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Heads Up

In This Issue:

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

SECeason's Greetings!

Highlights of the 2010 AICPA National Conference on Current SEC and PCAOB Developments

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

It's hard to imagine a better venue than the annual SEC[1] conference to announce whether, how, and when public-company SEC registrants in the United States will be incorporating IFRSs into the U.S. financial reporting system. But alas, no such announcement was made this year. SEC Chairman Mary Schapiro did highlight that its decision on IFRSs is a top priority. She further indicated that if the Commission does decide to incorporate IFRSs into the U.S. financial reporting system, constituents would most likely have at least four years to comply. One SEC staff member also introduced a potential approach to incorporation: "condorsement" (a merging of the terms convergence and endorsement).

However, incorporation of IFRSs was not the only topic of interest at this year's conference. The SEC staff and other presenters shared their views on a range of financial reporting, auditing, and standard-setting topics. In the Executive Summary below, we cover the major themes discussed at the conference; later sections outline speeches and presentations in more detail.

Organized by topic, this *Heads Up* extracts key insights from nearly 25 hours of material discussed at the 2010 Conference. It focuses on experts' views on financial reporting and auditing matters as well as accounting and auditing standard-setting initiatives. This publication also includes links to information available elsewhere — for example, details on new or proposed accounting guidance are on the FASB's Web site at www.fasb.org. Links to publicly available speeches and presentations from the conference are available in Appendix C.

Executive Summary

Many of this year's themes were similar to those of the past few years, but this year also included a few new items such as the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). We hope that you will find our executive summary useful in navigating the happenings at this year's conference.

[1] The abbreviations referenced in this *Heads Up* are defined in Appendix B: Abbreviations.

Conference Themes

Restoring and Upholding Investor Confidence and Public Trust

Not surprisingly, the SEC and other regulators emphasized restoring and upholding public confidence in financial reporting — with many noting the vital role that the accounting profession plays in the financial markets. Ms. Schapiro noted that the SEC and other regulators have been working to restore the public trust in the capital markets that was eroded by "the scandals and crises of the last decade." She highlighted recent SEC investor protection efforts, including revitalization of its enforcement and examination divisions; increasing "transparency in areas that may breed systemic risk" (e.g., the asset-backed securities market); and rulemaking to implement the Dodd-Frank Act.

Ms. Schapiro acknowledged, however, that the SEC's efforts alone cannot restore the lost trust; she added that the accounting profession is "an important line of defense" in the protection of capital markets and restoration of investor confidence, and she urged accountants to question the reporting of results and to challenge the quality of financial statement disclosures.

Others also focused on the importance of public trust to the accounting profession. James Kroeker, chief accountant in the SEC's Office of the Chief Accountant, challenged the profession to enhance the "objectivity and integrity" required of accounting professionals and to "[c]ontinue to identify strong leaders in [the] profession who have a clear record of acting [in] the interest of investors and the public." Mr. Kroeker offered ideas on how the accounting profession can enhance public trust, including focusing on the importance of independence and the auditor's duty to shareholders and the public and "meeting complexity with transparent accounting and disclosure."

Daniel Goelzer, acting chairman of the PCAOB, echoed the sentiments of Ms. Schapiro and Mr. Kroeker, noting that "[r]eliable financial reporting is one of the linchpins on which our capital markets depend." He also noted, "The auditor's job is to protect these investors' interest in accurate, complete, and fairly presented financial information by independently reviewing and reporting on management's financial statements."

International Convergence of Financial Reporting Standards

The tone on international convergence of financial reporting standards was also set at the top. Senior representatives from the SEC, FASB, and IASB all stressed the importance of high-quality financial reporting standards. Ms. Schapiro recognized the progress the FASB and IASB have made in converging international accounting standards but conceded that "the path towards convergence has proved steep and winding at times." She stated that "[c]onvergence [of accounting standards] is a top priority for the SEC" but cautioned that the converged standards must be "high-quality improvements over current standards."

Further clarifications of Ms. Schapiro's views on IFRS incorporation were provided in a question-and-answer session following her prepared remarks. She indicated that the SEC is still on track to make a final decision in 2011 regarding the use of IFRSs by U.S. issuers (although the SEC does not feel bound to a June 2011 decision deadline). In addition, she believes that a minimum four-year implementation period is "likely" but a decision about that is still "a specific decision point for the Commission."

Building on Ms. Schapiro's comments, Mr. Kroeker commented on the FASB's and IASB's considerable progress on convergence, especially their joint issuance of exposure drafts on lease accounting and revenue recognition. He stated that those standards are "a model for how convergence can and should be approached." Mr. Kroeker added that the SEC is "working aggressively to pursue the broad goal of a single set of high quality standards, to do so in a way that protects U.S. investors and our capital markets, and to consider approaches to achieving both of those goals in ways that are as cost effective as possible."

Representatives from the accounting standard-setting bodies (FASB and IASB) also weighed in on their convergence progress. Sir David Tweedie, chairman of the IASB, emphasized the need for a single set of high-quality, global standards. He outlined the potential benefits of such a set of standards, including greater cross-border investment, increased comparability of financial information across political boundaries, lower cost of capital, and easier consolidation of global entities.

Leslie Seidman, acting chairman of the FASB, noted that the FASB and IASB have been working together since 2001, intending to eliminate significant differences between U.S. GAAP and IFRSs by developing joint standards in areas in which significant improvements are warranted, yet trying to avoid creating new differences in the process.

FASB Board member Russell Golden emphasized that neither board will rush to issue a standard that, in its opinion, does not improve current financial reporting requirements. However, Mr. Golden acknowledged that the June 2011 target date is important, since the SEC's decision of whether to incorporate IFRSs into the U.S. financial reporting system will be influenced by the status of the boards' convergence efforts in 2011. Mr. Golden indicated that the boards' modified strategy and work plan have enabled them to focus on aspects of U.S. GAAP and IFRSs that need the most improvement.

Dodd-Frank Act

The Dodd-Frank Act was also on the minds of the SEC and PCAOB staffs. Meredith Cross, director in the SEC's Division of Corporation Finance (the "Division"), said that the SEC has been very busy complying with the act's rulemaking mandate. However, she noted that this mandate would not affect the Division's timely reviews of filings.

Ms. Cross observed that the potential rules would cover a variety of topics, including:

- "Say on pay" and uninstructed broker votes.
- Compensation committees.
- "Pay equity ratio," "pay to performance ratio," hedging equity positions, and clawback.
- Regulation D (accredited investor determination).
- Specialized disclosures (e.g., conflict minerals, coal or mine-safe coal and other mine safety issues, payments by resource extraction issuers to foreign governments or the U.S. government).
- Requirements related to asset-backed securities.

The Dodd-Frank Act also expanded the PCAOB's oversight over auditors of broker-dealers. Brian Croteau, deputy chief accountant in the SEC's Office of the Chief Accountant, noted that through the Dodd-Frank Act, "the PCAOB has been granted comprehensive oversight authority over broker-dealer auditors, and we will be working closely with them as they move expeditiously to implement that authority." In addition to creating a broker-dealer funding system and an inspections program to facilitate this oversight, the PCAOB will need to develop auditing standards applicable to broker-dealer financial statement audits and attestation standards applicable to broker-dealer compliance reporting requirements. The SEC has provided transitional guidance on its existing rules for nonissuer broker-dealers to clarify that audits of these entities should be performed in accordance with AICPA standards. Martin Baumann, chief auditor and director of professional standards at the PCAOB, stated, "The Madoff scandal highlighted the risk investors can face regarding the safekeeping of their assets. As such, this standard-setting project is a high priority item on our agenda."

Communicating With Investors

Several SEC staff members stressed the need to communicate with investors in the most transparent way possible. Wayne Carnall, the Division's chief accountant, stressed that registrants should prepare disclosures for investors rather than to avoid comments from the SEC staff. In addition, Mr. Carnall believes that FASB *Accounting Standards Codification* (ASC or the "Codification") references are not informative to investors and encourages registrants to describe accounting concepts rather than simply refer to particular Codification sections. Brian Bhandari, an accounting branch chief in the Division, further elaborated on the following types of disclosures, or lack of disclosures, that may prompt comments from the Division during its filing review process:

- Missing or incomplete disclosures required by U.S. GAAP or SEC rules.
- Expectations of the impact from external events (e.g., impact of the economy).
- Inconsistencies between different sources of information (e.g., articles, press releases, analyst calls, and filed documents).
- Accounting implications of underlying agreements filed as exhibits to the registrant's filings.
- Limited discussion of changes in the registrant's business.
- Changes in liquidity.
- Lack of specificity in accounting policies.

Disclosures about contingencies were also of concern. Ms. Cross noted that the Division was reviewing the litigation disclosures in registrants' filings to ensure compliance with the accounting and disclosure requirements for contingencies in ASC 450[2] (formerly Statement 5). She emphasized that ASC 450 requires disclosure of the amount or range of reasonably possible losses expected as a result of litigation. Ms. Cross also highlighted that the Division issued "Dear CFO" letters to remind banks to disclose exposures to litigation and to state attorney general investigations; the impact of foreclosure delays on results of operations; and the exposure to mortgage putbacks and a rollforward of those exposures. Mr. Baumann expanded on this theme, reminding accountants of their responsibilities to account for and disclose loss contingencies, and advised auditors to be aware of the potential risks of material misstatement related to the proper accounting for and disclosure of recourse liabilities, litigation, and other loss contingencies.

Impact of Continued Economic Uncertainty on Financial Reporting and Internal Control Over Financial Reporting

Current Economic Environment

In the view of some speakers, the economy is not out of the woods yet. Mr. Baumann noted that the "ongoing economic challenges and uncertainties pose significant risks for financial reporting and auditing." In his opinion, "audit risk, as it has been since the start of the economic crisis, continues to be very high." He further stated, "it's important to recognize that fraud risk also continues to be elevated." Mr. Baumann reminded auditors of the continuing applicability of several pieces of guidance, including PCAOB Staff Audit Practice Alerts.

Mr. Goelzer and Mr. Baumann also referred to the *Report on Observations of PCAOB Inspectors Related to Audit Risk Areas Affected by the Economic Crisis* that the PCAOB issued in September 2010. Mr. Goelzer stated, "In my view, the report neither shows that audit failures caused the financial crisis nor that better auditing could have prevented it. What it does show is that the major firms must do a better job in adjusting to emerging audit risks as economic conditions change so that investors will have reliable information about the performance and financial position of public companies under economic stress."

Internal Control Over Financial Reporting

Several speakers provided reminders of important considerations related to internal control over financial reporting (ICFR). Mr. Croteau indicated that although nonaccelerated filers have been exempted from the audit requirement of Section 404(b) of the Sarbanes-Oxley Act of 2002 (the "Sarbanes-Oxley Act"), management's responsibilities for evaluating and reporting on ICFR under Section 404(a) are unchanged. Mr. Croteau also emphasized the need to refresh the approach to evaluating internal controls each year, particularly in a way that keeps up with emerging financial reporting risks. He stated that "this effort must go well beyond a rollforward of testing of the operating effectiveness of the same list of controls each year." Further, he noted that the "assessment should consider, for example, whether the design of controls has kept up with economic or business conditions or changes in financial reporting requirements."

In observing that disclosures of material weaknesses should be a "leading indicator" of potential financial reporting problems, Mr. Baumann indicated that "[m]aterial weaknesses seem to be reported, generally, only in connection with a restatement — where the material weakness is often obvious." He further stated, "In many cases a material weakness likely existed before the restatement as well, but unfortunately the ICFR audits are often not identifying them." Craig Olinger, deputy chief accountant in the Division, reiterated that the existence of a material weakness is not conditional on a restatement; rather, it depends only on the reasonable possibility of a material misstatement. In addition, he confirmed that most material weaknesses also result in ineffective disclosure controls and processes because most material weaknesses affect financial disclosures and are, therefore, likely indicators of ineffective disclosure controls and procedures. Others commented that the staff expects to see more disclosures regarding changes in ICFR. When a material weakness exists, its identification and description should be disclosed.

[2] The full title of each standard referenced in this *Heads Up* appears in Appendix A: Glossary of Topics, Standards, and Regulations.

Contents

Speech Topics

Audit Standard Setting and Other PCAOB Activities

Speakers	Topics Covered
• Martin Baumann, Chief Auditor and Director of Professional Standards, PCAOB • Brian Croteau, Deputy Chief Accountant, SEC's Office of the Chief Accountant • Daniel Goelzer, Acting Chairman, PCAOB • John Offenbacher, Senior Associate Chief Accountant, SEC's Office of the Chief Accountant • Mary Schapiro, Chairman, SEC	• Audit quality and investor protection • Current economic environment • Standard setting • Other PCAOB activities

Audit Quality and Investor Protection

A common theme expressed by many of this year's presenters was audit quality and its relationship to investor protection and restoring public confidence. In her keynote address, Ms. Schapiro noted that our markets depend on the confidence of investors which rests, in large part, with accountants and auditors. She also noted the importance of accurate and transparent financial reporting, stating that the "fact is that an essential touchstone of functioning capital markets is an investor's ability to get an unvarnished assessment of a company's financial condition." Ms. Schapiro further noted that the work of accountants and auditors in providing independent verification is critical to the effective functioning of our capital markets.

Mr. Goelzer echoed Ms. Schapiro's statements, and in stressing the role of the auditor, he indicated that more than half of Americans invest their savings in securities. He continued by stating that the "auditor's job is to protect these investors' interest in accurate, complete, and fairly presented financial information by independently reviewing and reporting on management's financial statements." In addition, Mr. Baumann cited the PCAOB's role in rebuilding investor confidence through transparent standard-setting activities that address "the most pressing audit issues, and developing standards with appropriate and robust requirements."

Current Economic Environment

In summarizing audit risk, Mr. Baumann noted his view that it remains as high as it was at the beginning of the economic crisis because of ongoing challenges and uncertainties that "pose significant risks for financial reporting and auditing." He also reminded registrants and audit practitioners to focus on fraud risk, which he believes continues to be amplified in the current economic environment. Mr. Baumann reminded auditors that as part of addressing these risks, they should continue to refer to guidance such as the PCAOB's Staff Practice Alerts, which can be found on the PCAOB's Web site.

Mr. Goelzer and Mr. Baumann also referred to the PCAOB's *Report on Observations of PCAOB Inspectors Related to Audit Risk Areas Affected by the Economic Crisis*, which was issued in September 2010. In summarizing the report, Mr. Goelzer indicated his belief that the economic crisis was not the result of audit failures nor could it have been prevented by "better auditing." However, he emphasized that the report demonstrated that auditors need to improve, namely, by adjusting procedures to address "emerging audit risks as economic conditions change."

Mr. Baumann also discussed the issuer and auditor implications associated with recent allegations related to mortgage documentation in which some financial institutions submitted erroneous or incomplete documents as part of foreclosure proceedings. Mr. Baumann cited the October 2010 "Dear CFO" letter sent to many issuers reminding them of their responsibilities related to accounting for and disclosing loss contingencies. He advised auditors to be aware of the potential risks of material misstatement related to the proper accounting and disclosure of recourse liabilities, litigation, and other loss contingencies. See the SEC Initiatives and Communications and Contingencies topics for additional information.

Standard Setting

Several speakers remarked on the PCAOB's standard-setting agenda for 2010 as well as its agenda for 2011 and beyond.

Editor's Note: The PCAOB's 2010–2012 standard-setting agenda is available on its Web site.

Speakers noted that the PCAOB completed the following standards in 2010:

- *PCAOB Auditing Standard No. 7,* Engagement Quality Review (AS7) — AS7 is effective for audit engagements for the first time this calendar year-end, and several speakers noted that they expect this standard to improve audit quality. Mr. Baumann indicated, "AS7 should substantially enhance the quality of the EQR by strengthening the review requirements, especially regarding (i) the qualifications of the reviewer, (ii) the procedures required to be performed and (iii) the documentation required of the reviewer." He further observed, "In many cases, I would expect the 2010 EQR to be performed in substantially greater depth than the concurring partner review was in 2009." Mr. Croteau noted that he expects PCAOB inspectors to focus on this area during the 2011 inspections of 2010 audits.
- *Risk assessment* — The PCAOB adopted eight new risk assessment standards that are currently awaiting SEC approval (expected before the end of December). Upon approval, these standards will be effective for audits of fiscal years beginning on or after December 15, 2010 (i.e., 2011 calendar-year-end audits). Mr. Goelzer stated that these standards (1) "provide a foundation for considering risk in the planning and performance of public company audits," (2) "are designed to better integrate consideration of fraud risk throughout the audit," and (3) "dovetail with the risk assessment [process] inherent in internal control auditing."

In summarizing the risk assessment standards, Mr. Baumann noted his belief that among other things, they would (1) improve planning procedures and consideration of materiality, (2) provide more guidance for multi-location audits, (3) better describe the partner's responsibilities in supervising the audit, (4) strengthen the requirements linking audit tests to assessed risks, (5) better integrate consideration of fraud throughout the audit, (6) provide for better comprehensive evaluation of audit evidence, and (7) place more focus on financial statement disclosures auditing procedures.

Speakers also noted that the following standards are on the PCAOB's agenda for 2011 (and beyond):

- *Auditor reporting model* — Several speakers noted that investors have commented that they expect more information from the auditor than the current pass/fail opinion model in the auditor's report. Mr. Baumann stated that the PCAOB has continued to receive input that reflects increasing investor dissatisfaction with "the current audit report itself." Mr. Goelzer noted that a project is under way to consider potential alternatives to the current model used to address potential needs of users of the financial statements.
- *Other projects* — Other projects the PCAOB has on its agenda include fair value, use of specialists, confirmations, principal auditor, audit committee communications, and going concern. Mr. Croteau highlighted the importance of considering the standards of other standard setters.

Editor's Note: For more information about the PCAOB's proposed auditing standard on communications with audit committees, see Deloitte's April 19, 2010, *Heads Up*.

Other PCAOB Activities

Oversight of Broker-Dealer Auditors

The Dodd-Frank Act expanded the oversight role of the PCAOB over auditors of all broker-dealers. Mr. Croteau noted that in addition to creating a broker-dealer funding system and an inspections program to facilitate this oversight, the PCAOB will need to develop auditing standards that apply to broker-dealer financial statement audits and attestation standards that apply to broker-dealer compliance reporting requirements. The SEC has provided transitional guidance on its existing rules for nonissuer broker-dealers to clarify that audits of these entities should be performed in accordance with AICPA standards. Mr. Baumann indicated, "The Madoff scandal highlighted the risk investors can face regarding the safekeeping of their assets. As such, this standard-setting project is a high-priority item on our agenda."

