

Discussion Document F

Topic: Financial Information Required in Registration Statements When there are Retrospective Accounting Changes

Background: FASB Statement 123(R) permits companies to adopt its provisions via modified retrospective application. Statement 154 requires companies to report a change in accounting principle through retrospective application.

Item 11 of Form S-3 requires inclusion/incorporation by reference of restated financial statements prepared in accordance with Regulation S-X if there has been a change in accounting principle or a correction in an error where such change or correction requires a material retroactive restatement of financial statements, or a business combination accounted for by the pooling of interest method. Item 11 also requires any financial information required because of a material disposition of assets outside the normal course of business.

Appendix C of the SEC Staff Training Manual describes situations involving reorganizations of entities under common control and discontinued operations when revised audited financial statements must be included in a registration statement when an event has occurred subsequent to the latest year-end balance sheet but before filing interim period financial statements. For reorganizations of entities under common control (accounted for in a manner similar to a pooling of interests) a company should provide supplemental audited financial statements that reflect retroactive combination of the entities being reorganized.

When the date of disposal or classification as held for sale occurs after the latest balance sheet included in a registration statement, only pro forma information should be presented for all periods to give effect to the actual or probable disposition, if significant. Under Statement 144, the historical financial statements are not revised to reclassify the business component's operations to discontinued operations until a company reports on a period that includes the date of sale or classification as held for sale.

Appendix C of the SEC Staff Training Manual indicates that retroactive presentation of stock splits would not require revision of previously filed financial statements when the financial statements are incorporated by reference in a registration statement or proxy as long as an appropriately revised selected financial data table is included in the registration statement.

Also, changes in reportable segments are not reflected in revised previously issued financial statements until the company reports on a period that includes the date of reorganization giving rise to the change in reportable segments.

SAB 74 (Topic 11-M) requires a registrant to disclose the effect of a new accounting standard that has not yet been adopted.

Question 1: If a company has disclosed that it will use the modified retrospective transition method to adopt Statement 123(R) or has disclosed that it will make an accounting change under Statement 154 requiring retrospective treatment in the financial statements and files a registration statement prior to filing its first interim period financial statements reflecting the adoption of Statement 123(R) or the accounting change, what financial information regarding the effects of these changes on previously issued financial statements should be included or incorporated by reference in the registration statement?

View A: Disclosure of the impending change (via the SAB 74 disclosure, in the case of a new accounting standard, or via repeating or incorporating by reference the previous disclosure of the voluntary accounting change) is sufficient.

There is no need to provide more extensive information until the accounting change has been reflected in historical financial statements. Requiring more extensive information would serve as an incentive for companies to avoid disclosing the method by which they will adopt new accounting standards in their SAB 74 disclosures and avoid announcing voluntary accounting changes in advance, because avoiding these disclosures reduces the risk of not being able to file a registration statement because the computations of the effect of the change may not be complete.

View B: Pro forma information depicting the accounting change is required. Consistent with the treatment of retrospective changes related to discontinued operations and reportable segments, the historical financial statements should not be revised until a company reports on a period that includes the date of adoption of the accounting change. Thus, if a calendar year-end company adopts Statement 123(R) using the modified retrospective method effective January 1, 2006, the company would present pro forma information in a new registration statement until its Form 10-Q for the quarterly period ending March 31, 2006 is filed.

It would be inconsistent with GAAP to require the primary historical financial statements to be restated before the period in which the change is adopted. The requirement for audited supplemental financial statements for reorganizations of entities under common control is unique to business combinations of that type.

Question 1A: If View B is appropriate, for what periods should registrants provide pro forma income statements prepared in accordance with Article 11?

Retrospective treatment applies to all years of historical financial statements presented in a filing. Topic Three, II.C.2 in the SEC Staff Training Manual indicates that pro forma presentation of all periods is required in situations where financial statements will be retroactively adjusted for the effects of application of GAAP related to a reorganization of entities under common control and discontinued operations.

View B1: Consistent with the guidance in the SEC Staff Training Manual that applies in other situations where the historical financial statements will be revised, pro forma income statements should be presented for all years presented (i.e., three years for S-X filers and two years for S-B filers).

