

Heads Up

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Members of the following Deloitte teams contributed to this issue of *Heads Up*: Accounting Standards and Communications, Audit and Assurance Services, and SEC Services.

To our colleagues at Deloitte, our clients, and our other friends, we wish each of you a joyous and peace-filled holiday season and a happy new year.

O SEC! O SEC!

Highlights of the 2012 AICPA National Conference on Current SEC and PCAOB Developments

by Deloitte & Touche LLP's National Office Departments of Professional Practice

Executive Summary

As temperatures dropped and December began, accountants and others once again headed to Washington, D.C., for the AICPA's¹ annual conference on current SEC and PCAOB developments. For three days, distinguished representatives from the SEC, PCAOB, accounting standard setters, and other professional groups presented their views on important developments affecting the accounting and auditing professions. This year's conference also featured discussion panels² on (1) current accounting practice issues, (2) user and investor views about financial reporting, and (3) identifying and managing sources of business growth.

Transparency and quality of financial reporting were significant conference themes. In his keynote address, SEC Commissioner Luis Aguilar highlighted the importance of the accounting profession's role as gatekeeper to the financial markets. He stressed that the investor's perspective must not be lost in the capital formation process, and he emphasized that registrants need to disclose "reliable and useful information, so that investors can better price risk and determine value."

Indeed, several speakers emphasized the importance of disclosing reliable information and of such information being based upon effective ICFR and sound audits. Mr. Aguilar noted that effective ICFR is important not only for reliable financial reporting but also to facilitate effective auditing. Consequently, he questioned the efficacy of accommodations that would allow certain issuers, such as emerging growth companies under the JOBS Act,³ to forego external audits of their ICFR because "evidence shows that independent attestation of internal controls promotes good financial reporting."

PCAOB Chairman James Doty noted that auditors should approach the audit the way he believes they have approached the proper application of accounting principles. He therefore encouraged them to continue to work to enhance their procedures by focusing "on auditing as its own discipline, to be studied, nurtured and trained."

¹ The abbreviations used in this publication are defined in [Appendix B](#).

² For a list of panelists and selected sessions, see [Appendix C](#).

³ The Jumpstart Our Business Startups Act.

The SEC staff reminded registrants that to improve transparency, their disclosures should fully “tell their story,” especially regarding significant judgments.

The SEC staff reminded registrants that to improve transparency, their disclosures should fully “tell their story,” especially regarding significant judgments. The staff reiterated the importance of using objective and verifiable information to support their judgments and estimates. In addition, Meredith Cross, director of the SEC’s Division of Corporation Finance, cautioned registrants to be mindful of their responses to the SEC staff’s comment letters because they are filed on EDGAR and may therefore become part of the registrant’s “total mix of information” and disclosure records. Speakers also outlined initiatives to increase the transparency and relevance of disclosures, including the FASB’s disclosure framework project and the SEC staff’s plans to hold a roundtable meeting, potentially focusing on existing “disclosure gaps,” with members of the accounting profession, attorneys, and regulators.

As in the prior year, IFRSs were again the subject of significant focus. Against the backdrop of SEC Chairman Mary Schapiro’s recent resignation and the designation of SEC Commissioner Elisse Walter as her successor, a decision was not expected anytime soon about whether and, if so, how and when IFRSs will be incorporated into the U.S. financial reporting system for public companies. However, incorporation of IFRSs remains a topic of interest, as revealed by numerous questions from conference participants about when a decision will be made.

Given that (1) a future decision about IFRSs is linked to progress in the FASB’s and IASB’s MoU convergence projects and (2) some level of divergence in these projects continues to be increasingly likely, FASB Chairman Leslie Seidman explained certain characteristics about standard setting in the United States. Ms. Seidman noted that standards for U.S. constituents must be clear, unambiguous, understood consistently, and accompanied by interpretive guidance. The increased use of IFRSs globally was described by IASB Chairman Hans Hoogervorst, who urged the United States to join other countries and adopt IFRSs. He indicated that IFRS constituents need the United States to clearly communicate its level of commitment to a single set of global standards. However, he also commented on the widespread adoption of IFRSs and noted that as a result of it, the risk of reversing the global convergence to IFRSs has decreased, regardless of the U.S. decision about IFRS adoption. Paul Beswick, acting chief accountant in the SEC’s Office of the Chief Accountant, emphasized that while convergence is an important factor in the decision about whether to adopt IFRSs in the United States, the ability to consistently enforce the application of such standards within and across jurisdictions is equally important.

Several other topics were touched upon. The SEC discussed its enforcement actions against registrants and auditors as well as its rulemaking efforts in response to mandates under the Dodd-Frank Act,⁴ the JOBS Act, the Iran-Syria Act,⁵ and other legislation. The PCAOB noted that it continues to focus on its inspections of auditors of U.S. registrants, to work with foreign jurisdictions to inspect foreign audit firms and foreign affiliates of U.S. audit firms, and to operationalize its responsibilities to inspect broker-dealers. Other PCAOB activities center on (1) continuing to remind auditors of their need to enhance their professional skepticism, (2) finalizing the auditor reporting model, and (3) implementing the PCAOB’s strategic plan.

⁴ The Dodd-Frank Wall Street Reform and Consumer Protection Act.

⁵ The Iran Threat Reduction and Syria Human Rights Act of 2012.

SEC and Related Developments

Selected Speakers

- Meredith Cross, Director, SEC's Division of Corporation Finance
- Jill Davis, Associate Chief Accountant, SEC's Division of Corporation Finance
- Craig Olinger, Acting Chief Accountant, SEC's Division of Corporation Finance
- Melissa Rocha, Accounting Branch Chief, SEC's Division of Corporation Finance, Office of Beverages, Apparel and Mining
- James Rosenberg, Senior Assistant Chief Accountant, SEC's Division of Corporation Finance, Office of Healthcare and Insurance
- Howard Scheck, Chief Accountant, SEC Enforcement Division
- Nili Shah, Deputy Chief Accountant, SEC's Division of Corporation Finance
- Mark Shannon, Associate Chief Accountant, SEC's Division of Corporation Finance
- Brad Skinner, Senior Assistant Chief Accountant, SEC's Division of Corporation Finance, Office of Natural Resources
- David Woodcock, Regional Director, SEC's Fort Worth Regional Office
- Susan Yount, Senior Accountant, SEC's Office of Interactive Data

Developments in the Division of Corporation Finance

Overview of Rulemaking Activities

Meredith Cross reported that similarly to 2011, the SEC staff was heavily focused in 2012 on implementing the provisions of various legislation, including the Dodd-Frank Act, the JOBS Act, and the Iran-Syria Act.⁶ She noted that in response to such provisions, the SEC has adopted and proposed several rules on topics such as clearing of swaps and derivatives, specialized disclosures,⁷ and compensation committees. In addition, she pointed out that the staff has already published [FAQs](#) on JOBS Act implementation issues and may release additional guidance on other final rules in the future.

Ms. Cross reminded conference participants that the Iran-Syria Act's disclosure requirements are "self-executing" and affect registrants' and their affiliates' SEC filings that are due after February 6, 2013. She emphasized that because the trigger for the disclosures is the due date of a periodic report (rather than the actual date of filing), registrants may not circumvent the disclosure requirements by filing periodic reports before February 6, 2013.

Editor's Note: On December 4, 2012, the SEC staff issued C&DIs that address the Iran-Syria Act. See [Exchange Act Sections](#), questions 147.01–.07.

Ms. Cross also discussed proxy-related disclosures about fees for an independent private sector audit (IPSA) in situations in which a registrant is required to obtain such an audit under the conflict minerals [final rule](#). She explained that if the registrant's financial statement auditor performs an IPSA of the registrant's conflict minerals report, the registrant should disclose such fees in the "all other fees" section of its proxy statement.

Jumpstart Our Business Startups Act

Ms. Cross noted that the staff in the Division of Corporation Finance has devoted substantial attention to the JOBS Act. The staff reacted quickly to its passage and has issued interpretive guidance in the form of FAQs that address emerging growth companies (EGCs) and other topics. In addition, she noted that future staff focus will be on completing rulemaking that is required under the JOBS Act, such as crowdfunding provisions and rules related to certain exempt offerings.

In a panel discussion, members of the SEC staff in the Division of Corporation Finance summarized Title I of the JOBS Act, which established the new EGC issuer status. The staff outlined (1) the requirements for a company to qualify (or subsequently disqualify) for EGC status, (2) financial statement and SEC reporting accommodations available to EGCs, (3) ability of EGCs to use private-company transition dates for new or revised accounting standards, and (4) other EGC accommodations such as reduced proxy disclosures and the exemption from an audit of an EGC's ICFR.

Editor's Note: See Deloitte's [SEC Comment Letters — Including Industry Insights: Highlighting Risks](#) for more information about the JOBS Act and SEC staff comments about EGCs.

⁶ The Iran-Syria Act, which was signed into law on August 10, 2012, requires entities to provide certain disclosures related to sanctionable events. Such disclosures must be provided in filings due after February 6, 2013.

⁷ The Dodd-Frank Act contains specialized disclosure provisions related to conflict minerals, mine safety violations, and extractive issuer payments to governments.

Filing Review Process

Meredith Cross also discussed the Division of Corporation Finance's filing review process. To enhance this process, the Division has created new offices and continued to hire experienced staff. According to Ms. Cross, one favorable result of filing review enhancement is fewer, but more targeted and meaningful, staff comments to registrants. She also noted that the interval for posting comment letters to EDGAR after completion of a review has decreased from 45 days to 20 days.

Further, Ms. Cross stressed that because all responses to comment letters are made publicly available, such responses may become part of both a registrant's "total mix of information" and its disclosure records (i.e., investors may read such responses similarly to how they interpret a registrant's other filings and publicly available information). Consequently, she reminded registrants to be mindful of their responses to the staff's comment letters.

The SEC staff provided a reminder of the top 10 best practices for responding to comments raised during the filing review process. These best practices were discussed in detail at last year's conference and remain applicable.

Editor's Note: See Deloitte's December 14, 2011, [Heads Up](#) for a detailed discussion of these best practices.

Melissa Rocha discussed the SEC staff's policy on e-mail and reminded conference participants that the staff now transmits its comment letters to registrants by e-mail. For comment letters issued for periodic reports (e.g., Forms 10-K, 10-Q, and 20-F⁸), the staff will call the registrant, typically the principal executive or financial officer, to obtain an appropriate e-mail address. The registrant is responsible for further distribution of the comment letter.

The process for providing comment letters for registration statements depends on whether the registration statement is filed publicly or submitted confidentially:

- For registration statements that are publicly filed, the SEC staff will call either the registrant or legal counsel to obtain the appropriate e-mail address.
- For confidential submissions, the staff will only contact legal counsel to obtain the appropriate e-mail address. This is done to preserve confidentiality, in the event that not everyone at the registrant is aware of the confidential submission.

Editor's Note: Certain FPIs and EGCs may submit draft registration statements for nonpublic review. For additional information on how to submit or file draft registration statements, see [How to Use EDGAR to Submit Draft Registration Statements and Amendments and File Them in Accordance With the Requirements of the JOBS Act](#) on the SEC's Web site.

Ms. Rocha stated that all correspondence with the SEC staff, including requests for additional time to respond to the staff's comments, must be submitted via EDGAR. She also noted that registrants that correspond with the SEC should not respond by e-mail to the staff's comment letter or use e-mail to provide any information that must be treated confidentially under Rule 83 of the SEC's Rules of Practice.

Editor's Note: Responses to comment letters are public information and are therefore subject to requests under the Freedom of Information Act. Registrants can request confidential treatment of portions of their comment letter responses or supplemental information. Such requests would need to meet the conditions in Rule 83. Before filing a confidential-treatment request, registrants are encouraged to consult with their legal counsel to determine whether their request meets the requirements of Rule 83 and [Staff Legal Bulletin No. 1](#).

⁸ For the full titles of standards and other literature cited in this publication or links to them, see [Appendix A](#).