Editor's Note: On December 14, 2010, the PCAOB proposed rules for public comment that would establish an interim inspection program for registered public accounting firms' audit of brokers and dealers.

Editor's Note: Mr. Offenbacher reminded the audience of the requirement of the auditor of the broker-dealer to perform a review of the accounting system, the internal accounting control, and procedures for safeguarding securities. Rule 17a-5 of the Securities Exchange Act of 1934 (the "Exchange Act") states that the "scope of the audit and review . . . shall be sufficient to provide reasonable assurance that any material inadequacies existing at the date of the examination . . . would be disclosed."

He also observed that the SEC Staff recently issued a joint letter to the AICPA's Stockbrokerage and Investment Banking Expert Panel regarding these matters.

Codification

Several speakers noted that codifying the PCAOB's auditing standards is becoming increasingly important and that a project to do so has been added to the PCAOB's strategic plan. Mr. Baumann indicated that the PCAOB has begun to integrate, or codify, the newly adopted standards with the interim standards to develop a new framework for the PCAOB's standards. Mr. Goelzer noted that the PCAOB has issued 15 standards that have superseded significant parts of the AUs and that a well-organized topical codification would make referring to the standards easier and would simplify the task of identifying differences between the PCAOB's standards and other auditing standards.

Inspection Activities

The PCAOB continues to pursue its goal of being able to inspect all portions of audits of entities participating in the U.S. capital markets. Mr. Goelzer indicated that "[r]obust oversight of audit work done in other countries is critical to the protection of U.S. investors, given that significant operations of many U.S. public companies are located beyond our shores." The PCAOB is working to break down the current barriers that exist in international locations while at the same time considering interim processes to address the ultimate goal of oversight.

Interaction With Accounting Standard Setters

Mr. Baumann indicated that his office has been monitoring the FASB and IASB convergence projects and have had discussions with the FASB, the SEC, and the PCAOB's Standing Advisory Group regarding the pace, volume, and nature of the proposed changes to GAAP. He noted that some areas of concern were:

1. The ability for all involved to comment and absorb the extent of change,
2. The significant decrease in guidance in certain proposed standards, and
3. The resulting increase in judgments, estimates and use of fair values in proposed standards — areas where [the PCAOB's] inspections have, at times, found audit problems in the past.

Consolidations

Speakers	Topics Covered
• Paul Beswick, Deputy Chief Accountant, SEC's Office of the Chief Accountant • Wesley Bricker, Professional Accounting Fellow, SEC's Office of the Chief Accountant • Lisa Watson, Professional Accounting Fellow, SEC's Office of the Chief Accountant	• Observations from adoption of Statement 167 • Derecognition for transfers of businesses not in legal entities • Identifying the scope and duration of a VIE's activities that are significant to its economic performance • Identifying which party or parties have the power to direct the activities of a VIE • Related-party considerations

Observations From Adoption of Statement 167

Mr. Beswick provided some observations regarding the first year of adoption of Statement 167 (codified in ASC 810-10). He noted that some registrants continue to focus on the quantitative approach under Interpretation 46(R) rather than on the qualitative approach of power and economics in Statement 167 (codified in ASC 810-10).

To have a controlling financial interest in a VIE, an entity must have both the power to direct the most significant activities of the entity and the obligation to absorb losses or receive benefits that could potentially be significant to the VIE. Mr. Beswick discussed both criteria. Regarding the first criterion, he noted that a reporting entity may conclude that a group of activities, rather than a single activity, may be most significant to the VIE's performance and that this determination will depend on the entity's structure, purpose, and design. He further indicated that consideration of protective rights should not be limited to the examples in Statement 167 (codified in ASC 810-10) and that registrants should also look to other sections of the Codification.

Editor's Note: For instance, ASC 810-20-25-19 gives examples of rights that would allow limited partners to block actions of the limited partnership but that would still be considered protective rights.

Mr. Beswick further stated that registrants should use a qualitative framework rather than rely on bright lines when assessing whether they have the obligation to absorb losses or right to receive benefits that could potentially be significant to the VIE. Mr. Beswick also discussed fees paid to a service provider in which some portion of the fee is "senior in subordination" (i.e., senior to other liabilities of the VIE). He noted that registrants should consider all facts and circumstances when assessing whether such a fee would represent a variable interest in accordance with ASC 810-10-55-37 and are encouraged to consult with the SEC staff regarding such fee arrangements.

Editor's Note: ASC 810-10-55-37 indicates that one criterion that must be met for a reporting entity to conclude that a fee paid to a decision maker or service provider is not a variable interest is that "[s]ubstantially all of the fees are at or above the same level of seniority as other operating liabilities of the VIE that arise in the normal course of the VIE's activities, such as trade payables." Generally, this condition would be met if, upon liquidation (or distribution), substantially all of the fees have the same level of priority as, or a higher level of priority than, other operating liabilities. Therefore, if such a condition is to be met, substantially all of the fees cannot be subordinate to other operating liabilities. If more than an insignificant amount of the fees has a payment priority that is subordinate to other operating liabilities, this condition would not be met and the fee would generally be considered a variable interest under ASC 810-10-55-37. However, as noted in Mr. Beswick's comments, all facts and circumstances should be considered.

Derecognition for Transfers of Businesses Not in Legal Entities

Ms. Watson voiced the SEC staff's concerns about situations in which "the lack of a legal entity could enable a company to bypass accounting guidance for derecognition of assets." To elaborate on this concern, she cited the following example of a situation the staff has encountered:

> [A] registrant transferred one of its businesses [not held in a separate legal entity] to a third party. As part of the arrangement, the third party was given the right to sell the business back to the registrant in the future for the same amount the business was worth at the date of the initial transaction. Prior to that option becoming exercisable, the registrant would continue to operate the business under a management agreement. The financial impact of the management agreement was that the registrant retained the risks and rewards of cash flows of the business while serving as the manager. If the put option is not exercised, the registrant has the unilateral right to extend the management agreement for several more years.

In this example, to determine whether derecognition was appropriate, the registrant analyzed whether it should consolidate the third-party transferee. Ultimately, the registrant concluded that it should not consolidate the third party and therefore "derecognized the business and recognized a gain on the sale."

Ms. Watson noted that the SEC staff challenged the registrant's analysis and conclusion, questioning whether it had adequately assessed the appropriateness of derecognizing the business. The staff's concern is that "if this assessment [is] not made, then any time a business is transferred to a third party without being housed in a separate legal entity, that business would be derecognized — and a gain or loss recognized — regardless of the nature and extent of continuing involvement." Ms. Watson indicated that such accounting would be inconsistent with ASU 2010-02. She informed participants of the staff's belief that, to be consistent with the guidance in this ASU, an entity should consider not only whether consolidation of the transferee is appropriate but also whether the entity still holds a controlling financial interest over the particular business that was transferred.

Identifying the Scope and Duration of a VIE's Activities That Are Significant to Its Economic Performance

Mr. Bricker noted that an entity must understand the scope and duration of the activities that are most significant to a VIE's economic performance to determine which party has the power over those activities. Such analysis should take into account the VIE's design and all activities necessary to fulfill its purpose; activities unrelated to the VIE's purpose or performed by parties that have no involvement with the VIE should be ignored. Mr. Bricker also emphasized that an entity must first appropriately identify the activities of a VIE that are most significant to its economic performance before reaching a conclusion that no party to the arrangement has a controlling financial interest.

Identifying Which Party or Parties Have the Power to Direct the Activities of a VIE

Mr. Bricker reminded registrants that when they assess which party has the power to direct the activities of the VIE that most significantly affect its economic performance, the sources of power "may be embedded in various arrangements and at various levels within the [VIE's] structure." Accordingly, an entity's analysis should focus not only on activities at the board level but also on those related to management, to servicing, or to financing agreements.

Special consideration may be required for financial entities that engage only in a limited range of activities or that exist for a single purpose (e.g., securitization structures) because the analysis of such VIEs may need to focus on decisions made at the VIE's inception and may require review of the formation documents. Such analysis also would need to take into account the VIE's significant ongoing activities and who has power over those activities.

Mr. Bricker noted that the SEC staff would view "with a healthy dose of skepticism" a registrant's assertion that power is shared among multiple unrelated parties such that no single party has the power to direct the activities that most significantly influence a VIE's economic performance. Under the accounting literature, such an assertion is valid only when "two or more unrelated parties together have the power to direct the activities of a [VIE] that most significantly impact [its] economic performance and if decisions about those activities require the consent of each of the parties sharing power."

Related-Party Considerations

Mr. Bricker addressed circumstances in which an entity concludes that as a group, the enterprise and its related parties meet the criteria for a primary beneficiary but no entity within the group would do so individually. In such circumstances, the reporting entity must consider the related party provisions of the VIE model to determine which member within the related-party group is the primary beneficiary; it cannot conclude that power is shared. Such a determination generally includes a qualitative analysis and will depend on the specific facts and circumstances.

Contingencies

Speakers	Topic Covered
• Wayne Carnall, Chief Accountant, SEC's Division of Corporation Finance • Angela Crane, Associate Chief Accountant, SEC's Division of Corporation Finance • Stephanie Hunsaker, Associate Chief Accountant, SEC's Division of Corporation Finance	• Loss contingencies

Loss Contingencies

Representatives from the SEC's Division of Corporation Finance discussed comments and observations related to registrants' disclosures about loss contingencies. The SEC staff observed that Regulation S-K, Item 103, and ASC 450 have different requirements and objectives and therefore should be approached separately to ensure compliance. Further, registrants should focus on the quality of their disclosures rather than "a large volume of pages." The staff noted the following regarding registrants' disclosures about loss contingencies:

- Frequently, disclosures do not explain the implications of the loss contingency for the registrant.
- Comments have focused on ensuring that disclosures about loss contingencies are (1) robust, (2) timely, and (3) consistent, regardless of the form of disclosure (e.g., legal proceedings, risk factors, MD&A, financial statement footnote disclosure, press releases, earnings calls).

- The staff has also commented on the lack of disclosures concerning reasonably possible losses. Registrants should disclose the amount (or range) of loss in excess of the amount currently recognized or a statement that such an estimate cannot be made.

The SEC staff expects management to carefully review the registrant's disclosures in each period and update them for changes in facts and circumstances. Such changes could result, for example, in accrual of a loss that is now probable, new disclosures regarding a reasonably possible loss that could not be estimated in previous periods, or revised disclosures about an estimated loss. As a loss contingency nears resolution, the staff would expect disclosures to include more quantitative information. Further, when a material settlement is disclosed during the period, the staff may review prior-period disclosures to determine whether these disclosures were appropriate.

Editor's Note: The staff clarified that it has no preconceived notion regarding the time that can elapse between first disclosure of a litigation contingency and completion of the quantification of the loss or range of loss.

The SEC staff will also challenge registrants that do not disclose the loss or range of loss because it cannot be estimated with "precision and confidence." That is, the staff expects registrants to go through the process and attempt to estimate the loss or range of loss before concluding that it cannot be estimated. Mr. Carnall remarked that management needs to "take back the financial statements" from the lawyers with respect to litigation disclosures.

Finally, the staff indicated that separate disclosure was not needed for each asserted claim; rather, asserted claims can be aggregated in a logical manner as long as the disclosure complies with ASC 450.

Editor's Note: See Deloitte's *SEC Comment Letters — Including Industry Insights: A Snapshot of Current Themes* for more information about loss contingencies, including extracts from SEC staff comments, Deloitte's analysis, and links to related resources.

Dodd-Frank and Other Rulemaking Activities

Speakers	Topics Covered
• Meredith Cross, Director, SEC's Division of Corporation Finance • Kevin Edgar, Senior Counsel, House Financial Services Committee • Linda Griggs, Partner, Morgan, Lewis & Bockius LLP • Stephanie Hunsaker, Associate Chief Accountant, SEC's Division of Corporation Finance • Mark Peterson, Vice President, Congressional and Political Affairs, AICPA • Dean Shahinian, Senior Counsel and Chief Securities Policy Advisor, Senate Banking, Housing and Urban Affairs Committee	• Dodd-Frank rulemaking activities • Other rulemaking activities

Dodd-Frank Rulemaking Activities

Ms. Cross indicated that the Dodd-Frank Act charges the SEC with extensive rulemaking and that the Commission has been busy executing this mandate. However, she emphasized that because different individuals are assigned to Dodd-Frank Act rulemaking, this mandate would not affect the timeliness of the Division of Corporation Finance (the "Division") in reviewing filings.

Ms. Cross cited various recent rule proposals and other efforts the Division has supported, many of which were addressed in more detail in a subsequent legislative panel discussion, as described below. The proposals include (1) "say on pay" and "say on frequency"; (2) unstructured broker votes requiring exchanges to prohibit brokers from voting on say on pay on behalf of their customers; (3) new requirements for compensation committees; (4) provisions related to "pay-to-equity ratio," "pay-to-performance ratio," hedging equity positions, and "clawback"; (5) Regulation D rulemaking related to the net worth calculation in the determination of who is an accredited investor; and (6) additional rule proposals related to asset-backed securities offerings, including one on warranties and representations and another on reviews of assets underlying asset-backed securities.

Editor's Note: Ms. Cross noted that exchanges have already implemented a rule for which uninstructed broker votes on "say on pay" would be prohibited in this upcoming proxy season.

In a panel discussion, Mr. Peterson provided background on the Dodd-Frank Act, stating that it stems from the financial crisis and may be the most sweeping legislation since the Great Depression. He then highlighted its five major provisions and compared it with the Sarbanes-Oxley Act. He indicated that while the Sarbanes-Oxley Act is about 66 pages and calls for 16 rulemakings and six studies, the Dodd-Frank Act is about 2,300 pages and calls for about 355 rulemakings and 70 studies by 10 agencies. Panelists then discussed a few of the major rulemakings and studies to date. Those of most interest to financial statement preparers are summarized below.

Editor's Note: For more information about the Dodd-Frank Act, see Deloitte's August 12, 2010, *Heads Up*.

Permanent Exemption From, and Studies Related to, Section 404(b) of the Sarbanes-Oxley Act

Section 989G of the Dodd-Frank Act added Section 404(c) of the Sarbanes-Oxley Act, which creates an exemption for nonaccelerated filers from the auditor attestation provisions of Section 404(b) of the Sarbanes-Oxley Act. In September 2010, the SEC finalized a rule permanently exempting nonaccelerated filers from Section 404(b); however, Section 404(a) was retained, which requires management annually to assess and report on the effectiveness of its internal controls over financial reporting.

Mr. Shahinian talked about a study mandated by the Dodd-Frank Act on compliance costs related to Section 404(b) for companies whose market capitalization is between $75 million and $250 million; comments on this study were due by December 6, 2010. He further stated that Section 989I of the Dodd-Frank Act also requires the GAO to conduct a follow-up study on the impact of the permanent exemption from Section 404(b). The GAO study will examine matters such as the frequency of accounting misstatements and investor confidence in the integrity of financial statements. The panelists then indicated that regulators' analysis of information from the completed studies could potentially lead them to further expand the exemption beyond nonaccelerated filers.

Executive Compensation Reforms

On October 18, 2010, the SEC issued for comment a proposed rule on "say-on-pay" and "say-on-frequency" provisions under Section 951 of the Dodd-Frank Act. The rule would require companies to conduct separate shareholder advisory votes to approve the compensation of executives and to determine how often such advisory votes would occur.

Ms. Griggs reminded registrants that regardless of whether the SEC has finalized the proposed rule, shareholder resolutions for the say-on-pay and say-on-frequency votes need to be included in a public company's proxy solicitation materials for its first annual shareholders' meeting occurring on or after January 21, 2011. While the resolutions are not binding, she cautioned that compensation committee members would be ill-advised to disregard them. She encouraged registrants to actively canvass shareholders to initiate the dialogue on compensation practices.

One potentially contentious provision discussed by Mr. Edgar and Mr. Shahinian is the requirement to disclose the ratio of CEO total compensation to the employee median total compensation in a registrant's annual proxy statements. The panelists indicated that, as currently worded, the provision would be extremely difficult to implement and that more guidance, and possibly technical correction legislation, would be needed to address implementation issues such as how to determine the elements of employee compensation and how to identify the population of employees that should be included in the calculation (e.g., full time vs. part time, global vs. domestic only). In addition, Ms. Griggs noted that the "clawback" provision for the recovery of erroneously awarded compensation, as worded in the Dodd-Frank Act, would need clarification. In particular, she expressed concerns about the difficulty of determining the amount of a "clawback" for equity awards (i.e., estimating the impact of restatements on a company's stock price).

Independence of Compensation Committee and Advisers

Ms. Griggs noted that the Dodd-Frank Act not only addresses the independence of compensation committees but also extends the independence requirements to compensation consultants and other advisers. She observed that it is currently unclear how independence for compensation committees will be defined and whether it will be consistent with independence requirements for audit committees, for example. Similarly, regarding independence requirements for compensation consultants, Ms. Griggs stated that it was not clear how these new rules would affect existing practice in light of the requirements established by the proxy disclosure enhancements rule finalized in December 2009. She

also indicated that it was unclear how independence for legal counsel and other advisers would be defined. In addition to containing independence considerations, these Dodd-Frank Act provisions require companies to include enhanced disclosures in proxy statements about services provided by compensation consultants, the associated fees, and any conflicts of interest.

Whistleblower Protection and Incentives

The Dodd-Frank Act also established a whistleblower program requiring the SEC to pay an award to individuals who voluntarily provide the Commission with original information about a violation of the federal securities laws that leads to successful enforcement or other related action. Panelists discussed the background of the provision, noting that it was enacted to incentivize individuals to report whistleblower information directly to the SEC by providing rewards for information that results in judgments in excess of $1 million. It was noted that the threshold is set at this level to discourage the reporting of "trivial matters."

Panelists remarked that the provision may create conflict between the new whistleblower enhancements and existing corporate compliance programs (i.e., it may create the incentive for an employee to report a matter directly to the SEC instead of first reporting it internally). In answering a question on this topic, Ms. Griggs pointed out that the SEC tried to balance the tension between Congress's goal of providing incentives to whistleblowers and the goals of corporate America to maintain effective compliance systems. She stated that the 90-day grace period within which a whistleblower may supply information to the SEC after first presenting it internally was a key example of trying to achieve that balance. However, she also acknowledged that the grace period may not give corporate compliance systems sufficient time to complete internal investigations. Ms. Griggs noted that the comment period for the SEC's proposed rule on this provision ends on December 17, 2010, and encouraged both registrants and audit practitioners to comment on it.

