
**CURRENT DEVELOPMENTS
IN THE
DIVISION OF CORPORATION FINANCE**
National Conference on Current SEC & PCAOB Developments
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Agenda

- ❖ **Introductions and Opening Remarks**
- ❖ **Division Activities**
- ❖ **Improving Communications**
- ❖ **Improving Disclosure**
- ❖ **Other Issues**
- ❖ **Closing Remarks**

Division Activities

Dodd-Frank Act - ICFR

Revised Item 308(b) – auditor attestation doesn't apply to non-accelerated filers

Item 308(a) - Management assessment and report on ICFR continues to apply

Requires SEC to conduct a study regarding auditor attestation for issuers with market capitalization between \$75 million - \$250 million

Internal Control over Financial Reporting

- ❖ Non-accelerated filer status
- ❖ Material weaknesses
- ❖ Restatements
- ❖ DCP vs. ICFR effectiveness
- ❖ Material changes in ICFR
- ❖ Disclosure issues
- ❖ Consolidation of VIEs – ASU 810

ICFR for registrants with substantially all of their operations outside the U.S.

Evaluating

- ❖ Background and training of CFO or other person(s) responsible for maintaining books and records and preparing financial statements**
- ❖ Seek information:**
 - Specific nature of U.S. GAAP experience**
 - Specific roles / duties of person with U.S. GAAP experience**
 - Services performed by a third party CPA or consultant – specific nature, extent**

ICFR for registrants with substantially all of their operations outside the U.S.

Immediate goal –disclosure of the material weakness, if appropriate

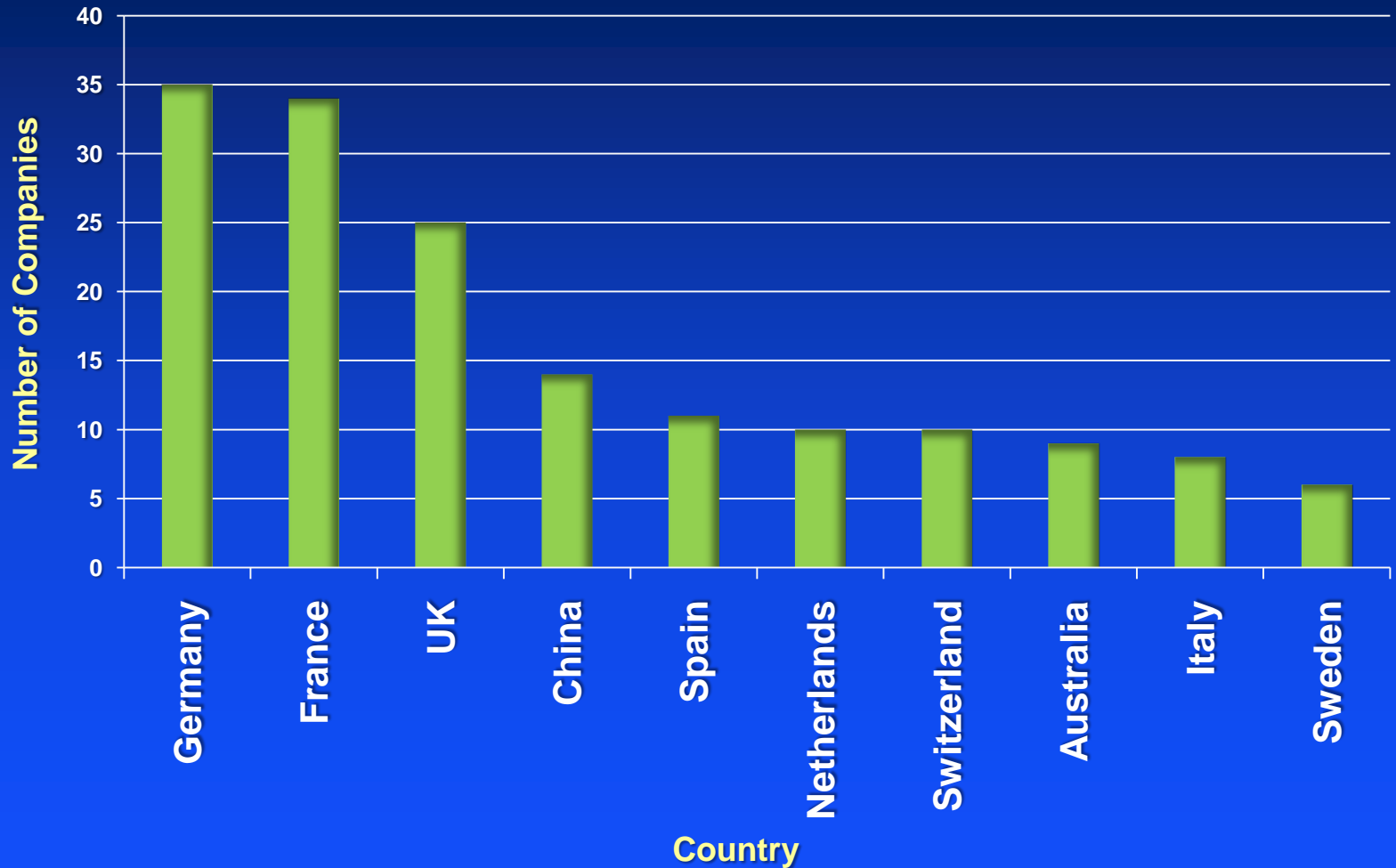
Broader / long-term goal – to improve the quality of financial reporting