Mark Shannon noted that the process described by Ms. Rocha applies only to comment letters on public filings or confidential submissions. The SEC staff's responses to confidential-treatment requests or waiver requests will not be e-mailed; rather they will be faxed or sent to the registrant via U.S. mail.

Editor's Note: In a separate Q&A session, Craig Olinger noted that registrants may submit prefilling or waiver requests via e-mail in accordance with the guidance on the SEC's Web site. For additional information on requesting interpretive guidance, see the Division of Corporation Finance's [Overview of the Legal, Regulatory and Capital Markets Offices](#).

Financial Statements of Guarantors and Issuers of Guaranteed Securities Registered or Being Registered (Regulation S-X, Rule 3-10)

Conditions for Reporting Relief

Nili Shah gave some background on Rule 3-10. Under Rule 3-10, a registrant must provide full financial statements for each subsidiary issuer and guarantor of registered debt or preferred securities in its registration statements and periodic reports under the Securities Exchange Act of 1934 (the "Exchange Act") unless relief is available. A registrant may be able to present more limited information in lieu of the full financial statements for each subsidiary if certain conditions are met. The SEC staff discussed two of these conditions that must be met for such relief: (1) the subsidiary issuers and guarantors must be 100 percent owned and (2) the guarantee must be full and unconditional.

Definition of 100 Percent Owned

Craig Olinger reminded registrants that under Rule 3-10, "100 percent owned" does not mean the same thing as "wholly owned," which is defined in Regulation S-X, Rule 1-02. The terms are therefore not interchangeable. Registrants must disclose that a subsidiary is 100 percent owned as one of the conditions for relief under Rule 3-10.

Editor's Note: In a Q&A session, Mr. Olinger clarified the distinction between wholly owned and 100 percent owned. Regulation S-X, Rule 1-02(aa), defines the term "wholly owned subsidiary" as "a subsidiary **substantially all** of whose outstanding voting shares are owned by its parent and/or the parent's other wholly owned subsidiaries" (emphasis added). During this session, Mr. Olinger indicated that wholly owned means that the parent owns substantially all of the outstanding voting stock of the subsidiary whereas 100 percent owned is defined as ownership of all outstanding shares of the subsidiary. See Rule 3-10(h)(1) for further clarification of the definition of 100 percent owned.

Full and Unconditional Guarantees and Release Provisions

The staff noted that the guarantee must be "full and unconditional" for relief under Rule 3-10. Similarly to a discussion at the 2011 AICPA conference, the staff indicated that a subsidiary whose guarantee is released automatically under one of the customary release provisions referred to in paragraph 2510.5 of the [FRM](#) may rely on the relief provided by Rule 3-10. Mr. Olinger clarified that registrants should disclose any qualifications of subsidiary guarantees and should not characterize a subsidiary guarantee as full and unconditional without disclosing the circumstances under which it can be released.

Editor's Note: For additional discussion of subsidiary release provisions, see Deloitte's [SEC Comment Letters — Including Industry Insights: Highlighting Risks](#) and December 14, 2011, [Heads Up](#).

Under Rule 3-10, "100 percent owned" does not mean the same thing as "wholly owned," which is defined in Regulation S-X, Rule 1-02.

Mr. Olinger also discussed debt indenture provisions that allow for the release of a parent guarantee. The FRM's guidance on customary release provisions only applies to subsidiary guarantees, not to parent guarantees. The staff explained that to qualify for Rule 3-10 relief, a registrant must meet certain conditions specified in the rule, one of which is the filing of the parent company's financial statements for the periods indicated. Therefore, if the parent could be released from its guarantee, there would be no basis for relief under Rule 3-10. Mr. Olinger pointed out, however, that the staff has allowed limited exceptions to parent release provisions, such as situations in which the parent's guarantee is released when the debt is repaid. He encouraged registrants to contact the staff regarding any parent release provisions in their debt indentures.

Recently Acquired Subsidiary Issuers or Subsidiary Guarantors (Regulation S-X, Rule 3-10(g))

Mr. Olinger discussed Rule 3-10(g), which applies to recently acquired subsidiary issuers or subsidiary guarantors. Under Rule 3-10(g), a registrant must provide separate financial statements of a significant subsidiary issuer or guarantor if the subsidiary's historical results have not been included in the parent's audited financial statements for at least nine months of the most recent fiscal year. Mr. Olinger noted that the significance test under Rule 3-10(g) is different from the tests under Regulation S-X, Rule 3-05, for businesses acquired or to be acquired. To determine significance under Rule 3-10(g), a registrant should compare the net book value or purchase price (whichever is greater) of the subsidiary with the principal amount of the securities being registered. If the test result equals or exceeds 20 percent, a registrant must file separate audited financial statements for the most recent fiscal year and unaudited interim financial statements for the appropriate interim period preceding the acquisition.

Editor's Note: Under Rule 3-05, a registrant must perform three tests specified in Rule 1-02(w) to determine the significance of an acquiree: the investment test, the asset test, and the income test. Because the significance tests under Rule 3-05 differ from those under Rule 3-10(g), a registrant must separately evaluate the significance of a recently acquired subsidiary issuer or guarantor under both rules. Financial statements may be required under Rule 3-10(g) but not under Rule 3-05, or vice versa.

For more information about Rules 3-05 and 3-10(g), see [Referring to the Standards of the PCAOB](#) section.

Mr. Olinger noted that in computing significance under Rule 3-10(g), a registrant must aggregate the acquisitions of a group of related subsidiary issuers or guarantors before their acquisition. He also reminded registrants that Rule 3-10(g) only requires financial statements in registration statements, not in periodic reports filed under the Exchange Act (e.g., Forms 10-K and 10-Q).

Editor's Note: Instruction 3 to Rule 3-10(g) indicates circumstances in which such subsidiaries are deemed related before they are acquired. Note that the meaning of "related" in this context is the same as that in Rule 3-05. For additional guidance on this topic, see Section 2530 of the FRM.

Condensed Consolidating Financial Information

Mr. Olinger also discussed form and content considerations related to the preparation of condensed consolidating financial information under Rule 3-10:

- The information should be presented in the same level of detail (i.e., the major financial statement captions) as interim financial statements prepared in accordance with Article 10 of Regulation S-X.
- The information should be presented in a columnar format in the footnotes to the financial statements.
- The information should be presented in accordance with U.S. GAAP (e.g., intercompany receivables should be shown as an asset and not as a negative long-term liability).

- The classifications in the condensed consolidated statement of cash flows should also comply with U.S. GAAP.
- A total for comprehensive income should be presented in either a single continuous statement or two separate but consecutive statements.

Editor’s Note: For additional guidance on this topic, see Section 2515 of the FRM.

Pro Forma Financial Information (Regulation S-X, Article 11)

Article 11 requires that a pro forma income statement include only adjustments that “give effect to events that are (i) directly attributable to the transaction, (ii) expected to have a continuing impact on the registrant, and (iii) factually supportable.” Nili Shah gave an update on the SEC staff’s view expressed at the 2011 AICPA conference regarding what constitutes a “continuing impact.” At the 2011 AICPA conference, the SEC staff communicated the view that items have a continuing impact if they are expected to affect operations or recur for a period greater than 12 months from the date of the initial occurrence.

Editor’s Note: See Deloitte’s December 14, 2011, [Heads Up](#) on the 2011 AICPA conference for additional information.

Ms. Shah clarified that the SEC staff has recently considered certain adjustments for which application of this prior view may need to be reconsidered. One example of an item that might be considered to have a continuing impact is interest expense for a short-term bridge loan financing that may be incurred for a period of less than 12 months. Ms. Shah indicated that the SEC staff may provide additional guidance in the future on such adjustments. In the meantime, she encouraged registrants to consult with the SEC staff regarding situations in which there is an item that will have an effect for a period of less than 12 months and the pro forma treatment of that item would be material to the pro forma financial statements.

Debt Covenants and Restrictions (Regulation S-X, Rule 4-08(e))

The SEC staff highlighted that registrants in **all** industries need to consider how certain circumstances in which covenants in debt agreements or restrictions from regulatory bodies might affect their ability to comply with their obligations to pay dividends to their parent. Registrants should identify such restrictions to assess their disclosure requirements under Regulation S-X, Rule 4-08(e).

Editor’s Note: See Deloitte’s [SEC Comment Letters — Including Industry Insights: Highlighting Risks](#) for additional information.

Frequent Areas of Comment

Staff members in the SEC’s Division of Corporation Finance discussed certain accounting and financial reporting topics that are frequently the subject of comment letters to registrants. The staff underscored that such comments often result from insufficient disclosures, particularly related to registrants’ exercise of judgment about significant matters. The staff stressed that registrants’ disclosures should “tell their story” in its entirety and state the reasons underlying their judgments. For example, registrants should discuss not only their assumptions related to significant estimates but also why they made such assumptions as well as alternatives to them, any related uncertainties, and how such uncertainties could affect their estimates. The staff also noted that investors benefit from transparent disclosures that tell the full story about a registrant’s operations, liquidity, and significant judgments.

Summarized below are the staff’s remarks related to comments about MD&A, non-GAAP financial measures, segment disclosures, income taxes, loss contingencies, revenue recognition, goodwill, variable interest entities, cybersecurity, risk factors, referring to standards of the PCAOB, and certain industry-specific matters.

Editor’s Note: See Deloitte’s [SEC Comment Letters — Including Industry Insights: Highlighting Risks](#) for a more detailed discussion about trends identified in the staff’s comment letters on these topics and many others.

Management’s Discussion and Analysis

Results of Operations

The SEC staff noted that MD&A is the leading source of SEC staff comments and that well over half of all MD&A-related comments are about the results of operations section. The staff reminded participants of a registrant’s requirement under Regulation S-K, Item 303(a)(3), to disclose in MD&A material known trends or uncertainties that may affect future performance (whether favorable or unfavorable). In addition, the SEC staff indicated that in many comments, registrants are asked to quantify components of overall changes in financial statement line items and to enhance their analysis of the underlying factors that cause such changes or the reasons for the components affecting the overall change. The staff also suggested that in addition to discussing how volume and product mix affect a registrant’s results of operations, the registrant should explain other potential influences, such as pricing changes, acquisitions, new contracts, inflation, and foreign exchange rates.

Melissa Rocha indicated that an analysis of changes at the segment level is often meaningful in MD&A. She noted that the staff asked one registrant to discuss the effects of events in the eurozone on the registrant’s segment results of operations, sales, and margins. Ms. Rocha also encouraged registrants to use appropriate metrics to help them “tell their story” — including those that may be common to their industry (e.g., same-store sales, average subscribers). The SEC staff distinguished such metrics from non-GAAP measures that are adjusted GAAP measures. In addition, if using a metric, a registrant should (1) describe how it is calculated; (2) discuss its limitations, if any; and (3) discuss how the metric links back to the financial statements if the relationship is unclear.

An analysis of changes at the segment level is often meaningful in MD&A.

Table of Contractual Obligations

Ms. Rocha indicated that some registrants have questioned how obligations subject to uncertainties about timing or amount should be presented in the table of contractual obligations. She noted that registrants should consider their circumstances and use judgment in determining whether to include such information in the table or the footnotes to the table. The staff indicated that the footnotes should be used to clarify amounts in the table and to (1) explain the nature of the obligations, including whether they were included in, or excluded from, the table (and the reasons for inclusion or exclusion); (2) describe whether the obligations are subject to uncertainty; and (3) describe the uncertainty.

Editor’s Note: This topic was discussed in more detail at the September 2012 joint meeting of the CAQ SEC Regulations Committee and the SEC staff. See the meeting [highlights](#) for additional information.

Considerations Related to Risks and Uncertainties

In addition to those comments made by the SEC staff, a separate MD&A reporting panel composed of users, preparers, and auditors discussed the MD&A section of SEC filings and offered general observations and best practices. Some of the panel’s recommendations for preparing MD&A included:

- Use “plain English” and tables; avoid jargon whenever possible.
- Describe only key changes in an overview section; avoid background information.

