEC staff to inquire into the reasonableness of their judgments as well as the process they used to develop them.

He further advised entities "to avoid developing a 'checklist' mentality, and take careful, good faith consideration of the individual facts and circumstances in reaching a conclusion regarding an accounting matter."

Year-End Reporting

This year's conference and its host of speakers gave those involved in all aspects of the financial reporting process much to think about as they head into this annual reporting season. As FASB Chairman Herz noted, "[W]e should aspire to financial reporting that's geared to providing relevant, 'decision useful,' and transparent financial information to investors and the capital markets."

See Deloitte's Special Report, SEC Comment Letters on Domestic Registrants — A Closer Look (third edition), for extracts of frequently issued SEC staff comments, Deloitte's analysis, and links to related resources. See also Deloitte's Special Report, SEC Comment Letters on Foreign Private Issuers Using IFRSs — A Closer Look (second edition), for companies that are foreign private issuers.

Contents

Speech Topics

Audit Standard Setting

Speakers	Topics Covered
• Martin F. Baumann, Chief Auditor and Director of Professional Standards, PCAOB's Office of the Chief Auditor • George Botic, Deputy Director, Inspections, Small Firm Program in the PCAOB's Division of Registration and Inspections • Daniel L. Goelzer, Acting Chairman, PCAOB • James L. Kroeker, Chief Accountant, SEC's Office of the Chief Accountant • Allison M. Patti, Professional Accounting Fellow, SEC's Office of the Chief Accountant	• Global convergence of auditing standards • PCAOB standard-setting update • Broker-dealer registration and legislation

Global Convergence of Auditing Standards

Several speakers addressed the global convergence of auditing standards and the importance of and need for the PCAOB to take the work of other standard-setters into account as it develops auditing standards for auditors of U.S. registrants.

Ms. Patti indicated that "[a]uditing standards play a critical role in the protection of investors within each country's securities market and are an important part of supporting investor confidence in financial reporting." She noted her "sense is that there is broad agreement among securities regulators, as well as among capital market participants, on the benefits of high quality international standards utilized for financial reporting" and remarked on how securities regulators (including the SEC through its membership in the International Organization of Securities Commissions (IOSCO)) and other relevant authorities are engaging in the international auditing standards arena.

Ms. Patti provided an overview of some of the major developments in the evolution of international auditing standards and highlighted the significant achievement of the International Auditing and Assurance Standards Board (IAASB) in completing, in February 2009, its "Clarity Project." This project was a comprehensive multi-year undertaking to improve the International Standards on Auditing (ISAs).

Editor's Note: The IAASB's completed Clarity Project including the complete set of clarified ISAs, is available on the International Federation of Accountants' (IFAC's) Web site. Most global accounting firms (including the "Big Four" and other multi-national firms) use the ISAs as the foundation of their audit policies and methodologies, which they supplement with local professional auditing standards as necessary.

Following the completion of the IAASB's Clarity Project, IOSCO "encourage[d] securities regulators to accept audits performed and reported in accordance with the clarified ISAs [for cross-border purposes] recognizing that the decision whether to do so will depend on a number of factors and circumstances in their jurisdiction." IOSCO also "encourage[d] securities regulators and relevant authorities to consider the clarified ISAs when setting auditing standards for national purposes, recognizing that factors at the national and regional level will be relevant to their considerations."

Ms. Patti noted that the PCAOB is responsible for setting auditing standards applicable to auditors of U.S registrants. Mr. Kroeker indicated that one of the key priorities in the Office of the Chief Accountant is to continue to provide effective oversight of the PCAOB, "particularly as they pursue a very aggressive standard setting agenda."

Editor's Note: The AICPA's Auditing Standards Board (ASB) is currently undertaking a project to clarify its standards and converge them with the ISAs. The ASB's Clarification and Convergence project is described in more detail on the AICPA's Web site.

Mr. Baumann discussed in more detail how the PCAOB considers the activities of other standard setters, including the IAASB and the ASB, in its standard-setting process. Mr. Baumann indicated that the PCAOB's process includes consideration of the ISAs and the ASB's standards, but acknowledged that differences between those standards and the PCAOB's standards exist and will continue to exist because of circumstances unique to the U.S. environment (e.g., the requirement for U.S registrants

to engage auditors to perform audits of their financial statements that are integrated with audits of their internal control over financial reporting). Mr. Baumann and Mr. Goelzer noted their expectations that the differences among the standards are likely to narrow and underscored their desire to avoid needless differences. Mr. Baumann also indicated that the PCAOB will highlight differences between the ISAs and the ASB's standards and referred to PCAOB Auditing Standard No. 7 (AS 7),[1] which contains such an analysis.

PCAOB Standard-Setting Update

Mr. Baumann provided an overview of auditing in the current economic environment and reminded auditors of Staff Audit Practice Alert No. 3, *Audit Considerations in the Current Economic Environment*, which remains particularly relevant. He also provided an overview of the PCAOB's standard-setting process and highlighted various PCAOB standard-setting activities, including:

- *AS 7* — Mr. Baumann stated that AS 7 has been approved by the PCAOB and is expected to be approved by the SEC before the end of the year. If approved, AS 7 will be effective for engagements (including quarterly reviews of interim financial information) for periods beginning on or after December 15, 2009. Mr. Baumann expressed his belief that AS 7 will improve audit quality by requiring another engagement partner to take a fresh, objective look at an engagement team's audit and to challenge what was done by the engagement team. Mr. Baumann discussed the various requirements of the standard, which is available on the PCAOB's Web site.

Editor's Note: In response to questions about the impact of AS 7 on audit fees, Mr. Baumann noted that one of the factors considered in the development of AS 7 was PCAOB inspection findings that suggested that the time and effort expended by engagement quality reviewers was not commensurate with the overall complexity of the engagement and audit effort that was expended by the engagement team. Therefore, AS 7 might result in increased audit costs.

- *Other projects* — Mr. Baumann also discussed some of the other standard-setting projects of the PCAOB, which are described on the PCAOB's Web site as part of its 2010 strategic plan. The Board will consider proposing or reproposing standards in the following areas: risk assessment (which will be a reproposal of the originally proposed standards), audit confirmations, accounting estimates (including fair value measurements and use of specialists), application of the Sarbanes-Oxley Act's provisions on "failure to supervise," signing the auditor's report, communications with audit committees, related parties, global quality control (including control over work of affiliated firms), principal auditor, subsequent events, and applicability of the requirements of the AICPA's SEC Practice Section (commonly known as "Appendix K"), which was superseded by the PCAOB. A detailed time line is included in the 2010 Strategic Plan.

Broker-Dealer Registration and Legislation

Since the signing of the Sarbanes-Oxley Act of 2002, the SEC had issued a series of orders granting nonpublic broker-dealers temporary exemptions from filing financial statements audited by a PCAOB-registered public accounting firm. The latest order, issued in December 2006, extended the exemption to financial statements for fiscal years ending before January 1, 2009. When the exemption expired, auditors of approximately 5,500 nonpublic securities broker-dealers were required to register with the PCAOB.

Mr. Botic commented that out of the roughly 1,200 firms that the PCAOB expects to register pursuant to this requirement, only 350 have registered to date. In addition, Mr. Goelzer and Mr. Kroeker expressed concerns that an expectations gap may exist for firms that have registered. That is, because the Sarbanes-Oxley Act does not empower the PCAOB to inspect, set standards for, or investigate audits performed by these firms, the public may believe that the PCAOB is exercising oversight when, in fact, it lacks the necessary authority. On December 11, 2009, the U.S. House of Representatives passed legislation to give the PCAOB oversight authority over broker-dealer auditors; this legislation is now under Senate consideration.

[1] The full title of each standard referenced in this *Heads Up* appears in Appendix A: Glossary of Standards.

Business Combinations and Joint Ventures

Speakers	Topics Covered
• Joshua S. Forgione, Associate Chief Accountant, SEC's Office of the Chief Accountant • Jay Hanson, Chair of the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants (AcSEC) • Douglas T. Parker, Professional Accounting Fellow, SEC's Office of the Chief Accountant	• Use of a newly formed entity to effect a business combination • Subsequent accounting for loans acquired in a business combination • Measuring the assets contributed to a joint venture

Use of a Newly Formed Entity to Effect a Business Combination

Mr. Parker discussed the use of a newly formed entity (NEWCO) to effect a business combination, specifically whether and when such a NEWCO should be considered the accounting acquirer. He gave two examples of potential business combination transactions (one involving a NEWCO and one that did not) that were structured differently in form but had the same economic outcome. He pointed out that ASC 805 (formerly Statement 141(R)) provides some relevant guidance on how to evaluate a NEWCO. Specifically, he cited ASC 805-10-55-15, which states:

> A new entity formed to effect a business combination is not necessarily the acquirer. If a new entity is formed to issue equity interests to effect a business combination, one of the combining entities that existed before the business combination shall be identified as the acquirer by applying the guidance in paragraphs 805-10-55-10 through 55-14. In contrast, a new entity that transfers cash or other assets or incurs liabilities as consideration may be the acquirer.

Mr. Parker indicated that some have interpreted the last sentence of the above guidance as meaning that for a NEWCO to be considered the accounting acquirer, it must have substance. He listed the following factors (not all-inclusive) an entity might consider when evaluating whether a NEWCO has substance:

(a) [W]hether the NEWCO survives the transaction;

(b) [T]he pre-combination activities of the NEWCO;

(c) [W]ho created the NEWCO;

(d) [T]he age of the NEWCO . . . ; and

(e) [W]hether the elements of the transaction are integrated or are preconditioned upon each other.

Mr. Parker also mentioned that sometimes preparers, auditors, and even regulators are "willing to overlook form in favor of substance" if the outcome results in better financial reporting. Since there is no guidance on how to evaluate the substance of a NEWCO used to effect a business combination in U.S. GAAP, he encouraged registrants and their auditors to apply "reasonable judgment" to such transactions. Finally, Mr. Parker noted that the SEC staff does not believe that a surviving NEWCO will **always** be the accounting acquirer and that registrants should be wary of assuming that the staff dislikes recapitalization accounting.

Editor's Note: ASC 805-10-25-5 and ASC 805-10-55-10 through 55-15 provide guidance on determining which entity is the accounting acquirer.

Subsequent Accounting for Loans Acquired in a Business Combination

ASC 805 requires that loans acquired in a business combination be measured and recognized at fair value, with no separate allowance for losses. However, ASC 805 is silent on the accounting for loans acquired after the acquisition date. Some have questioned whether acquirers should follow the guidance in ASC 310-20 (formerly Statement 91) or the guidance in ASC 310-30 (formerly SOP 03-3). In a question-and-answer session, Mr. Hanson stated that the SEC staff has indicated in recent informal conversations that unless clarifying guidance is issued, it would accept either approach with one caveat, namely, that if an acquirer chooses to apply ASC 310-30, it must follow it in its entirety, including all the required disclosures.

Editor's Note: For more information about these topics, see Deloitte's roadmap, Accounting for Business Combinations, Goodwill, and Other Intangible Assets.

Measuring the Assets Contributed to a Joint Venture

The guidance on noncontrolling interests in ASC 810-10 (formerly Statement 160) has raised questions about a joint venture entity's accounting for joint venture formation transactions. Historically, the staff has expressed "strong views" about the use of fair value in recording noncash assets that are contributed to a joint venture. However, Mr. Forgione noted that "[i]n the absence of additional standard setting, there may be more circumstances where it may be appropriate to record the contributed business at fair value." Entities should consider the specific facts and circumstances, including whether new basis accounting would result in "decision-useful information to investors." No other details were provided by the staff.

Consolidations

Speakers	Topics Covered
• James L. Kroeker, Chief Accountant, SEC's Office of the Chief Accountant • Arie S. Wilgenburg, Professional Accounting Fellow, SEC's Office of the Chief Accountant	• Evaluating the substance of transactions • Factors to consider in determining whether an enterprise has a controlling financial interest in an entity • Shared power and economic substance

Evaluating the Substance of Transactions

Mr. Kroeker praised the FASB's new off-balance-sheet accounting requirements that will "have the potential to noticeably improve the financial reporting landscape for many regulated financial institutions." However, he acknowledged the potential for future structuring to achieve specific accounting results and reminded constituents to "remain vigilant when evaluating the substance, or lack thereof, of elements of transactions included to achieve specific accounting results."

Editor's Note: On June 12, 2009, the FASB issued Statements 166 and 167 (neither Statement has been codified as yet). Statement 166 amends the derecognition guidance in Statement 140 and eliminates the exemption from consolidation for qualifying special-purpose entities (QSPEs). As a result, a transferor will need to evaluate all existing QSPEs to determine whether they must now be consolidated in accordance with Statement 167.

Statement 167 amends the consolidation guidance applicable to variable interest entities. The amendments will significantly affect the overall consolidation analysis under Interpretation 46(R). While the Board's discussion leading up to the issuance of Statement 167 focused extensively on structured finance entities, the amendments to the consolidation guidance affect all entities and enterprises currently within the scope of Interpretation 46(R), as well as QSPEs that are currently excluded from the scope of Interpretation 46(R).

Statement 166 is effective for financial asset transfers occurring after the beginning of an entity's first fiscal year that begins after November 15, 2009, and Statement 167 is effective as of the beginning of the first fiscal year that begins after November 15, 2009 (calendar-year-end companies must adopt it on January 1, 2010). For additional information on Statements 166 and 167, see Deloitte's June 16, 2009, and October 20, 2009, *Heads Up* newsletters. For more information about the FASB's proposed deferral of Statement 167 for certain entities, see Deloitte's December 4, 2009, *Heads Up*.

Factors to Consider in Determining Whether an Enterprise Has a Controlling Financial Interest in an Entity

The core principle of Statement 167 is that a reporting enterprise consolidates a variable interest entity if it has a controlling financial interest in that entity. Mr. Wilgenburg emphasized that to have a controlling financial interest in another entity, an enterprise must have both of the following characteristics: (1) power over the activities that most significantly affect the entity's economic performance and (2) an interest that is exposed to losses or benefits of the entity that could potentially be significant.

Mr. Wilgenburg then focused on the judgment of whether an interest contains an exposure that "could potentially be significant." He stated that the assessment of significance should be based on qualitative and quantitative factors and

remarked that this assessment is analogous to the determination of materiality, which is "based on the total mix of information." He provided the following list of qualitative factors (not all-inclusive) that an enterprise might consider when determining whether it has a controlling financial interest in an entity:

- "The purpose and design of the entity," including the risks that the entity was "designed to create and pass on to its variable interest holders."
- The terms and characteristics of the enterprise's financial interest. Mr. Wilgenburg noted that although the "probability of certain events occurring would generally not factor into an analysis of whether a financial interest could potentially be significant," an enterprise should consider the interest's terms and characteristics (including the interest's level of seniority).
- The business purpose for holding an interest. Mr. Wilgenburg gave the example of a trading-desk employee's purchase of a "financial interest in a structure solely for short-term trading purposes." He noted that such a situation might be looked at differently than a situation "in which a sponsor transfers financial assets into a structure, sells off various tranches, but retains a residual interest in the structure." In the former example, "the decision making associated with managing the structure is independent of the short-term investment decision."

Editor's Note: On a related topic, in a question-and-answer panel at the conference, Jill Davis, associate chief accountant in the SEC's Office of the Chief Accountant, indicated that the SEC staff frequently requests registrants to expand their disclosures about why a variable interest entity was or was not consolidated.

Shared Power and Economic Substance

Mr. Wilgenburg emphasized that an enterprise should consider only substantive terms when applying Statement 167. He noted that the SEC staff has become aware of proposed structures with the following characteristics:

- A reporting enterprise transfers underperforming assets to a vehicle that is managed by a third party.
- The structures are "designed to achieve deconsolidation of underperforming assets."
- The "economic result [of the transaction] leaves substantially all of the risks of ownership with the [reporting enterprise]."
- The third-party manager has a minimal equity interest and the return of its equity is essentially guaranteed on the basis of the structure of its management fee.
- The reporting enterprise can remove the manager "if the manager's performance is unsatisfactory."

