

SEC REGULATIONS COMMITTEE
Joint Meeting with SEC Staff
October 29, 2001
SEC Headquarters – Washington, D.C.

HIGHLIGHTS

NOTICE: The AICPA SEC Regulations Committee meets periodically with the staff of the SEC to discuss emerging technical accounting and reporting issues relating to SEC rules and regulations. The purpose of the following highlights is to summarize the issues discussed at the meetings. These highlights have not been considered and acted on by senior technical committees of the AICPA, or by the Financial Accounting Standards Board, and do not represent an official position of either organization.

In addition, these highlights are not authoritative positions or interpretations issued by the SEC or its staff. The highlights were not transcribed by the SEC and have not been considered or acted upon by the SEC or its staff. Accordingly, these highlights do not constitute an official statement of the views of the Commission or of the staff of the Commission.

I. ATTENDANCE

A. SEC Regulations Committee

Amy Ripepi, Chair
Ernie Baugh
David Einhorn
John Gerdener
Wendy Hambleton
Jay Hartig
Gary Illiano
Scott Pohlman
Bob Rouse
Roy Van Brunt
John Wolfson
Bill Yeates
Mary Jane Young

B. Securities and Exchange Commission

Office of the Chief Accountant

Robert Herdman, Chief Accountant
Scott Blackley, Professional Accounting Fellow
Jackson Day, Deputy Chief Accountant
Shelly Luisi, Associate Chief Accountant

Jenifer Minke-Girard, Associate Chief Accountant
Michael Pierce, Professional Accounting Fellow
Jane Poulin, Associate Chief Accountant
Esmerelda Rodriguez, Associate Chief Accountant
Michael Thompson, Professional Accounting Fellow

Division of Corporation Finance

Craig Olinger, Deputy Chief Accountant
Carol Stacey, Associate Chief Accountant

Division of Enforcement

Charles Niemeier, Chief Accountant

C. AICPA

Annette Schumacher Barr
Jennifer Roddy, SECPS

D. Guests

Kurt Hohl
Mark Spelker

II. PERSONNEL CHANGES

Chief Accountant Bob Herdman announced the following staffing additions to the Office of the Chief Accountant:

- Steve Henning, Academic Fellow
- Burt Meher, Assistant Chief Accountant

He added that Robert Bayless has resigned from his position as Chief Accountant in the Division of Corporation Finance and that Craig Olinger will serve as Acting Chief Accountant until a successor is found.

III. STATUS UPDATES

A. Equity Compensation Plan Disclosure Proposal

The Staff discussed the status and timing of its Equity Compensation Plan Disclosure proposal. *Subsequent Note: On December 19, the Commission adopted amendments to its rules and forms under the Securities Exchange Act of 1934 to enhance company disclosure of employee stock option plans and other equity compensation arrangements. Registrants must*

comply with the new disclosure requirements for their annual reports on Forms 10-K or 10-KSB to be filed for fiscal years ending on or after March 15, 2002 and for proxy and information statements for meetings of, or action by, security holders occurring on or after June 15, 2002. Companies will have to provide detailed information about their equity compensation plans in a new table in their annual reports on Forms 10-K and 10-KSB filed with the SEC. This information will also have to be included in a company's proxy or information statement in years in which the company is submitting a compensation plan for security holder approval. The table will include the number and weighted-average exercise price of outstanding options, warrants and rights, and the number of securities available for future issuance under a company's existing equity compensation plans. The new disclosure will be given separately for plans that have been approved by security holders and plans that have not been approved by security holders. The amendments are posted to the SEC's website at www.sec.gov (Refs. 33-8048; 34-45189).

B. Supplemental Financial Information Proposal

The staff is analyzing comment letters received on this proposal as well as considering other concerns regarding the adequacy of environmental reserves and related disclosures. It is not likely that final rules will be issued prior to year end.

C. Guide 3 Revisions

The staff hopes to issue proposed revisions to Guide 3 by the end of the year. The revisions will not apply to this year's reporting.