- Focus on matters that are likely to have a material impact.
- Monitor competitors' disclosures and any associated SEC staff comments.
- Ensure that the question "why" is answered.
- Avoid boilerplate risk factors.
- Evaluate whether multiple factors are driving a change and quantify each factor.
- Consider combining year-over-year comparison tables.
- Use a disclosure committee and checklists.

A panelist noted that it can be particularly challenging for entities to comply with the requirement to disclose known trends and uncertainties. The panelist commented that an essential aspect of such compliance is the establishment of a robust process for monitoring both internal and external developments. In addition, the panelist suggested that input should come from various sources within an organization and that special care should be taken to maintain consistency between the content of MD&A and that of earnings calls or other similar company communications.

Though not specifically MD&A-related, a topic emphasized by another panelist was the challenge certain companies will face in complying with the Iran-Syria Act (see [H.R. 1905](#) for the complete text of the Act), which requires that registrants disclose whether they or their "affiliates" have engaged in certain activities related to Iran during the period covered by a report. In addition to noting that many aspects of the requirement are difficult to implement, the panelist clarified that the term "affiliate" will most likely be interpreted broadly and will encompass more than a registrant and its consolidated subsidiaries.

Editor's Note: This requirement applies to quarterly and annual reports that must be filed with the SEC after February 6, 2013. Registrants preparing for this new requirement are encouraged to refer to the [Exchange Act Sections](#), questions 147.01–.07, of the SEC's C&DIs for recently issued implementation guidance.

Non-GAAP Financial Measures

The SEC staff provided an update about potentially misleading non-GAAP financial measures that remove recurring cash operating expenses that are necessary to run a business. The staff noted that although it has not observed widespread use of such measures, it continues to remind registrants to avoid misleading presentations of non-GAAP financial measures. The staff also reminded registrants that presenting a full non-GAAP income statement in a press release or an SEC filing to reconcile a non-GAAP financial measure is inappropriate because such presentation gives the non-GAAP financial measure undue prominence.

In discussing non-GAAP financial measures that adjust GAAP measures for pension-related items, the staff specifically noted concerns when a registrant presents adjustments (to a GAAP measure) as "non-cash pension expense" or is unclear about what the adjustment represents (e.g., removal of amortization of losses, removal of all non-service-related pension expense). The staff suggested that registrants clearly label such adjustments and avoid using confusing or unclear terms in their disclosures.

Some registrants have recently changed their method of accounting for pension plans to immediately recognize actuarial gains and losses in the income statement. Such registrants have presented non-GAAP financial measures that remove the actual gain or loss from the performance measure. The SEC noted that such measures may confuse investors in the absence of sufficient quantitative context about the nature of the adjustment.

Editor's Note: In May 2012, Jim Kroeker, then SEC Chief Accountant, publicly commented about the staff's focus on pension-related non-GAAP financial measures. His remarks were discussed at the June 2012 joint meeting of the CAQ SEC Regulations Committee and the SEC staff. See the meeting [highlights](#) for additional information.

Because many registrants have begun returning to profitability, they are considering whether they should reverse a previously recognized valuation allowance.

Segment Disclosures

Mark Shannon indicated that the SEC staff's comments on registrants' segment disclosures have continued to focus on how operating segments are identified and aggregated into reportable segments (his comments were consistent with those discussed on this topic during the 2011 AICPA conference). In addition, he suggested that when responding to staff comments, registrants should focus on including sufficiently detailed information for the staff to understand all significant judgments that the registrant used in identifying and aggregating operating segments, including a detailed description of all events and circumstances (both recurring and nonrecurring) that influenced these judgments and how such events and circumstances were applied to the segment guidance.

In addition, Mr. Shannon noted that registrants should continually monitor any changes in facts and circumstances that may affect the identification or aggregation of operating segments (e.g., changes in internal reporting after an acquisition and whether economic measures of aggregated operating segments, which a registrant assumed would become more similar in the future, have not converged as expected over time).

Income Taxes

Mr. Shannon reiterated comments made at last year's AICPA conference about assessing the realizability of DTAs. The SEC staff had noted that it would have difficulty agreeing with a registrant's assertion that losses incurred during the economic downturn are aberrations but that it would base its conclusions on a registrant's specific facts and circumstances. Mr. Shannon also reminded registrants that in assessing the realizability of DTAs, they should consider cumulative losses in recent years to be significant negative evidence and that to avoid recognizing a valuation allowance, they would need to overcome such evidence with significant objective and verifiable positive evidence. He explained that although under U.S. GAAP it is theoretically possible to do so, overcoming negative evidence presented by cumulative losses is difficult.

Mr. Shannon also noted that because many registrants have begun returning to profitability, they are considering whether they should reverse a previously recognized valuation allowance. He indicated that factors for registrants to consider in making this determination would include:

- The magnitude and duration of past losses.
- The magnitude and duration of current profitability.
- Changes in the above two factors that drove losses in the past and those currently driving profitability.

Further, he noted that registrants should bear in mind that the goal of the assessment is to determine whether sufficient positive evidence outweighs existing negative evidence. He emphasized the importance of evidence that is objectively verifiable and noted that it carries more weight than evidence that is not. In addition, Nili Shah explained that in performing their analysis, registrants should (1) assess the sustainability of profits in the current economic environment and (2) consider their track record of accurately forecasting future financial results. She noted that any doubt about sustainability of profitability in a period of economic uncertainty may give rise to evidence that is less objectively verifiable. Likewise, an entity's poor track record of accurately forecasting future results would also result in future profit projections that are less objectively verifiable. Thus, such evidence would carry less weight in a valuation allowance assessment.

Ms. Shah also pointed out that registrants' disclosures should include a discussion of the factors or reasons that led to a reversal of a valuation allowance that effectively answers the question "why now." Such disclosures would include a comprehensive analysis of all available positive and negative evidence and how the entity weighed each piece of evidence in its assessment. She also reminded registrants that the same disclosures would be expected when there is significant negative evidence and a registrant concludes that a valuation allowance is necessary.

Loss Contingencies

The SEC staff noted that loss contingencies are a frequent topic of SEC staff comment and that the types of comments issued in 2012 were consistent with those issued the previous year. The staff highlighted the following two key observations related to loss contingencies: (1) because a high degree of professional judgment is required in recognizing loss contingencies, entities should clearly disclose the full "story" related to the contingencies and (2) loss contingency disclosures should be continually evaluated over time as facts and circumstances change. Panel members also explained that they do not anticipate that the FASB's removal of the loss contingency project from its agenda will affect the frequency or types of SEC staff comments because the staff focuses on enforcing existing guidance under ASC 450.

Revenue Recognition

The SEC staff indicated that it frequently comments on revenue recognition. James Rosenberg noted that the staff often asks registrants whether they met the "collection is reasonably assured" criterion before recognizing revenue. He pointed out that registrants receiving this comment often have certain things in common; for instance, such entities might sell products to resellers, have "very high day sales outstanding," and report high gross margins. Mr. Rosenberg asked registrants to consider the following factors when determining whether the collection of revenue is reasonably assured:

- The customer's creditworthiness.
- Payment terms of the arrangement.
- Historical practices for resolving payment disputes.
- Aging trend of receivables.
- Collection and write-off history.

In the context of selling products to resellers, Mr. Rosenberg reminded registrants to also consider the fixed or determinable criteria when recognizing revenue, especially when the substance of an arrangement is that the price is not fixed or determinable until it is sold to the end customer.

Goodwill

The staff has continued to focus on goodwill-related disclosures in MD&A, particularly those required by Section 9510 of the FRM. Ms. Rocha and Mr. Shannon stressed that although registrants often provide the appropriate disclosures before incurring an impairment charge, they sometimes fail to disclose the specific events and circumstances that led to the charge in the period of impairment. The staff also suggested that after performing an interim impairment test, a registrant should disclose (1) that it performed the test, (2) the event that triggered the test, and (3) the test result, even if it passed the test. The purpose of such disclosures is to help investors understand the continued risks and what has changed since the registrant filed its last Form 10-K.

In addition, the staff discussed how registrants allocate assets and liabilities to reporting units when performing the goodwill impairment test. The staff noted that registrants, particularly in regulated industries, allocate shareholders' equity to various reporting units and then use the allocated amount as a proxy for the carrying value of the reporting units. In such situations, the staff wants registrants to explain the basis of allocation, particularly when 100 percent of the shareholders' equity is not allocated, and how such allocation is in accordance with the current guidance under both U.S. GAAP and IFRSs. The staff continues to evaluate the appropriateness of using such a proxy.

Variable Interest Entities

The staff indicated that it continues to focus on the consolidation of overseas VIE arrangements. Some countries prohibit foreign ownership in certain industries. Registrants often use wholly foreign-owned entity structures to invest in such industries. Ms. Rocha and Brad Skinner indicated that the staff has been requesting registrants to provide expanded disclosures about the risks associated with the registrants' involvement with such VIEs. The staff indicated that rather than provide boilerplate disclosures, registrants should describe the relevant terms of their contractual arrangements with the VIE and how such arrangements convey the elements of control.

The staff expects registrants to disclose the critical judgments made in relation to their involvement in the VIEs, such as the validity and enforceability of contracts with the parties involved and whether there are any restrictions on the registrant's contractual rights. Further, details related to VIEs, such as the nature, purpose, size, and activities of the VIEs, should also be disclosed. Moreover, the staff pointed out that a registrant should provide information in its MD&A that would allow investors to assess the effects on the registrant's deconsolidation of the VIE. The MD&A should also describe economics flowing to the registrant as a result of its involvement in the VIE (e.g., if material service fees under contractual arrangements are not being settled).

Cybersecurity

Issued in October 2011, CFDG Topic No. 2 clarifies a registrant's obligation to disclose material cybersecurity risks or incidents in different sections of its filings, including (1) financial statements, (2) risk factors, (3) legal proceedings, and (4) conclusions about the effectiveness of the entity's disclosure controls and procedures. In her remarks, Ms. Rocha discussed the SEC's cybersecurity disclosure guidance and gave examples of the types of comments registrants receive.

Ms. Rocha indicated that the staff may monitor information outside of a registrant's filings and ask why certain incidents are not disclosed in the filing or why a registrant merely acknowledges its susceptibility to an attack in its risk factors and does not disclose actual incidents that occurred. The staff also may challenge the sufficiency of a registrant's disclosures. Although registrants need not disclose details about incidents that could compromise their security measures, their disclosures must sufficiently inform investors of their risk exposure.

Overall, the staff believes that disclosure of cybersecurity matters has improved from previous years. Registrants' MD&A has discussed how both successful and unsuccessful cyber attacks have affected operations (e.g., through reduced revenues or increased mitigation, prevention, or remediation costs), which is consistent with the SEC Regulation S-K requirement to disclose a trend, event, or uncertainty that is reasonably likely to materially affect results of operations.

Further, Craig Olinger reminded registrants to consider the appropriate accounting guidance on recognition, measurement, and classification and the related financial statement impact when they incur costs to prevent cyber attacks or mitigate damages. Ms. Rocha also indicated that cyber incidents may affect a registrant's conclusion about the effectiveness of its disclosure controls and procedures, echoing the guidance in CFDG Topic No. 2 that "[t]o the extent cyber incidents pose a risk to a registrant's ability to record, process, summarize, and report information that is required to be disclosed in Commission filings, management should also consider whether there are any deficiencies in its disclosure controls and procedures that would render them ineffective."

The SEC staff reminded registrants whose principal auditor is located in a country or jurisdiction where the PCAOB is unable to conduct inspections to highlight that fact in their risk factor disclosures.

Risk Factors — PCAOB Inability to Inspect Foreign Auditors

In certain foreign jurisdictions, the PCAOB has been unable to conduct inspections of registered public accounting firms and has therefore been unable to regularly evaluate these firms' audits and quality control procedures. The SEC staff reminded registrants whose principal auditor is located in a country or jurisdiction where the PCAOB is unable to conduct inspections to highlight that fact in their risk factor disclosures and to state that the benefits of PCAOB inspections are not available to investors that rely on such auditors' reports.