IFRS Work Plan

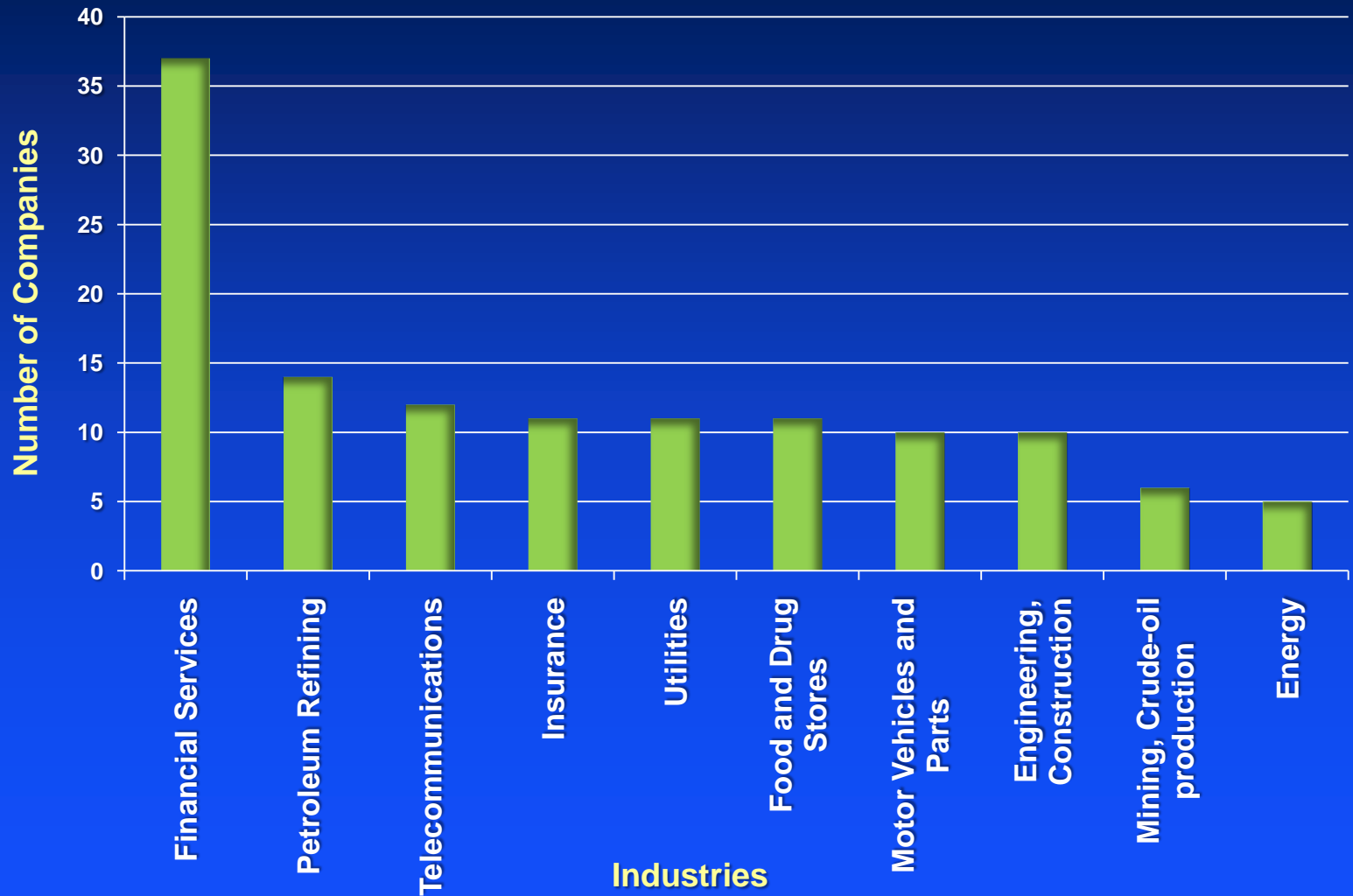
IFRS Work Plan

- ❖ Evaluating how application of IFRS in practice affects the comparability of across jurisdictions by country and industries
- ❖ Sample companies include:
 - SEC registrants and non-SEC registrants
 - Wide range of jurisdictions and industries

IFRS Survey: Sample Companies by Country



IFRS Survey: Sample Companies by Industry



IFRS Work Plan

Considering how companies have applied IFRS including accounting policy choices that are:

- **Permitted under IFRS**
- **Required when IFRS relies on management judgment, or**
- **Required when IFRS does not provide specific guidance**

Short Term Borrowings Proposal

Short-term Borrowings (STB) Proposal

- ❖ **Proposed Rule – issued Sept 2010 – comment period closed November 29, 2010**
- ❖ **Goal: Increase transparency in the presentation of borrowings and financing activities and exposure to liquidity risks**
 - **More expansive for “financial companies” but more significant increase in disclosures for non-financial companies**
 - **Both quantitative and qualitative disclosures**
 - **Fact Sheet available on SEC website:**
<http://www.sec.gov/news/press/2010/2010-169.htm>

Short-term Borrowings (STB) Proposal

New Proposed Disclosures - Quantitative:

- The amount outstanding at the end of the reporting period and the weighted average interest rate on those borrowings
- The average amount outstanding during the period** and the weighted average interest rate on those borrowings
- The maximum amount outstanding during the period**

** Calculation will vary depending on whether a financial company or non-financial company

Short-term Borrowings (STB) Proposal

New Proposed Disclosures – Qualitative

- General description of the STB arrangements included in each category and the business purpose of those arrangements
- Importance of STBs liquidity, capital resources, market-risk support, credit-risk support or other benefits
- Reasons for the maximum reported level for the reporting period
- Reasons for any material differences between average STBs and period-end STBs

Short-term Borrowings (STB) Proposal

Applicability & Reporting Periods

- Annual reports – 3 years + fourth quarter data (but transition period for Co's not currently subject to Guide 3 requirements)
- Quarterly reports – just data for current quarter (no comparative requirement)
- SRCs have limited disclosures in quarterly reports and don't have to provide fourth quarter data in 10-K
- Rules would apply to FPIs but not MJDS filers

MD&A Interpretive Release

❖ Issued at the same time as STB Proposal

Related to liquidity and funding disclosures – *guidance now effective*

❖ Focus:

- Structures used to mask financial condition
- Leverage ratios
- Table of Contractual Obligations

