CAQ SEC Regulations Committee
March 27, 2012 - 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 or acted on by senior technical committees of the AICPA and do not represent an official position of the AICPA or 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subsequent issuance of technical pronouncements or positions taken by the SEC staff, nor are they deleted when they are superseded by the issuance of subsequent highlights or authoritative accounting or auditing literature.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

Melanie Dolan, Chair
Steve Meisel, Vice Chair
Jack Ciesielski
Brad Davidson
Christine Davine
Jack Day
Tom Elder

Russell Hodge
Bridgette Hodges
Chris Holmes
Jeff Lenz
Kevin McBride
Scott Pohlman
Sandra Peters
Michelle Stillman

B. Securities and Exchange Commission

Division of Corporation Finance (Division)

Craig Olinger, Acting Chief Accountant
Nili Shah, Deputy Chief Accountant
Tamara Brightwell, Senior Special Counsel
Angela Crane, Associate Chief Accountant
Jill Davis, Associate Chief Accountant
Louise Dorsey, Associate Chief Accountant
Todd Hardiman, Associate Chief Accountant
Gerald Laporte, Chief, Office of Small Business Policy
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
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

Rob Skubic, KPMG
John May, PwC

II. DIVISION OF CORPORATION FINANCE PERSONNEL AND ORGANIZATIONAL UPDATE

Craig Olinger indicated that there had not been any notable personnel or organizational changes at the Division of Corporation Finance since the last SEC Regulations Committee meeting in September 2011.

This was the first Joint Committee Meeting at which Melanie Dolan served as Chair and Steve Meisel served as Vice Chair. The Committee thanked the SEC staff for their participation in the December 2011 AICPA National Conference on Current SEC and PCAOB Developments (the 2011 Conference). The SEC staff's input and presentations were very positively received by the audience.

III. CURRENT FINANCIAL REPORTING MATTERS

A. Management's Use of Third-Party Pricing Services

At the 2011 Conference, the SEC staff communicated its expectations about management's responsibilities when using third-party pricing services for estimating and disclosing the fair value of investment securities and other financial instruments. Mark Shannon noted that the SEC staff's objective for commenting on management's use of third-party pricing services was primarily to remind registrants of their responsibility for the information included in SEC filings. Mr. Shannon noted that the SEC staff is not far enough along with its 2011 filing reviews to provide insight into whether registrants have adequately considered the SEC staff's comments in this area and provided appropriate disclosure.

The Committee informed the SEC staff that based on its experience to date, registrants appear to be taking appropriate actions to respond to the comments made by the staff. The Committee added that the staff's comments have assisted registrants in obtaining additional information from, and transparency into the pricing practices used by, third-party vendors.

B. Disclosures Under Rule 3-10 of Regulation S-X

To date, the SEC staff has not encountered many issues in applying its interpretive guidance on "customary" subsidiary guarantee release provisions included in Section 2510.5 of the Financial Reporting Manual.

Mr. Olinger mentioned the staff was recently asked to consider a provision in which a subsidiary's guarantee would be released in the event of the parent's partial sale of its interest in the subsidiary or the subsidiary's issuance of its own equity to a third party. That provision was not contemplated as one of the "customary" subsidiary release provisions. In the fact pattern under consideration, the staff concluded that the guarantee would not be considered

"full and unconditional" for purposes of applying S-X 3-10 and therefore the relief provided in S-X 3-10 would not be available..

C. Loss Contingency Disclosures

The Committee noted that it has observed continued improvements in loss contingency disclosures. Generally, the Committee believes that sufficient awareness exists of the SEC staff's focus and expectations in the area of loss contingency disclosures and accordingly, registrants are making concerted efforts to provide enhanced disclosures.

Ms. Shah informed the Committee that the SEC staff has shared its observations regarding loss contingency disclosures and engaged in dialogue with members of the legal community.

D. Goodwill Impairment Disclosures

Kyle Moffatt observed that during its recent filing reviews, the SEC staff has seen improvements in the nature and extent of disclosures around registrants' goodwill impairment tests provided in MD&A and the notes to financial statements. The level of MD&A disclosure observed has generally been commensurate with the suggestions articulated in Financial Reporting Manual Section 9510.