Editor's Note: This topic was discussed in more detail at the March 2012 joint meeting of the CAQ SEC Regulations Committee and the SEC staff. See the meeting [highlights](#) for additional information.

Referring to the Standards of the PCAOB

PCAOB Auditing Standard 1 requires an auditor to refer to the "standards of the Public Company Accounting Oversight Board (United States)" in connection with audit engagements performed for issuers in accordance with the auditing and related professional practice standards of the PCAOB. The SEC staff has observed that auditors' reports for issuers have occasionally inappropriately referred to the "auditing standards" of the PCAOB. The staff clarified that it is not appropriate for such auditors' reports to refer only to "auditing standards" since this qualifying language may imply that the auditor did not adhere to other standards of the PCAOB (e.g., its independence standards).

However, the SEC staff noted that reference to the PCAOB's auditing standards in the auditor's report for certain nonissuers may be acceptable. For example, the audit report on the financial statements of a business acquired under Regulation S-X, Rule 3-05, could refer only to auditing standards since an audit in accordance with U.S. GAAS would be appropriate for such nonissuer. However, if the principal auditor of an issuer refers to the report of another auditor in its report (e.g., an auditor of a nonissuer equity method investee whose financial statements are provided under Regulation S-X, Rule 3-09), the report of the other auditor must not include limiting language and must refer to the standards of the PCAOB.

For more information on this topic, see [CAQ Alert 2012-16](#).

Editor's Note: For financial statements of a recently acquired guarantor subsidiary under Rule 3-10(g), reference to the auditing standards of the PCAOB would not be appropriate in the audit report because the recently acquired guarantor subsidiary is itself an issuer. For additional guidance, see paragraph 4110.5 of the FRM, which contains a chart outlining application of certain PCAOB reporting requirements for various types of issuer and nonissuer entities.

Biotechnology and Pharmaceutical Industries

Multiple-Element Arrangements

Mr. Rosenberg described a typical multiple-element arrangement in the biotechnology and pharmaceutical industries, in which a vendor licenses intellectual property to a customer. He suggested that entities could improve their required disclosures about the nature and terms of such arrangements by (1) separating the description of the obligations and rights from the discussion of how they were accounted for, (2) ensuring that such descriptions are complete (i.e., that all material terms are disclosed), and (3) precisely describing the rights conveyed by the license. Registrants were reminded to explicitly identify each deliverable in the arrangement and explain why it represents (or does not represent) a separate unit of accounting. Mr. Rosenberg noted that a key factor in the determination of whether a license is a separate unit of accounting is often whether the customer can resell the license; the SEC staff often requests registrants to enhance their disclosures on this topic.

Moreover, Mr. Rosenberg suggested that registrants could improve their disclosures about the relative selling price method for allocating arrangement consideration by (1) quantifying the total arrangement consideration to be allocated, (2) identifying the amount of consideration allocated to each unit of accounting, and (3) explaining how the estimated selling price for each unit was determined (including the significant assumptions used). Regarding the milestone method of revenue recognition, Mr. Rosenberg pointed out that the SEC staff has requested several registrants to separately quantify and describe the terms of individually significant milestones.

High-Tech Industry

Accounting for Virtual Goods

Mr. Skinner explained that virtual goods are defined as nonphysical objects sold for use in online communities or online games, such as clothing, equipment, weapons, speed, power, or health. He pointed out that the sale of virtual goods represents a “service” and not the sale of an “actual good.” Given the recent emergence of this industry and the consequent lack of industry-specific guidance, Mr. Skinner reiterated the SEC staff’s request for enhanced disclosures about a registrant’s accounting policies, including all recognition and measurement assumptions used. He noted that the period over which revenue is recognized is an important assumption that can be associated with the expected life of the game, user, or virtual good.

The SEC staff also expects registrants to provide enhanced disclosures about (1) how customers acquire virtual goods; (2) significant terms related to virtual currency, including processing fees and refund provisions; (3) how they account for virtual currency credits and processing fees; (4) any regulatory or legal requirements to refund unused virtual currency and prepaid player balances; and (5) whether transactions are recorded on a gross or net basis.

Banking and Securities

European Sovereign Debt

CFDG Topic No. 4 encourages registrants to disclose “[h]ow management is monitoring and/or mitigating the effects of indirect exposure in [its analysis of risk, including] how the registrant identifies [its] indirect exposures.” Mr. Shannon observed that registrants differ in how they define indirect exposures to sovereign debt. In response, the staff has asked registrants to specifically disclose how they have defined indirect exposures. He also noted that the staff will question registrants about their indirect exposure to sovereign debt when the staff observes that such risks exist and the registrant has not provided any disclosures about them. In describing how it manages its indirect exposure to sovereign debt, the registrant could (1) describe how it considers and manages such risks; (2) quantify related amounts; (3) describe any stress testing that is performed or provide a sensitivity analysis; and (4) disclose quantitative information about the level of netting of country exposures (i.e., in-country assets less in-country liabilities) related to redenomination and devaluation risk.

Mr. Shannon also observed that the staff has requested registrants to disclose when they have included indexed or tranching credit default swaps in the tabular disclosure of their exposures to sovereign debt. They should also identify where these amounts are presented in the tabular disclosures, separately quantify the amount of purchased and sold protection, and present the amounts by country and counterparty. If a registrant excludes indexed or tranching credit default swaps from its tabular disclosures, it should similarly provide this information.

Although specifically developed for financial institutions, CFDG Topic No. 4 applies to any registrant with material exposures to European sovereign debt.

Editor’s Note: The staff also discussed CFDG Topic No. 5, which applies to financial institutions of any size and other registrants with material lending activities.

Allowance for Loan Losses

Mr. Shannon noted that the staff has focused on situations in which a registrant's net income is significantly affected by the release of reserves from the registrant's allowance for loan losses. He indicated that the staff expects registrants to provide, in their MD&A, (1) transparent quantitative disclosures about the effect the release of the reserves had on net income and (2) a discussion of how and why it was appropriate to release the reserves on the basis of changes in the registrant's asset quality. Registrants should also consider disclosing the nature of the reserve release and the potential for future releases of, or increases in, the reserve. He also indicated that the staff may request additional disclosures about the assumptions management used to develop its allowance for loan losses.

Fair Value Disclosures

Mr. Shannon noted that the staff has focused on three topics related to fair value disclosures under ASU 2011-04: (1) quantitative information about significant unobservable inputs used in Level 3 measurements, (2) disclosing the use of multiple valuation techniques for a class of assets or liabilities, and (3) narrative descriptions of the sensitivity of Level 3 measurements to changes in significant unobservable inputs. Mr. Shannon noted that the staff will often request entities to disclose a weighted average of the inputs used in a Level 3 measurement when a registrant has used a wide range of inputs. He suggested that when a weighted average is not meaningful, entities can provide qualitative disclosures about the distribution of the range of values presented. Ideally, this disclosure would address each significant input and describe the reason for the wide range.

Mr. Shannon also noted that the staff will often request registrants to identify and quantify the portion of a class of assets or liabilities measured by using a particular valuation technique when multiple techniques are used. Finally, he observed that disclosures about the sensitivity of Level 3 measurements to changes in significant unobservable inputs could be more granular and transparent. He indicated that it may be helpful for registrants to discuss the specific inputs that changed in the sensitivity analysis and the effect of changing those significant unobservable inputs.

Insurance

Mr. Rosenberg noted that under U.S. GAAP and SEC regulations, insurers must make certain disclosures about their statutory capital and dividend restrictions. Such disclosure is important because it may provide insight into known trends or uncertainties that could affect the insurer's liquidity or results of operations. A registrant should further discuss and analyze such trends or uncertainties in its MD&A.

The SEC staff's comments to a number of registrants have noted that they are (1) inappropriately labeling their statutory capital disclosures as "unaudited," "preliminary," or "subject to revision" and (2) not disclosing the amount of statutory capital and surplus necessary to meet regulatory requirements in accordance with U.S. GAAP.

Although he acknowledged that some companies may not have finalized their statutory financial statements by the time they issue their audited U.S. GAAP financial statements, Mr. Rosenberg stressed that disclosures about statutory capital are required under U.S. GAAP and should be audited like any other disclosures; moreover, such disclosures should not depend on finalization of the statutory financial statements. Mr. Rosenberg also indicated that simply stating that an insurer meets regulatory capital requirements does not satisfy the disclosure requirements and may prevent an investor from obtaining important information such as whether the insurer significantly exceeds or barely meets its capital requirements.

He also noted that the staff has observed that many registrants also do not fully comply with the SEC's dividend restriction disclosure requirements. Mr. Rosenberg indicated that registrants must disclose restrictions on payments both (1) from a subsidiary to its parent and (2) from the parent to its stockholders (see the [Debt Covenants and Restrictions \(Regulation S-X, Rule 4-08\(e\)\)](#) section).

Foreign Private Issuers

Compliance With SEC Reporting Matters

Craig Olinger and Jill Davis shared their observations regarding how registrants that use IFRSs as issued by the IASB can comply with SEC reporting requirements.

As speakers had noted at prior AICPA conferences, Ms. Davis emphasized that using the statement “IFRS as issued by the IASB” is a prerequisite for omitting the U.S. GAAP reconciliation and that the statement must be included in both the financial statements and the auditor’s report. She stated that if a registrant does not clearly assert compliance with IFRSs as issued by the IASB in both places, the registrant must provide a reconciliation to U.S. GAAP.

Editor’s Note: The SEC staff’s view, as expressed at the 2011 AICPA conference, is that when the statement is omitted, the registrant has two choices: amend the periodic annual report to add the statement or provide the U.S. GAAP reconciliation. For more information on the requirements to include this language in audit reports, see [CAQ Alert 2012-05](#).

Ms. Davis also noted that some issuers had included a PCAOB audit report that did not contain the unconditional statement of “substantial doubt” when referring to going-concern matters. In these cases, the issuer was asked to provide an audit report that used the phrase “substantial doubt.”

Editor’s Note: The staff discussed going-concern language at the November 2011 meeting of the International Practices Task Force (IPTF), a task force of the CAQ SEC Regulations Committee. See the meeting [highlights](#) for more information.

Ms. Davis discussed the inclusion of historical home-country GAAP (“previous GAAP”) financial information in the Form 20-F when a registrant files financial statements in accordance with IFRSs as issued by the IASB for the first time. Form 20-F permits, but does not require, the inclusion of previous GAAP information. However, some registrants presented a single table of selected financial data showing side-by-side comparisons of previous GAAP and IFRS information, which is prohibited under Form 20-F. Ms. Davis also noted that registrants should not provide MD&A discussions that compare IFRS financial information with previous GAAP information because Form 20-F does not permit such comparisons.

Editor’s Note: See Instruction G of Form 20-F for requirements related to previous GAAP information.

The staff discussed a number of observations related to registrants that adopted IFRSs as issued by the IASB for the first time, including those noted above, at the May 2012 meeting of the IPTF. See the meeting [highlights](#) for more information.

Mr. Olinger discussed transition issues that will arise upon the adoption of IFRSs 10, 11, and 12. The IASB amended these standards in June 2012 to provide entities with alternatives for transition. One alternative is to retrospectively adjust only the immediately preceding period to reflect the application of the standards. If an SEC registrant presents three years of comparable financial information, the oldest period presented (i.e., the third year back) will not reflect the application of the new standards (i.e., all three years will not be consistently presented). Mr. Olinger emphasized the need for registrants to clearly disclose — in the financial statements, selected financial data, and MD&A — which periods have, and have not, been retrospectively adjusted.

Editor’s Note: IFRSs 10, 11, and 12 are effective for annual periods beginning on or after January 1, 2013; early application is permitted in certain circumstances. For more information on the transition guidance, see Deloitte Touche Tohmatsu’s July 2012 [IFRS in Focus](#).