Mr. Wilgenburg pointed out that although power may superficially appear to be shared in this structure, the above facts indicate that the reporting enterprise may not have relinquished control of the assets and that the third-party manager may be acting strictly as an agent.

Mr. Wilgenburg also discussed structures that include a buy-sell clause that could be an in-substance call option for the reporting enterprise "if the manager does not have the financial ability to exercise its rights under the buy-sell provision." He remarked that "this may be an indication that the manager is simply acting as an agent on behalf of the reporting enterprise."

Editor's Note: For information about the impact of a registrants consolidation of VIEs upon adopting Statement 167 on management's report on ICFR, see Inclusion of Consolidated VIEs in Management's Reporting on ICFR.

Fair Value

Speakers	Topics Covered
• Kristofer Anderson, Valuation Fellow, FASB • Theresa Cooper, Global Controller (Center of Excellence), General Electric Company • Evan Sussholz, Professional Accounting Fellow (Valuation Specialist), SEC's Office of the Chief Accountant	• Market participant assumptions in the measurement of fair value • SEC focus areas • Best practices for working with the SEC on valuation issues • Valuation issues

Editor's Note: Kristofer Anderson also gave an update on the FASB's ongoing fair value projects. See FASB Project Update for more information.

Market Participant Assumptions in the Measurement of Fair Value

ASC 820 (formerly Statement 157) requires that fair value be measured from the perspective of market participants. This concept is relatively easy to apply in active markets; however, entities often encounter challenges when applying the concept to assets and liabilities for which observable pricing information is not available. Accordingly, developing market participant assumptions to measure fair value may present challenges as a result of the lack of information or the inability to obtain consistent information.

Mr. Sussholz provided a framework that a reporting entity could use to develop market participant assumptions for fair value measurements. Mr. Sussholz noted that generally most fair value measurements of assets and liabilities that trade in inactive markets or for which a market does not exist will begin by first taking into account the reporting entity's own assumptions. However, he noted that reasonable judgment should be applied in the determination of whether a reporting entity's own assumptions are representative of market participant assumptions. Mr. Sussholz suggested that in making this determination, a reporting entity consider the following questions:

1. "What are the potential exit markets for an asset and what is the asset's principal or most advantageous market?"

   Mr. Sussholz responded to this question by providing the following consideration points:

   - Whether the market for the asset is active, inactive, or has become recently inactive.
   - Whether there are distinct groups or clusters within the distinct groups of potential market participants (e.g., large versus small, profitable versus unprofitable, etc.).
   - The competitive nature of the potential markets (i.e., perfect competition, monopolistic or oligopolistic competition, fragmented markets).

2. "What is the highest and best use for the asset?"

   Mr. Sussholz pointed out that for a reporting entity to answer this question, "it should identify all of the potential uses of the asset within each potential exit market and determine if the value of the asset would be maximized by using the asset on a stand-alone basis . . . or in conjunction with other assets."

3. "Who are the potential market participants and what are their distinguishing characteristics?"

   While Mr. Sussholz acknowledged that ASC 820 "does not require a reporting entity to identify specific market participants," he did state that understanding "the characteristics that distinguish [the potential] market participants . . . will play a significant role in understanding how [potential] market participants would use the asset being measured [and] the value that those market participants would place on that asset."

4. "How do the market participant characteristics compare to the reporting entity's own characteristics?"

   Mr. Sussholz pointed out that the "significant distinguishing characteristics" of the potential market participants identified in Question 3 should be reconciled to the reporting entity's own characteristics in the determination of whether adjustments are needed to the reporting entity's own assumptions for the entity to appropriately measure the fair value of the asset. While he acknowledged that there may be instances in which adjustments to a reporting entity's own assumptions are not necessary, he stated that it is the SEC staff's expectation that a reporting entity will apply reasonable judgment when making this determination.

Mr. Sussholz noted there are likely to be "additional factors that one could consider when performing . . . the process of determining market participant assumptions." He also indicated that the process can be iterative and that therefore it is likely that rather than being answered sequentially, questions "will be answered continuously throughout the process."

In concluding his remarks, Mr. Sussholz stated that the SEC "staff will continue to inquire about the process employed and judgments made by a reporting entity when developing market participant assumptions."

SEC Focus Areas

Mr. Sussholz noted that in reviewing fair value measurements included in corporate filings, the SEC focuses on four key areas: (1) compliance with applicable GAAP (i.e., ASC 820), (2) appropriate valuation methods, (3) reasonableness of significant assumptions used in the valuation, and (4) appropriate disclosures. He observed that common errors identified by the staff include assumptions that do not reflect views of market participants; insufficient due diligence by management in understanding the nature of price quotes received from third-party providers, such as brokers and pricing services; and use of inappropriate valuation methods to measure financial and nonfinancial assets.

Best Practices for Working With the SEC on Valuation Issues

Mr. Sussholz observed that when interacting with the staff on complex or material valuation issues, it may be beneficial to include valuation specialists earlier in the discussion and make valuation reports available to the SEC staff, since these actions may help expedite the review process. Ms. Cooper, Mr. Anderson, and Mr. Sussholz emphasized that the ultimate responsibility for determining fair value measurements rests with management, regardless of third-party services employed by the organization, such as the use of broker quotes or fair value specialists.

Valuation Issues

The panelists also discussed certain valuation issues, including the following:

- *Multiple valuation techniques* — Mr. Sussholz emphasized that when using multiple valuation techniques to determine fair value, entities need to apply the same level of rigor to each approach. This process should include (1) documenting the basis for using reasonable and supportable assumptions and (2) determining how weights were assigned to each approach in measuring fair value.
- *Orderly transactions* — Mr. Sussholz observed that organizations have encountered significant difficulty in determining when a transaction price is not orderly. He emphasized that such a determination requires significant judgment and that entities must document (and support with appropriate evidence) their basis for concluding that a transaction price is not orderly.

  Editor's Note: Entities must document their basis for concluding that a transaction is or is not orderly in accordance with ASC 820.
- *Valuation methods* — Mr. Sussholz highlighted that the staff has requested valuation reports from entities in numerous circumstances and in certain cases has required entities to reperform their valuations because they used inappropriate valuation methods or unreasonable assumptions.
- *Third-party service providers* — Mr. Sussholz and Mr. Anderson reemphasized the need for management to understand the information obtained from third-party service providers. Specifically, Mr. Sussholz noted that if management is unable to obtain the information behind the quotes, management needs to perform its own corroborative calculations and market research.
- *Control premiums* — In responding to a question about the SEC's views and judgments regarding control premiums, Mr. Sussholz reaffirmed the comments made by Mr. Robert G. Fox III in his speech at the 2008 Conference, when he stated that the SEC staff "does not have 'bright line' tests [for] determining the reasonableness of a control premium."

Editor's Note: In response to a question regarding the Valuation Resource Group (VRG), Mr. Anderson noted that the public session of the VRG meeting is open to all observers and that the minutes of the public meetings are available on the FASB's Web site.

FASB Project Update

Speakers	Topics Covered
• Kristofer Anderson, Valuation Fellow, FASB • Paul A. Beswick, Deputy Chief Accountant for Professional Practice, SEC's Office of the Chief Accountant • Patrick Finnegan, Member, IASB • Russell Golden, Technical Director, FASB • James L. Kroeker, Chief Accountant, SEC's Office of the Chief Accountant	• Contingencies project • Fair value projects • Financial instruments project • Going-concern project • Lease project • Multi-employer pension plan disclosure project • Revenue recognition project

Contingencies Project

Mr. Golden briefly discussed the status of the FASB's project on disclosure of certain loss contingencies in light of the June 2008 release of the exposure draft on this topic. Mr. Golden noted that as a result of subsequent deliberations by the Board and in consultation with preparers and attorneys, the staff now believes that it should focus on factual evidence and transparent disclosures about litigation contingencies rather than require entities to predict the outcome of litigation. Mr. Golden noted that the FASB staff plans to finalize the project in 2010. The effective date of the final ASU is expected to apply to 2010 financial statements.

Editor's Note: In response to a question about potential re-exposure of the exposure draft, Mr. Golden noted that the Board has not yet deliberated this issue. However, he suggested it was likely that a proposed ASU would be exposed for public comment, possibly in the first quarter of 2010. For more information about the project, see the FASB's Web site.

Fair Value Projects

Mr. Anderson gave an update on the project for improving disclosures about fair value measurements. He observed that the FASB is expected to finalize the ASU on this topic soon and that the Board will exclude sensitivity analysis, the most controversial aspect of the project, from the final standard for now. Further, Mr. Anderson noted that since the sensitivity analysis requirement proposed in the exposure draft was based on the current requirements in IFRS 7, the Board has directed the FASB staff to obtain feedback from constituents on the effectiveness of these disclosures in financial statements prepared in accordance with IFRSs. He also pointed out that the final ASU will be effective for the first reporting period (including interim periods) beginning after December 15, 2009, except for the requirement to provide the Level 3 activity between purchases, sales, issuances, and settlements on a gross basis, which will be effective for the first reporting period (including interim periods) beginning after December 15, 2010.

Mr. Anderson also gave an update on a project the FASB recently added to its agenda to achieve convergence with the IASB's fair value measurement standard when it is finalized in 2010. He noted that although there are certain differences between ASC 820 and the IASB's exposure draft of its fair value measurements standard, the IASB's proposed standard is largely consistent with ASC 820. Mr. Anderson observed that the staff will propose a project plan at the December 2009 joint FASB and IASB board meeting to initiate deliberations of the differences between the IASB's exposure draft and ASC 820 in the first quarter of 2010, with a plan to issue an exposure draft in the second quarter of 2010. He further indicated that he expects the FASB will issue a converged final standard toward the end of the third quarter of 2010. The FASB will determine the effective date at a future Board meeting.

Financial Instruments Project

Mr. Golden noted that the FASB's and the IASB's joint project on accounting for financial instruments is its most important and difficult project and that it is likely to be the most controversial one on the FASB's agenda. Mr. Golden indicated that the path the Board is pursuing on this topic should bridge the gap between the concerns raised by constituents regarding the measurement of financial instruments at either amortized cost or fair value.

Editor's Note: Chairman Herz also discussed the status of the financial instruments project and reconciliation of the views on whether to use amortized cost or fair value. See Decoupling the Role of Accounting Standard Setters From That of Banking Regulators and "Bridging the Divide" in the Financial Instruments Project for more information.

Mr. Golden noted that one of the more significant decisions the Board has made concerning this project is the proposal to require entities to present one single statement of comprehensive income. Because this change will affect entities that do not have significant holdings of financial instruments, the staff is proposing to remove the proposal from the financial instruments project and create a separate project for it. Mr. Golden suggested that an exposure draft is likely to be released for public comment in the first quarter of 2010.

Mr. Kroeker noted his strong support for the financial instruments project. He indicated that the recent actions of the FASB on impairments were meant to be an interim solution and stated that it is "important that momentum not be lost at this critical juncture and that aggressive timetables be met for a more comprehensive high-quality solution to the accounting for financial assets." More specifically, he acknowledged investors' need for greater transparency of fair value information and suggested that information derived from an amortized cost basis may also be of equal importance to investors. Accordingly, he stated that less emphasis should be placed on whether the use of fair value or amortized cost is appropriate, but rather that for certain assets, there is room for information derived from both models and that "the focus should be on how to best portray that information."

Editor's Note: For more information about the project, see the FASB's Web site and Deloitte's November 17, 2009; November 11, 2009; and October 27, 2009, *Heads Up* newsletters.

Mr. Beswick remarked on the financial instruments project as well, indicating that the following two aspects of the project are "proving to be vexing for some":

- When an entity should recognize changes in fair value in the financial statements.
- Whether it is necessary to improve how the provision for loan losses is determined.

Mr. Beswick focused on the second of these aspects, dividing his discussion of the current loan loss provisioning model into "The Good, the Bad and the Ugly."

In terms of the good, Mr. Beswick applauded the efforts of the FASB and IASB to work together to form an expert advisory panel to address impairments. He stressed that such efforts will help improve the transparency of information provided to investors.

Regarding the bad, Mr. Beswick acknowledged that certain "groups and individuals" have been voicing concerns that the two boards "currently are exposing differing models." However, he reminded conference participants that these are only exposure drafts, not final standards. Entities are encouraged to write a comment letter to one or both boards. Mr. Beswick further remarked that the FASB and IASB recently agreed to joint monthly meetings to discuss convergence projects. He believes the boards will be able to "work out their differences through this [convergence] process."

As for the ugly, Mr. Beswick has heard a number of comments indicating that the FASB and the IASB "did not go far enough in providing management discretion in their proposed models." However, he remarked that the objectives of the individuals making these comments appear to differ from the boards' goals of providing "investors with credible, transparent, and comparable financial information they can rely on to make sound investment and credit decisions."

Going-Concern Project

Mr. Golden noted that the staff now believes that the project should focus on an entity's disclosures about risks and how the entity manages these risks. Mr. Golden observed that the Board will re-expose a proposed ASU for public comment, but he did not provide an estimated time frame for exposure.

Editor's Note: We expect this project will not be completed in time for the 2009 year-end reporting season as had been originally proposed. For more information about the project, see the FASB's Web site.

Lease Project

Mr. Finnegan discussed some preliminary decisions the FASB and IASB have made about lessee and lessor accounting since the release of their joint discussion paper on leases in March 2009. He indicated that the boards strived for symmetry between lessee and lessor accounting. Under the preliminary decisions, a lessee would record a right-of-use asset and a liability for its obligation to make rental payments and a lessor would record an asset for the right to receive rental payments and a corresponding liability for the lessor's performance obligations under the lease.

Multi-Employer Pension Plan Disclosure Project

Mr. Golden indicated that the FASB staff is working on identifying what type of information should be disclosed by multi-employer pension plans in the participants' financial statements. Mr. Golden noted that the need for more transparent disclosures has been stressed in the current economic environment because these plans continue to incur increasing deficits, and employees (current and retired) rely on the future value of them.

Revenue Recognition Project

Mr. Finnegan clarified that the objective of the proposed revenue model is to simplify and converge existing standards rather than drastically change current revenue recognition. In particular, he discussed the application of the proposed model to contracts currently accounted for under the percentage-of-completion method. He noted that the FASB and IASB do not intend to abolish the percentage-of-completion method in contract accounting but acknowledged that the boards still have some work to do on the proposed model's notion of "continuous delivery."

Mr. Finnegan also noted that the exposure draft on the proposed revenue model will include indicators to help entities determine whether control of goods or services has transferred to the customer. These indicators include the customer's (1) unconditional obligation to pay for the assets, (2) legal title to the assets, (3) right to sell the assets, and (4) physical possession of the assets.

Financial Instruments

Speaker	Topics Covered
• Brian W. Fields, Professional Accounting Fellow, SEC's Office of the Chief Accountant	• Contracts on own stock and redeemable equity shares • Derivatives and hedging • Scope of transfers of financial assets

Editor's Note: Several speakers also discussed the ongoing FASB's and IASB's financial instruments project. See FASB Project Update for information.

Contracts on Own Stock and Redeemable Equity Shares

Certain contracts on an entity's own stock and redeemable equity shares can be classified as permanent equity if it can be determined that the entity is in control of settlement options (i.e., it can avoid paying cash at settlement). The staff has been asked who needs to have the power to control the settlement of the contract to conclude that the entity is in control of a settlement option. Mr. Fields indicated that generally the "power to control the form of settlement . . . would rest with the party or parties tasked with management [such as the Board of Directors or the general partner in the case of a limited partnership] or governance by the owners of the entity."

In discussing situations in which control may not reside with management or the governance structure (e.g., board of directors) of an entity, Mr. Fields gave an example of callable preferred stock in which the preferred shareholders (noncontrolling class of equity) have a right to take control of the Board upon the entity's failure to pay dividends and thereby force the entity to exercise its call option. In the absence of other provisions that block such a right, the shares would be classified in temporary equity because of the contingent control right and the embedded call option (i.e., the combination is in substance a contingent put right).

