SEC Regulations Committee
April 8, 2004 - Joint Meeting with SEC Staff
SEC Offices – Washington DC

HIGHLIGHTS

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.

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I. ATTENDANCE

A. SEC Regulations Committee

Jay Hartig, Chair
Gerard Brinkman
Greg Clifton
Melanie Dolan
David Follett
Dave Hinshaw
Chris Holmes
Jeff Lenz
Scott Pohlman
Leonard Weinstock
Tom Weirich
John Wolfson

B. Securities and Exchange Commission

Office of the Chief Accountant

Donald Nicolaisen, Chief Accountant
Scott Taub, Deputy Chief Accountant
Doug Alkema, Professional Accounting Fellow
Jack Albert, Associate Chief Accountant
Andrew Bailey, Deputy Chief Accountant
Cathy Cole, Associate Chief Accountant
Greg Faucette, Professional Accounting Fellow
Russell Hodge, Professional Accounting Fellow
Gerald Anthony Lopez, Associate Chief Accountant
Shelly Luisi, Senior Associate Chief Accountant

Chad Kokenge, Professional Accounting Fellow

Division of Corporation Finance

Carol Stacey, Chief Accountant
Craig Olinger, Deputy Chief Accountant
Todd Hardiman, Associate Chief Accountant
Joel Levine, Associate Chief Accountant
Leslie Overton, Associate Chief Accountant

Division of Enforcement

Susan Markel, Chief Accountant

Division of Investment Management

Brian Bullard, Chief Accountant
James D. Campbell, Associate Chief Accountant

C. AICPA

Annette Schumacher Barr

II. RECENT ORGANIZATIONAL AND STAFF CHANGES

A. Office of the Chief Accountant (OCA)

The staff provided the following update of personnel and organizational changes in OCA:

- OCA plans to hire six Professional Accounting Fellows (PAFs) this year, three current PAFs are departing, and one current PAF is staying and taking on a new role in the office. By June 2004, a total of 10 PAFs will be on staff, which is a net increase of two over the prior year. OCA plans to hire two academic fellows, one for accounting and one for auditing this year. Several MBA interns will also be hired for the summer.
- OCA plans to double its space this year and is currently attempting to fill a number of permanent staff positions. The Office is also looking for individuals with valuation and XBRL expertise.
- Don Nicolaisen noted that he inherited an "extremely good group of people" when he started with the Commission in October.

B. Division of Corporation Finance

Carol Stacey provided the following update of personnel changes in the Division of Corporation Finance:

- The Division continues to fill open positions. Thirty people have accepted offers and recruiters have been very active in the search for qualified individuals to fill an additional 60-70 openings. All new hires will work for Disclosure Operations.
- The Division plans to add three Associate Chief Accountants in the Office of Chief Accountant. One MBA intern will also be hired.
- The Division also would like to add three additional Associate Directors in Disclosure Operations.

C. Division of Enforcement

Susan Markel stated that the Enforcement Division also continues to hire additional accountants but is close to its target number.

D. Division of Investment Management (IM)

Brian Bullard stated that six new accountants have been added to IM's Disclosure Office with two accountants being added in the IM Chief Accountant's Office.

III. STATUS UPDATES

A. Division of Corporation Finance Update

- The staff in the Division are currently working through 2003 Form 10-K reviews. In accordance with Sarbanes-Oxley, the staff is required to review all filings over a three-year cycle. The staff intends to meet this mandate. Although no particular industries are targeted, the staff is currently focusing on larger companies. As in previous years, the staff will look closely at certain areas such as off-balance sheet arrangements, MD&A disclosures (both accounting and legal), revenue recognition, segment disclosures and SFAS 142 and 144 impairments.
- New Form 8-K final rules and Foreign Private Issuer proposed rules and requirements have been recently issued.
- The staff is currently working on issuing rulemaking guidance regarding asset-backed securities (issued May 3, 2004). In addition, the staff still has on its agenda issuing a release related to the securities act reform.
- Internal training materials have recently been developed. These training materials are not available for external distribution. The 2000 (publicly available) SEC Staff Training Manual has not been updated.
- The International Issues Outline has been updated as of October 1, 2003. The staff plans on updating both the Current Accounting and Disclosure Outline and the Current Rulemaking Outline in the near future.
- Regarding the comments on the proxy process release, the Commission has received approximately 15,000 comment letters. The staff will have to review the comments and determine how to proceed.

B. Division of Enforcement Update

Susan Markel provided the following update of activity in the Division of Enforcement:

- The staff continues to receive a steady stream of referrals. The staff is in a "business-as-usual-plus" mode due to an increased number of referrals from other SEC Divisions and the internet website (nearly 1,000 referrals a day come from the site).
- The types of enforcement cases the staff encounters include 1) revenue recognition, 2) signing of false certifications and 3) opinions issued by firms not registered by the PCAOB.
- The goal of the enforcement staff is to "get in front" of massive frauds before they snowball. To that end, the staff has begun employing a new technique termed "wildcatting" in which enforcement begins early investigations in companies or even industries where certain items may not look right.

C. Division of Investment Management Update

Brian Bullard provided the following update of activity in the Division of Investment Management (IM):

- IM staff have been busy with filing reviews (IM is also required under Sarbanes-Oxley to review all filings over a three-year cycle). The results of these reviews have ranged from oral comments relaying recommendations on how to improve future reporting to referrals to the Division of Enforcement (IM is also subject to the three-year review cycle mandate in the Sarbanes-Oxley Act).

IV. MD&A DISCLOSURES

Don Nicolaison asked Committee members whether they thought that companies had taken steps to improve their MD&As after the SEC's recent interpretive release. The Committee responded that improvement was generally neutral. Several committee members said that getting companies to cut down on the length of disclosures was difficult. Companies often deal with disclosure issues by adding more and more disclosures. Many companies have tried to balance the goal of eliminating bulk with responding to comments from the staff asking for additional disclosure.

Committee members also suggested that word needed to be spread to the American Bar Association to cut back on the length and density of MD&As. Carol Stacey said that Alan Beller, the Division Director, had been getting the message out to the legal profession. MD&A was one of the biggest areas of focus at a recent "SEC Speaks" conference, the audience of which is primarily lawyers.

Committee members also stated that companies have been operating under time pressures to get filings out under the new accelerated deadlines. It was added that the timing of the interpretive release (December 2003) may have contributed to companies' inability or reluctance to incorporate many of the items outlined in the interpretive release. Mr. Nicolaisen urged firms to work with their clients in this area. He noted that in this day and age, it is not acceptable for 99% of all MD&A wording to be the same as previous years. Both Chairman Donaldson and Alan Beller are very passionate about meaningful MD&A reporting and adherence to the MD&A interpretive release. The staff may hold another meeting with the firms in order to stress the importance of this issue.

V. STAFF DECISIONS ON MATERIALITY AND THE NEED FOR RESTATEMENT

The Committee asked the staff to comment on indications some members had recently received that "OCA makes the call on accounting issues and Corporation Finance decides on materiality" (i.e., the necessity to restate financial statements). The staff responded by making the following points regarding materiality assessments:

- In specific registrant matters, generally a materiality assessment goes hand in hand with the accounting analysis and historically the Chief Accountant of the Commission ultimately decides whether or not a company is required to restate for a particular accounting issue.
- Regarding staff discussions with registrants about specific materiality assessments, companies and their auditors should express firm conclusions on whether they believe an item is material or not material at the time of the discussion (i.e., do the financial statements need to be changed or don't they?). The staff will always expect the company and its auditors to take a position on materiality first before it weighs in on the matter.
- One issue that the staff has recently been considering occurs in situations where an accounting practice had been followed in the past that may not have been GAAP, but the difference was not material in any individual prior year. Now, after a number of years of following the practice, there may be a sizable amount sitting on the balance sheet. The company may be unable to correct the cumulative balance amount because if this balance were taken through the income statement, the adjustment would be material. In dealing with these effects, some companies have adopted an "Iron Curtain" approach and others have taken a "Rollover" approach. The staff does not like the idea of two acceptable assessment methods for dealing with this issue.
- The PCAOB will also be looking at the issue of materiality in the context of audit work.
- Given these issues, the staff indicated that there may need to be more guidance on materiality.

VI. INCLUSION OF PENSION AND POSTRETIREMENT BENEFITS ON CONTRACTUAL OBLIGATIONS TABLE

The Committee asked the staff for clarification regarding whether pension and postretirement benefits are required to be included in the contractual obligations table.

Carol Stacey replied that pension and OPEB funding obligations should be included in the contractual obligations table if material contributions will be required. At a minimum, if not included in the table, registrants should disclose material pension or OPEB funding obligations with an explanation that these amounts are not included in the table. The staff may consider issuing a FAQ regarding FR 67 to address these types of issues.

VII. COMPILATION OF SEC REGULATIONS COMMITTEE HIGHLIGHTS

Mr. Hartig noted that the Committee is considering a project that would compile the highlights of previous joint meetings of the AICPA SEC Regulations Committee and the SEC staff into a searchable (by topic) database . The Committee noted that this process would require a substantial time commitment but believed that its potential benefits to users render it worthy of further discussion and pursuit. The project would involve both the compilation of existing highlights as well as a review for guidance that is no longer relevant or correct. Going forward, the compendium could be updated to reflect new highlights as well as new accounting pronouncements, rules and regulations. Mr. Hartig asked the staff if they would be interested in collaborating in this effort by participating in the review process. The staff agreed that a compendium of highlights would be a beneficial document and stated that it would consider the Committee's request regarding participation in the project.