Specialized Disclosures

Ms. Cross also discussed the staff's efforts related to some of the specialized disclosures called for by the Dodd-Frank Act, namely, conflict minerals, coal and other mine safety issues, and payments by resource extraction issuers to the United States and foreign governments. Ms. Cross noted that the mine safety provision requiring specific disclosures about mine safety violations was self-operative; it became effective upon enactment of the Act. She further stated that because the Act requires the SEC to issue final rules on conflict minerals and resource extraction by mid-April, she expects the SEC to publish proposals soon.

Editor's Note: On December 15, 2010, to implement the requirements of Section 1502 of the Dodd-Frank Act, the SEC voted to propose new rules related to the disclosure of conflict minerals as well as disclosure of mine safety information and payments to governments related to extracting oil, natural gas, or minerals.

Other Rulemaking Activities

Ms. Hunsaker discussed the SEC's (1) proposed rule on disclosures about short-term borrowings and (2) companion release on presentation of liquidity and capital resources disclosures in MD&A. She stated that the goals of the proposed rules are "to increase transparency in the presentation of a registrant's short-term borrowing and funding activities, and exposure to liquidity risks in the range of their activities."

Editor's Note: Ms. Hunsaker discussed in detail the various aspects of the proposed rule and companion release. For more information on the proposed rule and companion release, see Deloitte's September 24, 2010, *Heads Up*.

Ms. Hunsaker stressed that the proposed rules apply to both financial and nonfinancial companies, although financial companies would calculate some of the quantitative disclosures differently than nonfinancial companies. As an example of one of the differences, she cited the requirement to disclose the maximum amount outstanding during the period. Financial companies would base this disclosure on the maximum closing amount outstanding on any day during the period, while nonfinancial companies would base it on the maximum month-end outstanding balance.

The highlight of her remarks was the acknowledgment that the final rule will not be effective for this year-end reporting season. However, the goal is to have the new disclosures in place for the first calendar quarter of 2011.

Editor's Note: Registrants should consider the staff's interpretive release on disclosure of short-term borrowings, which is already effective.

Financial Instruments

Speaker	Topic Covered
• Todd Hardiman, Associate Chief Accountant, SEC's Division of Corporation Finance	• Determining whether an instrument (or embedded feature) is indexed to an entity's own stock

Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity's Own Stock

ASC 815-40 (formerly EITF Issue 07-5) provides guidance on determining whether an equity-linked instrument (or embedded feature) is indexed to an entity's own stock, which is an important step in the evaluation of whether the equity-linked instrument (or embedded feature) will be accounted for as a derivative. Mr. Hardiman discussed the SEC staff's increased focus on a registrant's application of ASC 815-40, noting that primarily small and medium-sized registrants seem to have failed to apply the guidance in Issue 07-5, which was effective for fiscal years beginning after December 15, 2008. He observed that some of these registrants have failed to assess an instrument's settlement provisions in determining whether the embedded feature is indexed to an entity's own stock. Further, he gave two examples of instruments to which the guidance has generally been misapplied: stock purchase warrants and debt instruments with embedded conversion options. Mr. Hardiman noted that in the assessment of a stock purchase warrant's settlement provisions under ASC 815-40, both the exercise price and the number of shares must be fixed (i.e., they cannot be adjusted or changed, unless the only variables that could affect the settlement amount are inputs to the fair value of a fixed-for-fixed forward or option on equity shares) for the instrument to be considered indexed to an entity's own stock.

Mr. Hardiman also discussed valuation and disclosure issues that the SEC staff has encountered with respect to equity-linked instruments. He pointed out that although a considerable number of registrants use the Black-Scholes-Merton option pricing model to value instruments whose inputs related to exercise price and number of shares are subject to change, a registrant should instead use a binomial model or Monte Carlo simulation when valuing such an instrument.

Lastly, Mr. Hardiman stressed the need for improved disclosures about provisions of an instrument that may trigger an adjustment to the exercise price or the number of shares (e.g., down-round provisions). He emphasized that the SEC may challenge generic disclosure such as "the instrument contains standard antidilution provisions." Further, he advised registrants that proper application of the requirements of ASC 815-40 requires careful evaluation and identification of any provisions that cause the exercise price or the number of shares to change.

Editor's Note: For more information about the application of Issue 07-5 (codified in ASC 815-40), see Deloitte's December 5, 2008, *Heads Up*.

Foreign Currency Matters

Speakers	Topic Covered
• Wayne Carnall, Chief Accountant, SEC's Division of Corporation Finance • Craig Olinger, Deputy Chief Accountant, SEC's Division of Corporation Finance	• Disclosures of foreign operations

Disclosures of Foreign Operations

During a panel session, Mr. Olinger addressed MD&A disclosure considerations for registrants with foreign operations in countries or geographic areas that may be affected by recent poor economic conditions. He noted that many registrants have foreign operations throughout the world that may be subject to material risks and uncertainties, such as political risks, currency risks, and business climate and taxation risks. Further, he stated that the effects of an adverse event related to these risks on a registrant's consolidated operations may be disproportionate to the relative size of the registrant's foreign operations. Therefore, in its MD&A, a registrant may need to discuss trends, risks, and uncertainties related to its operations in individual countries or geographic areas and possibly supplement such disclosure with disaggregated financial information about those operations.

Mr. Olinger used the example of the recent economic turmoil in Venezuela to highlight the types of MD&A disclosures a registrant should consider providing to investors to describe the effects of adverse events on an entity's foreign operations. He emphasized that his list of disclosures should not be considered all-inclusive. Also, in a related question-and-answer session, he clarified that the suggested disclosures could apply to all of a registrant's foreign operations, not just those located in Venezuela. The suggested disclosures include the following:

- Information about the business and financial risks of the foreign operations:
  - The impact of price controls on business operations.
  - Recent or expected changes in business practices to address prevailing conditions in the environment.
  - The impact of exchange rates and the related restrictions on the registrant's ability to repatriate funds (to the United States).
- Information about the broad financial statement impact of the foreign operations:
  - Amounts of monetary assets and liabilities by denomination of the currency (e.g., the local currency vs. U.S. dollar).
  - Disaggregated balance sheet, income statement, and cash flow information for the registrant's foreign operations.
  - The reasonably likely effects of known trends and uncertainties related to the registrant's foreign operations.

Editor's Note: In separate, ensuing question-and-answer sessions, Mr. Olinger and Mr. Carnall reemphasized many of the themes in Mr. Olinger's original remarks. Mr. Olinger reiterated the importance of a registrant's providing robust MD&A disclosures when its exposures in foreign operations could disproportionately affect consolidated operations.

Mr. Carnall also noted that a registrant's assessment of whether it needs to provide disaggregated financial information about its foreign operations in its MD&A must take into account more than just the percentage of consolidated revenues contributed by the foreign operation. The registrant also should consider how the foreign operations might affect the consolidated entity's liquidity. For example, a foreign operation that holds significant liquid assets may have an exposure to exchange rate fluctuations that could affect the registrant's liquidity. Mr. Carnall also stated that registrants with foreign operations in Venezuela (and potentially other countries) should continue to provide robust disclosures and that the sufficiency of such disclosures may be an area of focus in future SEC staff reviews.

Goodwill

Speaker	Topic Covered
• Sagar Teotia, Professional Accounting Fellow, SEC's Office of the Chief Accountant	• Allocating goodwill in a disposal involving a franchising agreement

Allocating Goodwill in a Disposal Involving a Franchising Agreement

Mr. Teotia discussed the effect of a franchising arrangement on the allocation of goodwill in a disposition of a portion of a reporting unit. Specifically, he commented on whether the fair value of the franchising agreement should be included in the value of the business disposed of, or the value of the business retained, in the determination of how much goodwill should be allocated to the carrying value. He stated that the SEC staff would not object to a registrant's including the fair value of the franchising arrangement as part of the value of the business retained when performing its relative fair value calculation; however, registrants should consider their specific facts and circumstances when performing their analysis.

IFRSs and the SEC's Work Plan

Speakers	Topics Covered
• Paul Beswick, Deputy Chief Accountant, SEC's Office of the Chief Accountant • Wayne Carnall, Chief Accountant, SEC's Division of Corporation Finance • Jill Davis, Associate Chief Accountant, SEC's Division of Corporation Finance • James Kroeker, Chief Accountant, SEC's Office of the Chief Accountant • Craig Olinger, Deputy Chief Accountant, SEC's Division of Corporation Finance • Mary Schapiro, Chairman, SEC	• International convergence • SEC work plan on adoption of IFRSs • IFRS work plan — efforts by the Division of Corporation Finance • Areas of consideration for IFRS preparers • Top 10 areas of SEC staff comment on IFRSs

International Convergence

Ms. Schapiro acknowledged that an increasingly complex and global financial market has presented challenges to the SEC and to the accounting profession. In discussing the effect of the globalization of capital markets on the auditing profession, she applauded the European Union's recent decision "that allows the PCAOB to negotiate agreements with individual countries that will permit the PCAOB to perform its oversight role." She also indicated that the SEC is "in the final stages" of selecting a new chair and two new board members for the PCAOB.

Ms. Schapiro recognized the progress made by the FASB and the IASB in converging international accounting standards but conceded that "the path towards convergence has proved steep and winding at times." She stated that "[c]onvergence [of accounting standards] is a top priority for the SEC" but cautioned that the converged standards must be "high-quality improvements over current standards."

Editor's Note: In response to questions about the SEC's work plan on the consideration of the use of IFRSs by entities in the United States, Ms. Schapiro indicated that (1) the SEC is still on track to make a final decision in 2011 on the use of IFRSs by U.S. issuers (although the SEC does not feel bound to a June 2011 decision deadline), (2) a minimum four-year implementation period is "likely" but a decision about that is still "a specific decision point for the Commission," and (3) the rule-making burden resulting from the Dodd-Frank Act should have a minimal effect on the work plan because a majority of that burden is carried by the SEC's Division of Trading and Markets, not the Office of the Chief Accountant. For additional information on the SEC's work plan, see Deloitte's November 1, 2010, *Heads Up*.

Mr. Kroeker commented on the FASB's and IASB's considerable progress on convergence, especially their joint issuance of exposure drafts on lease accounting and revenue recognition. He stated that those standards are "a model for how convergence can and should be approached."

Mr. Kroeker went on to say that he strongly hoped that "every effort [would] continue to be made to seek converged approaches. Doing so would go a long way toward facilitating the consideration of incorporating IFRS for U.S. companies and whether U.S. investors and our capital markets would be well-served as a result." He also made it clear that the "resulting product of the convergence efforts must be standards that are improved, comprehensive and sustainable solutions."

In concluding his remarks on convergence, Mr. Kroeker stated that the SEC is "working aggressively to pursue the broad goal of a single set of high quality standards, to do so in a way that protects U.S. investors and our capital markets, and to consider approaches to achieving both of those goals in ways that are as cost effective as possible."

For a discussion of convergence of international inspections, see the Audit Standard Setting and Other PCAOB Activities topic.

SEC Work Plan on Adoption of IFRSs

Mr. Beswick gave an update on the SEC's work plan for considering the incorporation of IFRSs into the U.S. financial reporting system. While the SEC has not reached a final conclusion on whether, how, or when this incorporation should take place, Mr. Beswick outlined one possible method, which he referred to as the "condorsement approach" (a merging of the terms convergence and endorsement). Under this approach:

- U.S. GAAP would continue to exist.
- The FASB and IASB would complete the projects that are currently part of their MoU.
- The FASB would not start any new major projects; rather, the Board would work for a certain period on converging existing U.S. GAAP with IFRSs that are not on the IASB's agenda. Differences between U.S. GAAP and IFRSs would be eliminated on a standard-by-standard basis to ensure that the resulting guidance is suitable for the U.S. capital markets.
- Going forward, the FASB would consider incorporating new IASB standards into U.S. GAAP without modification, provided that such standards are in the best interest of the U.S. capital markets.

Mr. Beswick indicated his belief that this approach is a reasonable alternative because it focuses on ensuring high-quality standards before their incorporation. He also questioned whether retrospective application of IFRSs was necessary and added that the SEC needs to carefully consider whether the costs of a "big bang" adoption approach outweigh the benefits. In later remarks, Mr. Kroeker agreed that the "condorsement approach" could be a reasonable method of incorporating IFRSs into the U.S. financial reporting system but noted that the SEC would retain regulatory oversight in any event.

Finally, Mr. Beswick noted that the FASB and IASB need to ensure that they focus on the quality of standards rather than on issuing them by a specific deadline.

IFRS Work Plan — Efforts by the Division of Corporation Finance

Mr. Carnall explained that one of the objectives the staff is trying to achieve under the IFRS work plan is to evaluate comparability of financial statements for all users of IFRSs. The SEC staff is assessing how the application of IFRSs in practice affects the comparability of financial statements across jurisdictions by country and by industry. Ms. Davis explained that as part of its evaluation, the Division of Corporation Finance (the "Division") is reviewing the financial statements of a significant number of entities, both registrants and nonregistrants. The staff selected the largest companies in the world that use IFRSs as represented by the Global Fortune 500 and included companies from more than 20 different jurisdictions and more than 30 industries.

Mr. Olinger reiterated that the staff is trying to understand how companies have applied IFRSs in practice. In conducting these reviews, the staff has analyzed compliance with accounting and disclosure policies and practices and choices made when companies adopt such policies. For example, the staff has evaluated policy choices among alternatives that are permitted under IFRSs, policy choices required when IFRSs rely on the application of management judgment, and policy choices required when there is no specific guidance under IFRSs. Most importantly, the staff has focused on the circumstances in which companies look to national standards or to other guidance and evaluated how those choices affect the comparability of IFRS financial statements among jurisdictions and industries.

Editor's Note: In a separate question-and-answer session, Mr. Olinger indicated that the results of the reviews described above are expected to be part of a public report. Additional details are yet to be determined.

Areas of Consideration for IFRS Preparers

Mr. Olinger indicated that the staff is frequently asked whether it uses U.S. GAAP to evaluate IFRS accounting issues. Ms. Davis noted that the staff only looks to IFRSs, not U.S. GAAP, to apply IFRSs. Because some view IFRSs as more challenging to apply, companies often look to other GAAP, including U.S. GAAP, to assist them with application. Ms. Davis cautioned that companies should not "analogize blindly," and that while sometimes it may be acceptable to do so, companies should remain cognizant of differences in application under each accounting model.

Mr. Olinger and Ms. Davis discussed areas in which significant judgment is allowed under IFRSs (e.g., financial statement presentation) as well as areas that are not addressed under IFRSs (e.g., insurance contracts). Ms. Davis indicated that because practice can be diverse in these circumstances, management should ensure that its accounting policy disclosures clearly explain the policies that have been elected and applied. In addition, Ms. Davis indicated that when accounting is not addressed under IFRSs, registrants should ensure that MD&A and the footnotes clearly explain "how the accounting policies selected reliably reflect the economic substance of the transaction as well as the effects of the policy on the IFRS financial statements."

Top 10 Areas of SEC Staff Comment on IFRSs

Ms. Davis, with the assistance of other members of the SEC staff, shared the following top 10 comment areas the SEC staff most frequently addresses in its reviews related to IFRSs.

Editor's Note: In a separate question-and-answer session, Mr. Olinger clarified that the top 10 comment areas are based on reviews performed by the Division's SEC staff in the ordinary course of business.

1. Financial Instruments

The SEC often seeks clarification and additional disclosure about the methods and market data registrants used to determine fair value, the criteria they used to determine whether financial instruments are impaired, the methods and assumptions they used in preparing related sensitivity analyses, and the criteria they applied when a financial instrument was derecognized.

2. Impairment of Assets

The SEC encourages expanded disclosure to clarify how cash generating units (CGUs) are determined, how management determined the level of goodwill allocation, and the key assumptions used to determine "value in use." The staff will also request disclosures about goodwill impairment testing and whether the CGU's recoverable amount is close to its book value. If an impairment has been recorded, the SEC will request disclosure of the events and circumstances that led to such impairment.

3. Financial Statement Presentation

The SEC asks registrants to clarify the reasons why certain revenue and expense items are excluded from measures of profit or loss on the income statement. Also, it inquires about the nature of expenses classified in each income statement line when an entity reports expenses by function. The SEC staff also asks about the classification of operating, investing, and financing activities on the statements of cash flows and the nature of financial assets included in cash equivalents.

4. Operating Segments

The SEC staff issues comments to obtain a better understanding of the factors used to determine operating segments and to improve the related disclosures. It also often asks whether operating segments have been aggregated if the disclosures are not clear. In addition, it will remind registrants to provide the entity-wide disclosures that are required (e.g., products and services, geographic areas, and major customers).

5. Revenue

Comments in this area often focus on clarity of disclosures because registrants often recite the IAS 18 revenue recognition criteria but do not explain how they have applied the criteria to their revenue transactions. For example, for multiple-element arrangements, the SEC asks for disclosure to explain when and how revenues are recognized and when and how related expenses, such as warranty expenses, are also recognized.

6. Income Taxes

The SEC staff requests entities to provide disclosure of deferred tax assets (DTAs) that have not been recognized and of whether the DTAs are reevaluated at each year-end. Also, the staff asks registrants to clarify the source of tax rates used and disclose when tax loss carryforwards will expire. The SEC has asked registrants to modify captions used in the rate reconciliation footnote disclosure to give users better understanding of the underlying components.

7. Property, Plant, and Equipment

The SEC staff asks registrants to disclose the depreciation methods used and the useful lives for each class of property, plant, and equipment. The staff also requires clarification of whether the reviews of residual values, useful lives, and depreciation methods used are performed as of each balance sheet date.

8. Employee Benefit Plans

SEC staff comments focus on clarification of the frequency of actuarial reviews and the source of discount rates used. The staff has also asked for clarification of a registrant's accounting policy for curtailments and settlements.

9. Provisions and Contingent Liabilities

Registrants receive comments about "boilerplate" accounting policy disclosures that do not provide insight into the nature of the obligation or uncertainty of the amount or timing of the expected payments. Also, registrants have been asked to disclose reversals of provisions as well as the impact of discounting.

10. Consolidated Financial Statements

The SEC staff frequently asks why conclusions about control are not consistent with voting power held (e.g., when a company has more than 50 percent voting power but has concluded that it does not control the entity). Also, the SEC staff will request entities to disclose the nature and extent of significant restrictions on the ability of subsidiaries to transfer funds to the parent.

