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Third Edition

SEC Comment Letters on Domestic Registrants
A Closer Look

Contents

Preface

The Sarbanes-Oxley Act of 2002 requires the SEC staff to review every issuer's disclosures, including financial statements, at least once every three years. The SEC staff's comments and registrants' responses are posted on the SEC's Web site and provide valuable insight into the SEC staff's common comment themes. Registrants can incorporate a review of the comments into their financial reporting process to help improve their financial statements and disclosures.

The third edition of *SEC Comment Letters on Domestic Registrants — A Closer Look* provides extracts from frequently issued SEC staff comments, along with additional analysis and links to related resources. This revised edition reflects new topics (e.g., consolidations, noncontrolling interests, and material contracts) and updates existing topics to reflect new areas that the SEC staff has commented on since the release of our second edition in February 2009. The SEC staff has continued to issue comments on all topics included in the second edition, such as revenue recognition, business combinations, segment reporting, financial instruments, and impairments. In addition, in light of the troubled credit markets, the staff has continued to closely scrutinize goodwill and intangible asset impairments, other-than-temporary impairments, deferred tax valuation allowances, pension liabilities, executive compensation disclosures, MD&A disclosures, debt covenant compliance, fair value disclosures, and the allowances for loan losses, just to name a few.

New to this third edition are sections on the following industries:

- Financial services, including the banking, securities, and real estate industries.
- Energy and resources, including the power and utilities and oil and gas industries.
- Health sciences, including the health care and life sciences industries.
- Consumer and industrial products, particularly the retail industry.

The appendixes of this Special Report offer additional valuable insights. For example, Appendix A gives a glimpse into the SEC staff's review and comment letter process, Appendix B discusses best practices for managing unresolved SEC comment letters, and Appendix C provides helpful tips on searching the SEC's database for comment letters.

Is your company a foreign private issuer? If the SEC ultimately allows domestic registrants to report under IFRSs, is your company considering filing IFRS financial statements? If you answered yes to either question, you might be interested in our companion publication, *SEC Comment Letters on Private Foreign Issuers Using IFRSs — A Closer Look*.

We hope that you find the third edition of this Special Report a valuable tool for improving your financial statements. We welcome your feedback. Please send us your thoughts and suggestions.

Members of the following Deloitte teams contributed to this third edition: Accounting Standards and Communications, SEC Services, Accounting Consultation, and the Industry Professional Practice Network.

Executive Summary

It probably comes as no surprise that the volatility and deterioriation in the credit and financial markets have heavily influenced the nature and focus of SEC staff comments on registrants' recent filings. The staff has focused on transparent reporting and disclosure in certain key areas: MD&A, goodwill impairment testing, valuation allowances and repatriation of foreign earnings, fair value, debt, other-than-temporary impairments, pensions, and executive compensation. A brief summary of these key areas is included below. All of these topics, and many more, are covered in more detail in the body of this publication.

Management's Discussion and Analysis

The SEC has repeatedly stressed the importance of MD&A to an investor's evaluation of his or her investment. In a speech on October 2, 2009, at the 48th Annual Corporate Counsel Institute of the Northwestern University School of Law, SEC Commissioner Elisse B. Walter stated:

> [The SEC's] efforts have been extensive, but, in my view, corporate MD&As are still not where they should be. I would like to see [registrants] recognize trends and uncertainties sooner; make reasonable likelihood determinations before they become more likely than not; and disclose this information to investors so that they can make their own, fully-informed investment decisions. And these disclosures should be made in a way that communicates to shareholders. I call on [registrants] to do everything that [they] can to assure that [they] provide disclosure that enables their owners, the shareholders, to view the [registrant] and its prospects through the eyes of its insiders.

These statements emphasize the SEC's focus on enhanced MD&A disclosures that are clear and provide meaningful information to investors. Several staff members have highlighted the need for registrants to adequately address in MD&A how the current financial and credit market environment is affecting their results of operations, liquidity and capital resources, and critical accounting policies. Such disclosures should include a discussion of any material opportunities, risks, and uncertainties.

As the subjectivity in determining amounts recognized in the balance sheet increases, so does the need for comprehensive and transparent footnote disclosures. The critical accounting policies section of MD&A should focus on those financial statement items that require significant management estimates and judgment. Registrants should not simply repeat their accounting policy disclosure from the footnotes to the financial statements. Instead, the SEC staff expects discussion and analysis of material uncertainties associated with the methods and assumptions underlying each critical accounting estimate. In addition, registrants should consider including an analysis of the sensitivity of estimates to change on the basis of outcomes that are reasonably likely to occur and that would have a material effect.

See the Management's Discussion and Analysis section for examples of, and additional insight into, MD&A comments.

Goodwill Impairment Testing

Given the current economic environment, the SEC staff continues to comment frequently on goodwill impairment. For example, the staff may comment when a registrant's revenues significantly decline or when a registrant's market capitalization significantly declines below book value, since such declines may indicate impairments in intangible assets and goodwill. The SEC staff may ask registrants that have recorded a goodwill impairment whether they also have considered the implications of the conditions that resulted in the impairment on any deferred tax assets.

The staff has also been asking for more robust and comprehensive disclosures about goodwill impairments. Goodwill impairment disclosures should not only focus on the noncash nature of the impairment but should also address the business and economic conditions that gave rise to the charge. We understand that the SEC staff will be asking for more disclosures about what the conditions that resulted in impairments mean to the registrant's business as well as for more forward-looking information about the risk of future impairments.

See the Business Combinations, Long-Lived Assets, and Impairments section for examples of, and additional insight into, goodwill comments.

Valuation Allowances and Repatriation of Foreign Earnings

In the current economic environment, the SEC staff has frequently commented on a registrant's assessment of the realizability of deferred tax assets and the tax accounting consequences of repatriating foreign earnings. When preparing disclosures about deferred tax valuation allowances, registrants should also consider disclosing, in the critical accounting estimates section of MD&A, (1) a discussion about the effect that the current economic environment is having on the realization assessments of their deferred tax asset balances and (2) any triggering events or new evidence leading to an adjustment of the valuation allowance as well as the effect on current and future results.

When preparing disclosures about the repatriation of foreign earnings, registrants should consider disclosing the current and anticipated effects of the repatriation on the entity. In addition, the SEC staff has encouraged registrants to disclose in MD&A whether the entity's need to repatriate foreign earnings is uncertain. Such disclosure might include the likelihood that such an event will occur and the likely effect on future earnings.

See the Income Taxes and Uncertain Tax Positions section for examples of, and additional insight into, comments on valuation allowances and repatriation of foreign earnings.

