CAQ SEC Regulations Committee
September 21, 2010 - Joint Meeting with SEC Staff
SEC Offices – Washington DC

HIGHLIGHTS

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I. ATTENDANCE

A. SEC Regulations Committee

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

Bridgette Hodges
Jeff Lenz
Steve Meisel
Scott Pohlman
Amy Ripepi
Tom Weirich
Don Zakrowski

B. Securities and Exchange Commission

Division of Corporation Finance

Wayne Carnall, Chief Accountant
Craig Olinger, Deputy Chief Accountant
Mark Kronforst, Deputy Chief Accountant
Angela Crane, Associate Chief Accountant
Jill Davis, Associate Chief Accountant
Louise Dorsey, Associate Chief Accountant
Michael Fay, Associate Chief Accountant
Todd Hardiman, Associate Chief Accountant
Stephanie Hunsaker, Associate Chief Accountant
Leslie Overton, Associate Chief Accountant
Michael Stehlik, Assistant Chief Accountant
Angela Andrews, Academic Fellow
Mark Green, Senior Special Counsel
Nasreen Mohammed, Assistant Chief Accountant

C. Office of Interactive Data

Jeff Naumann, Assistant Director

D. Center for Audit Quality

Annette Schumacher Barr

E. Guests

Carolyn Clemmings, E&Y
John May, PwC

II. DIVISION OF CORPORATION FINANCE PERSONNEL AND ORGANIZATIONAL UPDATE

A. Personnel Changes

Wayne Carnall announced the following personnel changes in Division:

- Paula Dubberly was named the Division's new Deputy Director of Policy and Capital Markets. Ms. Dubberly will oversee two new offices in the Division, one focused on asset-backed securities and other structured finance products, the second focused on new securities products and capital market trends.
- Angela Andrews is the Division's new Academic Fellow. During her fellowship, Ms. Andrews will assist in analyzing and evaluating data for IFRS-related projects, among other activities. Ms. Andrews obtained her PhD from Michigan State and is an assistant professor at Wayne State University.
- Joel Levine, formerly the Assistant Director, Office of Interactive Disclosure, has returned to the Division as an Associate Chief Accountant. Mr. Levine will be working on IFRS-related projects in the near term.
- Michael Fay, Associate Chief Accountant, has been assigned to the Division's Regulatory Policy group working with Deputy Chief Accountant Mark Kronforst.
- Brian Breheny, the Deputy Director for Legal and Regulatory Policy, has left the Division. His position has not yet been filled.

B. New Division Offices

On July 16, 2010, the Division announced the creation of three specialized offices to enhance its disclosure review and policy operations. The new offices will focus on (1) large financial services companies, (2) asset-backed securities and other structured products and (3) new securities products and capital markets trends. Mr. Carnall described the office (and twelfth industry group) that will focus on large financial services companies – including the largest banks, but excluding the insurance companies. As it will be concentrating on the largest financial services companies, the number of companies that will be assigned to this group will be significantly less than the other 11 AD groups. The smaller number of registrants will allow the SEC staff in the new office to perform more "continuous reviews" – the review of all filings shortly after the filing is made. In addition, Mr. Carnall explained that this office plans to explore new approaches to performing filing reviews. One such method might be to engage in an ongoing dialogue with its registrants. As an example, Mr. Carnall observed that the SEC staff might meet periodically with certain registrants to discuss staff comments on the filing.

Mr. Carnall noted that the large financial services companies office may not be fully operational until 2011 because key staff positions will need to be filled and various operational aspects will need to be addressed.

III. CURRENT FINANCIAL REPORTING MATTERS

A. Implications of the Dodd-Frank Act

Mr. Carnall shared the following observations regarding financial reporting implications of The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act):

- **Section 404(b) of the Sarbanes-Oxley Act of 2002 (SOX)**

  The SEC's final rule, *Internal Control over Financial Reporting in Exchange Act Periodic Reports of Non-Accelerated Filers*, exempts non-accelerated filers from Section 404(b) of the Sarbanes-Oxley Act of 2002. Mr. Carnall noted that non-accelerated filers are not required to comply with Section 404(b) of SOX by statute.