Ms. Davis indicated that the items in this list are very similar to those the SEC staff focuses on when it reviews financial statements prepared under U.S. GAAP. The nature of the comments raised by the staff is a reflection of the economics of the underlying transactions and the issues the registrants face in the daily operations of their business and not necessarily the accounting principles that are applied.

Income Tax Disclosure Matters

Speaker	Topic Covered
• Jill Davis, Associate Chief Accountant, SEC's Division of Corporation Finance	• Division of Corporation Finance developments — income taxes

Division of Corporation Finance Developments — Income Taxes

Ms. Davis noted that while most income-tax-related disclosure requirements are included in ASC 740, Regulation S-X, Rule 4-08(h), contains additional disclosure requirements. One of the requirements in Rule 4-08(h) is to disclose "the components of income (loss) before income tax expense (benefit) as either domestic or foreign." Ms. Davis indicated that some registrants' disclosures about these components have been limited in circumstances in which the registrants had a very low income tax expense because a substantial amount of profits were derived from countries with little or no tax. She explained that the disclosures provided should allow an investor to easily determine the effective tax rate for net income attributable to domestic operations and foreign operations and stated that the lack of such disclosure may result in SEC staff comments.

Ms. Davis noted that another topic the staff has commented on in relation to domestic and foreign taxes is the income tax rate reconciliation disclosure requirement in ASC 740-10-50-11 and 50-12. She observed that registrants sometimes disclose that a large number in the tax rate reconciliation is attributable to the differences in tax rates between a U.S. and a foreign jurisdiction when, in fact, the number might be attributable to other differences. In addition, Ms. Davis reminded registrants of the requirement in Regulation S-X, Rule 4-08(h), to disclose each reconciling item that exceeds 5 percent of the income tax expense at the statutory federal income tax rate. She also encouraged registrants to consider including additional discussion of items that may significantly affect the tax rate reconciliation and cited potential tax rate changes in Ireland as an example. However, she cautioned that registrants need to evaluate their tax-related issues carefully to determine whether they are in compliance with the requirement.

Ms. Davis specifically discussed a reconciling item associated with undistributed earnings of foreign subsidiaries for which deferred taxes have not been recognized. She pointed out that if a registrant asserts that the earnings of a foreign subsidiary are permanently reinvested in the subsidiary and will not be repatriated to the home country, the foreign earnings will not be subject to income tax and a rate reconciliation item will therefore result. The registrant should consider discussing in its MD&A the assertion and its effect on the company's liquidity. Ms. Davis gave an example in which a registrant appears to have sufficient cash and short-term investments to satisfy its debt obligation that may be due on the basis of the amounts reported on its consolidated balance sheet. However, if a significant portion of the cash and short-term investments are in a foreign subsidiary for which deferred taxes have not been recognized because of the assertion that the subsidiary's earnings are reinvested indefinitely, the company should provide a discussion in MD&A to inform investors that if the entity were to repatriate the cash or short-term investments to satisfy the company's debt obligation, a significant tax liability may result.

Editor's Note: For more information about the SEC staff's comments on income tax disclosure, see the "Income Taxes and Uncertain Tax Positions" section of Deloitte's *SEC Comment Letters — Including Industry Insights: A Snapshot of Current Themes*. For further discussion of incremental SEC disclosure requirements related to income tax expense and the income tax rate reconciliation, see Rule 4-08(h).

Independence of the Standard-Setting Process

Speaker	Topics Covered
• Nilima Shah, Associate Chief Accountant, SEC's Office of the Chief Accountant	• Standard-setting process • Letter and spirit of accounting requirements

Standard-Setting Process

Ms. Shah opened by explaining that one of the primary roles of the Office of the Chief Accountant is to oversee the accounting standard-setting process. She noted that this role includes monitoring the FASB to verify that it is operating in the best interest of the public; ensuring that the results of the FASB's standard-setting process are credible, independent, and unbiased; and checking that "each standard adopted . . . is within an acceptable range of alternatives that serve the public interest and benefit investors."

Letter and Spirit of Accounting Requirements

Ms. Shah suggested that constituents take a more meaningful role in the financial reporting process by complying with the "letter and spirit" of existing guidance. To clarify, she remarked that, while entities must adhere to explicit requirements (the "letter") in GAAP, they could better consider the spirit of financial reporting when GAAP standards contain only minimal requirements or do not address certain topics. Ms. Shah pointed out that the purpose of an entity's compliance with the spirit of the guidance is "to provide financial information about a reporting entity that's useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources to the entity." She further noted that "improved compliance with and enforcement of both the letter and the spirit of accounting requirements would help the FASB and IASB more effectively pursue their mission and focus their efforts" and could lessen the need for detailed standard setting.

To illustrate the need for better compliance with the letter of accounting requirements, Ms. Shah suggested that lack of compliance with existing standards may be more responsible for inadequate loss contingency disclosures rather than a lack of sufficient guidance. She noted that the FASB has recently decided to defer further deliberation of its project on loss contingency disclosures on the basis of feedback the Board received from comment letters indicating that improved compliance with existing guidance in ASC 450 may "better meet user needs."

As an example of the need to comply with the spirit of accounting requirements, Ms. Shah cited the amendment of the pension and other postretirement benefit disclosure requirements in Statement 132 via the issuance of Statement 132(R) and FSP FAS 132(R)-1. Her point related to the minimum requirements that certain standards contain, which in spirit, should not be seen as prescriptive or all-inclusive. Specifically, Statement 132(R) amended Statement 132 to require certain disclosures for a minimum of three pension plan asset categories and an "other" category. Statement 132(R) also encouraged entities to disclose additional categories when such disclosure would be useful. However, the Board found that (1) entities were not disclosing information beyond these minimum categories, (2) disclosures were not providing users with sufficient information, and (3) the "other" classification had significantly increased as a percentage of total plan assets. In response to these concerns, the Board issued FSP FAS 132(R)-1, which improved the required disclosures by (1) providing a disclosure principle and examples of categories and (2) eliminating the minimum listing requirements (this is similar to what the IASB is currently considering for IAS 19). Overall, Ms. Shah questioned whether the FASB's amendments would have been needed if compliance with the spirit of the original standard had been better.

Ms. Shah cited the use of IFRSs by foreign private issuers as an additional example illustrating the importance of following the spirit of a standard. For example, she noted that views differ on whether IFRSs permit push-down accounting and on how entities should account for combinations under common control under IFRSs. Ms. Shah suggested that in cases in which multiple interpretations of IFRSs are possible, including disclosures that are not explicitly required may help improve the comparability of financial statements. She did, however, emphasize that, in the absence of guidance in IFRSs, compliance with the spirit of financial reporting does not necessarily mean compliance with U.S. GAAP (i.e., in such circumstances, it is not the SEC's objective to force entities to comply with U.S. GAAP).

In closing, Ms. Shah noted that disclosure should be viewed "as a communication rather than a check-the-box exercise." The onus for improved disclosures is not only on the preparers to achieve the spirit of the framework but also on auditors and regulators to seek proper disclosure to facilitate users' understanding of material events reflected in the financial statements and the related uncertainties. Ms. Shah was concerned that unless a change is made in this respect, we will continue to see prescriptive guidance that contains long lists of required minimum disclosures that cannot adequately address all situations an entity may encounter. Such guidance can lead entities to provide too much disclosure (disclosure of information that is not useful to users or investors) or not to disclose useful information (since the relevant disclosure may not be included in the required list).

Interactive Data

Speakers	Topic Covered
• Tony Mealy, Senior Accountant, SEC's Office of Interactive Disclosure • Susan Yount, Senior Accountant, SEC's Office of Interactive Disclosure	• eXtensible Business Reporting Language (XBRL)

eXtensible Business Reporting Language (XBRL)

Mr. Mealy noted that under the SEC's rules, three groups are required to submit data to the SEC in XBRL format: (1) registrants that have been phased-in under the SEC's rules (and are required to submit XBRL-tagged financial reports and schedules ("interactive data") as an exhibit to certain filings), (2) certain credit rating agencies, and (3) mutual funds (beginning in 2011). The submission requirements for registrants are phased in over a three-year period that began in 2009. Most registrants will be phased in under the rules by the end of 2011. Mr. Mealy further indicated that the SEC staff has been using data collected from these groups to assess compliance with its interactive data rules and for various data analysis efforts among the Commission's divisions. In addition, he summarized best practices for the first-time filing of interactive data and provided an overview of the staff observations posted to the SEC's Web site in November 2010. The staff observations are based on a review of interactive data file submissions from June to August 2010 and cover approximately 1,500 filers, 5,000 related filings, and over 4 million interactive data points.

Mr. Mealy cautioned registrants not to wait until the last minute to prepare their XBRL submissions. He noted that each submission is subjected to numerous automated validation checks and that registrants should allow sufficient time to address issues identified by that validation. He noted that an effective strategy for first-time interactive data filers is to treat the initial XBRL submission like any other major project. Setting a timeline, involving the right people during the process (especially the board of directors and senior management), and using the test submission process on the SEC's Web site were all identified as best practices for a successful adoption. Although the SEC staff noted that the interactive data exhibits submitted by registrants were generally of high quality, Mr. Mealy indicated that the three primary areas of diversity or incorrect usage identified in the staff's observations were (1) negative values, (2) extending elements, and (3) axis and member use. He also suggested that filers use as a resource the SEC's Staff Interpretations and FAQs Related to Interactive Data Disclosure in addition to the posted staff observations.

Editor's Note: The SEC rules also phase in a requirement for registrants to tag the notes to their financial statements and financial statement schedules in greater detail, typically in the second year of adoption (although this may not apply to registrants that change phase-in groups). Complying with these additional detailed tagging requirements will require substantial additional effort. A registrant should also consider treating the preparation of its first detail-tagged interactive data file as a distinct "major project" and follow a process similar to that used for its first interactive data filing.

Ms. Yount outlined the 2011 taxonomy update that is expected to be released in early 2011 and that will be required for filings on or after July 15, 2011. The majority of the elements from the 2009 taxonomy will not change. However, the 2011 taxonomy will incorporate changes that (1) update the elements to add FASB codification references, (2) clarify certain element definitions and standard labels, (3) align its structure with current disclosure practices, (4) update it for new accounting guidance added to the Codification, and (5) add common extensions used by filers. New elements will be clearly labeled and deleted or superseded elements (referred to as "deprecated elements") will be similarly identified. These deprecated elements should no longer be used in future interactive data files. Ms. Yount encouraged filers to obtain the current draft of the 2011 taxonomy update from the FASB's Web site and to monitor it for the final release in 2011.

Editor's Note: Additional considerations and information about interactive data and phase-in requirements can be found in Deloitte's *SEC Comment Letters — Including Industry Insights: A Snapshot of Current Themes* and on the SEC's Web site.

Internal Control Over Financial Reporting

Speakers	Topics Covered
• Martin Baumann, Chief Auditor and Director of Professional Standards, PCAOB • Angela Crane, Associate Chief Accountant, SEC's Division of Corporation Finance • Brian Croteau, Deputy Chief Accountant, SEC's Office of the Chief Accountant • John Offenbacher, Senior Associate Chief Accountant, SEC's Office of the Chief Accountant • Craig Olinger, Deputy Chief Accountant, SEC's Division of Corporation Finance	• Exemption for nonaccelerated filers • Disclosures

Exemption for Nonaccelerated Filers

Mr. Croteau indicated that although nonaccelerated filers have been exempted from the audit requirement of Section 404(b) of the Sarbanes-Oxley Act, management's responsibilities for evaluating and reporting on ICFR under Section 404(a) are unchanged. He also emphasized that in carrying out its responsibilities, management needs to update its approach to evaluating internal controls each year, particularly in a way that keeps up with emerging financial reporting risks. Mr. Croteau clarified that the evaluation should not start with the same list of controls and consist merely of performing rollforward testing of operating effectiveness of those controls. He indicated that the evaluation should instead also take into account new controls and "whether the design of controls has kept up with economic or business conditions or changes in financial reporting requirements."

Disclosures

In observing that disclosures of material weaknesses should be a "leading indicator" of potential financial reporting problems, Mr. Baumann indicated that "[m]aterial weaknesses seem to be reported, generally, only in connection with a restatement — where the material weakness is often obvious." He further stated that in "many cases a material weakness likely existed before the restatement as well, but unfortunately the ICFR audits are often not identifying them."

In discussing material weaknesses and restatements, Mr. Olinger reiterated that the existence of a material weakness is not restricted to situations in which a restatement occurs but rather depends only on the reasonable possibility of a material misstatement. In addition, he confirmed that most material weaknesses result in ineffective disclosure controls and procedures because most material weaknesses affect financial disclosures and are, therefore, likely indicators of ineffective disclosure controls and processes.

Ms. Crane commented that the SEC staff expects to see more disclosures about material changes in ICFR, especially in light of actions taken by registrants to respond to the current economic environment, such as workforce reductions and other changes to improve efficiencies, which would most likely result in changes to ICFR. She added that the staff frequently comments when management concludes that ICFR is ineffective because of a material weakness and, in its subsequent annual assessment, reports that ICFR is effective. Ms. Crane noted that often registrants do not disclose a change in ICFR in any of the intervening interim periods. She added that it is important for management to monitor and consider disclosure of the change in the quarter in which management corrects the material weakness. Ms. Crane also reminded registrants that when a material weakness exists, its identification and description should be disclosed.

Editor's Note: In a subsequent question-and-answer session, Ms. Crane elaborated on ICFR considerations related to consolidation of VIEs and management's assessment of its competence and knowledge of U.S. GAAP when a majority of its subsidiaries are outside the United States. Ms. Crane provided information related to a scope exception for VIEs that were in existence before December 15, 2003, but are consolidated as a result of the revised consolidation guidance in ASC 810-10. Ms. Crane indicated that registrants may receive staff comments in this situation because it pertains to when the majority of a registrant's subsidiaries are foreign operations, and she noted that registrants should assess the U.S. GAAP competence and knowledge of those preparing U.S. financial information overseas for ICFR implications.

For additional information, see the "Consolidations and Variable Interest Entities" and "Internal Control Over Financial Reporting" sections of in Deloitte's *SEC Comment Letters — Including Industry Insights: A Snapshot of Current Themes* publication.

Miscellaneous Reporting Topics

Speakers	Topics Covered
• Ian Ball, IFAC CEO, IIRC Working Group Co-Chair • Helle Bank Jorgensen, Sustainability Advisory Leader, PricewaterhouseCoopers LLP • Angela Crane, Associate Chief Accountant, SEC's Division of Corporation Finance • Brian Croteau, Deputy Chief Accountant, SEC's Office of the Chief Accountant • Daniel Goelzer, Acting Chairman, PCAOB • Todd Hardiman, Associate Chief Accountant, SEC's Division of Corporation Finance • Bruce Kahn, Director and Senior Investment Analyst, DB Climate Change Advisors • Robert Khuzami, Director, SEC's Division of Enforcement • Bob Laux, Microsoft Senior Director of Financial Accounting and Reporting, IIRC Working Group Member • Steve Leffin, Corporate Sustainability Manager, UPS • Howard Scheck, Chief Accountant, SEC's Division of Enforcement • Beth Schneider, Director, Deloitte & Touche LLP, AICPA Sustainability Task Force Chair • Sagar Teotia, Professional Accounting Fellow, SEC's Office of the Chief Accountant • Ken Witt, AICPA Technical Manager, AICPA Sustainability Initiative	• Auditor independence • Early extinguishment of debt involving related parties • Enforcement of SEC and PCAOB regulations • Materiality • Segment reporting • Sustainability reporting and assurance

Auditor Independence

Mr. Croteau addressed two specific matters related to auditor independence. First, he observed that private companies that might decide to raise public capital, and their auditors, should be aware that the auditor must be independent for all years included in a registration statement (typically, three years). Since there are differences between the AICPA and SEC independence rules, auditors and management should take into account management's future plans when they consider these requirements. Second, he noted that auditors and management should give appropriate consideration to the prevention of prohibited nonaudit services to affiliates of audit clients, specifically venture capital and private equity firms with upstream affiliates and brother-sister companies that are controlled by the venture capital or private equity firm.

Early Extinguishment of Debt Involving Related Parties

Mr. Teotia discussed whether an extinguishment of debt in nontroubled debt restructurings between related parties should be considered an early extinguishment of debt or a capital contribution from a related party. He added that because the staff does not have bright-line views on the appropriate accounting, registrants should review all facts and circumstances. To evaluate the transaction, a registrant may consider several factors, including (1) the role of the related party, (2) reasons why the related party would accept common stock valued lower than the carrying amount of the debt (if applicable), and (3) whether the substance of the arrangement was a forgiveness of debt owed to a related party.

Enforcement of SEC and PCAOB Regulations

Mr. Khuzami discussed a sampling of the accounting and fraud investigations representing 20 percent of the enforcement cases the SEC filed last year. In demonstrating the commitment of the Division of Corporation Finance to prosecute "wrong-doers" that put their own interests ahead of those of investors, Mr. Khuzami described enforcement actions taken against CEOs, CFOs, CAOs, controllers, audit committee chairs, and auditors. These examples included the improper accounting for exclusivity payments, "cookie-jar" reserves, bill-and-hold arrangements, "sham" reinsurance transactions, as well as cases involving the misappropriation of company funds for personal expenses, deficient audits, insider trading, and FCPA violations. Mr. Khuzami reminded participants about the important roles (e.g., in-house CPA, auditor, forensic accountant) accountants play in the prevention, deterrence, and detection of accounting fraud and investor protection.

Mr. Khuzami further noted that the SEC is still soliciting comments on its proposed rule to implement the whistleblower protection and incentive provision (Section 922) of the Dodd-Frank Act. Given that no comment letters have been received from accountants, he encouraged them to respond before the December 17 deadline.

See the Dodd-Frank and Other Rulemaking Activities topic for additional information on the whistleblower proposal.

Editor's Note: For more information about the specific provisions about the Dodd-Frank Act, see Deloitte's August 12, 2010, *Heads Up*.

Mr. Scheck highlighted his assumption that most SEC practitioners and accountants are honest and hardworking individuals who understand that consistently providing investors with transparent, comparable, high-quality financial information is essential to the public company financial reporting system and the integrity of the financial markets. However, he noted that a minority of "bad apples cook the books" and put actions such as keeping their jobs, getting their bonuses, and selling stock at high prices ahead of investors' interests. He highlighted that accounting frauds:

- Typically start small.
- Are not limited to small registrants.
- Typically involve senior management, such as a CFO or CAO.
- Provide for a motive (allowing for rationalization of the fraud).
- Involve less than robust materiality assessments.
- Include fraudulent intent.