Derivatives and Hedging

Mr. Fields discussed common errors made by entities in defining the terms of the embedded feature to be evaluated in a hybrid instrument. Mr. Fields stressed that in evaluating an embedded feature, entities should make sure that "the embedded feature and host contract identified add up to the actual hybrid instrument that [they] are ultimately accounting for." This analysis can further affect the following:

1. The analysis of whether a feature is clearly and closely related to its host
2. Whether the feature would have the characteristic of net settlement if it were a freestanding instrument
3. Whether the feature qualifies for a scope exception to derivative accounting; and
4. The measurement of the feature's value should it require bifurcation

Regarding hedge accounting, Mr. Fields noted that the SEC had been aware that some entities were planning to expand the use of shortcut or critical-terms-match methods for a number of hedging relationships. He cautioned that those "hedging methods that do not require a full evaluation of effectiveness are intended for straightforward hedging relationships involving conventional instruments. To the extent a hedging relationship involves unusual terms that raise questions about the level of effectiveness of the hedge a more complete analysis of ineffectiveness would likely be necessary."

In responding to a question about whether the SEC would object to entities designating "late-term" fair value hedges under the shortcut method, Mr. Fields stated that, subject to no significant ineffectiveness and no unusual instrument terms, an entity is not necessarily precluded from applying the shortcut method even if the hedging instrument (e.g., a swap) was entered into after the initial recognition of the hedged item (e.g., debt).

Scope of Transfers of Financial Assets

Mr. Fields noted that an entity whose transfer of financial assets would not qualify as a sale under the guidance in ASC 860 (including Statement 166, which has not yet been codified in ASC 860) might attempt to structure a transaction in a manner that sidesteps the criteria for sale accounting. In such a structure, an entity would first transfer the financial assets to a newly created subsidiary (e.g., special-purpose entity) in exchange for all senior and subordinated interests in the subsidiary. All interests are in legal-form equity and do not contain a maturity date. The entity then sells the senior interests to outside investors. The activities of the subsidiary are significantly limited and do not have the breadth and scope of activities of a business. Because it may seem that the sale of the senior interests represented an equity transaction involving owners, the entity might assert that the guidance in ASC 860 does not apply and account for the sale of the senior interests as the issuance of a noncontrolling equity interest rather than as collateralized debt.

Editor's Note: ASC 860-10-15-4(f) states that investments by owners in a business entity are not within the scope of ASC 860, and ASC 860-10-55-13 states that the guidance in ASC 860-10 "does not apply to a transfer of an ownership interest in a consolidated subsidiary by its parent if that consolidated subsidiary holds nonfinancial assets." We do not expect this guidance to be affected by the amendments in Statement 166, which have not yet been codified.

Mr. Fields cautioned that "when a subsidiary is created simply to issue beneficial interests backed by financial assets rather than to engage in substantive business activities," the sale of beneficial interests in the subsidiary "should be viewed as transfers of interests in the financial assets themselves" and ASC 860 would apply.

Editor's Note: Similar views were expressed by SEC Professional Practice Fellow Armando Pimentel at the 1997 Conference.

Mr. Fields concluded that under ASC 860, a transfer of financial assets should be presented as a collateralized borrowing if the transfer does not qualify for sale accounting under that guidance; "presentation [of the proceeds received] as an equity interest in the reporting entity is not a possible outcome."

In addressing a question about the scope of ASC 860 for transfers of equity interests in nonbusiness entities that hold financial assets, Mr. Fields stated that entities need to apply significant judgment in determining "what is a business and what is an asset-backed financing structure."

Foreign Currency Issues

Speaker	Topic Covered
• Wayne E. Carnall, Chief Accountant, SEC's Division of Corporation Finance • Craig C. Olinger, Deputy Chief Accountant, SEC's Division of Corporation Finance	• Venezuela and foreign-currency issues

Venezuela and Foreign-Currency Issues

Mr. Olinger discussed two issues related to Venezuela's economic situation that may have an impact on registrants' financial statements: (1) whether Venezuela's economy should be classified as highly inflationary and (2) the exchange rate that an entity should use in foreign-currency translation and foreign-currency remeasurement in its Venezuela operations.

Editor's Note: ASC 830 (formerly Statement 52) defines a highly inflationary economy as one that has experienced a cumulative inflation rate of 100 percent or more for the most recent three-year period. Under ASC 830, if a country's economy is classified as highly inflationary, the financial statements of the foreign entity must be remeasured in the functional currency of the reporting entity on a prospective basis.

Mr. Olinger indicated that Venezuela has two inflation indices. One is a metropolitan index, which covers two large cities and was used before January 1, 2008. The other is a newer national index used after January 1, 2008. Currently, the older index is above 100 percent, which would mean that the economy is highly inflationary. The blended three-year cumulative inflation rate, which is calculated by using the newer index for periods after January 1, 2008, is currently at 99.6 percent. Mr. Olinger advised registrants to plan on classifying Venezuela's economy as highly inflationary as of January 1, 2010. If the new index decreases later in December such that it never hits 100 percent, the SEC staff will discuss the matter further with the International Practices Task Force.

Editor's Note: On December 10, 2009, one day after Mr. Olinger's speech, the National Consumer Price Index for November 2009 was released. The blended three-year cumulative inflation index for this month rose to 100.8 percent. Both indices are now over 100 percent, which indicates a highly inflationary economy in accordance with ASC 830.

Regarding the second issue (i.e., which exchange rate an entity should use in translating the financial statements of its Venezuelan operations), Mr. Olinger indicated that Venezuela has two exchange rates. The first rate is the official rate; an entity can exchange currency at this rate only by going through a fairly elaborate government approval process. The other rate is referred to as the "parallel rate"; an entity can use an alternative mechanism to exchange currency at this rate. Currently, the parallel rate is three times weaker against the U.S. dollar than the official rate. The SEC staff understands that the ability to obtain the official rate varies from industry to industry and from company to company.

Mr. Olinger noted that there is no "one size fits all" approach to determining the appropriate exchange rate. Rather, this determination should be based on individual facts and circumstances and entities should be prepared to support their conclusion to auditors and regulators.

In addition, Mr. Olinger reminded entities about disclosures that may be appropriate, including:

- The exchange rate used, and the effect or potential effect on the financial statements.
- Summarized financial information of the Venezuelan subsidiary.
- Net monetary assets and liabilities, including the currency in which they are denominated.

Mr. Olinger cautioned that such disclosures have been lacking and that the SEC staff will be looking for them in 2009 filings.

In addition, during a question-and-answer session, Mr. Carnall noted that entities with operations in Venezuela may want to consider the Caterpillar Enforcement Action (one of the first actions brought regarding MD&A). Because of the disparity between the official and parallel rate, there could be significant ramifications when the hyperinflationary barrier is crossed and the functional currency changes from the bolivar. He noted that an entity could be obligated to provide disclosures if the entity has reason to believe the financial statement effect will be material in the future, even if it has been immaterial historically.

Goodwill Impairment

Speakers	Topics Covered
• Mark Kronforst, Deputy Chief Accountant (Regulatory Policy), SEC's Division of Corporation Finance • Evan Sussholz, Professional Accounting Fellow (Valuation Specialist), SEC's Office of the Chief Accountant	• Calculating the fair value of a reporting unit in step 1 of a goodwill impairment test • Goodwill impairment disclosures

Calculating the Fair Value of a Reporting Unit in Step 1 of a Goodwill Impairment Test

Mr. Sussholz discussed the application of ASC 350 (formerly Statement 142) in the calculation of the fair value of a reporting unit in the first step of a goodwill impairment test (comparison of the fair value of the reporting unit to the carrying value of the reporting unit including goodwill). ASC 350-20-35-22 states that the "fair value of a reporting unit refers to the price that would be received to sell the unit as a whole in an orderly transaction between market participants at the measurement date." A question that has come up in the application of this guidance is whether the fair value of a reporting unit refers to the reporting unit's equity value or its enterprise value. Mr. Sussholz stated that enterprise value is "commonly defined as the sum of the fair value of debt and equity." While in many circumstances the SEC staff does not expect that the use of equity value instead of enterprise value would affect the result of a step 1 test, "one example [of] when the selected approach could impact the result is when [the] carrying value of equity in a reporting unit is negative."

Mr. Sussholz went on to give an example of a reporting unit with a negative equity carrying value that "would seemingly always 'pass' a step one goodwill impairment test performed on an equity basis, despite the fact that significant goodwill may exist and the underlying operations of [the reporting unit] may be deteriorating." Mr. Sussholz suggested that in this example, using enterprise value rather than equity value in step 1 of the goodwill impairment test may be more appropriate because it would provide a better indication of potential impairment.

Mr. Sussholz stated that in determining whether an alternative approach to a step 1 goodwill impairment test is appropriate, companies should consider various factors including (1) their operations, (2) "market participant assumptions", and (3) "potential structure of a hypothetical sale transaction." However, "regardless of the approach selected, the composition of the carrying value must be the same as the composition of the fair value determination." For example, if the carrying value is based on equity, then step 1 of the goodwill impairment test should be at the equity level.

Finally, Mr. Sussholz cautioned that if using an equity basis rather than an enterprise basis affects whether a reporting unit passes or fails step 1 of the goodwill impairment test, management should use reasonable judgment to determine whether step 2 of the goodwill impairment test should be performed.

Goodwill Impairment Disclosures

Mr. Kronforst discussed the SEC staff's increased focus on critical accounting policy disclosures about goodwill impairment in MD&A. The staff recently reviewed step 1 goodwill impairment test disclosures from various registrants' filings as well as a significant number of SEC comment letters and related response letters. The review revealed that there is diversity in the nature of the disclosures entities are providing. Mr. Kronforst acknowledged the difficulty in providing investors with clear, concise, and meaningful disclosures.

On the basis of its review and the evolution of its views on this topic, the SEC staff developed its expectations of what registrants should disclose about potential material goodwill impairments. Mr. Kronforst noted that a registrant should disclose any known material uncertainties regarding the potential failure of step 1 of a goodwill impairment test, in accordance with Regulation S-K, Item 303. He indicated that if a registrant has a reporting unit with material goodwill that is at risk for failing step 1 of the goodwill impairment test, the registrant should disclose that risk. Further, he outlined the following additional expected disclosures for each reporting unit whose fair value as of the impairment testing date was not substantially in excess of its carrying value:

- The percentage by which the fair value exceeded the carrying value as of the most recent step 1 test (under ASC 350-20-35-4 through 35-8).
- The amount of goodwill allocated to the reporting unit.

- A description of the key assumptions that drive fair value and a discussion of any uncertainties inherent in those assumptions.
- A discussion of potential events, circumstances, or both, that could have a negative effect on fair value.

Mr. Kronforst further pointed out that when the fair value for all reporting units is substantially in excess of the respective reporting unit's carrying value, the registrant should disclose this assertion.

Mr. Kronforst noted that there is no set threshold or bright-line percentage for determining whether a reporting unit's fair value is "substantially" in excess of its carrying value. In determining what is considered substantial, a registrant should consider the specific facts and circumstances, such as the nature of the assumptions, the methods used, industry considerations, and other relevant factors. Mr. Kronforst indicated, however, that the lower the percentage excess, the higher the risk of future impairment. The SEC staff believes that if there is a narrow margin, it would be counterintuitive and more difficult for a registrant to conclude that there is not a known uncertainty that should be addressed. However, Mr. Kronforst encouraged registrants that reach such a conclusion to explain this in their disclosures.

Regarding MD&A disclosure of the key assumptions used in goodwill impairment testing, Mr. Kronforst noted that registrants typically have disclosed only some of the relevant discounted cash flow assumptions. Generally, registrants have disclosed the weighted-average cost of capital assumptions but have not disclosed cash flow growth rates. The SEC staff has noted that because disclosing only certain key assumptions does not provide users with the complete "story," a registrant should describe the key assumptions that drive fair value.

Mr. Kronforst also discussed disclosures about sensitivity analyses for changes in assumptions that affect the goodwill impairment test. He indicated that it is not necessarily meaningful for a registrant to disclose a sensitivity analysis because of the interrelatedness of some of the assumptions and the complexity of the model. However, he cautioned that sensitivity analyses are still meaningful for other critical accounting policy disclosures.

Income Tax Disclosure Matters

Speaker	Topics Covered
• Jill Davis, Associate Chief Accountant, SEC's Division of Corporation Finance	• Income tax disclosures and MD&A • Undistributed earnings of foreign subsidiaries • Classification of deferred taxes

Income Tax Disclosures and MD&A

Ms. Davis highlighted certain income tax disclosure matters that registrants should consider when preparing MD&A. She noted that registrants often analyze income taxes in their MD&A by performing a simple year-to-year comparison of amounts reported in the income statement. She encouraged registrants to consider their income tax footnote disclosure when writing the MD&A and specifically pointed to the rate reconciliation disclosure requirements of Regulation S-X, Rule 4-08(h)(2). Under these requirements, companies must reconcile, in a tabular format, the amount of reported total income tax expense (benefit) to the amount of income tax that would have been incurred by using reported pretax income at the statutory federal income tax rate. Ms. Davis noted that the reconciling line items in this table, such as the write-off of goodwill that is not deductible for tax purposes, give a reader insight into areas currently affecting the registrant as well as what the registrant may face going forward. She added, "It's a great source of information to tell a story."

While discussing the rate reconciliation, Ms. Davis reminded registrants that Regulation S-X, Rule 4-08(h), requires separate disclosure of all significant reconciling items. Amounts that are significant should not be combined in an "other" category. The SEC staff may issue a comment when the "other" line item is large or if the registrant does not disclose an item that the staff would expect to see. Further, a registrant should not combine unrelated tax reconciling items into a line item that is significant on its own.

Editor's Note: Regulation S-X, Rule 4-08(h)(2), defines the threshold for reporting reconciling items in the rate reconciliation as 5 percent of the income tax expense at the statutory federal income tax rate. Ms. Davis referred to such items as "significant" in her remarks.

Ms. Davis explained that the SEC staff will use a "mix of information" from a registrant's footnote disclosure about uncertain tax positions and its income tax rate reconciliation to determine whether the registrant has provided a sufficient analysis in MD&A. She acknowledged that the accounting for income taxes, particularly uncertain tax positions, is an area that requires a great deal of management judgment. The critical accounting policies disclosure should explain, among other items, why assumptions have changed or why the actual result changed and is different from what was assumed. She also noted that the nonrecurring nature of many items in the rate reconciliation, including changes related to uncertain tax positions, lends itself to MD&A disclosure.

In addition, Ms. Davis referred to the requirements in Regulation S-X, Rule 4-08(h)(1), regarding footnote disclosure of the components of income (loss) before income tax as either domestic or foreign in nature. If the geographic origin of income has shifted, a registrant should consider whether MD&A needs to explain the registrant's sources of pretax income in terms of domestic and foreign income, addressing any relevant changes in trends or in the focus of the registrant's business.

Undistributed Earnings of Foreign Subsidiaries

Ms. Davis discussed a potential rate reconciliation item, undistributed earnings of foreign subsidiaries. If a registrant asserts that the earnings of a foreign subsidiary are permanently reinvested in the subsidiary and will not be repatriated to the home country, the foreign earnings will not be subject to income tax and a rate reconciliation item will therefore result. Questions that the SEC staff will consider in determining whether the registrant's MD&A disclosures are adequate in this area include the following:

- Does the registrant currently have sufficient liquidity to make this assertion?
- Does the MD&A explain the cash resources that are located in the foreign countries/subsidiaries and the impact on the registrant's liquidity?

Classification of Deferred Taxes

Ms. Davis also reminded registrants that the classification of deferred taxes as current or noncurrent is based on the related assets and liabilities and not on when the income tax item will be settled. Registrants should highlight in MD&A material changes in income tax items that are not apparent from the footnote disclosure, such as when there is a difference between the balance sheet classification of deferred taxes and the settlement of those items.