D. Report of Investigation and Statement Regarding the Relationship of Cooperation to Commission Enforcement Decisions

The staff stated that on October 23, the Commission issued a Report of Investigation and Statement, in which it articulated a framework for evaluating cooperation in determining whether and how to charge violations of the federal securities laws. The Report identifies four broad measures of a company's cooperation: self-policing prior to the discovery of the misconduct; self-reporting of the misconduct; the remedial steps taken upon learning of the misconduct; and cooperation with law enforcement authorities. The criteria are set forth in greater detail in the Report. Credit for cooperative behavior may range from taking no enforcement action at all to bringing reduced charges, seeking lighter sanctions, or including mitigating language in documents the Commission uses to announce and resolve enforcement actions. In issuing the Report, the Commission explained its recent decision not to take enforcement action against a company it had investigated for financial statement

irregularities. The Commission noted, among other things, the prompt remedial actions voluntarily undertaken by the company and the company's cooperation with the Commission's staff. (Rel. 34-44969; AAE Rel. 1470)

IV. CURRENT PRACTICE ISSUES

Discussion Document A

Topic: Regulation S-X Article 11 Pro Formas and a Change in Accounting Principle

Question: When a registrant changes an accounting principle (either voluntarily or to reflect a new standard), how should that change in accounting be reflected in Article 11 pro forma financial statements?

Background: When a registrant voluntarily changes an accounting principle that is accounted for as a cumulative effect, APB No. 20 requires disclosure of pro forma information related to the effect of the change on prior periods. When a registrant changes and accounting principle to reflect a new standard, that new standard often has specific transition requirements that may or may not call for the disclosure of pro forma information related to the effect of the change on prior periods. For example, the adoption of SAB No. 101 followed the requirements of APB No. 20 and thus a cumulative effect change reported as a result of SAB No. 101 was accompanied by pro forma information. However, the adoption of SFAS No. 133 does not require the presentation of pro forma information.

The 1996 edition of the Staff Training Manual stated the following related to changes in accounting and Article 11 pro formas.

III. Content of pro forma statements

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B. Pro forma condensed income statements

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7. Where the registrant has adopted a change in accounting principle, the pro forma information should apply consistently the newly adopted accounting principle to all periods presented.

The 2000 edition of the Staff Training Manual (Item II.C.4.c)(3) of Topic Three; page 3-5) states the following:

Nature of Item	Treatment in Pro Forma Financial Information
(3) Conforming change in accounting principles	Pro forma information should consistently apply the newly adopted accounting principles

adopted by registrant	to all periods presented.
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Discussion: Based on the 1996 Training Manual, we believe that the Article 11 presentation of pro forma effects of a new accounting standard was driven by GAAP. In other words, registrants would reflect accounting changes in the Article 11 pro forma if GAAP (i.e. APB No. 20 or the new standard) required pro forma information. For example, Article 11 pro forma information would reflect the effect of SAB No. 101 in the prior period because that change resulted in pro forma information under APB No. 20. However, Article 11 pro forma effects would not be presented for SFAS No. 133 because that standard did not require pro forma information.

The guidance in the 2000 edition of the Staff Training Manual was changed to add the word "conforming". What did the staff intend to convey by this change? Our initial thought was that perhaps this change was made to indicate that the guidance related to conforming adjustments made following a business combination accounted for as a pooling of interests. However, that may not be an appropriate reading because the guidance specifically mentions a "change in accounting principles adopted by registrant" and "the newly adopted accounting principles." Thus this section does not seem to relate to adjustments to conform accounting policies following a pooling. Further, Item II.G.2.a) of Topic Three of the 2000 edition of the Staff Training Manual, on page 3-10, specifically discusses pro forma adjustments for conformity of accounting policies following a business combination accounted for as a pooling of interests. Did the staff intend to change practice by adding the word "conforming"?

Staff Response:

The staff did not intend to change practice with respect to changes in accounting principle made either voluntarily or to reflect a new standard. In those circumstances, the staff agrees with the analysis in the first paragraph under "Discussion" above. The reference to "conforming change" in the Staff Training Manual excerpt cited above is intended to address circumstances where accounting principles of the combining company in a business combination accounted for as a pooling are being conformed to those of the issuer. It also applies to circumstances where accounting principles of the acquiree in a purchase are being conformed to those of the acquirer.