Mr. Moffatt commented that the SEC staff is not far enough along with its 2011 filing reviews to provide detailed insight regarding the use of the qualitative assessment performed under ASU 2011-08, *Testing Goodwill for Impairment*. The SEC staff expects to see qualitative assessments used in situations in which a registrant's industry and entity-specific operating results have generally improved in recent periods or in situations in which it is clear that the fair value of a reporting unit is in excess of its carrying value. Staff have issued comments when disclosures are unclear or inconsistent with ASU 2011-08.

The Committee indicated that it appears registrants are using the qualitative assessment when it is clear the fair value of a reporting unit exceeds its carrying value, which is consistent with the FASB and SEC staff's belief that the use of the qualitative assessment would not cause a change in the timing of the recognition of a goodwill impairment charge.

E. Disclosure of Risk Factor when Significant Operations are in Jurisdictions not Subject to PCAOB Inspection

Certain foreign jurisdictions do not allow the PCAOB access to inspect a registrant's Independent Registered Public Accounting Firm's audits and its quality control procedures. In situations in which the principal audit firm of a registrant is located in a country or jurisdiction for which the PCAOB is not

allowed to perform inspections, the SEC staff has issued comments requesting registrants to confirm that they will disclose this fact under a separate risk factor heading. Mr. Olinger described the risk factor as a situation in which a portion of the regulatory oversight framework is missing and that investors who rely on the auditors' audit reports may be deprived of the benefits of PCAOB inspections. The SEC staff may issue comments to include this type of risk factor disclosure in future filings. Mr. Olinger noted that the SEC staff would not object if registrants provide factual disclosure in the risk factor that the PCAOB does not have access to inspect any auditors in the particular country or jurisdiction and that the lack of access provided to the PCAOB is not limited to the registrant's auditors.

F. Canadian Auditors' Reports

Mr. Olinger noted that, in certain recently filed Canadian Form 20-Fs and Form 40-Fs, the financial statements were prepared under "IFRS as issued by the IASB," but the auditor's report only indicated that the financial statements were prepared under IFRS (i.e., the audit report did not also designate that the financial statements were prepared under "IFRS as issued by the IASB"). SEC rules require that in order to omit the US GAAP reconciliation, issuers who include financial statements prepared in accordance with IFRS as issued by the IASB in their filings with the SEC must also include an audit report that unreservedly and explicitly states an opinion on whether the financial statements comply with IFRS **as issued by the IASB** (and not just IFRS). Mr. Olinger also referred to the Center for Audit Quality's (CAQ) Alert 2012-05 communicating this requirement.

IV. IFRS WORK PLAN

Mr. Olinger commented that the Office of the Chief Accountant is actively focusing on finalizing and summarizing its findings and observations under the Work Plan. The analysis will be used by the SEC to evaluate its next steps and courses of action with respect to whether IFRS might be further incorporated into the financial reporting system.

V. IMPLEMENTATION AND INTERPRETATION OF RECENT SEC RELEASES

A. CF Disclosure Guidance: Topic No. 3 – Cybersecurity

Mr. Olinger noted that while the SEC staff has limited experience with respect to the nature and extent of disclosures provided in response to this guidance, the expectation is that disclosures related to cybersecurity will be considered in future filing reviews. Mr. Olinger mentioned that registrants should consider the materiality of the related risks in determining the nature and extent of disclosure.

B. CF Disclosure Guidance: Topic No. 4 – European Sovereign Debt Exposure

Mr. Moffatt noted that the SEC staff is not yet far enough along with its 2011 filing reviews to provide detailed insight with respect to the nature and extent of disclosures provided about European sovereign debt exposures in response to the SEC staff's guidance in this area. However, he noted that for certain reviews performed by the Financial Services II Group, which is responsible for reviews of large financial institutions, the SEC staff has seen improved and enhanced disclosures with respect to European sovereign debt exposures of certain countries. In almost all cases, the registrants whose filings have been reviewed to date have provided the required disclosures on a country-by-country basis. The SEC staff did note, however, that additional improvements could be made to disclosure with respect to the nature and extent to which credit default swaps were used by registrants to mitigate their risks.

Mr. Olinger commented that the guidance issued by the SEC staff in this area was not intended to be exclusively applicable to financial institutions or exposures in Europe. To the extent the disclosures are relevant to registrants in other industries or applicable to exposures in other countries or jurisdictions outside of Europe, the SEC staff would expect the guidance to be considered.

VI. OBSERVATIONS RELATED TO XBRL FILINGS

Mark Green noted a very high registrant compliance rate with respect to the phase-in and application of XBRL filing requirements. The use of the 30-day grace period by filers has not been extensive. In instances where the 30-day grace period has been used, it is rare that the full 30 days is used (i.e., most filings are made within two weeks).

