

**SEC Regulations Committee  
Center for Audit Quality  
July 8, 2008 - Joint Meeting with SEC Staff  
SEC Offices – Washington DC**

**HIGHLIGHTS**

**NOTICE:** The SEC Regulations Committee of the Center for Audit Quality 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  
Doug Bennett  
Leonard Brams  
Jack Ciesielski  
Michael Cinalli  
Brad Davidson  
Melanie Dolan  
Karin French  
Leonard Gatti  
Bob Laux  
Jeff Lenz  
Steve Meisel  
Scott Pohlman  
Amy Ripepi  
Tom Weirich  
Kurtis Wolff

**B. Securities and Exchange Commission**

*Office of the Chief Accountant*

Jim Kroeker, Deputy Chief Accountant

*Division of Corporation Finance*

Wayne Carnall, Chief Accountant  
Craig Olinger, Deputy Chief Accountant  
Louise Dorsey, Associate Chief Accountant  
Michael Fay, Associate Chief Accountant  
Stephanie Hunsaker, Associate Chief Accountant  
Todd Hardiman, Associate Chief Accountant  
Steven Jacobs, Associate Chief Accountant  
Joel Levine, Associate Chief Accountant  
Cheryl Linthicum, Academic Fellow  
Leslie Overton, Associate Chief Accountant  
Michael Stehlik, Staff Accountant

*Division of Enforcement*

Susan Markel, Chief Accountant

**C. Center for Audit Quality**

Annette Schumacher Barr

**D. Guests**

Nedra Downing, D&T  
John May, PwC

**II. Commission and Division Organizational and Staff Changes**

**A. Office of the Chief Accountant (OCA) Update**

With great sadness, Mr. Kroeker announced the passing of Brett Williams who died at the age of 33 from heart failure. Brett was a Professional Accounting Fellow (PAF) in OCA assisting with CIFI activities.

**B. Division of Corporation Finance (Corp Fin) Update**

Mr. Carnall introduced Michael Fay as a new Associate Chief Accountant in the Division's Chief Accountant's Office. Michael will serve as liaison with the Telecommunications Group within the Division. He has been with the Commission for over 10 years and has been a branch chief since 2004. In addition to being a CPA, he is a member of the bar.

## C. Division of Enforcement

Susan Markel noted that two Enforcement staff members have left the Commission and the staff is currently reviewing applicants to fill the vacancies. She added that Robert Bayless, long-time SEC staff member and former Chief Accountant of the Division of Corporation Finance, will be retiring in August. She noted that Mr. Bayless served the Commission and the public with hard work and dedication for many years.

## III. Status Update of Projects/Issues

### A. Credit Market Issues/Fair Value Concerns

#### *SEC Roundtable on Fair Value Accounting and Auditing Standards.*

Wayne Carnall noted that the Commission will host a [roundtable](#) on July 9, 2008, to facilitate an open discussion of the benefits and potential challenges associated with existing fair value accounting and auditing standards. The archived video webcast of the roundtable can be found at <http://www.connectlive.com/events/secroundtable070908/>

#### *First Quarter Filings – Staff Observations Regarding Valuations and Credit Environment.*

The staff summarized the following observations regarding fair value disclosures in first quarter filings:

- In March, the Division of Corporation Finance sent a “Dear CFO” [letter](#) to certain public companies identifying a number of disclosure issues they may wish to consider in preparing Management's Discussion and Analysis (MD&A) for their upcoming quarterly reports on Form 10-Q. The staff reviewed 29 10-Qs of the issuers who received the letter directly. Of the 29 companies reviewed, all provided some information, but none of the 29 companies provided all the disclosures the staff suggested for consideration. In particular, the staff noted that none of the companies disclosed a range of estimates of a fair value or disclosure about any expected recovery in fair value during the expected holding period. Wayne Carnall observed that, although not required by U.S. GAAP, some of the suggested disclosures are required under IFRS 7.
- Companies generally did a good job of disclosing the effect of changes in their own credit risk on the fair value of structured notes, however, the staff expressed concern regarding the level of disclosure of the effect of changes in a company's own credit risk on the fair value of [derivative liabilities](#).
- In their reviews of first quarter filings, the staff asked registrants for information on the valuation techniques and assumptions used in arriving at the fair value (including the impact of any related discount adjustments for the lack of liquidity) of auction rate securities.

