

**AICPA SEC Regulations Committee
June 20, 2006 - 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.

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
Jack Ciesielski
Melanie Dolan
Clarence Ebersole
David Follett
Karin French
Jay Hartig
Steve Henning
David Hinshaw
Chris Holmes
Bob Laux
Jeff Lenz
Scott Pohlman
Amy Ripepi

B. Securities and Exchange Commission

Office of the Chief Accountant

Scott Taub, Acting Chief Accountant
John Albert, Senior Associate Chief Accountant
Tammy Bieber, Senior Advisor to the Chief Accountant

Robert Burns, Chief Counsel
Cathy Cole, Associate Chief Accountant
Brian Croteau, Associate Chief Accountant
Julie Erhardt, Deputy Chief Accountant
Mike Gaynor, Professional Accounting Fellow
Melanie Jacobson, Special Counsel
Len Jui, Assistant Chief Accountant
Mike Kigin, Senior Associate Chief Accountant
Cheryl Linthicum, Academic Fellow
Mark Mahar, Associate Chief Accountant
Joseph McGrath, Professional Accounting Fellow
Jennifer Minke-Girard, Senior Associate Chief Accountant
Nancy Salisbury, Senior Associate Chief Accountant
Alison Spivey, Associate Chief Accountant
Charlotte Thomas, Research Specialist

Division of Corporation Finance

Carol Stacey, Chief Accountant
Louise Dorsey, Associate Chief Accountant
Stephanie Hunsaker, Associate Chief Accountant
Todd Hardiman, Associate Chief Accountant
Joel Levine, Associate Chief Accountant
Andrew McLelland, Academic Fellow
Leslie Overton, Associate Chief Accountant
Sondra Stokes, Associate Chief Accountant

Division of Enforcement

Susan Markel, Chief Accountant
Charles Wright, Senior Legal Advisor

Division of Investment Management

Brian Bullard, Chief Accountant
Toai Cheng, Assistant Chief Accountant

C. AICPA Center for Public Company Audit Firms

Lillian Ceynowa
Annette Schumacher Barr

D. Guests

Karen Van Compernelle, D&T

II. DIVISION UPDATES

A. Office of the Chief Accountant (OCA) Update

Scott Taub provided an update on personnel changes at the Commission and in OCA:

- Commissioner Cynthia Glassman announced on May 15, 2006 that she would be leaving the Commission. Commissioner Glassman's last day is expected to be July 14, 2006.
- Kathleen Casey was nominated on May 18, 2006 and the Senate is expected to act on her nomination soon. *[Note: Subsequent to the meeting, Kathleen Casey's nomination was approved by the Senate. She was sworn in on July 17, 2006.]*
- Sandie Kim joined the SEC staff in June 2006 as a Professional Accounting Fellow (PAF) and Josh Jones will join the SEC staff as a PAF in the summer of 2006. Both will serve two-year terms. Outgoing PAFs are Shan Benedict, Jennifer Burns, Mark Northan, Brian Roberson, and Pamela Schlosser. All outgoing PAFs have left the Commission except for Mark Northan whose last day is June 23, 2006. The staff anticipates filling the three remaining PAF positions this summer.
- Mike Kigin is retiring effective July 3, 2006 after 30 years of service to the Commission.
- Marilyn Thaemert, Tony Lopez and Greg Cross have left the Commission.
- Overall, OCA has ten fewer individuals than the same time last year.

In addition, Scott Taub provided an update on the following OCA initiatives:

- The SEC staff is working with standard setters to develop a structure to help change requirements in order to reduce complexity in accounting and increase transparency in financial statement reporting. The SEC staff continues to consider principles-based standards as a possible means to achieve this goal.
- Chairman Cox continues to emphasize the benefits of XBRL and the interactive data initiative. The SEC staff is working to eliminate barriers that prevent XBRL usage and has identified various incentives to promote XBRL reporting. The SEC staff is also exploring the development of better technological tools that will facilitate increased usage.

B. Division of Corporation Finance Update

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

- New Division Director

In March, John White joined the SEC Staff as the Director of the Division of Corporation Finance. Mr. White's initial primary areas of

concentration are the proposed rule on executive compensation disclosures and 404-related issues.

