CAQ SEC Regulations Committee
June 28, 2011 - Joint Meeting with SEC Staff
SEC Offices – Washington DC

HIGHLIGHTS

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I. ATTENDANCE

A. SEC Regulations Committee

Chris Holmes, Chair
Melanie Dolan, Vice Chair
Pete Bible
Jim Brendel
Jack Ciesielski
Brad Davidson
Christine Davine
David Follett

Bridgette Hodges
Wayne Landsman
Jeff Lenz
Kevin McBride
Sandra Peters
Scott Pohlman
Michelle Stillman
Don Zakrowski

B. Securities and Exchange Commission

Division of Corporation Finance

Tom Kim, Chief Counsel and Associate Director
Jonathan Ingram, Deputy Chief Counsel
Mark Kronforst, Associate Director
Wayne Carnall, Chief Accountant
Craig Olinger, Deputy Chief Accountant
Nili Shah, Deputy Chief Accountant
Suzanne Hayes, Assistant Director
Jill Davis, Associate Chief Accountant
Louise Dorsey, Associate Chief Accountant
Todd Hardiman, Associate Chief Accountant
Joel Levine, Associate Chief Accountant
Ryan Milne, Associate Chief Accountant
Kyle Moffatt, Associate Chief Accountant
Leslie Overton, Associate Chief Accountant
Mark Shannon, Associate Chief Accountant
Ted Uehlinger, Associate Chief Accountant
Michael Stehlik, Assistant Chief Accountant
Mark Green, Senior Special Counsel

Office of the Chief Accountant (OCA)

Mike Starr, Deputy 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 AND ORGANIZATIONAL UPDATE

A. Personnel Changes

The staff provided the following update of personnel developments in the Division:

- **Ryan Milne, Kyle Moffatt and Mark Shannon** were promoted to Associate Chief Accountants in the Division. Mr. Milne will work in the policy group and Mr. Moffat and Mr. Shannon will work in the operations group.

- **Craig Olinger** won a 2011 Distinguished Service Award, the SEC's highest award, recognizing outstanding contributions to the work of the Commission.

- **Jill Davis** won the 2011 SEC Andrew Barr Award, which is given to an accountant who displays the qualities of outstanding accounting ability, analysis, critical judgment and creativity, along with dedication to public service and the Commission. The performance of the individual receiving this award consistently demonstrates high standards of personal and professional integrity.

- **Wayne Carnall,** Chief Accountant in the Division since December 2007, is leaving the SEC as of June 30, 2011 to rejoin the national office of PricewaterhouseCoopers. His position has not yet been filled.

Mr. Carnall recognized the Committee members for the effort and time commitment they incur for the betterment of financial reporting by public companies. Mr. Holmes thanked Mr. Carnall for his years of service at the Commission, in particular his successful efforts to resolve and communicate issues in a timely and effective fashion. After the personnel update, Mr. Carnall excused himself from the meeting.

B. Specialized Office Focusing on Large Financial Institutions - Assistant Director's Office 12 (AD 12)

AD 12, which was created last year and has been operational since April, is responsible for the review of approximately 60 of the largest banks (including 3 investment banks) and certain government sponsored entities. The number of registrants assigned to this office is expected to increase over time. Stephanie Hunsaker serves as the Senior Assistant Chief Accountant, and Kevin W. Vaughn is the Accounting Branch Chief. AD 12 also includes six staff accountants, two special counsel and two legal staff.

Ms. Hayes commented that the filing reviews of registrants by AD 12 are consistent with other offices, but there are "continuous reviews" of some filers (e.g., reviewing and commenting on each SEC filing, as well as intervening press releases).

III. CURRENT FINANCIAL REPORTING MATTERS

A. Notification of Completion of Exchange Act Filing Review

The letter the Division staff sends to registrants upon completion of the review of their Exchange Act filings contains the following new paragraph:

> *We have completed our review of your filing[s]. We remind you that our comments or changes to disclosure in response to our comments do not foreclose the Commission from taking any action with respect to the company or the filing[s] and the company may not assert staff comments as a defense in any proceeding initiated by the Commission or any person under the federal securities laws of the United States. We urge all persons who are responsible for the accuracy and adequacy of the disclosure in the filing[s] to be certain that the filing[s] include[s] the information the Securities Exchange Act of 1934 and all applicable rules require.*

Mr. Kronforst stated that there are no implications to registrants of the new language.