VIII. COMMUNICATIONS WITH AUDIT COMMITTEES

Mr. Hartig also brought up the issue of Regulation S-X, Article 2-07, communications with audit committees in situations where issuers file very frequently. Some of the firms are trying to come up with a mechanism to deal with the issue for entities needing 2-3 consents a week. What level of communication is required? Are real time discussions required? When should the discussions take place? Should it take place every time there is an audit committee meeting? Are written communications required with every consent? He indicated that some of the audit firms have identified what they think are best practices.

IX. CURRENT PRACTICE ISSUES

A. Form S-8 Reporting Requirements for Effects of Subsequent Events on Financial Statements

Background: Appendix C of the Staff Training Manual (Manual) states that certain events that occur after the end of a fiscal year will require retroactive restatement of (or revisions to) the prior financial statements if they are reissued. Such events may include a discontinued operation, a change in reportable segments, or adoption of a new accounting standard (for example, the transitional disclosures required by paragraph 61 of FASB Statement No. 142).

Question: Is a registrant required to incorporate by reference or include restated financial statements that reflect the impact of such an event in an <u>initial or post-effective amendment</u> to Form S-8?

Discussion: The instructions to Form S-8 do not contain any requirement for a company to update the registration statement for material events that occur after the end of a fiscal year which require retroactive restatement of the prior financial statements.

Section C.II of the Manual discusses the applicability of the updating requirements in Item 11(b) of Form S-3 to other registration statements and proxies. Item 11(b) of Form S-3 requires "restated financial statements prepared in accordance with Regulation S-X" in registration statements filed or amended after the date of a business combination accounted for as a pooling of interests. In Section C.II, the staff indicates that the updating requirements specified in Form S-3 are applicable to any registration statement or proxy following a pooling of interests except Form S-8.

View A: Form S-8 is not required to be updated to reflect the impact of material events (i.e. discontinued operations, change in reportable segments) that occur after the end of a fiscal year which require retroactive restatement of the prior financial statements.

View B: Form S-8 is required to be updated to reflect the impact of certain material events that occur after the end of a fiscal year which require retroactive restatement of the prior financial statements.

Staff Response: The Staff takes View A. Further, in a follow-up question from the Committee, the Staff concurred that Part III Proxy Statement information is not required to be on file (either included in the filed Form 10-K or in a filed proxy statement) prior to the filing/effective date of a Form S-8, unlike this requirement for other registrations statements (i.e. S-2, S-3, S-4) which does require Part III Proxy statement information to be on file prior to the effective date of such registration statement.

B. Presentation of Discontinued Operations in Predecessor Financial Statements

Question: Are predecessor financial statements required to be restated to reflect the impact of a disposal accounted for as a discontinued operation in the successor's financial statements?

Background: Paragraph 43 of FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* (FAS 144), states:

In a period in which a component of an entity has been disposed of or is classified as held for sale, the income statement of a business enterprise (or statement of activities of a not-for-profit organization) for current and prior periods shall report the results of operations of the component, including any gain or loss recognized in accordance with paragraph 27, in discontinued operations. [emphasis added]

However, it is not clear whether the guidance in paragraph 43 of FAS 144 should be applied to predecessor financial statements in circumstances where the successor entity reports a discontinued operation. An example of an event that creates a predecessor/ successor situation is the push-down of purchase accounting from an acquisition or the application of fresh-start reporting by a registrant upon emergence from bankruptcy.

We understand the SEC staff has informally indicated to at least one registrant that the determination of whether predecessor financial statements are required to be restated for a successor's discontinued operation is based on a registrant's particular facts and circumstances, such as what gave rise to the change in basis, the timing of the successor's discontinued operation relative to the change in basis, whether there was a change in business strategy and/or management as a result of the new shareholder group, the difficulty involved in pushing back the discontinued operation to the predecessor financial statements, and whether the predecessor was a carve-out of a larger entity.

Discussion: It is not clear how a registrant should apply the guidance in paragraph 43 of FAS 144 when a disposal accounted for as a discontinued operation is recorded in the successor's financial statements.

View A: Predecessor financial statements are not required to be restated to reflect the impact of a successor's discontinued operation. The predecessor's financial statements are those of a different reporting entity, with potentially different management and accounting systems and which were prepared using a different basis of accounting and, therefore, are not comparable.

View B: Predecessor financial statements are required to be restated to reflect the impact of a successor's discontinued operations. FAS 144 does not provide any exceptions to the requirement in paragraph 43 to restate all periods presented to reflect the impact of a discontinued operation.

View C: Determination of whether the predecessor financial statement must be restated to reflect the impact of a successor's discontinued operations is dependent on a registrant's particular facts and circumstances.

If View C – Specifically, what factors should be considered, and how should they be analyzed, when assessing whether the predecessor financial statements are required to be restated to reflect the impact of a successor's discontinued operation? For example, should the predecessor financial statements be restated if the event that gave rise to the change in basis was the push-down of purchase accounting from an acquisition? What if the change in basis was due to the application of fresh-start reporting upon emergence from bankruptcy? How does a change in business strategy or management as a result of the new shareholder group impact the assessment? What is meant by the difficulty involved in pushing back the discontinued operation to the predecessor financial statements?

Staff Response: The Staff takes View B. The Staff commented that View B achieves comparability for all fiscal periods presented; the Staff views comparability as an important and useful factor for readers to assess trend information in financial statements. However, registrants should contact the Staff if unusual facts and circumstances may prohibit the company's ability to reclassify predecessor fiscal periods.

C. Relationship between guarantees under FIN 45 and the calculation of the ratio of earnings to fixed charges.

Background: Item 503 of Regulation S-K requires a ratio of earnings to fixed charges to be presented in a registration statement if debt securities are being registered. The SEC Staff Training Manual Topic 8.II.B, includes in the definition of fixed charges "amounts accrued with respect to guarantees of other parties' obligations."

FASB Interpretation No. (FIN) 45, which was issued in November 2002, requires an entity that "undertakes an obligation to stand ready to perform over the term of a guarantee in the event that specified triggering events or conditions occur" to recognize a liability for that guarantee. Prior to the issuance of FIN 45 many companies applied the guidance in FASB Statement No. (FAS) 5 to guarantees, and therefore only recognized a liability for a guarantee if it was probable that payments would be required under that guarantee.

Question: Should the calculation of the fixed charges included in the ratio of earnings to fixed charges include a liability recognized for a guarantee under the provisions of FIN 45, or only include the liability if it is probable that payments will be required under the guarantee (i.e. following the guidance for loss contingencies under FAS 5)?

Discussion: FIN 45 was issued to clarify the requirements of FAS 5 relating to the guarantor's accounting for certain guarantees issued. The recording of a liability for a guarantor's obligation under FIN 45 does not take into consideration the probability of the guarantor being required to make payments under the guarantee. Paragraph 9 of FIN 45 states the following: "Because the issuance of a guarantee imposes a non-contingent obligation to stand ready to perform…Statement 5 regarding the guarantor's contingent obligation under a guarantee should be not interpreted as prohibiting the guarantor from initially recognizing a liability for that guarantee even though it is *not* probable that payments will be required under that guarantee."

However, the intent of the ratio of earnings to fixed charges is to provide investors with a measure of a registrant's ability to meet its fixed obligations associated with related debt securities. As such, it would appear that the guidance in FAS 5 with respect to recording a loss at the point in which it becomes probable a loss exists is consistent with the notion of a "fixed" charge. Some believe that including liabilities for guarantees accounted for under FIN 45 in the ratio of earnings to fixed charges would alter the basic intent of that measure.

View A: (FAS 5 approach) The registrant's ratio of earnings to fixed charges should include amounts with respect to the guarantee of another parties' obligation only when it is probable that such obligation will be incurred by the registrant. That approach would be consistent with the notion of a fixed charge.

View B: (FIN 45 approach) All amounts accrued for guarantees should be included in the ratio of earnings to fixed charges. The contingent aspect of the obligation is factored into the fair value of a liability recorded under FIN 45.

Staff Response: The Staff takes View A. In addition, registrants should disclose the nature of guarantee arrangements accounted for under FIN 45 and how the company has treated the guarantee in the calculation of the ratio of earnings to fixed charges.

D. Applying Accelerated Filer Status When a Registrant Changes Its Fiscal Year-End

The due dates of a registrant's reports on Forms 10-K or 10-Q (including transition reports) are determined based on whether or not the registrant is an accelerated filer as defined in Exchange Act Rule 12b-2.

Question: How should a registrant determine the due dates of its transition report and the first three quarterly reports of the new fiscal year in connection with a change it fiscal year-end?

View A: The registrant should use its accelerated filer status (and associated filing deadlines) as determined at the end of its most recently completed fiscal year and should not reassess its accelerated filer status at the close of the transition period unless the transition period covers a period of nine months or more in which case the end of the transition period should be treated like the end of a fiscal year.

View B: The registrant should reassess its status as an accelerated filer as of the end of the transition period (i.e., its new fiscal year end) treating the transition period as if it were a fiscal year without regard to the length of the transition period. However, the common equity public float test should be based on the last business day of the registrant's most recently completed second fiscal quarter of its old fiscal year-end.

View C: The registrant should reassess its status as an accelerated filer as of the end of the transition period (i.e., its new fiscal year end) treating the transition period as if it were a fiscal year without regard to the length of the transition period. The common equity public float test should be based on the last business day of what would have been the registrant's most recently completed second fiscal quarter if the close of the transition period were actually the end of a full fiscal year (e.g., a pro forma second fiscal quarter).