Mr. Green commented that the Division of Risk, Strategy, and Financial Innovation publishes its observations with respect to the use and adoption of XBRL. The most recent publication of observations was issued in December 2011. Mike Starr noted that the staff will continue to monitor the use of XBRL and expects to focus on the most recent phase-in group, which represents filers applying detailed tagging for the first time in June 2012. Additionally, the SEC staff are exploring whether to recommend to the Commission that they give registrants the option to submit interactive data filings using xhtml (also called "in-line" XBRL).

VII. CAPITAL FORMATION INITIATIVES

In March, the U.S. House and Senate approved the "Jumpstart Our Business Startups Act" (the JOBS Act). The JOBS Act consists of a package of bills intended to make it easier for smaller companies to raise public and private capital in the U.S. financial markets. The JOBS Act creates a new category of issuers called emerging growth companies. Emerging growth companies will benefit from a number accommodations under the U.S. securities laws.

[Note: President Obama signed the JOBS Act into law on April 5, 2012.]

Gerald Laporte, Chief of the Office of Small Business Policy, commented that certain of the provisions included in the JOBS Act are consistent with the recommendations made by the SEC Advisory Committee on Small and Emerging Companies established by the Commission last year. Mr. Laporte noted that certain portions of the JOBS Act (e.g., Title I which includes the rules and requirements for emerging growth companies) were drafted to be self-executing, which means that they were intended to become effective immediately. However, other provisions of the JOBS Act (e.g., provisions in (i) Title III relating to certain "crowdfunding" activities and (ii) Title IV relating to a small issues exemption under the Securities Act) require further action and rulemaking by the SEC.

[Note: On April 5, 2012, the SEC's Division of Corporation Finance issued a statement explaining how the confidential review process for emerging growth companies will work under the JOBS Act. The announcement can be found on the SEC website at: http://www.sec.gov/divisions/corpfin/cfannouncements/draftregstatements.htm]

The SEC's Division of Corporation Finance has also issued the following Frequently Asked Questions on:

- *Confidential Submission Process for Emerging Growth Companies at http://www.sec.gov/divisions/corpfin/guidance/cfjumpstartfaq.htm (April 10, 2012)*
- *Changes to the Requirements for Exchange Act Registration and Deregistration at http://www.sec.gov/divisions/corpfin/guidance/cfjjobsactfaq-12g.htm (April 11, 2012)*
- *General Applicability on Title I of the JOBS Act at http://www.sec.gov/divisions/corpfin/guidance/cfjjobsactfaq-title-i-general.htm (April 16, 2012)*

Comments on the various initiatives, including rulemaking and studies, may be submitted even before official comment periods are opened at http://www.sec.gov/spotlight/jobsactcomments.shtml.]

VIII. SEC STAFF AND OTHER INITIATIVES

A. Financial Reporting Manual

Mr. Stehlik noted that the next update to the Division's Financial Reporting Manual (FRM) is expected to be issued soon, with updates dated as of December 31, 2011.

[Note: On April 13, 2012, the Division's staff issued its quarterly update of the FRM.]

B. Financial Reporting Series

The SEC staff summarized the findings and observations from the recent Financial Reporting Series roundtable on "Understanding and Communicating Measurement Uncertainty in Financial Statements." Mike Starr noted that these observations related to (i) an appropriate measurement basis to account for transactions in the financial statements and (ii) a disclosure framework. Participants at the roundtable cautioned against financial reporting becoming financial analysis and said that financial reporting should be based on an entity's specific business model. Participants in the roundtables did not take issue with the volume of required disclosures but were interested in ways in which the disclosure framework could be improved.

Ms. Shah acknowledged the FASB staff has an active project to address the disclosure framework. Separately, the SEC staff is identifying ways to improve and enhance the existing disclosures by identifying and eliminating redundant and out-of-date disclosure requirements. The redundant disclosures are likely to comprise instances where disclosure requirements are duplicative *within* SEC rules and regulations and *between* SEC rules and regulations and U.S. GAAP; where disclosures are repetitive in practice due to misapplication of the existing rules; and where disclosures are repetitive in practice due to the inter-relatedness of various parts of a filing.