- **Staffing Update**

Rachel Mincin is on a leave of absence. Three Branch Chiefs have left the Division; these individuals will be replaced with internal promotions (i.e., no additional staff accountants will be hired as replacements).

- **Reviews of Registrant Filings**

SEC staff members are in the process of reviewing 2005 10-K filings with the expectation of meeting internal deadlines (Sarbanes-Oxley mandates that the Division complete reviews of all public companies at least once every three years). The Division is focusing initially on larger companies and has started reviews of some smaller companies. In large part, the issues that are raising comments are similar to those noted in previous reporting seasons. The SEC staff is also issuing a number of comments related to EITF 00-19 and the classification of derivative instruments as debt or equity, hedge accounting and classification issues in the statement of cash flows.

- **Electronic Effectiveness Notices**

The SEC website (Division of Corporation Finance home page) has been updated to include the following link to Electronic Effectiveness Notices:

<http://www.sec.gov/cgi-bin/browse-edgar?action=geteffect>

The link shows filings and effectiveness by date and can be searched by company name or Central Index Key (CIK).

C. Enforcement Update

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

- **Recent Organizational and Staff Changes**

The Enforcement Division has approximately 100 accounting staff across the country, including 34 at the Washington D.C. Headquarters. There have been no significant staffing changes since April and no new job openings have been posted.

- **Recent Enforcement Cases and Investigations**

Fannie Mae Settlement. On May 23rd, 2006 the Commission and the Office of Federal Housing Enterprise Oversight jointly announced

settlements with Fannie Mae for accounting fraud. The settlements require the company to pay a penalty of \$400 million. Ms. Markel added that this case illustrates the Division's ability to settle cases on a piecemeal basis.

Stock Option Investigations. Chairman Cox has indicated that stock option accounting, particularly the practice of back-dating and spring-loading stock options is an area of rulemaking and enforcement interest for the Commission. The Enforcement Division has recently begun a series of investigations related to this practice and will continue to request information and documentation related to stock option grants.

Financial Fraud. Financial fraud is still a priority for the Division of Enforcement. Enforcement staff continue to take an increasing number of referrals from the Division of Corporation Finance. A number of the issues being investigated involve vendor rebates, issues with books and records, and independence matters, specifically related to the time-out periods required by partners of independent registered public accounting firms. Ms. Markel noted that questions regarding independence matters should be directed to the Office of the Chief Accountant.

D. Investment Management (IM) Update

Brian Bullard provided the following update of activities in the Division of Investment Management:

- **Recent Organizational and Staff Changes**

Andrew "Buddy" Donohue was named the division's new Director and began on May 15, 2006. Susan Wyderko, Director of the Office of Investor Education and Assistance, is leaving the SEC in June 2006. The Division maintains consistent staffing levels.

- **XBRL Application to Investment Companies**

The Division hosted a Roundtable on XBRL on June 12, 2006 which included analysts, preparers and investors. The purpose of the Roundtable was to discuss the application of XBRL in the disclosure regime for investment companies. The Division is in the process of accumulating information obtained at the Roundtable.

Mr. Bullard noted that the Investment Company Institute has engaged an outside firm to develop disclosure taxonomies for investment companies. The results of this project are expected to be released in the first quarter of 2007.

Mr. Bullard added that two investment companies now file their financial statements using XBRL.

. Electronic Effectiveness Notices

The Division of Investment Management has also begun posting Electronic Effectiveness Notices (see Section II) B) above).

III. STATUS UPDATE OF PROJECTS/ISSUES

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. The draft compilation, which is organized by rule/regulation, contains numerous superseded discussion documents. Upon finalization of the draft the staff will review the compilation.

B. Materiality

This project deals with the use of the “iron curtain” and “rollover” methods of quantifying errors. The SEC staff reported that the proposed guidance includes specific transition provisions to address items that existed at the beginning of the year and is similar to the treatment of these items to SFAS No. 154, *Accounting Changes and Error Corrections a replacement of APB Opinion No. 20 and FASB Statement No. 3*. Mr. Taub noted that the proposed guidance is in the process of internal review and it is uncertain at this point if or when the guidance will be issued.