- The staff indicated that they have noted situations in which registrants have disclosed the fact that fair values have declined but failed to quantify the decline or provide the assumptions that were used in measuring the decline. The staff encourages registrants to consider whether additional information would be useful to investors.
- In situations where registrants have determined fair values based on broker quotes (including non-binding broker quotes), the staff asked registrants for information on how they validated such quotes (e.g., how have they evaluated the models used by the brokers) and the quality of the data underlying non-binding quotes.
- Jim Kroeker observed that if the application of fair value accounting standards results in counter-intuitive results (e.g., recognizing income from writing down an issuer's liabilities due to deterioration in its credit quality), those results should be explained so investors are aware and understand the reasons.
- Wayne Carnall emphasized that companies have “the freedom and the responsibility to provide disclosure in MD&A to facilitate the transparency and understandability of the financial statements.”
- Susan Markel stated that Enforcement would be “interested” in any lack of adequate disclosure in this area

## **B. Successor to the Staff Training Manual**

Mr. Carnall provided an update of the staff's efforts in updating the Staff Training Manual. The staff is committed to issuing a successor to the current document (under a new title) by the end of September. The document will be a comprehensive source of staff interpretations on financial reporting matters. The document will also include many staff positions contained in [discussion documents](#) addressed in joint meetings of the SEC Regulations Committee and the staff. The goal of the staff is to make future updates to this document on a real-time basis.

[NOTE: Subsequent to the meeting, the Division of Corporation Finance Financial Reporting Manual was posted to the SEC website at <http://sec.gov/divisions/corpfm/cffinancialreportingmanual.shtml>.]

## **C. PCAOB's Forum on Auditing in the Small Business Environment**

Mr. Carnall noted that the SEC staff was invited to participate in the [PCAOB's Forum on Auditing in the Small Business Environment](#). These presentations are geared toward registered accounting firms and public companies in the small business community. The SEC staff presentations, which focus on “common problems” facing the auditor of smaller companies, have been very well received. Wayne noted that the SEC staff's involvement in the Forum provides them with an invaluable opportunity to communicate with smaller auditing firms, which is very beneficial to the staff. After the

Forum is complete, the staff plans to post the slide deck (along with detailed speaker notes) to the SEC website.

[NOTE: Subsequent to the meeting, the slides and detailed speaker notes from the staff presentations were posted to the SEC website at <http://www.sec.gov/news/speech/2008/spch111708wc-slides.pdf>.]

#### **D. Division of Corporation Finance New Electronic Mailbox**

The staff announced that the Division of Corporation Finance has established an electronic mailbox for the submission of pre-filing letters and other correspondence intended for the Division's Chief Accounting Office. Instructions for using the electronic mailbox will be posted to the SEC website (under the "Contact Us" section of the SEC homepage and "Information about the Division" on the Corp Fin homepage) in the near future. The address of the mailbox: [DCAOLetters@sec.gov](mailto:DCAOLetters@sec.gov)

#### **E. Consents of Experts**

The staff discussed the question of whether a reference to an expert (e.g., a valuation professional) in an SEC filing requires the expert to be specifically named and a consent be obtained. Mr. Carnall noted that this is a legal (versus accounting) issue and as such it will be addressed by the Office of Chief Counsel who expects to publish interpretive guidance later this year that will be posted to the SEC website.

[NOTE: Subsequent to the meeting, this question was addressed by the staff in an update to the Division's [Compliance and Disclosure Interpretations](#) ("C&DIs") - see Questions 141.01 and 141.02.]

#### **F. Codification of SEC Independence Requirements**

Mr. Kroeker stated that the staff is working on a codification of the Commission's independence requirements.