Discussion Document B

Topic: Transition Disclosure Issues Related to FASB Statements 141 and 142 (Business Combinations and Goodwill/Intangibles)

Questions:

1. What SAB 74 disclosures should registrants make in filings made prior to the adoption of Statements 141 and 142?
2. What disclosures should registrants make in interim financial statements covering the quarter in which they adopt Statements 141 and 142?
3. How should registrants present the effects of Statements 141 and 142 in Article 11 pro forma information?

Question 1 – Background and Discussion

Statement 141, *Business Combinations*, and Statement 142, *Goodwill and Other Intangible Assets*, have been issued, but most registrants have not adopted them yet. We understand that if the effects of these Statements are expected to be material, these registrants should make SAB 74 (Topic 11-M) disclosures in periodic reports and transactional filings. These disclosures should be made in filings made or declared effective after these Statements were issued.

SAB 74 requires a registrant to disclose:

- A brief description of the new standard.
- The date the registrant must adopt the new standard.
- If early adoption is permitted and the registrant plans to adopt early, the date that it plans to adopt.
- The impact the new standard will have on reported financial position and results of operations. If the registrant has quantified the impact, it should indicate the estimated amount. If not, the registrant should so state.

What issues should registrants consider in preparing their disclosures?

We understand that a registrant's initial SAB No. 74 disclosures may indicate, if true, that a registrant has not yet quantified the effects of adoption or the adoption date. However, we also understand that a registrant should disclose whatever information it does know and update its disclosures when it has new information.

Registrants will typically need to consider the following questions in assessing the effects of Statements 141 and 142:

1. Will we recognize any impairments? If so, how much?
2. Will we eliminate any negative goodwill? If so, how much?

3. How much goodwill amortization will we stop recording?
4. How much will our amortization of identifiable intangible assets be reduced?
5. Which intangibles will we consider to have indefinite lives?
6. What balance sheet reclassifications will we make?

Many registrants will be able to answer questions 2 and 3 above very soon after reading the new Statements. We understand that these registrants should quantify the effects of these items in their SAB 74 disclosures. If a registrant is unable to answer these questions, we understand that it should inform readers that it is assessing these matters and has not yet determined whether or the extent to which they will affect the financial statements. However, we understand that registrants should communicate what they do know. For example, if a registrant expects to record an impairment but does not know the amount, it should disclose these facts.

Is our understanding correct? Are there other issues registrants should be aware of?

Staff Response:

Your understanding is correct.

Question 2 – Background and Discussion

Rule 10-01(a)(5) of Regulation S-X states, in part:

“Registrants may presume that users of the interim financial information have read or have access to the audited financial statements for the preceding fiscal year and that the adequacy of additional disclosure needed for a fair presentation...may be determined in that context...[D]isclosure shall be provided where events subsequent to the end of the most recent fiscal year have occurred which have material impact on the registrant. Disclosures should encompass for example, significant changes since the end of the most recently completed fiscal year in such items as: accounting principles and practices...”

Based on this rule, what disclosures should registrants make in interim financial statements covering the quarter in which they adopt Statements 141 and 142?

We understand that registrants should comply with the applicable disclosure requirements of Statements 141 and 142 related to both annual and interim financial statements.

Is our understanding correct? Are there specific issues registrants should be aware of?

Staff Response:

Your understanding is correct.

Question 3 – Background and Discussion

Statements 141 and 142 apply to business combinations completed after June 30, 2001. Acquisitions completed prior to July 1, 2001 must be accounted for under APB 16 and 17 until Statements 141 and 142 are adopted. Statement 142 applies in its entirety to fiscal years beginning after December 15, 2001. Some registrants may adopt Statement 142 early.

How should registrants present the effects of Statements 141 and 142 in Article 11 pro forma Information? We understand that the answer to this question depends on the date a business combination was completed and the date Statement 142 is adopted in its entirety. Consider the example of a registrant with a calendar year-end that adopts Statement 142 effective January 1, 2002.