The SEC staff is also considering guidance for interim periods, but noted that this guidance could not be issued until the annual materiality guidance is issued.

C. Update of the Staff Training Manual

The SEC staff is making progress on finalizing the Updated Staff Training Manual and hopes to complete the update by the end of 2006. The SEC staff is currently considering whether the document should be made publicly available as interpretive guidance. The Committee encouraged the staff to make the Staff Training Manual available for auditors, preparers and attorneys as it provides useful information about how to apply specific rules and interpretations. The Committee also plans to include in the Compilation of SEC Regulations Committee Highlights changes in SEC staff positions reflected in the Updated Staff Training Manual.

D. Accounting Practice Issues

1. Potential guidance on interpretation of EITF 03-9, *Determination of Useful Life of Renewable Intangible Assets under FASB Statement No. 142*

The Office of the Chief Accountant discussed the possibility of the SEC staff writing and issuing interpretive guidance related to the determination of the useful life of an intangible asset that is believed to be renewable. The guidance would address questions related to the meaning of specific terms used in FASB Statement No. 142 and EITF 03-9 including “substantial cost” and “material modifications”. The SEC staff noted that there are significant judgments and assumptions required to evaluate these types of intangible assets and indicated that many believe additional guidance is needed to interpret the literature.

2. Practice developments involving EITF Topic D-97

Mr. Taub expressed concern with recent developments in practice regarding the matters addressed in EITF Topic D-97, *Push-Down Accounting*. The SEC staff is considering whether its push down accounting guidance requires clarification or amplification.

E. Section 404

Concept Release – Management Reporting on Internal Controls

The Division of Corporation Finance noted that the Commission has received a significant number of requests for additional guidance on management’s reports on internal control over financial reporting. The Commission expects to issue a concept release in the near term in order to solicit views on the development of additional guidance for management regarding its evaluation and assessment of internal control over financial reporting. The concept release would be subject to a 60 day comment period followed by a notice of proposed rulemaking and comment period with the final rule / interpretive guidance expected to be issued at the end of 2006 or first quarter 2007.

To assist in the SEC’s development of guidance, the staff plans as part of the Concept Release process to solicit companies to provide the staff with examples of process plans and related documentation on assessing internal control over financial reporting.

Note: Subsequent to the meeting, the SEC issued a Concept Release Concerning Management’s Reports on Internal Control Over Financial Reporting. The Concept Release can be obtained at:

<http://www.sec.gov/rules/concept/2006/34-54122.pdf>

Revisions to Auditing Standard No. 2

The SEC Staff indicated that they are working with the PCAOB on the proposed revisions to Auditing Standard No. 2 as part of their oversight role. Any revisions to Auditing Standard No. 2 must be approved by the SEC.

- **Extension for Non-Accelerated Filers to Comply with Section 404 of the Sarbanes-Oxley Act of 2002**

The Division of Corporation Finance noted that the Commission may issue a short postponement of the effective date for compliance with Section 404 of the Sarbanes-Oxley Act of 2002 for non-accelerated filers. It is expected that compliance would be required for fiscal years beginning on or after December 16, 2007. The postponement is being issued to provide non-accelerated filers with the benefit of the management guidance on how to complete the assessment of internal control over financial reporting and their auditors with the ability to evaluate and implement the expected revisions to Auditing Standard No. 2, as discussed above.

The SEC indicated that it is also considering whether it should require management's assessment but delay the auditor's assessment for one year.

- **FAQs for Foreign Private Issuers ("FPI") related to Section 404 of the Sarbanes-Oxley Act of 2002**

The SEC Staff indicated that they were considering issuing in the near future a series of frequently asked questions (FAQ) related to Section 404 of the Sarbanes-Oxley Act of 2002 specifically related to FPI. The SEC staff has not determined how the FAQs will be published but did note that an FPI that meets the "large accelerated filer" or "accelerated filer" definition is currently required to comply with 404 reporting requirements for periods ending after July 15, 2006. The SEC staff also emphasized that the guidance will likely not address unique facts and circumstances relating to FPIs. Such issues should be directed to the appropriate office.

The Commission issued a press release on May 17, 2006 which provides additional information related to the concept release, revisions to Auditing Standard No. 2 and the extension for non-accelerated filers to comply with Section 404. The press release can be found at <http://www.sec.gov/news/press/2006/2006-75.htm>.