B. Loss Contingency Disclosures

The accounting and disclosure of loss contingencies continues to be an area of focus in filing reviews. Ms. Shah summarized SEC staff views and observations on loss contingency disclosures, including:

- Registrants must comply with ASC 450, *Contingencies*.
- Registrants should use language in their disclosures that is consistent with ASC 450 (e.g., "reasonably possible loss" as opposed to "potential loss").
- Disclosures should not have confusing, contradictory or unclear language (see "Note" below for further discussion regarding this point)
- Aggregation of contingencies for disclosure purposes is acceptable and helps mitigate registrants' confidentiality concerns.
- If a registrant discloses that a contingency is not estimable, the SEC staff may request supplemental information about the registrant's process and efforts to conclude an amount is not estimable.
- Registrants must also comply with other requirements related to disclosures of loss contingencies, including Regulation S-K Item 103, *Legal Proceedings*, which has different disclosure objectives than ASC 450, and SAB Topic 5-Y, *Accounting and Disclosures Related to Loss Contingencies*.

Ms. Shah stated that the SEC staff noted improvements in loss contingency disclosures by financial institutions. The SEC staff is still looking for improvement in other filers' disclosures.

Note: The Division staff also discussed loss contingencies on a June 24, 2011 CAQ webcast, which is available at http://video.webcasts.com/events/pmny001/viewer/eFrame.jsp?mei=38939&cf=aicp001&tp=.

C. Definition of "Full and Unconditional" related to Guaranteed Securities under Rule 3-10 of Regulation S-X

Members of the Committee and the SEC staff discussed certain aspects of the full and unconditional guarantee requirement in Rule 3-10 of S-X. The SEC staff indicated they would update the Committee as developments occur.

D. Reverse Mergers

In June 2011, the SEC issued an *Investor Bulletin* on risks of investing in reverse merger companies noting the SEC and U.S. exchanges recently suspended trading in a more than a dozen reverse merger companies, citing a lack of current, accurate information about these companies and their finances. Mr. Ingram noted that reverse mergers currently are a major focus of the SEC. Ms. Shah commented that reverse merger entities must have transparent disclosures to help investors understand the nature of the entity and that for certain reverse mergers the SEC staff is concerned about the sufficiency of the related Form 8-K disclosures, which must be consistent with Form 10 (i.e., Exchange Act registration disclosures).

E. Study of IFRS Application

The Division staff is nearing completion of its study of the application of IFRS. Mr. Olinger explained that the SEC staff expects to publicly release observations later this year.

Mr. Olinger also highlighted the IFRS Roundtable scheduled for July 7, 2011 comprised of smaller company, regulator and investor panels.

[Note: The IFRS Roundtable occurred on July 7, 2011. An archived video of the Roundtable can be viewed on the SEC website at http://sec.gov/news/otherwebcasts/2011/ifrsroundtable070711.shtml.]

F. Non-GAAP Financial Measures

Ms. Shah noted that Regulation G, *General rules regarding disclosure of non-GAAP financial measures*, prohibits disclosure of misleading non-GAAP financial measures in filings, press releases and other public disclosures. For example, the exclusion from a non-GAAP financial measure of normal, cash operating expenses necessary to operate the business could be misleading.

IV. XBRL

A. XBRL Taxonomy for IFRS Filers

The SEC staff previously shared its view through an interpretive letter to the CAQ that foreign private issuers (FPIs) preparing financial statements in accordance with IFRS as issued by the IASB are not required to submit XBRL financial statements to the SEC or post them on their corporate website, if any, until the SEC approves an IFRS taxonomy.

Mr. Starr stated that it is unlikely the 2011 Form 20-F of calendar year FPIs who use IFRS will require any XBRL tagging. The final SEC approval of an IFRS taxonomy also would provide time for FPIs to prepare to use the taxonomy before their first filing deadline. Mr. Green indicated that, until required to file with XBRL, the cover page of Form 20-F, which requires indication, by a Yes or No checkmark, whether the FPI has submitted (and posted to its website) all required XBRL exhibits, should have two blank boxes (consistent with Exchange Act Forms Compliance & Disclosure Interpretation (C&DI) 105.04).

