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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.

O Come, All Ye Accountants!

Highlights of the 2011 AICPA National Conference on Current SEC and PCAOB Developments

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

Nearly 2,000 people descended on Washington, D.C., for this year's annual AICPA[1] conference, hoping to hear, among other things, the SEC announce whether and, if so, how and when IFRSs will be incorporated into the U.S. financial reporting system for public companies. But unfortunately, after three days, another conference ended with no such announcement. SEC Chief Accountant James Kroeker noted that although the SEC was expected to reach a decision by the end of 2011, a final determination has not yet been made. However, Mr. Kroeker did point out that the SEC staff (1) has completed the majority of its fieldwork and (2) is working toward finalizing a comprehensive report on its work plan, which is expected to be completed within the next few months.

However, incorporation of IFRSs was not the only subject 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 matters. Organized by topic, this *Heads Up* contains key insights into items discussed at this year's conference, focusing on experts' views on financial reporting and auditing matters as well as on 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. Also see Selected Sessions and Speakers for links to publicly available speeches and presentations from the conference.

Executive Summary

Many of this year's themes were similar to those of recent years, with a few new items such as (1) management's and auditors' responsibilities related to information received from pricing services and (2) the SEC's renewed focus on transparency through enhanced disclosures and other initiatives like the roundtable series on financial reporting. This executive summary gives a brief overview of the major themes discussed at the conference; later sections outline speeches and presentations in more detail.

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

Conference Themes

Adoption of IFRSs

Mr. Kroeker stated that he remains positive about the prospect of IFRS incorporation but wants to ensure that a "strong and lasting framework" is established. He added that the feedback received on the SEC's potential approach to incorporating IFRSs into the U.S. reporting system has been encouraging. Similarly, SEC Deputy Chief Accountant Paul Beswick indicated in his posted remarks (Mr. Beswick did not attend this year's conference) that the SEC "received a lot of well thought out and helpful feedback" on its May 2011 staff paper on potential ways for IFRSs to be incorporated into the U.S. financial system. In discussing his views on the staff paper, Mr. Kroeker stated his belief that the framework for incorporating IFRSs should (1) "[p]rovide both in fact and in substantive operation clear U.S. authority over standards applicable in the U.S. capital markets"; (2) "[p]rovide for and facilitate a strong U.S. voice in the process of establishing global accounting standards"; and (3) "[b]e responsive to the economic and other impacts of change."

FASB Chairman Leslie Seidman and IASB Chairman Hans Hoogervorst also generally support the endorsement approach described in the SEC's May 2011 staff paper. Ms. Seidman described a "modified incorporation" approach that the FASB's parent organization, the FAF, had proposed to the SEC. Under this approach, the boards would complete their priority convergence projects and the IASB would subsequently issue new accounting standards. The FASB would later incorporate the standards into U.S. GAAP. In addition, the FASB would retain the ability to set U.S. standards if there are significant topics that are not on the IASB's active agenda. In his remarks, Mr. Hoogervorst seemed more cautious about this approach. He stated that there should be a clear timeline for the completion of the initial endorsement process and that there should be a very high threshold for non-endorsement. Further, he expressed his view that deviations from standards issued by the IASB should be "extremely rare."

Editor's Note: Mr. Kroeker and Ms. Seidman believed that the SEC should consider whether to retain U.S. GAAP as the basis for U.S. financial reporting after the incorporation of IFRSs into U.S. GAAP. This would mitigate the costs and complexity of introducing a new set of standards under regulatory regimes, contractual documents, and U.S. laws in which compliance with U.S. GAAP is often specifically contemplated.

Mr. Hoogervorst also suggested that before making a final decision about the incorporation of IFRSs, the SEC should seriously consider giving a limited number of U.S. companies the option to early adopt IFRSs for their consolidated financial reporting in SEC filings. He argued that this would be a good test of whether IFRSs work in the U.S. financial system and would signal the U.S. commitment to adopt IFRSs. However, Mr. Kroeker and Ms. Seidman questioned the notion of permitting the optional use of IFRSs domestically. Ms. Seidman noted that rule makers and financial statement users have cited investors' concerns that allowing such an option would result in a lack of comparability in financial reporting.

Status of International Convergence of Financial Reporting Standards

Throughout the conference, senior representatives from the SEC, FASB, and IASB gave updates on numerous standard-setting projects for converging and jointly improving accounting standards, including those on financial instruments, revenue, and leasing. They all stressed the importance of high-quality financial reporting standards. Mr. Kroeker recognized the progress the FASB and IASB have made in converging international accounting standards and noted that although many of the projects have taken longer than originally expected, largely because of ongoing deliberations, he believed that "success should be, and ultimately will be, measured by the quality of the resulting output." Mr. Kroeker admitted that at this time, many of the projects are still months or more away from finalization; however, he believes that the additional time is warranted.

In contrast to his recent speech in Australia, in which he suggested ending the convergence efforts, Mr. Hoogervorst stated that the "convergence history with FASB has been extremely useful in getting us to a point where IFRS and US GAAP are much improved and closer together." However, he did state that in the long term, "the *status quo* is an unstable way of decision making that inevitably leads to diverged solutions or sub-optimal outcomes." He cited a number of examples illustrating his concerns that "when you have two boards of independently thinking professionals, sometimes they will simply reach different conclusions."

Mr. Kroeker noted that although the progress on certain projects was encouraging, including the finalization of a converged standard on other comprehensive income and the recent joint developments on leases and revenue, a convergence solution to a project such as financial instruments seems less possible at this time. Nevertheless, he encouraged the boards to continue to move forward, even when there is a disparity, and take "all reasonable steps to maximize the prospect of converged, high-quality solutions."

The Auditing Profession and Attributes to Improve Audit Quality

A common theme at this year's conference was the importance of audit quality and its relationship to investor protection and restoring public confidence. PCAOB Chairman James Doty noted that "[w]e are experiencing extraordinarily challenging times, and change driven by external events and circumstances as well as change inside the profession." Given the current challenges, presenters outlined actions that management, auditors, audit committees, and other stakeholders can take to improve audit quality and restore the confidence of investors.

Mr. Kroeker and Mr. Doty both discussed the three projects that the PCAOB has under way as part of its initiatives to enhance the relevance, credibility, and transparency of audits. Mr. Doty explained that the concept release on the auditor's reporting model was not intended to change the fundamental role of the auditor but to respond to investors' call for more insight into the auditor's work. He also described the basis for the PCAOB's concept release on auditor rotation, explaining that mandatory auditor rotation would reduce the pressures that are threatening to undermine auditor independence. Mr. Doty further expressed his belief that the PCAOB's proposed amendments to its auditing standards would improve audit transparency by enhancing disclosures about audit participants, including the partner in charge of the audit, and about other firms involved in the audit.

Mr. Doty discussed recent inspection results and noted that the results "show a significant and concerning increase in inspection findings." This concern was echoed by Mr. Kroeker, who commented that although he thought that the performance of auditors and the reliability of financial reporting had improved significantly, the deficiencies identified in PCAOB inspections indicated that there was still room for improvement.

Another topic discussed by Mr. Kroeker was audit committees and the critical role that they play in helping audit firms and regulators improve audit quality. He covered many of the current expectations of audit committees and challenged them to improve their oversight responsibilities going forward, including asking the "tough questions of the auditor" throughout the year and during reappointments.

Responsibilities Regarding Information From Pricing Services

With the impacts of the financial crisis still lingering in the United States, the continued focus on the valuation of assets — particularly financial instruments — is not surprising. SEC and PCAOB staff members stressed the importance of auditors' procedures to adequately challenge the valuation assertion for investments, especially those that are not exchange-traded, because registrants often rely on valuations from third-party pricing services to determine the investments' fair value. However, considerable emphasis was also placed on the responsibilities of a registrant's management and audit committees to comply with GAAP related to the proper recording and disclosure of investments (subject to valuations from pricing services) within the fair value hierarchy by (1) adequately considering pricing services' valuation techniques and assumptions and (2) maintaining a sufficient system of internal control over financial reporting. Auditors were also reminded of their responsibility to evaluate the effectiveness of registrants' internal controls over information received from pricing services and that a registrant's procedures may help auditors assess the presence of control deficiencies and their severity.

Improving Transparency

Transparency was a frequent topic of discussion at this year's conference. Presenters stressed the importance of providing transparent disclosures to better inform investors about key material risks and uncertainties affecting registrants — stemming mainly from macroeconomic conditions and their specific impacts. In particular, the SEC staff has issued guidance on, and staff comment letters have asked registrants to provide enhanced disclosures about, liquidity, loss contingencies, income taxes, and asset impairment. The SEC staff continues to encourage registrants to (1) provide early warning disclosures (to avoid later "surprise" disclosures) and (2) to revisit disclosures to reduce "disclosure overload" (i.e., repetition of information in disclosures).

The SEC staff also indicated that other initiatives are under way to promote transparency in the financial reporting system. These include active outreach initiatives to solicit feedback from U.S. stakeholders. One recent initiative discussed at this year's conference was the SEC's new roundtable series on financial reporting (the "Financial Reporting Series"). Mr. Kroeker noted that the intention of the Financial Reporting Series is to gather "a broad spectrum of views and foster an informed dialogue on some of the most difficult financial reporting topics." Roundtable participants include capital market entities, preparers, and auditors. The insights from the Financial Reporting Series will be shared not only with the SEC staff but also with the PCAOB, the FASB, and any other regulators or interested parties that would find it useful in "early identification of risks related to, as well as areas for potential improvements in, the reliability and usefulness of financial reporting to investors."

The inaugural roundtable on November 8, 2011, focused on measurement uncertainty in financial reporting. Some key takeaways that the SEC, FASB, and PCAOB may consider going forward include:

- Ensuring that financial reporting is not commingled with financial analysis.
- Improving the content of the financial reporting package as a whole.
- Establishing clear measurement and disclosure frameworks (that is, a "compass" or "anchor" for financial reporting).

Selected Sessions and Speakers

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

Sessions/Speakers

Keynote Address — PCAOB

- James Doty, Chairman, PCAOB

Remarks of the SEC Chief Accountant

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

Remarks of the SEC Deputy Chief Accountants

- Paul Beswick, Deputy Chief Accountant, SEC's Office of the Chief Accountant (via prepared remarks)
- Brian Croteau, Deputy Chief Accountant, SEC's Office of the Chief Accountant
- Julie Erhardt, Deputy Chief Accountant, SEC's Office of the Chief Accountant
- Mike Starr, Deputy Chief Accountant for Policy Support and Market Monitoring, SEC's Office of the Chief Accountant

OCA — Current Projects

- Shelley Luisi, Senior Associate Chief Accountant, SEC's Office of the Chief Accountant
- Jenifer Minke-Girard, Senior Associate Chief Accountant, SEC's Office of the Chief Accountant
- Christian Peo, Professional Accounting Fellow, SEC's Office of the Chief Accountant
- Jason Plourde, Professional Accounting Fellow, SEC's Office of the Chief Accountant

Developments in the Division of Corporation Finance

- Meredith Cross, Director, SEC's Division of Corporation Finance
- Todd Hardiman, Associate Chief Accountant, SEC's Division of Corporation Finance
- Ryan Milne, Associate Chief Accountant, SEC's Division of Corporation Finance
- Kyle Moffatt, Associate Chief Accountant, SEC's Division of Corporation Finance
- Craig Olinger, Deputy Chief Accountant, SEC's Division of Corporation Finance
- Nili Shah, Deputy Chief Accountant, SEC's Division of Corporation Finance
- Mark Shannon, Associate Chief Accountant, SEC's Division of Corporation Finance

MD&A Panel

- Brian Lane, Partner, Gibson, Dunn & Crutcher LLP
- Michael McTiernan, Assistant Director, SEC's Division of Corporation Finance
- Michael Widgren, Vice President, Corporate Controller, and CAO, Visteon

Sessions/Speakers

FASB and IASB Chair Addresses

- Hans Hoogervorst, Chairman, IASB
- Leslie Seidman, Chairman, FASB

Accounting Standard Setting Update

- Susan Cosper, Technical Director and EITF Chairman, FASB
- Alan Teixeira, Senior Director — Technical Activities, IFRS Foundation

Auditing Standard Setting Update

- Martin Baumann, Chief Auditor and Director of Professional Standards, PCAOB
- Jay Hanson, Board Member, PCAOB
- Jamie Miller, Vice President — Controller and Chief Accounting Officer, General Electric Company

SEC Enforcement Division Update

- Robert Khuzami, Director, SEC's Division of Enforcement
- Howard Scheck, Chief Accountant, SEC's Division of Enforcement

FinREC Update

- Richard Paul, Chairman, FinREC, and Partner, Deloitte & Touche LLP

Revenue Recognition

- Kenneth Bement, Project Manager, FASB
- Russell Hodge, Global Technical Controller, General Electric Company
- Paul Munter, Partner, Department of Professional Practice — Audit and Advisory, KPMG
- Liesl Nebel, Accounting Policy Controller, Intel Corporation

Financial Instruments

- Terry Cooper, Global Controller, General Electric Company
- Jon Howard, Partner, Deloitte & Touche LLP
- Xihao Hu, Senior Vice President and Chief Accountant, Toronto-Dominion Bank Group
- John Smith, Board Member, IASB

Leases

- John Bishop, Partner, PricewaterhouseCoopers LLP
- Danielle Zeyher, Project Manager, FASB

Sessions/Speakers	Sessions/Speakers
SEC Staff Reviews — A Closer Look • Brian Bhandari, Accounting Branch Chief, Division of Corporation Finance Office of Beverages, Apparel and Mining, SEC • Andrea Genschaw, Vice President and Assistant Controller, Level 3 Communications • James Lopez, Legal Branch Chief, Division of Corporation Finance Office of Beverages, Apparel and Mining, SEC • Jamie Miller, Vice President — Controller and Chief Accounting Officer, General Electric Company • Melissa Rocha, Accounting Branch Chief, Division of Corporation Finance Office of Beverages, Apparel and Mining, SEC **PCAOB Registration, Inspection, and Enforcement Update** • Robert Maday, Regional Associate Director, Inspections • Claudius Modesti, Director, Enforcement • Helen Munter, Director, Division of Registration & Inspections	**XBRL Update** • Jeffrey Naumann, Director, Deloitte & Touche LLP • Campbell Pryde, President and CEO, XBRL US • Ted Uehlinger, Associate Chief Accountant, SEC • Susan Yount, Office of Interactive Data, SEC **Adopting IFRS in the U.S. Regulatory Environment** • Susan Callahan, Manager, Accounting Policy & Special Studies, Ford Motor Company • Craig Olinger, Deputy Chief Accountant, SEC's Division of Corporation Finance • Jill Davis, Associate Chief Accountant, SEC's Division of Corporation Finance

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Speech Topics

Audit Standard Setting and Other PCAOB Activities

A common theme expressed by many of this year's presenters was the importance of audit quality and its relationship to investor protection and restoring public confidence. For example, Mr. Doty noted, "We are experiencing extraordinarily challenging times, and change driven by external events and circumstances as well as change inside the profession." He also remarked that the "financial audit is the linchpin for restoring confidence." Given the current economic challenges, presenters outlined actions that management, auditors, audit committees, and other stakeholders can take to improve audit quality and restore the confidence of investors.