Improving Communications

Financial Reporting Manual

FRM – Updates This Year

❖ Topic 8: Non-GAAP Measures

❖ Topic 2: Other Financial Statements

- Calculating significance – S-X 1-02(w)
- Guarantor reporting – S-X 3-10
- General partnership balance sheet
- IFRS for Small and Medium-sized Enterprises (SMEs)

❖ Section 9500: Critical Accounting Estimates

- Goodwill Impairment
- Stock Compensation in IPO

Topic 8: Non-GAAP Measures

Non-GAAP Measures

- ❖ **January 2010 Compliance and Disclosure Interpretations**
- ❖ **Guidance removed some of the barriers to providing disclosure**
- ❖ **Registrants providing more non-GAAP information in filed documents**
- ❖ **Broad observation – keep prominence in mind**

Non-GAAP Measures

- ❖ Shares used in diluted per share performance measure – recalculate
- ❖ GAAP cash flow per share
 - Commission view - ASR 142
 - Declaring it a performance measure does not alleviate concerns
- ❖ Staff will carefully evaluate measures that are similar to GAAP cash flow and presented on a per share basis
- ❖ Materiality

Topic 2: Other Financial Statements Required

Calculating Significance

Present F/S or Financial Data of Other Entities

Determine Using 3 Significance Tests
[S-X 1-02(w)]:

1. Asset test
2. Investment Test
3. Income Test

Calculating Significance

Income Test

Registrant's Share of Acquiree's/Investee's Pre-Tax Income/Loss from Continuing Operations for Most Recently Completed Fiscal Year ("numerator")

DIVIDED BY

Registrant's Pre-Tax Income/Loss from Continuing Operations for Most Recently Completed Fiscal Year ("denominator")

Calculating Significance

Income Test – Use of Income Averaging

Registrant's Share of Acquiree's/Investee's Pre-Tax Income/Loss from Continuing Operations for Most Recently Completed Fiscal Year
("numerator")

DIVIDED BY

Registrant's 5-YEAR AVERAGE Pre-Tax Income/Loss from Continuing Operations
("denominator")

Calculating Significance

Income Test – Use of Income Averaging

[Computational Note 2 to S-X 1-02(w)]

“If income of the registrant and its subsidiaries consolidated exclusive of amounts attributable to any noncontrolling interests for the most recent fiscal year is at least 10 percent lower than the average of income for the last five fiscal years, such average income should be submitted for purposes of the computation. Any loss year should be omitted for purposes of computing average income”

Calculating Significance

Income Averaging [S-X 1-02(w)]

Old Practice – Prohibit Averaging if Pre-Tax Loss in Most Recent Fiscal Year

	Income in 2009	Loss in 2009
	Unchanged	Old Practice
2005	\$100	\$100
2006	\$100	\$100
2007	\$100	\$100
2008	\$100	\$100
2009	\$1	(\$1)
Income Test Denominator	\$80	\$1

Calculating Significance Income Averaging [S-X 1-02(w)]

❖ Regulation S-X

- ◆ “registrant’s equity in income from continuing operations [of the tested entity]”

Description of Income Test [S-X 1-02(w)]

- ◆ “If income of the registrant....”

Use of Average Income [S-X 1-02(w)
Computational Note 2]

- ◆ “ Equity in earnings of [investee]”

Income Statement Line Items [S-X 5-03(b)12]

❖ Practical Implications

Calculating Significance

Income Averaging [S-X 1-02(w)]

New Practice – Remove Prohibition on Averaging if Pre-Tax Loss in Most Recent Fiscal Year

	Income in 2009	Loss in 2009
	Unchanged	New Practice
2005	\$100	\$100
2006	\$100	\$100
2007	\$100	\$100
2008	\$100	\$100
2009	\$1	(\$1)
Denominator	\$80	\$80

Calculating Significance Equity Method Investee

Income Test

Registrant's Share of Investee's Pre-Tax
Income/Loss from Continuing Operations
for Most Recently Completed Fiscal Year
("numerator")

DIVIDED BY

Registrant's Pre-Tax Income/Loss from
Continuing Operations
for Most Recently Completed Fiscal Year
("denominator")

Calculating Significance

Income Test – Equity Method Investees

❖ *New Practice :*

The numerator is calculated based on the registrant's proportionate share of the pre-tax income from continuing operations of the separate financial statements of the investee prepared in accordance with U.S. GAAP for the period in which the registrant recognizes income or loss from the investee under the equity method adjusted for any basis difference.