IX. CURRENT PRACTICE ISSUES

A. Application of ASU 2011-05 to Parent-Only and Guarantor Financial Statement Reporting Requirements

ASU No. 2011-05, as amended by ASU No. 2011-12, revises ASC 220, *Comprehensive Income*, to require that a registrant report comprehensive income either in a single continuous financial statement or in two separate but consecutive financial statements. The ASUs eliminate the option of presenting the components of other comprehensive income (OCI) as part of the statement of changes in stockholders' equity.

When preparing guarantor condensed consolidating financial information under Rule 3-10 of Regulation S-X, paragraph (i) instructs companies to

follow the general guidance on interim financial statements in Article 10 of Regulation S-X as it relates to the form and content of the condensed consolidating financial information. Rule 12-04 of Regulation S-X contains a similar instruction that applies when preparing parent-only condensed financial information required by Rule 5-04.

Mr. Shannon noted that Section 1120 of the Financial Reporting Manual (FRM) was previously revised to reflect the requirement of ASU 2011-05 to present a statement of comprehensive income in one of the two formats required by the ASU. The intent of the revision to the FRM was to indicate that condensed financial information prepared in accordance with Article 10 should also include a statement of comprehensive income. As parent-only and condensed consolidating financial information provided under Rules 5-04 and 3-10 of Regulation S-X, respectively, are prepared following the guidance in Article 10, each would require presentation of total comprehensive income in one of the two prescribed statement formats for all periods presented upon adoption of ASU 2011-12.

[Note: On April 13, 2012, the Division's staff released its quarterly update of the FRM. The revisions include updates to section 1110, 1120, 2515.2, and 2810.1 for the adoption of ASU 2011-12 as well as to clarify the above view.]

B. Disclosure Requirements for an Existing Registrant That No Longer Meets the Definition of a Smaller Reporting Company

SEC rules and regulations provide separate reporting and disclosure requirements for registrants that meet the definition of a smaller reporting company. The SEC staff addressed the situation where an existing registrant no longer meets the definition of a smaller reporting company and subsequently files a new or amended registration statement or proxy/information statement before it is required to file its first Form 10-K as an "other reporting company." To illustrate the scenario, the following example was considered:

> *Example:* Company A, a calendar year-end SEC registrant, met the definition of a smaller reporting company set forth in S-K Item 10(f)(1) as of June 30, 2010 and at all prior assessment dates.
>
> Company A reassessed its smaller reporting company status as of June 30, 2011 and determined that Company A will not meet the definition of a smaller reporting company, and therefore must transition to the disclosure requirements applicable to an "other reporting company," beginning with its March 31, 2012 Form 10-Q.
>
> As permitted by S-K Item 10(f)(2)(i), Company A filed its June 30 and September 30, 2011 Forms 10-Q and its December 31, 2011 Form 10-K using the scaled disclosures available to a smaller reporting company.

> Additionally, in reliance on Exchange Act Forms Compliance and Disclosure Interpretation 104.13, Company A prepared its proxy statement for its 2012 annual shareholder meeting using the scaled disclosures available to a smaller reporting company.

The SEC staff noted that registrants in this situation should follow the item requirements of the applicable forms when determining the level of disclosure to be provided. Form S-3 does not specifically describe the content required in that registration statement other than to require incorporation by reference of the most recently filed periodic reports. In this case, if a Form S-3 (or a Form S-4 for an S-3 eligible issuer) is filed after the 2011 Form 10-K is filed, the registrant may incorporate by reference that 2011 Form 10-K containing the scaled disclosures prepared as a smaller reporting company. On the other hand, Form S-1 (and Form S-4 for issuers that are not S-3 eligible) describe specific disclosures required, such as financial statements meeting the requirements of Regulation S-X. If a Form S-1 (or Form S-4 for a non-S-3 eligible issuer) is initially filed in 2012, it will require that the registrant include or incorporate by reference the disclosures applicable to an "other reporting company." The SEC staff commented that their interpretations related to this issue cover all of the disclosures contained in a registration statement (e.g., MD&A disclosures, scaling under Regulation S-K) and are not limited to the financial statement requirements under Regulation S-X.