Editor's Note: Ms. Davis and Wayne E. Carnall, chief accountant in the SEC's Division of Corporation Finance, as moderator for this discussion, referred to Mr. Jacobs's remarks at the 2008 Conference regarding deferred tax valuation allowances and the repatriation of foreign earnings. For more information, see Deloitte's December 18, 2008, *Heads Up*.

Independence of the Standard-Setting Process

Speakers	Topics Covered
• Robert H. Herz, Chairman, FASB • James L. Kroeker, Chief Accountant, SEC's Office of the Chief Accountant • Elisse B. Walter, Commissioner, SEC	• Independent accounting standard setting • Decoupling the role of accounting standard setters from that of banking regulators and "bridging the divide" in the financial instruments project • GASB funding

Independent Accounting Standard Setting

Commissioner Walter discussed the need to "protect the independence of the standard-setting process" and to remain focused on "full and fair disclosure" to investors. She outlined her belief that regulators should leave the independence of the standard-setting process intact and that accounting standards should be:

- [F]air and objective.
- [B]ased on expert analysis and judgment.
- [F]ree of undue influence, both political and commercial.

Ms. Walter pointed out that the independence of the standard-setting process should not be set aside when extraordinary events occur, and she described alternative approaches to the independent standard-setting process as "unwise and short-sighted." She emphasized that (1) standard setters must continue to ensure broad applicability of accounting guidance and must be accountable and stay current with the real world and (2) the body of accounting standards must be of high quality and relevant.

Decoupling the Role of Accounting Standard Setters From That of Banking Regulators and "Bridging the Divide" in the Financial Instruments Project

As the debates continue over fair value accounting for financial instruments and the oversight of the accounting standard-setting process, Chairman Herz called for a "decoupling" of banking capital regulatory requirements from accounting standard setting.

While accounting standard setters and banking regulators both "share a deep interest" in strong banks and a strong economy, Mr. Herz suggested that their roles are often confused. He pointed out that the objective of accounting standards is to provide investors and the capital markets with "relevant, reliable, transparent, timely, and unbiased financial information." In contrast, the objective of regulatory requirements is to "ensure the safety and soundness of financial institutions and stability of the financial system." While these roles share some commonality, they are not the same.

Chairman Herz described how, over the past year, some parties have sought to "change the objectives of financial reporting and the approach to accounting standard setting in the U.S." He noted that as the financial crisis intensified, some financial institutions and others called for not only changes in how the fair value and impairment standards apply in inactive and distressed markets but also for "the SEC and Congress to eliminate or defer the requirements to recognize losses on impaired financial assets." Such parties also sought to enable banking regulators to override and change accounting standards "to achieve bank regulatory and financial stability objectives."

In addition, Chairman Herz remarked that some have argued that accounting requirements made the financial crisis worse by forcing them to recognize losses that may never be "realized" if market values recover. Specifically, Mr. Herz stated:

> Critics have said that current standards . . . impose "procyclical" burdens on financial institutions and can cause instability in the financial system. For example, they contend that fair value can overstate the "true" value of financial assets in "irrationally exuberant" up markets and understate their true value in times of market turmoil and decline. They also contend that reporting declining asset values in down markets constrains banks' ability to make loans and causes them to sell assets at depressed prices to conserve capital, thereby exerting further downward pressure on asset values.

Chairman Herz acknowledged that accounting requirements can cause procyclicality but that "so can any information that accurately reports current economic . . . conditions." He therefore reiterated the importance of standards that help lead to transparent reporting and help avoid the hiding of losses to avert procyclical effects. As evidence, he cited the December 2008 SEC report to Congress on mark-to-market accounting, which examined bank failures during 2008. Mr. Herz indicated that the report "concluded that, contrary to the assertions of some parties, the credit crisis in the U.S. did not result from fair value accounting but, rather, from growing (and often masked) credit losses, asset quality problems, and eroding investor and lender confidence." He concluded that "while the use of fair value in reporting can have procyclical effects on behavior, timely recognition of problems at financial institutions can have countercyclical effects through lessening the impact of financial downturns by providing an early warning of developing problems."

Mr. Herz recommended that instead of relaxing, eliminating, or deferring accounting requirements or creating a regulatory body that would oversee the standard-setting process, bank regulators should have "the authority and appropriate flexibility they need to effectively regulate the banking system." He further stated:

> [I]n instances in which the needs of regulators deviate from the informational requirements of investors, the reporting to investors should not be subordinated to the needs of regulators. To do so could degrade the financial information available to investors and reduce public trust and confidence in the capital markets.

Editor's Note: In his speech at the conference, IASB Member James J. Leisenring discussed the criticisms of fair value accounting raised by regulators during the credit crisis, noting that regulators' objectives are different from financial reporting objectives. He stressed that because regulators are concerned chiefly with the safety and soundness of the financial system, they should have access to the information they need to meet their objectives and should not try to manipulate accounting standards, as doing so would undermine the credibility of financial reporting and could ultimately prolong an economic downturn.

On the subject of the FASB's ongoing financial instruments project, Chairman Herz acknowledged that fair value measurement is "a very controversial subject on which informed and reasonable people disagree." According to Mr. Herz, while most people "agree that fair value is a more relevant measure than historical cost for financial instruments" that are classified as trading or held for sale, many disagree that it is the most relevant measure for "financial instruments that are being held for investment or collection of contractual cash flows."

Accordingly, in its financial instruments project, the FASB is seeking ways to "bridge the divide." The FASB's current decisions would require an entity to account for trading assets and liabilities, derivatives, and equity securities at fair value, with changes in fair value included in net income. However, for portfolios of loans and debt securities for which the business model and the characteristics of the instruments indicate that the entity will realize most of the value from cash collection, the FASB's current decisions would require presentation of both amortized cost and fair value on the balance sheet, with changes in fair value included in other comprehensive income rather than earnings. Mr. Herz stated that this model not only might better inform banking regulators about the fair value of financial instruments but also would provide them with the information they need to continue to compute regulatory capital in the same way they do today.

Editor's Note: For more information about the FASB's and IASB's financial instruments project, see Deloitte's October 27, 2009, *Heads Up*.

GASB Funding

Mr. Kroeker discussed the GASB, noting that governmental accounting standards are of "significant importance to the U.S. capital markets . . . and to the credibility of the accounting profession." However, he added that funding for the GASB has been a challenge and that "a more independent and stable source of funding for the GASB" is an important objective. He also emphasized the need to "strengthen the requirements for the use of GASB standards on a more comprehensive basis."

Internal Control Over Financial Reporting

Speakers	Topics Covered
• Doug Besch, Professional Accounting Fellow, SEC's Office of the Chief Accountant • Paul A. Beswick, Deputy Chief Accountant for Professional Practice, SEC's Office of the Chief Accountant • Cynthia M. Fornelli, Executive Director, Center for Audit Quality (CAQ) • Steven C. Jacobs, Associate Chief Accountant, SEC's Division of Corporation Finance	• Exemption of nonaccelerated filers from compliance with Section 404(b) of the Sarbanes-Oxley Act of 2002 • Trends in reported material weaknesses • Evaluating the design and operation of controls • Inclusion of consolidated VIEs in management's reports on ICFR • Required disclosures about material changes in ICFR

Exemption of Nonaccelerated Filers From Compliance With Section 404(b) of the Sarbanes-Oxley Act of 2002

Ms. Fornelli discussed proposed amendments to the Investor Protection Act presented to Congress in October 2009 that would permanently exempt nonaccelerated filers from complying with Section 404(b) of the Sarbanes-Oxley Act of 2002 (SOX). She noted that SOX has "provided significant benefits to investors, companies, and the capital markets" and has "helped restore investor confidence." Ms. Fornelli also stated that regulators have taken steps to lower overall compliance costs for companies of all sizes and cited a study conducted by the SEC that indicated costs have decreased by almost one-third since 2007. She also indicated that she was troubled that key elements of a law that were deemed essential are now seen as disposable and concluded her remarks by stating that "SOX has been a public success story" and "should be preserved for all investors' sake, not just those in large public companies."

Editor's Note: In a separate question-and-answer session, Mr. Beswick stated that the decision of whether to permanently exempt nonaccelerated filers from complying with Section 404(b) is in the hands of Congress. He noted, however, that the SEC's cost study found that as registrants became more experienced with Section 404, costs were going down in a "statistically significant way."

Editor's Note: On December 11, 2009, the House, in a vote of 223 to 202, passed the Wall Street Reform and Consumer Protection Act of 2009, a broad financial regulatory reform bill that includes an exemption for nonaccelerated filers from complying with Section 404(b). The Senate is expected to take action on its financial reform bill in early 2010; at this point, it is not clear whether the Senate version of the legislation will include a similar provision related to Section 404(b). The House and Senate must approve a final version of the financial reform legislation before it becomes law; the legislation must also be signed by President Obama.

Trends in Reported Material Weaknesses

Mr. Besch cited some statistics indicating that the percentage of registrants reporting material weaknesses has declined in each of the past five years (from 16 percent in 2004 to 4 percent in 2009 (through September 30, 2009)), "despite what has arguably been one of the most challenging financial reporting environments of recent times." He noted that this decrease may have occurred because registrants have addressed previously reported material weaknesses and have continued to strengthen their ICFR. However, he also expressed concerns that the trend could indicate that material weaknesses exist but are not being identified and reported. He referred to the October report of the Senior Supervisors Group to the Financial Stability Board, which identified various control deficiencies that appear to be related to ICFR, and reiterated his skepticism that all material weaknesses were being reported by noting that "only three [of the 101] U.S. financial institution registrants with assets in excess of $50 billion reported ineffective ICFR in 2008."

Mr. Besch also noted that the percentage of material weaknesses reported in conjunction with material adjustments has increased for each of the past five years (from 55 percent in 2004 to 75 percent in 2009 (through September 30, 2009)). He suggested that one possible reason for this trend is that "registrants and auditors may not conclude deficiencies in ICFR are material weaknesses unless they identify material adjustments." That is, the reported existence of material weaknesses could be a lagging, rather than a leading, indicator of ineffective ICFR. Mr. Besch noted that if his suggestion is true, unidentified material weaknesses could have existed in prior periods or may exist currently and previously identified deficiencies may not have been appropriately evaluated for severity. He also questioned whether material weaknesses in monitoring and risk assessment should have been reported, notwithstanding the absense of material adjustments or a financial statement restatement to correct material errors. Mr. Besch concluded his remarks by suggesting that the trend in reported material weaknesses may indicate that entities could focus more on assessing "what could go wrong" when evaluating the design of controls.

Editor's Note: For additional discussion of the link between material adjustments to the financial statements and material weaknesses and the evaluation of deficiencies, see the speech by Josh Jones (who at the time was a professional accounting fellow in the SEC's Office of the Chief Accountant) at the 2007 Conference. In that speech, Mr. Jones also commented on the evaluation of the design of ICFR.

Evaluating the Design and Operation of Controls

Mr. Besch discussed the responsibility of registrants and auditors to assess the impact of changes in accounting requirements on ICFR. He cited the recent modifications in accounting requirements for business combinations and multiple-deliverable revenue arrangements as two especially important examples of such changes. Mr. Besch also gave examples of questions that registrants and auditors might contemplate when evaluating the impact of these accounting changes on the effectiveness of the design of internal controls.

In response to a question about the impact of the current economic environment on the effectiveness of ICFR, Mr. Besch discussed fair value measurements and the struggles registrants and auditors may face in understanding the assumptions or models used to value certain complex products, especially when registrants use quotes from a broker-dealer or outside pricing service. Mr. Besch reminded registrants and their auditors that "registrants have responsibility for maintaining effective [ICFR] and to the extent that registrants are unable to provide their auditors with sufficient information about the underlying assumptions and models that underlie the valuations that they record in their financial statements, they likely have a deficiency in [ICFR]" that both the registrant and its auditor would need to evaluate to determine whether a material weakness exists.

Editor's Note: PCAOB Chief Auditor Martin F. Baumann also discussed the challenges associated with determining and auditing fair value measurements in illiquid markets, emphasizing that both management and auditors need appropriate information to support their judgments. The PCAOB also has a standard-setting project for auditing estimates, including the use of specialists. For more information, see the summary of Mr. Baumann's remarks on the PCAOB's standard-setting update.

Editor's Note: Mr. Besch referred to a speech at the 2008 Conference by Marc Panucci (who at the time was associate chief accountant in the SEC's Office of the Chief Accountant), which also addressed challenging market conditions that could have an impact on ICFR.

Mr. Beswick also discussed the evaluation of the design of ICFR when he was asked to comment on distinguishing between key controls and nonkey controls. Mr. Beswick stated that instead of focusing on identifying key controls and nonkey controls, companies should "focus on controls that mitigate the risk of material misstatements." He noted that it is up to the registrant, as well as its auditor, on a separate basis, to determine the right mix of controls on the basis of the registrant's circumstances.

Inclusion of Consolidated VIEs in Management's Reports on ICFR

Mr. Besch discussed the impact of a registrant's consolidation of VIEs upon adopting Statement 167 on management's report on ICFR. He noted that the SEC's September 2007 *Management's Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports — Frequently Asked Questions* (the "staff's FAQs") addresses situations in which registrants could potentially exclude certain VIEs from management's reports on ICFR. However, Mr. Besch stated that, with one exception, registrants will be expected to include VIEs consolidated upon adoption of Statement 167 in management's reports on ICFR, since the staff believes that registrants "will likely have the right or authority to assess the internal controls of the consolidated entity, and since the consolidation will occur as of the first day of the fiscal year, registrants will have sufficient time to perform that assessment." The exception in the staff's FAQs, which he noted that the staff expects to "rarely occur," relates to consolidated VIEs that were in existence before December 15, 2003, and for which registrants, despite having control, do not possess the right or authority, and also lack the ability, to assess the internal controls.

Editor's Note: The staff's FAQs are available on the SEC's Web site.

Required Disclosures About Material Changes in ICFR

Mr. Jacobs discussed disclosures about material changes in ICFR that registrants must include in quarterly filings on Form 10-Q and annual filings on Form 10-K in the case of the fourth quarter (under Regulation S-K, Item 308(c)), noting that such disclosures "are intended to alert investors to circumstances that may create risk through their effect on the registrant's internal control." He commented that despite the intent of Item 308, registrants frequently use boilerplate language stating that there were no material changes in ICFR in the period, when conclusions on the effectiveness of ICFR have changed or the company has disclosed an identifiable event that may indicate a change in ICFR (such as a layoff of employees or a change in an outsourcing arrangement). Mr. Jacobs reminded the audience that the remediation of a material weakness is a material change in ICFR that the SEC would expect to be disclosed. He also indicated that if a registrant changes its conclusion from ineffective to effective without ever disclosing a change in its ICFR, the SEC staff would most likely comment on a registrant's lack of disclosures in the quarterly filings as well as its conclusion about the effectiveness of ICFR. He also noted that if the registrant cannot identify specific changes made to its ICFR, the SEC staff may challenge its conclusion that the material weakness was, in fact, remediated.

Editor's Note: The identification of a material weakness is a material change in ICFR that a registrant should disclose. Question 7 of the staff's FAQs provides further guidance on Item 308(c)'s requirements to disclose material changes in ICFR on a quarterly and annual basis. The SEC's guidance on management's ICFR reports (Interpretive Release 33-8810) also includes guidance on what management should include in disclosures about material weaknesses and notes that while disclosure of the existence of a material weakness is important, a registrant may also need to disclose other material information to form an overall picture that is not misleading.

Editor's Note: Once a registrant has completed its first annual assessment of ICFR, its auditor is responsible, in accordance with PCAOB AU Section 722, for performing certain limited procedures relating to management's disclosures about material changes in ICFR. The purpose of performing these procedures is to determine whether the auditor has become aware of any material modifications that, in the auditor's judgment, should be made to the disclosures for the registrant's certifications about ICFR to be accurate and to comply with the requirements of Section 302 of the Sarbanes-Oxley Act. The auditor performs these procedures as part of its review of the registrant's interim financial information.