- Calculate Proportionate Interest Using Investee's Financial Statements

Calculating Significance Equity Method Investee

Registrant's Share of Investee's Pre-Tax Income/Loss from Continuing Operations

OLD	NEW
+/- Basis Difference ASC 323-10-35-32A and -34	+/- Basis Difference ASC 323-10-35-32A and -34
+/- Impairment Charge @ Investor-Level	
+/- Certain Gains/Losses from Stock Sale by Registrant	
+/- Dilution Gains/Losses from Stock Sale by Investee	
+/- Investee's Preferred Dividends	

Calculating Significance Disposed Business

Income Test

Registrant's Share of Disposed Business's Pre-Tax Income/Loss from Continuing Operations for Most Recently Completed Fiscal Year
("numerator")

DIVIDED BY

Registrant's Pre-Tax Income/Loss from Continuing Operations for Most Recently Completed Fiscal Year
("denominator")

Calculating Significance Disposed Business

Income Test

Effect of Classification of Disposed Business on Denominator of Income Test

- Disposed Business = Discontinued Operation
 - Denominator of Income Test Excludes Disposed Business
- Disposed Business = Not a Discontinued Operation
 - Denominator of Income Test Includes Disposed Business

Guarantor Reporting – S-X 3-10

Overview

Practice Issues

- ❖ 100%-owned subsidiary
- ❖ Full and unconditional guarantee

Guarantor Reporting – S-X 3-10

Condensed Consolidating Information

- **Article 10 Level Detail**

	Parent	Sub Issuer	Sub Guarantor	Non-Guarantor	Elim	Consolidated
Assets	X	X	X	X	X	X
	X	X	X	X	X	X
	X	X	X	X	X	X
Liabilities	X	X	X	X	X	X
	X	X	X	X	X	X
	X	X	X	X	X	X
S/E	X	X	X	X	X	X

Guarantor Reporting – S-X 3-10

Condensed consolidating financial information

- ❖ **Direct and indirect subsidiaries of the parent**
- ❖ **Condition for relief, not merely a footnote**

Guarantor Reporting – S-X 3-10

Consequences of not meeting all conditions for relief

- ❖ Full registrant financial statements
- ❖ Separate Exchange Act reports

General Partnership Balance Sheet

- ❖ **SAB 113 eliminated for oil and gas companies that are not SRCs**
- ❖ **S-X 8-07 still requires for SRCs**
- ❖ **Eliminated “automatic requirement” for other companies**
- ❖ **If not required still should have clear disclosure**
- ❖ **Disclosures to be provided**

IFRS for SMEs

- ❖ **Non-issuers (3-05s and 3-09s) that are foreign businesses [S-X 1-02(I)]**
- ❖ **Must reconcile to U.S. GAAP**
- ❖ **Not appropriate for issuers, predecessors of issuers, domestic businesses, or domestic investees**

Section 9500: Critical Accounting Estimates

Goodwill Impairment

- ❖ **Guidance provided at 2009 conference targeted at reporting units at risk of failing step one of impairment test**
- ❖ **Critical estimate disclosures within MD&A**
- ❖ **Comment process streamlined, but staff continues to probe in certain situations**
- ❖ **Best practice – more robust disclosure when indicators of impairment appear to exist**

Stock-Based Compensation

IPO – Critical Estimates

- ❖ **Financial Reporting Update – Section 9520**
- ❖ **If considered critical policy under Release 33-8350, consider providing:**
 - **Description of methods/assumptions**
 - **Table disclosing grant information**
 - **Narrative disclosures describing factors contributing to changes in value**
 - **Targeted at twelve months preceding latest balance sheet, but additional disclosure may be necessary**

