SEC Regulations Committee Highlights

Joint Meeting with SEC Staff - March 20, 2001

Location: SEC Headquarters – Washington, D.C.

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.

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I. **ATTENDANCE**

A. **SEC Regulations Committee**

- Amy Ripepi, Chair
- Ernie Baugh
- John Gerdener
- Wendy Hambleton
- Jay Hartig
- Chris Holmes
- Jim Ledwith
- Bob Rouse
- Roy Van Brunt
- John Wolfson
- Bill Yeates
- Mary Jane Young

B. **Securities and Exchange Commission**

Office of the Chief Accountant

- Lynn Turner, Chief Accountant
- Andrew Bailey, Academic Fellow
- Bob Burns, Chief Counsel
- Sam Burke, Associate Chief Accountant
- Carina Canedo, Professional Accounting Fellow
- Andrew Hubacker, Assistant Chief Accountant
- Mike Kigin, Associate Chief Accountant
- Shelly Luisi, Associate Chief Accountant
- Michael Pierce, Professional Accounting Fellow

Division of Corporation Finance

- Robert Bayless, Chief Accountant

C. **AICPA**

- Annette Schumacher Barr
- Jennifer Roddy, SECPS

D. **Guests**

- Eric Casey, KPMG
- David Cace, Richard A. Eisner & Co.
- Gary Illiano, Grant Thornton
- Louay Khatib, Ernst & Young
- Scott Pohlman, McGladrey & Pullen

II. STATUS UPDATES

A. Valuations

Lynn Turner asked about the status of the Committee's efforts to provide guidance on cheap stock valuations. Amy Ripepi reported that, after careful review and consideration, it was determined that the issues involved extend beyond both the scope and expertise of the Committee. In order to fully and adequately address these issues, the AICPA will establish a cross-functional Valuations Task Force. The Task Force will consist of auditors, appraisers and industry accountants and will operate under AcSEC's oversight. Valuation issues such as cheap stock, IPR&D and APB 16 will be addressed. Lynn Turner stated that he will follow up with AcSEC Chair Mark Sever to discuss the task force and its formation.

B. Disclosure of Equity Compensation Plan Information

(Release No. 33-7944; January 26, 2001)

The staff provided the following update regarding the equity compensation plan disclosure proposal:

We have been urged to consider the need for greater transparency of all equity compensation plans, whether or not the plans have received security holder approval. Some market participants have expressed concern that a growing number of employee stock plans escape security holder scrutiny because they are not submitted for approval. Disclosure of the overall number of securities of a registrant authorized for issuance under employee stock option plans then in effect is sometimes available indirectly through the registrant's financial statements included in its annual report to security holders. However, this disclosure is not consistently available in any one location or format, may not include information disaggregated for each plan, and may not include stock options granted to non-employees.

We are proposing amendments that would require registrants to disclose, at least annually, information about the total number of securities that have been authorized for issuance under each equity compensation plan in effect as of the end of the last completed fiscal year, whether or not the plans have been approved by security holders. This disclosure would be set forth in a tabular format

- in the registrant's proxy statement whenever the registrant is seeking security holder action regarding a compensation plan; or

- in the registrant's annual report on Form 10-K in years when the registrant is not seeking security holder action regarding a compensation plan.

These amendments would require disclosure in a registrant's proxy statement or annual report on Form 10-K or 10-KSB of the following information:

- the number of securities authorized for issuance under each equity compensation plan of the registrant in effect as of the end of the most recently completed fiscal year;
- the number of securities issued pursuant to equity awards made during the last completed fiscal year, plus the number of securities to be issued upon the exercise of options, warrants or rights granted during the last completed fiscal year, under each plan;
- the number of securities to be issued upon the exercise of outstanding options, warrants or rights under each plan; and
- other than securities to be issued upon the exercise of outstanding options, warrants or rights, the number of securities remaining available for future issuance under each plan.