International Accounting and Reporting

Speakers	Topics Covered
• Wayne E. Carnall, Chief Accountant, SEC's Division of Corporation Finance • Patrick Finnegan, Member, IASB • James L. Kroeker, Chief Accountant, SEC's Office of the Chief Accountant • James J. Leisenring, Member, IASB • Craig C. Olinger, Deputy Chief Accountant, SEC's Division of Corporation Finance • Elisse B. Walter, Commissioner, SEC	• Convergence of accounting standards • IFRS implementation issues • Updating registration statements with interim financial statements • Use of domestic forms by foreign incorporated issuers • IFRSs for small and medium-size entities • Combined financial statements under IFRSs • International Financial Reporting Standard 9

Convergence of Accounting Standards

Commissioner Walter remarked that a single set of high-quality global accounting standards continues to be recognized by the SEC "as an important objective and is a priority." The FASB and IASB have focused their recent efforts on addressing "important issues raised by the financial crisis" and are continuing to work toward convergence of U.S. GAAP and IFRSs.

Ms. Walter indicated that the offices of the Chief Accountant and the Division of Corporation Finance have been working to evaluate the more than 200 letters received on the proposed IFRS roadmap. She noted that most of the comments questioned the "workability of various aspects of the proposed approach." While respondents generally agreed on the need to move toward global convergence, there were a number of strongly held, diverse views regarding "the best plan" for achieving a global set of standards. In Mr. Kroeker's discussion, he indicated that the SEC still has to address and evaluate, at a minimum, the following areas:

- U.S. investor understanding of and perspectives on IFRS;
- The development and application of IFRS for use as the single set of globally accepted accounting standards for U.S. issuers;
- The impact on the U.S. regulatory environment;
- Preparer considerations, including, among other matters, changes to accounting systems, changes to contractual agreements, corporate governance considerations, and litigation contingencies;
- Human capital readiness; and
- The role of the FASB in achieving the goal of a single global standard.

Commissioner Walter emphasized that the SEC will move forward with "incorporating IFRS into the U.S. capital markets if, and only if, it is the right thing to do for U.S. investors." She indicated that the SEC "will likely consider further action [on the proposed roadmap] sometime in early 2010."

In moving toward global convergence, an important consideration for the SEC is the strength of the IASB's governance structure. In comments on the proposed IFRS roadmap, respondents expressed significant concerns about whether there would be a continuing role for the FASB under just one set of global accounting standards. Commissioner Walter emphasized that she is "eager to explore the continuing role of FASB in the event global standards are adopted."

Editor's Note: For additional information on the SEC's proposed roadmap, see Deloitte's November 17, 2008, *Heads Up*.

Mr. Kroeker indicated that irrespective of the future of a single set of high-quality global accounting standards, the FASB and the IASB should work together to "raise the quality of financial reporting standards in the U.S. and around the globe." He added that because investor protection is critical, accounting standards "must be designed to foster [the] public trust" rather than "attempt to compensate for today's banking crisis." Further, he stated that the process by which accounting standards are developed is as important as the standards themselves. He described the process as being independent (in both fact and appearance) and transparent and "one in which the standard setter seeks and considers input from all constituents openly, but also one in which the standard setter is then allowed to independently exercise its expert judgment." He offered his "unwavering support" for the independent standard-setting process.

Mr. Leisenring reaffirmed the commitment by the FASB and IASB to develop a single set of high-quality accounting standards. He noted that the achievement of this goal would require improvements to existing standards and a "start over" of other standards. He emphasized that for convergence to be successful, the FASB and IASB should focus on the major projects and not attempt to address every difference between U.S. GAAP and IFRSs.

Mr. Finnegan responded to concerns that the high costs of adopting IFRSs would negatively affect investors. He noted that it is currently costly for investors to understand different sets of accounting standards. A single set of high-quality accounting standards would increase comparability and reduce costs for investors over the long term.

Editor's Note: For information about the status of all current projects on the IASB's agenda, including projected timetables, meeting summaries, and tentative decisions, see the IASB's Web site.

For more information about the IASB's projects, see:

- Deloitte's November 17, 2009, *Heads Up*, "IASB Issues IFRS on Classification and Measurement of Financial Assets."
- Deloitte's November 10, 2009, *Heads Up*, "IASB Proposes New Approach to Accounting for Credit Losses."
- Deloitte's October 27, 2009, *Heads Up*, "Accounting for Financial Instruments May Never Be the Same Again — An Update on the FASB's and IASB's Joint Project on Financial Instruments."
- Deloitte's March 30, 2009, *Heads Up*, "FASB and IASB Issue Preliminary Views on Lease Accounting — Boards Propose to Eliminate Operating Leases."
- Deloitte's January 22, 2009, *Heads Up*, "IASB Issues an Exposure Draft on Consolidation."
- Deloitte's January 6, 2009, *Heads Up*, "FASB and IASB Issue Discussion Paper on Revenue Recognition."
- Deloitte's November 10, 2008, *Heads Up*, "FASB and IASB Issue Discussion Paper on Financial Statement Presentation."

IFRS Implementation Issues

Mr. Olinger gave an update on a number of IFRS implementation issues that have been resolved since the 2008 Conference. He discussed the information that the SEC staff expects when registrants have presented financial statements under more than one set of GAAP before their first-time adoption of IFRSs as issued by the IASB (e.g., in home-country GAAP in their local market and in U.S. GAAP in their SEC filings).

Editor's Note: For more information, see Section 6345.1 of the SEC Financial Reporting Manual (the "Manual").

He also updated participants on information the SEC staff expects in the period registrants begin using IFRSs, as issued by the IASB, in their SEC filings, when registrants have previously adopted IFRSs as issued by the IASB in presenting their financial statements in their local market but had continued to present financial statements in U.S. GAAP in their SEC filings.

Editor's Note: For more information, see Section 6345.2 of the Manual.

Updating Registration Statements With Interim Financial Statements

Mr. Olinger reminded participants that Item 8.A.5 of Form 20-F contains the requirement for a foreign private issuer to update a registration statement to include interim financial statements. He offered the following two examples to illustrate when including interim financial information in the registration statement would be considered a voluntary update and would also necessitate inclusion of MD&A and pro forma financial information (if applicable) for the interim period:

- Including more recent U.S. GAAP interim financial statements than required by Item 8.A.5 of Form 20-F, when those financial statements are consistent with Regulation S-X, Article 10.
- Including more recent home-country GAAP interim financial statements than required by Item 8.A.5 of Form 20-F, when those financial statements are consistent with Article 10, and include a U.S. GAAP reconciliation.

He explained that these requirements result from the staff's belief that when a registrant provides this type of U.S. GAAP information, it is targeting the U.S. market. Therefore, those interim financial statements result in a requirement for the registration statement to be updated with a complete presentation of interim information, including MD&A and pro forma financial information.

He noted that when a registrant files by using IFRSs as issued by the IASB and voluntarily provides, in a manner consistent with IAS 34, interim financial statements that are more recent than required by Item 8.A.5 of Form 20-F in a registration statement, the updating requirement is not triggered because the registrant is not necessarily targeting the U.S. market and may be publishing interim statements in its home market.

When a registrant voluntarily provides more recent interim financial statements than required by Item 8.A.5 of Form 20-F and those interim financial statements are consistent with either Article 10 or IAS 34 and reflect a change in accounting principle for which retrospective application is required or elected, a change in segments, or a discontinued operation, revised audited annual financial statements reflecting the retrospective adjustment would be required in a registration statement. This is because in such circumstances, the interim financial statements are no longer comparable to the annual financial statements.

Editor's Note: For more information, see Section 13100 of the Manual. Although this guidance is written for domestic issuers, it would also apply to foreign private issuers.

Mr. Olinger noted that measurement-period adjustments to a purchase price in a business combination under IFRS 3, like those under ASC 805 (formerly Statement 141(R)), are retrospectively applied. In a manner consistent with the staff's position for domestic issuers, if a registrant reporting under IFRSs has a material measurement-period adjustment after the issuance of its most recent annual financial statements, the registrant must include revised financial statements that reflect the retrospective adjustment in a new registration statement. This is the case even if interim financial information for the period in which the material measurement-period adjustment occurred has not been published.

Editor's Note: For more information about the SEC staff position for domestic issuers (which would also apply to foreign private issuers reporting in, or performing an Item 18 of Form 20-F reconciliation to, U.S. GAAP), see SEC Reporting — Regulation S-X.

Use of Domestic Forms by Foreign Incorporated Issuers

Mr. Olinger discussed the following points for foreign incorporated issuers that use domestic forms:

- If the registrant no longer meets the definition of a foreign private issuer, the financial statements and selected financial data should be recast into U.S. GAAP for all periods presented in the financial statements.

Editor's Note: There has been a long-standing informal staff accommodation for Canadian issuers that do not meet the definition of a foreign private issuer. This accommodation allows such issuers to report in Canadian GAAP, with a reconciliation to U.S. GAAP, while the issuer uses domestic forms. Beginning in fiscal year 2011, this accommodation will no longer be available. For more information, see Sections 6120.4 and 6120.5 of the Manual.

- Foreign private issuers that voluntarily file on domestic forms may file financial statements:
  - Prepared under home-country GAAP and provide a reconciliation to U.S. GAAP under Item 18 of Form 20-F.
  - Prepared under IFRS as issued by the IASB without reconciliation to U.S. GAAP.

In both cases, the filings should prominently disclose that the company meets the definition of a foreign private issuer but is voluntarily filing on domestic forms.

Editor's Note: For more information, see Section 6120.6 of the Manual.

IFRSs for Small and Medium-Size Entities

Mr. Olinger mentioned that the SEC staff is currently considering whether IFRSs for small and medium-size entities (SMEs) will be acceptable for nonissuers (e.g., when a registrant acquires a significant nonpublic entity and financial statements under Regulation S-X, Rule 3-05, are required). He indicated that no conclusion has been reached. He recommended that registrants contact the staff if they encounter this issue. He also noted that financial statements prepared under IFRSs for SMEs would not qualify for relief from the U.S. GAAP reconciliation requirement.

Combined Financial Statements Under IFRSs

Mr. Olinger indicated that there is uncertainty regarding the appropriateness of combined financial statements (for commonly controlled entities) under IFRSs as issued by the IASB. While the IASB currently has a project on its agenda that addresses this issue, he recommended that registrants contact the staff if they encounter this issue.

International Financial Reporting Standard 9

Mr. Leisenring discussed the recent issuance of IFRS 9 and noted that it is not effective until 2013. Although the standard can be adopted early, he warned that IFRS 9 may be subject to future amendments as the IASB works with the FASB on a converged standard. He believes that there will be significant differences between the FASB's final standard and IFRS 9 that the IASB will need to address.

Editor's Note: IFRS 9 significantly overhauls the accounting requirements for financial instruments under IAS 39 by replacing the existing classification and measurement requirements for financial assets. IFRS 9 is mandatory for annual periods beginning on or after January 1, 2013, with early application permitted. For more information about the IASB's financial instruments project, see Deloitte's November 17, 2009, *Heads Up*, which summarizes the key provisions of IFRS 9.

In addition, the IASB recently issued an exposure draft, *Financial Instruments: Amortised Cost and Impairment*. For more information about the IASB's proposed new approach to accounting for credit losses, see Deloitte's November 10, 2009, *Heads Up*.

Also see the FASB's Web site and Deloitte's October 27, 2009, *Heads Up* for additional information on the project.

Non-GAAP Measures

Speakers	Topic Covered
• Meredith Cross, Director, SEC's Division of Corporation Finance • Jason S. Flemmons, Associate Chief Accountant, SEC's Division of Enforcement • Mark Kronforst, Deputy Chief Accountant (Regulatory Policy), SEC's Division of Corporation Finance • Craig C. Olinger, Deputy Chief Accountant, SEC's Division of Corporation Finance	• Non-GAAP measures

Non-GAAP Measures

Ms. Cross indicated that in keeping with the SEC staff's focus on enhancing disclosure requirements for the benefit of investors, the staff is conducting a review of the current interpretations of non-GAAP measures. The purpose of the review is to ensure that the interpretations are not being read "in a fashion that causes companies to keep key information out of their filings which they are otherwise using to tell investors their story [through communications such as earnings calls and press releases] and which they believe is the most meaningful indicator of how they are doing." The staff has noted an inconsistency between (1) the focus of information on company Web sites, earnings releases, and presentations to

analysts and (2) disclosures in their filings. Ms. Cross also noted that registrants may be omitting non-GAAP measures from their filings because of concerns about future SEC staff comments. However, she explained that she is not suggesting that companies throw caution to the wind and go back to some of the practices that existed before Regulation G was issued and that "led to the crackdown on non-GAAP measures."

Mr. Kronforst indicated that registrants may be omitting some of their key performance measures because of some of the SEC staff guidance. The staff plans to revise the guidance before year-end so that it can be considered in annual filings of calendar-year-end companies and in press releases. The new guidance will be issued as Compliance and Disclosure Interpretations, and the SEC Financial Reporting Manual section on non-GAAP measures will be updated.

Mr. Kronforst indicated that the focus of changes would be to revise guidance in the SEC's Frequently Asked Questions Regarding the Use of Non-GAAP Financial Measures ("FAQ").

Although Mr. Kronforst indicated that changes may be made to the answers to other questions in the FAQ as well, he and Mr. Olinger highlighted three that may be revised: FAQs 8, 9, and 28. Mr. Kronforst noted that FAQs 8 and 9 address the use of adjustments for charges in arriving at non-GAAP measures. The answers to both questions indicate that registrants must meet the burden of demonstrating the usefulness of any measure that excludes recurring items. Further, the answer to FAQ 8 outlines disclosures required when registrants include such recurring items as adjustments. Mr. Kronforst also indicated that the staff was carefully examining the language in the answer to these questions.

Mr. Olinger discussed revisions to FAQ 28, which addresses the application of non-GAAP rules to foreign private issuers and indicates that measures that are required or expressly permitted by standard setters will not be prohibited under the non-GAAP rules. The FAQ currently defines "expressly permitted" as being specifically identified by a standard setter as an acceptable measure. In practice, few measures meet the definition of expressly permitted, although the measures may be "de facto require[d]" or permitted by a home country regulator. The staff is considering revising FAQ 28 to address this issue.

Note that Mr. Kronforst indicated that the new guidance will stress that the disclosures related to non-GAAP measures needs to continue to include explanations that are clear, understandable, and specific to the registrant and its industry.

Mr. Flemmons discussed an enforcement action involving misleading pro forma reporting of non-GAAP financial measures. He cautioned against manipulating financial metrics to trick investors "into believing that a downturn in GAAP earnings is temporary and not attributable to [an entity's] core operations" (e.g., by excluding ordinary, recurring operating expenses from reported non-GAAP earnings under the pretense that these costs were unusual or nonrecurring).

Editor's Note: In a question-and-answer session, Wayne Carnall, chief accountant in the SEC's Division of Corporation Finance, addressed the staff's planned changes to its guidance and the enforcement proceeding and noted that the planned changes are not inconsistent. He explained that the purpose of the changes is to allow entities to communicate information they feel is important to investors. This information should not be misleading and "[the SEC staff] will never advocate the communication of fraudulent information in any form of communication to the public."

Revenue Recognition

Speakers	Topics Covered
• Joshua S. Forgione, Associate Chief Accountant, SEC's Office of the Chief Accountant • Arie S. Wilgenburg, Professional Accounting Fellow, SEC's Office of the Chief Accountant	• Stand-alone value in multiple-element arrangements • Bill-and-hold arrangements

Stand-Alone Value in Multiple-Element Arrangements

Mr. Wilgenburg discussed the recently issued ASU 2009-13 (formerly EITF Issue 08-1), which provides guidance on multiple-deliverable arrangements. He focused on the analysis of whether a delivered item has stand-alone value to a customer, explaining that this criterion is important to the determination of whether a revenue arrangement involving multiple deliverables contains more than one unit of accounting. He indicated that a "deliverable has value on a standalone basis (a) if it is sold separately by any vendor or (b) the customer could resell the delivered item on a standalone basis."