Fair Value

The SEC staff continues to focus on disclosures related to the turmoil in the credit markets as well as the disclosures required by ASC 820 (formerly Statement 157).[1] In addition to providing fair value disclosures in accordance with ASC 820, registrants are encouraged to provide transparent disclosures in MD&A about the use of significant unobservable inputs in fair value measurements and about fair value measurements of material financial instruments that are not traded actively.

When fair value measurements rely on unobservable inputs, the SEC staff believes registrants should consider disclosing (1) the valuation models used to determine fair value, (2) the significant inputs into the models, (3) the assumptions that could have the greatest impact on the valuations, and (4) whether, how, and why those assumptions have changed from prior years. When material financial instruments are not traded actively, the staff believes registrants should consider providing additional information regarding how inactive markets have affected their valuation techniques and the inputs used in those models. In some cases, the staff has asked for detailed information regarding how a registrant concluded that a market was inactive, such as (1) the criteria used in determining that a market is inactive, including the interpretation of the definition of an inactive market, and (2) the specific date on which the registrant last considered the market active and the length of time between that date and the date of the fair value measurement.

See the Fair Value and the Turmoil in the Credit Markets section for examples of, and additional insight into, comments on fair value measurements and disclosures.

Debt

Because the financial difficulties of registrants have increased as a result of the current credit crisis, registrants should consider enhancing disclosures about debt covenant compliance to include a discussion of the terms of the most severe covenants and how the registrant has complied with those covenants. In addition, a registrant may present a table illustrating the registrant's most material actual debt-covenant ratios as of the latest balance sheet date compared with the minimum/maximum amounts permitted under debt agreements. Such transparent disclosures will enable investors to understand the risk of future noncompliance.

See the Debt section for examples of, and additional insight into, debt-related comments.

Other-Than-Temporary Impairments (OTTI)

The SEC staff continues to focus on OTTI, primarily because of the prolonged deterioration in the credit markets and the significant decline in value of many investments (e.g., asset-backed securities, mortgage-backed securities, auction rate securities, corporate debt, perpetual preferred stock, equity securities). Registrants are encouraged to describe how they concluded that an investment with a fair value below amortized cost is not other-than-temporarily impaired.

For those investments that are other-than-temporarily impaired, the staff has asked what factors, negative and positive, the registrant used in its OTTI determination. The staff may also question whether the impairment was recorded in the appropriate period and may ask what factors have changed since the last reporting period and how the registrant has considered these changes. Disclosures should provide users with an understanding of how a registrant measured credit losses recognized in earnings under ASC 320-10-35 (formerly Statement 115 and FSP FAS 115-1 and FAS 124-1) and the related inputs and assumptions by major security type.

See the Investments section for examples of, and additional insight into, comments on other-than-temporary impairments.

Pensions

The SEC staff continues to comment on registrants' disclosures about key assumptions that represent critical inputs for calculating the pension obligation and fair value of plan assets. Given the recent volatility in the financial markets, comments have focused on increased disclosures about (1) how registrants considered recent market performance in determining their key assumptions, (2) the impact of recent market performance on net periodic benefit cost and an entity's financial position, and (3) the impact of funding requirements on an entity's liquidity.

The SEC staff has also been requesting sensitivity analyses for a registrant's pension obligations. These disclosures should focus on changes in key assumptions that are reasonably likely to occur and that could be material to an entity, such as the discount rate used to calculate an entity's benefit obligation.

See the Pensions and Other Postretirement Benefits section for examples of, and additional insight into, pension-related comments.

Executive Compensation

It is also no surprise that the SEC staff continues to comment on executive compensation, given the attention this subject received throughout the credit crisis. Because these themes have been publicly discussed, the SEC has stated that registrants are expected to understand the rules and apply them, and a registrant that receives a staff comment regarding material noncompliance may be asked to amend its filings.

The staff has indicated that a registrant's compensation discussion and analysis should focus more on analyzing material principles and important factors influencing the registrant's executive compensation policies and decisions. When the SEC staff asks a registrant to enhance its analysis, the staff does not necessarily mean that the registrant should lengthen its disclosure. Rather, the staff prefers clearer and more concise disclosures with more tables and graphs.

If a registrant uses performance targets, it should disclose them and provide information about their use. The executive compensation disclosure requirements allow registrants to exclude performance targets and other factors or criteria involving confidential information if the disclosure of such information would result in competitive harm. While registrants are not required to formally request confidential treatment to omit these disclosures, they must meet the confidential-treatment standard and demonstrate to the staff upon request that they have done so. Even if omission of targets or other factors or criteria is appropriate, registrants should consider disclosing information about how difficult it would be for the executive, or how likely it would be for the registrant, to achieve the undisclosed target levels or other factors.

See the Executive Compensation section for examples of, and additional insight into, comments on executive compensation.

Accounting and Disclosure Topics

Asset Retirement Obligations

Examples of SEC Comments

- We note that you are subject to a variety of governmental regulation. In connection with this . . ., please tell us whether there are any legal obligations with respect to retirement of your properties associated with such regulation and your consideration of [ASC 410-20 (formerly Statement 143 and Interpretation 47)] in this regard.
- Explain to us in detail why you do not have sufficient information to estimate a reasonable range of expected retirement dates for certain asset retirement obligations. Please advise what steps you are taking to obtain such information.

The SEC staff often issues comments questioning why a registrant did not record an asset retirement obligation when disclosures in the filing appear to indicate that the registrant may have an obligation. Further, a registrant that includes disclosures such as “settlement dates are unknown at this time,” or other similar language concerning the inability to reasonably estimate the fair value of asset retirement obligations, may receive an SEC staff comment asking for more detail about how the registrant reached this conclusion and the extent of the registrant’s uncertainty. Registrants must disclose (1) that they have not recorded asset retirement obligations that cannot be reasonably estimated and (2) the reason they could not be reasonably estimated in accordance with ASC 410-20-50-2 (formerly paragraph 22 of Statement 143).

ASC 410-20-25-6 (formerly paragraph 4 of Interpretation 47) states that an “entity has sufficient information to reasonably estimate the fair value of an asset retirement obligation” in the following situations:

- When it is evident that the fair value of the asset retirement obligation has been included in the purchase price of the asset.
- When there is an active market for the transfer of the asset retirement obligation to a third party.
- When an entity has sufficient information to apply an expected present value technique.

