

**SEC Regulations Committee
July 10, 2007 - Joint Meeting with SEC Staff
SEC Offices – Washington DC**

HIGHLIGHTS

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

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

I. ATTENDANCE

A. SEC Regulations Committee

John Wolfson, Chair
Chris Holmes, Vice Chair
Michael Cinalli
Brad Davidson
Melanie Dolan
David Follett
Karin French
Steve Henning
Bob Laux
Jeff Lenz
Steve Meisel
Scott Pohlman
Amy Ripepi
Kurtis Wolff

B. Securities and Exchange Commission

Office of the Chief Accountant

John Albert, Senior Associate Chief Accountant
Muneera Carr, Professional Accounting Fellow
Brian Croteau, Associate Chief Accountant
Jeff Ellis, Professional Accounting Fellow
Julie Erhardt, Deputy Chief Accountant
Josh Forgione, Assistant Chief Accountant
Amy Hargrett, Associate Chief Accountant

Josh Jones, Professional Accounting Fellow
Len Jui, Associate Chief Accountant
Sandie Kim, Professional Accounting Fellow
Katrina Kimpel, Professional Accounting Fellow
Jim Kroeker, Deputy Chief Accountant
Janet Luallen, Associate Chief Accountant
Mark Mahar, Associate Chief Accountant
Robert Malhotra, Professional Accounting Fellow
Jenifer Minke-Girard, Senior Associate Chief Accountant
Jeff Minton, Chief Counsel
Marlene Plumlee, Academic Fellow
Nili Shah, Assistant Chief Accountant
Cheryl Tjon-Hing, Valuation Specialist
Joseph Ucuzoglu, Senior Advisor to the Chief Accountant
Courtney Windler, Intern
Oscar M. Young, Jr. Associate Chief Accountant

Division of Corporation Finance

Craig Olinger, Deputy Chief Accountant
Louise Dorsey, Associate Chief Accountant
Paula Dubberly, Associate Director (Legal)
Parveen P. Gupta, Academic Fellow
Stephanie Hunsaker, Associate Chief Accountant
Todd Hardiman, Associate Chief Accountant
Steven Jacobs, Associate Chief Accountant
Joel Levine, Associate Chief Accountant
Leslie Overton, Associate Chief Accountant
Barry Summer, Associate Director (Operations)

Division of Enforcement

Charles Wright, Senior Legal Advisor

Division of Investment Management

Rick Sennett, Chief Accountant
Toai Cheng, Assistant Chief Accountant
Bryan Morris, Assistant Chief Accountant

C. Center for Audit Quality

Kellie Sclafani
Jeanne Parsons
Annette Schumacher Barr

D. Guests

Nedra Downing, D&T
John May, PwC

II. DIVISION UPDATES

A. Office of the Chief Accountant (OCA) Update

Julie Erhardt provided the following update of the activities in the Office of the Chief Accountant:

- Staffing Update
 - Jeff Minton has been named Chief Counsel in OCA, replacing Bob Burns.
 - Four new Professional Accounting Fellows have been named: Robert Malhotra, Muneera Carr, Liza McAndrew Moberg and Jeffrey Ellis.
 - Nancy Salisbury has left the Commission.
- Julie Erhardt stated that OCA staff has been working on various initiatives including AS 5 and IFRS.

B. Division of Corporation Finance Update

Craig Olinger provided the following Division of Corporation Finance update:

- Cheryl Linthicum will re-join the Commission staff in August as the new Corp Fin Academic Fellow. Linthicum previously served as an OCA Academic Fellow
- Corp Fin staff has been busy working on the various rulemaking proposals that were issued in the second and third quarter of this year, including the recent IFRS rulemaking and small business initiatives. The proposals that the staff is referring to can be obtained from the SEC website at <http://sec.gov/rules/proposed.shtml>

C. Enforcement Update

Charles Wright provided the following update of activities in the Division of Enforcement:

- Staffing Update

The Enforcement Division has 35 accountants at headquarters and 90 accountants nationwide.
- Recent Enforcement Cases and Investigations

Enforcement staff continues to investigate stock option grant backdating cases. In addition, the Enforcement staff investigates the steady stream of cases that are referred to them from other divisions and whistleblowers.

D. Division of Investment Management (IM) Update

Rick Sennett stated that Investment Management has hired two staff members since April.

III. STATUS UPDATE OF PROJECTS

A. Compilation of SEC Regulations Committee Meeting Highlights

In September 2005, the Committee provided the SEC staff with a copy of the draft compilation that incorporates joint meeting discussion documents from the 1994 to 2005 highlights. John Wolfson reported that work continues on this project this summer. As soon as a draft is finalized it will be submitted to the staff for review.

B. Update of the *Staff Training Manual*

The SEC staff is making steady progress on finalizing an update of its *Staff Training Manual* and has completed drafting most sections. An expected completion date has not been set.