To illustrate the concept of stand-alone value to a customer, Mr. Wilgenburg described an example in which a company sells (1) a biotech license on a unique technology (i.e., no other vendor sells a similar item) that will be used in the development of a new drug and (2) ongoing proprietary research and development services that are "essential in order to derive value from the technology." The company never sells the technology without the R&D services. In addition, the customer is not permitted to sublicense or resell the technology.

Mr. Wilgenburg noted that because the license in this example does not have stand-alone value, "the license should be combined with the R&D services as a single unit of accounting." He indicated that if the example were modified so that the R&D services can be provided by other vendors, the license might have stand-alone value.

Mr. Wilgenburg concluded his remarks on this topic by stating that "the analysis of standalone value must be based on the individual facts and circumstances for each arrangement."

Editor's Note: Also at the conference, a revenue recognition panel of industry experts discussed ASUs 2009-13 and 2009-14 (formerly EITF Issue 09-3). More specifically, the panel offered its perspectives on potential transition and implementation challenges that may arise as entities adopt these ASUs. For more information about application of ASU 2009-13 and the related transition and implementation challenges, see Deloitte's October 1, 2009, *Heads Up* and Financial Reporting Alert 09-6. For more information about application of ASU 2009-14 and the related transition and implementation challenges, see Deloitte's October 23, 2009, *Heads Up*.

Bill-and-Hold Arrangements

SAB Topic 13 outlines seven criteria that must be met for revenue to be recognized in a bill-and-hold arrangement (i.e., when delivery has not occurred). Mr. Forgione focused on the following two of the seven criteria and provided some insight on how the staff has evaluated them in bill-and-hold arrangements:

- The "seller must not have retained any specific performance obligation such that the earnings process is not complete"
- The "equipment or product must be complete and ready for shipment"

Mr. Forgione described an example in which (1) a customer has committed to a purchase but has requested that the vendor store the product and (2) the vendor holds the goods in an unfinished state because (a) doing so is less costly and (b) the final processing of the product is usually performed just before shipment. In this situation, the vendor concluded that it met most of the SAB Topic 13 criteria, but because the vendor retained certain performance obligations, the product was not in its final form for delivery as specified and requested by the customer. The staff believes that it would generally be inappropriate to conclude that the effort required to complete the product before delivery would be inconsequential or perfunctory when the product has not been delivered to the customer and additional processing is necessary to complete the product before shipment (i.e., inconsequential and perfunctory concepts apply to postdelivery performance obligations not predelivery performance obligations).

The staff also considered questions about the interaction of these criteria in a bill-and-hold arrangement that is part of a multiple-element arrangement. These questions have arisen in light of the FASB's Accounting Standards Update (ASU 2009-13) of ASC 605, which reflects the consensus reached by the EITF on multiple-element arrangements. Mr. Forgione noted that some might believe that an incomplete product could be considered a unit of account that is separate from the service a vendor is required to perform to complete the product before shipment in a bill-and-hold arrangement. However, as noted above, Mr. Forgione stated that "to qualify for revenue recognition on a bill-and-hold basis, the product held must be in the form that the customer will receive upon delivery."

Editor's Note: Patrick Finnegan, member, IASB, also provided an update on the FASB's and IASB's revenue recognition project. See FASB Project Update for more information. Also see Deloitte's October 1, 2009, *Heads Up* on the consensus reached by the EITF on multiple-element arrangements.

SEC Communications

Speakers	Topics Covered
• Wayne E. Carnall, Chief Accountant, SEC's Division of Corporation Finance • Angela Crane, Associate Chief Accountant, SEC's Division of Corporation Finance • Jill Davis, Associate Chief Accountant, SEC's Division of Corporation Finance	• Financial Reporting Manual • Compliance and Disclosure Interpretations • Areas of frequent staff comment — financial institutions • Guidance for smaller issuers • Eliminating old guidance from the SEC's Web site

Financial Reporting Manual

Mr. Carnall indicated that the SEC staff achieved its 2009 goal of updating the Financial Reporting Manual (the "Manual") quarterly. The most recent revision was released in December 2009 and included updates as of September 30, 2009.

Editor's Note: The Manual is intended for use by the SEC staff, but provides useful insights about SEC reporting matters for registrants. The SEC staff intends to update the Manual periodically. Changes will be posted in the "What's New" section of its Web site and the date of the last update will be indicated in each section of the Manual.

Ms. Crane highlighted the following current-year updates to the Manual:

- Content was added on the final rule on foreign issuer reporting enhancements.
- Topic 4, "Independent Accountants Involvement," was added.
- Guidance was clarified on retrospective revisions of financial statements (i.e., changes in accounting principles, segments, and discontinued operations).
- The SEC staff revised its views on accounting for shares placed in escrow in conjunction with financing transactions.
- The SEC staff revised its views on registration of auditors in an initial public offering.
- The new FASB Codification references were included.
- An index was added.

Ms. Crane explained that the SEC staff uses the following sources to update the Manual: (1) comments issued during the filing review process and input from the Division staff, (2) new accounting standards or regulations, and (3) meetings of the Center for Audit Quality's (CAQ's) SEC Regulations Committee. She also encouraged accounting firms and law firms to contact the SEC staff if they see something in the Manual that needs to be revised or clarified.

Ms. Davis indicated that the SEC staff has shared its views on emerging financial reporting issues with the SEC Regulations Committee for over 25 years, but not all of the views have been incorporated into the Manual. She noted that the SEC staff plans to review the minutes from those meetings as well as past meetings of the CAQ's International Practices Task Force to determine whether any topics need to be added to the Manual. Ms. Davis noted that "the most important take away here is that all these topics will be centralized in the [Manual] so they are all in one location so that will be easy for investors to locate."

Compliance and Disclosure Interpretations

The SEC's Compliance and Disclosure Interpretations also reflect the staff's views. They were initially published in July of 2008 and replaced the 1997 and 1999 SEC staff "Telephone Interpretations" and the November 2000 "Current Issues and Rulemaking Project Outline." The interpretations are not rules, regulations, or statements of the SEC, but rather general guidance that should not be relied on as authoritative. Ms. Crane indicated that they represent a joint effort of the Division's Office of Chief Counsel and Office of the Chief Accountant.

Editor's Note: The Compliance and Disclosure Interpretations contain useful information for attorneys as well as accountants.

Areas of Frequent Staff Comment — Financial Institutions

Mr. Carnall announced that the SEC staff has posted to its Web site a presentation on Areas of Frequent Staff Comment — Financial Institutions. The objective of this guidance is to provide an overview of issues that the SEC staff frequently encounters when reviewing filings of small community banks. Other financial institutions, however, may find some of this information useful as well. The guidance highlights the following areas of frequent SEC staff comment:

- Allowance for loan losses.
- Troubled debt restructurings.
- Other real estate owned.
- Purchased loans.
- U.S. Treasury mortgage modification programs.
- Securities impairment.
- Goodwill impairment.
- Deferred tax asset valuation.
- Fair value disclosures.
- Troubled Asset Relief Program transactions.
- Regulatory actions or recommendations.
- FDIC assisted transactions.

Guidance for Smaller Issuers

Mr. Carnall noted that the SEC staff has participated in the Forums on Auditing in the Small Business Environment hosted by the PCAOB. Through this program, the SEC staff conducts seminars for auditors from smaller registered public accounting firms and directors and financial executives of smaller public companies.

Editor's Note: Last year's Forum presentation, SEC Staff Review of Common Financial Reporting Issues Facing Smaller Issuers, is available (with detailed speaker notes) on the SEC's Web site. Although the title refers to "smaller issuers," larger companies may also find it useful. This year's Forum presentation is expected to be published shortly and will also be available on the SEC's Web site.

Eliminating Old Guidance From the SEC's Web Site

Mr. Carnall indicated that one of the Division's goals for the upcoming year is to eliminate certain information on its Web site that is old and outdated. He warned constituents to be careful about relying on such information.

SEC Initiatives on Core Disclosures and Financial Reporting Simplicity

Speakers	Topics Covered
• Wayne E. Carnall, Chief Accountant, SEC's Division of Corporation Finance • Meredith Cross, Director, SEC's Division of Corporation Finance • Steven C. Jacobs, Associate Chief Accountant, SEC's Division of Corporation Finance	• Core disclosure project • Disclosure of the impact of recently issued accounting standards (SAB Topic 11.M)

Core Disclosure Project

In October of this year the SEC published its draft Strategic Plan, which outlines the Commission's strategic initiatives for 2010 through 2015. One goal of this plan is to ensure investors have access to high-quality information that is useful in making investment decisions. The plan also includes the core disclosure project, which will comprise a comprehensive review of the SEC's current disclosure requirements, with the goal of modernizing disclosures and eliminating redundancy. The importance of the core disclosure project and attaining simplification and consistency in communications with investors

in the upcoming reporting season was a theme heard throughout the conference. Ms. Cross stated that the focus is on obtaining "the right disclosure, not more disclosure" and that it "imposes a huge burden on investors to wade through [disclosure] to see what's important. It's also a waste of time and money to prepare that type of disclosure."

Ms. Cross identified the risk factors section required by Regulation S-K, Item 503, as an example of a substantive disclosure requirement ripe for modification. She noted she would "like to . . . get away from mind-numbing risk factors disclosures." She also pointed to the listing of properties owned or leased by a registrant (required by Regulation S-K, Item 102) and questioned whether this information is meaningful to an investor. Critical accounting policy disclosure will also be reconsidered as part of the project.

Risk disclosures are also being considered under the core disclosure project. Ms. Cross envisions an overarching risk analysis that pulls from disclosures currently found in MD&A; quantitative and qualitative market risk disclosures required by Regulation S-K, Item 305; risk factor items; and corporate governance disclosures. This would be a focused discussion of the primary risks facing a company and how those risks are addressed, including how the company manages risk at the enterprise level and how the board monitors this risk management.

Editor's Note: Mr. Carnall clarified that the staff was considering rule making as part of the core disclosure project to not only modify existing rules on risk factors and market risk but to add a new section that would require a broad-based discussion of risk.

Another goal of the core disclosure project is simplification. Mr. Carnall encouraged companies to write their disclosures with the investor in mind, not the SEC staff, by viewing the periodic report (Forms 10-K or 10-Q) as "a communication document, not a compliance document." For example, Mr. Carnall believes that accounting codification references are not informative to investors, and stated that "[w]hat we would rather see [is that] you explain the accounting concept, not the particular [ASC] reference number." Mr. Carnall indicated that the SEC staff will continue to review registrants' Web sites to ensure that information that is presented on the Web site delivers a message that is consistent with information disclosed in the registrants' filings with the SEC. The staff will also listen to analyst calls.

Editor's Note: A specific example cited by Mr. Carnall noted situations in which the registrant's key performance indicators discussed on the registrant's Web site were different from the key performance indicators disclosed in the registrant's Form 10-K. The SEC is contemplating issuing guidance encouraging consistency in these disclosures. See Non-GAAP Measures for additional information.

Disclosure of the Impact of Recently Issued Accounting Standards (SAB Topic 11.M)

Disclosure of the effect of recent accounting pronouncements should be considered in both MD&A and the footnotes to the financial statements. SAB Topic 11.M requires disclosure of (1) what management knows or (2) the reasonably estimable impact that adoption of the standard is expected to have. Mr. Carnall indicated disclosure could be in the form of a range or directional trend if the actual impact is not known.

Editor's Note: Mr. Carnall clarified that when a registrant adopts a new accounting standard that will not affect the reported results (i.e., it requires enhanced disclosures), SAB Topic 11.M disclosure is not required.

Mr. Jacobs noted that SAB Topic 11.M disclosure often comprises a "laundry list of new standards" that will have no material impact on the financial statements upon adoption, and he reminded registrants to focus on the purpose of the disclosure. Regarding the disclosure provided in the financial statements, Mr. Jacobs recommended that companies focus on the accounting change, how it will be adopted, and, in the case of a retrospective adoption, consider how the financial statements presented might be different the next time they are issued. In the context of MD&A, Mr. Jacobs urged registrants to consider the effect of adoption on the operations, financial condition, or liquidity of the registrant in future periods. The discussion in MD&A may cover the impact on debt covenants or changes in business practices and could consider both qualitative and quantitative factors.

Editor's Note: Refer to slide 26 in the "Current Developments in the Division of Corporation Finance" presentation, available on the SEC's Web site, regarding SAB Topic 11.M and the different focus in MD&A and financial statements.

Mr. Jacobs suggested that disclosure may be necessary when a standard has been issued, even if it will not have a material effect on the financial statements. This would be the case when a user could reasonably believe that the adoption could have a material impact. He described a situation in which an entity has a variable interest in a variable interest entity (which is evident from the disclosure) but the entity's adoption of Statement 167 will not have a material impact on future filings because the adoption does not change the primary beneficiary determination. Because the investor is aware of the existence of a variable interest entity, the fact that there will be no impact on the financial statements upon adoption of Statement 167 may be meaningful disclosure.

SEC Reporting — Other Topics

Speakers	Topics Covered
• Wayne E. Carnall, Chief Accountant, SEC's Division of Corporation Finance • Meredith Cross, Director, SEC's Division of Corporation Finance • Brian J. Lane, Partner, Gibson, Dunn & Crutcher LLP	• Division of Corporation Finance projects and goals • Other MD&A considerations

Division of Corporation Finance Projects and Goals

Ms. Cross gave an overview of several activities and ongoing projects taking place in the Division of Corporation Finance (the "Division").

Editor's Note: In addition to the goals below, Ms. Cross discussed two other goals that are covered in SEC Initiatives on Core Disclosures and Financial Reporting Simplicity and Non-GAAP Measures.

She also addressed the following four Division goals:

- Satisfy the mandate established by the Sarbanes-Oxley Act of 2002 to review every issuer's disclosures at least once every three years by providing high-quality reviews that "add value to the disclosure landscape."
- Prepare for changes in rules and guidance addressing disclosures regarding governance matters and ensure that the proxy voting system is serving participants well.
- Adjust rules and disclosure requirements to address shortcomings highlighted by the financial crisis.
- Review disclosure requirements and internal processes to ensure that the Division is "well-positioned for the future."

Ms. Cross indicated that the new Division of Risk, Strategy, and Financial Innovation ("Risk-Fin") will be working with the Division to consider any potential revisions to the risk-based selective review program and the screening criteria used by the SEC staff to select filings for review.

Editor's Note: According to the SEC's Web site, Risk-Fin was established in September 2009 "to help [further] identify developing risks and trends in the financial markets."

With respect to the staff's goal regarding corporate governance matters and disclosures in proxy statements, Ms. Cross highlighted the following items related to the proxy process that either have been recently proposed or are expected in the near future:

- Proposed rule on proxy access.
- Proposed rules regarding proxy disclosure enhancements, including improvements to executive compensation disclosures. Ms. Cross is "hopeful that we can have these rules applied to the upcoming proxy season." (For more information on the proposals, see Deloitte's July 2009 Hot Topics newsletter.)

Editor's Note: The SEC finalized these proposals, with certain modifications, at an open meeting on December 16, 2009.

- A concept release on proxy vote tabulation that is expected in the near term.
- Proposed rules regarding Internet availability of proxy materials.

Regarding the goal of considering potential rule changes to address the shortcomings highlighted by the financial crisis, Ms. Cross discussed (1) the recently issued proposed rules and concept release relating to credit rating agencies, (2) strengthening the rules related to asset-backed issuers, and (3) a new Novel Securities Task Force. The task force, comprising lawyers, accountants, and others, will provide issuers, investment bankers, etc., with quick and effective resolutions for issues relating to new types of securities being offered to investors. The SEC staff plans to post the protocol for submitting issues to the task force on its Web site in the near future.