This information would be provided without regard to whether the equity compensation plan was previously approved by a registrant's security holders. Registrants would be required to identify, either in the table or through a narrative statement, which of the equity compensation plans, if any, was adopted without security holder approval. They also would be required to provide a brief, narrative description of the material features of each plan adopted without security holder approval during the last completed fiscal year.

The comment period ends April 2, 2001.

C. **Supplemental Financial Information Proposal**

Lynn Turner stated that the staff is in the process of addressing concerns raised in the comment process, such as those regarding the disclosure of sensitive items (e.g., tax, environmental and litigation accruals).

D. **Guide 3 Revisions**

Mr. Turner stated that the staff continues to work on its revisions to Guide 3. He has asked the staff to review other resources such as the Shipley Committee Report for considerations regarding loan grading and market risk disclosures. The intent of the staff is to arrive at a Guide 3 that will apply to all financial institutions, not just banks

E. **O'Malley Report**

Mr. Turner reported that the staff has implemented each of the O'Malley Report's recommendations for the SEC. He added that the staff is closely monitoring the implementation status of the other groups noted in the O'Malley Report. To that end, he asked whether the Committee has adopted the recommendations it received. Amy Ripepi responded that, in accordance

with the recommendations, the POB will oversee the processes and activities conducted by the Committee. It is anticipated that a POB representative will attend future Committee meetings.

III. OCA REGISTRANT ISSUES

A. Disclosures

Robert Bayless encouraged registrants and auditors to read the speech he made at "The SEC Speaks in 2001" on March 2, 2001. The speech, which is posted on the SEC website at http://www.sec.gov/news/speech/spch464.htm, describes key disclosures his staff will look for in their reviews of annual reports and other filings by continuing registrants.

Lynn Turner also recommended that the staff's 2000 Audit Risk Alert Letter be reviewed for additional information regarding the staff's position on various disclosures. This letter is posted on the SEC website at http://www.sec.gov/info/accountants/staffletters/audrsk2k.htm. He noted that some of the concerns raised in this letter have become even more relevant given current market factors.

Mr. Turner made the following additional observations relative to adequate disclosures:

- *OPEB Accruals.* Increases in the trend in health care costs have given rise to concerns about the adequacy of OPEB accruals. Preparers and auditors should review the assumptions that are being used to calculate the OPEB obligation in light of these trends. Adequate disclosures should be provided in MD&A on the impact of such costs on current operations and future trends.

- *Restructurings and Layoffs.* The staff has reviewed a number of filings in which disclosures describing recent restructurings and employee layoffs were deficient. For example, the number of actual employees laid-off is required to be disclosed but was missing in some filings. Registrants should adhere to the guidance in Staff Accounting Bulletin (SAB) No. 100 and EITF Issue No. 94-3, *Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (Including Certain Costs Incurred in a Restructuring) when making such disclosures.*

- *Impairments*. The staff has reviewed a number of recent filings in which impairment losses were recorded. In their reviews, the staff asked registrants a number of questions relating to the business environment around the time the impairment was recorded (e.g., top ten customers, revenue streams, cash flow data, employment records, etc). In reviewing the data received, the staff found evidence that the impairments actually occurred before they were recorded. Registrants should take steps to ensure that impairment losses are recorded on a timely basis and that adequate disclosures are provided.

B. Iron Curtain vs. Rollover

Mr. Turner stated that the staff believes the iron curtain method (which compares all misstatements, regardless of the period for which the misstatement relates, against current year results of operations, balance sheet, and cash flows) is the preferable method for disposing of audit differences. The staff would challenge any change from the iron curtain method to the rollover approach. The staff believes that the method the auditor chooses to dispose of audit differences should be 1) clearly identified in the audit workpapers and 2) applied consistently for all accounts and for all audit periods. Both SAB 99 and SAB 32 provide the appropriate guidance with respect to adjustments that may be immaterial in one period, but are material in a future period.