ASC 410-20-25-8 (formerly paragraph 5 of Interpretation 47) goes on to clarify that circumstances in which an entity has sufficient information to apply an expected present value technique include:

- When the settlement date and the method of settlement have been specified in the law, regulation, or contract that gave rise to the legal obligation.
- When an entity has information to reasonably estimate the (1) settlement date (or range of potential settlement dates), (2) method of settlement (or potential methods of settlement), and (3) probabilities associated with potential settlement dates and potential methods of settlement.

Business Combinations, Long-Lived Assets, and Impairments

Business Combinations

Examples of SEC Comments

- *Assigning Amounts to Assets Acquired and Liabilities Assumed* — Please tell us and in future filings disclose how you determined the fair value of the assets acquired. Specifically address each identifiable intangible asset recognized.
- *Contingent Consideration* — We note . . . that in connection with certain recent acquisitions, the company may be obligated to pay additional consideration if certain earnings objectives are achieved. We also note from the disclosures in Note [X] that during [the current year and prior year], the company paid [$X million] and [$X million], respectively, of additional purchase price consideration for acquisitions completed in prior years and the accrued additional purchase consideration was recorded as goodwill. Please tell us and revise the notes to your financial statements in future filings to explain in further detail the nature and terms of the conditions which must occur for this contingent consideration to become payable. As part of your response, please specifically address whether any of these payments are or were contingent upon the former shareholders of the acquired entities remaining employed with the company. Your response should also explain in further detail why you believe it is appropriate to account for the accruals and payments made as part of the purchase price for the acquisitions rather than as compensation expense. Refer to the guidance outlined in paragraphs 25–34 of Statement 141 and Issue 95-8.
- *Customer-Relationship Intangible Assets* — Please tell us why you believe that the straight-line method of amortization is more appropriate than an accelerated method of amortization for the customer relationship intangible asset given that customer relationships frequently have a higher rate of attrition in earlier periods with the rate of attrition declining over time.

Although many of the comments above relate to acquisitions accounted for under Statement 141 (superseded by ASC 805, formerly Statement 141(R)), many comments in this section will continue to be relevant for acquisitions accounted for under ASC 805.[1]

Assigning Amounts to Assets Acquired and Liabilities Assumed

The SEC staff frequently asks questions about how amounts are assigned to assets acquired and liabilities assumed in business combinations. In particular, the staff asks registrants that have recorded significant goodwill why they have not attributed value to identifiable intangible assets. The SEC staff has also been reminding registrants that ASC 805-30-50-1(a) (formerly paragraph 68(e) of Statement 141(R)) requires disclosure of "a qualitative description of the factors that make up the goodwill recognized, such as expected synergies from combining operations of the acquiree and the acquirer, intangible assets that do not qualify for separate recognition, or other factors."

The SEC staff often comments when a registrant indicates in a filing or press release that an intangible asset was acquired but that the asset was not separately recorded as part of the business combination. For example, the SEC staff often asks why a registrant did not recognize a customer-related intangible asset if it discloses in its Management's Discussion and Analysis (MD&A) that it acquired contracts with customers in a business combination.

In addition, the SEC staff may ask detailed questions about material revisions to the initial accounting for a business combination. For example, the staff may ask what significant assumptions have changed that support a revision to the value of intangible assets.

Contingent Consideration

The SEC staff often asks registrants to provide additional disclosures about the nature and terms of contingent consideration arrangements and the conditions that must be met for the arrangement to become payable. The staff may ask registrants to provide more detail about the appropriateness of accounting for the arrangement as part of the consideration transferred for the acquisition rather than as compensation expense. For example, ASC 805-10-55-24 and 55-25 (formerly paragraphs A86 and A87 of Statement 141(R)) provide factors for entities to consider in determining whether an arrangement represents compensation for services, use of property, or profit sharing. ASC 805-10-55-25(a) states that a "contingent consideration arrangement in which the payments are automatically forfeited if employment terminates is compensation for postcombination services." The SEC staff has been requesting that registrants specifically disclose whether any of the arrangements are contingent on the continuing employment of the selling shareholders.

[1] In December 2007, the FASB issued Statement 141(R), which replaced Statement 141 and became effective for acquisitions occurring in annual periods beginning after December 15, 2008. Statement 141(R) elevates the role played by fair value and dramatically changes the accounting for business combinations. Statement 141(R) was codified into ASC 805.

ASC 805 changes the way a registrant accounts for contingent consideration. Under Statement 141, contingent consideration was generally not recognized until the contingency was resolved and the consideration became issuable. ASC 805 requires that registrants recognize contingent consideration at fair value as of the acquisition date. Under ASC 805, the staff may ask for additional disclosure about the nature and terms of contingent consideration arrangements. In addition, the staff may ask registrants to disclose how they determined the fair value of the arrangement.

Customer-Relationship Intangible Assets

Another topic the SEC staff has commented on is the accounting for customer relationships. The staff often asks registrants to justify "long" useful lives for customer relationships, sometimes asking for an analysis of customer attrition rates both before and after the acquisition. For example, a registrant may be asked to substantiate a useful life that exceeds five to ten years.

The SEC staff also issues comments about the use of straight-line versus accelerated amortization methods. ASC 350-30-35-6 (formerly paragraph 12 of Statement 142) requires entities to amortize identifiable intangible assets by using a method based on the pattern in which the economic benefits of the assets are consumed and prohibits defaulting to the use of the straight-line method unless the pattern cannot be reliably determined. Consequently, the SEC staff may challenge a registrant that uses the straight-line method of amortization, even when useful lives are short, on the basis of the assertion that it cannot determine the pattern in which the economic benefits of the assets are consumed. The staff's comments indicate that acquired customer relationships tend to benefit a registrant the most in the years immediately after the acquisition and that it is more appropriate to amortize these assets on an accelerated basis.