  Members of the Committee noted that they had received inquiries concerning the scope of the exemption - specifically, whether any issuer with public float below $75 million would be exempt from 404(b) of SOX. The staff noted that the Commission's rules are specific to issuers that are neither accelerated filers nor large accelerated filers as those terms are defined in Exchange Act Rule 12b-2. Further, the accelerated filer exit provisions specify that an accelerated filer does not become a non-accelerated filer unless its worldwide public float decreases below $50 million at the annual measurement date. The Committee suggested the SEC staff re-emphasize the interplay of the accelerated filer exit provisions and Section 404(b) compliance, perhaps in a Compliance & Disclosure Interpretation (CDI).

- **Dodd-Frank Act Section 1504, *Disclosure of Payments by Resource Extraction Issuers***

  This provision of the Act requires the SEC to issue rules requiring SEC registrants to disclose payments made to foreign governments and the US Federal Government in their annual reports. The Dodd-Frank Act requires the SEC to issue a final rule no later than 270 days from July 21, 2010 (the date of enactment). The SEC has indicated that it intends to propose related disclosure rules in the fourth quarter of 2010 and adopt final rules in the first quarter of 2011. Accordingly, it is unlikely that the new rules would be effective in time for the 2010 Form 10-K filings of calendar year registrants.

- **Dodd-Frank Act Section 1503, *Reporting Requirements Regarding Coal or Other Mine Safety***

  This provision of the Act requires SEC registrants that operate mines directly or through a subsidiary to disclose certain mine safety information in their periodic filings. The Act does not require the SEC to issue new rules to implement the provisions of this Section, although the SEC is authorized to do so. The SEC currently plans to propose rules regarding disclosure of mine safety information in November to December 2010 timeframe. Section 1503 took effect on August 20, 2010 and registrants will be required to comply in their periodic reports filed after this date.

Note: *[The SEC website contains a detailed timeline for the Commission's implementation of the Dodd -Frank Act. See http://sec.gov/spotlight/dodd-frank.shtml.]*

B. Loss Contingency Disclosures

Mr. Carnall noted that the SEC staff continues to focus on loss contingency disclosures and whether companies are in compliance with the existing requirements of GAAP for contingent losses (ASC 450, *Contingencies* (formerly SFAS No. 5)). In particular, Mr. Carnall noted that the staff is seeking to determine registrants' compliance with the existing GAAP requirement to disclose, if significant, the amount or range of reasonably possible losses in excess of the amount accrued. Additionally, upon the announcement of a material settlement, the SEC staff may review prior period disclosures and make inquiries of registrants to understand (1) whether appropriate disclosure was made if the contingent loss was reasonably possible as of previous reporting dates, and (2) whether any related accruals were appropriately recognized (and disclosed in MD&A if necessary) in the period the contingent loss became probable and reasonably estimable. Additionally, the staff may inquire about periods in which the company recognizes the expense.

Mr. Carnall also commented that the loss contingency disclosure requirements of GAAP and Item 103, *Legal Proceedings*, of Regulation S-K have different objectives. Mr. Carnall observed that attempts to satisfy both objectives through an integrated set of disclosure often result in lengthy factual recitations rather than focusing on the underlying loss contingency, the related exposure and the likelihood of a loss.

C. Non-GAAP Financial Measures

Mr. Carnall summarized recent SEC staff comments on non-GAAP financial measures, including:

- It is inappropriate to present a full non-GAAP income statement in an SEC filing. (Question 102.1 of the CDIs on Non-GAAP Financial Measures states that such presentation attaches undue prominence to the non-GAAP information.)
- The prohibition on presenting non-GAAP financial measures with greater prominence than GAAP measures encompasses both the order of presentation and the degree of emphasis. For example, the SEC staff may challenge a discussion of non-GAAP financial measures that significantly exceeds the length of the discussion of the corresponding GAAP measures.
- The presentation of a non-GAAP financial measure should clearly describe the nature of any adjustments to a standard measure and should not describe an adjusted measure using terminology that would imply it is an unadjusted measure. For example, a measure that includes adjustments to the standard definition of EBITDA should not be labeled "EBITDA". (See Question 103.01 of the CDIs on Non-GAAP Financial Measures)
- If a registrant has a GAAP net loss but discloses non-GAAP net income, any presentation of non-GAAP earnings per share should be based on, or accompanied by a presentation of, non-GAAP diluted earnings per share that gives effect to any dilutive potential common shares outstanding even if they were antidilutive to the computation of diluted GAAP loss per share.