Current Economic Environment

Mr. Baumann noted that preparers and auditors are operating in a highly challenging and volatile economic environment that creates unique challenges for each. He also discussed PCAOB Staff Audit Practice Alert No. 9, *Assessing and Responding to Risk in the Current Economic Environment* ("Practice Alert 9"), which was issued by the PCAOB on the same day as Mr. Baumann's remarks and is intended to help auditors identify and respond to matters that are unique to the current economic environment. He observed that Practice Alert 9 covers four areas: (1) considering the impact of economic conditions on the audit, (2) auditing fair value measurements and estimates, (3) considering a company's ability to continue as a going concern, and (4) auditing financial statement disclosures.

Mr. Baumann reminded preparers and auditors that PCAOB Auditing Standards 8–15, also referred to as the "risk assessment standards," are effective for the first time this year, and he emphasized the importance of considering these standards in responding to the challenging economic environment. He observed that the risk assessment standards establish enhanced requirements for the auditor's risk assessment process, provide additional factors relevant to identifying significant risk in the audit, and enhance the requirements for auditing financial statement disclosures. Mr. Baumann also reiterated the observation in Practice Alert 9 that the economic environment might require auditors to reassess the appropriateness of the planned audit strategy, materiality levels, risk assessments (including identified fraud risks and other significant risks), and planned audit responses. For example, Practice Alert 9 describes the required evaluation of whether the prior year's information remains relevant and reliable as a basis for identification of, and response to, risks of material misstatement in the current year, given the volatile environment. Practice Alert 9 also refers to PCAOB Staff Audit Practice Alert No. 8, *Audit Risks in Certain Emerging Markets* ("Practice Alert 8"), which addresses heightened risk of fraud in audits of companies with operations in emerging markets. Mr. Baumann also emphasized the importance of financial statement disclosures and the auditor's related responsibilities under the risk assessment standards.

Editor's Note: Even though Practice Alert 8 is intended for auditors, management and audit committees may find it useful in understanding risks of material misstatement that may exist in emerging markets.

Update to Auditor's Reporting Model Project

In June 2011, the PCAOB issued a concept release on potential changes to the auditor's reporting model in response to calls from investors on the need for more transparency. Mr. Croteau remarked that the reporting model project "deals with questions about perceived information asymmetry between investors, management, audit committees and auditors and contemplates the appropriate role for auditors in reducing that asymmetry." Mr. Doty noted that the PCAOB is exploring ways to increase the usefulness of the auditor's report but does not intend to make the auditor the primary source of information and analysis. Likewise, Mr. Croteau stated that he believes "it's important to preserve their role as auditors rather than preparers of a company's financial reporting information."

Various speakers noted that a large number of responses had been received on the concept release. Mr. Doty indicated that there was "an evident emerging consensus on some matters" such as the need for the auditor's report to change but to retain the binary (i.e., "pass/fail") model. Responses from constituents included support for different alternatives proposed, including the required use of an emphasis paragraph, an Auditor's Discussion and Analysis, or an audit of the MD&A. The PCAOB plans to meet in March 2012 to discuss the comments received and anticipates issuing a proposed auditing standard during 2012.

Editor's Note: For more information about the PCAOB's proposed auditing standard on the form of the auditor's report, see Deloitte's June 28, 2011, *Heads Up*. The International Auditing and Assurance Standards Board (IAASB) also has an active project on the auditor's report. The IAASB completed an exposure period of its consultation paper, *Enhancing the Value of Auditor Reporting: Exploring Options for Change*, on September 16, 2011. More information about this project is available on the International Federation of Accountants' Web site.

Auditor Independence and Skepticism

In August 2011, the PCAOB issued a concept release to solicit public comment on ways that auditor independence, objectivity, and professional skepticism could be enhanced. One approach considered in the concept release was the mandatory rotation of audit firms. Mr. Baumann and Mr. Hanson described the rationale for the PCAOB's proposal. Mr. Hanson noted that "auditor rotation is one thing that [the PCAOB is] putting out there for comment that may or may not solve the problem." Mr. Doty stated that "[a]uditor skepticism is the foundation for investor confidence in financial reporting [and] because skepticism is a state of mind [and] objectivity a silent success, their absence is rarely documented and can be particularly difficult to detect." Mr. Doty also cited the November 30, 2011, European Commission proposal for regulation "on the quality of audits of public interest entities," including a six-year term limit on audit engagements. He indicated that the PCAOB will thoughtfully evaluate the details, timing, and implications of the European proposal on the current concept release. Mr. Doty encouraged participants to submit candid feedback on the concept release before the close of the comment period on December 14, 2011, and to present alternative views that might solve the quality deficiencies.

Editor's Note: For more information about the PCAOB's concept release on auditor independence and audit firm rotation, see Deloitte's August 26, 2011, *Heads Up*.

Audit Committees

While acknowledging the importance of auditors and regulators in improving audit quality, Mr. Kroeker described the key role that audit committees play in improving audit quality. He noted that audit committees of listed issuers are directly responsible for the appointment, compensation, and oversight of the registered public accounting firm and suggested that "even the best audit committees can find ways to improve." Mr. Kroeker remarked that "appropriate audit committee oversight includes asking tough questions of the auditor, for example, about the culture at the audit firm, the results of PCAOB and internal inspections, the impact of non-audit service on auditor independence and objectivity, the audit team's risk assessments, and the quality and sufficiency of audit evidence obtained by audit team." In addition, Mr. Baumann noted the importance of the audit committee and described steps that the PCAOB is taking to improve the ability of audit committees to fulfill their oversight responsibilities. Specifically, he mentioned the PCAOB's standard on communication with the audit committee, which was intended to (1) enhance the relevance and effectiveness of the communications between the auditor and the audit committee and (2) emphasize the importance of effective, two-way communications between the auditor and the audit committee to better achieve the objectives of the audit. Mr. Baumann explained that the PCAOB intends to repropose this standard to reflect changes made in response to comments received during the initial exposure period in 2010 and as a result of the issuance of Auditing Standards 8–15. The reproposed standard will include communication requirements that are based on, and linked to, the auditor performance requirements in the PCAOB's auditing standards and interim auditing standards to help give audit committees the information they need to fulfill their obligations to shareholders. The reproposed standard will be a communication standard and will include no new requirements related to the performance of the audit itself.

Editor's Note: For more information about the PCAOB's original proposed release on audit committee communications, see Deloitte's July 26, 2010, *Heads Up*.

Broker-Dealer Reporting

In June 2011, the SEC proposed amendments to Rule 17a-5 to facilitate the ability of the PCAOB to implement its oversight of broker-dealers under the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"). In July, the PCAOB proposed new auditing and attestation standards for the audits of brokers and dealers. Mr. Croteau observed that because the SEC has not yet voted on a final rule, broker-dealers and their auditors should continue to comply with the existing requirements of Rule 17a-5, and auditors should refer to AICPA standards, rather than PCAOB standards, in their audit and attestation reports.

Cross-Border Inspections

The PCAOB continues to pursue its goal of being able to inspect all registered public accounting firms, regardless of geography, including firms that play a substantial role in audits of issuers. Mr. Doty indicated that "[inspection] findings demonstrate why it's so important that [the PCAOB] look at the parts of the audit not performed by the principal auditor, whether the principal auditor was in the U.S. or elsewhere. Indeed, they should be — and are — of concern to audit regulators everywhere." Mr. Doty noted that the PCAOB has recently made considerable progress in signing joint inspection agreements with European regulators and that he hopes the "Chinese authorities will also embrace joint inspections."

COSO Update

Mr. Peo indicated that the Committee of Sponsoring Organizations (COSO) has a project to update its internal controls framework and encouraged feedback on the proposed changes when they are issued. The proposed framework is expected to be released for public comment shortly, and the comment period is expected to close near the end of March 2012.

Consolidations

Variable Interest Arrangements in China

Noting that China has unique regulatory restrictions that prohibit foreign ownership in certain industries, Mr. Milne and Mr. Moffatt discussed disclosure considerations for registrants that, as a result of the Chinese restrictions, have used variable interest arrangements (and other contractual arrangements) to structure their foreign operations in China.

Focusing first on the principles-based disclosures in ASC 810, Mr. Milne and Mr. Moffatt discussed providing disclosures to give financial statement readers information about applicable risks of a Chinese foreign operation. He pointed out that in addition to complying with the disclosure requirements of ASC 810, registrants should consider disclosing the significant terms of a contract, such as (1) when it expires, (2) how it can be renewed, and (3) how the operator of the VIE can terminate the contract. Mr. Milne also noted other typical risks that a registrant should consider disclosing, including the following:

- Uncertainties related to whether an agreement is enforceable if it is not registered with the appropriate governmental authority.
- Uncertainties related to whether a contractual arrangement may be found to be in violation of Chinese regulations.
- Risks of misaligned interests when the owners of the VIE are different from the owners of the majority of the company's subsidiary.

Accordingly, Mr. Milne stated that a registrant's disclosures "should describe the risks and uncertainties and also describe how the company concluded that consolidation was still appropriate." Finally, Mr. Moffatt noted, regarding VIE structures in China, that "almost all of their assets in the operation are related to these specific VIEs" and that, as a result, "not only should there be disclosure about financial position, performance, and cash flows about the specific VIE, but there also should be disclosure related to that apart from the VIE." He indicated that registrants could provide such disclosures through (1) the inclusion of condensed consolidated balance sheets, income statements, and cash flow statements, in tabular form, for the most recent period presented or (2) a prominently presented narrative describing the assets and operations outside the VIE.

Editor's Note: In addition to focusing on registrants that have substantially all of their operations outside the United States, the SEC staff continues to comment on registrants' assessments related to consolidation of VIEs. Specifically, the staff's comments have centered on analyses of, and disclosures about, the registrant's (1) power to direct activities of a VIE that most significantly affect the VIE's economic performance and (2) rights to economic benefits or obligations to absorb losses. See Deloitte's *SEC Comment Letters — Including Industry Insights: Improving Transparency* for additional insight into consolidation of VIEs.

Contingencies

Loss Contingencies

Representatives from the SEC's Division of Corporation Finance discussed comments and observations related to registrants' disclosures about loss contingencies. Ms. Shah noted that the staff has continued to focus on both the accounting for and disclosures about loss contingencies, particularly on aspects that continue to evolve from the prior year (e.g., unexpected accruals and settlements, reasonably possible range of loss, and improving the clarity of disclosures). In addition, she indicated that there is a new focus on registrants' disclosures about loss recoveries from third parties and accrual of legal fees.

Regarding third-party recovery of losses, registrants were reminded to disclose (1) whether ranges of reasonably possible losses are disclosed gross or net of anticipated recoveries from third parties, (2) risks related to collectibility of anticipated recoveries, and (3) their accounting policy for uncertain recoveries. In providing such disclosures, registrants should consider all sources of recoveries, including insurance proceeds and indemnification agreements. The staff noted that registrants need to further consider the risk that these third parties may not be able to cover their obligation and how such a risk may affect their financial statements. For further discussion of these issues, see the highlights of the September 2011 CAQ SEC Regulations Committee joint meeting with the SEC staff.

The SEC staff further noted that ASC 450 does not include specific guidance on accounting for legal fees that a registrant has incurred or will incur. Registrants were reminded to disclose their policy for accruing legal costs. That is, entities should disclose whether legal costs are recorded "as incurred" or within the overall accrual for the related loss contingency and where these costs have been classified in the statement of operations.

The staff reiterated that registrants continue to struggle with renewing their disclosures about loss contingencies as related litigation evolves over time. In particular, the staff noted that disclosures should include more quantitative information as time passes or as a loss contingency nears resolution. Further, when a material settlement is disclosed during a period, the staff may review prior-period disclosures to determine whether such disclosures were appropriate. The staff indicated that, whenever possible, registrants need to focus on providing early-warning disclosures regarding the possibility of incurring a loss or settlement in future periods to avoid "surprise" disclosures in their financial statements.

In addition, Ms. Shah commented that registrants continue to use unclear language in their disclosures about loss contingencies. She encouraged registrants to keep disclosures simple and to use terminology in ASC 450 (such as "probable," "reasonably possible," and "remote") when drafting disclosures. Further, the staff noted that a registrant's contention that providing information about a loss contingency may be detrimental to efforts to litigate or settle it does not obviate the need to comply with the disclosure requirements of ASC 450. The staff noted that separate disclosure for each asserted claim is not required and that 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: Improving Transparency* for more information about loss contingencies, including extracts from SEC staff comments, Deloitte's analysis, and links to related resources.

Fair Value

Use of Third-Party Pricing Services to Measure Fair Value

The SEC staff and the PCAOB highlighted that management may use third-party pricing information to help it measure fair value and develop disclosures about those fair value measurements.

SEC Staff Comments

Mr. Shannon provided a sample of the types of comments that are typically issued to registrants that use third-party pricing information. The SEC staff in both the Division of Corporation Finance and the Division of Investment Management asks similar questions of registrants and registered investment companies. Such questions address topics such as how the entity uses the pricing services in complying with financial statement accounting and disclosure requirements, MD&A disclosure, management's assessment of ICFR, and the basic requirement to maintain books and records. Most notably, the staff has commented and raised questions on:

- Management's evaluation of the appropriateness of the third-party models as well as the accuracy and completeness of the data used in the valuation.
- The assessment of the observability of the data used in the valuation and how the information affected the fair value hierarchy determination.
- Third-party pricing service caveats on the use or reliability of the fair value estimates.
- The internal controls governing the use of the third-party pricing service.
- Management's determination that assumptions used in the valuation are consistent with management's accounting framework and are consistent with GAAP.