He cautioned that the SEC will investigate and prosecute registrants involved in transactions that are technically accounted for correctly but for which fraudulent intent has been demonstrated. He cautioned participants that those who "play Three-Card Monte" with a public company's financial reporting and disclosure face heightened reputational, regulatory, and legal risk.

He cautioned that when evaluating whether a fraud matter or accounting error is material, registrants should not treat SAB 99's qualitative factors on materiality as an all-inclusive list and that companies should be prepared to support a conclusion that a quantitatively material item is immaterial because in his opinion such a situation would be rare.

He concluded by reminding the audience that investors are the ultimate clients and that auditors should not allow investors to be misled by accounting gimmicks even when there is some business purpose that would allow wrongdoers to rationalize the accounting treatment under GAAP. He warned that accountants and auditors can be charged with aiding and abetting, even when they have not masterminded the fraud, and that the SEC can suspend accountants and auditors from practicing before them.

On the topic of PCAOB enforcement actions, Mr. Goelzer indicated that he does not believe that investors, the general public, or the profession are well-served by nonpublic enforcement proceedings. He noted that during the summer of 2010, the PCAOB asked Congress to amend the Sarbanes-Oxley Act to make PCAOB enforcement proceedings public once the investigation is complete, and the PCAOB has approved the charges.

Materiality

Mr. Hardiman discussed how a registrant considers non-GAAP measures when performing its materiality assessments under SABs 99 and 108, noting that certain registrants have argued that a quantitatively large error in GAAP financial information is immaterial when it has a quantitatively small impact on non-GAAP measures. He indicated that such an argument is not persuasive, since a quantitatively material GAAP error does not become immaterial simply because of the presentation of non-GAAP measures. Mr. Hardiman further stated that "as with any discussion of materiality, it's important to look at the total mix of information, and . . . the important thing here is that the non-GAAP measures [do not represent] the total mix of information, [but] it's just a piece of it." In addition, he indicated that registrants, in looking at the total mix of information, need to consider the effect of the error on information communicated to their investors, which includes GAAP financial information.

Editor's Note: For more information about materiality assessments and related comment letter trends, see Deloitte's *SEC Comment Letters — Including Industry Insights: A Snapshot of Current Themes*.

Segment Reporting

Ms. Crane discussed the SEC's process of reviewing an entity's segment-related footnote disclosures. She noted that the SEC performs a comprehensive review of an entity's MD&A to ensure consistency with the footnote disclosures and that it reviews other sources of public information, including an entity's Web sites and webcasts. If there appear to be inconsistencies, it is not uncommon for the SEC staff to request the information provided to a registrant's chief operating decision maker (CODM), board of directors, or its audit committee. She indicated that a common observation from this process is that registrants inappropriately aggregate operating segments reviewed by the CODMs. She noted that in these instances, registrants occasionally argue that the CODM does not make operating decisions on the basis of such information. The staff is "usually skeptical about this assertion" but will review all facts and circumstances when evaluating such disclosures.

Editor's Note: See Deloitte's *SEC Comment Letters — Including Industry Insights: A Snapshot of Current Themes* for a discussion of frequently issued SEC staff comments on segment reporting, Deloitte's analysis, and links to related resources.

Sustainability Reporting and Assurance

Integrated Reporting

The panelists' discussion of integrated reporting focused on the efforts under way to develop a conceptual global framework to enhance disclosures by incorporating social and environmental impacts into a company's financial reporting. The panelists indicated that their goal was to lead a global effort to help prevent countries from developing their own individual jurisdictional approaches to integrated reporting that later would need to be converged.

The concept of integrated reporting has been evolving beyond its traditional boundaries. The IIRC has indicated that its objective is to "create a globally accepted [integrated reporting] framework . . . which brings together financial, environmental, social and governance information in a clear, concise, consistent and comparable format." The panelists agreed that such reporting should provide meaningful and transparent information in a manageable format for investors and other stakeholders. Further, they agreed that preparers should focus on longer-term perspectives and on the impact of factors such as costs to a company related to (1) the environmental impacts of using natural resources and (2) the availability of natural resources used in their production processes.

Sustainability and GHG Assurance

The panelists also discussed issues and risks related to sustainability and greenhouse gas emissions (GHG) assurance. While no conclusions were reached, the panelists identified considerations related to the specialized skills, knowledge, and expertise they thought practitioners might need for these types of engagements. They also discussed scope, materiality, consistency of reporting, determining and assigning responsibilities, and establishing baseline measurements for reporting. Although there are currently no regulatory requirements for obtaining assurance on sustainability and GHG, an increasing number of entities are working toward developing processes to ensure that the information provided to investors is accurate and supportable. In addition, panelists noted that some entities have started requesting sustainability and GHG information from their vendors and will most likely expect their vendors to provide some level of assurance on the information in the future.

Editor's Note: Panelists were asked whether these efforts are considered to be "an evolution or a revolution." Integrated reporting projects were described as "evolutionary"; the establishment of a global framework is expected to be a long-term objective.

The panel noted diversity in the level of guidance currently available globally, spanning from certain countries such as Denmark, which already requires integrated reporting, to countries that have no or limited guidance. For example, in the United States, a framework requiring integrated reporting does not exist; however, in February 2010 the SEC issued an interpretive release on climate change disclosures, which registrants are expected to consider when preparing their MD&A.

Real Estate

Speaker	Topic Covered
• Lisa Watson, Professional Accounting Fellow, SEC's Office of the Chief Accountant	• Accounting for foreclosed real estate involving loan participations

Accounting for Foreclosed Real Estate Involving Loan Participations

Ms. Watson noted that over the past few months, the SEC staff has focused on the "accounting by banks when they foreclose on the real estate collateralizing a loan, if a participation interest in that loan had been transferred to one or more other banks."

Editor's Note: A participating loan is originated by a bank (typically referred to as the "lead bank" in the transaction) when a borrower requests a loan in a larger amount than the individual bank is willing to lend to a borrower. After originating the loan, the lead bank transfers an undivided interest in the loan to another bank or group of banks (typically referred to as a participating bank or banks). If the criteria for sale accounting in ASC 860 are met, the lead bank accounts for the loan participation as a sale, derecognizing the portion of the loan transferred to the participating bank(s).

She remarked that in the event of borrower default and foreclosure on the underlying real estate, banks will sometimes establish a limited liability company to take title to the real estate. The SEC staff has focused, however, on the reverse case in which "banks should account for their pro-rata share of the foreclosed real estate when a separate legal entity is **not** formed to hold title" (emphasis added).

In discussing potential accounting alternatives, Ms. Watson indicated that "legal title may be held in a variety of ways" and that participation agreements do not have standard contractual terms. Accordingly, an entity must understand all the arrangement's terms, including the rights and obligations of the lead bank and the participating bank(s), to reach an appropriate accounting conclusion. Ms. Watson stressed that because there is no "blanket conclusion that can be applied under the current accounting standards," an entity may consider multiple factors when performing such an analysis. Further, she noted that an entity may be able to analogize to other accounting literature in situations in which the general guidance on real estate is not applicable (e.g., if the foreclosed real estate is not held in the form of a corporate joint venture, a partnership, or an undivided interest).

Editor's Note: The accounting guidance on involvement in real estate primarily includes ASC 970 and ASC 360-20.

Ms. Watson indicated that an entity may be able to evaluate the transaction by focusing on the manner in which title to the real estate is held. She emphasized that "[w]ith foreclosed real estate, the manner in which title is held depends on . . . the contractual terms of the participation agreement" as well as the applicable law of the ruling jurisdiction. To be considered an undivided interest within the scope of the real estate guidance, title must be held individually to the extent of each party's interest.

In addition, Ms. Watson noted that other key factors for entities to consider in determining how to account for such real estate transactions are the "ability to make decisions and the extent of each bank's exposure to economic risks and rewards." Specifically, she stated:

> Sometimes a bank's right to participate in making decisions about significant financings, development, sale, or operations is viewed as a protective right. But when real estate is owned due to foreclosure, the decisions to be made might be expected to be fairly limited, especially in light of regulatory constraints on the ability of banks to hold Other Real Estate Owned. As a result, the extent of each bank's rights to participate in those types of decisions may be of particular importance.

After discussing general real estate guidance, Ms. Watson briefly touched on sales of real estate, noting that an entity is permitted to recognize partial sales of real estate "if certain conditions are met" and that an entity accounting for sales of foreclosed real estate may be able to analogize to this guidance depending on the facts and circumstances.

Ms. Watson concluded her discussion of this topic by noting that the EITF is currently deliberating whether "an investor should deconsolidate a subsidiary that is in-substance real estate" and that the SEC staff's views would continue to evolve as the EITF debates the issue.

Editor's Note: The EITF is currently considering whether an investor should deconsolidate a subsidiary that is in-substance real estate as part of EITF Issue 10-E. See Deloitte's November 2010 *EITF Snapshot* for further discussion about EITF Issue 10-E.

SEC Initiatives and Communications

Speakers	Topics Covered
• Wayne Carnall, Chief Accountant, SEC's Division of Corporation Finance • Angela Crane, Associate Chief Accountant, SEC's Division of Corporation Finance • Meredith Cross, Director, SEC's Division of Corporation Finance • Jill Davis, Associate Chief Accountant, SEC's Division of Corporation Finance • Stephanie Hunsaker, Associate Chief Accountant, SEC's Division of Corporation Finance • Mark Kronforst, Associate Director, SEC's Division of Corporation Finance	• SEC initiatives • SEC communications

SEC Initiatives

In discussing the Division of Corporation Finance's (the "Division's") various staff initiatives, goals, and accomplishments, Ms. Cross highlighted (1) the staff's core disclosures project, (2) the restructuring of some offices within the Division, (3) the staff's "fresh look" at the filing review program, (4) rulemaking efforts, and (5) the Division's efforts related to the IFRS work plan. With regard to the core disclosures project, the objective of which is to achieve consistency and simplicity in disclosures, Ms. Cross indicated that although completion remains a staff goal, the project has been deferred in light of the extensive rulemaking the staff must undertake as a result of the Dodd-Frank Act. She also briefly summarized personnel changes in offices such as Disclosure Operations.

Ms. Cross indicated that the Division has continued to comply with its mandate to review all filers at least once every three years and now is looking to find additional ways to improve and streamline the review program. She indicated that although plans are still being formulated, areas of focus include increasing effectiveness with smaller companies and with the legal portion of the reviews. She stated, "On the legal side, we're looking for ways to do different types of legal reviews

to get the most bang for our buck in the program" and noted that the staff is considering targeted reviews of governance disclosure and risk-related reviews. In addition, Ms. Cross discussed efforts, mainly resulting from staff reviews, to increase and improve staff communications to help registrants improve their filings. Areas of focus include contingencies, non-GAAP measures, and items discussed in "Dear CFO" letters, which are communications sent to certain registrants' CFOs, that provide disclosure suggestions and that the SEC posts to its Web site because they are more broadly applicable.

With respect to rulemaking activities, Ms. Cross identified accomplishments on proxy projects, including (1) a final rule issued in December 2009 requiring new disclosures about risk, compensation, corporate governance, and revisions to the reporting of stock and option awards; (2) the publication of a concept release to improve proxy and other rules and the infrastructure for proxy voting; and (3) a final rule, whose effective date has been deferred pending a legal challenge, facilitating the rights of shareholders to nominate directors to an entity's board ("proxy access" rules). Ms. Cross also noted the Division's issuance of rules related to asset-backed securities, a concept release on climate change disclosures, and a proposed rule and companion interpretative release on short-term borrowing disclosures in MD&A. For additional information on the short-term borrowing disclosure proposal and interpretative release, see the Dodd-Frank and Other Rulemaking Activities topic.

Editor's Note: Ms. Cross indicated that although the comment period for the short-term borrowing proposed rule has ended, she did not believe that the rules will be completed in time to be effective for the 2010 Form 10-K season and stated that registrants should not be "concerned coming up with procedures to do these new calculations in that timeframe." However, she did caution registrants to consider the interpretive release, which is already effective.

Ms. Cross stated that the Division was also involved in various efforts related to the IFRS work plan. In particular, she noted that the staff was currently assessing consistency and comparability of IFRS reporting in various markets. Such assessment includes staff reviews of IFRS filers and nonfilers that report under IFRSs. In addition, the staff is considering practical implementation issues with respect to IFRSs (e.g., impact of IFRS adoption on contracts, tax rules, and state laws that currently refer to U.S. GAAP) and has asked, and will continue to ask, constituents for their input. See the IFRSs and the SEC's Work Plan section for additional information on the IFRS work plan.

SEC Communications

"Dear CFO" Letters

Ms. Hunsaker remarked on the purpose of Dear CFO letters and summarized issues addressed in the letters issued in 2010. She noted that Dear CFO letters allow the SEC staff to timely communicate concerns to affected parties. Although the letters are sent to the CFOs of specific registrants, the staff also posts them to the SEC's Web site because the staff believes they have broader applicability and that registrants should consider them when preparing MD&A disclosures. Dear CFO letters do not replace or amend existing GAAP or SEC reporting requirements but rather highlight areas (1) in which disclosures could be enhanced or improved and (2) that may be subject to increased staff scrutiny. Ms. Hunsaker noted that the SEC staff frequently follows up and reviews changes made to the subsequent filings of the registrants that received a letter as well as those registrants similarly affected.

Ms. Hunsaker also commented on the two Dear CFO letters issued in 2010:

- The March 2010 letter requested information about repurchase agreements, securities lending transactions, or other transactions involving the transfer of financial assets with an obligation to repurchase the transferred assets.
- The October 2010 letter reminded registrants of their disclosure obligations in light of continued concerns about potential risks and costs associated with mortgage and foreclosure-related activities or exposures.

Editor's Note: See the "Management's Discussion and Analysis" section of Deloitte's *SEC Comment Letters — Including Industry Insights: A Snapshot of Current Themes* for more information about these two Dear CFO letters.

SEC Financial Reporting Manual

Mr. Carnall noted that the SEC staff achieved its goal of updating the SEC Financial Reporting Manual (FRM) on a quarterly basis throughout 2010. The most recent revision was released in December 2010 and included updates through September 30, 2010.

Editor's Note: Although the FRM is intended for use by the SEC staff, registrants may also find its insights into SEC reporting matters helpful. Changes are posted in the "What's New" section of the Division's Web site, and the date of the last update is indicated in each section of the FRM.

Ms. Crane highlighted the following significant updates made to the FRM in the current year:

- Revision of Topic 8.
- Amendments to Topic 2.
- Clarification of the calculation of significance and guarantor reporting under Regulation S-X, Rule 3-10.
- Details about when a general partnership balance sheet is needed.
- Explanation of when IFRSs for small and medium-sized entities (SMEs) are an acceptable basis for Regulation S-X, Rule 3-05 or Rule 3-09, financial statements.
- Revisions to guidance on critical accounting policies related to goodwill impairment and stock-based compensation in initial public offerings.

Ms. Crane pointed out that last year, the SEC staff embarked on a project to review over 25 years of SEC Regulations Committee meeting highlights to determine whether any topics needed to be added to the FRM. She discussed the outcome of the Division's efforts to assess these meeting highlights, noting that the review did not result in very many FRM updates. She concluded that this was because many of the views expressed in the meeting highlights were either already addressed or not within the scope of topics the FRM covers. However, she pointed out that certain highlights did necessitate the expansion of existing guidance in the FRM. These changes were primarily incorporated into the FRM during updates in 2010 and are expected to be fully incorporated by March 2011.

Ms. Davis also noted that the SEC staff plans to review the highlights of past meetings of the Center for Audit Quality's (CAQ's) International Practices Task Force to determine whether any topics discussed at these meetings need to be added to the FRM.

Critical Accounting Policies — Goodwill and Stock-Based Compensation

Mr. Kronforst remarked that the changes made to the FRM related to the impairment of goodwill (that were discussed at last year's conference) allowed the comment process to "become more efficient at least as far as addressing [the] critical accounting policy for goodwill impairment." However, he added that the SEC staff continues to observe inconsistencies regarding goodwill impairment (e.g., not recognizing an impairment when indicators of one exist), and he noted that the SEC staff "expect[s] more robust disclosure . . . and asked for much more detailed disclosures." He stated that the lack of disclosures may have resulted from "a sense that [the SEC staff was] backing off of goodwill impairment" but indicated that wasn't the case.

Mr. Kronforst discussed the recent addition of stock compensation guidance to the FRM for entities filing their initial registration statements. He stated that the guidance was added because disclosures were diverse and that there "could be some benefit for [the SEC to issue] something in the FRM" about stock compensation for companies filing their initial registration statement. He indicated that some of the expected disclosures about stock compensation include "the description of the methods and assumptions," grant information, and "narrative disclosures describing the factors contributing to the changes in value." Further, he stated that the SEC staff is "focused on the inputs of the models to determine fair value" but that "independent and contemporaneous valuations are the best practice" in the determination of fair value. He added that registrants should "focus on significant assumptions [and] significant changes in value" in their disclosures.

In addition, see the SEC Reporting — Regulation S-X topic for additional FRM changes on significant-subsidiary tests.

Eliminating Old Guidance From the SEC's Web Site

Mr. Carnall indicated that the Division is still working to accomplish its goal of eliminating certain outdated information from its Web site. Ms. Crane gave an update on the status of the Web site review, indicating that the Division's assessment of "thousands of pages of material" is nearly complete. The data were categorized as (1) relevant information to be retained, (2) superseded information to be archived, or (3) information to be added to the FRM. The Division plans to continue its reviews through 2011.

SEC Reporting — Foreign Private Issuers and Foreign Businesses

Speakers	Topics Covered
• Jill Davis, Associate Chief Accountant, SEC's Division of Corporation Finance • Craig Olinger, Deputy Chief Accountant, SEC's Division of Corporation Finance	• Nonissuer financial statement considerations • Change in accountants • Referencing the use of IFRSs as issued by the IASB • Subsequent-event considerations • Use of *IFRS for SMEs* • Canadian transition to IFRSs • Canadian GAAP for private enterprises

Nonissuer Financial Statement Considerations

Ms. Davis discussed whether the audit report of a foreign subsidiary (nonissuer) must be prepared in accordance with U.S. auditing standards (i.e., PCAOB standards or U.S. GAAS) or local auditing standards when those nonissuer financial statements are included in the Form 20-F of a foreign private issuer. Ms. Davis indicated that a registrant is only allowed to include an auditors' report for nonissuer financial statements that use U.S. auditing standards. When the nonissuer's financial statements are not audited under U.S. standards, the staff views the nonissuer as being unaudited, and the nonissuer's auditors' report should not be included in the financial statements. When nonissuer financial statements are provided voluntarily (not as a result of any requirements), the staff suggests the registrant include the nonissuer's financial information but not its audit report. A registrant that includes an audit report that is not in accordance with U.S. standards may be asked to remove the audit opinion (even if provided voluntarily).