B. Status of Relief Requested

SEC XBRL rules require all domestic registrants to tag financial statements for periods on or after June 15, 2011. As discussed at the March 29, 2011 SEC Regulations Committee Meeting, the Committee on Corporate Reporting ("CCR") of Financial Executives International (FEI) recommended the SEC make the following four modifications to assist registrants in preparing filings with detailed XBRL tagging:

- Delay the required submission of XBRL filings by a week after the filing of the related Exchange Act report
- Allow block tagging for non-standard/company specific notes instead of detail tagging
- Allow wholly-owned subsidiaries that qualify for abbreviated disclosure rules to be exempt from detail tagging requirements
- Delay the limited liability phase-out

Mr. Starr stated that, while the SEC staff is open to modifying the guidance for detail tagging of notes, it must better understand the use of such XBRL-tagged data by investors (i.e., what XBRL-tagged data in the notes is being used by investors and how, and whether relief for issuers might harm investors). There is an ongoing dialogue between the SEC staff on the one hand and CCR and investors on the other to better understand XBRL use in practice. In addition, a leading university is considering hosting a roundtable dialogue among the SEC staff, preparers and investors. Mr. Starr clarified that the SEC staff currently does not intend to recommend a delay in the required submission of XBRL filings or the limited liability phase-out.

C. Third Party Service Providers

Members of the Committee expressed concern about XBRL third party service providers having the capacity to meet registrant filing deadlines with the phase-in of accelerated and non-accelerated filers for periods on or after June 15, 2011 (i.e., the June 30, 2011 quarter for calendar year-end companies).

D. Required XBRL Tagging Outside the Financial Statements and Footnote

Under the SEC's final rule, *Interactive Data to Improve Financial Reporting*, information required to be formatted in XBRL includes a registrant's primary financial statements, notes and financial statement schedules for all periods included in the financial statements. However, filers using US GAAP are permitted to include required segment disclosures in other sections of a filing outside the notes to the financial statements (e.g., in disclosures under Regulation S-K, Item 101, *Description of Business*) with appropriate references to explain the information was audited and is an integral component of the financial statements. Similarly, many banks that prepare their financial statements in accordance with IFRS present their audited IFRS 7 risk disclosures physically outside of the financial statements (with a narrative to explain which information was audited). These disclosures are presented in other sections of a filing from the financial statements, and are referred to at the bottom of the balance sheet with disclosure (e.g., the accompanying notes on pages X to X, the audited sections of 'Report of the Directors: Risk' on pages X to X, 'Critical accounting policies' on pages X to X and the audited sections of "Report of the Directors: Impact of Market Turmoil' on pages X to X form an integral part of these financial statements).

Mr. Green commented that these disclosures, although located physically outside the financial statements, form a part of the financial statements and therefore require XBRL tagging. Mr. Levine observed that unaudited footnotes also require XBRL tagging, but that Regulation S-K Item 302 disclosures of quarterly financial data presented outside the financial statements are not required to be tagged.

E. Transition to XBRL Reporting after the Phase-In Period is Over

Mr. Green discussed the application of XBRL reporting requirements in Item 601(b)(101) of Regulation S-K and Rules 405 and 406T of Regulation S-T to a newly public company after the phase-in of XBRL reporting is complete (i.e., subsequent to June 15, 2012).

- **Interactive data file not required in a company's initial registration statement**

  The commentary on page 69 of Release 33-9002 states that "interactive data exhibits will not be required for initial public offerings." In addition, Item 601(b)(101)(i) of Regulation S-K requires an interactive data file "except that an Interactive Data File: first is required for a periodic report on Form 10-Q ...." Therefore, an Interactive Data File is not required in a company's initial registration statement.

- **For a registrant using domestic forms, the first periodic report that must contain an Interactive Data File is a Form 10-Q**

  Item 601(b)(101)(i)(C) of Regulation S-K requires an interactive data file in a filing that "contains financial statements of the registrant for a fiscal period that ends on or after June 15, 2011." As noted above, pursuant to Item 601(b)(101)(i) of Regulation S-K, an interactive data file "first is required for a periodic report on Form 10-Q ...." Therefore:

  a. If a newly public company's first periodic report as an SEC registrant is its Form 10-Q for the quarter ending September 30, 2012, it would need to include an Interactive Data File in that Form 10-Q.
  b. If a newly public company's first periodic report as an SEC registrant is its Form 10-K for the year ending December 31, 2012, that Form 10-K *would not need* to include an Interactive Data File. The company would need to include an Interactive Data File in its Form 10-Q for the quarter ending March 31, 2013.

- **First Interactive Data File that must have detail tagged data**

  During the phase-in period for XBRL reporting, Rule 405(f) of Regulation S-T permits registrants to omit certain tags from footnotes and financial statement schedules during the first year of XBRL compliance. However, the relief provided by Rule 405(f) is available only "if none of the financial statements for which an Interactive Data File is required is for a fiscal period that ends on or after June 15, 2012." For example, assume that a domestic registrant with a calendar year-end completes an initial public offering, and the registration statement covering the IPO contains financial statements for the six

months ended June 30, 2012. The Interactive Data File in the September 30, 2012 Form 10-Q of this registrant must be detail tagged.

