SEC Regulations Committee Highlights

Joint Meeting with SEC Staff - April 24, 1996

Location: SEC Headquarters – Washington, D.C.

NOTICE: The AICPA SEC Regulations Committee meets periodically with the staff of the SEC to discuss emerging technical accounting and reporting issues relating to SEC rules and regulations. The purpose of the following highlights is to summarize the issues discussed at the meetings. These highlights have not been considered and acted on by senior technical committees of the AICPA, or by the Financial Accounting Standards Board, and do not represent an official position of either organization.

In addition, these highlights are not authoritative positions or interpretations issued by the SEC or its staff. The highlights were not transcribed by the SEC and have not been considered or acted upon by the SEC or its staff. Accordingly, these highlights do not constitute an official statement of the views of the Commission or of the staff of the Commission.

I. ATTENDANCE

A. *SEC Regulations Committee*

Thomas L. Milan, Chairman
John L. Archambault
Val Bitton
Rusty Brinkman
Edward C. Drosdick
Michael D. Foley
Lee Graul
Jay P. Hartig
Robert H. Herz
Eric Press
Arthur J. Radin
Lucien K. Sandefur
Stewart Sandman

B. *Securities and Exchange Commission*

Office of the Chief Accountant
Steve Swad, Deputy Chief Accountant
Jack Albert, Associate Chief Accountant
Tracey Barber, Professional Accounting Fellow
Scott Bayless, Assistant Chief Accountant
Brian Heckler, Professional Accounting Fellow
Mike Kigin, Associate Chief Accountant
Timothy McKay, Assistant Chief Accountant
Russell Mallett, III, Professional Accounting Fellow
Larry Soper, Staff Accountant
Mary Tokar, Professional Accounting Fellow
Roy Van Brunt, Assistant Chief Accountant

Division of Corporation Finance

Robert Bayless, Chief Accountant
Wayne Carnall, Associate Director Accounting Operations
Kurt Hohl, Associate Chief Accountant

C. *AICPA Staff*

Annette Schumacher Barr, Technical Manager

D. *Guests*

Chris Holmes, Ernst & Young

II. STAFF UPDATE

Steve Swad noted that in June, Mary Tokar, Mike Morrissey and Tracey Barber will end their two year term as Professional Accounting Fellows with the SEC. He acknowledged their service to the Commission and thanked them for their contributions.

III. POOLING OF INTERESTS

Brian Heckler discussed the SEC staff's views regarding the effect of the spin-off (distribution to shareholders) of "extraneous" assets in contemplation of a business combination on pooling-of-interests accounting. The staff has analyzed spin-offs or distributions to shareholders within the two-year period prior to consummation of a business combination as an alteration of equity interests. To the extent that the alteration is "in contemplation" of the business combination, the spin-off or distribution would be inconsistent with the requirements of paragraph 47c for pooling of interests accounting.

Mr. Heckler also discussed the application of paragraph 48(c) of Opinion 16 (the prohibition on significant planned dispositions of assets following a pooling-of-interests combination) where assets are pending disposal at the consummation date. An issuing company may have operations that were acquired in a previous purchase business combination, that are classified as "assets held for sale" (see EITF Nos. 87-11 and 90-6), and that are significant. A question arises whether the actual disposition of those assets subsequent to the consummation date of another business combination would preclude pooling-of-interests accounting for that business combination under paragraph 48(c). The staff has not addressed this issue formally but discussed the issue briefly in the context of this meeting. The staff believes the resolution of this question is extremely fact dependent. The staff would encourage a registrant with this issue to formally present the facts to the staff along with their analysis of the application of APB Opinion 16, Business Combinations, to the combination.

IV. DECS (DEBT EXCHANGEABLE FOR COMMON STOCK)

Russ Mallett discussed the staff's views regarding the accounting by the issuer of DECS - debt that is exchangeable into common stock of another company. At maturity, the holders of DECS receive either common stock of another company owned by the issuer of DECS (based on an exchange formula) or, at the option of the issuer, an equivalent amount of cash. DECS provide a mechanism to capture the unrealized gain on a common stock investment while deferring the tax consequences of an actual sale. The SEC staff has concluded that DECS should be accounted for as indexed debt instruments under EITF No. 86-28 such that the DECS liability should be adjusted to reflect changes in the cash redemption amount at maturity based on changes in the fair value of the related common stock.