#### **G. Oil and Gas Proposed Rulemaking**

On June 25 the Commission issued proposed rulemaking entitled *Modernization of the Oil and Gas Reporting Requirements*. Mr. Carnall encouraged those interested to respond to the request for comments, and the staff is looking forward to reviewing the responses. Comments are due September 8.

#### **H. Staff Guidance on Routine Pre-Clearance Issues**

Mr. Carnall noted that there are a number of pre-clearance issues that are routinely submitted to the Division of Corporation Finance. The staff hopes to

issue guidance on these routine issues that will provide certain criteria that, if met, will allow registrants to proceed without submitting pre-clearance requests.

## **I. Requirement for Updated Financial Statements for S-8 Filings**

The Committee asked the staff to clarify whether financial statements incorporated by reference in a new registration statement on Form S-8 need to be updated to reflect a material discontinued operation, change in reportable segments or accounting change that requires retrospective application. The staff is continuing to discuss this issue internally.

[NOTE: Subsequent to the meeting, the staff provided the following position with respect to this issue:

The staff understands that there has been confusion regarding the need to provide restated financial statements in a Form S-8 for certain events occurring after the filing of a Form 10-K that result in differences between the financial presentation in the Form 10-K and subsequent Form 10-Qs that are incorporated by reference into the S-8. Item 11 of Form S-3 has two provisions – paragraph “a” that requires the registrant to describe all material changes in the registrant’s affairs which have occurred since the end of the latest annual report. Paragraph “b” requires the company to file restated financial statements for certain events – such as when there is a change in accounting principle that requires material retroactive restatement. The staff has analogized the specifics points in Item 11(b) to other fact patterns that require retroactive application – such as disc ops, changes in segment presentations, etc. Form S-8 has the same concepts as Form S-3 regarding the need to describe material changes. However, it does not contain a similar requirement included in paragraph b of Item 11 Form S-3 regarding restated financial statements. It is the responsibility of the Company and their counsel to determine if there has been a material change that is required to be disclosed in a Form S-8. Likewise, it is the responsibility of the auditor to determine if they will issue a consent to the use of their report if there has been a change in the financial statements that is reflected in the 10-Q but the annual accounts have not been retroactively restated.]

## **J. Updating SAB Codification for FAS 141R/160**

Mr. Kroeker acknowledged that there are a number of areas in which published accounting and disclosure positions of the SEC or the staff might conflict with Statement 141R and Statement 160. The SEC staff is in the process of updating its codification of SEC Staff Accounting Bulletins by the adoption date of the new standards. Additionally, the staff indicated that they are working on a recommendation to the Commission for technical amendments to Regulations S-X and S-K. The Committee offered to share input regarding items that should be included in this update.

#### IV. SPECIFIC PRACTICE ISSUES – DISCUSSION DOCUMENTS

The following emerging practice issues were raised at the meeting and discussion documents have been posted to the [Center for Audit Quality website](#) at the URL indicated.

*[OPEN ITEM to add URLs to documents when documents are finalized and posted.]*

- A. Restricted Net Assets Computations after FAS 160 is Implemented**
- B. Smaller Reporting Companies – Plan of Operations**
- C. Not Used**
- D. Evaluating the Significance of an Equity Method Investee in Interim Periods and Associated Disclosure Issues**
- E. Performing the significance tests for acquisitions of noncontrolling interests in a consolidated subsidiary after the adoption of FAS 160**
- F. Significance Testing and Reporting upon Adoption of FAS 141R and FAS 160 for an Acquisition of an Equity Interest that Results in Obtaining Control**
- G. Significance Testing and Reporting upon Adoption of FAS 141R and FAS 160 for a Disposition of an Equity Interest that Results in Loss of Control**
- H. Article 11 pro forma information transitioning to Statement 141R**
- I. Significance Calculations Under Rule 3-09**
- J. Application of S-K, Item 302(a), *Selected Quarterly Financial Data*, to a private company in a Form S-4**