Stock-Based Compensation

IPO – Critical Estimates

- ❖ Value changes inconsistent with operations and/or development of the company may result in more disclosure
- ❖ Explicit reference to fair value inputs
- ❖ Not intended as a stand-alone summary of all events affecting the company
- ❖ Focus on significant
- ❖ Best practice – independent and contemporaneous valuations

Website Updates

- ❖ **CF Accounting web page**
- ❖ **Banking power point presentation**

FRM Project

FRM Project

CAQ SEC Regulations Committee Meeting Highlights

Dear CFO Letters

Dear CFO Letter - Repos

- ❖ Issued and posted to SEC website in March

<http://www.sec.gov/divisions/corpfin/guidance/cforepurchase0310.htm>

- ❖ Request for information about repurchase agreements, securities lending transactions, or other transactions involving the transfer of financial assets

Dear CFO Letter– Mortgage & Foreclosure-Related Activities

- ❖ Issued and posted to SEC website in October

<http://www.sec.gov/divisions/corpfin/guidance/cfoforeclosure1010.htm>

- ❖ Similar to most Dear CFO letters (other than Repo letter), no response required
- ❖ Disclosures should address effects to companies based on their roles as originator, securitizer, servicer, and investor

IFRS Issues

IFRS Top Ten

10. Consolidated financial statements - IAS 27
9. Provisions, contingent liabilities – IAS 37
8. Employee benefits – IAS 19
7. Property, plant and equipment – IAS 16
6. Income taxes – IAS 12

IFRS Top Ten

5. Revenue - IAS 18
4. Operating segments – IFRS 8
3. Financial statement presentation - IAS 1 & 7
2. Impairment of assets – IAS 36
1. Financial instruments – IAS 39, 32 & IFRS 7

Improving Disclosure

Summarized Financial Data

S-X4-08(g)

Summarized Financial Information [S-X 4-08(g)]

Facts:

- Registrant
 - U.S. Domestic Company
 - F/S prepared using U.S. GAAP

- Equity Method Investee
 - Foreign Business
 - F/S prepared using Home Country GAAP, which is NOT U.S. GAAP

Summarized Financial Information

[S-X 4-08(g)]

Polling Question: Since the U.S. domestic company is required to present its financial statements in accordance with U.S. GAAP, what basis of accounting should it use when it calculate its share of the income of the foreign business?

- A. Foreign Business's Home Country GAAP
- B. U.S. GAAP
- C. IFRS as issued by the IASB
- D. Other
- E. I don't know / not applicable

Summarized Financial Information

[S-X 4-08(g)]

Polling Question: When a U.S. domestic company is required to present in its U.S. GAAP financial statements summarized financial data of the foreign business, what basis of accounting should be used to present that summarized financial data?

- A. Foreign Business's Home Country GAAP
- B. U.S. GAAP
- C. IFRS as issued by the IASB
- D. Other
- E. I don't know / not applicable

Hint: See Release 33-7118, fn 30

Summarized Financial Information

[S-X 4-08(g)]

Polling Question: Is it acceptable for a U.S. Domestic Company to present summarized financial data of a foreign business prepared on the basis of the foreign business's home country GAAP if the disclosure includes a statement below the summarized data to the effect that:

“The differences between U.S. GAAP and home country GAAP did not materially impact the amounts reflected in U.S. Domestic Company's consolidated financial statements.”