Like last year, the topics on which the staff commented most frequently were similar to those for domestic registrants, continuing to underscore that the economics of transactions, rather than the underlying GAAP, is the primary factor prompting the staff's comments.

Mr. Olinger further pointed out that in May 2012, the IASB issued annual improvements to IFRS 1. Under the new guidance, an entity that has applied IFRSs in a previous reporting period, but whose financial statements for the most recent annual period were not prepared in accordance with IFRSs, can readopt IFRSs and reapply IFRS 1. Before the amendment to IFRS 1, the definition of a first-time adopter in Form 20-F was consistent with that in IFRSs. An entity that is contemplating the reapplication of IFRS 1 and is currently a reporting issuer or plans to become an issuer should consult with the SEC staff to determine whether its facts and circumstances would enable it to use the accommodations for first-time adopters that are available in Form 20-F.

Editor's Note: For more information on the annual improvements to IFRSs, see Deloitte Touche Tohmatsu's May 2012 *IFRS in Focus*.

Comment Letter Themes

Mr. Olinger noted that 965 FPIs are registered with the SEC this year, of which approximately one-third are Canadian issuers, primarily from the natural resource and health care industries. In addition, he stated that the number of FPIs that report under IFRSs doubled relative to the prior year to approximately 400 issuers.

Ms. Davis presented the comments most frequently noted in the staff's reviews of FPIs' financial statements. Like last year, the topics on which the staff commented most frequently were similar to those for domestic registrants, continuing to underscore that the economics of transactions, rather than the underlying GAAP, is the primary factor prompting the staff's comments. These topics are:

- *Financial instruments* — The staff's comments have focused on (1) how financial institutions evaluate their loan portfolios and sovereign debt for impairment and (2) disclosures about the methods that registrants use to determine fair value, the nature and extent of risks (including liquidity and market risks), loans that are past due, and credit enhancements.
- *Presentation of financial statements* — The staff has requested registrants to clarify the nature of items excluded from or included in the line items, the nature of expenses, and the accounting policies that management needed to use significant judgment in developing them. The staff also asked about the nature of items classified as cash and cash equivalents in the statement of cash flows.
- *Provisions and contingent liabilities* — Comments on this topic have focused on the completeness of registrants' disclosures about provisions and uncertainties and risks arising from contingencies, as well as on the appropriateness of the groupings of provisions into classes.
- *Asset impairments* — The staff has commented on issuers' aggregation of cash-generating units, the use of post-tax discount rates in determining value in use, and the level at which management monitors goodwill for impairment.
- *Consolidation* — The staff's comments on this topic have centered on conclusions and issuers' disclosures about investments in associates and interests in joint ventures, including the nature and terms of the relationships with subsidiaries (e.g., restrictions).
- *Revenue recognition* — The staff has questioned registrants regarding the completeness and clarity of their disclosures about the nature of revenue transactions, how they applied the IAS 18 revenue recognition criteria, and their accounting for multiple-element arrangements.
- *Operating segments* — The SEC staff has continued to frequently comment on identification and aggregation of operating segments and completeness of a registrant's disclosures under IFRS 8.

- *Income taxes* — Such comments have focused mainly on the rate reconciliations for tax assets and the nature of the items disclosed as well as on the completeness and adequacy of disclosures required by IAS 12, particularly regarding the amount of deferred tax assets that was not recognized.
- *Business combinations* — The staff emphasized the need for expanded disclosures and clarification about purchase price allocations, as well as the nature and the financial effect of the business combination.

Editor’s Note: See Deloitte’s [SEC Comment Letters on Foreign Private Issuers Using IFRSs — A Closer Look](#) for more information about these and other comment trends affecting FPIs reporting under IFRSs.

Other SEC-Related Matters

Interactive Data — XBRL

Ms. Yount provided an update on the SEC’s interactive data (XBRL) program, highlighting that the phase-in of all groups specified under the rules has been completed; therefore, all filers subject to these requirements are submitting detail-tagged financial statements and footnotes. Ms. Yount elaborated on this by highlighting that an estimated 80 percent of the filing population has not yet filed an XBRL-tagged Form 10-K. Thus, when such filings are submitted in early 2013, the SEC will have its first complete set of XBRL data. She also reminded registrants that the limited liability period granted by the rules is ending for some registrants; as a result, the interactive data exhibits submitted by those registrants will be subject to the same liability⁹ as the rest of the filing.

Ms. Yount indicated that the SEC staff is using interactive data to (1) analyze the disclosures of all public companies, (2) better understand the impact of regulatory or accounting standard changes on registrants, and (3) support analyses performed by the SEC’s various divisions, including the Division of Corporation Finance; the Office of the Chief Accountant; the Division of Risk, Strategy and Financial Innovation; and the Division of Enforcement.

The SEC expects to approve the 2013 XBRL taxonomy for use by registrants in EDGAR filings in early 2013. Although registrants will still be able to use the 2012 taxonomy in their year-end filings, Ms. Yount emphasized that the SEC staff strongly encourages registrants to transition to the latest version of the taxonomy as soon as reasonably possible. Further, Ms. Yount noted that the SEC still has not yet approved an IFRS taxonomy for use by FPIs and that she could not predict when such an approval will be granted.

Editor’s Note: In a panel discussion on international issues, Jill Davis noted instances in which FPIs applied the U.S. GAAP taxonomy to their IFRS financial statements. The staff has asked these registrants to not provide XBRL information until a taxonomy has been approved for their use.

Ms. Yount reiterated that the SEC staff continues to see basic errors in interactive data submissions and directed registrants to the [staff’s observations](#) on the SEC’s Web site for additional details.

⁹ Ms. Yount stressed that the limited liability provisions under Section 232.406T of Regulation S-T only apply to filers that make a good-faith effort to comply with the rules and who promptly correct the errors upon identifying them. Section 232.406T applies to any interactive data file submitted to the SEC less than 24 months after the registrant first was required to submit an interactive data file to the SEC.

Finally, in her remarks and in the ensuing Q&A session, Ms. Yount addressed preparers' concerns about the challenges of complying with the XBRL rules. She indicated that the SEC staff continues to monitor registrants' implementation of the rules and is open to exploring ways of making the requirements easier to comply with. For example, the staff is assessing the feasibility of allowing registrants to use the Inline XBRL¹⁰ format for filings instead of requiring them to submit the same financial information both in an HTML format (for EDGAR) and in XBRL.

Editor's Note: Other panelists noted that as more companies are phased in under the detailed tagging requirements for interactive data, (1) more and more users are focusing on how best to use such data for analysis or other information gathering and (2) users are emphasizing the need for more reliable and higher-quality data and are encouraging preparers to consider obtaining assurance on their interactive data.

Division of Enforcement Update and Initiatives

David Woodcock reported that the Division of Enforcement continues to make progress on its whistleblower and cooperation programs. He gave a few examples of the programs' continuing success, including the following:

- The cooperation program continues to be a primary tool for enforcement tips and information.
- The Division entered into 46 cooperation agreements related to insider trading, financial statement and accounting frauds, and investment adviser frauds.
- The whistleblower program received approximately 3,000 complaints over the past year from every U.S. state and over 40 countries. The most common complaints were related to corporate disclosures, financial statements, and offerings fraud and manipulation.
- In August 2012, the first whistleblower award was made for \$50,000, which represents one-third of the amount collected to that date.

Mr. Woodcock also addressed situations in which an auditor or accountant is permitted to be a whistleblower. He noted that auditors (external or internal) and accountants are generally precluded from being a whistleblower (i.e., able to receive monetary awards) if information is obtained through their audits or engagements that are required under the federal securities law. However, he pointed out that there are three exceptions to this rule: (1) the auditor believes that disclosure of whistleblower information is necessary to prevent substantial injury to the company or its investors, (2) the client is acting to impede an investigation of misconduct, or (3) 120 days have passed, after which the whistleblower information is reported to the auditor's or accountant's direct supervisor or to the registrant's chief compliance officer or chief legal officer. Mr. Woodcock clarified that an audit firm's employee may report its own accounting firm if it suspects that the firm has violated professional standards or securities laws. However, for the employee to be eligible for an award when information implicates the audit firm, the information would also need to result in penalties for the registrant.

Howard Scheck noted that the Division continues to coordinate with the PCAOB to identify potential auditor misconduct. The coordination efforts include quarterly meetings and regular discussions about general issues or various hot topics. One topic of such discussions is cross-border investigations, such as those focusing on registrants domiciled in China.

Mr. Scheck also noted that on December 3, 2012, the SEC filed administrative proceedings against five China-based accounting firms for alleged violations of the Exchange Act and the Sarbanes-Oxley Act of 2002. The accounting firms were charged with failing to provide the SEC with audit working papers related to certain Chinese companies trading on U.S. markets.

¹⁰ Inline XBRL is a format of XBRL that allows embedding of XBRL tags into an HTML document. While registrants would still be required to submit multiple data files to the SEC, certain challenges would be alleviated, since XBRL information could be layered over a registrant's traditional XHTML filing (i.e., the registrant would not be required to manage two separate financial statement formats).

As noted at last year's conference, Mr. Scheck emphasized that the Division's enforcement reviews continue to focus on (1) the sufficiency and quality of evidence collected by an audit engagement team to reach its conclusions and (2) potential violations of Section 10A of the Exchange Act (i.e., requirements related to auditing SEC registrants' financial statements) by auditors. A noteworthy concern continues to be about an accountant's or auditor's failure to follow up on issues after they have been identified. Regarding materiality assessments, he noted that quantitative considerations continue to be too heavily emphasized while qualitative factors are often insufficiently evaluated.

Auditing and PCAOB Developments

Selected Speakers

- Luis Aguilar, Commissioner, SEC
- Martin Baumann, Chief Auditor and Director of Professional Standards, PCAOB
- Paul Beswick, Acting Chief Accountant, SEC's Office of the Chief Accountant
- Brian Croteau, Deputy Chief Accountant, SEC's Office of the Chief Accountant
- James Doty, Chairman, PCAOB
- Cynthia Fornelli, Executive Director, CAQ
- Jeanette Franzel, Board Member, PCAOB
- Jay Hanson, Board Member, PCAOB
- David Landsittel, Chairman, COSO
- Helen Munter, Director, Division of Registration and Inspections, PCAOB

Audit Quality and Its Continued Importance

Roles of the Auditor, Management, and the Audit Committee in Contributing to High-Quality Audits

Ten years after the passage of the Sarbanes-Oxley Act, the importance of reliable financial reporting and the significant role that high-quality audits play in contributing to it are still top of mind for regulators and accounting professionals.

Speakers at the conference highlighted the critical roles played by the auditor, management, and the audit committee in contributing to audit quality. James Doty observed that the confidence of investors is affected by the quality of independent auditing and that financial misreporting can have unanticipated and far-reaching effects, such as layoffs and inefficient use of capital. Mr. Doty encouraged audit firms to continue to make quality their first priority and to design actions and make the necessary investments to achieve excellence in quality. He also stated that "[a]udit committees have a role in fostering not just integrity in management's reporting, but the vitality and viability of the independent audit." Mr. Doty discussed the PCAOB's inspection division's plans to deepen its analysis of inspection findings to provide useful information to audit committees so that they may be in a better position to champion audit quality; the presenters from the PCAOB's Division of Enforcement and Investigations and Division of Registration and Inspections echoed this sentiment.

Cynthia Fornelli noted that the CAQ has released several resources to help audit committees interact with and evaluate auditors. In addition, Brian Croteau and Martin Baumann remarked that outreach to audit committees is one of the PCAOB's strategic priorities and that the PCAOB's August 2012 issuance of Auditing Standard 16 supports this priority. This standard, which is pending final SEC approval, encourages two-way dialogue between the auditor and audit committee and establishes requirements for the auditor's communication with the audit committee about the execution of the audit. The PCAOB has also issued nonauthoritative guidance for audit committees.