F. Status of Proposal to Revise Executive Compensation Disclosures

The SEC staff indicated that the SEC expects to issue the final rule on executive compensation disclosures in the summer of 2006. The SEC staff is currently working through the review of comment letters received. Some of

the most significant concerns relate to the proposed disclosures of compensation for “other highly paid executives” and disclosures of the fair value of options granted in the current year rather than only the period cost of share-based payments as determined under FAS 123(R).

[Note: On July 26, 2006 the SEC voted to approve the issuance of the final executive compensation disclosure rules. The press release discussing the final rules can be obtained at

<http://www.sec.gov/news/press/2006/2006-123.htm>

G. Update of Current Accounting and Disclosures Issues

The SEC staff indicated that they are in the process of working on an update of the Current Accounting and Disclosure Issues which was last issued in December 2005. The SEC staff indicated it will be at least a couple of months before an update is issued.

H. Disclosure requirements under SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*

The Office of the Chief Accountant indicated that they are receiving an increased number of questions regarding the determination of operating segments and the meaning of “similar economic characteristics” as the term is used in SFAS No. 131 paragraph 17. The SEC staff indicated that the economic characteristics evaluated should be based on the financial information provided to the chief operating decision maker (“CODM”) along with basic financial information such as revenue and gross margin of each operating segment. The Division of Corporation Finance noted that if the CODM is receiving financial information, it is assumed to be useful information not only to the CODM but also to investors. The SEC staff cautioned registrants about appealing an answer regarding the aggregation of operating segments to the Office of the Chief Accountant when revenues and gross margins for each operating segment are significantly different.

The Division of Corporation Finance also indicated that they continue to issue frequent comments related to SFAS No. 131. The SEC staff noted that registrants will often include a description of products or locations, but then do not consider these to be separate operating segments for disclosure purposes in MD&A and the financial statements. The SEC staff indicated that several registrants have been questioned regarding the lack of segments disclosed when the registrant reports specific geographic regions of the United States to the Chief Operating Decision Maker. The SEC staff has questioned among other things, how the business is being run and the way decisions are made for each geographic region (i.e. local management, regionally, corporate, etc.), the economic differences in the geographic regions and the differences in work forces in the geographic regions. The SEC staff declined to make any broad statement regarding specific industries, but noted that some industries are experiencing more issues than others.

I. Internet Availability of Proxy Materials and Amendments to the Tender Offer Best Price Rules

The SEC staff indicated that the Commission expects to issue final rules on the Internet Availability of Proxy Materials and the Amendments to the Tender Offer Best Price Rules in the summer of 2006. The proposed rules and comment letters received can be obtained from the SEC website at <http://www.sec.gov/rules/proposed/proposedarchive/proposed2005.shtml>.

J. Telephone Interpretations

The SEC staff indicated that the Manual of Publicly Available Telephone Interpretations posted on the SEC website is now classified by topic rather than by date. The Manual can be obtained at:

<http://www.sec.gov/interps/telephone.shtml>

K. Recent Comment Letters

The Committee asked about SEC staff requests in recent comment letters regarding the requirements to disclose gross profit within the income statement. The SEC staff observed that certain entities (most commonly in the financial institution/banking industry) have been reporting income statement items by nature of the item rather than by function even though Regulation S-X 5-03 requires the reporting by function. Also, the practice of reporting a combination of both function and nature and the inconsistent application of nature/function between revenues and expenses can be confusing to the reader. The SEC staff expressed concern regarding this noncompliance with Regulation S-X and added that it is considering remedial actions to address the issue.

L. PCAOB FAQ on Adjustments to Prior-Period Financial Statements Audited by a Predecessor Auditor

The Committee discussed the *PCAOB FAQ on Adjustments to Prior-Period Financial Statements Audited by a Predecessor Auditor* that was issued on June 9, 2006. Specifically, the Committee referred to question number 9 (Q9) which would allow a predecessor auditor to issue an audit report to be filed with the SEC which included “except for” language. The Committee noted that historically the SEC has not accepted these types of reports and asked whether the SEC staff agreed with this position. The SEC staff noted that they would accept this type of a report provided the totality of both audit reports provides coverage over all the financial statements for all periods (i.e., there are no gaps in the audit balances or periods). The SEC staff stated that it considers this position consistent with the guidance provided in AU 9508.