Impairment Testing of Goodwill and Long-Lived Assets

Examples of SEC Comments

- *Goodwill Impairment Testing* — We see that goodwill comprises approximately [XX%] of your assets at [year-end]. We also note that revenues and net income continued to decline in the first quarter of 2009 due to decreases in volume, a slowdown in the economy, declining demand from the [XXX] and [YYY] markets and increased competition from imports. Please tell us how you considered these factors in determining whether goodwill was impaired at [year-end]. In addition, tell us whether these items are indicators of potential impairment that would require you to perform a goodwill impairment analysis subsequent to [year-end].
- *Goodwill Impairment Testing* — We note that you recognized a goodwill impairment charge during the year. . . . In the interest of providing investors with a better insight into management's judgments in accounting for goodwill impairments, please revise future filings to provide the following disclosures as part of your critical accounting policy:
  - The reporting unit level at which you test goodwill for impairment and your basis for that determination;
  - Sufficient information to enable an investor to understand how you estimate the fair value of your reporting units and why management selected that method as being the most meaningful in preparing your goodwill impairment analyses';
  - A . . . description of the material assumptions used . . .;
  - If applicable, how the assumptions and methodologies used for valuing goodwill in the current year have changed since the prior year, highlighting the impact of any changes; and
  - If or how you consider your market capitalization relative to your net book value in evaluating goodwill for impairment.
- *Goodwill Impairment Testing* — We note there was a significant decline in your market capitalization during the third quarter. . . . It appears this is a triggering event that could require you to reassess your goodwill for impairment. Please tell us what consideration you gave to reassessing the recoverability of your goodwill in the third quarter. If you did not perform impairment tests, please explain why. To the extent that impairment tests were performed tell us how you determined that no impairment existed including in your response what impact the current economic environment had on your cash flow assumptions.
- *Long-Lived-Asset Impairment Testing* — Please revise to describe the impaired long-lived assets or asset groups, the facts and circumstances leading to the impairments and the segment in which impaired long-lived assets or asset groups are reported.
- *Early-Warning Disclosures* — Item 303 of Regulation S-K requires MD&A disclosure of material uncertainties unless management has concluded that the uncertainty is not reasonably likely to materially impact future operating results. Potential asset write-offs are, inherently, uncertainties over the recoverability of recorded assets and require disclosure prior to the period of the impairment charge. Also, Section 216 of the Financial Reporting Codification states that "registrants have an obligation to forewarn public investors of the deteriorating conditions which, unless reversed, may result in a subsequent write-off. This includes an obligation to provide information regarding the magnitude of exposure to loss." Please tell us why you have not included such disclosure in MD&A. Given the significant decline in your operating results, it would appear as though you should be explaining to investors how you determined that your tangible and intangible assets are realizable and that you do not foresee recognizing a material write-down or impairment charge in the future. Otherwise, please provide us with the disclosure you intend to include in future filings.

Goodwill Impairment Testing

Given the current economic environment, the SEC staff continues to comment frequently on goodwill impairment. For example, the staff may comment when a registrant's revenues decline or when a registrant's market capitalization declines below book value, since such declines may indicate impairments in intangible assets and goodwill. The SEC staff may ask registrants that have recorded a goodwill impairment whether they also have considered the implications of the conditions that resulted in the impairment of any deferred tax assets. The staff's valuation experts may be involved in the review of goodwill valuation reports. The staff has also been asking for more robust and comprehensive disclosures about goodwill impairments, including the following:

- Registrants' policies for impairment testing.
- The organization of registrants' reporting units.
- The amount of goodwill allocated to the reporting units.
- A detailed description of the steps performed to review goodwill for recoverability.
- The nature of the valuation techniques used, including descriptions of the significant estimates and assumptions used to determine the fair value of the reporting units.
- The results of the most recently completed impairment tests.

At the June 23, 2009, CAQ SEC Regulations Committee Joint Meeting With the SEC Staff, Mr. Wayne Carnall, chief accountant in the SEC's Division of Corporation Finance, observed that even though "registrants have provided voluminous disclosures regarding goodwill impairments within the critical accounting policy section of [MD&A], it is not always clear how the information is meaningful to investors." The disclosures have often focused on the noncash nature of the goodwill impairment but have not addressed the business and economic conditions that gave rise to the charge. We understand that the SEC staff will be asking for more disclosures in MD&A about what the conditions that resulted in impairments mean to the registrant's business as well as for more forward-looking information about the risk of future impairments, such as:

- The percentage by which the fair value of the reporting unit exceeds its carrying value as of the most recent step 1 test under ASC 350-20-35-4 through 35-8 (formerly paragraph 19 of Statement 142).
- The amount of goodwill allocated to the reporting unit.
- A description of the assumptions that drive the estimated fair value and a discussion of the uncertainty associated with the key assumptions.
- A discussion of any potential events, circumstances, or both, that could have a negative effect on the estimated fair value.

Mr. Carnall stated that the SEC staff "is considering providing . . . guidance in the near-term to provide registrants with a better understanding of its expectations in this area."

At the 2008 AICPA Conference,[2] Mr. Robert Fox III, a professional accounting fellow in the SEC's Office of the Chief Accountant, raised several points about goodwill impairment. For example, he remarked that the market capitalization of a registrant may not fully reflect the aggregate fair values of all the registrant's reporting units. Mr. Fox pointed to ASC 350-20-35-22 and 35-23 (formerly paragraph 23 of Statement 142), noting that "an entity might derive 'substantial value' from the ability to obtain control." Accordingly, this control premium may cause the fair value of all the registrant's reporting units to exceed the registrant's market capitalization. He also indicated that while it would be "prudent" for an entity to reconcile the aggregate fair value of its reporting units to its market capitalization, the entity should also consider other factors when assessing goodwill for impairment.

Also at the 2008 AICPA Conference, Mr. Steven Jacobs, associate chief accountant in the SEC's Division of Corporation Finance, shared his perspective on goodwill impairment in the current economic environment. He suggested that entities consider the following indicators or "triggering events" in addition to those in ASC 350-20-35-30 (formerly paragraph 28 of Statement 142):

- Cash or operating losses at the reporting unit.
- Consecutive operating results that are significantly lower than analysts' or internal forecasts.
- Significant revisions to internal or external forecasts.

[2] At the annual AICPA National Conference on Current SEC and PCAOB Developments (the "AICPA Conference") each December, regulators and standard setters give preparers updates on recent accounting, auditing, and SEC rules as well as a look inside their areas of focus for the reporting season ahead. Each year, Deloitte prepares a comprehensive *Heads Up* newsletter covering remarks made at the conference, which is available at www.deloitte.com.

- A new restructuring plan (an entity should also consider whether this constitutes a reorganization of its reporting structure and whether a reallocation of goodwill is required).
- Market capitalization that is below book value.
- A negative long-term outlook for the industry in which the reporting unit operates.
- An increase in deferred tax valuation allowances at the reporting unit, which could arise from a reduction in the reporting unit's projected taxable income.

Mr. Jacobs noted that the SEC staff often asks entities how they have evaluated instances in which market capitalization is less than book value. He indicated that an entity should consider whether a decline in its market capitalization (1) aligns with comparative market indices resulting from general market movements or (2) is related to entity-specific events or indicators that lead to a triggering event. He stressed that as the severity and duration of a deficiency increase, the SEC staff becomes more skeptical of an entity's assertion that a triggering event has not occurred. (For additional information, see Deloitte's *Heads Up* on the 2008 AICPA Conference.)