Management's Responsibility

Management has a number of responsibilities related to the use of third-party pricing services, the information obtained, and the ultimate financial reporting of the valuations performed by the pricing service. SEC staff comments ultimately stem from management's obligations to comply with GAAP, including disclosure requirements, and to maintain appropriate internal controls, including ICFR, to prevent or detect material misstatements.

Regarding compliance with GAAP, management must consider the valuation techniques and assumptions used by the pricing service, particularly in markets in which securities are not actively traded. Mr. Plourde stated the following:

> If the pricing service only provides a price for a given CUSIP with no information about the models or assumptions used to price it, **management may not have enough information to assess the appropriateness of that price to determine whether it is in conformity with GAAP**. [Emphasis added]

Mr. Plourde further indicated:

> In addition to complying with GAAP, management is required to maintain a system of internal control over financial reporting sufficient to provide, among other things, reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in conformity with GAAP or any other criteria applicable to such statements.

In his view, "more complex and less actively traded securities may have [greater] risk of misstatement" because of their valuation uncertainty. As a result of such uncertainty, "[m]anagement may need to design controls" to adequately consider information obtained from "multiple pricing services and/or other sources of fair value information to assure that the prices recorded for securities are indicative of fair value." He cited examples of controls, including:

- Management's interaction with the pricing service through what some term the "pricing challenge" process and through so-called "deep dives," in which management can obtain more detailed information from pricing services about the assumptions, inputs, and other information used to price securities.
- Monitoring of the pricing services assumptions and changes thereto or other monitoring of market data.
- Obtaining independent audit reports on the internal controls of pricing services.

Mr. Plourde emphasized that management should ask the following questions about the use of third-party pricing service information:

- Do we have sufficient information about the values provided by pricing services to know that we're complying with GAAP?
- Have we adequately considered the judgments that have been made by third parties in order to be comfortable with our responsibility for the reasonableness of such judgments?
- Do we have a sufficient understanding of the sources of information and the processes used to develop it to identify risks to reliable financial reporting?
- Have we identified, documented, and tested controls to adequately address the risks to reliable financial reporting?

Editor's Note: The SEC staff's remarks focused not only on fair value measurements and related assessments of ICFR but also on financial statement disclosures about fair value measurements. The SEC staff indicated that when using information obtained from pricing services, management may need to consider whether the information is sufficient to determine where in the fair value hierarchy to classify the resulting fair value measurement. Mr. Plourde stated that "If management cannot determine whether the inputs to a pricing service's valuation model are observable, it may be difficult to determine if in fact the security in question can be accurately disclosed in Level 2 of the fair value hierarchy."

Auditor's Responsibility

Mr. Baumann remarked that just as management needs to take responsibility for the use of third-party pricing services, "[a]uditors can't simply rely on third party prices to audit what [preparers have recorded; auditors] have to understand how the values were determined, understand the inputs and the assumptions." Ms. Munter added that "a key point we are focused on . . . is the need for an auditor to test the underlying methods and assumptions used to value harder-to-value financial instruments."

Editor's Note: The PCAOB has established a Pricing Services Task Force of its Standing Advisory Group to focus on the auditing of fair value of financial instruments that are not actively traded and on the use of third-party pricing sources. The task force provides insight into current issues related to auditing the fair value of financial instruments, which may result in the development of new standards or guidance by the PCAOB. In the first quarter of 2012, the PCAOB plans to issue proposed amendments to its auditing standards related to auditing the fair value of financial instruments.

The SEC staff indicated that auditors also may find the management considerations discussed above informative when considering their audit procedures on the fair value measurements and internal controls related to fair value measurements when management incorporates information from a pricing service. The SEC staff believes that such considerations may help to inform the auditor's assessment of the presence and severity of control deficiencies.

Editor's Note: Although he did not speak at the conference, in his prepared remarks, Mr. Beswick addressed building public trust in the valuation profession, which continues to become a more prominent fixture in accounting and auditing today. He noted that regardless of whether valuation professionals are serving as management's adviser or as an auditor's specialist, such professionals should use "methodologies that have strong conceptual merit, supported by consistent and supportable assumptions, and are in conformity with the requirements of the relevant accounting standards." Mr. Beswick went on to suggest that the financial marketplace would be well served to require uniform qualifications in education and work experience, a standard continuing education curriculum, and consistent standards of practice, ethics, and a code of conduct.

Foreign Currency Matters

Effect of Foreign Currency Fluctuations

Given recent and ongoing volatilities of the U.S. dollar against foreign currencies, Mr. Milne gave his views on how disclosures could address such fluctuations and provide investors with information to help them assess the impact of changes in exchange rates. Specifically, he stated that registrants should "consider not only the effects on items on the [income statement], such as revenues and costs, but also consider the effects on items not on the [income statement], such as backlog, same-store sales, or other key operating measures." He also noted that the SEC staff will expect consistency in disclosures about the impacts of foreign currency fluctuations from period to period (including any non-GAAP cost and currency measures) and that positive revenue impacts should have the same prominence as negative revenue impacts in the disclosures.

When asked to share his perspectives about disclosures on market risk, Mr. Milne indicated that the SEC staff would look for the following four elements:

- The nature of currency risks, including descriptions of (1) currencies within the environments in which the company operates and (2) unhedged assets, liabilities, and commitments.
- Changes in the risk exposures.

- How currency price risk and related exposures are managed.
- Known trends in currency prices or anticipated exchange rates in future reporting periods.

Goodwill

Amendments on Goodwill Impairment Testing

In September 2011, the FASB issued ASU 2011-08,[2] which amends the guidance in ASC 350-20 on testing goodwill for impairment. Under the revised guidance, entities testing goodwill for impairment have the option of performing a qualitative assessment before calculating the fair value of a reporting unit in step one of the goodwill impairment test (this qualitative assessment is often referred to as "step zero").

Mr. Moffatt indicated that the SEC staff did not expect that the revised guidance would result in material changes in the outcome of impairment testing and discussed two aspects of goodwill impairment testing on which the staff may provide comments to registrants. First, he noted that the staff would most likely comment if a registrant concludes and discloses that adoption of ASU 2011-08 has had a material impact on its financial statements, since the staff would not expect such an impact. Second, he indicated that the staff may comment if it appears that a registrant selected the step zero option to avoid an impairment charge for a reporting unit that is at risk of failing step one of the impairment test.

Mr. Moffatt emphasized that while the revised guidance did not add any new disclosure requirements to ASC 350-20, the staff continues to comment on a registrant's compliance with the disclosure requirements in ASC 350-20 as well as with the guidance in Section 9510 of the FRM on disclosures about each reporting unit deemed at risk for failing step one of the impairment test.

Editor's Note: Section 9510 of the FRM discusses the staff's views on goodwill impairment disclosures in the critical accounting estimates section of MD&A. Under Section 9510 of the FRM, "[r]egistrants should consider providing the following disclosures for each reporting unit that is at risk of failing step one of the impairment test (defined in ASC Topic 350):

a. The percentage by which fair value exceeded carrying value as of the date of the most recent test;

b. The amount of goodwill allocated to the reporting unit;

c. A description of the methods and key assumptions used and how the key assumptions were determined;

d. A discussion of the degree of uncertainty associated with the key assumptions. The discussion regarding uncertainty should provide specifics to the extent possible (e.g., the valuation model assumes recovery from a business downturn within a defined period of time); and

e. A description of potential events and/or changes in circumstances that could reasonably be expected to negatively affect the key assumptions."

Further, Mr. Moffatt reminded registrants that in addition to considerations related to ASU 2011-08, the SEC staff often comments on registrants' determination of reporting units for the purpose of performing a goodwill impairment test. ASC 350-20 defines a reporting unit as "an operating segment or one level below an operating segment" (also known as a "component"). Components with similar economic characteristics may be aggregated to form a reporting unit.

Mr. Moffatt also indicated that the correct identification of operating segments — from day one (and thereafter) — has important implications for goodwill impairment testing. The SEC staff has observed a number of situations in which registrants perform goodwill impairment testing at too high a level, such as the reportable segment level (which could represent an aggregation of operating segments). Other situations include the aggregation of components that (1) do not have similar economic characteristics and (2) reside in different operating segments. In short, Mr. Moffatt noted that the SEC staff may issue comments to better understand how reporting units are defined, when components are aggregated, or how components' economic characteristics are similar. For more information related to operating segment considerations, see the Segment Reporting topic of this publication.

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

Editor's Note: See Deloitte's *SEC Comment Letters — Including Industry Insights: Improving Transparency* for a discussion of frequent SEC staff comments on goodwill. Also see Deloitte's September 16, 2011, *Heads Up* for an overview of ASU 2011-08's amendments to goodwill impairment testing.

IFRSs and the SEC's Work Plan

International Convergence

Ms. Seidman and Mr. Hoogervorst both commented on the need for high-quality, global accounting standards. Mr. Hoogervorst noted that given today's dynamic global capital markets, "[i]nvestors need comparable, reliable financial reporting around the world." He asserted that currently more than 100 countries require or permit the use of IFRSs, including the majority of G20 countries. Further, countries that are still deciding whether to require full adoption of IFRSs are waiting for a decision by the SEC. Ms. Seidman indicated that the FASB also supports the goal of high-quality, comparable global standards, and similar comments were made by Mr. Kroeker, who stated that he remained positive about the potential prospects of IFRS incorporation but wanted to ensure that this "opportunity [is used] to establish a strong and lasting framework."

Mr. Beswick's prepared remarks state that not all constituents favor convergence. His remarks also note that some constituents responded to the SEC's May 2011 staff paper, *Exploring a Possible Method of Incorporation*, with significant concerns that (1) a strong enough case has not been made for mandatory incorporation of IFRSs, (2) the cost of incorporation is much greater than the value of the expected benefit, and (3) concerns about the quality of existing IFRSs.

Editor's Note: See Deloitte's June 1, 2011, *Heads Up* for additional information on the SEC's May 2011 staff paper.

SEC's Work Plan on Adoption of IFRSs

Mr. Kroeker admitted that while the SEC was expected to decide whether to incorporate IFRSs into the U.S. financial reporting system by the end of 2011, a decision has not yet been made. However, he did indicate that the staff has completed the majority of its field work. Mr. Beswick's speech notes that the remaining open items include (1) the completion of the FASB's and IASB's convergence projects and (2) the finalization of two independent reviews of the IASB's governance structure and strategy that could be used to support the IASB as an independent yet accountable standard-setting body. Both Mr. Kroeker and Mr. Beswick noted that sometime in 2012, the SEC staff is expected to finalize its comprehensive report summarizing its progress on its work plan.

Mr. Beswick's prepared remarks offered his perspective on some of the more significant points provided by constituents during outreach activities related to the SEC's May 2011 staff paper. He grouped these points into themes, including (1) support for a single set of high-quality globally accepted accounting standards, (2) support for an endorsement mechanism as outlined in the SEC's May 2011 staff paper, and (3) support for a plan to allow the boards to focus on making progress on the joint standard-setting projects before incorporating IFRSs into the United States.

Editor's Note: See Deloitte's November 8, 2011, *Heads Up* for a discussion of comments received on the SEC's May 2011 staff paper.

One of the major themes of the endorsement mechanism concept is the belief that the FASB's role is important and that the FASB should consider whether to endorse standards on a standard-by-standard basis since it is in the best position to act in the interest of U.S. investors and U.S. capital markets. To further support this view, those commenting highlighted that the FASB has a long history of developing high-quality standards and may be a positive influence on developing high-quality IFRSs. Furthermore, maintaining a strong FASB will (1) help preserve SEC regulatory authority and address U.S. GAAP in other laws and regulations, (2) allow the FASB to provide technical assistance to the IASB, (3) ensure a robust due process by the IASB, and (4) help U.S. capital markets implement IASB standards.

Ms. Seidman discussed the approach outlined in a comment letter submitted by the FAF in response to the SEC's May 2011 staff paper. In its letter, the FAF noted that it agreed with the fundamental incorporation concepts of the SEC staff's proposal and expressed strong support for IFRSs to become the foundation for future accounting standards. However, the FAF also shared the concerns expressed by several U.S. stakeholders about the staff paper. Accordingly, the letter offered an alternative approach under which IFRSs would be incorporated into U.S. GAAP over time.

Editor's Note: In its comment letter, the FAF noted that it agreed with the fundamental incorporation concepts of the SEC staff's proposal because such concepts (1) demonstrate U.S. commitment to developing global accounting standards, (2) preserve U.S. GAAP as the required standards for U.S. financial reporting, (3) retain U.S. oversight over accounting standard setting in U.S. capital markets, (4) allow high-quality comparable standards to be issued on the basis of a common set of financial reporting standards, and (5) permit a gradual transition toward common, global standards that are based on IFRSs.

However, as a result of concerns outlined in responses to the staff paper submitted by U.S. stakeholders, the FAF recommended that the SEC address (1) the diminished role of the SEC in protecting investors in the U.S. capital markets because the SEC would no longer be the sole regulator in U.S. markets; (2) concerns about transferring significant authority to an international standard-setting body in which there is inconsistency in reporting, auditing, and enforcement of IFRSs; and (3) reduction of the FASB's role and influence.

Accordingly, the FAF offered an alternative incorporation approach that would first focus on the short-term, more practical goal of establishing **highly comparable** (but not necessarily identical) financial reporting standards that would be based on IFRSs. The FAF suggested that having a single set of global accounting standards would be the longer-term objective.

Ms. Seidman indicated that under the FAF's proposal, the FASB would retain its authority as the U.S. independent standard setter with the ability to set its own technical agenda for projects of significant importance to U.S. financial reporting that are not on the IASB's agenda. She indicated that although this is probably the most controversial aspect of the proposal, there is a need to have a "nimble and responsive" body within the U.S. to address U.S.-specific issues. The FASB would attempt to bring such U.S.-specific issues to the IASB or IFRIC, but to the extent those organizations decide not to take on an issue, the FASB would be in a position to address them.

Ms. Seidman also noted that "it is *not* in the best interest of [U.S.] investors to withdraw GAAP in areas where there is no clear accounting standard under IFRS, such as in the case of rate regulation." Ms. Seidman envisioned that in such cases, constituents ought to follow U.S. GAAP, at least until the IASB takes on a new project or sets new standards to address such unique matters.