C. Alerts to be Issued by the Division of Corporation Finance or Office of the Chief Accountant

The staff has previously indicated that it might issue alerts or letters containing general guidance and identifying additional factors registrants should consider in evaluating filings. At the meeting, both OCA and Division of Corporation Finance staff stated that no alerts are planned at this time. Jim Kroeker added that issues relating to expanded disclosures on sub-prime loans would be a potential issue for such an alert, and he believes the profession is currently addressing the issue.

Rick Sennett noted that the Division of Investment Management issued a [Letter to Fidelity Investments, Massachusetts Financial Services Company and Oppenheimer Funds, Inc.](#) on June 28, 2007 providing the staff's views on the implementation of FASB Interpretation No. 48 by registered investment companies (RICs). The SEC staff did not support certain accommodations requested on behalf of RICs. Instead the SEC staff essentially concluded that RICs should (1) exercise reasonable diligence to expeditiously include the current status of FIN 48 liabilities in each net asset value computation (e.g., as often as daily), (2) determine FIN 48 liabilities without regard to any anticipated reimbursement (even where there is an established history of reimbursement), and (3) recognize an indemnification receivable only if anticipated reimbursement is probable (e.g., based on a contractual

commitment from the investment advisor or another third party to reimburse a recognized income tax contingency).

D. Current Accounting and Disclosures Issues

The Division of Corporation Finance published an update of its [Current Accounting and Disclosures Issues](#) in November 2006 and the current efforts are underway for the next update.

E. Status Update on Committee Documents Provided to the Staff

1. *Rule 3-10, 3-16 Task Force Discussion Document*. A document addressing the application of Rules 3-10 and 3-16 of Regulation S-X to automatic shelf registration statements has been sent to the staff. The staff indicated it is still considering this issue.
2. *Financial Statements of Credit Enhancers and Related Accountants' Consents in Filings by Asset-Backed Issuers*. A discussion document addressing the application of Regulation AB was sent to the SEC staff on July 31, 2006. The SEC staff did not object to the Committee's recommendations on the first of the two questions posed in the document (see Appendix B to the [September 26, 2006 Joint Meeting Highlights](#)). Paula Dubberly indicated that the staff will review the document's second issue (addressing whether a credit enhancer's quarterly financial statements are required to be filed on Form 10-D). In the interim, registrants with live fact patterns in this area should discuss the issue with the staff.
3. *Financial Statement Requirements in an IPO When a Merger of Entities Under Common Control Occurs at the Closing Date* (Documents D from the April 2007 Meeting). Craig Olinger stated that the staff encourages registrants with the fact pattern discussed in this paper to consult with the staff regarding the primary financial statement requirements in their particular facts and circumstances. Mr. Olinger also indicated that they would consider requests for relief to use combined financial amounts as the denominator for purposes of significance calculations in determining other financial statement requirements for the filing (e.g., Rules 3-05 and 3-09 of Regulation S-X). Note: The finalized [Document D from the April 17, 2007 Joint Meeting](#) is posted on the Center's website.

F. Proxy Developments

The staff noted that the SEC has not yet issued the final rules on mandatory internet availability of proxy materials, which will become effective January 1, 2008. The staff expects the final rule to be issued soon. The staff also noted that three issuers had already followed the new rule on voluntary internet availability of proxy materials, which became effective July 1, 2007. The final rules were issued July 26, 2007. The new rules become effective for large accelerated filers for proxy solicitations made on or after January 1, 2008. Registrants that are not large accelerated filers may follow the new rules

for proxy solicitations on or after January 1, 2008 and must follow the new rules for proxy solicitations on or after January 1, 2009.

G. Reporting on Internal Control Over Financial Reporting

The staff summarized recent internal control initiatives, including the issuance of final interpretive guidance regarding management's report on internal control over financial reporting and request for comments on the definition of a significant deficiency. The staff added that it is likely that the Commission will act on AS 5 by July 27 (45 days after publication in the *Federal Register*).

[Note: The SEC approved AS 5 and adopted the definition of significant deficiency at its July 25, 2007 Open Meeting. The AS 5 order and the rule amendments relating to the definition of significant deficiency are available on the SEC's website.]

H. IFRS Rule Proposal and Concept Release

Julie Erhardt discussed the recent SEC proposal Acceptance from Foreign Private Issuers of Financial Statements Prepared in Accordance with International Financial Reporting Standards Without Reconciliation to U.S. GAAP, adding that comments are due 75 days after publication in the Federal Register (September 24, 2007). The SEC also plans to release a Concept Release soliciting views on the possibility of allowing domestic registrants the option of reporting under either IFRS or U.S. GAAP. *[Note: The SEC voted to publish the Concept Release at its July 25, 2007 Open Meeting. The comment period will extend for 90 days after it is published in the Federal Register.]*

IV. RECENT DEVELOPMENTS/CURRENT ISSUES

A. Complexity/Transparency Initiative

Jim Kroeker described the recent formation of Advisory Committee on Improving Financial Reporting. The Advisory Committee will examine the U.S. financial reporting system with the goals of reducing unnecessary complexity and making information more useful and understandable for investors. *[Note: Subsequent to the meeting, the SEC announced the members of the Advisory Committee. The first meeting of the Advisory Committee was held on August 2, 2007.]*

B. Staff Consideration of Additional Materiality Guidance

Jim Kroeker stated that the staff continues to consider materiality issues and the need for further guidance in this area. Some issues that are under consideration include 1) classification errors, 2) segment reporting, 3) assessment of quantitatively significant errors in light of qualitative factors, 4) interim materiality, and 5) the application of paragraph 29 of APB 28. As part

of their deliberations, the staff has met with representatives of an ad hoc task force (which includes representatives from among the preparer, investor/analyst, academic, legal and public accounting communities) to gain additional insight.