Committee Recommendation: The Committee supports View A based on General Instruction A(3) of Form 10-K which states: "Transition reports on this Form shall be filed in accordance with the requirements set forth in Rule 13a-10 or Rule 15d-10 applicable when the registrant changes its fiscal year end" [emphasis added]. The requirements that are applicable when the registrant changes its fiscal year-end should be based on the registrant's status as of the end of its most recently completed fiscal year. The Committee also supports View A in light of the fact that Views B and C could lead to the need to reassess accelerated filer status in connection with a 10-Q filing (e.g., a change in year-end of less than 6 months reported on Form 10-Q) or when a transition report is not being filed at all (e.g., a transition period of a month or less) which could lead to the need to file a 10-Q on an accelerated basis prior to the time that the registrant had filed a Form 10-K on an accelerated basis. The Committee recognizes, however, that transition periods of nine-months or more should be treated as fiscal years consistent with

Rule 3-06 of Regulation S-X.

Examples: The following examples depict how each of the three Views would be applied to various changes in fiscal year-end.

Application of Views A, B and C

Company X has a June 30 fiscal year-end. As of June 30, 2004, Company X was not an accelerated filer (as defined in Exchange Act Rule 12b-2) solely because the aggregate market value of the voting and non-voting common equity held by non-affiliates was less than $75 million as of December 31, 2003. Company X met all of the other criteria for being an accelerated filer.

Beginning January 15, 2004 and at all times since then, the aggregate market value of the voting and non-voting common equity held by non-affiliates has exceeded $75 million.

On November 15, 2004, Company X determined to change its fiscal year-end. The grid below depicts the due dates of the transition report and Form 10-Q filings for the new fiscal year that would result from the application of Views A, B and C assuming that Company X changes its year-end to July 31, November 30, December 31 and March 31:

New Fiscal Year-End	View A	View B	View C
July 31, 2004			
Accelerated filer?	No	No	Yes
10-Qs of new fiscal year due?	45 days	45 days	40 days
November 30, 2004			
Accelerated filer?	No	No	Yes
Transition report (10-Q) due?	45 days	45 days	45 days
Transition report (10-K) due?	90 days	90 days	75 days
10-Qs of new fiscal year due?	45 days	45 days	40 days
December 31, 2004			
Accelerated filer?	No	No	Yes
Transition report (10-K) due?	90 days	90 days	60 days
10-Qs of new fiscal year due?	45 days	45 days	35 days
March 31, 2005			
Accelerated filer?	Yes	No	Yes
Transition report (10-K) due?	60 days	90 days	60 days
10-Qs of new fiscal year due?	35 days	45 days	35 days

Staff Response: The Staff takes View C. Registrants should treat the end of a transition period as the new year-end for the company. From the end of the transition period, registrants would then look back 6 months to determine whether the company qualifies as an accelerated filer. The Staff concurs with -the View C conclusions outlined in the Application table set forth above.

E. Determining the Section 404 Reporting Requirements When a Registrant Changes Its Fiscal Year-End

In Release No. 33-8238, *Final Rule: Management's Reports on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports* (as amended by Release No. 33-8392 of the same name), the Commission stated that:

> A company that is an "accelerated filer," as defined in Exchange Act Rule 12b-2, must begin to comply with the management report on internal control over financial reporting requirement and the related registered public accounting firm report requirement in Items 308(a) and (b) of Regulations S-K and S-B for its first fiscal year ending on or after November 15, 2004. A non-accelerated filer must begin to comply with these requirements for its first fiscal year ending on or after July 15, 2005.

Question: How are the Commission's requirements relating to the report of management on internal control over financial reporting ("404 Report") impacted by changes in fiscal year-end?

View A: Transition reports filed on Forms 10-K/10-KSB (whether by rule or by election) must include a 404 Report, subject to the transition provisions specified in Release No. 33-8392. The transition provisions relating to 404 Reports should be applied only to fiscal years (or a transition period that is deemed to constitute a year under Rule 3-06 of Regulation S-X). Transition reports on Forms 10-Q/10-QSB are not required to include a 404 Report.

View B: Transition reports filed on Forms 10-K/10-KSB (whether by rule or by election) must include a 404 Report, subject to the transition provisions specified in Release No. 33-8392. The transition provisions relating to 404 Reports should be applied to any transition period as if it were a fiscal year. Transition reports on Forms 10-Q/10-QSB are not required to include a 404 Report.

Committee Recommendation: The Committee supports View A. The Committee believes that transition reports on Forms 10-K/10-KSB should include a 404 report (subject to transition provisions) because those forms are required to respond to Item 308(a) of Regulations S-K/S-B. Similarly, the Committee does not believe that transition reports on Forms 10-Q/10-QSB should be required to include a 404 Report because those forms are not required to respond to Item 308(a) of Regulations S-K/S-B. With respect to transition provisions, the Committee believes that the transition provisions were intended to apply to periods that constitute a fiscal year (including a transition period of nine-months or more).

Examples: The following examples depict how each of the two Views would be applied to various changes in fiscal year-end.

Application of Views A and B

Company X has a May 31 fiscal year-end.

On November 15, 2004, Company X determined to change its fiscal year-end and will be filing its transition report on Form 10-K (even with respect to the change of 1 months and 5 months). The grid below depicts the conclusions (applying Views A and B) as to whether the transition report will need to include a 404 Report.

Note: A/F=Accelerated filer; N/A/F=Non-accelerated filer

New Fiscal Year-End	View A		View B	
	A/F	N/A/F	A/F	N/A/F
June 30 , 2004	No	No	No	No
October 31, 2004	No	No	No	No
November 30, 2004	No	No	Yes	No
February 28, 2005	Yes	No	Yes	No

* * * * * * * * * *

Assume the same facts as above except that the determination to change fiscal year-end was November 15, 2005. The grid below depicts the conclusions (applying Views A and B) as to whether the transition report will need to include a 404 Report.

New Fiscal Year-End	View A		View B	
	A/F	N/A/F	A/F	N/A/F
June 30 , 2005	Yes	No	Yes	No
October 31, 2005	Yes	No	Yes	Yes
November 30, 2005	Yes	No	Yes	Yes
February 28, 2006	Yes	Yes	Yes	Yes

Staff Response: The Staff takes View B. The Staff noted that the term "fiscal year" in the rule quoted above from Release No. 33-8238, *Final Rule: Management's Reports on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports* (as amended by Release No. 33-8392 of the same name) replaced the term "annual report" from the proposed rule in order to include transition period ends.

Additional Committee Question: In a scenario where a calendar year-end company has historically been a voluntary filer (perhaps due to a bank debt requirement), completes and has a registration statement declared effective prior to June 30, 2004 and whose market capitalization is greater than $75 million at June 30, 2004, is that company deemed to be an accelerated filer and subject to 404 reporting at December 31, 2004?

Staff Response: The Staff stated that it is considering issuing a question and answer document on Sarbanes-Oxley 404 reporting. The Staff requested firms to submit scenarios and questions such as these to be considered for inclusion. The Staff defers its answer to this additional question pending the issuance of that document. Note: the SEC staff issued the document "Management's Report on Internal Control Over Financial Reporting and Disclosure in Exchange Act Periodic Reports:Frequently Asked Questions"subsequent to the April 8, 2004, SEC Regulations Committee Meeting. See Question 7 in that document for the answer to this above question.

F. Applying Accelerated Filer Rules In Connection With a Reverse Merger

Facts: Company A, is a March 31 year-end SEC registrant. As of March 31, 2004, Company A was an accelerated filer (as defined in Exchange Act Rule 12b-2). The aggregate market value of the voting and non-voting common equity held by non-affiliates has exceeded $75 million at all times since its inception.

Company I is a calendar year-end SEC registrant. As of December 31, 2003, Company I was not an accelerated filer solely because the aggregate market value of the voting and non-voting common equity held by non-affiliates was less than $75 million as of June 30, 2003 (i.e., the last business day of Company I's most recently completed second fiscal quarter). Company I met all of the other criteria for being an accelerated filer.

On October 15, 2004, Company I and Company A consummated a business combination which was accounted for as a reverse acquisition. Company I is the legal issuer but Company A is the accounting acquirer.

The aggregate market value of Company I's voting and non-voting common equity held by non-affiliates remained less than $75 million until the date it acquired Company A.

Company I filed an Item 2 Form 8-K reporting the consummation of the transaction within 15 days of October 15, 2004. Although it was permitted to take up to 60 days more, at the same time as filing the Form 8-K reporting the consummation of the merger with Company A, Company I also filed Company A's financial statements for each of the three years in the period ended March 31, 2004 (audited) and for the three-month periods ended June 30, 2004 and 2003 (unaudited).

Company I filed its September 30, 2004 Form 10-Q (with Company I's pre-merger f/s) within 45 days after September 30, 2004.

Question 1: If Company I retains its December 31 year-end, when will its transition report on Form 10-K covering the period from April 1, 2004 through December 31, 2004 be due?

View A-1: Company I's transition report on Form 10-K is due 90 days after December 31, 2004 Company I is only required to reassess its status as an accelerated filer as of the end of its fiscal year. Because the period from April 1, 2004 through December 31, 2004 is a "transition period" rather than a fiscal year, Company I is not required to reassess its accelerated filer status until December 31, 2005.

View A-2: Company I's transition report on Form 10-K is due 90 days after December 31, 2004. Although Company I must reassess its status as an accelerated filer as of its current fiscal year end (December 31, 2004), the aggregate market value of the voting and non-voting common equity held by non-affiliates was less than $75 million as of the last business day of Company I's most recently completed second fiscal quarter (June 30, 2004).

View A-3: Company I's transition report on Form 10-K is due 90 days after December 31, 2004.

This view is supported by General Instruction A(3) of Form 10-K which states: "Transition reports on this Form shall be filed in accordance with the requirements set forth in Rule 13a-10 or Rule 15d-10 applicable when the registrant changes its fiscal year end." [emphasis added] When (i.e., at the time) the need for Company I to file a transition report was triggered (October 15, 2004) it was a non-accelerated filer. Accordingly, pursuant to Rule 13a-10, the form is due not more than 90 days after the later of (i) the close of the transition period or (ii) the date of the determination to change the fiscal closing date. Because the close of the transition period (December 31, 2004) is later than the date of the determination to change the fiscal closing date (which is the consummation date--October 15, 2004), the transition report on form 10-K will be due 90 days after December 31, 2004.