Mr. Turner added that the Commission's Enforcement Division staff have been sensitized to this issue and are aware of the staff's position.

C. Non-standard Journal Entries

Mr. Turner stated that the staff expects that in performing appropriate audit procedures, the auditor will gain an understanding of the nature and volume of non-standard journal entries, how non-standard journal entries are processed, what controls exist that are effective in ensuring that non-standard journal entries are properly recorded, and to what extent there is adequate segregation of duties and supervision. The auditor should ensure that sufficient, competent, verifiable evidential matter is obtained to support the auditor's conclusion that the non-standard journal entries selected for testing are properly recorded. All non-standard journal entries that individually OR in the aggregate, are material to the financial statements, should be reviewed.

He added that auditors should consider the O'Malley Panel's observations in assessing the risk of material misstatement arising from fraudulent financial reporting in connection with the performance of procedures required by Statement on Auditing Standards (SAS) No. 82, *Consideration of Fraud in a Financial Statement Audit.*

IV. INDEPENDENCE

Mr. Turner noted that the Commission's recently-issued independence rules are now in effect. He made the following observations regarding their implementation:

A. Proxies

Registrants and their auditors should refer to Coca Cola's most recent proxy disclosures in which Warren Buffet did an outstanding job of disclosing independence discussions and considerations. These disclosures are an excellent example and should serve as a model for others to follow.

Robert Bayless added that this year, DCF is screening proxies filed in preliminary form primarily to determine whether the disclosures are there. Next year the staff will provide additional guidance and will perform more

extensive reviews.

B. Bookkeeping

Mr. Turner noted that his office is receiving numerous calls regarding the performance of bookkeeping services and whether such services impair independence under the new rules. He noted that the Commission's independence rules have included certain bookkeeping prohibitions for many years. In addition to the existing prohibitions, the new rules now require that the performance of any such services be clearly outlined in the ISB letter. The purpose of the ISB letter is to spell out any matters or relationships, such as the performance of bookkeeping services, between the auditor and client that may impact on the auditor's independence. He urged auditors to make sure their ISB letters fully and adequately describe all bookkeeping arrangements. If the external auditors become aware of additional services that were not initially disclosed in the ISB letter, they should issue an amended letter immediately.

The staff is particularly interested in the communications and training that firms have done with their international affiliates regarding the new independence rules, especially as they relate to the performance of bookkeeping services. In addition, CFOs of registrant companies need to ensure that their foreign subsidiaries are not retaining their external auditors for bookkeeping services in a manner that violates the new rules.

He emphasized that he expects auditors and registrants to address this issue immediately to ensure they are in full and absolute compliance with the rules.

V. CHANGES IN ESTIMATES

Lynn Turner stated that the staff is encountering numerous situations in which changes in estimates have not been adequately disclosed and/or supported. The guidance in APB No. 20 is clear: changes in estimates should be disclosed and there must be valid support for the change. The developments that precipitated the change should also be discussed in MD&A. The staff in the Division of Enforcement are handling a number of cases involving this issue.

VI. RESTATEMENTS

Lynn Turner noted that the staff has just completed its study of restatements in which restatements from 1997, 1998 and 1999 were tracked. The staff noted that there was an increase in the level of restatements over the three-year period and that the number-one cause related to revenue recognition issues. The staff also studied the corresponding change in market capitalization and found that such revenue restatements also resulted in the greatest loss to investors.

VII. CURRENT PRACTICE ISSUES

A. Transition Issue Related to Quarterly Financial Data

Question: If a registrant was not required to present quarterly financial data

for 1999 in its 1999 Form 10-K based on size test exemption that was provided in the prior rules, is it required to present quarterly financial for both 1999 and 2000 in its 2000 Form 10-K based on the revised rules? If the 1999 information is required to be presented, is the auditor required to review the 1999 quarterly information even if no reviews were performed in the prior year?