Editor's Note: For more information about Auditing Standard 16, see Deloitte's September 18, 2012, [Heads Up](#). Also see the CAQ's Web site for its [practice aid](#) on discussions with audit committees about inspection findings and quality-control matters. Further, [PCAOB Release 2012-003](#) provides additional information that audit committees may use to gather information from their auditors about audit firm inspections.

See Deloitte's August 30, 2012, [Heads Up](#) for additional information for audit committees about the PCAOB inspection process.

In addition to reaffirming the roles played by the auditor, management, and the audit committee in achieving high-quality audits, speakers at the conference discussed other matters that influence high-quality audits and provided insight into activities the PCAOB is undertaking.

“It is the responsibility of each individual auditor to appropriately apply professional skepticism throughout the audit, including in identifying and assessing the risks of material misstatement, performing tests of controls and substantive procedures to respond to the risks, and evaluating the results of the audit.”

Auditor Independence, Objectivity, and Professional Skepticism

In August 2011, the PCAOB issued a concept release to solicit public comment on ways in which auditor independence, objectivity, and professional skepticism could be enhanced. One approach considered in the concept release is the mandatory rotation of audit firms. There were a variety of views expressed for and against mandatory rotation.

Mr. Baumann announced that the PCAOB has issued [Staff Audit Practice Alert No. 10](#) on professional skepticism in audits. This alert reminds readers that it is important for the auditor to exercise professional skepticism in conducting an audit. As noted in the practice alert:

It is the responsibility of each individual auditor to appropriately apply professional skepticism throughout the audit, including in identifying and assessing the risks of material misstatement, performing tests of controls and substantive procedures to respond to the risks, and evaluating the results of the audit. This involves, among other things, considering what can go wrong with the financial statements, performing audit procedures to obtain sufficient appropriate audit evidence rather than merely obtaining the most readily available evidence to corroborate management’s assertions, and critically evaluating all audit evidence regardless of whether it corroborates or contradicts management’s assertions.

Paul Beswick introduced the subject of auditor independence, including whether accountants’ expanding practices into areas unrelated to their primary competencies undermines investor confidence in audits or affects audit quality; Mr. Doty voiced similar concerns. Jeanette Franzel mentioned other factors that she believes contribute to auditor independence, including the role of the audit committee and auditors’ strict adherence to auditing standards, including requirements related to professional skepticism and independence.

Audit Standard Setting and Other Projects

PCAOB Strategic Plan and Ongoing Activities

James Doty noted that the PCAOB recently reaffirmed its strategic plan that was adopted in 2011 and has set the following near-term priorities to improve audit quality in the interest of the investing public:

- Deepening its analysis of inspection findings and improving its reporting, with a goal of providing useful information to audit committees to help them promote audit quality.
- Identifying audit quality measures, with a longer-term goal of (1) tracking such measures over time and across firms and networks of firms and (2) back-testing them for their predictive value.
- Evaluating its standard-setting process and framework, including developing a new framework to organize and “integrate the interim standards with” the PCAOB’s new standards.

Editor’s Note: For more information about the [strategic plan](#), see the PCAOB’s Web site.

Management and auditors need to perform a more robust evaluation of financial reporting risks, including how these risks change over time, their impact on ICFR, and the controls designed to address such risks.

Update to Auditor's Reporting Model Project

In June 2011, the PCAOB issued a concept release on potential changes to the auditor's reporting model in response to investors calling for greater transparency. Regarding the proposal for auditors to emphasize certain matters, Brian Croteau indicated that it was important to develop appropriate criteria for determining what to emphasize and sufficient direction for what should be said about matters being emphasized. Mr. Croteau also stressed a continuing theme related to the role management plays, stating that additional emphasis in the auditor's report may also lead to improvements to management's disclosures. He also noted that this project requires coordination between audit and accounting standard setters and that the ideas and information gathered from the IAASB and European Commission on this topic may be beneficial to the consideration of how best to improve the auditor's report. Mr. Doty also expressed his belief that the PCAOB's project has benefited from the PCAOB's interactions with the IAASB on this topic.

Editor's Note: For more information about the PCAOB's proposed auditing standard on the form of the auditor's report, see Deloitte's June 28, 2011, [Heads Up](#).

The PCAOB's November 2012 standard-setting agenda indicates that the Board is expected to issue a proposal on audit reporting in the first half of 2013. Martin Baumann reiterated this timing and indicated that there is support for changing the current report format.

Editor's Note: See the IAASB's Web site for the current status of the [auditor reporting project](#).

ICFR and Other Audit-Related Matters

Internal Control Over Financial Reporting

There is widespread belief that investors have benefited from improvements in the reliability of financial reporting in the 10 years since the Sarbanes-Oxley Act became law. Brian Croteau encouraged auditors to continue to question the sufficiency of audit procedures, especially in those areas that are challenging to audit. He identified several aspects of ICFR that could be improved:

- At last year's conference, there was significant focus on the use of third-party pricing services. While progress has been made in this area, there is still room for improvement. Specifically, he noted that registrants should focus on developing and maintaining controls that identify when securities begin to become thinly traded. Such controls are important so that necessary changes to the valuation approach, and to the related measurement and disclosures, can be made on a timely basis. However, Helen Munter also acknowledged that inspection issues related to pricing services have decreased in 2012 and that she is encouraged by these results.
- Management and auditors need to perform a more robust evaluation of financial reporting risks, including how these risks change over time, their impact on ICFR, and the controls designed to address such risks.
- All components of ICFR, including risk assessment and monitoring, need to be considered, and the evaluation of those components needs to be better linked to deficiencies identified in the control activity component.

Ms. Munter continued the discussion of ICFR-related improvements and noted that the PCAOB expects to release a [Rule 4010](#) report in the near future that will focus on findings related to the application of [PCAOB Auditing Standard 5](#). She identified the following areas in which auditors struggle to meet the requirements to support their audit of ICFR:

- Identifying and sufficiently testing controls, including determining that the controls appropriately address the identified risks.
- Management review-type controls, which often are not precise enough to detect a material misstatement.
- Evaluation of control deficiencies, including (1) identifying findings or exceptions in control or substantive work but failing to determine whether they relate to deficient controls and (2) not appropriately evaluating the severity of identified deficiencies.
- Inappropriately relying on compensating controls to address an identified risk.

Ms. Munter also noted that issuers play a role in ICFR and encouraged auditors and issuers to engage in discussions about the controls that exist, how they are documented, and how they address the identified risks. Such discussions may help auditors better test and rely on certain controls.

Editor’s Note: See the [Enhanced COSO Framework](#) section and the suggestion that companies use the opportunity for the new framework to voluntarily refresh and improve their internal control.

In addition, Mr. Beswick emphasized that reliable financial reporting depends on management’s ongoing commitment to maintaining effective ICFR. He reminded conference participants that management and auditors still have certain responsibilities for ICFR even if the company is not subject to Section 404(b) of the Sarbanes-Oxley Act (i.e., the requirement to have the auditor attest to, and report on, management’s assessment of its internal controls).

Editor’s Note: Irrespective of whether Section 404(b) of the Sarbanes-Oxley Act is applicable, management still has certain responsibilities for establishing and maintaining an adequate internal control structure and procedures for financial reporting, as well as for assessing the effectiveness of such structures and procedures. In addition, the PCAOB’s auditing standards provide various responsibilities the auditor has for understanding and considering internal control as part of performing a financial statement audit.

Enhanced COSO Framework

David Landsittel and other panelists discussed COSO’s project to update its *Internal Control — Integrated Framework*, including the significant enhancements in the revised framework and their views regarding the revisions. Although the definition and components of internal control will remain the same in the revised framework, one of the more significant changes is the incorporation of 17 principles to explicitly articulate and describe the components of internal control. The panelists noted that the potential impact of the revised framework will vary for each entity and will depend on how closely an entity’s interpretation of the original framework reflects the 17 principles. Furthermore, the panelists suggested that there will probably be impacts on an entity’s documentation of internal control, particularly with respect to showing how an entity’s internal control reflects the 17 principles.

Because COSO does not have authority as a standard setter, it does not plan to suggest an implementation date for the revised framework. While guidance regarding transition for the purposes of Section 404 of the Sarbanes-Oxley Act may come from the SEC or the PCAOB, panelists suggested that companies may want to voluntarily refresh their internal control in 2013 to reflect the revised framework's updated concepts. COSO is expected to issue its revised framework and two companion documents — *Internal Control Over External Financial Reporting: Compendium of Approaches* and *Examples and Illustrative Tools for Assessing Effectiveness of a System of Internal Control* — in the spring of 2013.

Editor's Note: For more information on the project to enhance COSO's *Internal Control — Integrated Framework*, see Deloitte's [February 6, 2012](#), and [August 7, 2012](#), *Heads Up* newsletters.

Cross-Border Audits

Another theme discussed by various conference speakers was the audit work performed by foreign auditors that issue audit reports or participate in audits of U.S. issuers and the PCAOB's ability to fulfill its inspection responsibilities related to such audits. Mr. Croteau, Luis Aguilar, Jay Hanson, and Ms. Munter discussed the progress made by the PCAOB in reaching agreements with certain foreign audit regulators to inspect the work of foreign auditors. However, they noted that there is still work to be done. Mr. Croteau noted that comment letters issued by the SEC's Division of Corporation Finance in 2012 included requests for management to provide risk-factor disclosures (see the [Risk Factors — PCAOB Inability to Inspect Foreign Auditors](#) section).

Editor's Note: The PCAOB has a standard-setting project on its near-term agenda to address improving the planning, supervision, and other aspects of audits involving other accounting firms, individual accountants, and specialists.

Broker and Dealer Reporting

In June 2011, the SEC proposed amendments to Rule 17a-5 of the Exchange Act to make it easier for the PCAOB to implement its oversight of broker-dealers under the Dodd-Frank Act. Further, in July 2011, the PCAOB proposed new auditing and attestation standards for audits of brokers and dealers; however, the SEC has not yet voted on a final rule. Mr. Croteau noted that auditors should apply AICPA standards, rather than PCAOB standards, when auditing brokers and dealers. He also reminded conference participants that the SEC's independence requirements apply to audits of brokers and dealers. In addition, he emphasized the need to obtain reasonable assurance that any material inadequacies in the accounting system, internal controls, and procedures for safeguarding securities would be disclosed in the accountant's supplemental report on material inadequacies.

SEC's Work Plan on the Incorporation of IFRSs

Selected Speakers

- Paul Beswick, Acting Chief Accountant, SEC's Office of the Chief Accountant
- Julie Erhardt, Deputy Chief Accountant, SEC's Office of the Chief Accountant
- Hans Hoogervorst, Chairman, IASB
- Jenifer Minke-Girard, Senior Associate Chief Accountant, SEC's Office of the Chief Accountant
- Leslie Seidman, Chairman, FASB

Path Toward a Single Set of Standards

Hans Hoogervorst discussed the increased use of IFRSs globally and urged the United States to adopt IFRSs. He indicated that current U.S. leadership at the IASB is significant and that the recent IASB appointments of Americans to the IASB and the trustees illustrate direct U.S. participation in the IASB standard-setting process. However, Mr. Hoogervorst advised that the future level of U.S. leadership at the IASB would need to be proportionate to its support of IFRSs. Therefore, he indicated that IFRS constituents need the United States to clearly communicate its level of commitment to a single set of global standards. Nevertheless, he noted that as a result of the widespread global adoption of IFRSs, the risk of undoing the global convergence to IFRSs has decreased, regardless of any U.S. decision about IFRS incorporation.

Mr. Beswick did not indicate when a final decision would be reached and noted that the staff will work with the new SEC chairman to determine the path forward.

In contrast, Leslie Seidman's remarks highlighted concerns with the U.S. incorporation of IFRSs. She commented that the decision of whether and, if so, how to incorporate IFRSs in the United States rightly rests with the SEC but noted that accounting standards, to be usable in the U.S. cultural environment, must be (1) clear and unambiguous, (2) open to consistent interpretation over time and from company to company, and (3) accompanied by additional interpretive guidance, even after the implementation period.