In a situation where Company A reports a discontinued operation in the first quarter of 2012 and then files a registration statement on Form S-1, S-3, or S-4, the Company is required to recast its annual financial statements to retrospectively report the discontinued operation (if the impact is material). The SEC staff indicated that those recast annual financial statements should be prepared on a basis consistent with the guidance provided above regarding the presentation of pre-recast annual financial statements in the respective registration statement. In other words, issuers filing on Form S-1 (or S-4 when not S-3 eligible) should recast the financial statements as if they were not a smaller reporting company and issuers filing on Form S-3 (or S-4 when S-3 eligible) may recast the financial statements as if they were a smaller reporting company. This position applies irrespective of whether the recast annual financial statements are included directly in the registration statement or filed under cover of Form 8-K and incorporated by reference.

The staff addressed the question of whether Company A may use the relief available to a smaller reporting company in connection with an Item 2.01 Form 8-K filed for a significant business acquisition after December 31, 2011 but before filing its March 31, 2012 Form 10-Q. Only a registrant that is a smaller reporting company may present financial statements of an acquired significant non-reporting business in accordance with Article 8 of Regulation S-X. The SEC staff indicated that if Company A made its initial filing on Form 8-K reporting an acquisition before January 1, 2012, it may provide the financial statements of the acquired non-reporting business in accordance with

Article 8 of Regulation S-X. If Company A made its initial filing on Form 8-K in 2012, those financial statements cannot be prepared using Article 8.

C. Pro Forma Financial Information

Pro Forma Adjustments

At the 2011 Conference, the SEC staff discussed application of the (1) factually supportable, (2) directly attributable and (3) continuing impact criteria in Article 11 of Regulation S-X. The staff emphasized that pro forma adjustments must be directly attributable to the transaction reflected in the pro forma financial information. For example, the incremental costs that a company expects to incur as a public company should not be reflected as a pro forma adjustment in an initial registration statement since such costs are not directly attributable to the transactions for which pro forma information is presented.

The SEC staff confirmed its view that it would be rare for these types of recurring costs to qualify as pro forma adjustments.

For costs that do not meet the pro forma criteria, the Committee discussed whether a company may include disclosure of the types and range of costs that it expects to incur or whether those costs would be considered projections subject to Item 10(b) of Regulation S-K. The SEC staff indicated that such disclosure may be permitted based on specific facts and circumstances.

The SEC staff does not currently have any definitive plans to provide additional guidance in, or updates to, the FRM related to Article 11 pro forma financial information; however, the staff will continue to evaluate whether additional guidance is necessary.

Pro forma financial information requirements pertaining to discontinued operations and common control mergers

In situations in which a registrant has discontinued operations or a common control merger that is not yet reflected in the annual historical financial statements, Section 3230.2 of the FRM requires presentation of retroactive pro forma financial information for these transactions for all periods presented. If pro forma financial information gives effect to other transactions (e.g., a new contractual arrangement or reduction in interest expense attributable to repayment of debt) in addition to discontinued operations or a common control merger, the pro forma presentations for the other transactions should be limited to the most recent year and interim period. Disclosures should clearly describe how transactions are reflected in the periods presented.

When a registrant presents pro forma financial information to reflect a business combination, a registrant may also need to give pro forma effect to

discontinued operations that occurred during the most recent year or interim period but did not trigger a separate pro forma reporting requirement (i.e., less than 10% significant). The SEC staff indicated that in this situation, the periods for which pro forma adjustments are presented generally should be based on the transaction that is triggering the pro forma reporting requirements (i.e., the business combination) and therefore the pro forma adjustment for the discontinued operations would be limited to only the most recent year and interim period. Nonetheless, while the separate pro forma reporting requirement may not have been triggered for the discontinued operation, the SEC staff indicated that if the registrant believes it material to investors, there may be circumstances where pro forma income statements for the discontinued operation may be necessary for the three most recent fiscal years (two years for a smaller reporting company) and comparative interim periods.

D. Disclosure Requirements for Auditor Changes within an International Network Under Item 304 of Regulation S-K

In 2011, the SEC staff provided interpretive guidance indicating that when a registrant has a change in auditors 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 C&DI 114.02). When a change in auditors takes place, S-K Item 304(a)(2) requires that a registrant disclose whether, within the two most recent fiscal years, 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. There is diversity in practice with respect to the level of disclosure provided in these situations and it is unclear what disclosure, if any, the SEC staff expects in this situation to comply with S-K Item 304(a)(2). Mr. Olinger indicated that generally the SEC staff would not object to excluding disclosure of consultations with members within the same global network that are performed in the ordinary course of the audit. An entity could include disclosure that there have been no consultations other than those conducted in the ordinary course of the audit, and the SEC staff would not require that a list of those normal course consultations be disclosed in the Form 8-K.