Mr. Carnall also commented that the SEC staff may listen to earnings and analysts calls to learn about a company and may issue comments on a discussion of inappropriate financial measures. For example, the SEC staff may challenge the oral discussion or website disclosure of operating cash flow per share or other per share measures not in accordance with ASR 142, which states that per share data other than that relating to net income, net assets and dividends, should be avoided in reporting financial results.

D. Article 11 Pro Forma Financial Information for an Acquired Foreign Business

When a US domestic issuer acquires a foreign business, the acquired business' financial statements presented to comply with Rule 3-05 of Regulation S-X (Rule S-X 8-04 for smaller reporting companies) may be prepared on a comprehensive basis other than U.S. GAAP (e.g., IFRS or local GAAP). Mr. Carnall commented that registrants are not required to separately present the conversion of the acquired foreign business's balance sheet and income statement to US GAAP in the pro forma adjustments. The SEC staff will not object if the adjustments to conform to US GAAP and the purchase accounting adjustments are combined for purposes of presentation in the pro forma information.

Mr. Carnall also noted that all the columns in the pro forma information should be presented using the reporting currency of the SEC registrant. Accordingly, the balance sheet and income statement of an acquired foreign business usually should be converted to the reporting currency to allow the pro forma columns to sum. The pro forma presentation should disclose the basis for the conversion either in narrative form or in a supplemental schedule to the pro forma information.

E. Venezuela

Considering the continued deterioration of economic conditions, Mr. Carnall emphasized the need for disclosure by any company with potential material exposure to further devaluations of the Venezuelan currency. Mr. Carnall had commented on the recommended disclosures in the April 2010 Committee meeting. Highlights of the April 2010 meeting are available at: http://thecaq.org/resources/secregs/pdfs/highlights/2010_0406_Highlights.pdf.

IV. IFRS WORK PLAN

Mr. Carnall noted that the Division staff is spending substantial time on the IFRS Work Plan. This work includes a review/analysis of financial statements of some of the largest companies in the world that use IFRS – both registrants and non registrants. One of the objectives of this project is to evaluate whether significant jurisdictional or other differences in the application of IFRS exist. The SEC staff will issue a progress report on the Work Plan in October 2010. Mr. Carnall indicated that this financial statement review project will not be completed until 2011.

V. XBRL

SEC XBRL rules required large accelerated filers with worldwide public float greater than $5 billion to detail tag financial statement notes and schedules for periods ending on or after June 15, 2010. Members of the Committee conveyed observations about the difficulties and delays many of these registrants encountered in their first detail XBRL tagging. Members of the Committee again expressed concern about the potential adverse effects of the XBRL timing requirements on the quality of financial reporting because of the incremental time required to reflect changes to the draft financial statements in the XBRL data. Specifically, members of the Committee noted that there could be as much as a 24-48 hour turnaround period to update the XBRL information for changes to the draft financial statements. As a result, registrants may decline to revise financial statements in response to comments from the audit committee and independent auditors.

Mark Green commented that the rules anticipated a learning curve in XBRL implementation. Mr. Green noted that the SEC rules addressed potential XBRL filing issues by (1) requiring the largest companies to implement XBRL reporting

first as part of a three-year phase-in, (2) providing a 30 day grace period for a registrant's first block tagged and detail tagged XBRL flings and (3) permitting registrants to request a hardship exemption. Mr. Green noted the SEC staff will continue to monitor the XBRL filing process. Jeff Naumann noted that the SEC staff also plans to communicate overall XBRL filing observations from its reviews. Although some comments may be communicated to individual registrants, the majority of XBRL comments will be made through a summary report on observations from all XBRL filing reviews.

Members of the Committee encouraged the SEC staff to closely monitor the resolution of the recent XBRL challenges in succeeding period reports and consider whether any adjustments to the SEC's XBRL reporting deadlines and requirements are warranted.

Mr. Green also highlighted that the Division issued updated Interactive Data CDIs on September 17, 2010 to clarify transition to XBRL reporting. The CDIs are consistent with April and June 2010 XBRL discussions with the Committee. The Interactive Data CDIs are available at: http://www.sec.gov./divisions/corpfin/cfguidance.shtml#interactivedata.

Wayne Carnall added that foreign private issuers that use US GAAP and have a float in excess of $5 billion that block tagged in their December 31, 2009 20-F would be required to detail tag interim information for periods after June 15, 2010 that are provided to comply with Form 20-F Item 8.A.5 nine month updating requirement. While the adopting release could be read to imply that a company would have one year to do block tagging, the regulation text is clear that for periods after June 15, 2010 detailed tagging is required.