- A. Yes**
- B. No**

Loss Contingencies

Loss Contingencies – ASC 450

❖ Differences between SK 103 and ASC 450

Observations:

- ❖ Expect co's to comply with existing standard
- ❖ Seeing lack of disclosure with respect to “reasonably possible” losses
 - Disclosure may indicate that it can't be done “with certainty” or “with confidence” and thus no estimate provided

Loss Contingencies – ASC 450

Observations (cont.):

- ❖ Disclosure of “reasonably possible” range may be done in the aggregate
- ❖ Staff may question lack of historical disclosures when settlements are disclosed in future periods

Form 8-K Item 4.01

Item 4.01 8-K

Polling Question: Which of the following was not derived from an actual 8-K disclosure as an explanation of change in auditor:

- A. The auditor is deceased
- B. The auditor can't be found
- C. The auditor is currently incarcerated
- D. The dog ate my auditor
- E. Both C&D

Item 4.01 8-K

- ❖ **Frequent comment areas**
 - Interim period
 - Going concern paragraph in audit report
- ❖ **ICFR report modifications**
- ❖ **Firm mergers**
- ❖ **Firm revocations**
- ❖ **Reportable events**

Liability or Equity?

Liability or Equity?

**EITF 07-5 Determining
Whether an Instrument (or
Embedded Feature) is Indexed
to an Entity's Own Stock
(ASC 815-40-15)**

Liability or Equity?

- ❖ **Freestanding warrants to buy registrant's stock and embedded conversion options**

Liability or Equity?

- 1. Indexed to the company's own stock?
(EITF 07-5/ASC 815-40-15)**
- 2. If indexed, does it meet the requirements to be classified in stockholders' equity?
(EITF 00-19/ASC 815-40-25)**

Liability or Equity?

Indexed to the company's own stock?

Evaluate :

- Contingent exercise provisions, if any
- Settlement provisions (new guidance as of 1/1/2009 for CYE)

Increased comments stem from new guidance related to the evaluation of the settlement provisions

Liability or Equity?

Indexed to the company's own stock?

Stock Purchase Warrant

- ❖ Exercise price and number of shares
 - Both fixed = Indexed
 - “Fixed-for-Fixed” (i.e. fixed price for fixed number of shares)
 - Not fixed = It depends
 - Are the variables inputs into fair value of “Fixed-for-Fixed” forward or option on equity shares?

Liability or Equity?

Indexed to the company's own stock?

Example Inputs into Fair Value of “Fixed-for-Fixed”

- Company's stock price
- Strike price
- Term
- Expected dividends or other dilutive activities
- Interest rates
- Stock price volatility
- Stock borrow costs
- Company's credit spread
- Ability to maintain standard hedge position in underlying shares

Liability or Equity?

Indexed to the company's own stock?

Problems:

- Variable settlement provisions
 - At-Market issuance of company's stock adjusts strike price and/or number of shares
(EITF 07-5, Ex. 8/ASC 815-40-55-33, Ex. 9)
- Valuation Issues
 - Use of Black Scholes method
- Imprecise Disclosure
 - “subject to standard anti-dilution adjustments”

Other Issues

Foreign Operations

Foreign Operations

Disclosures

- ❖ Information about business and financial risks
- ❖ Financial statement effects

Foreign Operations

- ❖ Disproportionate effects
- ❖ Disaggregated information
- ❖ *In the Matter of Caterpillar, Inc.*
Release 34-30532 (3/31/1992)
- ❖ 1989 and 2003 MD&A Interpretive Releases

Income Tax

Income Taxes

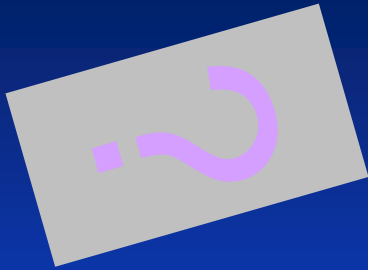
- **Domestic vs. foreign taxable income (loss)**
 - Disclosure of pre-tax income and income tax expense
- **Possible impact on liquidity**
 - Repatriation to a U.S. parent company from a foreign tax jurisdiction
- **Significant estimates and assumptions used**
 - Impact of changes on results and liquidity
- **Rate reconciliation**
 - Captions describe the nature of the adjustments

Issuance of Financial Statements

Issuance of Financial Statements

- ❖ **What constitutes issuance**
- ❖ **Reissuance of predecessor auditor reports**

Other Topics



Questions

