CAQ SEC Regulations Committee
June 24, 2010 - Joint Meeting with SEC Staff
SEC Offices – Washington DC

HIGHLIGHTS

NOTICE: The Center for Audit Quality (CAQ) SEC Regulations Committee meets periodically with the staff of the SEC to discuss emerging financial 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. The highlights do not represent official positions of the CAQ. As with all other documents issued by the CAQ, these highlights are not authoritative and users are urged to refer directly to applicable authoritative pronouncements for the text of the technical literature. These highlights do not purport to be applicable or sufficient to the circumstances of any work performed by practitioners. They are not intended to be a substitute for professional judgment applied by practitioners.

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.

As available on this website, Highlights of Joint Meetings of the SEC Regulations Committee and its International Practices Task Force (IPTF) and the SEC staff are not updated for the subsequent issuance of technical pronouncements or positions taken by the SEC staff, nor are they deleted when they are superseded by the issuance of subsequent highlights or authoritative accounting or auditing literature. As a result, the information, commentary or guidance contained herein may not be current or accurate and the CAQ is under no obligation to update such information. Readers are therefore urged to refer to current authoritative or source material.

I. ATTENDANCE

A. SEC Regulations Committee

Chris Holmes, Chair
Melanie Dolan, Vice Chair
Peter Bible
Jack Ciesielski
Brad Davidson
Christine Davine
Tom Elder

Dave Follett
Bridgette Hodges
Jeff Lenz
Steve Meisel
Scott Pohlman
Amy Ripepi
Tom Weirich

B. Securities and Exchange Commission

Division of Corporation Finance

Wayne Carnall, Chief Accountant
Craig Olinger, Deputy Chief Accountant
Mark Kronforst, Deputy Chief Accountant
Jill Davis, Associate Chief Accountant
Louise Dorsey, Associate Chief Accountant
Todd Hardiman, Associate Chief Accountant
Steven Jacobs, Associate Chief Accountant
Joel Levine, Associate Chief Accountant
Michael Stehlik, Assistant Chief Accountant
John Robinson, Academic Fellow
Mark Green, Senior Special Counsel
Nasreen Mohammed, Assistant Chief Accountant

C. Center for Audit Quality

Annette Schumacher Barr

D. Guests

Carolyn Clemmings, E&Y
John May, PwC

II. DIVISION OF CORPORATION FINANCE PERSONNEL UPDATE

Wayne Carnall announced that Michael Stehlik is now an Assistant Chief Accountant and announced that Mark Kronforst was awarded the Andrew Barr Award. Mr. Carnall also noted Joel Levine, previously the Assistant Director in the Office of Interactive Disclosure, has returned to the Division of Corporation Finance (the Division) as an Associate Chief Accountant.

III. CURRENT FINANCIAL REPORTING MATTERS

A. Effect of Current Events on Disclosures

Mr. Carnall commented that material implications of both the recent environmental issues in the Gulf of Mexico and the healthcare legislation should be discussed in MD&A. For example, if a gulf coast hotel chain is reasonably likely to have materially reduced revenue because it is reasonably likely there will be decreased tourism, or if an energy company is reasonably likely to experience material changes in results of operations because it is reasonably likely there will be an offshore drilling moratorium, those entities should evaluate the need to disclose that information in their MD&A.

B. REIT IPOs

Mr. Carnall summarized recent activity in real estate investment trust (REIT) initial public offerings (IPOs). In a number of transactions, the Division questioned whether the formation transaction required new basis accounting. Mr. Carnall noted that in the REIT structures that were being used, the SEC staff did not object to the presentation of carry-over basis financial statements.

C. Cheap Stock

Mr. Carnall addressed equity securities issued as compensation while a company was privately held in an IPO. Mr. Carnall encouraged companies to have contemporaneous valuations to determine the fair value of equity securities issued as, or underlying, compensation. The 2004 AICPA Practice Aid, *Valuation of Privately-Held-Company Equity Securities Issued As Compensation* (the Practice Aid) includes recommended disclosures. Mr. Carnall noted that the Practice Aid differentiates the extent of disclosures based on the nature of the valuation (independent contemporaneous valuation vs. retrospective or internal valuation). The SEC staff is currently evaluating an approach that places more focus on the inputs used in the valuations and expects to incorporate disclosure expectations into a future release of the Division's Financial Reporting Manual.

D. Contingency Disclosures

Mr. Carnall noted that in connection with its reviews, the staff has issued comments in situations in which the company does not appear to have complied with ASC 450, *Contingencies* (formerly SFAS No. 5). Mr. Carnall commented that when there was a reasonable possibility of a loss in excess of the amount accrued that these companies did not disclose an estimate of the amount of possible loss or range of loss or state that such an estimate cannot be made. Mr. Carnall added that he would expect that disclosures about a loss contingency would be updated as additional information becomes available. With the passage of time, there is a greater presumption that it would be possible for the company to provide quantitative information.