VI. SEC STAFF AND OTHER INITIATIVES

A. Financial Reporting Manual (FRM)

The next update to the Division's Financial Reporting Manual (FRM) is expected to be issued soon, with updates dated as of June 30, 2010. Another FRM update, with updates dated September 30, 2010, is planned for later in the fall. By the FRM update in March 2011 (with updates dated December 31, 2010), the Division expects to complete the incorporation of selected past Committee Highlights.

[Note: On October 1, the SEC staff issued its quarterly update of the FRM. The revisions include updates for issues related to Regulation S-X Rule 3-09, Rule 3-10, and Rule 3-16, as well as other changes. The revisions are reflected as of June 30, 2010 and therefore do not reflect items attributable to the Dodd-Frank Act.]

B. CDIs Regarding Consents from Securities Ratings Agencies

Section 939G of the Dodd-Frank Act repealed Securities Act Rule 436(g), which previously exempted nationally registered statistical ratings organizations (NRSRO) from being considered experts when their securities ratings were used in a registration statement under the Securities Act. The Division issued Securities Act Rules CDIs 233.04 to 233.08 in response to the Dodd-Frank Act to clarify when a NSRSO is required to provide its consent. CDI 233.04 states the NRSRO's consent would be required if the issuer includes the credit rating in its registration statement or Section 10(a) prospectus (directly or through incorporation by reference), unless the rating information is included only for the purpose of satisfying disclosure requirements ("issuer disclosure-related ratings information"). The CDI cites the following as examples of issuer disclosure-related ratings information: disclosure of a credit rating in the context of a risk factor discussion, changes to a credit rating, MD&A discussion of the liquidity of the registrant, the cost of funds for a registrant, or the terms of agreements, including potential support to variable interest entities, that refer to credit ratings. Members of the Committee noted that issuers frequently have questions regarding whether or not a particular disclosure would trigger a consent requirement and about progress toward a solution for asset-backed issuers at the expiration of the 6 month transition period provided by the SEC staff in July 2010. Mr. Carnall thanked the Committee for sharing their concerns. Given the nature of the issue, he recommends that companies discuss the issue with their legal counsel and if necessary, questions can be directed to the Office of Chief Counsel.

VII. CURRENT PRACTICE ISSUES

A. Financial Statements of "Lower Tier" Companies

The SEC staff has previously addressed whether financial statements of "lower tier" entities (i.e., acquirees and equity investees) are required with respect to entities for which financial statements are required under S-X Rules 3-05, 3-09, 3-10 and 3-16 (and any corresponding rules applicable to smaller reporting companies). Topic 2, *Other Financial Statements Required*, of the FRM provides much of the interpretive guidance.

The SEC staff has not provided similar interpretive guidance with respect to acquired real estate operations for which financial information is required under S-X Rule 3-14. If a registrant acquires real estate operations whose financial statements include either recently acquired properties or investments in real estate that are accounted for under the equity method, the Committee questioned whether S-X Rule 3-14 requires any financial information with respect to such "lower tier" real estate operations. Mr. Olinger commented that such fact patterns do not arise often and the appropriate financial presentation should be determined

based on the specific facts and circumstances. Accordingly, the Division staff encourages pre-filing consultation by registrants in these circumstances.

B. Applicability of the Disclosure Requirements of Item 3(f) of Form S-4 When the Target is a Reporting Company That is Significant at or below the 20% Level

Item 3(f) of Form S-4 sets forth certain pro forma and pro forma equivalent per share disclosures that may be required in connection with a business combination transaction. Item 17(b)(7)(ii) of Form S-4 indicates that pro forma and comparative share data are not required for an insignificant nonreporting target if the registrant's shareholders are not voting and the transaction is not a roll-up. The Committee asked whether a registrant is required to provide the disclosures set forth in Item 3(f) of Form S-4 if all of the elements specified by Item 17(b)(7)(ii) are present except that the insignificant target is an SEC reporting company. Mr. Olinger responded that registrants should follow the specific Form S-4 instructions if an insignificant target is an SEC reporting company (i.e., provide the disclosures set forth in Item 3(f) of Form S-4), but may wish to discuss their circumstances with the SEC staff if compliance with the instructions of Form S-4 is problematic.