- Combinations completed before July 1, 2001 – Registrants should not retroactively apply the new accounting standards to combinations completed before July 1, 2001. Therefore, pro forma financial statements reflecting such combinations should present their effects in accordance with APB 16 and 17.
- Combinations completed after June 30, 2001 – The historical financial statements will reflect these combinations in accordance with Statements 141 and 142. The pro forma financial statements should reflect the accounting that will be applied. Therefore, the pro forma financial statements should also reflect these combinations in accordance with Statements 141 and 142.

We understand that registrants should disclose the accounting standards that were used to compute the pro forma effects of the transactions they present.

Rules covering management's discussion and analysis (MD&A) require registrants to disclose the effects of known events that are reasonably likely to materially affect their operating results or financial condition. When a registrant's financial statements will be significantly affected by both a recent acquisition that occurred before July 1, 2001 and new standards for accounting for that acquisition, we understand that the MD&A rules and SAB 74 require it to communicate the effects of both of these events. To accomplish this, a registrant might discuss the effects of the new accounting standards on its pro forma

amounts. However, we understand that registrants generally cannot compute the pro forma effects of applying Statement 142 as of an earlier date. Therefore, we understand that these disclosures should be carefully worded to avoid implying that they represent the pro forma effects of retroactively applying Statement 142.

Is our understanding correct? Are there other issues registrants should be aware of?

Staff Response:

Your understanding is correct.

Discussion Document C

Topic: Status of Topic 2.A.2 of the SAB Codification following issuance of SFAS 141

Question: Is SAB Topic 2.A.2 still relevant given paragraphs 17-19 of SFAS 141, which superseded APB 16?

Background: Question 1 of SAB Topic 2.A.2 specifically interprets the APB 16 presumption that the acquiring entity is that whose former common stockholders receive the larger portion of the voting rights in the combined corporation. Paragraph 17 of SFAS 141 provides revised guidance on identifying the acquiring entity, and it is clear from that standard and its basis for conclusions that the FASB did not intend for any one factor to be given more weight in all circumstances.

Question 2 of SAB Topic 2.A.2 addresses business combinations involving more than two parties, which APB 16 did not specifically address. However, paragraph 18 of SFAS does provide guidance on identifying the acquiring entity in a multi-party business combination.

In a letter dated August 16, 2001, then-Chief Accountant Lynn Turner provided the staff's preliminary views in urging the EITF to address various implementation issues involving SFAS 141 and 142. The following excerpt from that letter provided the following as the staff's views.

Determining the Acquirer

- 4) Presumption – The guidance applicable to identifying an acquirer in paragraphs 17 – 18 of SFAS No. 141 does not carry forward the presumptive language from paragraph 70 of APB Opinion No. 16. That language in APB Opinion No. 16 indicates that the former shareholder interests which either retain or receive the larger portion of the voting rights in the combined company is presumed to be the acquiring company.

Under the revised criteria, evidence provided by retaining or receiving greater proportionate voting rights is identified as one of several characteristics to be evaluated in identifying an acquiring corporation. The staff continues to believe that its views on the determination of the accounting acquirer as set forth in Topic 2.A.2. are appropriate.

- 5) Newco as Acquirer – Paragraph 19 of SFAS No. 141 includes a prohibition against identifying a Newco as being the acquirer in a business combination, consistent with paragraph 71 of APB Opinion No. 16. The staff continues to believe however, that when a Newco has any precombination activities that are deemed to be significant, the Newco cannot be viewed as a new corporation solely formed to issue stock to effect a business combination and therefore could be deemed the accounting acquirer.

In a letter dated September 13, 2001, Tim Lucas, FASB Director of Research and Technical Activities provided the following FASB staff comments related to those SEC staff views:

Determining the Acquirer

4. Presumption—In developing FAS 141, the Board considered and decided not to retain the presumptive approach to identifying the acquirer that was required to be used under APB 16. The FASB staff notes that one of the factors to consider in identifying the acquiring entity (refer to paragraphs 15–19 of FAS 141) is the shareholder group that receives or retains the larger portion of voting rights in the combined entity. However, FAS 141 does not identify that factor as presumptive evidence of the acquiring entity. The FASB staff plans to ask the SEC to consider conforming the requirements of SAB 97 to FAS 141.