Mr. Carnall also shared his goals for the future. He indicated that he would like to take a look at the following reporting requirements and consider ways to improve disclosure:

- *Item 11(b) of Form S-3* — Item 11(b) of Form S-3 requires "restated financial statements prepared in accordance with Regulation S-X if there has been a change in accounting principles or a correction in an error where such change or correction requires a material retroactive restatement of financial statements." Mr. Carnall expressed some concerns about the potential delays that this requirement may cause for registrants trying to access the markets. He noted that the SEC staff "want[s] to see if there are other possible alternatives" to filing audited restated financial statements.
- *Rule 3-05* — When a registrant acquires, or it is probable that it will acquire, a significant business, the SEC staff may require the filing of certain financial statements. Mr. Carnall emphasized that the rules are complex and wants to ensure that the information provided is the "most useful" and is provided "when need[ed]."
- *Rules 3-09 and 4-08(g)* — When a registrant has a significant equity method investment, the registrant may be required to provide separate financial statements of the investee, summarized financial information of the investee, or both. Mr. Carnall expressed concerns about the "lack of correlation" between the financial statements required under Rule 3-09 and the financial statements of the registrant (if, for example, the registrant and the equity investee have different fiscal year-ends, follow different bases of accounting, or both). Mr. Carnall further indicated that the SEC staff is considering expanding the Rule 4-08(g) disclosure requirements to ensure that financial statement users are better able to evaluate significant equity investees.

Continuing with the discussion, Mr. Carnall described the following additional goals:

- Eliminate old guidance from the SEC's Web site.
- Update the SEC Financial Reporting Manual (the "Manual") on a quarterly basis.
- Provide guidance on routine reporting matters when certain criteria are met.
- Maintain and update guidance for smaller community banks.
- Update Form 8-K requirements, primarily for changes in auditors.

Editor's Note: For more information about updates to the Manual and about eliminating old guidance on the SEC's Web site, see SEC Communications.

Other MD&A Considerations

Mr. Lane outlined the following tips for registrants to consider when preparing MD&A:

- Use plain English and avoid the use of legal jargon.
- Provide an effective executive summary to highlight material events and changes in the current period.
- Provide better analysis. Registrants can do so by adding a "why" at the end of each sentence in MD&A as initially drafted and adding information to address those questions.
- Quantify the effect of multiple factors that contribute to the overall change in a financial statement line item.
- Consider disclosures related to the Troubled Asset Relief Program and the program's impact on the company's operations.

Mr. Carnall emphasized the importance of the liquidity section. He encouraged registrants to read the remarks of Michael J. Fay, associate chief accountant in the SEC's Division of Corporation Finance, at the 2008 Conference. In his remarks, Mr. Fay discussed the importance of the liquidity section and provided observations and considerations for registrants.

Mr. Carnall also encouraged large multinational companies with significant operations outside the United States to disclose the impact of fluctuations in the reporting currency and the impact that foreign-currency fluctuations have on the underlying businesses.

SEC Reporting — Regulation S-X

Speakers	Topics Covered
• Michael J. Fay, Associate Chief Accountant, SEC's Division of Corporation Finance • Steven C. Jacobs, Associate Chief Accountant, SEC's Division of Corporation Finance • Craig C. Olinger, Deputy Chief Accountant, SEC's Division of Corporation Finance	• SEC reporting considerations for acquired or to be acquired businesses (Rule 3-05) • SEC reporting considerations related to investments in equity method investees (Rules 3-09 and 4-08(g)) • Selected financial data and pro forma financial information • Special-purpose acquisition companies

SEC Reporting Considerations for Acquired or to Be Acquired Businesses (Rule 3-05)

Editor's Note: When a registrant ("acquirer") consummates or it is probable that it will consummate a significant business acquisition, Regulation S-X, Rule 3-05, may require the filing of certain financial statements for the acquired or to be acquired business ("acquiree"). For example, the registrant may be required to file a Form 8-K with financial statements for a significant acquiree. Further, if the registrant files a registration statement or a proxy statement, separate financial statements for the acquiree may be required in addition to the registrant's financial statements. Including the acquiree's separate financial statements allows current and prospective investors to evaluate the future impact of the acquiree on the registrant's consolidated results.

Financial statements of an acquiree are required only if they meet the definition of a business for SEC reporting purposes. Mr. Olinger reminded participants that for this purpose, the staff applies the definition of a business in Regulation S-X, Rule 11-01, and not the U.S. GAAP definition in ASC 805-10-20.

Mr. Olinger indicated that registrants often submit a prefiling request on this topic. He indicated that preparers often focus on the list of attributes in Rule 3-05 and overlook the first two elements: (1) that an acquired entity is presumed to be a business and (2) whether the revenue generating activity is generally the same before and after the transaction.

Mr. Jacobs observed instances in which registrants wishing to seek a formal request for waivers of Rule 3-05 financial reporting and disclosure requirements attempted to make the case that the acquiree did not constitute a business and therefore avoid providing any historical financial statements. He acknowledged that the "SEC requirements for information to be provided may not really be a one-size-fits-all model." For example, there may be some factors in a transaction that may indicate that certain other financial information may be more meaningful to investors than the historical financial statements themselves. Mr. Jacobs encouraged registrants and their advisors to "focus the submission [for a waiver] on what historical financial information might be provided and be more meaningful."

Editor's Note: As described in Regulation S-X, Rule 1-02(w), a registrant must perform the following three tests to determine the significance of an acquiree: the investment test, the asset test, and the income test. The test that results in the highest significance is used to determine the financial statement periods of the acquiree that must be presented.

Mr. Olinger indicated that in unique circumstances, the SEC staff may waive certain financial statement requirements when the results of a significance test are anomalous to the other significance tests. He indicated there is no defined meaning of "anomalous"; however, Mr. Olinger believes that if a test is clearly out of line with all other relevant indicators, a registrant may consider requesting relief from the SEC. Mr. Olinger noted that even in these unique circumstances, the SEC staff is unlikely to waive the financial statements for all of the audited periods that Rule 3-05 requires. Mr. Olinger further noted that "the outcome of a request could be a reduced number of periods rather than an outright waiver."

On a related matter, Mr. Olinger noted that if the registrant itself has limited operations, the acquiree may be considered the predecessor in the transaction. In these circumstances, the registrant would be required to present financial statements of the acquiree for all periods in accordance with Regulation S-X, Rules 3-01 and 3-02. Rule 3-05 does not apply to the acquisition of a business that is a predecessor of the registrant.

Continuing the discussion on Rule 3-05, Mr. Olinger commented on the impact the adoption of ASC 805 (formerly Statement 141(R)) has on the significance tests for acquired businesses. He reminded registrants that the significance tests have not changed as a result of the implementation of ASC 805; however, the amounts that are included in the investment test may be different as a result of a few factors. First, transaction costs must now be expensed as incurred. Accordingly, such costs are no longer included in the investment test. Second, contingent consideration must be recorded at fair value as of the acquisition date and is now included, at fair value, in the investment test.

Editor's Note: Regarding the calculation of the investment test for a business combination, paragraph 2015.5 of the SEC Financial Reporting Manual (the "Manual") indicates that the registrant should compare the "consideration transferred," as adjusted for certain items, with the registrant's preacquisition consolidated assets. Since the fair value of contingent consideration is included in the "consideration transferred," such amounts are included in the investment test.

Mr. Olinger highlighted a second implementation issue associated with ASC 805 and the significance tests for acquired businesses. He indicated that if a measurement period adjustment (MPA) is recognized on a prior business combination and the registrant is testing a current acquisition, then the registrant should include the MPA in the denominator for all three significance tests even if it is not yet reflected in the registrant's historical financial statements. In addition, Mr. Olinger reminded registrants that for registration statements, "revised financial statements that reflect the post-balance sheet [MPA] are necessary . . . even if the interim period updating is not yet required."

Editor's Note: For more information on MPA, see paragraph 2020.1 and section 13600 of the Manual.

For additional information on many of the issues discussed above as well as guidance on other SEC reporting considerations for acquired or to be acquired businesses, see Deloitte's Roadmap to Applying SEC Regulation S-X to the Acquisition of a Business.

SEC Reporting Considerations Related to Investments in Equity Method Investees (Rules 3-09 and 4-08(g))

Editor's Note: When a registrant has a significant equity method investment, the registrant may be required to provide separate financial statements of the investee, summarized financial information of the investee, or both under Regulation S-X, Rules 3-09 and 4-08(g). In determining whether separate annual financial statements of an equity method investee are required under Rule 3-09(a), a registrant must perform the investment and income tests, but not the asset test, in Rule 1-02(w) to assess the equity method investee for significance. However, to determine whether summarized financial information is required under Rule 4-08(g), a registrant must perform all three significance tests.

The SEC staff may also waive certain Rule 3-09 financial statement requirements when the results of the two significance tests are significantly disproportionate. Mr. Olinger recommended that registrants perform the significance tests as written in Rule 1-02(w) and consider all the facts and circumstances to determine whether the results of the tests are anomalous. He pointed out that unlike preacquisition results for acquired businesses, "an anomaly may be more difficult to demonstrate with an equity investee because of its nature. If the investment is ongoing, if it continues to impact the [registrant's] results and if the [registrant] continues to have significant influence over the investee . . . it's going to be a little more difficult to demonstrate that the [equity method] investee's financials lack relevance to the [registrant]."

Editor's Note: During the conference, Wayne E. Carnall, chief accountant in the SEC's Division of Corporation Finance, shared his goals for the future, some of which related to ways to improve the reporting and disclosure requirements under Rules 3-05, 3-09, and 4-08(g). For additional information, see SEC Reporting — Other Topics.

In addition, Mr. Olinger indicated that the SEC staff is currently considering whether IFRSs for smaller reporting entities will be acceptable for nonissuers (e.g., when a registrant provides financial statements under Rules 3-05 or 3-09). See International Accounting and Reporting for additional information. While Mr. Olinger's remarks were directed at foreign registrants, they also apply to a domestic registrant.

Selected Financial Data and Pro Forma Financial Information

In April 2009, the Commission adopted technical amendments to its rules, forms, and schedules and made other technical changes to the Codification of Financial Reporting Polices in SEC Rule 33-9026. These revisions were related to the issuance of ASC 805 and of ASC 810 (formerly Statement 160). ASC 810-10-50 requires that the amount of income from continuing operations attributable to the parent be presented either on the face of the income statement or in the notes. Mr. Jacobs noted that technical amendments related to ASC 810-10-50 were not made to selected financial data (Regulation S-K, Item 301) or pro forma financial information (Regulation S-X, Article 11). The absence of specific guidance regarding the impact of noncontrolling interest on income from continuing operations has resulted in a variety of alternative presentations in SEC filings.

Selected financial data requires the disclosure of various balance sheet and income statement line items, including income (loss) from continuing operations, and per share data. Item 301 does not specify whether the income (loss) from continuing operations should be presented in total including noncontrolling interest or whether only the portion that is attributable to the parent (registrant) should be presented. Mr. Jacobs recommended additional disclosure of noncontrolling interest in selected financial data when noncontrolling interest is not separately presented in the selected financial data table and when it has a material impact on the amount of income allocable to the registrant. The disclosure could be presented parenthetically or as a footnote to the table.

Similarly, Article 11 requires disclosure of income (loss) from continuing operations in the pro forma income statement and does not specify how to treat noncontrolling interests in that presentation. Mr. Jacobs indicated that the staff has accepted multiple presentations, including (1) income from continuing operations attributable to the registrant (whether that measure is presented on the face of the registrant's consolidated income statement or derived by making an adjustment for noncontrolling interest) or (2) a pro forma income statement that includes the presentation of income from discontinued operations and net income attributable to the registrant.

Special-Purpose Acquisition Companies

Editor's Note: Special-purpose acquisition companies (SPACs) are companies with no operations that undergo an initial public offering (IPO) with the intention of acquiring an operating company with the IPO proceeds. Typically, SPACs must complete a purchase transaction within a specified period from the IPO date or refund the proceeds from the IPO to the original investors. SPAC shareholders have the right to approve the proposed business combination before the transaction occurs.

Mr. Jacobs indicated the following reasons why the staff has generally not granted requests to waive the financial statements of the operating company that is to be acquired by a SPAC in a purchase transaction:

- The historical financial statements of the operating company are imperative to SPAC shareholders. In the absence of such financial information, a SPAC shareholder would be "voting blindly."
- The operating company is generally deemed the predecessor to the SPAC after the transaction.
- The acquired operations are presumed to meet the definition of a business under Article 11 because the SPAC has no current or ongoing operations or even infrastructure to operate a business, and the operations of the registrant after the transaction are primarily that of the acquired operations.

Mr. Fay indicated that the SEC views these acquisitions differently from acquisitions under Rule 3-05. He reminded preparers that when a registrant succeeds to substantially all of the operations of an acquired business and the registrant's own operations before the succession is insignificant relative to the operations acquired, the acquired business will generally be deemed the predecessor. The predecessor financial statements must cover the period up to the business combination date with no lapse in periods for reports issued after the transaction. Mr. Fay noted that MD&A and selected financial data are required for the predecessor and must cover all relevant periods, as if they were the registrant's.

Mr. Jacobs noted that when a SPAC acquires multiple companies, it may be appropriate to have more than one predecessor, although this would be unusual. The staff will not object to the determination that multiple predecessors exist, as this results in more information for investors. Mr. Jacobs informed preparers that the level of disclosure (both periods presented and MD&A) would need to be identical for each of the predecessors identified.

Editor's Note: The historical financial statements of the predecessor (for pre-acquisition periods) are deemed to be those of the registrant. Rule 3-05 on acquired entities does not apply; rather, Rules 3-01 and 3-02 governing the registrant's financial statements apply.

Both predecessor and registrant financial statements should be presented for preacquisition periods if the registrant has more than nominal operating costs. For example, if the SPAC's financial statements include expenses for acquisition-related costs under ASC 805-10-25-23, the SPAC's historical financial statements may need to be included in Forms 10-K and 10-Q.

Editor's Note: SPACs were discussed at the June 2009 meeting of the Center for Audit Quality's (CAQ's) SEC Regulations Committee. See the minutes on the CAQ's Web site for further information.

Segment Reporting

Speaker	Topic Covered
• Michael J. Fay, Associate Chief Accountant, SEC's Division of Corporation Finance	• Aggregation of operating segments into reportable segments and other areas of focus

Aggregation of Operating Segments Into Reportable Segments and Other Areas of Focus

Mr. Fay discussed segment issues that have been addressed during the filing review process over the past year. One area of focus by the Division of Corporation Finance has been the proper aggregation of operating segments into reportable segments.

ASC 280 (formerly Statement 131) permits an entity to aggregate two or more operating segments if the aggregation is "consistent with the objective and basic principles [of ASC 280], if the segments have similar economic characteristics," and if the segments are similar in each of five areas identified in ASC 280-10-50-11 (formerly paragraph 17 of Statement 131). ASC 280 does not define the term "similar" or provide much guidance on the aggregation criteria. As a result, the determination of whether two or more operating segments are similar depends on the individual facts and circumstances.

Mr. Fay indicated that the analysis of economic characteristics may lead to a number of questions from the SEC staff in their efforts to understand the entity's basis for economic "similarity in the face of indicators of dissimilarity." He advised entities to more fully consider the totality of all the facts, including indicators of dissimilarity, in their methodology for analyzing economic characteristics. Entities might undertake a process to evaluate "the line items, measures and metrics that correlate with the future prospects of their operating segments and fully look at indicators [of] dissimilarity inherent [in their] historical results."

ASC 280-10-50-11 states that segments with similar economic characteristics would be expected to have similar long-term average gross margins, but does not give any other examples of what an entity may use to evaluate economic characteristics. Mr. Fay remarked that economic factors and line items to consider "will vary by company [and] by industry," but that similar operating segments are expected to have "essentially the same future prospects." He highlighted that long-term trends in the following financial statement line items of the segments may provide good indicators of similarity or dissimilarity:

- Revenue.
- Cash flows.
- Gross profit.
- Profit or loss.
- Cost of goods sold.
- Net income.