C. Executive Compensation Disclosures

The SEC staff stated that it is performing reviews of 2007 proxy filings for compliance with the new executive compensation disclosure rules. . The SEC staff has not issued any comment letters on the proxy reviews yet, but has issued comment letters on the executive compensation disclosures in transactional filings. The SEC staff noted that although registrants have generally been doing a good job in adhering to the new rules, there have been a number of recurring observations that have been noted in comment letters:

- The CD&A could provide better analysis of executive compensation decisions.
- If registrants have an adequate basis for omitting incentive plan performance targets, they should provide the alternate disclosure regarding the relative likelihood that those performance targets will be met.
- Descriptions of incentive plan performance targets should be specific.
- Regardless of the terminology used, “benchmarking” executive compensation should be accompanied by an identification of the other companies that were used for benchmarking purposes.
- In disclosing executive compensation decisions, registrants should provide a clear description about the respective roles and responsibilities of the CEO, compensation consultants and the compensation committee in the decision making process.

The SEC staff is considering what guidance, if any, to issue addressing the results of the compliance reviews.

D. Risk Factors Relating to the Financial Reporting Process

Sometimes registrants disclose risk factors identifying potential risks that the registrant might be required to restate or make other changes to financial statements. These risk factors discuss the complexities of the accounting standards, explain that they can be interpreted or applied differently, either by the SEC staff or by successor auditors (when there has been a change in auditors), and communicate that such differences in interpretation or application could cause a restatement of the registrant’s financial statements. The Committee solicited the SEC staff’s views as to when such risk factor disclosures might be appropriate. The SEC staff expressed concern that such disclosures could be an attempt to dilute the responsibility that the registrant takes for its financial statements. The SEC staff also stated that a risk factor would not satisfy the specificity required by SK Item 503(c) if the registrant merely identifies the complexity of financial reporting and the generic risk of a subsequent financial restatement. However, the SEC staff noted that, as part

of its review of a specific filing, it will evaluate specific risk factors based on a registrant's specific facts and circumstances.

E. Reporting on Internal Controls in a Reverse Merger and the December 2006 Release

In light of the December 2006 amendments that provide an "IPO accommodation" by deferring Section 404 reporting by a new public company until its second SEC annual report, the Committee asked the SEC staff for its views on whether this accommodation also would apply in a reverse merger when the accounting acquirer was not a public company. The SEC staff noted that it continues to address the reporting requirements of a reverse merger on a facts and circumstances basis. Accordingly, a registrant with this fact pattern is encouraged to consult with the legal staff in the Division of Corporation Finance's Office of the Chief Counsel to determine its Section 404 reporting requirements.

F. Requirement to Name Valuation Specialists as "Experts" and Obtain Consents from Them

The Committee and the SEC staff discussed whether Rule 436 of Regulation C might apply when registrants make reference to the use of valuation specialists in disclosures that are included or incorporated by reference in filings made under the Securities Act of 1933. Specifically, the Committee and the SEC staff discussed whether or not a reference to the use of a valuation specialist would trigger the need to obtain a consent from the specialist. The Committee and the SEC staff plan to further discuss the topic.

V. SPECIFIC PRACTICE ISSUES – DISCUSSION DOCUMENTS

The following emerging practice issues were addressed at the meeting and discussion documents have been posted to the Center for Audit Quality website at the URL indicated.

- A. **[Reporting Requirements of Rule 4-08\(g\) of Regulation S-X for Periods in which the Investee is Less than 10% Significant](#)**
- B. **[When Rule 3-05 Financial Statements Must be Provided in Registration Statements Covering Secondary Offerings](#)**
- C. **[Applying Rule 3-09 of Regulation S-X to an Equity Method Investee in the Real Estate Industry](#)**
- D. **[When Stock Based Executive Compensation That Is Capitalized or Deferred Should Be Reported In The Summary Compensation Table](#)**
- E. **Application of Rules 3-09 and 4-08(g) of Regulation S-X to Investments Accounted for Using the Fair Value Option under Statement of Financial Accounting Standards No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities." that Otherwise Would be Accounted for Under the Equity Method under APB 18, "The Equity Method of Accounting for Investments in Common Stock." (REVISED Discussion**

Document A from April 17, 2007 Joint Meeting) *[The discussion document related to this issue was finalized with the staff at the October 11, 2007 Joint Meeting. See http://www.thecaq.org/resources/secregs/pdfs/discussdocs/October11_2007_DiscussionDocument_F.pdf for the final discussion document.]*