Change in Accountants

Mr. Olinger discussed requirements for disclosure of a change in accountants and disagreements between foreign private issuers (FPIs) and their independent accountants. FPIs are required to make such disclosures in their annual Form 20-F. In contrast, domestic registrants are required to make the disclosures on a more timely basis in a Form 8-K. Mr. Olinger indicated that when the change in accountants and disagreements disclosures in the Form 20-F are deficient, the staff will typically ask for an amendment of the form rather than allowing the registrant to wait another year to make the revised disclosures.

Referencing the Use of IFRSs as Issued by the IASB

Mr. Olinger indicated that the SEC will request the registrant to amend its Form 20-F when the registrant hasn't asserted, and the audit report hasn't indicated, compliance with "IFRSs as issued by the IASB." Paragraph 6310.2 of the FRM indicates that the "accounting policy footnote must state compliance with IFRS as issued by the IASB and the auditor's report must opine on compliance with IFRS as issued by the IASB." When an entity does not prepare its financial statements in accordance with IFRSs as issued by the IASB, the FPI is required to provide a reconciliation to U.S. GAAP to assist investors in understanding the nature and effect of the accounting differences on the financial statements.

Mr. Olinger emphasized that using the statement "IFRSs as issued by the IASB" is clearly a prerequisite for omission of the U.S. GAAP reconciliation and that the statement must be included in both the financial statements and the auditors' report. In response to SEC comments on the matter, some registrants have suggested that their filings are merely missing a sentence when the statement is not included. The SEC staff's view is that when the statement is omitted, the registrant has two choices: add the statement or add the U.S. GAAP reconciliation.

Subsequent-Event Considerations

Mr. Olinger discussed the interplay between subsequent-event considerations under IAS 10 and the SEC's requirement for registrants to retrospectively adjust, in certain circumstances, previously issued financial statements before their inclusion in registration statements. IAS 10 requires the disclosure of the date the financial statements were authorized for issue. It states that the purpose of the disclosure is to indicate to a user that the financial statements do not reflect the impact of events after such date. Under the SEC's rules and registration form requirements, registrants must, as discussed in paragraph 13110.2 of the FRM, retrospectively revise "pre-event audited financial statements . . . incorporated by reference to reflect a subsequent change in accounting principle (or consistent with staff practice, discontinued operations and changes in segment presentation) if the [registration statement] also incorporates by reference post-event interim financial statements."

Editor's Note: Topic 13 of the FRM provides additional guidance on the effect of subsequent events on financial statements required to be included or incorporated by reference into registration statements and proxy filings.

Mr. Olinger stated that some view IAS 10 as establishing a fixed date after which the financial statements are deemed "closed" (i.e., not reflecting information obtained after the date when the financial statements were authorized for issue). This view has resulted in questions being raised about whether an IFRS preparer that is required to retrospectively adjust certain information under the SEC requirements would be forced to reevaluate all events affecting the financial statements (e.g., litigation settlements and bad debts arising in the interim period) to ensure that the recast financial statements reflect all information that provides evidence about conditions that existed at the end of the reporting period up to the date of authorization of the revised financial statements.

This approach would differ significantly from the way the SEC requirements have historically been applied. Annual financial statements that are recast under the SEC's requirements are only revised for items such as a change in accounting principle requiring retrospective application, discontinued operations, or a change in segment presentation.

Mr. Olinger clarified that the SEC's rules are clear that in the case of a registration statement, the recasting of previously issued financial statements must occur in the situations noted above. He did not comment on how IAS 10 should be applied in this situation, but encouraged registrants to "look at [the reissuance] very carefully" because the SEC's rules are not intended to fully reopen the financial statements for all subsequent events. Rather, the intent is to obtain comparability between the annual and interim periods and therefore make adjustments solely related to the specific item that is triggering the requirement to retrospectively revise the financial statements.

Mr. Olinger also provided a recent example in which a registrant, in connection with an initial public offering, received an SEC staff comment requesting expansion of the entity's accounting policy disclosure. The entity was sensitive about making this disclosure policy improvement because of what it viewed as the potential need to reopen its financial statements under IAS 10 for the period between the annual financial statements and the receipt of comments from the SEC staff on its filing. Mr. Olinger indicated that the SEC staff is "skeptical" of the notion that IFRSs prevent an entity from expanding such disclosure and creating more transparency to financial statement users.

Use of *IFRS for SMEs*

Editor's Note: When a registrant consummates or it is probable that it will consummate a significant business acquisition, Regulation S-X, Rule 3-05, may require the filing of certain financial statements for the acquired or to be acquired business ("acquiree"). When a registrant has a significant equity method investment ("investee"), the registrant may be required to provide separate financial statements of the investee under Regulation S-X, Rule 3-09.

Financial statements filed with the SEC to fulfill the requirements of Rule 3-05 and Rule 3-09 for entities that qualify as foreign businesses, as defined in Regulation S-X, Rule 1-02(l), may be prepared in accordance with U.S. GAAP, IFRSs as issued by the IASB, or in accordance with a comprehensive body of accounting principles other than U.S. GAAP or IFRSs as issued by the IASB (local GAAP). If the primary financial statements are prepared in accordance with local GAAP, reconciliation to U.S. GAAP is required.

Mr. Olinger explained that *IFRS for SMEs* is specifically not intended for use in the financial statements of issuers, predecessors of issuers, domestic acquirees, or domestic investees. He did clarify that under certain circumstances, the SEC has concluded that *IFRS for SMEs* is acceptable for certain investees under Rule 3-05 and certain acquirees under Rule 3-09.

To apply *IFRS for SMEs*, the entity must be an acquiree or investee that meets the SEC's definition of a foreign business, and the financial statements must be reconciled to U.S. GAAP. Although the SEC has concluded that *IFRS for SMEs* is a comprehensive basis of accounting as contemplated by Form 20-F, in its December 2007 adopting release, the SEC notes that *IFRS for SMEs* is not part of IFRSs as issued by the IASB. Therefore, it does not qualify for relief from the U.S. GAAP reconciliation requirement. In essence, the SEC treats *IFRS for SMEs* in the same manner as it treats local GAAP of a nonissuer. Mr. Olinger further clarified that the accommodation under which reconciliation to U.S. GAAP is not required (i.e., for financial statements of such acquirees and investees that are at or below the 30 percent significance level) is available for financial statements prepared in accordance with *IFRS for SMEs*.

Editor's Note: *IFRS for SMEs* was discussed at the May 2010 meeting of the CAQ's International Practices Task Force. See the highlights on the CAQ's Web site for further information.

Canadian Transition to IFRSs

Mr. Olinger highlighted a transitional issue that might affect a Canadian foreign private issuer that adopts IFRSs and executes a registration statement in the United States during 2011. To illustrate the issue, he used an example in which a registration statement is executed in October 2011 and would presumably require (1) the entity's annual financial statements for 2008, 2009, and 2010 and (2) a six-month interim statement. Also assume the entity applied Canadian GAAP with a reconciliation to U.S. GAAP in its annual financial statements for the last three years.

Given the Canadian entity's transition to IFRSs during the period, Mr. Oligner noted that the issue at hand is what the basis of presentation should be for both the interim and the annual financial statements for the registration statement (e.g., IFRSs or Canadian GAAP for all periods). However, he acknowledged that the SEC staff is still considering the answer to this question and that he simply wanted to raise "awareness" about it.

Editor's Note: Canadian entities making the transition to IFRSs should continue to monitor this area because guidance is expected to be forthcoming.

Canadian GAAP for Private Enterprises

Mr. Olinger commented on a matter related to the use of Canadian GAAP for private entities that could be a "sleeper issue" for U.S. companies. He indicated that at the core of the matter is that private company Canadian GAAP may permit but not require certain accounting (e.g., consolidation of subsidiaries or joint venture accounting). As a result, when a U.S. or foreign company acquires an entity that uses Canadian GAAP for private entities, it may need to assess whether the financial statements of the private entity required under Rule 3-05 or Rule 3-09 will need a more comprehensive basis of accounting, such as U.S. GAAP or IFRSs as issued by the IASB. The outcome of this assessment depends on factors such as whether the private entity has voluntarily elected to include elements in its financial statements that would have been required as part of a comprehensive basis of accounting but that were otherwise optional under local GAAP. If the entity has not applied such elections, it is more likely in this scenario that the Canadian private entity may be required to adopt a more comprehensive basis of accounting before its financial statements or financial information is included in a document filed with the SEC. Mr. Olinger encouraged registrants to consult with the SEC staff if they encounter this issue.

SEC Reporting — Other Topics

Speakers	Topics Covered
• James Barge, Executive Vice President and Chief Financial Officer, Viacom Inc. • Wayne Carnall, Chief Accountant, SEC's Division of Corporation Finance • Meredith Cross, Director, SEC's Division of Corporation Finance • Mark Kronforst, Associate Director, SEC's Division of Corporation Finance • Brian Lane, Partner, Gibson, Dunn & Crutcher LLP • Craig Olinger, Deputy Chief Accountant, SEC's Division of Corporation Finance	• Non-GAAP financial measures • Change in accountants • Management's discussion and analysis

Non-GAAP Financial Measures

Ms. Cross began the discussion by referring to the SEC staff's C&DIs on the use of non-GAAP financial measures, which were issued in January 2010 and reflect the staff's revised guidance on this topic. She outlined a few points related to the disclosure of non-GAAP measures:

- The SEC staff does not require registrants to include non-GAAP measures in their filings with the SEC, even if they use non-GAAP measures outside of their filings.
- If a registrant intends to disclose a non-GAAP measure outside of its filings, but does not include the same measure within its filings, the registrant may need to include other disclosures in its filings (e.g., a description of the component parts of the non-GAAP measure) to ensure that it is telling "a consistent story inside and outside [the] filings."
- A registrant should not present a non-GAAP measure that is misleading — either in a filing or outside of a filing.
- Non-GAAP measures should not be given greater prominence than the most directly comparable GAAP measure.

Editor's Note: At the September 2010 CAQ SEC Regulations Committee Meeting With the SEC Staff, the staff stated that "the prohibition on presenting non-GAAP financial measures with greater prominence than GAAP measures encompasses both the order of presentation and the degree of emphasis" and that a registrant may receive a comment if its discussion of non-GAAP financial measures is significantly longer than its discussion of the corresponding GAAP financial measures.

Mr. Kronforst indicated that the SEC staff is seeing more non-GAAP information in filed documents and also discussed the prominence given to non-GAAP measures. He indicated that the SEC staff has issued some comments to registrants suggesting they improve their disclosures in this area (e.g., by streamlining the non-GAAP discussion, changing the order, or some combination). During a panel discussion on MD&A, Mr. Carnall further noted that if a registrant's non-GAAP measure is the focal point in all of its outside communications, but is not included in filed documents, the SEC staff will most likely ask why.

Mr. Kronforst mentioned a specific example of a non-GAAP measure involving the calculation of the number of dilutive shares used in the presentation of a non-GAAP per-share performance measure. In the example, a registrant has reported a net loss for the period for GAAP purposes but, after certain adjustments, has also presented a non-GAAP performance measure that results in the presentation of non-GAAP net income rather than a loss. Given the net loss incurred during the period, the registrant may not have presented diluted earnings per share in the financial statements. The staff indicated that since the registrant is disclosing a non-GAAP measure that reflects positive income, the registrant may, depending on the facts and circumstances, need to recalculate a diluted non-GAAP per-share measure.

Mr. Kronforst also highlighted another issue: the disclosure of cash flow per-share measures that are prohibited by SEC rules. He reminded participants of the guidance in ASR 142 that "raised concerns about investor understanding and relevance to investors" and stated that "such a measure carries a high risk of being materially misleading to investors." He noted that ASR 142 also applies to non-GAAP disclosures that are not subject to certain provisions of Regulation S-K, Item 10(e) (e.g., press releases). Mr. Kronforst further discussed non-GAAP measures that a registrant may refer to as performance measures but that are substantially similar to cash flow per-share information. He stressed that the staff will evaluate such disclosures on a facts and circumstances basis.

During a panel discussion on MD&A, Mr. Carnall indicated his belief that multinational registrants should provide some disclosure, if material, of how exchange rates affect results of operations. Discussions that include a constant-currency presentation are considered non-GAAP disclosures on which the staff provided guidance in Question 104.06 of the C&DIs.

Editor's Note: For more information about the Division of Corporation Finance's C&DIs on non-GAAP measures and a discussion of certain changes the C&DIs made to the SEC staff's previous guidance, see Deloitte's January 20, 2010, *Heads Up*. Also see Deloitte's *SEC Comment Letters — Including Industry Insights: A Snapshot of Current Themes* for more information about non-GAAP financial measures.

Change in Accountants

Editor's Note: If a registrant or a significant subsidiary whose report the principal accountant relied on has a change in the independent accountant who was previously engaged to audit its financial statements ("change in accountant" or "change in auditor"), the registrant must provide the disclosures required by Regulation S-K, Item 304, in an Item 4.01 Form 8-K, a proxy statement, a registration statement, or a Form 10-K.

Mr. Carnall noted that every year, registrants file hundreds of Forms 8-K to disclose a change in auditors. The SEC staff reviews all of these Forms 8-K and writes a large number of comment letters in response. Mr. Kronforst shared the following common SEC staff comments on this topic:

- Item 304(a)(1)(iv) requires disclosures of certain items that may have occurred "during the registrant's two most recent fiscal years and any subsequent interim period." Mr. Kronforst pointed out that registrants must provide the disclosures regarding whether certain items occurred for the subsequent interim period up to and including the date on which the client/auditor relationship ended. Many registrants have misinterpreted this "subsequent interim period" to mean through the last fiscal quarter.
- Among other things, Item 304(a)(1)(ii) requires a registrant to disclose whether a modification regarding uncertainty in the accountant's report existed for each of the past two years. Mr. Kronforst noted that a going-concern paragraph is a modification that registrants should disclose under Item 304. He also clarified that the requirements of this Item only apply to the accountant's report on the financial statements and do not extend to ICFR opinions.

Editor's Note: We believe that Item 304(a)(1)(v)(A) would require registrants to disclose an adverse ICFR opinion as a reportable event.

Mr. Kronforst further discussed two circumstances in which a registrant would consider its disclosure obligations under Item 304 and Item 4.01 of Form 8-K:

- *Merger of accounting firms* — Mr. Kronforst observed that a merger of accounting firms may trigger the need for disclosures under Item 304 but that this would depend on the specific facts and circumstances associated with the merger. Mr. Carnall encouraged registrants to consult with the staff if this matter arises.
- *PCAOB revocation of an auditor's registration* — Mr. Kronforst remarked that once the accountant's registration is revoked, audit reports issued by that accountant may no longer be included in a registrant's filings and that a PCAOB-registered firm generally would need to reaudit those financial statements before they are included in future filings. Paragraph 4115.2 of the FRM states that when providing the information required by Item 304 regarding a change in accountant for a firm whose registration was revoked by the PCAOB, a registrant should give the reasons why the accountant resigned (i.e., they should disclose that the PCAOB has revoked its registration).

Editor's Note: In a question-and-answer session, Mr. Olinger, deputy chief accountant in the SEC's Division of Corporation Finance, noted that additional disclosure under Item 304 about reasons why an accountant resigned was specific to PCAOB revocation.

Finally, Mr. Kronforst noted that a registrant that has no reportable events under Item 304 is not required to state that fact. This differs from the requirement in Item 304(a)(1)(iv) to state that there have been no disagreements, if there were none.

The SEC staff expects to issue guidance on this topic in the near future.

Editor's Note: For a discussion of disclosures about changes in accountants for foreign private issuers, see the SEC Reporting — Foreign Private Issuers and Foreign Businesses topic. For more information about a change in accountants, see Sections 4115 and 4500 of the FRM.

Management's Discussion and Analysis

A diverse group of panelists offered various perspectives on the MD&A section of SEC filings. Mr. Carnall noted that registrants often focus more on compliance than on communication when preparing their filings. He suggested that management try to include information that an investor would need to make sound investment decisions.

Mr. Lane led a discussion in which the panelists gave the following tips for registrants to consider when preparing MD&A:

- Use plain English and write for ordinary investors, not sophisticated analysts.
- Management's analysis of the item being disclosed is critical to comprehensive discussion of a topic. Disclosures should answer the question "why."
- The SEC staff has encouraged registrants to use tabular disclosures to present quantitative information. While often such disclosures are not required, they may help investors understand a registrant's business.
- MD&A should start with an overview highlighting material events and changes rather than emphasizing boilerplate facts carried forward from year to year. Panelists noted that management should try to avoid using phrases such as "we are the leading provider of" in the overview, indicating that such information is best presented in the "Business" section of the filing. They also recommended that management use the overview to briefly summarize, in order of significance (from most to least significant), the items that occurred during the period.
- Consideration of disclosures provided by peer groups, competitors, and industry groups can help registrants determine the most relevant information to provide; however, management should not rely on such disclosures. That is, while it may be a good idea, in certain circumstances, for a registrant to consider making its disclosures consistent with those of peers, competitors, and industry groups, the staff ultimately expects a registrant to tailor its disclosures to its own business. Thus, if the staff questions a registrant about its disclosures, it may not be persuasive for the registrant to argue that it was making the disclosures consistent with those of its peers — regarding either how a disclosure is presented or whether one is presented at all.

- There is a greater focus on providing disaggregated information to help investors understand factors underlying a business's performance and liquidity. For example, panelists remarked that registrants should provide a breakdown of significant components of revenue and expenses. In addition, registrants should be prepared to receive staff comments questioning whether the level of detail is appropriate for critical accounting estimates such as fair value, reserves (including loan loss reserves), and actuarial assumptions.
- If multiple factors contribute to an overall change in a financial statement line item, a registrant should individually quantify those factors (e.g., price and volume impacts). Panelists noted that a registrant that fails to quantify these factors may receive an SEC staff comment requesting that such information be provided.