Asset Grouping for Goodwill Impairment Testing

The SEC staff may also comment on asset grouping for goodwill impairment testing, especially if the registrant does not clearly disclose that it tests goodwill at the reporting-unit level. A reporting unit is defined as (1) an operating segment[3] or (2) "one level below an operating segment (also referred to as a component)." A component is a reporting unit if it "constitutes a business[4] for which discrete financial information[5] is available and segment management[6] . . . regularly reviews the operating results of that component." ASC 350-20-35-35 (formerly paragraph 30 of Statement 142) requires registrants to aggregate two or more components of an operating segment into a single reporting unit if they share similar economic characteristics. When determining whether two or more reporting units have similar economic characteristics, the registrant should apply the guidance in EITF Topic D-101 and ASC 280-10-50-11 (formerly paragraph 17 of Statement 131).

While a registrant must aggregate the components of an operating segment when performing goodwill impairment testing and must consider the components a single reporting unit if they have similar economic characteristics, the registrant is not permitted to aggregate separate operating segments into one reporting unit. At a minimum, each operating segment is a reporting unit that the registrant should test separately. In addition, the registrant should not aggregate components from different operating segments that share similar economic characteristics into a single reporting unit.

Other Long-Lived-Asset Impairment Testing

Like goodwill impairments, long-lived-asset impairments continue to be an area of the SEC staff's focus in the current economic environment. The SEC staff may request a registrant that is recording impairment charges to either disclose or inform the staff about the following:

- The adequacy and frequency of the registrant's asset impairment tests.
- The factors, indicators, or both, used by management to evaluate whether the carrying value of other long-lived assets may not be recoverable.
- The methods and assumptions used in impairment tests.
- The timing of the impairment, especially if events that could result in impairments occurred in periods before the registrant recorded the impairment. Under these circumstances, the SEC staff may ask registrants to justify why the impairment was not recorded in the previous period.
- How many reporting units the registrant has and whether any have declining fair values.
- The types of events that could result in impairments.
- Comprehensive disclosure, in the critical accounting policies section of MD&A, about the registrant's process for assessing impairments.
- The facts and circumstances leading to impairments, along with a reminder that a registrant may be required to disclose in MD&A risks and uncertainties associated with the recoverability of assets in the periods before an impairment is recorded.

[3] The term "operating segment" is defined in ASC 280-10-50-1 (formerly paragraph 10 of Statement 131).

[4] For guidance on determining whether an asset group constitutes a "business," see ASC 805-10-55-4 through 55-9 (formerly paragraphs A4–A9 of Statement 141(R)). Before the effective date of ASC 805, see Issue 98-3 for this guidance.

[5] The term "discrete financial information" is defined in ASC 350-20-55-4 (formerly EITF Topic D-101).

[6] The term "segment management" is defined in ASC 280-10-50-7 and 50-8 (formerly paragraph 14 of Statement 131).

Asset Grouping for Other Long-Lived-Asset Impairment Testing

The SEC staff also frequently questions how a registrant groups assets for impairment tests, especially when the registrant's disclosure is not clear that long-lived assets are tested for impairment at the asset-group level. ASC 360-10-20 (formerly paragraph 4 of Statement 144) defines an asset group as the "lowest level for which identifiable cash flows are largely independent of the cash flows of other assets and liabilities." The SEC staff has frequently issued comments to registrants that have tested long-lived assets at an operating-segment, a reportable-segment, or a reporting-unit level, since there are often identifiable cash flows below such a level. Registrants should begin at the lowest level of cash flows in the organization and should group assets at a higher level only if it is appropriate to do so. In determining whether to group assets at a higher level, registrants should consider the following factors: (1) the existence of shared costs, (2) the interdependence of assets, and (3) the extent to which purchases are made on a combined basis.

Early-Warning Disclosures

The SEC staff has also been commenting that registrants should consider disclosing possible asset write-offs in filings before the period of the impairment charge. At the 2008 AICPA Conference, Mr. Jacobs urged entities to provide early-warning disclosures in MD&A (see Regulation S-K, Item 303(a)(3)(ii)) and in the notes to the financial statements when any of the following occur:

- The entity triggers an interim goodwill impairment test and narrowly passes step 1.
- The entity fails step 1 but the application of step 2 does not result in an impairment.
- The entity has not triggered an interim goodwill impairment test, but events that are reasonably likely to occur in the near future may trigger such a test.

In addition, Section 216 of the SEC Financial Reporting Codification requires registrants to forewarn investors about deteriorating conditions that may result in write-offs and about the magnitude of the potential loss.

Use of Valuation Experts

The SEC staff has been commenting on the use of valuation experts (1) for assigning amounts to assets acquired and liabilities assumed and (2) in connection with an entity's impairment testing. See the Use of Experts and Consents section of this publication for the staff's current position on this topic.

Other Deloitte Resources

- *Accounting for Business Combinations and Related Topics: A Roadmap to Applying FASB Statements 141(R), 142, and 160*.
- *SEC Reporting for Business Combinations and Related Topics: A Roadmap to Applying Regulation S-X to the Acquisition of a Business*.
- June 2, 2009, *Heads Up*, "FASB Issues Guidance on Combinations Involving Not-for-Profit Entities."
- April 2, 2009, *Heads Up*, "FASB Amends Statement 141(R)'s Guidance on Contingencies."

Capitalization of Costs

Examples of SEC Comments

- *Determination of Costs* — We note that you made capital investments totaling [$XX]. . . . [P]lease (i) quantify for us the significant components of these investments that are attributable to "maintenance," . . . (ii) explain to us why it is appropriate to capitalize maintenance and provide us an underlying accounting policy, (iii) explain to us with specificity how you differentiate between repairs and maintenance that are expensed as incurred from maintenance that is capitalized, and (iv) tell us whether you capitalize any internal payroll costs as it relates to maintenance. As part of your response with regard to (iii), if you state that maintenance appreciably extends the life, increases the capacity, or improves the efficiency or safety of an underlying asset, please (i) explain with specificity how you measure the change and make these determinations and (ii) provide us with examples.
- *Determination of Costs* — Please explain to us the type and nature of maintenance costs that you defer as plant turnaround costs and how these costs differ from the maintenance and repair cost that you expense as incurred. Please be detailed in your response.
- *Capitalization of Interest* — We believe that you should not capitalize interest related to the purchase of an asset until it is a qualifying asset . . . . Please provide us with detailed calculations showing how you have calculated the interest that you have capitalized . . . by period . . . since you initiated this practice.