The Committee further asked the SEC staff for clarification regarding question number 11 (Q1 1), which indicates that a successor auditor may not

audit and report on the adjustments made to the prior-period financial statements if he or she has not yet completed an audit of the current-period financial statements. The Committee asked for clarification for situations in which the predecessor auditor is no longer independent and is not able to audit the adjustments and the successor auditor has not completed an audit. The staff emphasized that if the successor auditor has not completed an audit, the staff believes that he or she has not gained sufficient knowledge of the company to adequately plan and perform an audit and as such they can not audit and report on the adjustments made to prior-period financial statements.

The SEC staff acknowledged that the Q&A addresses many, but not all, of the issues that frequently arise when changes are required to financial statements in periods audited by a predecessor auditor. The SEC staff indicated that registrants should consult with the staff if they encounter circumstances that are not clearly addressed in the Q&A.

M. Additional Discussion Documents for Staff Review

The Committee noted that it is finalizing a discussion document that addresses the requirement to include financial statements of credit enhancers and related accountants' consents in filings pursuant to Regulation AB. In addition, the Committee is also finalizing a discussion document that addresses various application issues relating to Regulation S-X 3-10 and 3-16. Both documents will be forwarded to the SEC staff for consideration in the near future.

IV. CURRENT PRACTICE ISSUES

The following emerging practice issues were addressed at the meeting and have been finalized in discussion documents that have been posted at the URL indicated.

- A. Whether Parent Company Financial Information Is Required When the Registrant has a Consolidated Shareholders' Deficit** (*See http://www.thecaq.org/resources/secregs/pdfs/discussdocs/Discussion_Document_A_06202006_Joint_Meeting.pdf for the final discussion document.*)
- B. Rule 3-09 Financial Statements in the Year in which an Investee is Disposed (Revisit of discussions from various prior meetings)** (*The discussion document relating to this issue was revised and brought back to the staff at the September 26, 2006 Joint Meeting. See http://www.thecaq.org/resources/secregs/pdfs/discussdocs/DocumentB_Rule3_09_Fin_Stmts_092606.pdf for the final discussion document.*)
- C. Application of Regulation S-X Rule 3-05 and Rule 3-09 when the registrant is a successor to a predecessor company** (*See http://thecaq.org/resources/secregs/pdfs/discussdocs/Discussion_Document_C_06202006_Joint_Meeting.pdf for the final discussion document.*)

- D. Application of Rule 3-10 of Regulation S-X When a Subsidiary Issuer Files a Form 15 (Follow-up to Discussion Document B from the March 12, 2002 Committee Meeting)** (*See http://thecaq.org/resources/secregs/pdfs/discussdocs/Discussion_Document_D_06202006_Joint_Meeting.pdf for the final discussion document.*)
- E. FAS 123R Disclosures in Interim Periods during the Year of Adoption** (*See http://thecaq.org/resources/secregs/pdfs/discussdocs/Discussion_Document_E_06202006_Joint_Meeting.pdf for the final discussion document.*)
- F. Financial Information Required in Registration Statements When there are Retrospective Accounting Changes** (*See http://thecaq.org/resources/secregs/pdfs/discussdocs/Discussion_Document_F_06202006_Joint_Meeting.pdf for the final discussion document.*)
- G. Pro Forma Financial Information Required in Registration Statements upon Adoption of Statement 123(R) Using the Modified Prospective Transition Method** (*See http://thecaq.org/resources/secregs/pdfs/discussdocs/Discussion_Document_G_06202006_Joint_Meeting.pdf for the final discussion document.*)
- H. Treatment in Pre-Adoption Pro Forma Income Statement of Options Given to Employees of a Target in a Business Combination after the Acquirer has Adopted Statement 123(R)** (*The discussion document related to this issue was addressed with the staff again at the September 26, 2006 Joint Meeting. See http://www.thecaq.org/resources/secregs/pdfs/discussdocs/DocumentC_092606.pdf for the final discussion document.*)