Background: Prior to the recent revisions of Item 302, quarterly financial data was not required to be presented by registrants that did not meet certain defined criteria in Item 302 (A)(5)

Revised Item 302 A (5) states that the requirement to present quarterly financial data "applies to any registrant, except a foreign private issuer, that has securities registered pursuant to sections 12(b) (15 U.S.C. 78l(b)) (other than mutual life insurance companies) or 12(g) of the Exchange Act (15 U.S.C. 78l(g)). "

Item 302 A (1) states that quarterly financial data should be provided "for each full quarter within the two most recent fiscal years and any subsequent interim period for which financial statements are included or are required to be included by Article 3 of Regulation S-X."

Discussion: There are no special transition provisions related to the recent revisions of Item 302. Accordingly, even though a registrant was not required to present quarterly data in 1999, it would appear that the registrant's Form 10-K for the year ended December 31, 2000 should contain quarterly data for two years, i.e. both 1999 and 2000.

Additionally, U.S. generally accepted auditing standards [CSAS AU 722. 38] indicate that when the financial statements to which the quarterly financial information relates have been reported upon by an independent auditor, the auditor also must review the quarterly data. The auditor's review should comply with the standards in Statement on Auditing Standards 71, "Interim Financial Information". Accordingly, in the above fact pattern, it would appear that both the 1999 and 2000 quarterly data presented as supplemental data under Item 302 should be reviewed by the auditor.

Staff Comment: We agree with this analysis of the requirements of Item 302 and GAAS. (Note that the response to Question 2 in SAB 6.G.1.c became obsolete upon the amendment of Item 302.) The staff will consider requests for no-action in unusual circumstances that prevent compliance with the rule without unreasonable cost or effort.

B. **IPOs and Quarterly Financial Data**

Question: Is quarterly financial data (Reg S-K Item 302) required to be presented in an IPO?

Background: Prior to the recent revisions of Item 302, quarterly financial data was not required to be presented in an IPO. The Committee is aware of several instances in which the staff commented that quarterly data is required

under the revised rules. The proposal and final release do not indicate that the SEC intended to extend the requirement for quarterly financial data to initial public offerings.

Item 302 A (5) states that the requirement to present quarterly financial data "applies to any registrant, except a foreign private issuer, that has securities registered pursuant to sections 12(b) (15 U.S.C. 78l(b)) (other than mutual life insurance companies) or 12(g) of the Exchange Act (15 U.S.C. 78l(g)). "

Discussion: Because a company in its initial registration does not have securities registered, it would appear that they are exempt from the requirement to present quarterly financial data. Based on conversations with Division of Corporation Finance staff, it appears they agree that quarterly financial data is not required in initial registrations. Is this an appropriate characterization of the staff's view?

Staff Comment: We agree with this analysis of the requirements of Item 302 in an initial registration statement. After the initial registration statement is declared effective, the registrant must comply with Item 302 in any Exchange or Securities Act document that calls for that disclosure.

C. Accounting for Stock Dividend when there is a Retained Deficit

Question: When a company has a retained deficit, is a stock dividend accounted for as a charge to retained earnings or a charge to capital surplus?

Background: Company A has a retained deficit and positive capital surplus. It also has preferred stock that requires an annual dividend payable in either cash or stock. The Company, as in the past, plans to distribute common stock as the required dividend on its preferred stock. Should the dividend should be accounted for at:

a. the fair value of the common stock being issued with a charge (increase) to retained deficit or
b. the par value of the common stock issued with a charge to capital surplus.

Legal counsel to Company A had advised that, under appropriate state law, a retained deficit does not preclude the issuance of the common stock dividend as the dividend could be declared from available capital surplus.

Discussion: One firm discussed this fact pattern with the SEC staff several years ago. In that situation (with facts identical to the above), the SEC staff took the position that the stock dividend should be recorded at par with a charge to capital surplus. The staff objected to treating the stock dividend as a charge to retained earnings at fair value. Although documentation of the basis for the staff's view is not available, one argument favoring this view is legal counsel's conclusion that the divided could be declared from available capital surplus.