- **Grace period -** Rule 405(a)(2)(ii) of Regulation S-T provides a grace period (i.e., an Interactive Data File may be submitted as an amendment no more than 30 days after the earlier of the due date or filing date of the first periodic report for which an Interactive Data File is submitted). After phase-in is complete, the grace period is still available for the initial XBRL submission.

- **Limited liability** - Rule 406T of Regulation S-T provides reduced liability provisions that apply until 24 months after a registrant was first required to submit an Interactive Data File, "but no later than October 31, 2014." Therefore:

  a. If a newly public company's first periodic report as an SEC registrant is its Form 10-Q for the quarter ending September 30, 2012, the reduced liability provisions would apply to the Interactive Data File in that Form 10-Q. Limited liability would continue to apply until filings made after October 31, 2014,
  b. If a newly public company's first Form 10-Q as an SEC registrant is filed after October 31, 2014, the Interactive Data File would be subject to the same liability provisions as the rest of the filing.

V. SEC STAFF AND OTHER INITIATIVES

A. Financial Reporting Manual (FRM)

The next update to the Division's Financial Reporting Manual (FRM) is expected to be issued by the end of June or early July, 2011, with updates dated as of March 31, 2011. This FRM update will complete the SEC staff project of incorporating 25 years of relevant Regs Committee Highlights into the FRM. Mr. Stehlik also noted that the FRM will include a summary of updates in the front of the publication with links to the updates within the FRM text. The next FRM project is to review and incorporate, as appropriate, International Practice Task Force (IPTF) Highlights since its inception about 20 years ago.

[Note: On July 1, 2011, the Division's staff released its quarterly update of the FRM. The revisions include updates for issues related to subsidiary guarantor financial statements, ICFR reporting requirements for newly public companies, reporting requirements in a reverse recapitalization, as well as other changes. Also note that a summary of changes in the current update is provided at the beginning of the FRM.]

VI. CURRENT PRACTICE ISSUES

A. Applicability of the SEC's Reporting Requirements to Acquisitions and Dispositions Made by a Consolidated Variable Interest Entity

Regulation S-X and Form 8-K include references that presume consolidation based on the voting interest model and have not been updated to reflect the variable interest model. For example, Item 2.01 of Form 8-K indicates that disclosure is required "[i]f the registrant or any of its majority-owned subsidiaries has completed the acquisition or disposition of a significant amount of assets" [emphasis added]. Nevertheless, Mr. Hardiman stated that the SEC staff believes that Item 2.01 of Form 8-K applies to acquisitions and dispositions made by a consolidated VIE. Members of the Committee suggested updating the Division FRM to clarify that Item 2.01 of Form 8-K is applicable to significant acquisitions or dispositions by a consolidated VIE.

B. Calculating Significance When a Registrant Concludes it Must Consolidate a VIE

Upon a reconsideration event under ASC 810 (SFAS No. 167) that makes a registrant the primary beneficiary of a variable interest entity (VIE), or when a registrant becomes initially involved with a VIE, the registrant should consider whether consolidation of the VIE meets the significance thresholds for reporting under Item 2.01 of Form 8-K (and Rule 3-05 of Regulation S-X), even though the registrant might have issued no consideration. If the VIE represents a business under Regulation S-X Rule 11-01(d) that is significant above the 20% level, an Item 2.01 Form 8-K (including Item 9.01 with S-X Rule 3-05 financial statements and pro forma financial information under S-X Article 11) would be required. If the VIE is not a business, an Item 2.01 Form 8-K (considering Item 9.01 with pro forma financial information under S-X Article 11) would be required if the VIE exceeds the applicable 10% significance test.

The Committee discussed with the SEC staff the application of the three significance tests by the primary beneficiary of a VIE that is a business. The asset and income tests of significance under Regulation S-X 1-02(w) are based on the registrant's *share* of the assets of the other entity and the registrant's *equity* in the other entity's income from continuing operations before taxes, extraordinary items and cumulative effect of a change in accounting principle exclusive of amounts attributable to non-controlling interests. However, the primary beneficiary often holds a relatively small equity interest in the VIE, such that the calculated significance might be low under the literal application of those significance tests.

With respect to the investment test , the Division FRM at Section 2015.5 states that the investment test should be based on total GAAP purchase price of the acquired business (adjusted to exclude carrying value of assets

transferred by the acquirer to the acquired business that will remain with the combined entity after the business combination). GAAP purchase price in this context means the "consideration transferred," excluding previously held equity interests.[1]

In many cases, a reconsideration event does not involve the transfer of consideration by the new primary beneficiary, nor is there a change in the relative equity interest of the primary beneficiary in the VIE.