Capitalization of costs is another area of SEC comment. The SEC staff has asked registrants questions about both their accounting and their disclosures for the capitalization of costs, such as plant turnaround costs and interest. However, the staff has primarily focused on increasing the transparency in the accounting for these costs through registrants' improved disclosures. The following are examples of the types of disclosures that the SEC staff has recently requested regarding the accounting for capitalized costs.

- Describe the types of costs that are capitalized as a component of deferred costs in the accounting policy footnote.
- For each period presented, provide a rollforward schedule of the beginning and ending balance of the deferred costs to include any additions (e.g., the amount of periodic deferrals) and amounts amortized in the accounting policy footnote.
- Disclose how you assess whether these capitalized costs are recoverable.
- Include a statement that the types of costs capitalized are consistent for all periods covered by the financial statements. If these costs are not consistent, disclose the changes in the components and the reasons for these changes.
- Disclose how you account for interest that is capitalized as part of the asset cost and disclose the amount capitalized.
- If the amount is greater than 5 percent of total assets, separately state the amount of deferred costs in the balance sheet or in a note thereto, as required by Regulation S-X, Rule 5-02(17).
- Discuss in MD&A any material events and uncertainties known to management that would cause the reported historical financial information not to be indicative of future operating results or of future financial conditions, such as when amortization of deferred costs is expected to increase and materially affect future operating results.

The staff has requested that registrants include these additional disclosures in their periodic reports in the notes to the financial statements, MD&A, or both, as appropriate.

Consolidations

Conclusions About Involvement With Variable Interest Entities

Examples of SEC Comments

- *Consolidated Variable Interests* — Please disclose how you determined that [Company A] is a variable interest entity pursuant to [ASC 810-10-15-12, 15-14 through 15-17, and 25-37 (formerly paragraphs 4–6 of Interpretation 46(R))]. If based on this analysis, [Company A] is a variable interest entity (VIE), please also disclose how you determined you were the primary beneficiary of this entity as well as provide the other disclosures required by [ASC 810-10-50-3 (formerly paragraph 23 of Interpretation 46(R))].
- *Nonconsolidated Variable Interests* — We note from your disclosures that you are not the primary beneficiary of any variable interest entities (VIEs). For any significant variable interests you hold in which you are not the primary beneficiary, please provide all of the disclosures required by [ASC 810-10-50-4 (formerly paragraph 24 of Interpretation 46(R))]. In this regard, while we note [your] disclosures . . . regarding equity method investments, it is not clear which entities . . . have been identified as variable interest entities.
- *Related-Party Considerations* — We note that [Company A] was formed for the purpose of acquiring real estate and leasing it to you. Provide us with additional details of the variable interest entity including your [ASC 810-10 (formerly Interpretation 46(R))] analysis. Tell us in detail how you considered [ASC 810-10-25-42 through 25-44 (formerly paragraphs 16 and 17 of Interpretation 46(R))].

The SEC staff has commented on registrants' assessments of their involvements with variable interest entities (VIEs). Specifically, the staff has asked registrants to disclose how they determined that an entity meets the VIE criteria in ASC 810-10 (formerly Interpretation 46(R)) and which of the specific VIE conditions in ASC 810-10-15-14 (formerly paragraph 5 of Interpretation 46(R)) an entity meets.

The staff has also challenged how registrants determined whether they were the primary beneficiary of a VIE. In situations in which a registrant's related parties are also involved with a VIE, the staff has asked for the registrant's analysis of which party in the related-party group is most closely associated with the VIE.

As noted at the June 23, 2009, CAQ SEC Regulations Committee Joint Meeting With the SEC Staff, an Item 2.01 Form 8-K is required "when a registrant concludes that it must consolidate a [VIE] as a result of a reconsideration event under [ASC 810-10-35]." In addition, "the registrant should consider whether the consolidation meets the significance thresholds . . . even if the registrant did not issue any consideration." If the VIE is significant and is a business as defined in Regulation S-X, Rule 11-01(d), the "Item 2.01 Form 8-K must include [Regulation S-X, Rule 3-05,] financial statements under Item 9.01 of Form 8-K, as well as pro forma financial statements under Article 11," if required. The SEC staff has indicated that it did not believe that a registrant's consolidation or deconsolidation of a VIE upon adoption of Interpretation 46(R) triggered the aforementioned requirements. We expect the staff to have a similar position regarding a registrant's adoption of Statement 167.

Disclosures About Variable Interest Entities

Example of an SEC Comment

- *Disclosures* — Please provide us with and revise future filings to include in your notes to your financial statements the disclosures outlined in [ASC 810-10-50-8 through 50-16 (formerly Appendix C of FSP FAS 140-4 and FIN 46(R)-8)], with regards to any ownership interests that you may have in a variable interest entity.

In December 2008, the FASB issued FSP FAS 140-4 and FIN 46(R)-8. This FSP, which was effective immediately for public companies, enhanced the transparency of disclosures associated with transfers of financial assets and an enterprise's involvement with VIEs, including qualifying special-purpose entities. Appendix C of the FSP (codified as ASC 810-10-50-8 through 50-16) focuses on disclosures about an enterprise's involvement with VIEs and its judgments and assumptions in accounting for them. The SEC staff has asked registrants with variable interests in a VIE that omit such disclosures to provide them.

Statement 167

On June 12, 2009, the FASB issued Statement 167,[1] which amends the consolidation guidance for VIEs. Statement 167 is effective for the first fiscal year that begins after November 15, 2009. The amendments will significantly affect the overall consolidation analysis under ASC 810-10. An enterprise will need to carefully reconsider its previous conclusions, including (1) whether an entity is a VIE, (2) whether the enterprise is the VIE's primary beneficiary, and (3) what type of financial statement disclosures are required.

Statement 167 modifies the approach for determining the primary beneficiary of a VIE. Under the old VIE model in ASC 810-10, it was often necessary to perform a quantitative analysis to determine which variable interest holder in a VIE absorbs a majority of its residual returns and is therefore considered the primary beneficiary. Under Statement 167, an enterprise determines qualitatively whether it has (1) the power to direct the activities of the VIE that most significantly affect the entity's economic performance and (2) the obligation to absorb losses of the VIE or right to receive benefits from the VIE that could potentially be significant to the VIE.

Note that the disclosure requirements under Statement 167 are generally consistent with those currently in ASC 810-10-50-8 through 50-16.