View B-1: Company I's transition report on Form 10-K is due 60 days after December 31, 2004. Company I succeeded to Company A's status as an accelerated filer by virtue of succeeding to its prior financial statement history (e.g., the historical financial information of Company A became the historical financial information of Company I).

View B-2: Company I's transition report on Form 10-K is due 60 days after December 31, 2004. Company I must reassess its accelerated filer status as of the end of its fiscal year (December 31, 2004) using the aggregate market value of Company A's voting and non-voting common equity held by non-affiliates as of the last business day of Company A's most recently completed second fiscal quarter (September 30, 2004).

Question 2: Does Company I's transition report on Form 10-K need to include a management report on internal control over financial reporting pursuant to Item 308 of Regulation S-K?

View A: If Company I is determined to be an accelerated filer as of December 31, 2004, then it is required to include a management report on internal control over financial reporting in its transition report on Form 10-K. If Company I is not considered an accelerated filer as of December 31, 2004, then it is not required to include a management report on internal control over financial reporting in its transition report on Form 10-K.

View B: Even if Company I is determined to be an accelerated filer as of December 31, 2004, Company I would not need to include a management report on internal control over financial reporting in its transition report. This view is supported by the transition provisions relating to the Commission's 404 rules require state that:

"A company that is an "accelerated filer," as defined in Exchange Act Rule 12b-2, as of the end of its first fiscal year ending on or after June 15, 2004, must begin to comply with the management report on internal control over financial reporting disclosure requirements in its annual report for that fiscal year."

Because a "transition report" is not an "annual report", by definition, Company I need not include a management report on internal control over financial reporting in its transition report.

Note: A rule release has removed the distinction in 404 rules between a transition report and an annual report. Thus, View B no longer represents a valid alternative view.

Question 3: When is Company I's March 31, 2005 Form 10-Q due?

View A: The filing deadline for Company I's March 31, 2005 Form 10-Q depends on whether or not Company I is determined to be an accelerated filer as of December 31, 2004.

View B: If the answer to Question 1 above is A-3, Company I must still make the accelerated filer assessment as of December 31, 2004 (pursuant to either the method described in Answer A-2 or B-2 to Question 1 above) and must follow the filing deadlines that correspond to that determination.

Question 4: If Company I elects to adopt the fiscal year of the accounting acquirer (March 31), when would Company I's March 31, 2005 Form 10-K be due?

View A: Company I's Form 10-K is due 90 days after March 31, 2005. Although Company I must reassess its status as an accelerated filer as of its current fiscal year end (March 31, 2005), the aggregate market value of the voting and non-voting common equity held by non-affiliates was less than $75 million as of the last business day of Company I's most recently completed second fiscal quarter (September 30, 2004).

View B-1: Company I's Form 10-K is due 60 days after March 31, 2005. Company I succeeded to Company A's status as an accelerated filer by virtue of succeeding to its prior financial statement history (e.g., the historical financial information of Company A became the historical financial information of Company I).

View B-2: Company I's transition report on Form 10-K is due 60 days after March 31, 2005. Company I must reassess its accelerated filer status as of the end of its fiscal year (March 31, 2005) using the aggregate market value of Company A's voting and non-voting common equity held by non-affiliates as of the last business day of Company A's most recently completed second fiscal quarter (September 30, 2004).

Staff Response: The Staff communicated that reverse mergers commonly involve unique facts and circumstances and would therefore encourage registrants to contact the Staff should a fact pattern such as this arise.

G. How the transition provisions of FAS 150 should be applied in an IPO.

Note: The specific situation described below was developed prior to the issuance of the FASB issued Staff Position 150-3 (FSP 150-3), on November 7, 2003. FSP 150-3 deferred the effective date for applying the provisions of Statement 150 for (a) mandatorily redeemable financial instruments of certain nonpublic entities and (b) certain mandatorily redeemable noncontrolling interests as outlined in the FSP. This example has not been altered to reflect the fact patterns that would reflective of a post FSP 150-3 scenario.

Background:

- A private, calendar year-end company is preparing an S-1 in September 2004 for an IPO.

- The S-1 includes audited financial statements for years ended December 31, 2003, 2002 and 2001 and unaudited financial statements for June 30, 2004 and 2003.

- The Company has mandatorily redeemable preferred stock that meets the FAS 150 definition of a Mandatorily Redeemable Financial Interest (MRFI). The security was issued on January 1, 1999 at its fair value and carries a 10% cumulative dividend. No dividends have been declared or paid since the date the security was issued.

- The Company has historically followed 'private company GAAP' for this MRFI and has not accrued any dividends since the date that the security was issued. The security is reported in the consolidated financial statements at the same amount at which it was issued.

- The financial statements included in the S-1 have been previously sent to the company's common shareholders, the private placement holders of the preferred stock and to the company's lenders.

- FAS 150's transition provisions are as follows:

  *29. This Statement shall be effective for financial instruments entered into or modified after May 31, 2003, and otherwise shall be effective at the beginning of the first interim period beginning after June 15, 2003, except for mandatorily redeemable financial instruments of a nonpublic entity. For mandatorily redeemable financial instruments of a nonpublic entity, this Statement shall be effective for existing or new contracts for fiscal periods beginning after December 15, 2003**.*

For financial instruments created before the issuance date of this Statement and still existing at the beginning of the interim period of adoption, transition shall be achieved by reporting the cumulative effect of a change in an accounting principle by initially measuring the financial instruments at fair value or other measurement attribute required by this Statement.

*** - see* **Note** *above*

30. For mandatorily redeemable financial instruments and physically settled forward purchase contracts subject to the measurement requirements in paragraph 22 of this Statement, "dividends" and other amounts paid or accrued prior to reclassification of the instrument as a liability shall not be reclassified as interest cost upon transition. Reclassification to liabilities of preexisting noncontrolling interests that were recognized in business combinations under the purchase method and are mandatorily redeemable shall not result in changes in amounts previously recognized under the purchase method.

31. Restatement of financial statements for earlier years presented is not permitted.

Question: As of what date should this company adopt FAS 150?

View A: Reflect the adoption of FAS 150 back to January 1, 1999 with no cumulative effect adjustment as of January 1, 2000. This view follows APB 20, paragraph 29 but disregards the fact that FAS 150 indicates that prior period financial statements cannot be restated. (It would in effect apply an "energized" version of ASR 268, from the date of issuance in reliance on par. 29, but moving the security past the mezzanine all the way to liabilities. In other words, treat the application of ASR 268 as now, in light of FAS 150, requiring a move into liability classification.) This could, however, result in IPO company accounting not always consistent with that of companies that have been public throughout the periods in question.

Proponents of View A note that in large measure, the point of par. 29 of APB 20 is to give greater weight, in an IPO, to the comparability benefits of restating prior periods. Proponents of View A recognize that FAS 150 clearly states that prior years presented may not be restated but that the same prohibition exists in the context of an elective change in accounting as well (and par. 29 of APB overrides that general rule). Proponents of View A also note that View B would result in financial statements in the S-1 which do not recognize FAS 150 (other than SAB 74 disclosure) and is inconsistent with the notion that a company preparing an S-1 should apply public company GAAP for all periods (e.g., need to reclassify mandatorily redeemable preferred out of permanent equity even though they weren't a public company during prior periods).

View B: Reflect the adoption of FAS 150 in Q3 of 2004, with a cumulative effect adjustment as of July 1, 2004 (e.g., do not reflect it in the financial statements included in the first filing of the S-1). This would give weight to the fact that the company was still nonpublic during the periods covered by the financial statements and would give weight virtually exclusively to the literal transition provisions and to the no-restatement notions included in FAS 150.

Proponents of View B note that it is the only method which would follow the explicit language of FAS 150 which proscribes the restatement of prior years presented.

View C: Adopt FAS 150 effective July 1, 2003 and therefore "restate" the financial statements for December 31, 2003 and June 30, 2004 (recording a cumulative catch as of July 1, 2003). This view would essentially treat the company as if it were any other pre-existing public company (e.g., a registrant prior to July 1, 2003).

Proponents of View C note that this method is the answer that would be achieved had the company been an SEC registrant for all periods presented and strikes a balance between APB 20 and the restatement proscription in FAS 150. Proponents of View C also note that this conclusion is consistent with conclusions reached with respect to IPO companies adopting other standards that prohibit retroactive application (e.g., FAS 106) and that the need to retrospectively evaluate some of the trickier types of securities going back three years could present some auditing problems.

Committee Recommendation: Either View A or View C would be acceptable.

Staff Response: The Staff takes View C. Similar to certain prior accounting standards, SFAS 150 has accounting treatment alternatives for public and nonpublic entities (and, after the issuance of FSP 150-3, for SEC and non SEC registrants). An entity is generally no longer eligible for the nonpublic company treatment alternatives when it is in the process of becoming a public entity. Such entities must comply with public company treatment alternatives in the standard as of the date that all public companies were required to adopt the standard, even if that requires a company that is in the process of filing an IPO to restate prior period financial statements. This approach is consistent with the staff's past practice for adoption of new standards with different treatment alternatives for public and nonpublic entities. It should be noted that the accommodation in APB 20, paragraph, 29, relative to a voluntary change in accounting principles in conjunction with an IPO does not apply in these circumstances.

In addition, for any periods prior to the date on which SFAS 150 is first adopted for any instrument, the company is required to comply with ASR 268 and Regulation S-X, Article 5-02.28, if applicable to such instrument. Under ASR 268, any securities with redemption features that are not solely within the control of the issuer must be classified outside of permanent equity.