Mr. Hoogervorst supported the endorsement approach outlined in the SEC's May 2011 staff paper as well as the FASB's role in that process. However, Mr. Hoogervorst recommended that the FASB have a high threshold for nonendorsement for the proposed model to work. This is to "ensure that any deviations [between the two standards] are extremely rare." Mr. Hoogervorst emphasized the need to have a clear timeline for this endorsement approach since he does not believe that convergence is a viable long-term solution.

Top 11 Topics of SEC Staff Comment on IFRSs

Mr. Olinger and Ms. Davis discussed the top 11 IFRS-related topics that the SEC staff most frequently addresses in its reviews of foreign private issuers (FPIs).

Editor's Note: In addition to a comprehensive review of nonregistrants and registrants alike, the SEC staff's November 2011 staff paper *A Comparison of U.S. GAAP and IFRS* includes a short section on the most frequent topics of comment in the Division of Corporation Finance's review of FPIs. The speakers noted that the top 11 topics discussed below only relate to FPIs. See Deloitte's December 2, 2011, *Heads Up* for more information about the staff paper.

1. Financial Instruments

The SEC staff's most frequent IFRS-related comments were on financial instruments, affecting most industries regulated by the SEC, not just the financial services industry. The staff's requests to registrants have included the following:

- Clarify, and potentially provide additional disclosures about, the criteria considered in the determination of whether a financial instrument was impaired.
- Provide additional details about the valuation methods and market data used to determine fair value.
- Explain why certain investments were measured at cost when other information supported fair value measurement.
- Perform additional analysis to support the classification of financial instruments as financial liabilities or equity.
- Provide expanded disclosures about valuation methods and assumptions used to prepare a sensitivity analysis.
- Supply additional information about value-at-risk calculations.
- Furnish more transparent disclosures about the components of debt securities by country.

2. Provisions and Contingent Liabilities

There has been a marked increase in comments on this topic compared with those made in prior years. Specifically, the SEC has requested that registrants expand or modify their disclosures to include the following:

- Comprehensive explanation of the reasons why a provision or contingent liability has been established.
- Greater insight into the uncertainties associated with the amount or timing of expected payments.
- Details regarding the methods and assumptions used to calculate provisions.
- A summary of provisions that were reversed.
- The impact of discounting.

In addition, the SEC has asked registrants to consider disaggregating certain dissimilar provisions or contingencies when appropriate.

3. Financial Statement Presentation

The SEC staff continues to comment on numerous income statement issues, addressing the presentation of multiple operating measures on the face of the income statement. The staff has cautioned registrants against providing different caption names that may result in user confusion, omitting operating measures, and failing to provide disclosures about expenses by nature when income is presented by function. In addition, the staff has asked questions about the cash flow statement, addressing matters such as classification of operating, investing, and financing activities in the statement of cash flows and the nature of financial assets included in cash equivalents. Finally, the SEC has commented when registrants omit required footnote disclosures and comparative footnote information.

4. Consolidation, Associates, and Joint Ventures

The SEC staff continues to frequently ask registrants to clarify their decisions and conclusions about consolidation-versus-equity method accounting when the result contradicts the voting power held (e.g., a registrant has more than 50 percent of the voting power but does not consolidate). In addition, the staff has commented when an expected disclosure is omitted or unclear — for instance, when registrants omit disclosures about the nature and extent of restrictions on an associate's or subsidiary's ability to transfer funds to its parent. Similarly, the staff has noted that footnote disclosures about associates and joint ventures are lacking at times, resulting in an unclear understanding of the nature of amounts disclosed, basis of accounting used (i.e., IFRSs or other local GAAP), or currency applied to balances.

5. Impairment of Assets

The SEC staff continues to encourage registrants to provide expanded disclosures to clarify how cash-generating units (CGUs) are determined and how management calculated the proportion of goodwill to allocate to them. In addition, the staff has asked registrants to expand their disclosures about the events or circumstances that resulted in the recognition of impairment losses and whether the CGU's recoverable amount is close to its book value.

6. Operating Segments

As it has done in prior years, the SEC staff has asked registrants to clarify or expand their disclosures about the factors they used in determining their operating segments. In addition, the staff continues to ask registrants to clarify whether their operating segments have been aggregated. Finally, the staff continues to remind registrants to provide the requisite entity-wide disclosures, including products and services, geographic areas, and major customers.

7. Revenue Recognition

As with its comments to domestic registrants, the SEC staff has requested expanded disclosures about revenue recognition policies, specifically elaboration of how such policies relate to the entity's revenue-generating activities and how the revenue criteria of IAS 18 are being applied to various transactions. In addition, the SEC continues to see diversity in practice related to application of guidance on complex transactions in multiple-element arrangements (i.e., although they are not required to, certain registrants may look to U.S. GAAP for guidance). Finally, the SEC has identified issues related to the recognition and measurement of expenses (e.g., warranty expenses).

8. Income Taxes

The SEC staff continues to comment on DTA disclosures regarding amounts not recognized as well as on disclosures related to tax loss carryforward status (i.e., when tax loss carryforwards will expire). Finally, the staff has asked questions about other schedule components, requesting additional information such as the sources of tax rates and the components of the tax rate reconciliation.

9. First-Time Adoption of IFRSs

This topic is new to the 2011 list. The SEC staff has asked registrants to clarify the nature of reconciling items between home-country GAAP and IFRSs, requesting information about the impact of the adoption of IFRSs on the cash flow statement and asking registrants to provide an opening statement of financial position.

10. Property, Plant, and Equipment

While the SEC staff's comments on this topic have decreased, the staff thought it would be prudent to remind registrants of certain disclosure requirements related to property, plant, and equipment, including the requirement to disclose the depreciation methods used and the useful lives for each class of property, plant, and equipment. In addition, registrants are required to perform reviews of residual values, useful lives, and depreciation methods at least annually.

11. Business Combinations

The SEC staff has frequently commented on this topic, and many of the comments are consistent with those for domestic registrants. In particular, the staff has commented on purchase price allocation, the process for accounting for step acquisitions, and treatment of transactions involving noncontrolling interests. In addition, the staff has questioned registrants' recognition of intangible assets and determination of amortization periods. Finally, the SEC has commented on common control transactions, which should be accounted for under IAS 8 rather than IFRS 3.

Income Tax Disclosure Matters

Realizability of Deferred Tax Assets in the Current Economic Environment

Mr. Shannon discussed the impact that the current economic environment could have on the assessment of the realizability of DTAs. Entities must consider all available evidence, both positive and negative, in determining whether a valuation allowance is needed to reduce a DTA to an amount that is more likely than not to be realized. ASC 740-10-30-21 states that "[f]orming a conclusion that a valuation allowance is not needed is difficult when there is negative evidence such as cumulative losses in recent years." However, ASC 740-10-30-22 gives examples of positive evidence that could be used to overcome this negative evidence. One example is "[a] strong earnings history exclusive of the loss that created the future deductible amount (tax loss carryforward or deductible temporary difference) coupled with evidence indicating that the loss (for example, an unusual, infrequent, or extraordinary item) is an aberration rather than a continuing condition." Mr.

Shannon said that some registrants are placing less weight on recent losses when weighing the positive and negative evidence because they view the current economic downturn as an "aberration." However, he stated that while each company's facts and circumstances could differ, in general it would be "pretty difficult to conclude the economic downturn is an aberration." He then reminded participants that overcoming such negative evidence would require significant objective positive evidence.

Foreign Income Taxes

Ms. Shah and Mr. Shannon discussed certain income tax matters in relation to registrants' significant foreign operations. Ms. Shah indicated that when a registrant with significant amounts of cash and short-term investments overseas has asserted that such amounts are permanently reinvested in its foreign operations, the SEC staff would expect the registrant to provide the following disclosures in an MD&A liquidity analysis:

- The amount of cash and short-term investments held by foreign subsidiaries that is not available to fund domestic operations unless the funds were repatriated.
- A statement that the company would need to accrue and pay taxes if repatriated.
- If true, a statement that the company does not intend to repatriate those funds.

Editor's Note: For more information about other disclosure considerations related to MD&A liquidity and capital resource narratives, see the MD&A topic of this publication.

Mr. Shannon discussed situations in which profits derived from a country with very low tax rates are disproportionately large compared with the revenue generated from that country. He indicated that because such instances may be caused by various tax structures or by where revenue is allocated, the SEC staff has requested registrants to provide "disaggregated financial information related to pretax income and effective tax rates from particular countries."

Editor's Note: See Deloitte's *SEC Comment Letters — Including Industry Insights: Improving Transparency* for more information about the SEC staff's comments related to income taxes.

Interactive Data

Mr. Starr discussed the continuing phase-in of the interactive data (XBRL) requirements and estimated that between eight and nine thousand registrants will have adopted the rules by the end of this year. He expects that it will take two to three years until the changes resulting from the XBRL mandate will be fully implemented. His thoughts were echoed by participants in the XBRL Update panel discussion, including Mr. Uehlinger and Ms. Yount, who commented on various issues related to registrants' adoption of the interactive data rules and noted how regulators and the marketplace are beginning to use that interactive data.

Mr. Starr noted that some registrant groups had expressed concern that certain provisions of the interactive data rules were overly burdensome and had recommended certain amendments to address those concerns. Although the SEC staff did not support all of the recommendations, Mr. Starr indicated that some merited further study, and he emphasized that the SEC staff welcomes such feedback and plans to continue to monitor the experience of preparers, service providers, and investors and to respond to any concerns in an appropriate, constructive way. He also expressed his belief that compliance costs associated with XBRL will decline significantly as registrants gain more experience and as the marketplace develops new interactive data file preparation and review tools with enhanced functionality to respond to market demands.

Mr. Starr and the XBRL Update panelists, including Mr. Pryde and Mr. Naumann, also responded to questions about whether anyone other than the SEC is actually using the XBRL data. They noted that some data aggregators are already using XBRL to gather information. Thus, analysts that use those service providers are indirectly benefitting from XBRL, although they may not be aware of that. Ms. Yount also noted that the requirements to use structured data are even being added to legislation, including some of the recent rules related to the Dodd-Frank Act.

XBRL Observations and Reviews

During the XBRL Update panel, Mr. Uehlinger discussed a number of findings from the June 2011, SEC staff report, "Staff Observations From Review of Interactive Data Financial Statements," and noted that the staff continues to encounter these issues in its reviews of interactive data. Findings include:

- Incorrect use of negative values.
- Creation of an extension when an existing standard taxonomy element should have been used.
- Improper tagging of alphanumeric values as a string data type.
- Failure to tag values included in subscripted text in tables.
- Failure to tag the financial statement schedules required by Regulation S-X, Article 12.
- Omission of calculation links from interactive data file submissions.

Editor's Note: See Deloitte's July 8, 2011, *Heads Up* for additional information about the SEC staff's observations on interactive data submissions.

Mr. Uehlinger also indicated that the staff expected to issue an updated set of observations in the near future. In December 2011, the SEC released "Staff Observations From the Review of Interactive Financial Statements," which summarizes common issues the staff identified for interactive data exhibits submitted during the second quarter of 2011.

Ms. Yount noted that although the SEC staff still prefers to pass along its interactive data comments in periodic staff observation documents and by issuing C&DIs, it still reserves the right to issue, and has issued, interactive data comments to individual registrants. Comments are typically triggered when the staff's analysis of its XBRL data sets identifies outliers (e.g., if an entity's market capitalization is tagged at an amount significantly larger than the norm for its peer group).

Mr. Uehlinger also cautioned registrants that the temporary hardship exemption under Regulation S-T, Rule 201, should only be used in the narrow circumstances defined by the rule.

Registrants are encouraged to contact the SEC staff with any questions about the interactive data requirements.

XBRL Taxonomy Considerations

U.S. GAAP Taxonomies

Ms. Yount indicated that the 2012 XBRL taxonomy is expected to be released and approved for use in early 2012. Once the 2012 taxonomy has been approved for EDGAR use, the 2009 taxonomy will be removed from the list of approved taxonomies. Thereafter, the SEC staff expects to maintain two approved taxonomies for use by registrants at any given point in time: (1) the current taxonomy (e.g., the newly approved 2012 taxonomy) and the most recent version previously in effect (e.g., the 2011 taxonomy). Any older version would no longer be approved for use. Ms. Yount also noted that in the future, periodic and annual taxonomy updates will be approved as warranted and that such updates will ultimately settle into a predictable timeline. She also added that once the 2012 taxonomy is approved for use, the SEC staff expects the FASB to provide registrants with access to a tool that will allow them to determine whether elements they use will be affected by the 2012 taxonomy update.

Editor's Note: Any registrant still using the 2009 taxonomy should make a concerted effort to transition to the 2011 taxonomy immediately after year-end. Otherwise, the removal of the 2009 taxonomy upon the release of the 2012 taxonomy may disrupt its interactive data preparation and review processes.

IFRS Taxonomies for Use by Foreign Private Issuers

Both Mr. Starr and Ms. Yount indicated that the SEC still has not approved an IFRS XBRL taxonomy for use by FPIs because of concerns about the lack of definitions and common reporting practice elements. The staff of the IFRS Foundation has been responsive to the SEC staff's concerns, and the SEC staff hopes to be able to complete its review of the revised IFRS taxonomy and make its recommendations to the SEC regarding approval of the IFRS taxonomy in the next several months. Both Mr. Starr and Ms. Yount assured FPIs that they would be given ample time to implement the interactive data rules once an IFRS taxonomy has been approved for use by the SEC.

Trends, Implementation Challenges, and Auditor Considerations

During the XBRL Update panel discussion, Mr. Naumann offered further insight into certain trends, implementation challenges, and auditor considerations for the XBRL mandate. He discussed implementation challenges faced by registrants, including (1) effectively integrating creation of the XBRL files into the overall financial reporting process; (2) creating an effective and efficient review process for interactive data files; (3) managing tag selection, data tagging, and taxonomy updates; (4) deciding whether to bring XBRL tagging in-house versus using a third-party service provider; and (5) assembling an XBRL team (both internal and external) with appropriate expertise that has appropriate responsibility and accountability. Mr. Naumann also noted that even though the SEC rules do not require any auditor involvement with interactive data, registrants may find auditors to be a useful resource. For example, auditors can perform agreed-upon procedures to compare the completeness, accuracy, and consistency of the XBRL data with the information furnished in the corresponding registrant filing. Registrants should remember, however, that management has the ultimate responsibility for the accuracy and completeness of its interactive data files.