Mr. Fay indicated that companies should identify the factors that best align with the future prospects of its operating segments, keeping in mind that "an analysis may need to expand or evolve as circumstances change". Mr. Fay noted that there is no single way to establish long-term trends. When doing so, companies may want to consider volatility underlying their trends as part of the totality of all the facts that are considered. The evaluation of long-term trends requires considerable judgment as there are no bright lines that define similarity or dissimilarity.

Other areas of focus in recent staff reviews related to segment reporting include comments on general information disclosures such as factors used to identify the reportable segments and a statement on whether operating segments are aggregated as required by ASC 280. Mr. Fay indicated that the staff frequently asks entities to provide copies of the information that the chief operating decision maker (CODM) and the board of directors receives and reviews. The staff frequently challenges an assertion that discrete results included in the CODM package are not being reviewed and used to allocate resources to and assess the performance of the segments and therefore are not operating segments. He also reminded companies that "the reporting package regularly received by the [CODM] should be evaluated against the identified operating segments periodically." Mr. Fay noted that "a number of companies have expanded their segment presentation as a result of the [staff's] review process."

Working With the SEC Staff

Speakers	Topics Covered
• Wayne E. Carnall, Chief Accountant, SEC's Division of Corporation Finance • Angela Crane, Associate Chief Accountant, SEC's Division of Corporation Finance • Joshua S. Forgione, Associate Chief Accountant, SEC's Office of the Chief Accountant • Craig C. Olinger, Deputy Chief Accountant, SEC's Division of Corporation Finance	• Division of Corporation Finance • Office of the Chief Accountant

Division of Corporation Finance

Ms. Crane discussed (1) the organization of the SEC's Division of Corporation Finance (the "Division"), (2) ways to obtain interpretive guidance and other assistance from the Division's Office of the Chief Accountant, (3) the Division's filing review process, and (4) the Division's reconsideration process.

Ms. Crane indicated there are various ways to obtain interpretive guidance from the Division's Office of the Chief Accountant. She stated that registrants, their advisors, or both may call the SEC staff to discuss issues informally. In addition, to allow for more effective and efficient communication, registrants may submit requests for interpretive advice and other assistance by completing the Corporation Finance Request Form for Interpretive Advice and Other Assistance ("Intake Form") on the SEC's Web site. Ms. Crane mentioned that questions submitted electronically are treated in the same manner as questions received by phone and can be made on a "no-name" basis. She also indicated that the SEC staff will respond by phone to the requests within one business day. The Intake Form can also be used to obtain interpretive guidance from other offices in the Division.

When registrants wish to seek a formal request for interpretations, accommodations, or waivers of financial reporting and disclosure requirements from the Division, they may e-mail a pre-filing letter to dcaoletters@sec.gov. The Division treats these requests like those received via traditional mail and will respond in writing within 10 business days.

Ms. Crane, as well as Mr. Olinger, recommended the following best practices for registrants preparing a pre-filing letter:

- "Clearly state [the] issue and relief sought."
- "Clearly state [the] facts and relate them to [an] analysis of [the] issue."
- "Clearly state [the] basis for relief."
- Clearly highlight why the specific situation is unusual and not contemplated by the rules.
- "Clearly describe proposed alternative presentation[s] and disclosures."

The slides used by Ms. Crane and the slides used by Mr. Olinger in their presentations are available on the SEC's Web site.

Mr. Carnall also shared some of his observations and recommendations on the filing-review process for registrants working with the Division's staff. He referred to situations during the comment-letter process in which registrants waited too long before they realized they should have involved their auditors, their auditor's national office, or their experts. He recommended that registrants "make [their] last response [their] first response." He further indicated that "the more effort and time [registrants] spend responding the first time, [the more efficient it is] for all of us."

Editor's Note: For additional information about the Division and working with the SEC staff, see the Division's Filing Review Process as well as its Overview of the Legal and Regulatory Policy Offices. These documents specify, among other items, (1) the organization of the Division and contact information, (2) how the Division selects filings for review, (3) the reconsideration process, and (4) how to request interpretive guidance.

Office of the Chief Accountant

Over the years, representatives of the SEC's Office of the Chief Accountant have spoken at the AICPA National Conference on Current SEC and PCAOB Developments. Mr. Forgione cautions that the staff's speeches are based on GAAP that is applicable at the time the speech is delivered, and as GAAP changes, so may the staff's views. Accordingly, registrants should consult with the SEC staff when they believe they have reached a reasonable conclusion but feel constrained by the staff's historical remarks.

XBRL

Speaker	Topics Covered
• Joel Levine, Assistant Director (Accounting Issues and Content Integrity), SEC's Office of Interactive Disclosure	• Tagging and filing requirements • Controls • Taxonomy

Tagging and Filing Requirements

Mr. Levine highlighted key tagging and filing requirements under Regulation S-T, Rule 405. He also noted that to comply with the rules and submit files in a timely manner, registrants should consider (1) reviewing the EDGAR Filer Manual on the SEC's Web site for detailed instructions on how to construct the interactive data (XBRL) file, (2) using the EDGAR test validation system to verify in advance that a submission can pass the EDGAR system's automated validation tests, and (3) using the "Previewer" feature on the SEC's Web site to compare the rendered image of their interactive data exhibits to their traditional financial statements before submitting them. Mr. Levine also encouraged registrants to start the mapping process for the detailed tagging of financial statement footnotes and schedules as soon as possible even if they are not required to submit such detailed tagged files until their second year of adoption.

Mr. Levine noted that the staff of the SEC's Office of Interactive Disclosure had reviewed submissions from the first phase-in group and identified a number of issues. The more noteworthy issues related to some registrants inappropriately selecting elements and incorrectly entering amounts as negative balances. The staff had also observed that some registrants had attempted to identically conform the rendered image of their interactive data exhibits to their traditional financial statement presentation, conforming the rendered image with the presentation is not only not required, but has resulted in deviations from the interactive data rules and Edgar Filer Manual. Mr. Levine identified (1) differences between the rendering and the traditional financial statements that the staff believes are avoidable and (2) differences that are not avoidable. On October 6, 2009, the staff issued a summary of its observations, which is available on the SEC's Web site.

Editor's Note: For more information on the interactive data rules, see Deloitte's February 6, 2009, *Heads Up* and XBRL Frequently Asked Questions (FAQ). See also the SEC staff's Compliance and Disclosure Interpretations (C&DIs) of the interactive data rules, which are available on the SEC's Web site and updated periodically. In addition, for more information on the staff's observations, see Deloitte's December 4, 2009, *Heads Up* and the staff's summary of its observations.

Controls

Mr. Levine confirmed that controls and procedures over XBRL submissions currently fall within the scope of disclosure controls and procedures. Therefore, a registrant should consider such controls in assessing compliance with Exchange Act Rules 13a-15 and 15d-15 and Regulation S-K, Item 307.

Mr. Levine also clarified that to determine whether controls and procedures over XBRL submissions might also fall within the scope of internal control over financial reporting (ICFR), a registrant should evaluate the extent to which interactive data technology is integrated into the process of preparing its traditional (i.e., non-interactive) financial statements. If the processes are interdependent, a registrant may need to assess internal controls over XBRL submissions in its consideration of ICFR. If a registrant's tagging process and its process for preparing financial statements are not interdependent, then an

internal control evaluation may not be necessary.

Editor's Note: Section II.C.4 of SEC Rule 33-9002 notes that the integration of interactive data technology into a registrant's business information processing "may have implications regarding internal control over financial reporting no different than any other controls or procedures related to the preparation of financial statements." Therefore, if a registrant uses the interactive data technology to prepare its traditional financial statements, XBRL should be considered as integrated into the financial reporting process and a registrant and its auditor should generally consider the integrated interactive data technology in their evaluation and reporting of ICFR.

Note also that although preparation of interactive data files falls within the definition of disclosure controls and procedures, the officer certification requirements of Exchange Act Rules 13a-14 and 15d-14 do not apply to interactive data files.

Taxonomy

Mr. Levine further noted that the SEC will annually make available an updated taxonomy for use within the EDGAR system. Before its formal release, the updated taxonomy will be exposed for public comment. Mr. Levine encouraged filers, analysts, and industry groups to take advantage of the comment period and submit suggestions, individually or jointly, to improve the taxonomy.

Appendix A: Glossary of Standards

FASB Accounting Standards Codification Topic 280, *Segment Reporting* (Statement 131)

FASB Accounting Standards Codification Subtopic 280-10, *Segment Reporting: Overall* (Statement 131)

FASB Accounting Standards Codification Subtopic 310-20, *Receivables: Nonrefundable Fees and Other Costs* (Statement 91)

FASB Accounting Standards Codification Subtopic 310-30, *Receivables: Loans and Debt Securities Acquired With Deteriorated Credit Quality* (SOP 03-3)

FASB Accounting Standards Codification Topic 350, *Intangibles — Goodwill and Other*

FASB Accounting Standards Codification Subtopic 350-20, *Intangibles — Goodwill and Other: Goodwill* (Statement 142)

FASB Accounting Standards Codification Topic 605, *Revenue Recognition*

FASB Accounting Standards Codification Topic 805, *Business Combinations* (Statement 141(R))

FASB Accounting Standards Codification Subtopic 805-10, *Business Combinations: Overall* (Statement 141(R))

FASB Accounting Standards Codification Topic 810, *Consolidation* (Statement 160)

FASB Accounting Standards Codification Subtopic 810-10, *Consolidation: Overall* (Statement 160)

FASB Accounting Standards Codification Topic 820, *Fair Value Measurements and Disclosures* (Statement 157)

FASB Accounting Standards Codification Topic 830, *Foreign Currency Matters*

FASB Accounting Standards Codification Topic 860, *Transfers and Servicing* (Statement 140)

FASB Accounting Standards Codification Subtopic 860-10, *Transfers and Servicing: Overall* (Statement 140)

FASB Accounting Standards Update No. 2009-14, *Certain Revenue Arrangements That Include Software Elements — a consensus of the FASB Emerging Issues Task Force* (EITF Issue 09-3)

FASB Accounting Standards Update No. 2009-13, *Multiple-Deliverable Revenue Arrangements — a consensus of the FASB Emerging Issues Task Force* (EITF Issue 08-1)

FASB Statement No. 167, *Amendments to FASB Interpretation No. 46(R)*

FASB Statement No. 166, *Accounting for Transfers of Financial Assets* — an amendment of FASB Statement No. 140

FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements* — an amendment of ARB No. 51

FASB Statement No. 157, *Fair Value Measurements*

FASB Statement No. 141(R), *Business Combinations*

FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* — a replacement of FASB Statement 125

FASB Statement No. 131, *Disclosures About Segments of an Enterprise and Related Information*

FASB Statement No. 91, *Accounting for Nonrefundable Fees and Costs Associated With Originating or Acquiring Loans and Initial Direct Costs of Leases* — an amendment of FASB Statements No. 13, 60, and 65 and a rescission of FASB Statement No. 17

FASB Statement No. 52, *Foreign Currency Translation*

FASB Interpretation No. 46(R), *Consolidation of Variable Interest Entities* — an interpretation of ARB No. 51

EITF Issue No. 09-3, "Applicability of AICPA Statement of Position 97-2 to Certain Arrangements That Include Software Elements"

EITF Issue No. 08-1, "Revenue Arrangements With Multiple Deliverables"

AICPA Statement of Position 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer*

PCAOB Auditing Standard No. 7, *Engagement Quality Review*

PCAOB AU Section 722, *Interim Financial Information*

SEC Staff Accounting Bulletin Topic 11.M, "Disclosure of the Impact That Recently Issued Accounting Standards Will Have on the Financial Statements of the Registrant When Adopted in a Future Period" (SAB 74)

SEC Staff Accounting Bulletin Topic 13, "Revenue Recognition" (SAB 101 and SAB 104)

Regulation S-X, Rule 1-02, "Definitions of Terms Used in Regulation S-X"

Regulation S-X, Rule 3-01, "Consolidated Balance Sheets"

Regulation S-X, Rule 3-02, "Consolidated Statements of Income and Changes in Financial Position"

Regulation S-X, Rule 3-05, "Financial Statements of Businesses Acquired or to Be Acquired"

Regulation S-X, Rule 3-09, "Separate Financial Statements of Subsidiaries Not Consolidated and 50 Percent or Less Owned Persons"

Regulation S-X, Rule 4-08, "General Notes to Financial Statements"

Regulation S-X, Article 10, "Interim Financial Statements"

Regulation S-X, Article 11, "Pro Forma Financial Information"

Regulation S-X, Rule 11-01, "Presentation Requirements"

Regulation S-K, Item 102, "Description of Property"

Regulation S-K, Item 301, "Selected Financial Data"

Regulation S-K, Item 303, "Management's Discussion and Analysis of Financial Condition and Results of Operations"

Regulation S-K, Item 305, "Quantitative and Qualitative Disclosures About Market Risk"

Regulation S-K, Item 307, "Controls and Procedures"

Regulation S-K, Item 308, "Internal Control Over Financial Reporting"

Regulation S-K, Item 503, "Prospectus Summary, Risk Factors, and Ratio of Earnings to Fixed Charges"

Regulation S-T, Rule 405, "Interactive Data File Submissions and Postings"

SEC Final Rule Release No. 33-9002, *Interactive Data to Improve Financial Reporting*

SEC Final Rule Release No. 33-9026, *Technical Amendments to Rules, Forms, Schedules and Codification of Financial Reporting Policies*

SEC Interpretive Release No. 33-8810, *Commission Guidance Regarding Management's Report on Internal Control Over Financial Reporting Under Section 13(a) or 15(d) of the Securities Exchange Act of 1934*

IAS 39, *Financial Instruments: Recognition and Measurement*

IAS 34, *Interim Financial Reporting*

IFRS 9, *Financial Instruments*

IFRS 7, *Financial Instruments: Disclosures*

IFRS 3, *Business Combinations*

Appendix B: Published Speeches and Presentations

The full text of conference speeches and presentations that are available on standard-setters' and other Web sites can be viewed by clicking the links below.

Speakers

Doug Besch, Professional Accounting Fellow, SEC's Office of the Chief Accountant

Paul A. Beswick, Deputy Chief Accountant for Professional Practice, SEC's Office of the Chief Accountant

Brian W. Fields, Professional Accounting Fellow, SEC's Office of the Chief Accountant

Jason S. Flemmons, Associate Chief Accountant, SEC's Division of Enforcement

Joshua S. Forgione, Associate Chief Accountant, SEC's Office of the Chief Accountant

Cynthia Fornelli, Executive Director, Center for Audit Quality (CAQ)

Daniel L. Goelzer, Acting Chairman, PCAOB

Robert H. Herz, Chairman, FASB

Robert S. Khuzami, Director, SEC's Division of Enforcement

James L. Kroeker, Chief Accountant, SEC's Office of the Chief Accountant

Douglas T. Parker, Professional Accounting Fellow, SEC's Office of the Chief Accountant

Allison M. Patti, Professional Accounting Fellow, SEC's Office of the Chief Accountant

Evan Sussholz, Professional Accounting Fellow (Valuation Specialist), SEC's Office of the Chief Accountant

Elisse B. Walter, Commissioner, SEC

Arie S. Wilgenburg, Professional Accounting Fellow, SEC's Office of the Chief Accountant

Slide Presentations

Martin F. Baumann, PCAOB's Office of the Chief Auditor — Current Developments

Wayne Carnall, Chief Accountant, SEC's Division of Corporation Finance, and other panelists — Current Developments in the SEC's Division of Corporation Finance

Angela Crane and Michael Stehlik, SEC's Division of Corporation Finance — Best Practices for Working with SEC Staff

Joel K. Levine, Assistant Director, Office of Interactive Disclosure — Presentation

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