Additional Question - FAS 150 Adoption in an IPO (Note: this issue was discussed with the staff subsequent to the joint meeting but was included in this discussion summary due to the relevance of the issue related to the topic above): How should the transition provisions of FAS 150 be applied in an equity IPO for a Company that has public debt outstanding.

Additional Discussion: The above discussion regarding the adoption of FAS 150 in an IPO does not explicitly address how the transition provisions of FAS 150 should be applied in an equity IPO for a Company that has public debt outstanding. As such, how does the discussion above apply to a company that is already public by virtue of having public debt outstanding and then pursues a public offering of its equity securities? Specifically, the question is whether in the public offering for its equity securities (the Form S-1), the company would adopt FAS 150 on July 1, 2003 despite the fact that in its historical public debt filings (Forms 10-K and 10-Q) the company adopts FAS 150 on January 1, 2004 in its Form 10-Q for the quarter ended March 31, 2004, as required by the transition rules of FAS 150, as modified by FSP FAS 150-3.

If the above discussion is applied and the Company's historical financials statements included in its Form S-1 to register its equity securities must adopt FAS 150 as of July 1, 2003, then the historical financial statements included in the S-1 will be inconsistent with the company's publicly filed historical financial statements in its periodic 1934 Act filings required as a result of having public debt securities outstanding. To have the same historical financial statements on file presented on different bases does not result in useful or meaningful financial information and is confusing to readers.

The following example illustrates the issue:

Company A, a calendar year-end company, has public debt outstanding but its equity is private. As such under FAS 150, the Company meets the definition of a nonpublic entity (as defined in FAS 150). Accordingly, under FAS 150, the Company is required to adopt FAS 150 on January 1, 2004, that is, in its quarter ended March 31, 2004.

However, the effective date of certain provisions of Statement 150 for certain mandatorily redeemable financial instruments has been deferred by FSP FAS 150-3, "Effective Date, Disclosures, and Transition for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests under FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity*".

Under FSP FAS 150-3, because the Company has public debt outstanding, it is considered a nonpublic SEC Registrant. Under FSP FAS 150-3, "Mandatorily redeemable financial instruments issued by SEC registrants are not eligible for either of those deferrals, even if the entity meets the definition of a nonpublic entity in Statement 150. Those entities shall follow the effective dates required by Statement 150 and related guidance" for classification, measurement and disclosure.

As such, the Company is required to adopt FAS 150 (for classification, measurement and disclosure) effective January 1, 2004 i.e., in its Form 10-Q for the period ended March 31, 2004.

Proposed Views:

The proposed solution to this situation is to permit the transition provisions of FAS 150 to be applied consistently in the historical financial statements presented in the equity IPO for a Company that has public debt outstanding. This consistency could be accomplished under either one of two views:

View A: Since the Company is required to adopt FAS 150 (as to classification, measurement and disclosure) on January 1, 2004 in its historical financial statements included in its Form 10Q for the quarter ended March 31, 2004, the S-1 should also reflect adoption of FAS 150 on January 1, 2004.

View B: The Company should adopt FAS 150 as of July 1, 2003 for both the 1934 Act filings and for the Form S-1. However, the previously filed Form 10-K for the year ended December 31, 2003 and the related quarterly periods ended September 30, 2003 and December 31, 2003 were compliant with GAAP when filed. As such, the 2003 Form 10-K and the September 30, 2003 Form 10Q should not be amended by filing a Form 10-K/A or a Form 10-Q/A. Rather, if this view were followed, the prior periods would be restated in current 1934 Act filings to reflect adoption of FAS 150 from July 1, 2003.

Staff Comment: The staff takes View A. This view reflects the requirements for adoption specified in FAS 150 without requiring restatement of previous filed financial statements that were compliant with GAAP at the time of filing.

H. "Public Company" GAAP Disclosures in Financial Statements Provided Under Rules 3-05, 3-09, 3-14 or Rule 3-16 of Regulation S-X

Question: Must financial statements filed with the SEC pursuant to Rules 3-05, 3-09, 3-14 or 3-16 of Regulation S-X comply with GAAP disclosures, and related transition provisions, that specifically apply to "public companies?"

Background: Financial statements of companies other than a registrant are required to be filed in certain circumstances. These financial statements must comply with GAAP and the provisions of Regulation S-X regarding form and content. However, some accounting standards require disclosures only by a "public company," as defined. In many cases, companies whose financial statements are filed under Rules 3-05, 3-09, 3-14 or 3-16 of Regulation S-X do not meet the GAAP standards' definitions of a public company. Regulation S-X and other SEC rules and regulations do not specify that all financial statements filed with the SEC must comply with GAAP disclosures that specifically apply only to "public companies."

Discussion: The extent and scope of financial statement disclosures required by GAAP may vary depending on whether the entity meets the definition of a "public company" as defined in the respective GAAP accounting pronouncement. That is, certain accounting pronouncements (e.g., Statement 132R) require disclosures specific to either a "public company" or to a "non-public entity" whereas other accounting pronouncements (e.g., Statement 128 or Statement 131) only require disclosures for a "public company." In addition, the transition provisions relating to the adoption of a new accounting pronouncement (e.g., FIN 46R, Statement 150, etc.) may differ depending on whether the entity meets the pronouncement's definition of a "public company."

View A – All financial statements included in filings with the SEC should comply with GAAP applicable to a "public company." The proponents of this view believe that investors expect and would benefit from the GAAP disclosures applicable to public companies. The proponents of this view also believe that the inclusion of a company's financial statements in an SEC filing subjects the company to the disclosure standards for a public company, whether those disclosures are specified in GAAP or SEC rules.

View B – A company should assess whether or not it meets the definition of a "public company" as defined in the respective GAAP accounting pronouncement in order to determine whether or not it must comply with the applicable disclosure requirements. When a company does not meet the GAAP definition of a public company (e.g., because it is not an issuer), it should not be required to comply with GAAP disclosures specified for a public company just because SEC rules require a registrant to provide its financial statements in the registrant's filing.

Committee Recommendation: The committee supports View B and further understands that View B is a long-standing Staff position.

Staff Response: The Staff takes View B. However, the staff encourages full disclosure.

I. Determining Significance of the Acquisition of a Portion of Another Entity Where Only Partial Financial Statement Information is Available

Question: How should the registrant compute the significance of an acquired business under the income test where the only financial information available is less than full financial statements?

Background and Discussion: Under S-X Rule 3-05, the periods for which financial statements of an acquired business are required to be filed is determined by reference to the significance tests in S-X Rule 1-02(w). The income significance test requires the comparison of income from continuing operations before income taxes, extraordinary items, and cumulative effect of a change in accounting principle of the acquired business with such income of the registrant.

In connection with certain acquisitions of a portion of another company, the only financial information available is less than full financial statements (e.g., often the only available financial information of the acquired business is revenue less direct costs). However, in such circumstances, the question arises as to how to compute significance of the acquired business under the income test. The income test of significance contained in S-X Rule 1-02(w) does not contemplate use of less than a full income statement when calculating significance. It should be noted that in these circumstances, the SEC staff requires pre-clearance when filing less than full financial statements in satisfaction of the requirements of S-X Rule 3-05.

View A - Compare revenue less direct costs of the acquired business to the registrant's comparable financial measure for purposes of computing the income test. The income test in S-X Rule 1-02(w) cannot be literally applied due to the truncated nature of the financial statements. The purpose of S-X Rule 3-05 is to determine the significance of an acquired business to the ongoing operations of a registrant. The Staff has long recognized that certain expense items may be excluded from carve out financial statements due to the inherent difficulties in identifying appropriate amounts. To calculate significance, it naturally follows that the basis for determining the denominator should be consistent with the basis for determining the numerator, as is the case when calculating significance under S-X Rule 3-09. For example, SAB Topic 1B does not require that interest expense on parent level debt be included in separate financial statements of a subsidiary in all situations. Not putting financial statements on a comparable basis for purpose of measuring significance will create a bias against highly leveraged acquirers in that revenues less direct expenses will likely always be disproportionately significant to pretax operating income of such registrants. Using a comparable measure provides a meaningful calculation of ongoing significance and is consistent with the Staff's historical practice.

View B - Compare revenue less direct costs of the acquired business to the registrant's income from continuing operations before income taxes, extraordinary items, and cumulative effect of a change in accounting principle. This calculation applies S-X 1-02(w) as closely as possible. If such computation exceeds 20%, comply with the requirements of Rule 3-05. A disproportionate measure of significance can be addressed by the SEC Staff in the same way that they have addressed other anomalies in S-X 1-02(w) significance calculations.

Staff Response: The Staff takes View B. As indicated in the background and discussion section above, registrants are required to contact the Staff in these circumstances. Should View B result in a distorted or impracticable answer, the company should alert the staff to that fact.

J. Determining the Transition Requirements for Reporting on Internal Control Over Financial Reporting ─ Small Business Issuers & Foreign Private Issuers

Questions: How should the following issuers determine whether they must comply with Regulation S-K Item 308(a) & (b) in annual reports for fiscal years ended on or after November 15, 2004:

a. An accelerated filer who will qualify as a small business issuer for purposes of reporting in its next fiscal year?

b. A foreign private issuer that files a Form 10-K rather than Form 20-F?

Background: As revised, registrants that meet the definition of an Accelerated Filer must report on internal control over financial reporting for fiscal years ending on or after November 15, 2004. All other issuers (including smaller companies who are not Accelerated Filers, small business issuers, companies with only registered debt and preferred securities, and foreign private issuers that file their annual report on Form 20-F or Form 40-F) must report on internal control over financial reporting for fiscal years ending on or after July 15, 2005.