Mr. Carnall expanded on Mr. Lane's suggestions by referring to Topic 9 of the FRM as well as to FRRs 36 and 72, which contain guidance on MD&A disclosures. More specifically, Mr. Carnall indicated that, in addition to price and volume impacts, registrants should disclose, if material, the impact (1) of fluctuations in the reporting currency and (2) that foreign currency fluctuations have on the results of operations. He gave examples of situations in which registrants will attempt to use non-GAAP constant-currency measures to provide these disclosures. (For more information, see the Foreign Currency Matters topic.)

In addition, Mr. Carnall indicated that registrants should consider how these fluctuations may affect their liquidity, particularly when they have significant cash overseas. He then referred to Ms. Davis's remarks, in her speech on income tax developments, about the importance of a discussion on liquidity with respect to undistributed earnings of foreign subsidiaries. (See the Income Tax Disclosure Matters topic for more information.) In discussing liquidity disclosures, Mr. Carnall also referred to the SEC's proposed rule on disclosures about short-term borrowing and its companion interpretive release. (For more information about the proposed rule and interpretive release, see the Dodd-Frank and Other Rulemaking Activities topic.)

Regarding forward-looking information, Mr. Lane indicated that a registrant's cautionary language needs to be meaningful for the registrant to receive safe-harbor protection and cited a recent court case in which the second district court had ruled otherwise. He stipulated that (1) disclosures should be company-specific, (2) boilerplate warnings will not suffice, and (3) registrants should revise the language in the disclosures from period to period as facts and circumstances change. The staff often asks registrants that provide generic disclosures to clarify how such disclosures are relevant to them. Mr. Barge provided a preparer's perspective, noting that materiality plays a part in the determination of what to include in these disclosures. He then cited examples involving his organization to illustrate Mr. Lane's points.

Finally, Mr. Lane described situations in which a registrant's use of credit ratings to discuss liquidity in MD&A would not trigger a consent requirement and referred to the staff's C&DIs on this topic.

Editor's Note: In response to a provision in the Dodd-Frank Act regarding expertization of credit ratings agencies, the SEC staff issued Question 233.04 of the C&DIs. This question states, in part, that "[a]n issuer also may refer to, or describe, its ratings in the context of its liquidity discussion in Management's Discussion and Analysis of Financial Condition and Results of Operations" without the credit rating agency's consent. For further discussion of expertization and other MD&A considerations, as well as staff comments on these topics, see the "Use of Experts and Consents" and "Management's Discussion and Analysis" sections of Deloitte's *SEC Comment Letters — Including Industry Insights: A Snapshot of Current Themes*.

SEC Reporting — Regulation S-X

Speakers	Topics Covered
• Todd Hardiman, Associate Chief Accountant, SEC's Division of Corporation Finance • Craig Olinger, Deputy Chief Accountant, SEC's Division of Corporation Finance	• Investments in foreign equity method investees (Rules 3-09 and 4-08(g)) • Significant-subsidiary tests (Rule 1-02(w)) • Financial statements of guarantors and issuers of guaranteed securities registered or being registered (Rule 3-10)

Investments in Foreign Equity Method Investees (Rules 3-09 and 4-08(g))

Editor's Note: When a registrant has a significant equity method investment ("investee"), the registrant may be required to provide separate financial statements of the investee, summarized financial information of the investee, or both under Regulation S-X, Rule 3-09, and Rule 4-08(g), respectively. In determining whether separate annual financial statements of an equity method investee are required under Rule 3-09(a), a registrant must perform the investment and income tests, but not the asset test, in Rule 1-02(w) to assess the equity method investee for significance. However, to determine whether summarized financial information is required under Rule 4-08(g), a registrant must perform all three significance tests.

When a domestic registrant has an investment in a foreign business that it accounts for under the equity method ("foreign investee"), the foreign investee's financial statements may be presented in accordance with a comprehensive type of GAAP other than U.S. GAAP ("local GAAP"). Mr. Hardiman observed that the domestic registrant must use the U.S. GAAP results of the foreign investee when performing the significance tests under Rule 4-08(g). In addition, Mr. Hardiman noted that when a domestic registrant is required by Rule 4-08(g) to include summarized financial information of the foreign investee in the notes to its annual financial statements, the summarized financial information must be presented in accordance with U.S. GAAP, as described in footnote 30 of SEC Final Rule 33-7118. He pointed out that this is required even when the differences between the local GAAP and U.S. GAAP do not materially affect the domestic registrant's financial statements.

Editor's Note: We believe that Mr. Hardiman's remarks on the significance tests, summarized above, would also apply to the significance tests under Rule 3-09.

Significant-Subsidiary Tests (Rule 1-02(w))

Mr. Hardiman discussed three recent changes to the FRM with respect to the income test in Rule 1-02(w). The revisions change (1) how significance is determined for equity method investees, (2) the manner in which average income is calculated, and (3) how significance is determined when a registrant disposes of a business that is classified as a discontinued operation.

Equity Method Investees

Editor's Note: The income test under Rule 1-02(w) is based on the registrant's "equity in the income from continuing operations before income taxes, extraordinary items and cumulative effect of a change in accounting principle of the subsidiary exclusive of amounts attributable to any noncontrolling interests" (i.e., the numerator) compared with "such income of the registrant and its subsidiaries consolidated for the most recently completed fiscal year" (i.e., the denominator). This amount is referred to as "pre-tax income from continuing operations" in the discussions below.

Mr. Hardiman highlighted the new changes to the FRM that simplify the calculation of the numerator in the income test for an investee. Section 2410.3 of the FRM states the following:

> The numerator is calculated based on the registrant's proportionate share of the pre-tax income from continuing operations reflected in the separate financial statements of the investee prepared in accordance with U.S. GAAP for the period in which the registrant recognizes income or loss from the investee under the equity method adjusted for any basis differences. In determining the basis differences that should be included for this test, the registrant should consider ASC 323-10-35-34 and ASC 323-10-35-32A. While not an exclusive list, items impacting net income of the registrant that should be excluded from the test are: impairment charges at the investor level, gains/losses from stock sales by the registrant; dilution gains/losses from stock sales by the investee, preferred dividends.

Editor's Note: The slides used by Mr. Hardiman in his presentation are available on the SEC's Web site. Those slides contain examples illustrating the difference between the staff's historical practice (the "old" method) and the new SEC staff interpretations (the "new" method). Under the old method, a registrant's share of the investee's pretax income from continuing operations may have been adjusted for other items such as impairment charges and certain gains and losses. Under the new method, the registrant's share of the investee's pretax income from continuing operations is only adjusted for basis differences.

Calculating Average Income

Mr. Hardiman indicated that, generally, a registrant should use its pretax income from continuing operations in the annual financial statements for the most recently completed audited fiscal year as the denominator in the income test. He noted that sometimes, however, an average of the registrant's pretax income from continuing operations for the last five fiscal years should be used, as discussed in computational note 2 of Rule 1-02(w)(3).

Mr. Hardiman explained that, historically, the SEC staff's interpretation has been that a registrant could not use average income if it reported a loss, rather than income, in the latest fiscal year. He pointed out, however, that the SEC staff's interpretation of this issue has recently changed and that the existence of a pretax loss in the most recent fiscal year would not prevent a registrant from using average income.

Editor's Note: In a question-and-answer panel at the conference, Mr. Hardiman indicated that in computing its average income for the last five fiscal years, a registrant that reported a loss in one or more of the years in the five-year period should assign each loss (in a given year) a value of zero to determine the numerator for this average; however, the denominator should remain at "five."

Mr. Hardiman also addressed whether a registrant may recalculate significance for prior years on the basis of the staff's new interpretations. He indicated that a registrant would not be required to provide the financial statements of an investee if the investee was considered significant in a previous year on the basis of the registrant's historical practice (i.e., not using average income because of a loss in the then most recent year) and is no longer significant under the new method.

For more information about the recently revised SEC staff interpretation regarding the use of average income, see Section 2015.8 of the FRM.

Calculating Significance of a Disposition When the Disposed Business Is Classified as a Discontinued Operation

Editor's Note: Item 2.01 of Form 8-K requires a registrant to file a Form 8-K to report a disposition if either an asset disposition or a business disposition exceeds 10 percent. The three significance tests in Rule 1-02(w) are used to measure the significance of the disposed business.

Mr. Hardiman indicated that the SEC staff has updated the FRM to clarify the calculation of the income test for a disposed business that is classified as a discontinued operation. He noted that a registrant should base the denominator of the income test on income from continuing operations when performing this calculation.

Editor's Note: For more information about the recently revised SEC staff interpretation, see Section 2130.3 of the FRM.

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

Mr. Olinger discussed Rule 3-10, noting that a guarantee of a registered debt security is itself a security under the Securities Act of 1933 and the Exchange Act. The "general rule" of Rule 3-10 is that a registrant must provide full financial statements for each subsidiary issuer and guarantor of registered debt securities. In addition, each subsidiary issuer and guarantor must comply with the periodic reporting requirements of the Exchange Act by filing its own periodic reports. If certain conditions for reporting relief are met, however, a registrant may be able to provide, in a footnote to the financial statements, condensed consolidating financial information or narrative disclosures about the subsidiary issuer or guarantor in lieu of full financial statements; further, the subsidiary issuer and guarantor would be exempt from the periodic reporting requirements under Rule 12h-5 of the Exchange Act.

Mr. Olinger stated, "It's important to remember that condensed consolidating information is not merely a footnote. Its presentation is one of the conditions that must be met for the reporting relief that [was] described earlier." He also pointed out that the conditions that allow entities to provide condensed consolidating financial information or narrative disclosures must be met as of each annual and quarterly period as long as the registered debt is outstanding.

Editor's Note: Rule 3-10 provides exceptions to its general rule whereby, if certain conditions are met, the registrant may, depending on its facts and circumstances, furnish modified financial information (i.e., condensed consolidating financial information or narrative disclosures). Two conditions that are common to all of the exceptions are that the (1) subsidiary issuer and guarantors must be 100 percent owned by the registrant and (2) guarantee must be "full and unconditional." For a definition of these and other terms (e.g., "minor" as discussed below) used in Rule 3-10, see Rule 3-10(h) and Section 2500 of the FRM.

Mr. Olinger highlighted the following recent practice issues:

- Each subsidiary issuer and guarantor must be 100 percent owned, directly and indirectly, by the parent issuer or guarantor for a registrant to provide condensed consolidating financial information or narrative disclosures. The SEC staff has indicated that a subsidiary in corporate form is 100 percent owned if all outstanding voting shares are owned by the parent; a subsidiary not in corporate form is 100 percent owned if all outstanding interests are owned by the parent. In a recent fact pattern, the parent owned all of the voting shares of a subsidiary. The nonvoting shares, however, were owned by a third party that had the power to appoint directors via contractual arrangements. In this circumstance, the staff determined that the subsidiary did not meet the definition of 100 percent owned.
- Another condition for relief from providing full financial statements is that each guarantee must be "full and unconditional." To meet this condition, the guarantee must, among other requirements, be in force throughout the term of the registered debt. The SEC staff has noted circumstances in which the debt indenture includes a provision allowing the guarantor to "opt out" of the guarantee during the term of the debt. The staff indicated that in this circumstance the guarantee would not be considered "full and unconditional."
- Many questions have arisen regarding the presentation of condensed consolidating financial information. The purpose of condensed consolidating financial information is to present the assets, liabilities, results of operations, and cash flows of the parent and its subsidiaries (i.e., the consolidating group). In this regard, investments in subsidiaries at each level must be presented under the equity method of accounting to ensure that the underlying assets, liabilities, results of operations, and cash flows are presented in the columns of the particular entities that hold the investments in subsidiaries.
- In limited circumstances, a registrant is permitted to provide narrative disclosures if certain additional conditions are met. One condition is that nonguarantor subsidiaries must be "minor." The staff indicated that the registrant must consider both direct and indirect subsidiaries in determining whether the nonguarantor subsidiaries are "minor."

Editor's Note: In a subsequent question-and-answer session, Mr. Olinger addressed a question related to Regulation S-X, Rule 3-16. Under Rule 3-16, a registrant must file full audited financial statements for each of the registrant's affiliates whose securities constitute "a substantial portion of the collateral" for any class of securities "registered or being registered." The question asked whether there is a difference between a pledge of subsidiary's stock and a lien on securities of a subsidiary that may collateralize registered securities of the parent. Mr. Olinger first noted that such a question should be directed to the Office of Chief Counsel in the Division of Corporation Finance. He did, however, note that the purpose of Rule 3-16 is to cover situations in which an investor initially owns a debt security but potentially could end up with an equity security of a subsidiary in the event of a default. He indicated that to the extent that a lien on securities of a subsidiary could create a situation in which a debt holder could potentially become a holder of an equity interest in the subsidiary, Rule 3-16 may be applicable. Registrants are encouraged to consult with their legal counsel regarding whether a lien on securities of an affiliate constitutes collateral under Rule 3-16.

Editor's Note: See Deloitte's *SEC Comment Letters — Including Industry Insights: A Snapshot of Current Themes* for more information about SEC reporting issues.

Standard Setting

Speakers	Topics Covered
• Kenneth Bement, Senior Project Director, FASB • John Bishop, Partner, PricewaterhouseCoopers LLP • Aaron Dahlke, Chief Accounting Officer, Aircastle • Brett Dooley, Director, Corporate Policies Group, JPMorgan Chase • Russell Golden, Board Member, FASB • Gregory McGahan, Partner, PricewaterhouseCoopers LLP • Mark Newsome, Director, ING Capital LLC • Henry Rees, Senior Project Manager, IASB • Leslie Seidman, Acting Chairman, FASB • Susan Stalnecker, Vice President, Finance — Treasurer, DuPont • Alan Teixeira, Director of Technical Activities, IASB • Sir David Tweedie, Chairman, IASB • Danielle Zeyher, Project Manager, FASB	• Accounting standards: international priorities • Standard-setting update • Revenue recognition • Leases • Financial instruments

Accounting Standards: International Priorities

Sir Tweedie emphasized the need for a single set of high-quality, global standards. He outlined the potential benefits of such a set of standards, including greater cross-border investment, increased comparability of financial information across political boundaries, lower cost of capital, and easier consolidation of global entities. Further, he stressed that only adoption of IFRSs in the United States, rather than convergence of U.S. GAAP with IFRSs, would achieve that goal. He emphasized that it would be critical for the SEC to make a decision in 2011 about whether and when to adopt IFRSs in the United States; otherwise, he cautioned, the pressure in some parts of Europe would increase to remove the current U.S. influence on IFRS standard setting.[3] Alternatively, the movement toward IFRSs as the single set of globally accepted accounting standards might unravel, which in his view would cause "European IFRS, Japanese IFRS, Chinese IFRS and [us to be] back to where we were 10 years ago."

Ms. Seidman noted that the FASB and IASB have been working together since 2001, intending to eliminate significant differences between U.S. GAAP and IFRSs by developing joint standards in areas in which significant improvements are warranted, yet trying to avoid creating new differences in the process. Ms. Seidman and Sir Tweedie summarized the work done so far and discussed the recent prioritization of the major projects — financial instruments, revenue recognition, fair value measurement, and leases — for which the objective remains to develop converged standards by June 2011. In addition, Ms. Seidman highlighted the boards' extensive outreach and educational efforts on the major projects, noting that these efforts would continue until the boards issue the final standards.

Editor's Note: Ms. Seidman and Sir Tweedie also provided an update on FASB-only, IASB-only, and other MoU projects, including the expected timing of the publication of any discussion papers, exposure drafts, or final standards. See the work plans on the FASB's and IASB's Web sites for more information.

On November 29, 2010, the boards published a progress report on their convergence agenda, which contains more information about the status of the major projects.

Lastly, Ms. Seidman expanded on certain FASB priorities, including:

- *The expansion of the Board from five to seven* — Indicating that she expects the expansion to take place early next year (or sooner, if possible).
- *The recommendations by the SEC Advisory Committee on Improvements to Financial Reporting (CIFiR)* — Reporting on progress on the FASB-related CIFiR recommendations to establish a post-implementation review process for both FASB and GASB standards and develop a disclosure framework.

[3] The IASB currently consists of 15 members, four of whom are from the United States. The IFRS Foundation, which is the governing body overseeing the IASB, currently consists of 20 trustees, five of whom are from the United States. Finally, the IFRS Foundation is publicly accountable to a monitoring board of securities regulators, with Mary Schapiro, the SEC chairman, being one of five members.

Editor's Note: Ms. Seidman underscored the FASB's strong support for CIFiR's recommendation to establish a financial reporting forum to provide timely and effective resolution of issues before they become ingrained in practice.

- *The Codification survey* — Highlighting a survey on the FASB's Web site requesting feedback from constituents on how to improve the effectiveness of the Codification.
- *The "Blue-Ribbon Panel" addressing private-company accounting* — Noting the FASB's increasing focus on the unique needs of, and targeted outreach to, private companies.

Finally, Sir Tweedie remarked that after the goal of establishing a single set of high-quality, global accounting standards has been met, the IASB would focus on improving IFRSs inherited from the predecessor body to the IASB that were incorporated into IFRSs without much deliberation.

Editor's Note: In the ensuing question-and-answer session, Ms. Seidman noted that if the SEC were to adopt IFRSs in the United States, the FASB would play a role similar to that of other national standard setters in countries that have adopted IFRSs. However, if IFRSs were incorporated in the United States through an endorsement process, the FASB would play the role of identifying the IFRSs it would like to modify and determining how best to implement those modifications. Ms. Seidman also indicated that in the near term, the FASB could play the role of determining any remaining differences between U.S. GAAP and IFRSs and evaluating them for their significance (i.e., whether these are differences that users care about).

When asked how long it would take the United States to adopt IFRSs, Sir Tweedie responded, in part:

> You will have time, and it is clearly what the SEC will think about. . . . Remember . . . the whole MoU is designed to bring U.S. GAAP and IFRSs closer together so there should be not a massive shock when the accounts are produced under IFRS. . . . What is the easiest way to ease you in? . . . It's clearly judged how long you need — maybe, several years — before you do the switch, if the decision [by the SEC to adopt IFRSs in the United States] is made.

Furthermore, addressing concerns about the IASB's political independence, Sir Tweedie stated, in part:

> [Both the IASB and FASB] have been pushed around . . . the Monitoring Board is going to help us because if one of the members of the Monitoring Board — Europe or Japan — . . . demands something, there are others there who can push back, and that is the counter to political interference. . . . That's why the decision [by the SEC on whether to adopt IFRSs in the United States] next year is so important because at present if somebody wants something and the SEC said 'We object,' the answer is 'So what? It does not affect you.' Once it might affect the U.S., the game completely changes.