Investments and Other-Than-Temporary Impairments

Sovereign Debt Disclosures

Mr. Moffatt focused on accounting and disclosures related to eurozone sovereign debt, especially debt issuances for which significant credit deterioration has occurred as a result of events in some eurozone member countries. He emphasized that management needs to ensure that recorded impairments are consistent with the guidance in ASC 320 (or IAS 39 for entities filing under IFRSs).

Regarding disclosures, Mr. Moffatt indicated that the Division of Corporation Finance would like to see enhanced and more transparent disclosures regarding exposures to foreign sovereign debt. Specifically, he noted that even if exposures to foreign loans do not meet or exceed the 1 percent net asset threshold in SEC Industry Guide 3, "Statistical Disclosure by Bank Holding Companies," the staff would expect to see MD&A disclosures from holders of Greek, Irish, Italian, Portuguese, and Spanish debt. Mr. Moffatt reminded registrants that a net approach (i.e., debt securities combined with purchased credit protection) to these disclosures would not be sufficient to allow investors to perform a true assessment of a registrant's credit risk exposure. Further, he pointed out that registrants should disclose limitations of credit protection in case "payout" is only allowed in certain circumstances (i.e., some credit default swap contracts may stipulate limitations under which no payout occurs if a negotiated default scenario is a triggering credit event).

Mr. Moffatt emphasized that registrants are encouraged to disclose gross and net exposures to sovereign debt "by country," which may lend itself to tabular presentation depending on the variety and scale of sovereign debt exposures and credit protection that a registrant may hold.

Leases

The Impact of Default Provisions on Lease Classification

Some lease agreements contain provisions that may require the lessee to purchase the leased asset or to make another payment if the lessee is in default on such provisions. Ms. Luisi discussed the requirement for entities to take such default provisions into account when considering lease classification at inception of the lease. Under ASC 840-10-25-14, the following four conditions must be met for default provisions not to affect lease classification:

a. The default covenant provision is customary in financing arrangements.

b. The occurrence of the event of default is objectively determinable (for example, subjective acceleration clauses would not satisfy this condition).

c. Predefined criteria, related solely to the lessee and its operations, have been established for the determination of the event of default.

d. It is reasonable to assume, based on the facts and circumstances that exist at lease inception, that the event of default will not occur.

Ms. Luisi pointed out that if any of these four conditions are not met, the maximum amount that the lessee could be required to pay under the default provision should be included in minimum lease payments for lease classification purposes. She further explained that if a clause allows the lessor to subjectively determine default, the conditions would not be met. To illustrate, she gave an example of a clause that would grant a lessor the sole discretion to declare whether a material adverse change, and thus a lease default, has occurred. She concluded that in such circumstances, the maximum required payment would be included in the minimum lease payments for lease classification purposes, regardless of the probability that a default will occur. That is, if the occurrence of the event of default is not objectively determinable, it does not matter how likely it is that this event will occur for lease classification purposes.

However, Ms. Luisi also noted that multiple views on measurement of the lease liability are acceptable if the lease is a capital lease. The views are to either (1) consider probability as part of the measurement (with an ongoing reassessment of probability as of each reporting period) or (2) recognize the maximum amount. Ms. Luisi stressed that the SEC staff expects entities to clearly disclose how they have accounted for potential payments under these types of default provisions.

Miscellaneous Reporting Topics

Division of Enforcement Update and Initiatives

Mr. Khuzami discussed a sampling of the enforcement cases the SEC filed last year, many stemming from conduct related to the financial crisis and cross-border activities, including those associated with audits of multinational registrants. The SEC collected approximately $2 billion in penalties and monetary sanctions, reflecting its ongoing effort to hold the financial reporting system more accountable. Mr. Khuzami indicated that the SEC has investigated and brought action when it has "determined that management [has engaged] in misconduct to override a company's internal methodologies . . . or omit material information." (See the Materiality topic for more information about materiality considerations.)

Moreover, Mr. Khuzami noted that these enforcement actions were taken against not only CEOs, CFOs, CAOs, and controllers but also audit committee chairmen and auditors. This collective enforcement effort has led to a redoubling of the SEC's focus on holding individuals responsible, particularly higher-level executives who are involved in "bad faith disclosure or bad faith overrides of best estimates." He reiterated that while the SEC will continue to respect professional judgment and not "second guess" good-faith decisions, enforcement actions will be taken when the evidence shows that management (1) did not rely on good-faith judgments or (2) relied on judgments that resulted from bad-faith processes. Examples of such improprieties include (1) improperly accounting for the allowance for loan loss and repurchase reserves and (2) ignoring or excluding disclosures about material risks. He reminded all participants (e.g., regulators, preparers, and auditors) about the important roles they play in restoring the public's trust in the U.S. financial reporting system.

Editor's Note: In elaborating on the role of audit committees, Mr. Khuzami noted an enforcement action brought against three former members of one registrant's audit committee. The action alleges that the audit committee members ignored numerous "red flags" signaling accounting fraud, reporting violations, and misappropriation of assets. Such red flags included (1) auditors' concerns and material-weakness letters, (2) controllers' complaints, (3) resignations of key financial reporting personnel, (4) outside parties' complaints, and (5) related-party transactions. See Deloitte's December 17, 2009, *Heads Up* on the 2009 AICPA Conference for additional remarks on audit committee considerations.

Mr. Scheck highlighted his belief that most accountants are "operating with objectivity, integrity, and a compliance with professional standards in preparing and auditing financial statements." However, he noted some concerns on the basis of the past year's reviews, mainly regarding auditors' compliance with Section 10A of the Securities Exchange Act of 1934 (i.e., audit requirements related to auditing SEC registrants' financial statements). Specifically, he indicated that reviews (some of which have taken place while an audit was ongoing) have highlighted situations in which auditors failed to (1) sufficiently challenge materiality assessments, (2) follow up regarding conflicting information, and (3) properly evaluate the company's internal audit expertise and objectivity, which auditors need to use when investigating an improper or illegal act. Mr. Scheck encouraged auditors to "continue fulfilling [their] role as gatekeepers . . . for investors" by, among other things, continuing to exercise professional skepticism when considering management representations, disclosures that lack transparency, and transactions that lack economic substance.

Mr. Khuzami also discussed the Division of Enforcement's two new initiatives: (1) the Cooperation Initiative and (2) the Whistleblower program. The Cooperation Initiative establishes incentives for individuals and companies to fully and truthfully cooperate and assist with SEC investigations and enforcement actions. Awards to participants in this initiative range from reduced potential charges and sanctions to the SEC's taking no enforcement action against them. Mr. Khuzami stated that the Cooperation Initiative has already resulted in approximately 35 cooperation agreements. In addition, he noted that because the Cooperation Initiative has enabled direct agreements with "cooperators," the SEC has not needed to rely as heavily on criminal authorities for testimony and has been able to conduct investigations according to its own timetable.

The Whistleblower program, established in response to a mandate of the Dodd-Frank Act, awards those who give the SEC "original information" leading to securities law enforcement actions that recover more than $1 million and offers whistleblowers additional protection (e.g., antiretaliatory provisions).

Editor's Note: For more information about the Whistleblower program, see Deloitte's September 1, 2011, *Heads Up*.

Error Corrections and Reclassifications

Mr. Hardiman shared recent observations on situations in which companies presented corrections of errors in previously issued financial statements as reclassifications. He emphasized that an error is "a mistake in recognition, measurement, presentation or disclosure in previously issued financial statements," while a reclassification is "a change from one presentation that complies with GAAP to another presentation that complies with GAAP." Therefore, if a revision is not a change from one acceptable presentation to another, it must be reported as a correction of an error. Financial statements that contain error corrections must include all disclosures required by ASC 250. Reclassifications should be disclosed if material.

Restatement Disclosures

Mr. Hardiman cited an example in which a material error was identified after an initial registration statement was filed. The company corrected the error in a pre-effective amendment and included all disclosures required by ASC 250. The SEC staff was asked whether the company could file a subsequent pre-effective amendment and remove the restatement disclosures. Mr. Hardiman stated that while practice was mixed, he did not believe GAAP supported such diversity. Therefore, the restatement disclosure should only be removed when the pre-effective amendment includes an update of the annual financial statements. He further clarified that an update of annual financial statements represents inclusion of a new set of audited annual financial statements that were not previously presented in the initial registration statement.

Editor's Note: We expect the SEC to post the slides used by Mr. Hardiman in his presentation on its Web site. Those slides contain examples illustrating when restatement disclosures may be removed.

In a separate question-and-answer session, Mr. Hardiman clarified that an **audit** of a subsequent **interim** period would not be a sufficient basis for removing the ASC 250 disclosures.

Mr. Hardiman highlighted that the objective behind the requirement to continue to provide restatement disclosures is to give financial statement users sufficient time to consider the impact of the disclosures. Mr. Hardiman therefore suggested that if a company intends to include restatement disclosures only for a very short period before updating its annual financial statements, the company should consult with the SEC staff before filing.

Editor's Note: In the question-and-answer session, Mr. Hardiman also stated that changes made to a private company's financial statements to apply accounting and disclosure requirements for public companies before the filing of an initial registration statement are not viewed as errors and that, in this case, restatement disclosures would not be required at the time of the initial filing. However, if the accounting and disclosure requirements for public companies were misapplied and such errors were discovered after the filing of the initial registration statement (i.e., were corrected in a pre-effective amendment), restatement disclosures would be required in accordance with ASC 250.

SEC's Roundtable on Uncertainty in Financial Reporting

Mr. Starr and Mr. Kroeker provided an overview of the first in a series of scheduled SEC-hosted roundtables on financial reporting. Mr. Kroeker explained that the insights from the financial reporting roundtables will be shared not only with the SEC staff but also with the PCAOB, the FASB, and any other regulators or interested parties that would find it useful for "early identification of risks related to, as well as areas for potential improvements in, the reliability and usefulness of financial reporting to investors."

The first roundtable focused on measurement uncertainty in financial reporting. Topics addressed included (1) what investors (or users) expect from financial reporting, (2) information that investors need to analyze companies and the related uncertainty, (3) suggestions for how to improve financial reporting, and (4) the auditor's role in reporting uncertainty. Participants included representatives from the SEC, PCAOB, and FASB as well as investors, preparers, users, academics, and auditors.

Mr. Starr and Mr. Kroeker highlighted the following three themes addressed at the roundtable that the SEC, PCAOB, and FASB may consider going forward:

- Caution should be exercised to ensure that "financial reporting is not comingled with financial analysis."
- Entities need to place greater emphasis on improving communication in the "financial reporting package, as a whole."
- "There should be established clear measurement and disclosure frameworks (that is, a "compass" or "anchor" for financial reporting)."

Editor's Note: For more information about the roundtables or about the upcoming webcast, see the SEC's Web site.

Materiality

Mr. Khuzami cited the results of recent materiality-related Supreme Court cases in which the court followed its previous precedents. He noted that the decisions "underscored that the materiality requirement is satisfied when there is a substantial likelihood that the disclosure of the omitted fact has been viewed by the reasonable investor to have significantly altered the total mix of information made available." Further, he cautioned registrants to avoid bright-line rules or litmus tests and "not to succumb" to rules of thumb or percentage thresholds when determining materiality because no one factor can be viewed as determinative.

Editor's Note: For additional information regarding materiality assessments and related comment letter trends, see Deloitte's *SEC Comment Letters — Including Industry Insights: Improving Transparency*.

Retrospective Application of ASU 2011-05, *Comprehensive Income*, in Connection With Filing a New Registration Statement

Mr. Shannon discussed ASU 2011-05, which revises ASC 220, *Comprehensive Income*. The ASU requires that a registrant report comprehensive income either in a single continuous financial statement or in two separate but consecutive financial statements and also requires retrospective application.

Editor's Note: See Deloitte's July 17, 2011, *Heads Up* on ASU 2011-05.

Mr. Shannon addressed the interaction between the adoption of the ASU and Item 11 of Form S-3, which requires "restated financial statements if there has been a change in accounting principle where such change . . . requires a material retroactive restatement of financial statements."

Editor's Note: Once the ASU has been reflected in issued interim financial statements, a registrant would normally be required to revise its historical annual financial statements included or incorporated by reference in a new or amended registration statement (if the change is material).

However, Mr. Shannon noted that the SEC staff would not object if the registrant concludes, and its auditor agrees, that there is no need to retrospectively revise the previously issued annual financial statements as long as the registration statement includes prominent transparent disclosure of the following:

- Net income.
- Components of other comprehensive income that would be on the face of the financial statements in accordance with ASU 2011-05.
- Reclassification adjustments that would appear in net income and other comprehensive income, to the extent required under the new guidance.
- Total other comprehensive income.
- Total comprehensive income.

This information should be included for all periods that would have been shown in retrospectively revised financial statements. Mr. Shannon suggested that a presentation similar to the table typically used to present selected financial data is one possible way to present this information in the registration statement.

Editor's Note: An alternative approach to present the suggested disclosures is to include the information in Item 5 of a Form 10-Q in the quarter of adoption. Thus, this information would be incorporated by reference into an existing or future registration statement.

For more information on this topic, see the highlights of the September 2011 CAQ SEC Regulations Committee joint meeting with the SEC staff.

Pension and Other Postemployment Benefit Plans

Ms. Shah and Mr. Milne emphasized the need for companies to provide transparent disclosures of how the accounting for a company's pension and other postemployment benefit (OPEB) plans, as well as the key assumptions and investment strategies underlying that accounting, affect the company's financial statements and its liquidity and capital resources. Companies also must ensure that the underlying assumptions used for their pension and OPEB accounting are reasonable relative to current market trends and assumptions being used by registrants with similar characteristics.

In their discussion, they also noted how the economy and volatility in the financial markets may affect a company's defined benefit plans and related disclosures. Ms. Shah noted that companies should provide sufficient disclosure about how changes to their plan assets and obligations may affect their liquidity and capital resources. She encouraged registrants to explain the trends and uncertainties related to a company's pension or OPEB obligations, citing an example of how an entity's statutory minimum funding requirements may be affected by changes in the measurement of its plan obligations and assets.