Mr. Hoogervorst commented that given developments in the global economy and standard setting, it is important for the IASB to determine how best to include national standard setters in the overall standard-setting process. He referred to the IASB's recently published invitation to comment on a proposal to establish its Accounting Standards Advisory Forum.¹¹ Further, he expressed his hope that the FASB would comment on and be involved in the standard-setting process. Ms. Seidman acknowledged that the standard-setting process has changed in recent years and that she looks forward to developing new ways to work with the IASB to create comparable financial statements for global investors.

Paul Beswick explained that since issuing its final report on the IFRS work plan, the SEC staff has "continued to receive feedback" on the project and understands that uncertainty will remain until a decision is made. Although Mr. Beswick did not indicate when a final decision would be reached, he noted that the staff will work with the new SEC chairman to determine the path forward.

Implications on U.S. Financial Reporting System

Jenifer Minke-Girard discussed the SEC's ongoing efforts to evaluate the implications of incorporating IFRSs into the U.S. financial reporting system. Her remarks highlighted observations and analyses from each of the key areas of the SEC staff's July 2012 final report on its work plan.¹² Ms. Minke-Girard emphasized that the objective of the final report was to provide information to the SEC and not to offer a recommendation on whether incorporation or adoption of IFRSs is in the best interest of U.S. stakeholders. Further, the final report was not intended to imply that the SEC has made a policy decision regarding the incorporation of IFRSs.

Editor's Note: During a Q&A session, Ms. Minke-Girard reiterated that the SEC has not indicated when it plans to make a final decision on the incorporation of IFRSs into the U.S. financial reporting system.

For more information about the final report on the staff's observations, see Deloitte's July 19, 2012, [Heads Up](#).

Possible Factors Affecting the Incorporation of IFRSs

Julie Erhardt discussed three broad "dimensions" that regulators or standard setters may consider when determining whether to adopt or incorporate IFRSs into their country's financial reporting system: (1) domestic upgrade, (2) foreign investment, and (3) foreign access.

A "domestic upgrade" is akin to a "make versus buy" decision for national accounting standard setters. Assessment of this dimension may include consideration of tangible and intangible factors. Tangible considerations may consist of quality, control, and costs. However, Ms. Erhardt's comments focused principally on the intangible factors a country may consider. Intangible factors may include (1) the standard-setting environment, (2) perceptions about national accounting standards, (3) whether adoption of IFRSs would give the country a "seat at the international table," and (4) whether "the impartiality of IFRS relative to the views of any particular country make it the most suitable common platform for a group of countries that are seeking this linkage."

¹¹ IASB Invitation to Comment, *Proposal to Establish an Accounting Standards Advisory Forum: Formalising the Engagement With National Standard-Setters in the IASB's Standard-Setting Process*.

¹² SEC Staff Final Report, *Work Plan for the Consideration of Incorporating International Financial Reporting Standards Into the Financial Reporting System for U.S. Issuers*. The SEC first directed its staff to develop the work plan in February 2010. See Deloitte's February 26, 2010, [Heads Up](#) for additional information about the work plan.

The “foreign investment” dimension is related a country’s need for foreign capital and whether use of IFRSs could reduce the cost of this capital. “Foreign access” addresses the ease of accessing foreign capital and whether common use of IFRSs by capital providers and capital seekers would expedite capital transfers.

Ms. Erhardt indicated that there are many additional nuances to these dimensions and that the decision of whether to adopt IFRSs will be more complicated if an analysis of the dimensions yields “mixed signals” (i.e., the analyses for different dimensions yield different conclusions regarding whether to adopt or incorporate IFRSs into a financial reporting system). For her key takeaway, Ms. Erhardt indicated that a country’s decision about whether to incorporate IFRSs will depend on more than the standards themselves.

Accounting and Financial Reporting Developments

Selected Speakers

- Paul Beswick, Acting Chief Accountant, SEC’s Office of the Chief Accountant
- Susan Cospers, Technical Director and EITF Chairman, FASB
- Shelley Luisi, Senior Associate Chief Accountant, SEC’s Office of the Chief Accountant
- Richard Paul, Chairman, FinREC, and Partner, Deloitte & Touche LLP
- Alan Teixeira, Senior Director, IFRS Foundation
- Cullen Walsh, Practice Fellow, FASB

Convergence Project Update

Panelists in the standard-setting discussion outlined the FASB’s and IASB’s convergence efforts related to revenue recognition, leases, and financial instruments. They summarized the history of the projects and noted major milestones as well as expected publication dates of exposure documents and final standards. The panelists also discussed the status of other selected projects and potential future activities, including (1) the disclosure framework, (2) going concern, (3) the Private Company Council, and (4) postimplementation reviews.

Paul Beswick acknowledged that the FASB and IASB have continued to put significant effort into their convergence projects despite their understandable “standard-setting fatigue.” In addition, he emphasized the importance of exposing these projects for public comment to obtain feedback from key stakeholders on how to improve the quality of the final standards. Mr. Beswick also clarified that while convergence is critical, consistent implementation across jurisdictions is also of utmost importance. On the subject of implementation, Mr. Beswick noted that the SEC is working with its global counterparts to try to achieve consistency. Moreover, he discussed the issuance of implementation guidance, cautioning against putting too much stock in nonauthoritative “first to press” implementation guides issued by “trade organizations and others.” He indicated that the FASB and SEC are currently considering a “more holistic approach to implementation guidance.”

Revenue Recognition

Susan Cospers stated that the project’s core principle is recognition of revenue that depicts the transfer of goods or services to customers in amounts that reflect the consideration to which an entity expects to be entitled in exchange for those goods or services. Her discussion of the boards’ joint redeliberations on revenue recognition focused primarily on tentative decisions that would change the guidance in the boards’ November 2011 [ED](#).

Ms. Cospers noted that constituent feedback on the ED fell into three broad categories:

- Requests to clarify and refine certain parts of the proposal (e.g., the principles behind separating performance obligations).
- Difficulty applying certain parts of the proposal (e.g., the requirement to consider the time value of consideration in transactions and retrospective transition).
- Disagreement with particular aspects of the proposal (e.g., disclosures and onerous contracts).

Ms. Cospers indicated that the boards have worked together over the past year to address many of these constituent concerns and have made a number of [tentative decisions](#) to remediate them. The boards will continue redeliberations over the coming months and expect to issue a final standard in the first half of 2013.

Editor's Note: For additional information about the ED, see Deloitte's November 15, 2011, [Heads Up](#). For a summary of trends observed in comment letters about the ED, see Deloitte's April 13, 2012, [Heads Up](#).

Leases

The panelists' discussion about leases centered on changes the boards have made over the past year in redeliberating the [ED](#). Cullen Walsh commented on tentative decisions about certain significant topics, including:

- The proposed right-of-use model.
- Subsequent measurement for lessees.
- Financial statement presentation.

Mr. Walsh indicated that the boards expect to issue a revised ED in the first quarter of 2013.

Editor's Note: For additional information about redeliberations in the boards' lease accounting project, see Deloitte's September 27, 2012, [Heads Up](#).

Financial Instruments

Ms. Cospers noted that the overall goal of the financial instruments project is to address both the complexities and inconsistencies within and between U.S. GAAP and IFRSs. The project is divided into three principal areas: (1) classification and measurement, (2) impairment, and (3) hedge accounting.

In addition, Ms. Cospers highlighted the many points of convergence between the two boards on classification and measurement and noted that the IASB agreed to reopen IFRS 9 for limited amendments to address concerns raised about the interaction between the insurance contracts standard and this project. As part of this process, the IASB agreed to more closely align its guidance with the FASB's business-model decisions by adding an FV-OCI asset category for debt instruments. She also indicated that the FASB has converged with the IASB on bifurcation of embedded derivatives in hybrid financial assets and that there would thus be no bifurcation of embedded derivatives; instead, the hybrid would be classified as FV-NI.

The IASB recently released its [ED](#) on the limited IFRS 9 amendments, and the FASB expects to issue its classification and measurement ED in the first quarter of 2013.

Editor's Note: For additional information about the boards' classification and measurement redeliberations and an overview of their tentative models, see Deloitte's September 24, 2012, [Heads Up](#).

Ms. Cospers noted that the FASB added the impairment project to its agenda to address complexities in U.S. GAAP (she noted that there are currently five impairment models in the United States) as well as to promote convergence with IFRSs. Over the past year, a number of questions and concerns have been raised about the jointly developed dual-measurement approach (often referred to as the "three bucket" model). Under the three-bucket model, an entity would measure credit losses on debt instruments by using either (1) 12 months of expected credit losses or (2) lifetime expected credit losses, depending on the level of deterioration in credit. Constituents indicated to the FASB that this model was not ideal because it (1) relies on two measurement methods and (2) potentially requires entities to use new methods to monitor the deterioration of credit. On the basis of this feedback, the FASB tentatively decided to require a single-measurement approach under which entities would recognize current expected credit losses.

The FASB expects to issue its ED on impairment in December 2012. The IASB will release its next due process document in the first quarter of 2013. Ms. Cospers underscored that the boards are still discussing the impairment project together and that upon the IASB's issuance of an ED, the FASB will issue a supplementary document to illustrate differences between the two models and to gather formal feedback on the IASB model.

The IASB has made significantly more progress in its hedge accounting project than the FASB. Ms. Cospers stated that the FASB is not likely to begin formal redeliberations of hedge accounting until after a final classification and measurement standard is issued. She expects those redeliberations to commence sometime in 2013. The IASB issued a draft of its revised general hedge accounting model in September 2012 and expects to issue final amendments in January 2013.

Editor's Note: For additional information about the IASB's draft of the revised general hedge accounting model, including a comparison of the model to current U.S. GAAP, see Deloitte's October 16, 2012, [Heads Up](#).

Insurance Contracts

Alan Teixeira summarized the current status of the insurance contracts project and pointed out that the boards are starting from two very different places. Insurance contracts accounting standards are well established in the United States. However, in other parts of the world, the guidance on insurance contracts is effectively temporary because IFRS 4 gives insurers the ability to use legacy guidance until a more robust insurance contract standard is finalized. He emphasized that there is significant demand for the IASB to complete its redeliberations on insurance contracts.

Mr. Teixeira also emphasized that although the FASB and IASB have reached different decisions about several aspects of the project, many of those are potentially minor in significance. He did, however, note that decisions related to acquisition costs could potentially be the source of substantial divergence.

The panelists noted that the IASB ED is expected to be released in March 2013 and that the FASB ED would follow in the second quarter of 2013.

Other Accounting and Reporting Topics

Financial Reporting and the Scope of the Financial Statements

Paul Beswick discussed the FASB's various disclosure projects, indicating that questions often arise regarding the type of information to include in financial statements versus the sort to include in a broader financial reporting package (e.g., the Form 10-K as a whole). He indicated that the SEC staff intends to hold a roundtable with members of the accounting profession, attorneys, and regulators to explore this issue; a potential focus of this roundtable would be to identify "disclosure gaps" in existing guidance.

FinREC

Rich Paul indicated that the AICPA's Financial Reporting Executive Committee (FinREC) publishes nonauthoritative financial reporting guidance, including audit and accounting guides, topical accounting and valuation guides, technical practice aids, and other publications. In addition, FinREC participates in FASB and IASB standard setting through the comment letter process.

Mr. Paul described three topical accounting and valuation guides that FinREC expects to update or issue in 2013: (1) *Testing Goodwill for Impairment*, (2) *Assets Acquired to Be Used in Research and Development Activities*, and (3) *Valuation of Privately-Held Company Equity Securities Issued as Compensation*. He noted that FinREC is currently seeking feedback¹³ on a working draft of a new chapter that is being added to the goodwill impairment testing guide to address the qualitative assessment under ASU 2011-08. Finally, Mr. Paul noted that FinREC and the AICPA are working on two new guides related to business combinations and revenue recognition.

¹³ Comments on the working draft are due by December 31, 2012.