The Committee also discussed how a primary beneficiary of a VIE that is not a business should assess significance. If the VIE is not a business, Instruction 4 of Item 2.01 of Form 8-K states "An acquisition or disposition shall be deemed to involve a significant amount of assets: (i) if the registrant's and its other subsidiaries' equity in the net book value of such assets or the amount paid or received for the assets upon such acquisition or disposition exceeded 10% of the total assets of the registrant and its consolidated subsidiaries . . ." Similar to a VIE that is a business, the primary beneficiary's equity in the net book value of a VIE that is not a business, and the amount paid in connection with the reconsideration event, could be low.

Mr. Hardiman noted that the SEC staff is interested in understanding how registrants calculate significance for VIEs in the situations described above and in similar situations such as a business combinations achieved without the transfer of consideration. The SEC staff encourages registrants that propose, based on a literal application of the significance tests, to omit financial statements that are material to consult CF-OCA about their particular facts and circumstances.

C. S-K Item 304 Disclosures for Auditor Changes within an International Network

The SEC staff has recently published guidance that, when a registrant changes its auditor from one member firm of a global network to another firm within the same network, it must file an Item 4.01 Form 8-K (Exchange Act Form 8-K Compliance & Disclosures Interpretation (C&DI) 114.02). When a change in auditors takes place, Item 304(a)(2) of Regulation S-K requires the registrant to disclose whether, within the two most recent fiscal years and subsequent interim period, it consulted with the newly engaged auditors on the application of accounting principles or the report to be rendered by the auditor. When a registrant changes from one firm to another within the same international network, the newly engaged firm may have participated in the audit of a portion of the registrant in prior years. The Committee noted that it is unclear what disclosure, if any, the SEC staff expects in this situation to comply with Item 304(a)(2) of Regulation S-K.

Mr. Kim noted that Item 304(a)(2) of Regulation S-K appears to be based on the more typical situation of a change in auditors that are unrelated to each

other and not a change from one member firm of a global network to another firm within the same network. Mr. Kim suggested that Committee members might wish to provide scenarios involving auditor changes within a single global network and the types of disclosures that would be required by Item 304(a)(2) but which the Committee members believe should not be required to be disclosed because they constitute ordinary course consultations. Thereafter, the SEC staff would consider providing guidance with respect to the related disclosures under S-K Item 304(a)(2).

D. Subsidiary Guarantor Financial Statements Provided under Rule 3-10(g) of Regulation S-X

In a registration statement for guaranteed debt, Rule 3-10(g) of Regulation S-X requires separate pre-acquisition financial statements of a recently acquired subsidiary guarantor that otherwise meets the conditions for omission of separate financial statements if (1) the subsidiary has not been included in the audited results of the parent company for at least nine months of the most recent fiscal year, and (2) the greater of the net book value or purchase price of the subsidiary is 20% or more of the principal amount of the securities being registered.

In some cases, pre-acquisition financial statements of a recently acquired subsidiary guarantor already will have been filed under S-X Rule 3-05, but the audit may have been conducted by a non-registered auditing firm and/or under AICPA auditing standards (US GAAS). However, because a subsidiary guarantor meets the Sarbanes-Oxley definition of an issuer, financial statements required under S-X Rule 3-10(g) are expected to be audited by a PCAOB registered firm in accordance with PCAOB auditing standards, and those financial statements are expected to comply with Regulation S-X and include financial statement disclosures based on whether the guarantor meets the definition of a "public company," as defined in the respective ASC section, at the effective date of the registration statement.

If compliance with S-X Rule 3-10(g) presents a hardship (e.g., requiring a reaudit by a registered public accounting firm or to comply with PCAOB auditing standards), Mr. Olinger recommended that companies consult the Division of Corporation Finance Office of Chief Accountant (CF-OCA) prior to filing. Mr. Olinger also affirmed that financial statements filed under Rule 3-10(g) must include public company GAAP disclosures. Members of the Committee observed that this could require the reissuance of financial statements previously filed to comply with S-X Rule 3-05 and the auditor performing audit procedures on the additional disclosures and issuing a dual-dated audit opinion.

[Note: The FRM was updated with respect to elements of this issue. See further discussion regarding the updated FRM at Section V.A. above.]

[1] The FRM at Section 2020.4 states that the remeasurement of a previously held equity interest in connection with applying business combination accounting should not be considered.