ARB 43 indicates that when the stock dividend is not in substance a stock

split, companies should charge the fair value of the stock dividend against retained earnings.[1] APB No. 29 indicates that dividends-in-kind are recorded at the fair value of the assets transferred. However, the literature does not address the accounting when retained earnings are in a deficit position.

Would the SEC staff object to accounting for a stock dividend in the above situation at fair value with a charge to retained earnings? Would the staff permit charging the stock dividend at par value to paid in capital?

Staff Comment: A significant fact in the question is that the stock dividend is payable to holders of preferred stock, rather than common stockholders. In this circumstance, we believe the dividend should be accounted for at fair value on a basis consistent with APB No. 29, with a corresponding decrease of income or increase of loss applicable to common shareholders. This accounting is appropriate to reflect the transfer of value (a new residual interest) to a class other than the common shareholders. However, we believe all stock dividends payable to common stockholders when retained earnings are in a deficit position should be accounted for by capitalizing only the stock's par value from paid in capital. Registrants are also advised to consider FRR 214 when there are pro rata stock distributions to shareholders.

[1]ARB 43 acknowledges state laws generally require the capitalization only of the par value of the shares issued. Accordingly ARB 43 notes that accounting for the stock divided at fair value will result in the capitalization of retained earnings in an amount in excess of that called for by the laws of the state of incorporation. However, the view in ARB 43 is that these legal requirements are, in effect, minimum requirements and do not prevent the capitalization of a larger amount per share.

D. Push-Down Accounting

Question: Can a registrant that initially elects to not apply push-down accounting later elect to apply it?

Background: Under SAB 5-J, if a company becomes substantially wholly owned, the acquirer's cost should be pushed down and reflected as a new cost basis in the company's financial statements. Generally, the SEC staff will not require or object to push-down accounting when a minority interest of greater than 5 percent but not more than 20 percent exists.

This question considers the fact pattern where an owner acquires sufficient ownership of an existing registrant so that push-down accounting is permitted but not required. At the time this level of ownership is reached, the registrant elects to not apply push-down accounting. Later, although there has been no change in ownership, the registrant decides it would rather apply push-down accounting.

- Is the registrant permitted to apply push-down accounting?
- Does the answer to the previous question depend on whether the decision to change the accounting was made in the year of the acquisition vs. a subsequent year?

- If push-down accounting is permitted, how should the change be reflected in the financial statements? Should the previously issued financial statements be restated?
- Is a preferability letter required?

Discussion: We are not aware of any SEC staff guidance on this question. SAB 5-J indicates that the SEC staff encourages the use of push-down accounting. This might indicate that the later application of push-down accounting is an improvement in reporting that is permitted. We note that if the company in question was not a registrant at the time of the change in ownership, it could restate its financial statements to apply push-down accounting in connection with an initial registration of securities.

On the other hand, the rationale for applying push-down accounting is that the parent has acquired the ability to control the form of ownership of the entity. The evaluation of whether the parent has this ability could be viewed as question of facts, the answer to which dictates whether push-down accounting should be used. Under this line of thinking, if not applying push-down accounting at the acquisition date was proper, a subsequent change in facts would be needed for push-down accounting to become permitted.

Staff Comment: We believe that push-down accounting is applied on the basis of the specific facts and circumstances at the time of the transaction. If the determination was proper at the acquisition, we believe no subsequent change by a registrant is permitted. We are unsure of how a subsequent change of facts would justify a change in the original determination. This position does not override the special exemption for an initial public distribution described in paragraph 29 of APB 20.

E. **Business vs. Asset - Utility Power Plants**

Question: Is a power plant a business or an asset under Regulation S-X Rule 11-01(d)?