Mr. Carnall emphasized that the SEC staff expects registrants to comply with ASC 450, including the applicable disclosure requirements. In response to a question, Mr. Carnall indicated that the disclosure can be aggregated in a logical manner vs. separate disclosure for each asserted claim. Mr. Carnall noted that the staff has also recently issued comments when there was a large settlement with little or no disclosure in earlier periods – e.g., why wasn't there disclosure?

E. Domestic Companies with Majority of Operations Outside US

Mr. Carnall observed that a number of US domestic registrants have substantially all of their operations outside the US (e.g., in China). In certain situations, the SEC staff may ask questions regarding management's experience and capability of preparing financial statements in accordance with US GAAP. The objective of the questions is to evaluate management's assertion that it has effective internal control over financial reporting.

Additionally, Mr. Carnall discussed situations and shared observations in which these companies were audited by a registered independent public accounting firm domiciled in the US.

[See also PCAOB Staff Audit Practice Alert No. 6, *Auditor Considerations Regarding Using The Work Of Other Auditors And Engaging Assistants From Outside The Firm*, which was issued on July 12, 2010.]

IV. IMPLEMENTATION AND INTERPRETATION OF RECENT SEC RELEASES

A. Section 404(b) for Non-Accelerated Filers

Under SEC rules, non-accelerated filers are required to comply with the auditor attestation requirement of Section 404(b) of the Sarbanes-Oxley Act of 2002 with respect to reports on internal control over financial reporting in annual reports for fiscal years ending on or after 15 June 2010. The financial regulatory reform bill in House-Senate Conference includes a permanent exemption from Section 404(b) for non-accelerated filers. If the bill becomes law with the permanent exemption, Mr. Carnall expects the SEC would act quickly to modify existing SEC rules to make them consistent with the law.

In the absence of a change in rules, Mr. Carnall confirmed that a voluntary filer would be required to have an audit of its internal control over financial reporting after the current SEC deferral ends.

NOTE: The Dodd-Frank Wall Street Reform and Consumer Protection Act was signed into law by President Obama on July 21, 2010.

B. XBRL

The Committee noted that the detail XBRL tagging required in the second year of XBRL compliance is expected to be especially time consuming with respect to the guarantor condensed consolidating financial information footnote required by S-X Rule 3-10. The Committee questioned whether the SEC staff had considered allowing block tagging that footnote. Mark Green commented that the SEC's final rule, *Interactive Data to Improve Financial Reporting* (Release Nos. 33-9002, 34-59324) requires detail tagging of footnotes in the second year of a phase-in group's XBRL compliance. Mr. Green also stated that the condensed consolidating footnote is permitted by S-X Rule 3-10 as an exception to full financial statements of guarantors. Under that relief, a registrant has the benefit of only detail tagging the guarantor footnote as opposed to full guarantor financial statements. Joel Levine stated that the majority of the XBRL tags of elements in the guarantor footnote are consistent with the XBRL tags used in the primary financial statements.

Regarding XBRL transition, Mr. Green noted that a transcript of the XBRL Public Education Seminar, which discussed transition, is now available on the SEC website (see http://www.sec.gov./news/otherwebcasts/2010/xbrlseminar032310-transcript.pdf). Mr. Green commented there are no new XBRL transition interpretations to communicate.

V. SEC STAFF AND OTHER INITIATIVES

A. Financial Reporting Manual (FRM)

Mr. Carnall noted that he expects the FRM update as of March 31, 2010 to be issued soon. The update will include revisions to Section 2805 on general partner financial statements and the incorporation of selected topics included in Highlights of previous Joint Meetings of the Regs Committee and the SEC staff (Highlights). Additional selected topics from previous Highlights will be included in future FRM updates. Jill Davis reported on the project to compile 25 years of Highlights to allow the Division staff to incorporate current and relevant information into the FRM and Compliance and Disclosure Interpretations. *[Note: On July 7, 2010 an updated version of the FRM as of March 31, 2010 was posted to the SEC website.]*

B. CDIs on Disclosures of Non-GAAP Financial Measures

Mr. Carnall addressed the Division's Compliance and Disclosure Interpretations (CDIs) on the use of non-GAAP financial measures. He reiterated that the SEC staff generally would not require an SEC filing to include a non-GAAP financial measure. However, the company does have an obligation to ensure the information in the filing is not misleading. For example, the disclosure of non-

GAAP information outside of the filing should not contradict the information included in the filing.