Trends in consultations with the staff may give some indication of the more difficult issues that accounting professionals encounter. Over the past 12 months, entities have most frequently consulted on accounting matters related to (1) financial assets, (2) consolidations, and (3) business combinations.

Current Accounting Practice Issues

An SEC staff member noted that the staff tracks consultation volume by topic. Trends in consultations with the staff may give some indication of the more difficult issues that accounting professionals encounter. Shelley Luisi noted that over the past 12 months, entities have most frequently consulted on accounting matters related to (1) financial assets, (2) consolidations, and (3) business combinations. She also noted that the SEC frequently receives questions on accounting for income taxes, specifically the realizability of DTAs.

Speakers on the panel on current practice issues discussed certain technical accounting matters that registrants often find challenging. These include whether to report revenue gross or net, consolidations of limited liability companies, eurozone considerations, and contingent consideration. Select topics are discussed in further detail below.

Reporting Gross as a Principal Versus Net as an Agent

One panelist emphasized that ASC 605-45 lists the following as strong indicators that an entity should report revenue gross as a principal instead of net as an agent: (1) the entity is the primary obligor and (2) the entity has general inventory risk in an arrangement. Regarding the assessment of whether the entity is the primary obligor, Ms. Luisi indicated that the staff will try to ascertain what product or service is desired by the customer, as described in ASC 605-45-45-4 (i.e., the staff will focus on “[w]hether [the company] is responsible for providing the product or service desired by the customer”).

Contingent Consideration

In a discussion about (1) a seller’s accounting for contingent consideration and (2) the accounting for contingent consideration in an asset acquisition, Ms. Luisi observed that while a final consensus was not reached on EITF Issues 09-4 and 09-2, respectively, the minutes and EDs of those Issues are informative.

In the minutes to meetings held to discuss EITF Issue 09-4, the FASB staff observed that there is conceptual merit for two possible methods of accounting for the seller’s contingent consideration:

1. Initially and subsequently measuring the contingent consideration at fair value.
2. Accounting for the consideration as a gain contingency in a manner consistent with ASC 450.

Regarding the accounting for contingent consideration in an asset acquisition, Ms. Luisi observed that while the Task Force did not reach a final consensus on EITF Issue 09-2, the ED and related minutes clarified existing GAAP. Thus, an entity should first determine whether the consideration is a derivative under ASC 815. If not, the entity would look to ASC 450 or ASC 323 for guidance on accounting for contingent consideration associated with the acquisition of an equity method investment.

Appendix A: Glossary of Topics, Standards, and Regulations

The standards and literature below were cited or linked to in this publication.

FASB Literature

For titles of *FASB Accounting Standards Codification* references, see Deloitte's "Titles of Topics and Subtopics in the *FASB Accounting Standards Codification*."

See the FASB's Web site for the titles of citations to:

- [Accounting Standards Updates](#).
- [Proposed Accounting Standards Updates](#).
- [Pre-Codification literature](#).

SEC Literature

- Regulation S-K:
 - Item 303, "Management's Discussion and Analysis of Financial Condition and Results of Operations"
- Regulation S-T:
 - Section 232.406T, "Temporary Rule Related to Interactive Data Files"
- Regulation S-X:
 - Rule 1-02, "Definitions of Terms Used in Regulation S-X (17 CFR Part 210)"
 - Rule 3-05, "Financial Statements of Businesses Acquired or to Be Acquired"
 - Rule 3-09, "Separate Financial Statements of Subsidiaries Not Consolidated and 50 Percent or Less Owned Persons"
 - Rule 3-10, "Financial Statements of Guarantors and Issuers of Guaranteed Securities Registered or Being Registered"
 - Rule 4-08, "General Notes to Financial Statements"
 - Article 10, "Interim Financial Statements"
 - Article 11, "Pro Forma Financial Information"
- Final Rules:
 - 33-9286, "Mine Safety Disclosure"
 - 33-9330, "Listing Standards for Compensation Committees"
 - 34-67716, "Conflict Minerals"
 - 34-67717, "Disclosure of Payments by Resource Extraction Issuers"
- SEC Rules of Practice:
 - Rule 83 (17 CFR 200.83), "Confidential Treatment Procedures Under the Freedom of Information Act"
- Forms:
 - Form 10-K — General Form of Annual Report
 - Form 10-Q — Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
 - Form 20-F — For Standardized Options
- Division of Corporation Finance's [Financial Reporting Manual](#) (FRM):
 - Topic 2, "Other Financial Statements Required"
 - Topic 4, "Independent Accountants' Involvement"
 - Topic 9, "Management's Discussion and Analysis of Financial Position and Results of Operations (MD&A)"

- Corporation Finance Disclosure Guidance:
 - Topic No. 2, “Cybersecurity”
 - Topic No. 4, “European Sovereign Debt Exposures”
 - Topic No. 5, “Staff Observations Regarding Disclosures of Smaller Financial Institutions”
- Staff Legal Bulletin:
 - No. 1, “Confidential Treatment Requests”

PCAOB Literature

- Staff Audit Practice Alerts:
 - No. 10, *Maintaining and Applying Professional Skepticism in Audits*
- Concept Releases:
 - 2012-003, *Information for Audit Committees About the PCAOB Inspection Process*
- Auditing Standards:
 - No. 1, *References in Auditors’ Reports to the Standards of the Public Company Accounting Oversight Board*
 - No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements*
 - No. 16, *Communications With Audit Committees* (pending SEC approval)

International Standards

See Deloitte’s [IASPlus](#) Web site for the titles of citations to:

- International Financial Reporting Standards.
- International Accounting Standards.

Appendix B: Abbreviations

Abbreviation	Description
AICPA	American Institute of Certified Public Accountants
ASC	FASB Accounting Standards Codification
ASU	FASB Accounting Standards Update
C&DI	compliance and disclosure interpretation
CAQ	Center for Audit Quality (affiliated with the AICPA)
CFDG	Corporation Finance Disclosure Guidance
COSO	Committee of Sponsoring Organizations
DTA	deferred tax asset
ED	exposure draft
EDGAR	SEC's Electronic Data Gathering, Analysis, and Retrieval system
EGC	emerging growth company
EITF	FASB's Emerging Issues Task Force
FAQ	frequently asked question
FASB	Financial Accounting Standards Board
FinREC	AICPA's Financial Reporting Executive Committee
FPI	foreign private issuer
FRM	SEC Financial Reporting Manual
FV-NI	fair value through net income
FV-OCI	fair value through other comprehensive income
GAAP	generally accepted accounting principles
GAAS	generally accepted auditing standards
HTML	HyperText Markup Language
IAASB	International Auditing and Assurance Standards Board
IAS	International Accounting Standard
IASB	International Accounting Standards Board
ICFR	internal control over financial reporting
IFRS	International Financial Reporting Standard
IPSA	independent private sector audit
IPTF	International Practices Task Force
JOBS Act	Jumpstart Our Business Startups Act

MD&A	Management's Discussion and Analysis
MoU	memorandum of understanding
PCAOB	Public Company Accounting Oversight Board
SEC	Securities and Exchange Commission
VIE	variable interest entity
XBRL	eXtensible Business Reporting Language

Appendix C: Selected Sessions and Speakers

The table below lists sessions and information about speakers on selected topics at the conference. The full text of conference speeches that are publicly available can be viewed by clicking the speaker's name.

Sessions/Speakers	Sessions/Speakers
Center for Audit Quality Update - Cynthia Fornelli, Executive Director, CAQ Keynote Address — SEC Luis Aguilar, Commissioner, SEC Remarks of the Acting SEC Chief Accountant Paul Beswick, Acting Chief Accountant, SEC's Office of the Chief Accountant OCA Policy Initiatives Brian Croteau, Deputy Chief Accountant, SEC's Office of the Chief Accountant Julie Erhardt, Deputy Chief Accountant, SEC's Office of the Chief Accountant Jenifer Minke-Girard, Senior Associate Chief Accountant, SEC's Office of the Chief Accountant Remarks of the Director of the Division of Corporation Finance - Meredith Cross, Director, SEC's Division of Corporation Finance Keynote Address — PCAOB James Doty, Chairman, PCAOB MD&A Reporting Panel Discussion - Brian Lane, Partner, Gibson, Dunn & Crutcher LLP - Katherine Gill-Charest, Senior Vice President, Controller, Chief Accounting Officer, Viacom - Michelle Stillman, Vice President-Internal Audit, Hewlett-Packard Current Practice Issues Panel - Douglas Barton, Partner, Deloitte & Touche LLP - Peter Bible, Partner, EisnerAmper, LLP - Adam Brown, Partner, BDO USA LLP - Randolph Green, Partner, KPMG LLP - Richard Jones, Partner, Ernst & Young LLP - Paul Kepple, U.S. Chief Accountant, PwC LLP - Shelly Luisi, Senior Associate Chief Accountant, SEC - Mark Scoles, Partner, Grant Thornton LLP	Developments in the Division of Corporation Finance - Craig Olinger, Acting Chief Accountant, SEC's Division of Corporation Finance - Melissa Rocha, Accounting Branch Chief, SEC's Division of Corporation Finance, Office of Beverages, Apparel and Mining - James Rosenberg, Senior Assistant Chief Accountant, SEC's Division of Corporation Finance, Office of Healthcare and Insurance - Brad Skinner, Senior Assistant Chief Accountant, SEC's Division of Corporation Finance, Office of Natural Resources - Nili Shah, Deputy Chief Accountant, SEC's Division of Corporation Finance - Mark Shannon, Associate Chief Accountant, SEC's Division of Corporation Finance FASB and IASB Chair Addresses Hans Hoogervorst, Chairman, IASB Leslie Seidman, Chairman, FASB FASB and IASB Accounting Standard-Setting Update - Susan Cospers, Technical Director and EITF Chairman, FASB - Alan Teixeira, Senior Director, IFRS Foundation - Cullen Walsh, Practice Fellow, FASB International Issues - Aaron Anderson, Group Head, Assistant Controller, MasterCard Worldwide - Jill Davis, Associate Chief Accountant, SEC's Division of Corporation Finance - Karin Dohm, Managing Director and Chief Accounting Officer — Head of Group External Reporting, Deutsche Bank AG - Paul Munter, Partner, KPMG LLP - Craig Olinger, Acting Chief Accountant, SEC's Division of Corporation Finance PCAOB Auditing Standard-Setting Update Martin Baumann, Chief Auditor and Director of Professional Standards, PCAOB - Jeanette Franzel, Board Member, PCAOB SEC Enforcement Actions Panel Discussion - David Woodcock, Regional Director Fort Worth Texas, SEC's Division of Enforcement - William McLucas, Partner, WilmerHale - Howard Scheck, Chief Accountant, SEC's Division of Enforcement

Sessions/Speakers	Sessions/Speakers
Revenue Recognition • Christopher Bolash, Partner, Ernst & Young LLP • Russell Hodge, Global Controller, General Electric Company • Mark LaMonte, Managing Director, Moody's Investor's Service • Michael Wood, Vice President, Controller, and Chief Accounting Officer, Raytheon FinREC's Valuation and Accounting Guides Update • Richard Paul, Chairman, FinREC, and Partner, Deloitte & Touche LLP PCAOB Registration, Inspection, and Enforcement Division Updates • Claudius Modesti, Director, Division of Enforcement and Investigations, PCAOB • Helen Munter, Director, Division of Registration and Inspections, PCAOB	XBRL Data — How to Maximize Its Usefulness • James Brendel, Partner, Hein & Associates LLP • Suzanne Morsfield, Director of Research, Columbia University • Pranav Ghai, Calcbench, Inc. • Alex Rapp, Calcbench, Inc. • Susan Yount, Office of Interactive Data, SEC An Update on COSO's Internal Controls Integrated Framework • David Landsittel, Chairman, COSO • William Schneider, Director of Accounting, AT&T Services, Inc. • Stephen Soske, Partner, PwC LLP • Kenneth Vander Wal, Past President, ISACA

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