Standard-Setting Update

Mr. Golden discussed the FASB's and IASB's common goal of developing a single set of high-quality accounting standards and emphasized that neither board will rush to issue a standard that, in its opinion, does not improve current financial reporting requirements. However, he acknowledged that the June 2011 target date is important, since the SEC's decision of whether to incorporate IFRSs into the U.S. financial reporting system will be influenced by the status of the boards' convergence efforts in 2011. Mr. Golden also gave an overview of the boards' current priorities and indicated that their modified strategy and work plan have enabled them to focus on aspects of U.S. GAAP and IFRSs that need the most improvement.

Mr. Teixeira and Mr. Golden further discussed the boards' convergence efforts, in particular the following projects:

- Fair value measurement.
- Consolidations.
- Other comprehensive income.

For these projects, they gave a timeline and summary of the history and major milestones as well as the expected timing of the publication of any exposure drafts or final standards.

Editor's Note: For more information about other comprehensive income and fair value measurement projects, see Deloitte's May 27, 2010, and June 30, 2010, *Heads Up* newsletters.

In addition, panel discussions at the conference addressed standard-setting activities related to revenue recognition, leases, and financial instruments.

Revenue Recognition

Mr. Bement and Mr. Rees focused on the feedback the FASB and IASB received as a result of the outreach activities they have undertaken in their joint project on revenue recognition, including conferences, private meetings, webcasts, and roundtables. In addition, they noted that the boards have been reviewing the nearly 1,000 comment letters they have received on the revenue recognition exposure draft. Mr. Rees indicated that while constituents generally support the principle of a single comprehensive revenue recognition model, they have expressed concerns about the exposure draft and how to apply its principles.

Editor's Note: The FASB and IASB staffs presented a summary of these concerns, along with a detailed timeline for further deliberation on the project, to the boards on December 14, 2010.

Mr. Rees specifically highlighted two principles in the exposure draft that garnered significant opposition from constituents: (1) the concept of control and (2) the identification of separate performance obligations. The boards' staffs believe that these principles are "fundamental" to the exposure draft and plan to take concerns about them to the boards for further deliberation in January. Mr. Rees discussed various other constituent concerns and noted that the boards will redeliberate them over the next several months.

Editor's Note: For more information about the feedback the boards have received, see Deloitte's December 9, 2010, *Heads Up*.

In the question-and-answer session, Mr. Rees noted that constituents were particularly "worked up" about the guidance on accounting for warranties and stated that it will definitely be subject to redeliberation.

When Mr. Bement was asked about whether accounting for long-term construction or production-type contracts (ASC 605-35) would be outside the scope of the project, he reiterated the boards' desire to achieve a single comprehensive revenue standard.

Finally, when asked about the timing for completing the project, Mr. Bement indicated that the plan was still to issue a final standard by the middle of 2011; however, he acknowledged the timeline was "aggressive."

Leases

The panelists' discussion of leases focused on the FASB's and IASB's recent exposure drafts on this subject, both published on August 17, 2010.

Editor's Note: For further discussion of the exposure drafts, see Deloitte's August 17, 2010, *Heads Up*.

The panelists highlighted comments constituents have made during the boards' outreach as well as in comment letters, noting that concerns have been raised about the proposals for both the lessee and lessor models.

For the lessee model, the panelists discussed:

- Evaluation of the lease term.
- Estimation of variable cash flows (contingent rents and residual value guarantees).
- Classification in the income statement.

Regarding the lessor model, the panelists mentioned that there has been significant debate concerning the suitability of having two models for lessors: the derecognition approach and the performance obligation approach. The panelists noted that entities may find it difficult to determine which model is appropriate in certain circumstances.

Other items mentioned as requiring further deliberation include lease incentives, build-to-suit leases, leasehold improvements, month-to-month leases, and inflation-adjusted rents.

Ms. Zeyher indicated that these items are likely to be considered during the boards' redeliberation process.

Financial Instruments

Representatives from the preparer, user, and auditor communities discussed certain elements of the FASB's exposure draft *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities*, which was issued in May 2010. Among other issues, the panelists discussed (1) whether fair value should be the primary measurement basis for financial instruments, (2) classification criteria based on an entity's business strategy, (3) the FASB's and IASB's credit impairment models, and (4) proposed revisions to hedge accounting. The remarks made by the panelists were generally consistent with the broad feedback received by the FASB in comment letters on the exposure draft, which were due September 30, 2010.

During their prepared remarks, Mr. Golden and Mr. Teixeira reiterated the boards' commitment to finalize their respective accounting standards on financial instruments by June 30, 2011.

Editor's Note: For more information on the exposure draft and comment letter analysis, see Deloitte's November 5, 2010, and May 28, 2010, *Heads Up* newsletters.

Working With the SEC Staff

Speakers	Topics Covered
• Linda Bergen, Director and Head of Research and Reporting, Corporate Accounting Policy, Citigroup • Brian Bhandari, Accounting Branch Chief, SEC's Division of Corporation Finance • Wayne Carnall, Chief Accountant, SEC's Division of Corporation Finance • Angela Crane, Associate Chief Accountant, SEC's Division of Corporation Finance • Jamie Miller, Vice President, Controller and Chief Accounting Officer, General Electric Company • Sagar Teotia, Professional Accounting Fellow, SEC's Office of the Chief Accountant	• SEC staff filing review observations • Diversity in the application of alternative accounting policies • Consultative process related to the application of IFRSs

SEC Staff Filing Review Observations

Ms. Crane discussed the types of filings that the SEC's Division of Corporation Finance (the "Division") reviews as well as the types of comments the Division may issue during the Division's filing review process. Ms. Crane indicated that in addition to filings with the SEC, information from other public sources, such as the registrant's Web site and earnings calls, may be subject to review and comment by the SEC staff. In addition, Mr. Carnall indicated that these are common sources of comments and questions.

Mr. Bhandari identified the following types of disclosures, or lack of disclosures, that may prompt comments from the SEC staff during its filing review process:

- Missing or incomplete disclosures required by GAAP or SEC rules.
- Expectations of external events (e.g., impact of the economy).
- Inconsistencies between different sources of information such as articles, press releases, analyst calls, and filed documents.
- Accounting implications of underlying agreements filed as exhibits to the registrant's filings.
- Limited discussion of changes in the registrant's business.
- Changes in liquidity.
- Lack of specificity in accounting policies.

Mr. Carnall stressed that registrants should prepare disclosures for investors rather than prepare them to avoid comments from the SEC staff. In addition, Mr. Carnall believes that Codification references are not informative to investors and encourages registrants to describe accounting concepts rather than refer to particular Codification sections. He also indicated that one of the Division's objectives is to conduct a "continuous review program" for selected financial institutions and financial related businesses. As part of this program, the SEC staff would review registrants' filings on an almost "real time basis," with the goal of performing more frequent and continuous reviews and resolving issues in a timelier manner. Mr. Carnall further noted that these registrants may in certain instances receive comments from the Division on their press releases even before they file their periodic reports.

Editor's Note: During the Conference, Meredith Cross, director of the SEC's Division of Corporation Finance, indicated that the Division is taking a fresh look at the review program and at how it can be more effective. For more information about the SEC review program, see the SEC Initiatives and Communications topic.

For additional information about the Division and its filing review process, see the Division's Filing Review Process as well as its Overview of the Legal and Regulatory Policy Offices. These documents specify, among other items, (1) the organization of the Division and contact information, (2) how the Division selects filings for review, (3) the reconsideration process, and (4) how to request interpretive guidance. Also, see Appendix A of Deloitte's *SEC Comment Letters — Including Industry Insights: A Snapshot of Current Themes* for additional information on the filing review process and the reconsideration process.

Diversity in the Application of Alternative Accounting Policies

Mr. Carnall referred to situations in which practice is diverse with respect to certain areas of accounting. He indicated that in those instances, the SEC staff may ask registrants to expand the disclosures in the notes to the financial statements or in MD&A to address issues of diversity or noncomparability. However, the SEC staff will not ask a registrant to disclose "hypothetical presentations" to explain what the registrant's results would have been if the registrant had chosen an alternative accounting treatment. In addition, the SEC staff may discuss the diversity with the SEC's Office of the Chief Accountant, the EITF, and standard setters to assess whether there should be a change in accounting standards to address the diversity.

Consultative Process Related to the Application of IFRSs

Mr. Teotia stated that the SEC staff's process for interpreting and answering IFRS-related inquiries is no different from the process it uses for U.S. GAAP-related inquires and can range from conducting internal research to having discussions with the inquiring parties, foreign regulators, and the IASB staff.

Appendix A: Glossary of Topics, Standards, and Regulations

FASB Accounting Standards Codification Subtopic 323-10, *Investments—Equity Method and Joint Ventures: Overall*

FASB Accounting Standards Codification Subtopic 360-20, *Property, Plant, and Equipment: Real Estate Sales*

FASB Accounting Standards Codification Topic 450, *Contingencies*

FASB Accounting Standards Codification Subtopic 605-35, *Revenue Recognition: Construction-Type and Production-Type Contracts*

FASB Accounting Standards Codification Topic 740, *Income Taxes*

FASB Accounting Standards Codification Subtopic 740-10, *Income Taxes: Overall*

FASB Accounting Standards Codification Subtopic 810-10, *Consolidation: Overall*

FASB Accounting Standards Codification Subtopic 810-20, *Consolidation: Control of Partnerships and Similar Entities*

FASB Accounting Standards Codification Subtopic 815-40, *Derivatives and Hedging: Contracts in Entity's Own Equity*

FASB Accounting Standards Codification Topic 860, *Transfers and Servicing*

FASB Accounting Standards Codification Topic 970, *Real Estate — General*

FASB Accounting Standards Update No. 2010-02, *Accounting and Reporting for Decreases in Ownership of a Subsidiary — A Scope Clarification*

FASB Statement No. 167, *Amendments to FASB Interpretation No. 46(R)*

FASB Statement No. 132(R), *Employers' Disclosures About Pensions and Other Postretirement Benefits* — an Amendment of FASB Statements No. 87, 88, and 106

FASB Statement No. 132, *Employers' Disclosures About Pensions and Other Postretirement Benefits* — an Amendment of FASB Statements No. 87, 88, and 106

FASB Statement No. 5, *Accounting for Contingencies*

FASB Interpretation No. 46(R), *Consolidation of Variable Interest Entities* — an Interpretation of ARB No. 51

FASB Staff Position (FSP) No. FAS 132(R)-1, "Employers' Disclosures About Postretirement Benefit Plan Assets"

EITF Issue No. 10-E, "Accounting for Deconsolidation of a Subsidiary That Is In-Substance Real Estate"

EITF Issue No. 07-5, "Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity's Own Stock"

SEC Staff Accounting Bulletin (SAB) No. 99, codified as SAB Topic 1.M, "Materiality"

SEC Staff Accounting Bulletin (SAB) No. 108, codified as SAB Topic 1.N, "Considering the Effects of Prior Year Misstatements When Quantifying Misstatements in Current Year Financial Statements"

SEC Regulation S-X, Rule 1-02, "Definitions of Terms Used in Regulation S-X (17 CFR Part 210)"

SEC Regulation S-X, Rule 3-05, "Financial Statements of Businesses Acquired or to Be Acquired"

SEC Regulation S-X, Rule 3-09, "Separate Financial Statements of Subsidiaries Not Consolidated and 50 Percent or Less Owned Persons"

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

SEC Regulation S-X, Rule 3-16, "Financial Statements of Affiliates Whose Securities Collateralize an Issue Registered or Being Registered"

SEC Regulation S-X, Rule 4-08, "General Notes to Financial Statements"

SEC Regulation S-K, Item 10(e), "Use of Non-GAAP Financial Measures in Commission Filings"

SEC Regulation S-K, Item 103, "Legal Proceedings"

SEC Regulation S-K, Item 304, "Changes in and Disagreements With Accountants on Accounting and Financial Disclosure"

SEC Accounting Series Release No. 142 (FRR Section 202), *Reporting Cash Flow and Other Related Data*

SEC Financial Reporting Release (FRR) No. 36, *Management's Discussion and Analysis of Financial Condition and Results of Operations; Certain Investment Company Disclosure*

SEC Financial Reporting Release (FRR) No. 72, *Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results Operations*

SEC Final Rule Release No. 33-7118, *Financial Statements of Significant Foreign Equity Investees and Acquired Foreign Businesses of Domestic Issuers and Financial Schedules*

SEC Final Rule Release No. 33-9002, *Interactive Data to Improve Financial Reporting*

SEC Final Rule Release No. 33-9089, *Proxy Disclosure Enhancements*

SEC Final Rule Release No. 33-9136, *Facilitating Shareholder Director Nominations*

SEC Final Rule Release No. 33-9142, *Internal Control Over Financial Reporting in Exchange Act Periodic Reports of Non-Accelerated Filers*

SEC Interpretive Release No. 33-9106, *Commission Guidance Regarding Disclosure Related to Climate Change*

SEC Interpretive Release No. 33-9144, *Commission Guidance on Presentation of Liquidity and Capital Resources Disclosures in Management's Discussion and Analysis*

SEC Concept Release No. 34-62495, *Concept Release on the U.S. Proxy System*

SEC Proposed Rule Release No. 33-9143, *Short-Term Borrowings Disclosure*

SEC Proposed Rule Release No. 33-9148, *Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act*

SEC Proposed Rule Release No. 33-9150, *Issuer Review of Assets in Offerings of Asset-Backed Securities*

SEC Proposed Rule Release No. 33-9153, *Shareholder Approval of Executive Compensation and Golden Parachute Compensation*

SEC Proposed Rule Release No. 34-63237, *Proposed Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934*

SEC Securities Exchange Act of 1934, Rule 12h-5, "Exemption for Subsidiary Issuers of Guaranteed Securities and Subsidiary Guarantors"

SEC Division of Corporation Finance: Financial Reporting Manual

- Topic 2, "Other Financial Statements Required"
- Topic 4, "Independent Accountants' Involvement"
- Topic 6, "Foreign Private Issuers & Foreign Businesses"
- Topic 8, "Non-GAAP Measures of Financial Performance, Liquidity and Net Worth"
- Topic 9, "Management's Discussion and Analysis of Financial Position and Results of Operations (MD&A)"
- Topic 13, "Effects of Subsequent Events on Financial Statements Required in Filings"

PCAOB Auditing Standard No. 7, *Engagement Quality Review*

PCAOB Staff Audit Practice Alert No. 2, *Matters Related to Auditing Fair Value Measurements of Financial Instruments and the Use of Specialists*

PCAOB Staff Audit Practice Alert No. 3, *Audit Considerations in the Current Economic Environment*

PCAOB Staff Audit Practice Alert No. 5, *Auditor Considerations Regarding Significant Unusual Transactions*

PCAOB Staff Audit Practice Alert No. 6, *Auditor Considerations Regarding Using the Work of Other Auditors and Engaging Assistants From Outside the Firm*

IAS 10, *Events After the Reporting Period*

IAS 18, *Revenue*

IAS 19, *Employee Benefits*

Appendix B: Abbreviations

Abbreviation	Description
AICPA	American Institute of Certified Public Accountants
ARB	Accounting Research Bulletin
ASC	FASB Accounting Standards Codification
ASR	Accounting Series Release
ASU	FASB Accounting Standards Update
AU	U.S. Auditing Standards
CAO	chief accounting officer
CAQ	Center for Audit Quality (affiliated with the AICPA)
CEO	chief executive officer
CFO	chief financial officer
CFR	Code of Federal Regulations
CGU	cash generating unit
CIFiR	SEC Advisory Committee on Improvements to Financial Reporting
CODM	chief operating decision maker
CPA	certified public accountant
C&DI	SEC Compliance and Disclosure Interpretation
DTA	deferred tax asset
EITF	FASB's Emerging Issues Task Force
EQR	engagement quality review
FASB	Financial Accounting Standards Board
FCPA	Foreign Corrupt Practices Act
FPI	foreign private issuer
FRM	SEC Financial Reporting Manual
FRR	Financial Reporting Release
FSP	FASB Staff Position
GAAP	generally accepted accounting principles
GAAS	generally accepted auditing standards
GAO	U.S. Government Accountability Office
GASB	Governmental Accounting Standards Board

GHG	greenhouse gas emissions
IAS	International Accounting Standard
IASB	International Accounting Standards Board
ICFR	internal control over financial reporting
IFAC	International Federation of Accountants
IFRS	International Financial Reporting Standard
IIRC	International Integrated Reporting Committee
MD&A	Management's Discussion and Analysis
MoU	Memorandum of Understanding
PCAOB	Public Company Accounting Oversight Board
SAB	SEC Staff Accounting Bulletin
SEC	Securities and Exchange Commission
SMEs	small and medium-sized entities
VIE	variable interest entity
XBRL	eXtensible Business Reporting Language

Appendix C: Published Speeches and Presentations

The full text of conference speeches and presentations that are publically available and can be viewed on standard-setters' and other Web sites can be viewed by clicking the links below.

Speakers

Martin Baumann, Chief Auditor and Director of Professional Standards, PCAOB

Paul Beswick, Deputy Chief Accountant, SEC's Office of the Chief Accountant

Wesley Bricker, Professional Accounting Fellow, SEC's Office of the Chief Accountant

Brian Croteau, Deputy Chief Accountant, SEC's Office of the Chief Accountant

Daniel Goelzer, Acting Chairman, PCAOB

James Kroeker, Chief Accountant, SEC's Office of the Chief Accountant

Claudius Modesti, Director of Enforcement, PCAOB

John Offenbacher, Senior Associate Chief Accountant, SEC's Office of the Chief Accountant

Nilima Shah, Associate Chief Accountant, SEC's Office of the Chief Accountant

Sagar Teotia, Professional Accounting Fellow, SEC's Office of the Chief Accountant

Lisa Watson, Professional Accounting Fellow, SEC's Office of the Chief Accountant

Slide Presentations

Wayne Carnall, Chief Accountant, SEC's Division of Corporation Finance, and other speakers

Wayne Carnall, Chief Accountant, SEC's Division of Corporation Finance, and other speakers

Craig Olinger, Deputy Chief Accountant, SEC's Division of Corporation Finance

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- Year-End Reporting: An Update on Current Issues and Items on the Horizon (January 10, 2 p.m. (EST)).

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