A company also may want to disclose in both qualitative and quantitative terms what its plan contributions have been in the past and the expected changes to those contributions. When discussing OPEB plans, which are usually funded as the related benefit payments become due, Mr. Milne noted that the disclosures required by U.S. GAAP of the plan's expected future benefit payments for each of the next five years, and the five years thereafter in aggregate, would provide an indication of a company's expected liquidity requirements and that such requirements may need to be discussed further in MD&A.

The staff noted that many companies are taking steps to "de-risk" their pension plans by acquiring bonds for their plan asset portfolios whose expected maturities match the expected timing of the plan's obligations. The staff reminded registrants that under U.S. GAAP, they are required to disclose their plan investment strategy. A company's MD&A disclosure also should inform investors about any changes to that investment strategy, the reasons for those changes, and how a change in a the strategy affects the underlying plan assumptions and the company's ability to fund the plans. For example, a decision to invest more in fixed income securities could be expected to lower the overall rate of return on plan assets.

The staff also noted that several registrants are changing their accounting policy to accelerate the recognition of actuarial gains and losses. This change in accounting policy is permitted under U.S. GAAP; however, a company is required to account for and disclose such a change in accounting policy in accordance with the requirements of ASC 250 and, under SEC rules, obtain a preferability letter from its auditors and would need to clearly disclose the new accounting policy for its plans. Companies should understand that such a change could result in a significant fourth-quarter adjustment when they remeasure their pension and OPEB plans, which would require additional disclosure. Companies that capitalize certain employee costs as part of inventory or property, plant, and equipment also would need to ensure that they properly account for the effects of the adjustment from the year-end remeasurement.

Editor's Note: For more information, see Deloitte's Financial Reporting Alert 11-2, *Pension Accounting Considerations Related to Changes in Amortization Policy for Gains and Losses and in the Market-Related Value of Plan Assets*.

The staff highlighted two additional points for companies to consider for the upcoming Form 10-K reporting season. Ms. Shah noted that companies that have both domestic and foreign plans need to be careful when aggregating such disclosures. Under U.S. GAAP, registrants are required to separately disclose in the financial statements information about foreign plans that are material and that have significantly different assumptions. Mr. Milne also noted that in their reviews of this year's Form 10-K disclosures, the SEC staff will take a close look at companies' compliance with the new multiemployer pension plan disclosure requirements.

Editor's Note: For a further discussion of defined benefit plan accounting and disclosure topics that may affect a registrant during the upcoming year-end reporting season, see Deloitte's Financial Reporting Alert 11-6, *Financial Reporting Considerations Related to Pension and Other Postretirement Benefits*.

SEC Reporting — Foreign Private Issuers and Foreign Businesses

Transition to IFRSs

Ms. Davis highlighted a transitional issue that might affect foreign private issuers that adopt IFRSs and execute a registration statement in the United States. To illustrate the issue, she used an example of a Canadian registrant who in 2010 reported under Canadian GAAP with a reconciliation to U.S. GAAP and in 2011 reported under IFRSs. Ms. Davis noted that given the transition to IFRSs during the period, 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). She suggested that a registrant in this situation should consider the guidance in Instruction G of Form 20-F. As part of that process, the registrant should develop an approach to providing a bridge between the previous GAAP financial statements and the subsequent IFRS financial statements. Ms. Davis encouraged registrants to contact the staff if they are unable to comply with one of the options in the instruction. She also indicated that paragraph 6340.4 of the FRM has been updated to provide three acceptable alternative approaches; however, she cautioned that the alternatives in the FRM were not the only acceptable ones.

References to the Use of IFRSs as Issued by the IASB

Similar to a discussion at the 2010 AICPA Conference, Ms. Davis commented that the SEC will request a registrant to amend its Form 20-F when the registrant has not asserted, and the audit report has not indicated, compliance with "IFRSs as issued by the IASB." She 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 auditor's report. 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.

Requirement for U.S. GAAP Reconciliation for “Nonforeign Business” Acquiree or Investee Financial Statements Prepared Under IFRSs as Issued by the IASB

In complying with Regulation S-X, Rules 3-05 and 3-09, an acquired or to be acquired business (i.e., acquiree) or investee that meets the definition of a foreign business in Regulation S-X, Rule 1-02(l), is not required to present its financial statements in accordance with U.S. GAAP. Ms. Davis noted that an acquiree or investee that is incorporated outside of the United States that does not meet the definition of a foreign business would be required to provide financial statements prepared in accordance with U.S. GAAP, home-country GAAP with a reconciliation to U.S. GAAP, or IFRSs with a reconciliation to U.S. GAAP. She clarified that acquirees or investees that would meet the definition of an FPI under Regulation C, Rule 405, if they were filing a registration statement may **not** use financial statements prepared in accordance with IFRSs that are not reconciled to U.S. GAAP without the SEC staff granting the entity relief. In considering requests for relief from preparing full U.S. GAAP financial statements or a U.S. GAAP reconciliation, Ms. Davis noted that the staff will consider whether the acquiree or investee prepares U.S. GAAP information for any other purpose, and why the entity does not meet the definition of a foreign business.

Editor’s Note: This issue was discussed at the September 2011 meeting of the CAQ SEC Regulations Committee. See the meeting highlights for further information.

SEC Reporting — Other Topics

Non-GAAP Financial Measures

Mr. Olinger referred to the 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. He indicated that the SEC staff has noticed a return in the types of non-GAAP financial measures that prompted the SEC to adopt the final rule on the use of non-GAAP financial measures to begin with. Mr. Olinger stated that the SEC staff understands that non-GAAP financial measures can be helpful to investors but that a registrant should not present misleading non-GAAP financial measures — either in a filing or outside of a filing (e.g., Web sites and press releases).

Further, Mr. Olinger indicated that the following items should not be excluded from non-GAAP financial measures:

- Expenses, such as traditional recurring cash operating expenses, that are necessary to run the business.
- The largest expenses that are necessary to generate the registrant’s revenues.

Editor’s Note: In a question-and-answer session, Mr. Hardiman suggested that a non-GAAP financial measure that eliminates all marketing expenses or all compensation expenses could be misleading.

Ms. Cross reiterated Mr. Olinger’s remarks and reminded conference participants that they should not eliminate recurring cash charges from a profit measure in a way that would be misleading.

Editor’s Note: For more information about the C&DIs on the use of non-GAAP financial 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: Improving Transparency* for more information about non-GAAP financial measures.

Management’s Discussion and Analysis

General MD&A Observations

A panel consisting of Mr. McTiernan, Mr. Widgren, and Mr. Lane led a discussion on the MD&A section of SEC filings and offered general observations and best practices. Mr. McTiernan noted that after general U.S. GAAP compliance issues, MD&A is one of the most important areas of a registrant’s filing that the SEC staff focuses on during a filing review. Consequently, MD&A-related comments are frequent because MD&A is intended to be the place in which a registrant tells its story "through the eyes of management." Panelists noted that preparing "good" MD&A may be difficult because of the increased complexities of operating in a global economy and managing, aggregating, and summarizing significant amounts of information. Panelists suggested that registrants do the following to prepare an effective MD&A:

- Use "plain English" and avoid jargon whenever possible.
- Include an "Overview" section discussing the key drivers and changes for the period.
- Avoid "boilerplate" disclosures. Disclosures should be tailored to the registrant and updated regularly for changes as well as for how they affect the registrant.
- Focus on key risks, trends, and uncertainties that are likely to have a material impact on the registrant's cash flows and performance. Examples of such risks, trends, and uncertainties may include (1) macroeconomic changes, (2) foreign operations, and (3) new accounting standards.
- Ensure that information presented in MD&A is consistent with the registrant's other SEC filings, Web sites, and public releases.
- Focus on analysis by answering the questions "why" and "how did we do" when addressing significant changes in business operations or results.
- Review previous SEC staff comments on, and reviews of, competitor filings to obtain broad industry perspectives.
- Identify key themes early by making inquiries of various groups within the registrant's organization. Streamline the drafting process by limiting MD&A preparers but potentially increasing the number of reviewers.

Liquidity and Capital Resources

Mr. McTiernan also highlighted the need for registrants to include appropriate narratives regarding liquidity and capital resources. Citing the ongoing turmoil in the financial markets as the primary reason for the SEC staff's increased focus on liquidity disclosures, he noted that it is important for MD&A to "accurately and comprehensively explain [a registrant's] liquidity story." In discussing aspects of this topic that the SEC staff has recently commented on, Mr. McTiernan advised that registrants consider including discussions of key liquidity indicators, such as leverage ratios and other metrics used by management to track liquidity. Further, he indicated that MD&A disclosures should take into account the impacts on a registrant's liquidity that result from the following factors (this list is not all-inclusive):

- Any changes in leverage strategies.
- Any strains on liquidity caused by changes in availability of previously reliable funding.
- Sources and uses of funds.
- Intraperiod debt levels.
- Restrictions on cash flows between the registrant (i.e., the parent) and its subsidiaries.
- The impact of liquidity on debt covenants and ratios.

Editor's Note: The SEC staff indicated that it continues to receive questions regarding intraperiod debt and other short-term borrowings. The staff reminded registrants of SEC Interpretive Release 33-9144, which was issued in September 2010 and became effective upon issuance. The interpretive release provides disclosure guidance that affects (1) liquidity and capital resources, (2) leverage ratios, and (3) contractual obligations. To address what the SEC staff called "debt masking" issues, the guidance also calls for registrants to provide certain disclosures when end-of-period debt balances are materially different from intraperiod borrowings.

The SEC also issued a proposed rule on short-term borrowings in September 2010 (jointly with the interpretive release) that would greatly increase the disclosures that a registrant is required to provide about short-term borrowings. Ms. Cross indicated that constituents have raised concerns that these requirements would be too costly to implement. Therefore, the SEC is currently performing an analysis to identify how best to provide investors with necessary information without creating an undue burden for filers. For more information about the proposed rule, see Deloitte's September 24, 2010, *Heads Up*.

During a separate panel session, Mr. Shannon reiterated the SEC staff's recent emphasis on liquidity disclosures in MD&A. His remarks concerned financial services registrants, particularly the registrants' disclosures about their excess liquidity pools; however, the underlying concepts would apply to other financing sources for other registrants. Mr. Shannon stated that "all registrants have an obligation to consider whether there are any known trends or demands or commitments or uncertainties, like a liquidity crisis, that will result in, or that are reasonably likely to result in, a registrant's liquidity increasing or decreasing in any material way."

He indicated that registrants should consider providing both qualitative and quantitative disclosures and that potential disclosure topics could include the reasons for maintaining an excess liquidity pool or the circumstances in which it would be necessary to access the excess liquidity. Mr. Shannon also pointed out that a registrant should consider providing qualitative disclosures about its overall strategy regarding excess liquidity pools, including (1) how an entity determines its target size for excess liquidity pools and (2) whether internal targets during the period have been attained.

Mr. Shannon also discussed the quantitative information that a registrant should consider disclosing about excess liquidity pools. Specifically, registrants should consider providing disclosures about material changes in daily balances and end-of-period balances, including amounts of excess liquidity held at subsidiaries. He indicated that registrants should also consider whether to include "stress tests" to estimate the amount of time it would take for registrants to use assets within a liquidity pool to fund obligations.

Editor's Note: See Deloitte's *SEC Comment Letters — Including Industry Insights: Improving Transparency* for more information about the SEC staff's recent comments on registrants' MD&A disclosures, including comments related to liquidity.

Disclosure of Immaterial Items and Disclosure "Overload"

Ms. Shah addressed MD&A in the context of concerns about disclosure "overload" in registrants' filings. She indicated that the SEC staff neither requires nor expects registrants to disclose immaterial items. Her observations were on three main topics:

- Inclusion of seemingly immaterial items in registrants' filings. For example, Ms. Shah noted that disclosures may include discussions of critical accounting estimates and accounting policies when the corresponding amounts that are recorded in the financial statements (or disclosed in footnotes) do not appear to be material.
- Disclosures about the nature and content of a new accounting standard, when the adoption of the new standard will be immaterial to the financial statements.
- Carryover of disclosures that were added to address previous SEC comments, even when the subject matter of the disclosures is no longer relevant or material.

In urging registrants to prepare disclosures for investors rather than to avoid potential staff comments, Ms. Shah also addressed the notion of disclosure "overload" — that is, the repetition of information within a filing. She pointed out that registrants will sometimes provide repetitive information even when the SEC or GAAP do not require it. For example, she remarked that loss contingency disclosures are often repetitive and indicated that the SEC staff would not object to the use of cross-references in such disclosures. However, Ms. Shah also cautioned against omitting required information from the footnotes because the financial statements need to be complete and stand on their own.

Internal Control Over Financial Reporting

Mr. Moffatt noted that the SEC staff has continued to focus on evaluating registrants' assertions that the internal controls of a foreign operation are effective. The staff indicated that foreign companies often become U.S. registrants through "back door" listings (i.e., when an operating company that has substantially all of its operations outside the United States merges with a U.S. shell company). Concerns are often expressed regarding the U.S. GAAP expertise needed to prepare such a registrant's financial statements. In evaluating assertions of expertise, the SEC staff attempts to ensure that management of the foreign operation has the appropriate knowledge and capability to prepare financial statements in accordance with U.S. GAAP. Mr. Moffatt indicated that appropriate background may be demonstrated through (1) education and ongoing training in U.S. GAAP, (2) professional qualifications such as a U.S. CPA license, and (3) professional experience either as an auditor or a preparer of U.S. GAAP financial statements. However, he added that viewing the Internet and attending one-off conferences would not be persuasive evidence of appropriate U.S. GAAP expertise. In concluding his remarks on this topic, Mr. Moffatt noted that the SEC staff's ultimate goal is to reduce material weaknesses by ensuring that registrants possess sufficient expertise and capabilities.

Editor's Note: For additional insight into the SEC staff's views on registrants' assessments of internal controls and foreign operations, see Deloitte's *SEC Comment Letters — Including Industry Insights: Improving Transparency* and December 16, 2010, *Heads Up* on the 2010 AICPA Conference.

Division of Corporation Finance Update

Filing Reviews

Ms. Cross discussed the Division of Corporation Finance's review program, noting that the staff reviewed over 5,000 registrants during the year ended September 30, 2011. Comment letters issued under the review program will be available on EDGAR no earlier than 20 business days after the review is complete, a substantial decrease from the prior policy of 45 days. Ms. Cross indicated that she would like to see this time frame further shortened. She also stated that the Division's Office of Capital Markets Trends will be reviewing prospectus supplements to existing shelf registration statements to help improve disclosures and gather data about these offerings.