Most of the SEC staff's comments will continue to be relevant once a registrant adopts Statement 167. Registrants should also be aware that the SEC staff has indicated it will be monitoring how registrants apply the new rules. On May 28, 2009, at a public conference, James Kroeker (now the SEC's chief accountant) stated that the SEC staff will focus on special-purpose vehicles that are not consolidated by registrants. In particular, he indicated that the staff will be highly skeptical if a registrant does not consolidate an entity when the registrant retains the substantive risks and rewards of ownership while the stated power is provided to another party.

At its November 11, 2009, Board meeting, the FASB tentatively decided to defer the effective date of Statement 167 for a reporting enterprise's interest in certain entities. This proposed deferral addresses concerns that applying the current requirements under Statement 167 will distort the financial statements of asset managers and that the IASB's proposed consolidation model may result in a different consolidation conclusion for asset managers. The Board also agreed to provide a deferral for money market mutual funds. Finally, the Board agreed to amend certain provisions of paragraph B22 of Interpretation 46(R), as amended by Statement 167, to change how a decision maker or service provider determines whether its fee is a variable interest. In the fourth quarter of 2009, the Board will issue a proposed Accounting Standards Update (ASU) that incorporates these tentative decisions. After the conclusion of the comment period, the Board will review the comment letters, redeliberate the issues, and issue a final ASU. The FASB staff indicated that it would attempt to finalize the guidance by the middle of January 2010.

Other Deloitte Resources

- November 11, 2009, *Heads Up*, "Board Votes to Defer Statement 167 for Interests in Certain Entities."
- October 20, 2009, *Heads Up*, "Guidance on Statement 167 Implementation Issues."
- June 16, 2009, *Heads Up*, "FASB Amends the Consolidation Guidance Related to Variable Interest Entities."
- December 16, 2008, *Heads Up*, "FASB's New Disclosure FSP Is Effective Immediately."
- *Consolidation of Variable Interest Entities: A Roadmap to Applying Interpretation 46(R)'s Consolidation Guidance (Third Edition).*

[1] An entity is required to provide SAB 74 disclosures about the effects of this recently issued accounting pronouncement before the adoption date. For more information, see the SAB Topic 11.M (SAB 74) — Disclosures on the Impact of Recently Issued Accounting Pronouncements section.

Contingencies

Example of an SEC Comment

- We remind you that [ASC 450-20-50-1 (formerly paragraph 9 of Statement 5)] states that in some circumstances it may be necessary to disclose the amount accrued for the financial statements not to be misleading. If an exposure to loss exists in excess of amounts accrued and it is reasonably possible that a loss or additional loss may have been incurred, please disclose the estimated possible loss or range of loss or state that such an estimate cannot be made for each legal matter. Please refer to [ASC 450-20-50-1 through 50-6 (formerly paragraphs 9 and 10 of Statement 5)], and revise your future filings accordingly.

The SEC staff and investors have expressed concern about the lack of timely and transparent disclosures concerning contingencies. In their view, registrants' information about the nature of each contingency and the amount of loss accrued is often insufficient. Registrants sometimes also fail to disclose the amount or range of possible loss when no amount is accrued because the loss is only reasonably possible (rather than probable). Registrants should ensure that disclosures about contingencies are specific rather than generic.

The SEC's *Current Accounting and Disclosure Issues in the Division of Corporation Finance* (as updated November 30, 2006) states, in part:

> Registrants, their auditors, and their advisors have a responsibility to critically assess the claims against the company in order to identify those for which losses should be accrued and those that are not accrued because the success of the claim is only reasonably possible. Disclosure should discuss the nature of the claim, the amount accrued, if any, and the possible range of loss for claims where any amount within the range of reasonably possible loss is material. Circumstances where a loss was accrued for a claim without disclosure in prior filings of the nature of the claim and the range of reasonably possible loss should be rare due to the nature of most contingencies. A registrant that accrues a significant loss for a contingency, but whose prior disclosure of the low end of the range of reasonably possible loss was zero with no loss accrued, should ensure that there is robust disclosure that explains what triggered the significant loss in the period in which it was recorded.

The following are examples of aspects of some registrants' contingency disclosures that the SEC has commented on:

- Lack of quantification of amounts accrued, if any, and possible loss or range of loss (or disclosure about why such an estimate cannot be made).
- Insufficient detail about new developments and their impact on current and future periods.
- Insufficient detail about judgments and assumptions underlying significant accruals.
- Lack of disclosure about what triggered a significant current-period accrual for a contingency when no loss or a significantly lower amount was accrued in prior years.
- Lack of disclosure about why no accrual estimate can be made.
- Broad, general disclosures made in the aggregate only.

In addition, inconsistent or unclear information in a registrant's filing often triggers SEC staff comments. For example, the SEC staff has challenged registrants that have (1) disclosed in their footnotes that the outcome of a contingency is not expected to materially affect their financial statements but (2) disclosed in the risk factors section of the filing that the same contingency's outcome could materially affect their financial results. Registrants have been asked to explain this inconsistency or revise their disclosures accordingly.

FASB's Contingencies Project

The FASB has a project on its agenda to enhance disclosure requirements for loss contingencies. In June 2008, the FASB issued an exposure draft of a proposed Statement that would have required expanded quantitative and qualitative disclosures about certain loss contingencies. In August 2009, the FASB decided that the objective of the new disclosure requirements would be for an entity to "disclose qualitative and quantitative information about the loss contingency to enable a financial statement user to understand the nature of the contingency and its potential timing and magnitude." The Board also decided on the following three broad principles:

1. Disclosures about litigation contingencies should focus on the contentions of the parties, rather than predictions about the future outcome.
2. Disclosures about a contingency should be more robust as the likelihood and magnitude of loss increase and as the contingency progresses toward resolution.
3. Disclosures should provide a summary of information that is publicly available about a case and indicate where users can obtain more information.

The FASB will continue to deliberate before issuing a final Accounting Standards Update.

Other Deloitte Resources

- April 2, 2009, *Heads Up*, "FASB Amends Statement 141(R)'s Guidance on Contingencies."
- June 10, 2008, *Heads Up*, "FASB Proposes Expanding Contingencies Disclosure."

Debt

Balance Sheet Classification

Example of an SEC Comment

- We note that . . . a lender provided you with a notice of continuing defaults related to your company's [loan agreement] . . . . Based upon the notice of default, it appears your company's borrowings from [the lender] should be classified as current liabilities in your balance sheet. In this regard, please tell us (i) when your company first violated the default provisions of [the loan agreement] and (ii) whether your company had defaulted on the agreement as of [period-end]. Furthermore, please confirm that all of your company's outstanding borrowings from [the lender] will be classified as current liabilities in your balance sheet until the aforementioned defaults are cured. Alternatively, tell us why you believe that the reclassification of your company's borrowings from [the lender] is not necessary.