Mr. Kronforst noted that registrants have received SEC staff comments about inconsistencies within their SEC filings or inconsistencies between the SEC filing and information outside of the SEC filing. Such comments are not limited to non-GAAP financial measures.

Mr. Carnall noted the Division staff has not performed an analysis to determine whether more non-GAAP financial measures are being included in SEC filings subsequent to the CDIs release, but acknowledged many registrants with December year-ends may not have had the opportunity to fully reassess their disclosures with respect to non-GAAP financial measures based upon the January 2010 release date of the CDIs.

C. CDIs on Regulation S-K

Regulation S-K CDI 119.24 notes that an equity incentive plan award with a service period preceding the grant date, resulting from the compensation committee's ability to exercise discretion to reduce the award, should be reported in the Summary Compensation Table (SCT) and Grants of Plan-Based Awards Table (GPAT) as compensation in the year in which the service inception date begins. Notwithstanding the accounting treatment for the award, the SEC staff believes reporting the award in this manner better reflects the compensation committee's decision to establish the award arrangement. The amount reported in both tables should be the fair value of the award at the service inception date, based upon the then-probable outcome of the performance conditions. The award should also be included in total compensation for the purposes of determining whether the executive officer is a named officer.

Mr. Carnall commented that the staff understands that situations in which the service inception date precedes the grant date are not common and when it does exist is frequently limited to the top executives. In these situations, preparers and auditors should evaluate the terms to determine the appropriate accounting.

Steven Jacobs noted the treatment specified by the CDI could apply to other situations based upon specific facts and circumstances. He added that the basis for the treatment specified by the CDI was to report compensation in the period of the compensation committee's decision to authorize and establish the award arrangement. However, the CDI would not apply to an equity award grant that requires shareholder or some additional level of approval, which should be reported in the SCT and the GPAT in the period that approval has been obtained.

D. Core Disclosure Project

Mr. Carnall noted that the pending financial regulatory reform legislation, and the resulting requirements for extensive SEC rulemaking, may delay the Division's planned core disclosure project.

VI. CURRENT PRACTICE ISSUES

A. Summarized financial information of equity investees

The table below sets forth the source of equity method investee disclosure guidance, the number of significance tests, the disclosure threshold and the determination of significance for interim and annual reporting by smaller reporting companies and other reporting companies.

	Other Reporting Companies		Smaller Reporting Companies	
	Annual	**Interim**	**Annual**	**Interim**
Source	Rule 4-08(g)	Rule 10-01(b)(1)	Rule 8-03(b)(3)[1]	Rule 8-03(b)(3)
Disclosure threshold	Exceeds 10%	Exceeds 20%	Exceeds 20%	Exceeds 20%
Number of tests	3	2	3	3
Asset test	The registrant's and its other subsidiaries' proportionate share of the total assets of the equity method investee as a percentage of the total assets of the registrants and its subsidiaries consolidated as of the end of each fiscal year presented.	N/A	Same as other reporting companies, except the asset test also applies to interim reporting.[2]	
Investment (equity) test	The registrant's and its other subsidiaries' investments in and advances to the equity method investee as a percentage of the total assets of the registrant and its subsidiaries consolidated as of the end of each fiscal year presented.	For interim measurement, use both the most recent balance sheet, which should correspond to the end of the year-to-date (cumulative) interim period used to measure significance under the income test, and the balance sheet as of the end of the most recently completed fiscal year that is included in the quarterly report.[3]	Same as other reporting companies.[2]	
Income test	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 equity method investee exclusive of amounts attributable to any noncontrolling interests as a percentage of such income of the registrant and its subsidiaries consolidated for each fiscal year presented.	For interim measurement, use the year-to-date interim period income statements.	The registrant's and other subsidiaries' equity in the income from continuing operations attributable to the equity method investee as a percentage of such income of the registrant and its subsidiaries consolidated for each fiscal year presented. For interim measurement, use the year-to-date interim period income statements. (This computation uses an after-tax measure of income.)	

In determining whether summarized financial information is required in either annual or interim financial statements, Mr. Carnall commented that a smaller reporting company may elect to apply the significance tests applicable to smaller reporting companies or other reporting entities and select the least onerous significance calculation for each significance test.

---

[1] The SEC Division of Corporation Finance Financial Reporting Manual (FRM) Notes to Section 2420.9 state, "The smaller reporting company requirement for summarized financial information is located within the S-X 8-03 requirements for interim financial statements. Notwithstanding the location of this requirement, the staff applies the S-X 8-03 requirement for summarized financial information to both annual and interim financial statements."