Exchange Act Rule 12b-2 defines an Accelerated Filer as a public company that meets all of the following conditions as of the end of any fiscal year ending on or after November 15, 2002:

(i) Has a public float of $75 million or more (measured using the market price of its common stock as of the last business day of the second fiscal quarter of the respective fiscal year);

(ii) Has been a public company for at least 12 months subject to the reporting requirements of Section 13(a) or 15(d) of the Exchange Act;

(iii) Has filed at least one SEC annual report; and

(iv) Is not a small business issuer eligible to use Forms 10-KSB and 10-QSB.

Discussion:

<u>An Accelerated Filer Subsequently Qualifies as a Small Business Issuer</u>

Once a company becomes an Accelerated Filer, it remains an Accelerated Filer until the company qualifies as a small business issuer. That is, an issuer continues to be an Accelerated Filer, subject to the earlier effective date of the Final 404 Rule, until its public float falls below $25 million (at some point during the last 60 days of two consecutive fiscal years) and it has revenues of less than $25 million (for two consecutive fiscal years). Under Regulation S-B Item 10(a)(2)(v), the determination that an issuer qualifies as a small business issuer as of the end of its fiscal year allows it to begin using SB forms in the first quarter of its next fiscal year.

It is not clear whether an Accelerated Filer that meets the definition of a small business as of the end of its first fiscal year ending on or after November 15, 2004 must comply with S-K Items 308(a) & (b) in its Form 10-K for that fiscal year (or whether that Form 10-K is subject to the accelerated reporting deadline). Assume a calendar year registrant met the definition of an Accelerated Filer at December 31, 2002. If this entity was eligible to file its March 31, 2005 quarterly report on Form 10-QSB (i.e., its revenues were less than $25 million in 2003 and 2004 and its public float was less than $25 million as of a date within 60 days prior to the end of 2003 and 2004), must it still comply with S-K Items 308(a) & (b) in its December 31, 2004 Form 10-K?

View A – At December 31, 2004, the company is an Accelerated Filer because it is not eligible to file its annual report on Form 10-KSB. Accordingly, the company must file the 2004 Form 10-K by March 1, 2005 (the accelerated reporting deadline) and report on internal control over financial reporting. Although such an issuer would be able to file its March 31, 2005 quarterly report on Form 10-QSB, it continues to be subject to the accelerated reporting deadlines and the transition provisions for internal control reporting with respect to Accelerated Filers.

View B – At December 31, 2004, the company meets the definition of a small business issuer, even though it cannot file its 2004 annual report on Form 10-KSB. Accordingly, the company is not an Accelerated Filer and must file the 2004 Form 10-K by March 31, 2005 (the normal reporting deadline). Further, as an eligible small business issuer, the company would not be required to report on internal control over financial reporting until its annual report for the year ended December 31, 2005 (i.e., subject to the transition provisions for internal control reporting with respect to small business issuers).

Committee Recommendation: The committee supports View B.

Staff Response to Questions a and b: The Staff takes View A. For consistency purposes, companies are required to follow the form that they are filing on. This view hold true for small business issuers and foreign private issuers. However, registrants are encouraged to contact the Staff should the application of View A not result in a practicable answer.

K. Preparing Pro Forma Financial Information Following a Registrant's Change in its Fiscal Year End

Question: How should a registrant prepare pro forma financial information under Article 11 of Regulation S-X when a change in its fiscal year resulted in a transition period of less than 9 months?

Background: When required under Article 11 of Regulation S-X, pro forma financial information generally must be provided for the most recent fiscal year and any subsequent interim period. Under S-X Rule 11-03(c)(3), when combining entities with different fiscal year ends, an acquired entity's income statement should be adjusted to within 93 days of the registrant's fiscal year, if practicable.

Discussion: It is not clear how a registrant should comply with Article 11 when the registrant changed its fiscal year in the prior year and filed a transition report for a period of less than 9 months. Consider the following example.

Example

- Registrant changed its fiscal year from 4/30/02 to 12/31/02
- Registrant filed a transition report on Form 10-K for the 8 month period ended 12/31/02 and the three years ended 4/30/02
- Registrant acquired a business (ABC) on 7/31/03 that was significant under Rule 1-02(w) of Regulation S-X
- ABC has a 12/31 year-end

Had the registrant not changed its fiscal year end during 2002, it would be required to provide the following pro forma financial information in its Form 8-K reporting the ABC acquisition:
- Balance sheet as of 4/30/03
- Income statement for the year ended 4/30/03

Since the transition report for the 8-month period ended 12/31/02 is less than 9 months, the registrant cannot use this period to satisfy the financial statement requirements of a period of 1 year under Rule 3-06 of Regulation S-X. Therefore, how should the registrant apply Article 11 for purposes of preparing the pro forma income statement for the period ended 12/31/02?

View A – The pro forma income statement for the "most recent fiscal year" should be based on the transition period of the registrant, supplemented as necessary by earlier periods sufficient to provide 9 to 12 months of historical financial information for the registrant. The following illustrates the application of View A to the pro forma financial information for the acquisition of ABC:

	11 Month Period Ended 12/31/02
Registrant	2/1/02 – 12/31/02 * (11 months)
ABC	1/1/02-12/31/02 (12 months)

* Derived as follows: 8-month transition period ended 12/31/02 + 3-month period ended 4/30/02 (i.e., the fourth fiscal quarter of the registrant's old fiscal year)

In this presentation, the pro forma income statement will include 11 months of historical financial information of the registrant. As a result, the registrant can rely on Rule 3-06 to satisfy the Article 11 requirement of preparing a pro forma income statement for the latest fiscal year.

View B – The pro forma income statement for the "most recent fiscal year" requires the registrant to present pro forma income statements for the transition period as well as the most recently completed fiscal year of the registrant. The following illustrates the application of View B to the pro forma financial information for the acquisition of ABC:

	8 Month Period Ended 12/31/02	Year Ended 4/30/02
Registrant	5/1/02 – 12/31/02 (8 months)	5/1/01 – 4/30/02 (12 months)
ABC ***	4/1/02 – 12/31/02* (9 months)	4/1/01 – 3/31/02** (12 months)

* Derived as follows: 2002 – YTD 3/31/02
** Derived as follows: 2001 + YTD 3/31/02 **-** YTD 3/31/01
*** Article 11-01(c)(3) would require disclosure of the periods combined

The proponents of View B believe that the Article 11 pro forma income statement presentation should correspond to the historical financial statement presentation of the registrant.

View C – Either View A or View B would be acceptable and would satisfy the requirements of Article 11.

Staff Response: The Staff concurs that the general approach outlined in either View A or View B could be an acceptable approach, however, in either view, the periods of the registrant and the acquiree should match; (i.e. 12 month to 12 month combination and 8 month to 8 month combination) an 8 month to 9 month combination or a 11 month to 12 month combination would not be appropriate.

L. Calculating Significance of Equity Investees Following the Registrant's Discontinued Operation Under SFAS No. 144

Question: How should a registrant calculate the significance of equity investees following a restatement of the registrant's financial statements to reflect a discontinued operation?

Background: Under S-X Rules 3-09 and 4-08(g), the significance of a registrant's equity investees is determined by reference to the significance tests in S-X Rule 1-02(w). The income significance test requires the comparison of income from continuing operations before income taxes, extraordinary items, and cumulative effect of a change in accounting principle of the acquired business with such income of the registrant. (Emphasis added.)

Assume a calendar year-end registrant owns certain equity method investments. Through December 31, 20X2, these investments did not meet the significance test at a 20% level (investment and income tests) to require presentation of separate financial statements under S-X Rule 3-09 in registrant's Form 10-K. (The asset, investment and income tests also would have been assessed at the 10% significance level to determine whether the registrant was required to present summarized financial information about the equity investees under Rule 4-08 (g) of Regulation S-X.) During 20X3, the registrant disposes of a portion of its business, for which discontinued operations treatment is required.

At the December 2003 AICPA SEC conference, the SEC staff stated that, following a discontinued operation in the current fiscal year, the registrant should not remeasure significance using the restated financial statements in any registration or proxy statement filed during the current fiscal year (even if the restated financial statements of prior fiscal periods are required to be included in such filings). However, the registrant must use its financial statements reflecting the discontinued operation for purposes of computing significance in connection with filing its current fiscal year Form 10-K. As a result, previously insignificant equity method investees (below 20% significance level) might now become significant and the current fiscal year Form 10-K might require separate financial statements of such equity method investees for all periods presented, audited in the periods in which significant.

In applying this guidance, should registrants perform the calculations to determine whether the 20% significance level was met in <u>any</u> of the three years presented in the Form 10-K based on the restated financial information reflecting the discontinued operation? Or, should registrants only test significance for the current fiscal year to determine the current reporting requirement? Is the answer different for purposes of Rule 3-09 vs. Rule 4-08(g)?

Once these questions are resolved, consideration should be given to whether, under either Rule 3-09 or Rule 4-08(g), is the answer different if the registrant sold the equity method investee prior to the year in which the discontinued operation occurred?

Any retrospective approach would give rise to a likelihood of a previously insignificant equity method investee becoming significant to a prior period. As a consequence, the registrant may be required to obtain separate audited financial statements of the investee for a period in which the investee was not separately audited.

View A - Registrant should use the restated financial statements (for all periods presented), which reflect the discontinued operation, to determine whether the equity method investment was significant for any period presented. Registrants should make the calculation at the end of each fiscal year based on the primary financial statements of the registrant presented in the annual report.

View B - Registrant should use the restated financial statements (for only the most recent fiscal year), which reflect the discontinued operation, to determine whether the equity method investment was significant for the most recent fiscal year. If the equity method investee was not significant in a previous year, that determination would not change as a result of the registrant's subsequent discontinued operations.