Editor's Note: In November 2011, the SEC issued its annual Performance and Accountability Report, which disclosed that the Division reviewed 48 percent of registrants during fiscal year 2011. This percentage is significantly higher than the average percentage of registrants that the Division is mandated to review under the Sarbanes-Oxley Act, which requires the Division to review every registrant at least once every three years.

New Disclosure Guidance

Ms. Cross informed participants that the Division began issuing Corporation Finance Disclosure Guidance (CFDG) in 2011. Two topics have been released to date: CFDG Topic No. 1, "Staff Observations in the Review of Forms 8-K Filed to Report Reverse Mergers and Similar Transactions," and CFDG Topic No. 2, "Cybersecurity."

Editor's Note: The Division's CFDG provides the SEC staff's views on disclosure obligations related to a particular issue. In a separate panel discussion, Mr. Olinger stated that in the future, the staff may issue CFDG in lieu of staff bulletins and "Dear CFO" letters.

SEC Reporting — Regulation S-X

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

Mr. Milne reminded registrants that pro forma information is required when (1) it is material to an understanding of a significant consummated or probable transaction, such as a business combination; (2) a transaction is subject to a shareholder vote; or (3) other conditions outlined in Article 11 are met. The pro forma financial information shows investors how a transaction might have affected the registrant's historical financial statements had the transaction occurred at an earlier date. Article 11 requires that pro forma balance sheet adjustments reflect events that are (1) factually supportable and (2) directly attributable to the transaction. In addition to meeting the above criteria, pro forma income statement adjustments must have a continuing impact on the registrant's operations.

Editor's Note: In a separate question-and-answer session, Mr. Hardiman clarified that the SEC staff's remarks are related to the preparation of pro forma financial information in accordance with Article 11. When preparing pro forma disclosures required by ASC 805, a registrant should apply the guidance in ASU 2010-29.

We expect the SEC to post the slides used by Mr. Milne and Mr. Hardiman in their presentation on its Web site. Article 11 and Topic 3 of the FRM provide additional guidance on pro forma financial information, including form and content requirements.

Criteria for Pro Forma Adjustments

Factually Supportable

One interpretation of "factually supportable" is having reliable, documented evidence (e.g., an executed agreement or consummated transaction). It is not based on the ability to estimate or reliably measure the adjustment.

To elaborate on "factually supportable," Mr. Hardiman and Mr. Milne discussed two examples, both involving situations in which a registrant is giving pro forma effect to a business combination:

- A registrant will be required to negotiate new compensation agreements with certain employees of the target. A pro forma adjustment related to compensation expense is not appropriate unless the agreements have actually been executed.
- A registrant has determined that it will terminate 14 percent of the target's work force after the acquisition. A pro forma adjustment related to compensation expense is not appropriate because the "termination is not limited to historical compensation expense" for the terminated employees. The registrant would need to look more broadly at the ramifications of the reduction in work force as well as at the impact that the reduction in the work force would have had on the underlying business (e.g., whether revenues would have remained the same, whether compensation costs for the remaining employees would have increased as a result of the additional workload). Generally, the effect of these items will be too uncertain to qualify for adjustment.

Directly Attributable

Mr. Hardiman stated that regarding the directly attributable criterion, the key issue is the determination of the underlying transaction to which the registrant is giving pro forma effect. Mr. Hardiman and Mr. Milne discussed two examples in which the underlying transaction is a business combination:

- A registrant should not include a pro forma adjustment to eliminate a goodwill impairment charge recognized in the prior year by the target. The previously reported charge is not related to the current-year acquisition.
- In pro forma financial information in an initial registration statement, the registrant should not include a pro forma adjustment for the expected incremental costs of being a public company. The pro forma adjustments should directly relate to the underlying business combination rather than to the registrant's initial public offering process.

Editor's Note: It is also unlikely that the estimated costs of being a public company would meet the factually supportable criterion discussed above.

Continuing Impact

If the pro forma adjustment is expected to affect more than one fiscal year, the adjustment will meet the continuing impact criterion. One example of a pro forma adjustment that has a continuing impact on the registrant's operations is depreciation and amortization expense.

Editor's Note: In a separate question-and-answer session, Mr. Hardiman discussed the treatment of transaction costs related to a business combination, which must be expensed as incurred in accordance with ASC 805. Because these costs are nonrecurring, they will not have a continuing impact. Such costs should be reflected in the pro forma balance sheet but would be omitted from the pro forma income statement.

Calculation of Pro Forma Adjustments

Article 11 states that when calculating pro forma adjustments, registrants should assume that the transaction occurred:

- As of the date of the most recent balance sheet for the pro forma balance sheet.
- At the beginning of the fiscal year presented for the pro forma income statement.

Mr. Hardiman clarified that the above guidance applies only to calculating the amount of the pro forma adjustment and should not be used to determine whether an adjustment is appropriate. For example, when preparing a pro forma income statement, it would be inappropriate for a registrant to make a pro forma adjustment for a charge in the historical financial statements on the basis of an assertion that if the transaction had been consummated at the beginning of the year, the charge would not have been incurred.

Disclosures

Mr. Hardiman clarified that a registrant should provide narrative disclosure if it determines that the criteria for a pro forma adjustment are not met but it expects to incur material costs that were not historically incurred.

Editor's Note: A registrant that has a reasonable basis to quantify such an adjustment should consider providing both narrative and quantified disclosures in the footnotes to the pro forma financial information.

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

Mr. Olinger provided some background on Rule 3-10. Under Rule 3-10, a registrant must provide full financial statements for each subsidiary issuer and guarantor of registered debt securities. If certain conditions are met, however, a registrant may be able to present more limited information (e.g., condensed consolidating financial information) in a footnote to the parent company's financial statements in lieu of the separate financial statements of the subsidiary issuer or guarantor. Further, in these circumstances, the subsidiary issuer and guarantor would be exempt from filing their own periodic reports under the Exchange Act.

Following up on a discussion at the 2010 AICPA Conference, Mr. Olinger discussed one of the conditions that must be met for registrants to be relieved from providing full financial statements of the subsidiary issuer or guarantor — that the guarantee must be "full and unconditional." He noted that typical problems registrants have had in complying with this condition include:

- Limiting or capping the guarantee amount so that the definition of "full" is not met.
- Delaying the guarantor's payment obligation, in the event of the issuer's default, thereby resulting in a guarantee that is not "unconditional."

In addition, Mr. Olinger pointed out that the SEC staff updated paragraph 2510.4 of the FRM to indicate that "an arrangement that permits a guarantor to opt out of its obligation prior to or during the term of the debt is not a full and unconditional guarantee."

Mr. Hardiman stated that that the SEC staff has seen some subsidiary guarantee release provisions, which are particularly common in high-yield debt offerings. If these provisions have the effect of releasing a subsidiary's guarantee when specified events occur, the guarantee is not "full and unconditional" because the guarantee must be in force throughout the term of the registered debt. However, a subsidiary whose guarantee is released automatically under customary circumstances may rely on Rule 3-10, provided that the other requirements in Rule 3-10 are met.

The SEC staff has updated paragraph 2510.5 of the FRM to address subsidiary guarantee release provisions, specifically what is considered a customary circumstance. Paragraph 2510.5 states that customary circumstances include:

- the subsidiary is sold or sells all of its assets;
- the subsidiary is declared "unrestricted" for covenant purposes;
- the subsidiary's guarantee of other indebtedness is terminated or released;
- the requirements for legal defeasance or covenant defeasance or to discharge the indenture have been satisfied;
- the rating on the parent's debt securities is changed to investment grade; or
- the parent's debt securities are converted or exchanged into equity securities.

Mr. Olinger indicated, as stated in paragraph 2510.5, that "[r]egistrants with questions about these and other types of customary circumstances in which [Rule 3-10] may be available notwithstanding the existence of arrangements that provide for the release of subsidiary guarantees" should contact the SEC staff in the Office of Chief Counsel within the Division of Corporation Finance.

Mr. Olinger also indicated that registrants should clearly disclose the nature of the subsidiary guarantee and the circumstances under which it will be released. Further, the guarantee should not be characterized as full and unconditional in these circumstances.

Mr. Hardiman clarified that guidance in the FRM applies only to subsidiary guarantees and not to parent guarantees that have release provisions.

Editor's Note: We expect the SEC to post the slides used by Mr. Olinger and Mr. Hardiman in their presentations on its Web site. Also see Deloitte's *SEC Comment Letters — Including Industry Insights: Improving Transparency* for more information about this topic.

Financial Statement Requirements for Acquired Troubled Financial Institutions

Mr. Shannon explained that a key point of SAB Topic 1.K is the notion of whether the federal assistance or guarantees are "essential" to the transaction or "pervasive." A question for registrants to consider in evaluating these terms is whether the financial assistance substantially reduces the relevance of the historical information of the acquired troubled financial institution. He indicated that this would be true, for example, in the case of loss-sharing arrangements. For transactions that do not include loss-sharing arrangements, Mr. Shannon suggested that a registrant should consider the significance of any federal assistance to the transaction as a whole. For example, a registrant should consider whether the purchase price included significant discounts on the fair value of the assets acquired. When transactions do not include a loss-sharing arrangement or a significant discount, the federal assistance may not be significant, although there could be other examples as well.

Editor's Note: Under Regulation S-X, Rule 3-05, when a registrant consummates, or it is probable that it will consummate, a significant business acquisition, the registrant may be required to file certain financial statements for the acquired or to be acquired business.

In response to the savings and loan crisis in the 1980s, the SEC staff issued SAB Topic 1.K, which provides guidance on applying Rule 3-05 to situations in which a registrant acquires a troubled financial institution as defined in that SAB Topic. SAB Topic 1.K offers relief from the requirement to provide historical audited financial statements of the troubled financial institution when (1) the institution's total acquired assets exceed 20 percent of the registrant's assets, (2) the historical financial statements are not reasonably available, and (3) "federal financial assistance or guarantees are an **essential** part of the transaction or . . . the nature and magnitude of federal assistance is so **pervasive** as to substantially reduce the relevance of such information to an assessment of future operations" (emphasis added).

Mr. Olinger suggested that any prefiling letters requesting relief from the financial statement requirements should include a robust analysis of why the federal assistance is significant.

Segment Reporting

Mr. Milne stated that the SEC staff continues to frequently comment on segment reporting not only because registrants continue to incorrectly apply the segment reporting requirements in ASC 280 but also because feedback continues to indicate that disaggregated segment information is important to investment decisions. He indicated that when reviewing a registrant's segment reporting, the SEC staff checks for consistency with the registrant's MD&A, footnote disclosures, and other sources of public information (including Web sites and webcasts). In reviewing MD&A and other public information, the staff also focuses on indicators of potential segment changes. Consequently, the presenters reminded registrants that receipt of prior SEC comments would not preclude future ones and gave the following examples of situations in which registrants need to assess information for potential changes to their operating and reportable segments: (1) new internal reporting systems, (2) organizational changes by new management or other reorganizations, and (3) acquisitions and dispositions.

During its review, it is not uncommon for the staff to request the information that a registrant provides to its chief operating decision maker (CODM), board of directors, or audit committee. The purpose of supplying this information is to help the SEC staff understand the registrant's current types of business activities and the different economic environments in which the entity operates. Mr. Milne highlighted, in a manner consistent with comments at the 2010 AICPA Conference, that the staff often observes, upon reviewing such information, an apparent disconnect between a registrant's definition of its operating segments and the information reviewed by the CODM. He added that common explanations that the staff receives for this apparent disconnect are that the CODM (1) receives the information but does not use it, (2) uses the information for other purposes, or (3) uses the information but does not regularly review it. The staff noted that it is usually "skeptical of those arguments" and that when a CODM receives information that includes discrete information (below the defined operating segment level), it would be "very difficult for a company to demonstrate the CODM does not regularly use that information." He further highlighted that "if the CODM uses it for one purpose, it would be difficult to argue that he or she ignores it for another purpose."

Mr. Moffatt underscored that operating segments can only be aggregated when certain criteria in ASC 280 are met. One of these criteria requires that the operating segments be economically similar. While economic similarity is not defined, Mr. Moffatt noted that operating segments "must be so similar that reporting them separately would not help users understand company performance or prospects of future cash flows" and indicated that similar long-term financial performance would often support this assertion. Although dissimilar past performance does not preclude aggregation and a registrant is able to look to future economic prospects, he indicated that the SEC staff may question a registrant's assertion of economic similarity based on future prospects when it appears unreasonable in relation to past performance. He also cited several examples of situations in which the evaluation may appear unreasonable, including (1) using a method that is based on metrics that converge over an unreasonable period into the future (particularly when management is not able to reliably estimate future economic prospects), (2) when past results indicate that the operating segments are not economically similar, and (3) when the economic similarity is caused by one-off-type events.

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

Standard-Setting Update

Convergence Projects

Ms. Cosper indicated that the FASB and IASB did not accomplish their objective, which they had established in 2010, of completing certain significant projects by June 30, 2011. She emphasized that because the boards' goal is to develop a highly comparable set of high-quality accounting standards, neither board will rush to issue standards that do not represent improvements to current financial reporting. However, she also pointed out that certain projects, such as fair value measurements and OCI, were completed over the past year.

In discussing the boards' convergence efforts related to revenue recognition, leases, and financial instruments, Ms. Cosper and Mr. Teixeira 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. The panelists also gave updates on various other projects and other potential future activities, including due process enhancements, post-implementation reviews, nonpublic entities, and XBRL.

Editor's Note: For more information about project status (both joint projects and FASB-only projects), including for recently completed projects, see Deloitte's *Accounting Roundup — Special Edition* (Updated November 2011).

Revenue Recognition

The panelists focused on the FASB's and IASB's revised exposure draft on revenue recognition, both published on November 14, 2011, for a 120-day comment period.

Editor's Note: For further discussion of the exposure draft, see Deloitte's November 15, 2011, *Heads Up*.

The panelists highlighted their views on certain guidance in the revised exposure draft. While certain panelists noted that the revised exposure draft represents a considerable improvement over the boards' June 2010 exposure draft in certain respects, they expressed concerns about other aspects of the proposed guidance, including (1) expected diversity in practice, (2) challenges with applying the transfer-of-control concept to agreements with distributors, (3) application of the requirement related to the time value of money, and (4) the extent of required disclosures.