[2] The FRM Notes to Section 2420.9 state, "The staff did not intend for the disclosure requirements for a smaller reporting company to be more onerous than those for a registrant that is not a smaller reporting company. Therefore, the staff determines significance for purposes of reporting summarized financial information by smaller reporting companies in a manner consistent with S-X 1-02(w), substituting 20% for 10%."

[3] Interim investment test guidance is from Section 2420.7 of the FRM.

B. PCAOB Registration for Auditors of Equity Method Investees

Mr. Carnall indicated that the chart in FRM 4110.5 would be revised to clarify the requirements of when the auditor of an equity affiliate needs to be registered with the PCAOB. Specifically, if the "substantial role" test is not met, the auditor of the equity affiliate does not need to be registered.

Mr. Carnall also noted that a Form 8-K filing by a special purpose acquisition company (SPAC) to report the acquisition of a predecessor entity (or by a public company to report an acquisition accounted for as a reverse merger) is deemed equivalent to an IPO registration statement that requires both a PCAOB registered firm and PCAOB standards with respect to the acquired company.

C. Impact on Article 11 Pro Forma Income Statement of Changes in the Fair Value of Contingent Consideration Related to a Business Combination (Update to Attachment #5 from April 2010 Meeting)

S-X Rule 11-02(b)(6) requires that pro forma adjustments related to a pro forma condensed income statement be computed assuming the transaction was consummated at the beginning of the fiscal year presented and include adjustments that give effect to events that are (i) directly attributable to the transaction, (ii) expected to have a continuing impact on the company, and (iii) factually supportable.

ASC 805 (formerly SFAS No. 141(R)) requires that contingent consideration issued in a business combination be recorded at its fair value on the acquisition date, and classified as either an asset, as a liability or as equity. Subsequent changes in fair value for asset- and liability-classified contingent consideration are usually recognized in earnings until the arrangement is settled.

The Committee questioned how a pro forma income statement that is being updated in connection with a new or amended registration statement or proxy/information statement should reflect known changes in the fair value of contingent consideration in post-acquisition periods. Mr. Carnall noted that the SEC staff does not believe such statements should reflect any pro forma adjustments to give effect to changes in the fair value of contingent consideration in periods different than those in which such changes were recognized in the acquirer's post-acquisition income statements. The SEC staff expects the pro forma financial information to include transparent disclosure about the contingent consideration arrangement and known changes in its fair value.

D. Pro Forma Income Information for a Business Combination – Computation and Presentation in MD&A

When a public company has completed a business combination, the accounting literature (ASC 805) requires disclosure of pro forma information in the notes to the financial statements. If comparable financial statements are presented, the

GAAP pro forma information reflects two alternative (and mutually exclusive) scenarios: prior year earnings as if the transaction occurred at the beginning of the prior year and current year earnings as if the transaction occurred at the beginning of the current year.

Under Regulation S-X Rule 11-02(c)(2)(i), when there has been a significant business combination, the registrant should present a pro forma condensed statement of income for the most recent fiscal year and for the period from the most recent fiscal year end to the most recent interim date for which a balance sheet is required. In effect, the Article 11 pro forma reflects just one scenario: prior year and year to date earnings as if the transaction occurred at the beginning of the prior year.

Item 303 of Regulation S-K (MD&A) requires the registrant to analyze the three-year period covered by the financial statements using year-to-year comparisons based on the financial statements included in the filing. The SEC staff has acknowledged that "there may be situations where comparisons other than those of the historical financial information may provide valuable supplemental and in certain cases, more relevant analyses, to fully discuss trends and changes." When a registrant determines that a supplemental discussion in MD&A based on pro forma information is appropriate and will enhance the discussion, FRM 9220.7 states that the pro forma financial information generally should be presented in a format consistent with S-X Article 11 but acknowledges that other formats may be appropriate depending on the facts and circumstances.

The Committee questioned whether a registrant may utilize GAAP pro forma information as the basis for a supplemental discussion in MD&A. Mr. Carnall stated that if Article 11 pro formas are included in a filing, it makes the most sense to use the Article 11 pro formas as the basis for any MD&A supplemental disclosures. If the filing includes both Article 11 and GAAP pro formas, the filing should explain the differences in the two pro forma presentations. If the GAAP pro formas are used as a basis for any MD&A supplemental disclosures, MD&A should include clear disclosure of the basis of the pro forma comparison. The SEC staff noted that in some cases, the registrant may choose to limit its supplemental discussion to the effect of the business combination on revenues; in these circumstances, the adjustments to arrive at the pro forma amount of revenue may be limited and easy to explain. In other cases the registrant may believe it is appropriate to also discuss the effect of the business combination on earnings. In these circumstances, the registrant may need to provide more detail regarding the nature and amount of the adjustments so that investors understand how the pro forma earnings amount was computed.