Committee Recommendation: The committee supports View B

Staff Response: The Staff takes View A. However, registrants are encouraged to contact the Staff should the application of View A not result in a practicable answer.

Additional Committee Follow-up Question: In reference to the Staff response above, what is the Staff's view regarding an equity investee that was sold during the current year and is deemed to be significant under S-X Rule 3-09 as a result of discontinued operations presentation.

Staff Response: The Staff commented that in a scenario where an equity investee was disposed of before the event that required discontinued operations presentation and not previously significant under Rule S-X 3-09 but became significant in the current period solely as a result of restatement due to discontinued operation presentation, financial statements of that equity investee would not be required.

M. Computing the Aggregate Significance of Individually Insignificant Acquired Businesses

Question: How should a registrant calculate the aggregate significance of individually insignificant acquired businesses for purposes of complying with S-X Rule 3-05 in a subsequent SEC filing?

Background: Rule 3-05(b)(2)(i) of Regulation S-X requires presentation of financial statements of at least the substantial majority of individually insignificant acquired businesses if their aggregate impact exceeds 50% significance under Rule 1-02(w). However, the rule does not specify how to calculate the aggregate significance of businesses acquired at various dates during the current fiscal year.

Discussion: Consider the following fact pattern: A calendar year-end registrant completes separate business acquisitions of other calendar year-end companies in January, March and September of 20X3. When the registrant completed the acquisition in January 20X3, it measured significance (individually resulting in the highest level of significance of 10% under the income test) using its 12/31/X1 financial statements (since those were the most recent filed statements at the time) and the 12/31/X1 financial statements of the acquired business (since those were the most recent pre-acquisition audited annual statements). When the registrant completed the March 20X3 acquisition, it measured significance (individually resulting in the highest level of significance of 15% under the income test) using its 12/31/X2 financial statements (since those had been filed by that time) and the 12/31/X1 financial statements of the acquired business (since those were the most recent pre-acquisition audited annual statements). When the registrant completed the September 20X3 acquisition, it measured significance (individually resulting in the highest level of significance of 18% under the income test) using the 12/31/X2 financial statements of both the registrant and the acquired business.

The circumstances of this example can be summarized as follows:

	Most Recent Annual Financial Statements		
Month of Acquisition	Registrant	Acquired Business	Significance
January	20X1	20X1	10%
March	20X2	20X1	15%
September	20X2	20X2	18%

Assume the registrant is filing a registration statement in December 20X3. How should the registrant calculate the aggregate significance of the businesses acquired in 20X3?

View A -Perform the aggregate significance test at the filing date using, at that time, the most recent pre-acquisition audited annual statements of the acquired businesses to the registrant's most recent annual audited pre-acquisition consolidated statements filed with the Commission (i.e. using the 20X2 financial statements of both the Registrant and the Acquired Business for each of the acquisitions presented above).

Note that this approach would not necessarily be consistent with the calculation of individual significance made at the date of each acquisition. In the above example, View A may require the significance of the January and March acquisitions to be recalculated for purposes of determining the aggregate significance of 20X3 acquisitions. Such a recalculation could result in a higher level of significance than the amount calculated at acquisition. As a consequence, the aggregate significance may be determined to be higher than 50%, which would not be the case under View B. Conversely, such a recalculation could result in a lower level of significance than the amount calculated at acquisition. As a consequence, the aggregate significance may be determined to be less than 50%, which may not be the case under View B (in a different fact pattern than that in the above example).

View B - Perform the aggregate significance test by combining the individual calculations of significance made at the date of each acquisition.

In the above example, View B would result in a conclusion that the aggregate significance of the three acquisitions was 43%. Accordingly, the registration statement would not require audited financial statements of any of the subsequently acquired businesses because their aggregate significance does not exceed 50%.

View C – Either View A or View B is acceptable.

Staff Response: The Staff takes View A.

N. Calculating significance of Equity Investees under Rule 3-09 of Regulation S-X when the registrant holds common and preferred stock in the equity investee

Question: For purposes of measuring significance of equity method investees under Rule 3-09 of Regulation S-X, should the numerator include preferred stock dividends if the registrant holds preferred stock in the equity investee in addition to common stock? If so, should preferred stock dividends be included in all cases in the numerator or is it a facts and circumstances evaluation? If it is facts and circumstances, what factors should be considered and how should they be analyzed when assessing whether preferred stock dividends should be included in the numerator?

Background: In a recent registrant review, the Staff concluded that a registrant incorrectly calculated significance under Rule 3-09 because dividends on the preferred stock owned in the investee were not included in the numerator. The registrant had calculated the numerator as the equity method investee income pick up available to common shareholders' on a pretax basis (the investee was profitable for all periods) and had not added preferred dividends. Preferred dividends were included in investment income in the statement of operations and did not impact the investment basis of the equity investment. Based on the registrant's calculation, separate financial statements of the equity investee were not required as the significance test was significantly below the 20% amount for each year. Due to the materiality of the preferred stock dividends, if preferred dividends were included in the numerator, separate financial statements of the equity investee would be required. The Staff required the registrant to provide the Rule 3-09 financial statements.

Guidance: For purposes of measuring significance of equity method investees under Rule 3-09 of Regulation S-X, registrants look to Rule 1-02(w) of Regulation S-X. The income test is:

> The registrant's and its other subsidiaries' equity in the income from continuing operations before income taxes, extraordinary items and cumulative effect of a change in accounting principle of the subsidiary exceeds 10 percent of such income of the registrant and its subsidiaries consolidated for the most recently completed fiscal year.

The SEC's Staff Training Manual (Topic Two, III.B.2) includes the following:

> For purposes of computing the income significance test under SX 3-09, use GAAP changes in the equity investment as presented in the income statement, which usually includes amortization of goodwill resulting from the registrant's equity investment and any writedown of the investment for impairment that is not otherwise reflected in the investee's financial statements.

EITF 98-13, *Accounting by an Equity Method Investor for Investee Losses When the Investor Has Loans to and Investments in Other Securities of the Investee*, discusses when an investor is required to account for a common stock investment using the equity method, how the equity method loss pickup from the application of Opinion 18 (when the carrying amount of the common stock has been reduced to zero) interacts with the applicable literature relating to investments in the other securities of the investee (either Statement 114 or Statement 115.)

Discussion: The literal words of Rule 1-02(w) do not contemplate inclusion of preferred dividends recorded from the equity investee in the numerator. It is not clear whether the Staff believes that preferred dividends should be included in all cases or on a facts and circumstance basis. And, if it is a facts and circumstances basis, it is unclear what factors should be considered and how they should be analyzed when assessing whether preferred stock dividends should be included in the numerator.

Staff Response: For purposes of measuring significance of equity method investees under Rule 3-09 of Regulation S-X, the numerator should include preferred stock dividends. The Staff commented that they were unable to contemplate a scenario in which preferred stock dividends would not be included.

O. Required Registration of Auditors of Equity Method Investees

Facts: Issuer A has an investment in a private company (investee) accounted for by the equity method of accounting. The investee is audited by another accounting firm. The principal auditor of Issuer A refers to the work of the other accounting firm and Issuer A includes the audit report of the other accounting firm in their Form 10-K.

Question: In the above-described situation, does the auditor of the investee need to be registered with the PCAOB?

Background: At the SEC conference in December 2003, remarks were made by the staff of Corporation Finance indicating that the staff believes that if an audit report is filed in a SEC document, the auditors issuing the report should be registered with the SEC. There was an exception mentioned for the auditors of financial statements required by Rule 3-05, as the audit report would only appear once in an SEC filing (assuming that the auditors of the 3-05 financial statements would not be continuing with the company and separate audit reports would not be filed with the Form 10-K going forward).

View A: An accounting firm that audits a private equity method investee need only be registered with the PCAOB if the requirements of PCAOB Rule 2100 are met. That is the accounting firm provides material services (20% of total engagement hours or fees provided by the principal auditor) or performs a majority of the services of a subsidiary or division, which comprises 20% or more of the total assets or revenues of the issuer. This view recognizes that the auditor of a private company, whose report appears in a SEC filing, participates in the audit of an issuer indirectly, while also recognizing the materiality thresholds of the PCAOB registration rules.

View B: Except for the rule 3-05 exception noted above, accounting firms that audit private equity method investees must be registered with the PCAOB if their audit report is included in a SEC filing.

Committee Recommendation: The Committee supports View A.

Staff Response: The Staff's believes that an accounting firm that audits a private subsidiary or equity method investee should be registered with the PCAOB if its audit report is included in an SEC filing. However, the Staff recognizes that the PCAOB's rules do not require this and plans to hold additional discussions with the PCAOB before requiring registration.

P. Clarification of SEC Announcement Regarding Topic D-42

Background: At the July 31, 2003 EITF meeting, the SEC Observer announced the SEC Staff's revised position relating to the application of Topic D-42 when calculating the excess of fair value of consideration transferred to holders of preferred stock over the carrying amount of the preferred stock in a registrant's balance sheet. In this revised position, the carrying amount of preferred stock should be reduced by the issuance costs of preferred stock, regardless of where such costs were initially classified on issuance. The SEC Staff announcement requires retroactive application in the first fiscal period ending after September 15, 2003 by restating the financial statements of prior periods in accordance with APB 20, paragraphs 27 through 30.

Question 1: Must registrants file amendments to periodic reports filed for periods ending <u>before</u> September 15, 2003 to reflect the revised SEC Staff position?

Discussion: No. Assuming that the registrant adopts the revised SEC Staff position in connection with its first fiscal period ending after September 15, 2003, the revised SEC Staff position should be applied retroactively to prior period financial statements when financial statements for periods ending <u>before</u> September 15, 2003 are reissued (together with financial statements for a period ending after September 15, 2003). Because the financial statements for periods ending before September 15, 2003 were not incorrect when originally filed, they need not be restated until they are reissued together with a set of financial statements for a period ending after the adoption of the revised SEC Staff position. This conclusion is consistent with the SEC Observer's reference to paragraph 27 of APB 20.