Background: A number of registrants have acquired power plants from utilities. Often, all of the power plant's output has historically been transferred to the seller's transmission and distribution operations. Sometimes, the power plant has had a small amount of third party revenue. After the transaction, the buyer will sell the plant's output to third parties. Sometimes it will continue to provide power to the seller.

For purposes of reporting significant acquisitions under the SEC's rules, whether the power plants are businesses or assets is not clear. Rule 11-01(d) states that this evaluation should consider whether there is sufficient continuity of the acquired entity's operations prior to and after the transaction so that disclosure of the prior financial information is material to an understanding of future operations. It also states that a registrant should consider whether the nature of the revenue-producing activity of the acquired component will remain generally the same as before the transaction.

Discussion: A number of registrants have concluded that it is not necessary

to provide financial statements of acquired power plants in their SEC filings. They have written to the SEC staff to discuss the reasons for their conclusions, and the staff has not objected to excluding the power plants' financial statements. Registrants' reasons for concluding power plants' financial statements weren't necessary have included the following:

- The power plant is not a business under Rule 11-01(d) because the operation lacks third party revenue and/or because there are planned changes in operations after the purchase.
- In a registration statement, the filing often contains a significant amount of historical and/or projected operating information about the power plant and this information, in the view of registrants, is sufficient to meet the needs of investors.

Should each of these fact patterns be pre-cleared? Is there general guidance that would be useful in reaching appropriate conclusions absent pre-clearance?

Staff Comment: This summary is generally correct, but pre-clearance may continue to be wise in many circumstances. The staff's analysis considers all the factors identified in Rule 11-01(d). Planned changes in operations may or may not affect the relevance of historical information, depending on the nature of those changes. Generally, the absence of third party sales is a persuasive indicator that historical information would not be meaningful. However, determinable market prices directly attributable to a commodity (such as posted oil prices for a producing property) may permit the preparation of meaningful historical financial information.

F. **Regulation S-X Rule 4-08(g) - Presenting information for individually significant investees**

Question: Can a registrant provide aggregated summarized financial information for all equity method investees under Rule 4-08(g), or does it need to separately disclose information for (1) investees that are greater than 10% significant and (2) aggregated information for those that are less than 10% significant? (Significance is defined by Regulation S-X Rule 1-02(w)).

Background: Regulation S-X Rule 4-08(g) calls for summarized financial information of investees to be presented if the investees are significant on an aggregated basis. The Rule states that the information may be presented on an individual or group basis. However, the rule does not state that a registrant should present summarized information for investees that are individually significant separately from the information for investees that are individually insignificant.

Discussion: On occasion, the SEC staff has asked registrants to present summarized data for investees that are individually significant separately from the data for investees that are individually insignificant. Is this a common staff practice that should be communicated to registrants?

Staff Comment: We believe that Rule 4-08(g) permits the aggregation of all

investees, whether individually significant or not, in most circumstances. However, in some circumstances, aggregation can be misleading or suppress important information. For example, the staff may request that investees in different businesses be aggregated separately. Separate information also may be requested for Individual investees that are very significant quantitatively or qualitatively.

G. **Rule 3-09 financial statements in the year in which an investee is acquired or disposed**

Question: When a registrant acquires or disposes of a significant equity method investee during the latest fiscal year, what Rule 3-09 investee financial statements does it need to present in its Form 10?K?

Background: When a registrant's equity method investee is 20% significant under the investment test or the income test of Rule 1-02(w) of Reg. S-X, Rule 3-09 requires the registrant to include audited financial statements of the investee in its Form 10-K. The Staff Training Manual (III.A of Topic 2) states that "the financial statements required should be for the *same annual audited periods as required by Rule 3-01 and 3-02." It also indicates that "**financial statements are not required for periods prior to the registrant's ownership of the investment." (emphasis added)***

Discussion: Year of acquisition - In the year a registrant acquires a significant investee, it is unclear whether the registrant should include audited investee financial statements for the entire year or just for the period of ownership. Obtaining audited investee financial statements from the date of acquisition may be impractical since the registrant does not control the investee. Conversely, audited investee financial statements that cover an entire fiscal year may not be meaningful when the registrant owned the investment for only a short time. Will the staff permit the inclusion of investee financial statements for the entire year in lieu of financial statements from the date of acquisition?