In EITF No. 86-28, the EITF did not reach consensus as to the classification of the amount corresponding to the adjustment of the carrying value of the indexed debt instrument, however, a majority of the Task Force believed expense treatment was appropriate. For DECS, that classification depends on the issuer's accounting for the related common stock. For common stock that is accounted for as "available for sale" under FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities, the issuer marks the common stock to fair value with a corresponding adjustment to stockholder's equity. For DECS related to "available for sale" common stock, the SEC staff will not object to recording the DECS adjustment to the FAS 115 stockholders' equity account. If the issuer accounts for the investment in common stock using the equity accounting method, the SEC staff believes that adjustments to the DECS liability should be recognized in the income statement. The staff has not addressed a DECS issue related to a cost basis investment, but indicated that it would likely analogize FASB Statement No. 80, Accounting for Futures Contracts, to determine the appropriate accounting.

Steve Swad said that the staff is considering publishing its views on the accounting for DECS.

V. "PUT-TOGETHER" TRANSACTIONS

Brian Heckler noted that the staff appreciates the effort made by the Committee in its proposal requesting additional interpretive guidance for "put-together" transactions (transactions that involve the combination of several businesses for the purpose of an initial public offering).

The staff is considering the extent to which additional interpretive guidance, if any, is necessary regarding the application of Staff Accounting Bulletin (SAB) No. 48, Transfers of Nonmonetary Assets by Promoters and Shareholders, to put-together transactions.

VI. RULE 3-05 STREAMLINING RULE PROPOSAL

Robert Bayless said that the staff is continuing to work on the SEC's June, 1995 rule proposal regarding acquired business financial statements. He said that the staff expects to complete its proposal regarding a final rule in a couple of months. The SEC has a number of outstanding rule proposals that require the staff to prioritize the allocation of its resources. The staff has been pursuing the less complicated rule proposals that have a higher likelihood of swift adoption.

VII. DISCLOSURE SIMPLIFICATION

Jack Albert discussed the Report of the Task Force on Disclosure Simplification and the related phase-one rule proposal. While the staff intended the phase-one rule proposal to contain only non-controversial amendments, financial analysts have objected to the proposed elimination of the earnings per share calculation/exhibit. The SEC can be expected to issue more rule proposals based on the Task Force recommendations.

VIII. STAFF ACCOUNTING BULLETINS

Steve Swad discussed the process and considerations for issuing a staff accounting bulletin ("SAB"). SABs disseminate the administrative interpretations and practices of the staff. They eliminate the need for repetitive comments and inquiries, and thereby save registrants time and money in the registration process. As SABs are staff positions, the staff does not discuss the scope or wording of proposed SABs with outside groups. The staff, however, welcomes unsolicited comments regarding accounting and disclosure topics, including those for which the staff ultimately may publish interpretive guidance.

IX. REMARKS OF THE CHIEF ACCOUNTANT – DIVISION OF CORPORATION FINANCE

Robert Bayless discussed the increased volume of filings as compared to last year. IPO filings are approximately 15% above last year, and total filings are 15-20% higher. Also, Division staff levels are approximately 15% below those of last year. Still, the Division is maintaining an average for issuing comment letters 30 days after the initial filin date with some taking longer.

Mr. Bayless noted that the increased volume of filings makes it difficult for the staff to grant requests for special processing. The staff can be expected to give preference in its reviews to complete filings. Incomplete filings that are expected to be corrected by amendment will not receive similar consideration.

Mr. Bayless encouraged registrants and their accountants to interact with the SEC staff in a frank and forthright manner. He cited instances where the failure of registrants to provide all relevant information in response to an SEC staff comment resulted in a considerably longer time to resolve staff comments. When the SEC staff has reason to doubt the credibility of registrant representations, the staff's increased level of skepticism naturally leads to a longer and more thorough review process.

Mr. Bayless stated that the staff has noticed an increasing level of reporting problems among companies formed in a "put-together" before their IPO. He observed that some of these problems may result from the combination of companies with disparate operations and internal control systems. The staff has noted a number of accounts receivable write-offs following a put-together, particularly in the health care field. He cautioned registrants and their auditors to pay particular attention to the quality of the recorded assets of the constituent companies.

Mr. Bayless noted that the EDGAR phase-in will be completed soon. All registrants, except foreign private issuers, will be filing electronically. When phase-in is complete on May 6, all registrants in the process of their initial public offering will be required to have an electronic filin without exception.

Mr. Bayless reported that the staff is continuing to work on an update of its training manual on accounting and disclosure. He expects the revised manual to be issued in a couple of months.

Mr. Bayless noted that the SEC Advisory Committee still is working to complete its formal recommendations to the SEC regarding an alternative company registration system.