For instance, assume that a calendar year-end registrant adopts the revised SEC Staff position in connection with the preparation of its quarterly report on Form 10-Q for the quarterly period ended September 30, 2003. At the time of filing the September 30, 2003 Form 10-Q, the registrant would be required to retroactively restate the comparative periods for the 3- and 9-month periods ended September 30, 2002 to reflect the revised SEC Staff position. Additionally, in connection with the preparation of the financial statements for the 9-month period ended September 30, 2003, the registrant would be required to retroactively apply the revised SEC Staff position for all 2003 activity (e.g., including the period from January 1, 2003 through June 30, 2003) and to the December 31, 2002 balance sheet. In doing this, all financial statements included in the September 30, 2003 Form 10-Q will be presented in accordance with the revised SEC Staff position. The registrant would <u>not</u> be required to file amendments to its previously filed Forms 10-Q or Forms 10-K for any period which ended prior to the adoption of the revised SEC Staff position.

Staff Response: The Staff concurs with the discussion outlined above.

Question 2: **If a registrant reissues the financial statements included in its most recent annual report on Form 10-K (e.g., by <u>including</u> them in a new registration statement or proxy/information statement) subsequent to the time that the registrant has issued financial statements for a period ending after the adoption of the revised SEC Staff position, must the registrant revise its annual financial statements in order to apply the revised SEC Staff position? Would the answer be different if the financial statements being reissued were being <u>incorporated by reference</u> into a registration statement or proxy/information statement rather than being included? Assume that the change is material to all periods presented.**

Discussion: There are several situations where generally accepted accounting principles (GAAP) require restatement of previously issued financial statements once a subsequent period's financial statements reflect a GAAP triggering event. These situations include stock splits, changes in segments under FAS 131, discontinued operations under FAS 144, initial adoption of FAS 128, transitional/pro forma disclosures under FAS 142 and FAS 143 and reclassifications upon adoption of FAS 145.

For changes in segments and discontinued operations reclassifications, the SEC staff has historically insisted on full restatement of annual financial statements to be included or incorporated by reference in a registration statement or proxy/information statement once a registrant has filed subsequent interim period financial statements that reflect the change in segments or discontinued operations treatment.

For the initial adoption of FAS 128 and FAS 145 as well as the transitional/pro forma disclosures relating to FAS 142 and FAS 143, the SEC staff provided accommodations for registrants incorporating financial statements by reference into new registration statements or proxy/information statements, if the auditor concluded that its report could be reissued without revising the financial statements. In those situations, the SEC staff allowed registrants to avoid full restatement before filing the next year's Form 10-K if the registrant provided the information required by the relevant accounting standard in the filing (in the proper context including selected financial data even though the rules of the form being used might not require such a table) or in a Form 10-Q incorporated by reference.

View A: Registrants adopting the revised SEC Staff position should restate annual financial statements included in a registration statement or proxy/information statement. However, registrants may avail themselves of the same accommodation afforded initial adoption of FAS 128, 142, 143 and 145 when financial statements are incorporated by reference in a registration statement or proxy/information statement if registrant concludes that the financial statements do not require restatement and the independent accountant will permit reissuance of their report without restatement. Registrants may disclose the revised amounts for income available to common shareholders, EPS and any other information requiring retroactive adjustment in selected financial data included in a registration statement or proxy/information statement or in a Form 10-Q incorporated by reference.

View B: Irrespective of whether the financial statements are included or incorporated by reference in the registration statement or proxy/information statement, the registrant must restate its financial statements to retroactively reflect the revised SEC Staff position. This conclusion is based on the fact that the application of the revised SEC Staff position requires all periods presented to be reported on a comparable basis. Additionally, Item 11 of Form S-3, for example, indicates that the prospectus must include or incorporate by reference "restated financial statements prepared in accordance with Regulation S-X if there has been a change in accounting principles…where such change...requires a material retroactive restatement of financial statements." Unlike the transitional/pro forma disclosures required by paragraph 61 of FAS 142 and paragraph 27 of FAS 143, the changes to adopt the revised SEC Staff position affect the primary historical financial statements and unlike the adoption of FAS 128 and FAS 145 or the impact of a stock split, the adjustments to the primary financial statements may require a greater level of context than can be adequately conveyed in a Selected Financial Data table.

Staff Response: The Staff takes View B.

Q: Interaction of Statement 143 and the Full Cost Rules

a. Impact on the full cost ceiling test

Background:
A company following the full cost method of accounting under Rule 4-10(c) of Regulation S-X must periodically calculate a limitation on capitalized costs, i.e., the full cost ceiling. Prior to adopting Statement 143[1], in calculating the full cost ceiling a company reduced the expected future revenues from proven oil and gas reserves by the estimated future expenditures to be incurred in developing and producing such reserves discounted using a factor specified in the rule. While expected future expenditures related to the asset retirement obligation (ARO) were included in the calculation of the ceiling test, no associated asset was recorded. Under Statement 143 a company must recognize a liability for an asset retirement obligation at fair value in the period in which the obligation is incurred. The company also must capitalize the associated asset retirement costs by increasing long-lived oil and gas assets by the same amount as the liability. Any asset retirement costs capitalized pursuant to Statement 143 are subject to the full cost ceiling limitation under Rule 4-10(c)(4) of Regulation S-X. If after adoption of Statement 143, a company were to continue calculating the full cost ceiling by reducing expected future net revenues by the cash flows required to settle the ARO, then the effect is to "double-count" such costs in the ceiling test. The assets that must be recovered would have been increased while the future net revenues available to recover the asset continue to be reduced by the amount of the ARO settlement cash flows.

Question 1: After adopting Statement 143, how should a company compute the full cost ceiling to avoid double-counting the expected future cash outflows associated with asset retirement costs?

Discussion:
After adoption of Statement 143, the future cash outflows associated with settling AROs that have been accrued on the balance sheet should be excluded from the computation of the present value of estimated future net revenues for purposes of the full cost ceiling calculation.[2, 3]

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[1] Statement of Financial Accounting Standards No. 143 (Statement 143), *Accounting for Asset Retirement Obligations*, is effective for financial statements issued for fiscal periods beginning after June 15, 2002.

[2] If an obligation for expected asset retirement costs has not been accrued under Statement 143 for certain asset retirement costs required to be included in the full cost ceiling calculation under Rule 4-10(c)(4), such costs should continue to be included in the full cost ceiling calculation.

[3] This approach is consistent with the guidance in paragraph 12 of Statement 143 on testing for impairment under Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. Under that guidance, the asset tested should include capitalized asset retirement costs. The estimated cash flows related to the associated ARO that has been recognized in the financial statements are to be excluded from both the undiscounted

Question 2: What disclosures should the company provide on the interaction of Statement 143 and the full cost rules?

Discussion: In order to inform financial statement users on the interaction of Statement 143 and the full cost rules, a company following such rules is expected to provide appropriate disclosures in the financial statement footnotes and Management's Discussion and Analysis explaining in detail how the adoption of Statement 143 impacts its accounting for oil and gas operations. This disclosure is expected to address each area of accounting that is impacted or expected to be impacted and should specifically address each way that the company's application of full cost accounting has changed as a result of adoption of Statement 143. These disclosures and discussions should include, but are not limited to, how the company's calculation of the ceiling test and depreciation, depletion, and amortization are affected by the adoption of Statement 143.

b. Impact of Statement 143 on the calculation of depreciation, depletion, and amortization

Background:
Regarding the base for depreciation, depletion, and amortization (DD&A) of proved reserves, Rule 4-10(c)(3)(i) of Regulations S-X states that "[c]osts to be amortized shall include (A) all capitalized costs, less accumulated amortization, other than the cost of properties described in paragraph (ii) below; (B) the estimated future expenditures (based on current costs) to be incurred in developing proved reserves; and (C) estimated dismantlement and abandonment costs, net of estimated salvage values." Statement 143 requires that asset retirement costs associated with all AROs that have been recognized as a result of exploration and development activities completed to date be included in capitalized costs of the company. Therefore, subsequent to the adoption of Statement 143, the estimated dismantlement and abandonment costs described in (C) above will be included in the capitalized costs described in (A) above, at least to the extent of exploration and development costs incurred to date. Any future development expenditures described in (B) above will create additional asset retirement obligations when those activities are performed in the future and the associated asset retirement costs will be capitalized at that time.

Question: Following the adoption of Statement 143, should the costs to be amortized under Rule 4-10(c)(3) of Regulation S-X include an amount for future asset retirement costs that are expected to result from future development activities?

Discussion: Companies should estimate the amount of future asset retirement costs that will be capitalized as a result of the future expenditures to be incurred in developing proved reserves and include those amounts in the costs to be amortized. To the extent that such asset retirement costs have not been recognized on the balance sheet pursuant to Statement 143, the rule continues to require that they be included in the base for computing DD&A.

Committee Response: This document on the interaction of SFAS 143 and the full cost

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cash flows used to test for recoverability and the discounted cash flows used to measure the asset's fair value.

rules was submitted by the SEC staff to the SEC Regulations Committee prior to the April 8, 2004, Committee meeting to generate discussion on these practice issues. Mr. Hartig indicated that the Committee had not had a chance to discuss the document at its April meeting but that the Committee members would forward their views to the SEC staff after they had the opportunity to further review the document. Mr. Hartig further said that if these interpretations of the interaction of the full cost rules and Statement 143 were to be adopted by the SEC staff, one of the obvious questions would be what is the transition, i.e., when and how should the accounting practices be adopted.