Year of disposition - Rule 3-09 and the guidance above raise the question of whether Rule 3-09 investee financial statements should continue to be provided after a registrant has disposed of its investment in the investee. The investee's financial statements could be necessary because either (a) current year income from the investee is significant to the registrant or (b) the investee was significant in prior years. The potential need to provide these financial statements raises both practical and relevance issues.

By disposing of its investment, the registrant moves from a position of significant influence to one of no influence. Therefore, the registrant may be unable to require the former investee to provide audited or unaudited financial statements. This problem becomes even more difficult if the investee's financial statements should cover only the period through the disposition date.

It is also unclear whether investors need investee financial statements when the registrant no longer owns the investment. Presenting summarized financial information for the investee pursuant to Rule 4-08(g) might be

sufficient. This approach would be similar to the approach an investor uses after it disposes of a consolidated investee that is reported as a discontinued operation under APB 30. (Paragraphs 8 and 18 of APB 30 require information which is similar to the information called for by Rule 4-08(g).) It seems inappropriate to require more information for an equity method investee that has been sold than is required for a consolidated investee that has been sold. Will the staff permit presentation of summarized information (Rule 4-08(g)) in lieu of full audited financial statements of the investee in the year of disposition? If not, will the staff permit financial statements of the investee for the entire year in lieu of financial statements through the date of disposition?

Staff Comment: The staff will favorably consider the kind of relief described in this question if the registrant determines that the financial statements specified by the rule cannot be obtained without undue difficulty or cost. However, if the investee is sold near the end of the most recent year, the staff may be more reluctant to waive the requirement if the investee is very significant quantitatively or qualitatively during that year. In this circumstance, the staff will consider, among other things, the significance of the registrant's participation in the investee's business, whether similar investments comprise a significant part of the registrant's business, and whether significant intercompany transactions have occurred.

H. Disclosures about Transfers and Servicing of Financial Assets

Question: What Statement 140 disclosures are required for non-calendar year companies in their Form 10-Qs for fiscal 2001, in light of the requirements of Article 10 of Regulation S-X?

Background: FASB Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, changes the accounting for financial asset transfers and liability extinguishments that occur after March 31, 2001, while leaving the accounting for previous securitizations and extinguishments unaffected, except in certain circumstances. The standard also requires new disclosures about securitized financial assets and retained interests in securitized financial assets in financial statements for fiscal years ending after December 15, 2000.

Regulation S-X, Article 10-01(a)(5), requires disclosure in an interim period of new accounting principles and practices, details in accounts that have changed significantly in amount or composition, and other significant changes that have occurred since the end of the most recently completed fiscal year. When a new standard is adopted in an interim period, the staff has interpreted this requirement to mean that all disclosures prescribed by the standard should be included in the interim financial statements, in addition to any transitional disclosures required by the standard.

Staff Comment: The disclosure requirements of the standard are set forth in paragraph 17a through 17g. We believe the disclosure requirements should be satisfied as follows, for non-calendar year registrants, in the interim period in which the standard is adopted:

Disclosures that mirror existing disclosure requirements. Paragraph 17 b, c, d, e, and g(2) were previously required by Statement 107 and Statement 125. If a registrant failed to provide these disclosures in prior financial statements, it should correct this deficiency by providing the disclosures in the interim period in which Statement 140 is adopted. That is, the interim period which includes April 1, 2001.