5. "Newco" as Acquirer—The FASB staff believes that the SEC's analysis of this item is consistent with the intent of FAS 141.

Discussion: The Turner letter was discussed at the September 20 meeting of the EITF. With respect to SAB Topic 2.A.2, it was the general sense of the EITF that the SEC staff should consider rescinding the old SAB, since the relevant accounting standard interpreted by SAB Topic 2.A.2 has been superseded, and the new accounting standard sets forth a revised framework for the exercise of judgment in identifying the acquiring entity. The SEC Observer indicated that the staff would reconsider the SAB. The Committee is interested to know the status of the staff's plans with respect to Topic 2.A.2.

With respect to Newco being the accounting acquirer, the discussion at the EITF meeting indicated that the SEC staff might be considering a more formal expression of its views, with which the FASB staff did not disagree. The Committee would be interested to know the status of the staff's plans with respect to any further communication of its views on this topic.

Staff Response:

The staff is pursuing this issue with the FASB staff and plans to discuss the need for this or similar guidance with the EITF Agenda Committee in November.

Discussion Document D

Topic: Predecessor Audited Financial Statements

Questions:

1. When predecessor audited financial statements are provided for part of a full year and successor audited financial statements for the rest of the year, are interim financial statements necessary for the predecessor for the corresponding period of the preceding fiscal year?

As an example, Newco (a shell Company with no operations) acquired Predecessor on June 25, 2000. Newco subsequently filed an IPO. The financial statements provided were:

- For the Predecessor - Two audited years ended December 31, 1999 and audited period ended June 25, 2000.
- For Newco (the Registrant) - Audited Financial statements for the period from inception date of January 15, 2000 through December 31, 2000 (there were no operations from formation on January 15 until acquisition on June 25, 2000) and unaudited interims for June 30, 2000 and June 30, 2001.

The SEC advised the registrant to provide prior year comparable information for the period ended June 25, 1999.

2. Registrants do have to provide unaudited financial statements for the corresponding period of the preceding fiscal year for a transition period. The transition period is either audited currently or subsequently and is considered to be part of the Registrant's audited fiscal year. However, that is usually as of a normal month-end cut-off. In the above example, assuming that the registrant must provide comparable information, could they provide information as of June 30 or must it be June 25 information?

Discussion:

We do not believe that interim prior year corresponding financial statements are necessary for an audited predecessor period of less than one year that is provided with audited financial statements for the successor for the rest of that audited fiscal year. The period ended June 25, 2000 is part of the audited December 31, 2000 calendar year of the Registrant and is not considered an interim period. We understand that for financial statements provided under Rule 3-05 of Regulation S-X, registrants are required to provide the comparable period of the preceding fiscal year for any interim period required. However, the audited period through

the acquisition date for a predecessor that is presented with the audited financial statements for the successor is part of an audited fiscal year that is provided under the Requirements of Rule 3-02 of Regulation S-X.

Considerations:

When pushdown accounting is used to reflect a change in basis in an existing entity, predecessor and successor financial statements are presented, separated by a black line before and after the pushdown date to emphasize the change in basis. In this presentation, the corresponding interim period is not provided for the predecessor period right before the change in basis.

Staff Response:

The staff agrees. Financial statements are not required for the comparative prior period corresponding to an audited predecessor period of less than one year that is provided with audited financial statements for the successor for the rest of that audited fiscal year.

Discussion Document E

TOPIC: Statement 143 and SAB TOPICS 5Y and 10b

Question:

Does the staff intend to amend Topics 5Y and 10b to be consistent, where appropriate, with Statement 143?

Background:

Questions 7 and 8 of SAB Topic 5Y include questions and interpretative responses relative to the accounting and disclosures associated with site restoration, post-closure and monitoring costs and environmental exit costs. Additionally, SAB Topic 10b includes a question and interpretative response relative to the disclosures associated with spent nuclear fuel and decontamination and decommissioning costs. Certain of these costs are now within the scope of Statement 143.

Staff Response:

The staff would be interested to see suggestions and examples of how the SAB topics could be changed to clarify their scope and interaction with SFAS 143 and will consider this input in evaluating the continued usefulness of this guidance.