One panelist recommended that financial statement preparers take "inventory" of existing contracts to determine the potential impact of applying the proposal. She noted that preparers may conclude that adoption of the proposed guidance would not significantly affect entities' current reporting under U.S. GAAP. Another panelist further suggested that financial statement preparers consult with their business and sales personnel when considering the effects of the proposed guidance on accounting for longer-term contracts, especially contracts that are currently being executed, because the proposed guidance will be applied retrospectively.

Finally, because financial statement users have emphasized the significance of the revenue line item, Mr. Bement stressed the importance of the boards' receiving input from constituents through the comment letter process and outreach efforts. Such feedback will be key to achieving a high-quality final standard.

Leases

The panelists' discussion of leases centered on changes that the FASB and IASB have made since issuing their joint exposure draft on August 17, 2010. They walked through the status of the project and mostly commented on the significant items that the boards have reconsidered, including the following:

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

The panelists discussed the boards' proposed changes to these items, commenting that they believed the proposed accounting for lease term and lease payments is generally consistent with current accounting. However, they pointed out that the proposed changes to the definition of a lease could cause arrangements that are considered leases under current accounting to no longer be considered leases under the proposed accounting, particularly in the energy sector.

Ms. Zeyher highlighted several topics that she thought the boards may deliberate further, including:

- Maximum term allowed for a lease to meet the short-term lease exception.
- Income statement recognition pattern for lessees (e.g., expense is higher in the earlier years of a lease arrangement because of the financing treatment of the lease obligation).
- Definition of investment property that a lessor uses to determine whether its leases of investment properties are outside the scope of the proposed receivable and residual lessor approach.

Regarding timing, Ms. Zeyher reiterated that the boards expect to issue a revised exposure draft in the first half of 2012 and a final standard in late 2012 or 2013.

Editor's Note: For further discussion of the exposure draft and subsequent redeliberations, see Deloitte's *Accounting Roundup — Special Edition* (Updated November 2011).

Financial Instruments

The panel discussed and compared certain aspects of the FASB's and IASB's proposals on accounting for financial instruments. Topics addressed included (1) the FASB's proposed classification and measurement of equity method investments, (2) the FASB's and IASB's joint credit impairment model and its application to debt securities, and (3) the effectiveness assessment and voluntary de-designation of a hedging relationship under the FASB's and IASB's respective hedging proposals. While the panelists generally supported certain aspects of the proposals, they also encouraged the FASB and the IASB to make these proposals less complex than current accounting.

Editor's Note: For more information about the FASB's and IASB's proposals on accounting for financial instruments, see Deloitte's *Accounting Roundup — Special Edition* (Updated November 2011) or the respective FASB and IASB project pages.

FinREC

Mr. Paul discussed the AICPA's Financial Reporting Executive Committee (FinREC), indicating that it is actively involved in providing nonauthoritative financial reporting guidance, including guides, technical practice aids, and other publications. In addition, FinREC participates in the FASB and IASB standard-setting process, primarily by submitting comment letters on the boards' proposals.

In addition to summarizing the committee's efforts over the past year, Mr. Paul noted that FinREC is currently seeking feedback on working drafts of two accounting and valuation guides: (1) a revised guide on accounting for assets acquired to be used in research and development activities (commonly referred to as the "IPR&D guide") and (2) a new guide on testing goodwill for impairment. Although comments on both guides are due by March 15, 2012, Mr. Paul indicated that FinREC would be open to extending the comment deadline if requested.

Mr. Paul also gave an overview of FinREC's working draft of its revised practice aid on the valuation of privately-held-company equity securities issued as compensation (commonly referred to as the "cheap stock practice aid"), which was posted for feedback in March 2011. He pointed out that in response to feedback received, FinREC will add a new chapter, "Inferring Value From Transactions in a Private Company's Stock," to the guide and plans to solicit feedback on that new guidance before finalizing the revisions.

Private-Company Financial Reporting

Ms. Seidman indicated that private companies have expressed concerns that accounting standards do not provide their users with relevant information, are too complex, and are costly to implement. She explained the importance of understanding whether these concerns are unique to private companies or apply equally to public companies. Ms. Seidman believes that the development of different accounting standards for private companies would be justified if the FASB identifies differences between information that is relevant to users of private-company financial statements and information that is relevant to users of public-company financial statements. However, she is not convinced that the issues of complexity and costs are unique to private companies and believes that everyone could probably benefit from simplified standards that are less costly to implement.

Ms. Seidman noted that the FASB has been conducting various outreach activities, including roundtables with private-company stakeholders, to understand what distinguishes private companies from public companies. Through these activities, the FASB has identified six distinguishing factors. She focused on two of these factors: (1) "users of private company reports are lenders, not external equity investors" and (2) private-company "management can provide any information it wishes to a current or potential lender or investor (that is, they are not subject to Regulation FD)." The FASB staff is currently analyzing how these factors will affect key accounting topics, such as recognition, measurement, and disclosure.

Ms. Seidman also discussed the Blue Ribbon Panel's recommendation that the FAF establish a new separate board to develop accounting standards for private companies. She noted that after significant consultation with a wide variety of private-company stakeholders, the FAF released its proposal, which recommends the formation of the Private Company Standards Improvement Council (PCSIC) rather than a separate board. Under the FAF's proposal, the council (which would be chaired by a FASB member) would evaluate the need for differences in current and future accounting standards for private companies. As with the current EITF process, the FASB would retain the responsibility to ratify the council's decisions. Ms. Seidman noted that the goal of this proposal would be to reduce complexity for all entities and only address differences that are unique to private companies, thereby limiting divergence between the accounting requirements. Ms. Seidman encouraged constituents to share their views by submitting comment letters on the proposal to the FAF before the January 14, 2012, deadline.

Editor's Note: Mr. Kroeker also provided his views on the Blue Ribbon Panel's recommendations in a question-and-answer session after his prepared remarks. In addressing a question about whether it makes sense to create a separate board that is responsible for private-company reporting standards, he expressed a view that was not entirely consistent with the Blue Ribbon Panel's recommendation. Although he generally agreed that exceptions or modifications to U.S. GAAP may be warranted for certain accounting areas, in his closing remarks he repeated that he did not believe that two different bodies should be responsible for establishing U.S. GAAP.

Working With the SEC Staff

Best Practices for Working With the SEC Staff

Mr. Bhandari, with the assistance of other members of the SEC staff, shared the following top 10 best practices for responding to comments raised during the filing review process:

- File all responses to comment letters on EDGAR.
- Amendments are not always required. The staff may ask for (1) amendments to existing filings, (2) disclosure in future filings, or (3) supplemental information. Be sure to seek clarification if you are not sure what is being requested.
- Document, Document, Document. Contemporaneous documentation for significant accounting conclusions is preferable.
- Keep EDGAR filer information current. This helps to ensure that the registrant timely receives correspondence from the staff and that it is sent to the appropriate registrant contacts.
- Avoid "cutting and pasting" from comment letter responses filed on EDGAR by other registrants. Each response should be specific to a registrant's facts and circumstances at a particular point in time.
- Respond promptly. Written responses should be sent to the staff within 10 business days. Request a reasonable extension if more time is needed.
- Involve accountants (and auditors) when responding to accounting-related comments. Similarly, involve attorneys for legal-related comments.
- Use all resources available to enable a registrant to understand its disclosure requirements and the staff's interpretations of those requirements (e.g., SEC rules and regulations, the FRM, C&DIs, disclosure guidance).
- Make the first response the last response. Involve the right people (including specialists) early, and prepare thorough responses that fully address the staff's questions. Clarify where and what additional disclosures will be provided in filings.
- Pick up the phone and call the staff. Schedule conference calls with the staff in advance to ensure that the right people will be on the call, and involve all interested parties early on in the process.

Filing Review Process

Mr. Bhandari and Ms. Rocha highlighted some procedural changes in the SEC staff's filing review process. Recently, as part of a pilot program, the staff began transmitting its comment letters to registrants by e-mail. Such transmission is intended to replace the staff's use of facsimile and mail unless a registrant specifically requests otherwise. Before e-mailing the letters, the staff uses information on EDGAR to contact the registrant, typically the principal executive or accounting officer, to obtain an appropriate e-mail address. Registrants should therefore keep their EDGAR filer information current.

Responses to comment letters are public information and are therefore subject to Freedom of Information Act requests. However, Mr. Lopez reminded registrants that they may request that portions of their comment letter responses or supplemental information be treated confidentially. Such requests would need to meet the conditions in Rule 83 of the Commission's Rules of Practice. Mr. Bhandari indicated that it would not be appropriate for registrants to request confidential treatment for an entire response letter. Mr. Lopez stated that when supplemental information is submitted to the staff under a confidential request, registrants can request whether they would like the supplemental information to be returned or destroyed (i.e., shredded) upon completion of the review process.

Editor's Note: Registrants are encouraged to consult with their legal counsel before filing a confidential treatment request to determine whether their requests meet the requirements of Rule 83 and Staff Legal Bulletin No. 1.

The staff may sometimes communicate orally to registrants. Ms. Rocha noted that the staff documents such oral discussions and may ask registrants to include written responses to them on EDGAR. Registrants can ask to receive these comments in writing if they prefer.

Editor's Note: For additional information, see the Division of Corporation Finance's Filing Review Process as well as its Overview of the Legal, Regulatory and Capital Markets 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 Appendixes B and C of Deloitte's *SEC Comment Letters — Including Industry Insights: Improving Transparency* for additional information on the SEC staff's review process and best practices for managing unresolved SEC comment letters.

Appendix A: Glossary of Topics, Standards, and Regulations

FASB Literature

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

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

- Accounting Standards Updates.
- Pre-Codification literature.

SEC Literature

- Staff Accounting Bulletin Topic 1.K, "Financial Statements of Acquired Troubled Financial Institutions"
- Regulation FD, "Fair Disclosure"
- Regulation S-X:
  - Rule 1-02, "Definitions of Terms Used in Regulation S-X (17 CFR Part 210)"
  - Rule 3-05, "Financial Statements of Businesses Acquired or to Be Acquired"
  - Rule 3-09, "Separate Financial Statements of Subsidiaries Not Consolidated and 50 Percent or Less Owned Persons"
  - Rule 3-10, "Financial Statements of Guarantors and Issuers of Guaranteed Securities Registered or Being Registered"
  - Article 11, "Pro Forma Financial Information"
  - Article 12, "Form and Content of Schedules"
- Rules, Proposed Rules, and Interpretive Releases:
  - Final Rule No. 33-8176, "Conditions for Use of Non-GAAP Financial Measures"
  - Proposed Rule No. 33-9143, "Short-Term Borrowings Disclosure"
  - Interpretive Release No. 33-9144, "Commission Guidance on Presentation of Liquidity and Capital Resources Disclosures in Management's Discussion and Analysis"
- Forms:
  - Form 8-K — *Current Reports* (Item 2.01)
  - Form 10-K — *General Form of Annual Report*
  - Form 10-Q — *Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934*
  - Form 20-F — *For Standardized Options*
  - Form S-3 — *Registration Statement Under the Securities Act of 1933*
- Industry Guide 3, "Statistical Disclosure by Bank Holding Companies"
- Division of Corporation Finance Financial Reporting Manual (FRM):
  - Topic 2, "Other Financial Statements Required"
  - Topic 3, "Pro Forma Financial Information"
  - Topic 6, "Foreign Private Issuers & Foreign Businesses"
  - Topic 9, "Management's Discussion and Analysis of Financial Position and Results of Operations (MD&A)"

- Corporation Finance Disclosure Guidance:
    - Topic No. 1, "Staff Observations in the Review of Forms 8-K Filed to Report Reverse Mergers and Similar Transactions"
    - Topic No. 2, "Cybersecurity"

PCAOB Literature

- Staff Audit Practice Alerts:
    - Practice Alert No. 8, *Audit Risks in Certain Emerging Markets*
    - Practice Alert No. 9, *Assessing and Responding to Risk in the Current Economic Environment*
- Concept Release No. 2011-003, *Possible Revisions to PCAOB Standards Related to Reports on Audited Financial Statements and Related Amendments to PCAOB Standards*
- Concept Release No. 2011-006, *Auditor Independence and Audit Firm Rotation*

International Standards

See Deloitte's IAS Plus Web site for the titles of citations to:

- International Financial Reporting Standards.
- International Accounting Standards.

Other Literature

Securities Exchange Act of 1934, Section 10A, "Audit Requirements"

Appendix B: Abbreviations

Abbreviation	Description
AICPA	American Institute of Certified Public Accountants
ASC	FASB Accounting Standards Codification
ASU	FASB Accounting Standards Update
CAO	chief accounting officer
CAQ	Center for Audit Quality (affiliated with the AICPA)
CFDG	Corporation Finance Disclosure Guidance
CEO	chief executive officer
CFO	chief financial officer
CGU	cash-generating unit
CODM	chief operating decision maker
COSO	Committee of Sponsoring Organizations
CPA	certified public accountant
C&DI	SEC's Division of Corporation Finance Compliance and Disclosure Interpretation
CUSIP	Committee on Uniform Security Identification Procedures
DTA	deferred tax asset
EDGAR	SEC's Electronic Data Gathering, Analysis, and Retrieval system
EITF	FASB's Emerging Issues Task Force
FAF	Financial Accounting Foundation (FASB's parent organization)
FASB	Financial Accounting Standards Board
FinREC	AICPA's Financial Reporting Executive Committee
FPI	foreign private issuer
FRM	SEC Financial Reporting Manual
GAAP	generally accepted accounting principles
G20	a group of 20 finance ministers and central bank governors
IAASB	International Auditing and Assurance Standards Board
IAS	International Accounting Standard
IASB	International Accounting Standards Board
ICFR	internal control over financial reporting
IFRS	International Financial Reporting Standard

IPR&D	in-process research and development
MD&A	Management's Discussion and Analysis
OCI	other comprehensive income
OPEB	other postemployment benefits
PCAOB	Public Company Accounting Oversight Board
PCSIC	Private Company Standards Improvement Council
SAB	SEC Staff Accounting Bulletin
SEC	Securities and Exchange Commission
VIE	variable interest entity
XBRL	eXtensible Business Reporting Language

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