Disclosures for changes in accounting policy. Paragraph 17a(1), f(1) and g(1) require disclosure of the entity's accounting policies. If adoption of the standard changes a registrant's accounting for securitized financial assets, or if a registrant failed to include this disclosure in prior financial statements, it should provide the disclosures in the interim period in which Statement 140 is adopted. That is, the interim period which includes April 1, 2001.

Transactions requiring disclosure. Paragraph 17a(2), a(3), f(2), and f(3) require disclosures related to certain transactions. If a registrant enters into material transactions in an interim period after the adoption date of the standard, it should provide these disclosures. The adoption date for the standard is April 1, 2001.

Other disclosures. We recommend that registrants provide paragraph 17 f(4) and g(4) disclosures in the interim period upon adoption. That is, the interim period which includes April 1, 2001. Also, in certain instances, these disclosures may be needed in the interim period in order for existing information not be misleading, or may be necessary to satisfy requirements of Item 303 of Regulation S-K. Paragraph 17g(3) disclosures should be considered by registrants to supplement their market risk disclosure (Item 305 of Regulation S-K) for sensitivity analysis, if material.

I. Disclosures about Derivative Instruments and Hedging Activities

Question: What Statement 133 disclosures are required for companies that adopt the standard in an interim period in their Form 10-Qs for fiscal 2001, in light of the requirements of Article 10 of Regulation S-X?

Background: FASB Statement 133, Accounting for Derivative Instruments and Hedging Activities, as amended by Statement 138, establishes for the first time a comprehensive accounting and reporting standard for derivative instruments and hedging activities. This standard is applicable to all fiscal quarters of all fiscal years beginning after June 15, 2000.

Regulation S-X, Article 10-01(a)(5), requires disclosure in an interim period of new accounting principles and practices, details in accounts that have changed significantly in amount or composition, and other significant changes that have occurred since the end of the most recently completed fiscal year. When a new standard is adopted in an interim period, the staff has interpreted this requirement to mean that all disclosures prescribed by the standard should be included in the interim financial statements, in addition to any transitional disclosures required by the standard.

Staff Comment: The disclosure requirements of the standard are set forth in

paragraphs 44 and 45, with enhanced disclosures for reporting changes in the components of comprehensive income in paragraphs 46 and 47, and transition disclosures in paragraph 53. We believe the disclosure requirements should be satisfied as follows in the interim period in which the standard is adopted:

Qualitative disclosures in paragraph 44. Disclosure is similar to what was required in Statement 119, modified for the updated rules on hedging. A registrant should enhance the Statement 119 disclosures provided previously to conform to paragraph 44 in the period of adoption.

Quantitative disclosures in paragraph 45. Paragraph 45 disclosures are required for every reporting period for which a complete set of financial statements is presented (i.e. annual financial statements). In the interim period of adoption, we believe a registrant should provide all paragraph 45 disclosures in order to inform the reader of the impact of adoption of the standard.

Disclosure of changes in the components of comprehensive income. Paragraph 53 requires disclosure in the year of adoption of the amount of gains and losses that are being reclassified into earnings during the 12 months following the date of adoption, which were associated with the transition adjustment recorded to AOCI. Therefore, although the components of OCI are not required to be disclosed under Article 10 of Regulation S-X, the paragraph 46 and 47 disclosures should be made in the interim period of adoption in order for the paragraph 53 disclosure to be meaningful.

Transition disclosures. Registrants should provide disclosure of transition amounts as well as disclosure of any reclassifications made upon adoption under paragraphs 54, 55 (both related to securities) or 56 (mortgage servicing rights).

Disclosure in subsequent interim periods. The qualitative disclosure should be updated when a registrant significantly changes its objectives for holding or issuing derivative instruments and/or strategies for achieving those objectives. Registrants should consider the paragraph 45 disclosures when complying with the requirements of Item 303 of Regulation S-K and Rule 10-01(a)(5) of Regulation S-X. Paragraph 46 and 47 disclosures about the impact of hedging on OCI should be provided if material events occur.