View B2: The guidance in the SEC Staff Training Manual was intended to apply only to reorganizations of entities under common control and discontinued operations and therefore should not extend to other retrospective changes. The circumstances cited in the Staff Training Manual are those in which additions or deletions to business operations are occurring. Pro forma income statements should only be presented for the most recent fiscal year and interim period.

View C: Provide audited revised primary financial statements reflecting the accounting change.

Item 11 of Form S-3 requires inclusion of restated financial statements if there has been a change in accounting principle where such change or correction requires a material retroactive restatement of financial statements regardless of whether financial statements for a period reflecting the event have been issued.

View D: Provide audited supplemental financial statements reflecting the accounting change.

Item 11 of Form S-3 requires inclusion of restated financial statements if there has been a change in accounting principle where such change or correction requires a material retroactive restatement of financial statements; however since the event occurred after the balance sheet it should only be reflected in audited supplemental financial statements.

Committee Recommendation: View A

SEC Staff Response: The staff agrees with View A and indicated that if the company knows the impact of adoption of FAS 123(R) they should include appropriate disclosures under Staff Accounting Bulletin 74, *Disclosures by Registrant When an Accounting Standard Has Been Issued But not yet Adopted*.

Question 2: If a calendar year-end company uses the modified retrospective transition method to adopt Statement 123(R) or has an accounting change under Statement 154 requiring retrospective treatment in the financial statements and files a registration statement after filing its first interim period financial statements reflecting the adoption of Statement 123(R) or the accounting change, what financial information regarding the effects of these changes on previously issued annual financial statements should be included in the registration statement? Would the conclusion be different if the previously issued annual financial statements are incorporated by reference, rather than included?

View A: Provide audited revised financial statements reflecting the accounting change. Item 11 of Form S-3 requires inclusion of restated financial statements if there has been a change in accounting principle where such change or correction requires a material retroactive restatement of financial statements. This approach is also required by Statements 144, 131, 123(R) and 154. The “accommodation approach” described in View B has only been extended to situations where transitional pro forma disclosures are required by a standard (i.e., Statements 142 and 145) or for earnings per share, which is an isolated calculation that appears on the face of the income statement. Net income is not affected in these situations.

View B: If the previously issued annual financial statements are incorporated by reference, rather than included, registrants may avail themselves of the same accommodations afforded initial adoption of Statements 128, 142 and 145 when financial statements are incorporated by reference in registration or proxy statements. That is, if registrants conclude that the financial statements do not require restatement and independent auditors will permit reissuance of their auditors’ report without restatement, registrants can disclose the reclassifications in selected financial data included in a registration or proxy statement, or in a Form 10-Q incorporated by reference.

There are several situations where GAAP requires restatement of previous period financial statements once a subsequent period’s financial statements reflect the GAAP triggering event. These situations include: changes in segments under FASB Statement 131; discontinued operations under Statement 144; initial adoption of Statement 128; transitional disclosures under Statements 142 and 143; and reclassification of debt extinguishment gains and losses under Statement 145 and EITF 03-06. For changes in segments and discontinued operations reclassifications, the SEC staff has insisted on full restatement of annual financial statements to be included or incorporated by reference in a registration or proxy statement, once a registrant has filed subsequent interim period financial statements that reflect the change in segments or discontinued operations treatment. For initial adoption of Statements 128, 142, 143 and 145 and EITF 03-06, the staff has provided accommodations for registrants incorporating financial statements by reference into new registration or proxy statements. In those situations, the SEC staff has allowed registrants to avoid full restatement before filing the next year’s Form 10-K if the registrant provided appropriate disclosure for all periods presented in the registration or proxy statement in the filing itself (e.g., along with selected financial data) or in a Form 10-Q or Form 8-K incorporated by reference.

Committee Recommendation: The Committee recommends View A and notes that the conclusion would not be different if the previously issued financial statements are incorporated by reference, rather than included.

SEC Staff Response: The staff agrees with View A.