The SEC staff has frequently commented on the appropriate balance sheet classification of outstanding debt amounts. When presenting a classified balance sheet, registrants must determine whether outstanding debt should be classified as current or noncurrent. In accordance with ASC 470-10-45-13 (formerly paragraph 8 of Statement 6), an entity should ensure that short-term obligations expected to be refinanced are classified as current liabilities, unless the entity intends to refinance the obligation on a long-term basis and this intent is supported by the entity's ability to consummate the refinancing (see ASC 470-10-45-14, formerly paragraphs 10 and 11 of Statement 6).

In addition, the SEC staff has focused on whether registrants have considered ASC 470-10-45-9 through 45-11 (formerly Issue 86-05 and paragraph 7 of ARB 43, Chapter 3A) when debt arrangements include provisions that result in the debt's being due on demand (i.e., callable by the creditor). Registrants should also consider ASC 470-10-45-2 and ASC 470-10-50-3 (formerly paragraph 3 of Technical Bulletin 79-3) when debt agreements contain subjective acceleration clauses, which accelerate the scheduled maturities of the obligation if certain events occur that are not objectively determinable.

Finally, the SEC staff has focused on the disclosures required when a violation of debt covenants has been waived by the creditor. Regulation S-X, Rule 4-08(c), requires that an entity disclose the amount of the obligation and the period of the waiver if the creditor has waived its right for a stated period.

Debt-Related Disclosures

Example of an SEC Comment

- We note that your senior credit facility contains restrictions on the payment of dividends. Please disclose the pertinent provisions of the restrictive covenants regarding payment of dividends and the amount of retained earnings or net income restricted or free of restrictions. Refer to Item 4-08(e)(1) of Regulation S-X.

The SEC staff has issued a number of comment letters focusing on the disclosure requirements in Rule 4-08(e) for restrictions imposed on a registrant's ability to pay dividends. Typically, these restrictions arise when loan agreements prohibit the registrant from paying cash dividends without the consent of a third party (i.e., the lender). In addition, in certain circumstances, these restrictions exist at a subsidiary-company level such that the registrant's subsidiary companies may not transfer amounts to the registrant without the consent of a third party. A registrant must disclose the nature of any restrictions on the ability of the registrant or any of its subsidiaries to pay dividends and the amounts subject to such restrictions.

A registrant should also ensure that it complies with Regulation S-X, Rule 5-04(c). Under Rule 5-04(c), if, as of the end of the most recent fiscal year, more than 25 percent of the consolidated net assets of the registrant are located at subsidiaries that are restricted from transferring the assets to the registrant, the registrant must provide stand-alone condensed financial statements, including certain disclosures, as a separate schedule.

Refinancing

Example of an SEC Comment

- Please tell us how you determined the proper accounting treatment related to your issuance of [$XXX] million of [X%] senior notes . . . . Specifically, address how you determined whether the termination of the [X%] junior subordinated debt qualified as a debt extinguishment with a gain or loss on termination under [ASC 470-50 (formerly Issue 96-19)]. Please reference any and all additional accounting guidance used in your analysis.

Over the past few years, the SEC and FASB staffs have focused on the accounting for debt modifications. At both the 2004 and 2003 AICPA Conferences, Mr. Robert J. Comerford, a professional accounting fellow in the SEC's Office of the Chief Accountant, discussed a number of debt modification issues, including the evaluation of modifications of conversion features embedded in debt instruments.

In accordance with ASC 470-50-40-10 (formerly Issue 96-19), an issuer that modifies a debt instrument must compare the present value of the original debt instrument's cash flows with the present value of the cash flows of the modified debt. If the present value of those cash flows differs by more than 10 percent, the modification is considered significant and extinguishment accounting is applied to the original debt instrument. In addition, the modification is considered significant if it (1) adds or eliminates a substantive conversion option or (2) affects the terms of an embedded conversion option and the change in fair value of the embedded conversion option is at least 10 percent of the carrying amount of the original debt instrument immediately before the modification.

The SEC staff's recent comments on this topic have focused on (1) the registrant's conclusion that a transaction should be accounted for as a debt extinguishment under ASC 470-50 and (2) disclosures about the significant components of the gains or losses recorded on a debt extinguishment, including how the components were calculated.

The recent credit crisis has made it increasingly difficult for registrants to access the credit markets for new debt issuances. Thus, modifications to existing debt and credit facilities have increased, as have troubled debt restructurings. The SEC has encouraged disclosures discussing a registrant's limitations and challenges with accessing and using funds under credit facilities in this economy, as well as how funds will affect a registrant's financial condition, results of operations, liquidity, etc. Such disclosures should include the risks and uncertainties associated with each financing option considered.

Financial Covenant Disclosures

Example of an SEC Comment

- We note your disclosure . . . regarding the risks that your substantial level of indebtedness places on your business. We further note your disclosure that you expect to take additional loans under your senior credit facility to pay your expenses and the interest on your debt. Given your reliance on your debt availability, please revise future filings to include a discussion regarding any circumstances that may limit the level of borrowings available to you under your senior credit facility. In addition, please include a tabular presentation of your actual ratios and other actual amounts versus the minimum/maximum ratios/amounts permitted under your financial covenants for your senior credit facility, senior subordinated notes, and senior discount notes. Such presentation will allow an investor to easily understand your current status in meeting your financial covenants. Such disclosure should only be excluded if you believe that the likelihood of default is remote. Refer to Section 501.03 of the Financial Reporting Codification for guidance.

Because the financial difficulties of registrants have increased as a result of the current credit crisis, it has become increasingly important for registrants to consider providing disclosures about covenant compliance to illustrate their financial condition and liquidity. These disclosures may include a discussion of the terms of the most severe covenants and how a registrant has complied with those covenants. In addition, a registrant may present a table illustrating the registrant's most material actual debt-covenant ratios as of the latest balance sheet date compared with the minimum/maximum amounts permitted under debt agreements. Such transparent disclosures will enable investors to understand the risk of future noncompliance.

At the 2008 AICPA Conference, Mr. Michael Fay, associate chief accountant in the SEC's Division of Corporation Finance, discussed the importance of the liquidity section of MD&A as well as factors registrants should consider in preparing for their upcoming filings. He referred to two interpretive releases[1] that provide guidance on preparing the liquidity section. He commented that in the liquidity section of MD&A, registrants frequently provide a one-sentence statement that they are in

[1] The 1989 and 2003 MD&A interpretive releases (section III.C of FR-36 and section IV of FR-72).

compliance with their debt covenants. Mr. Fay noted that registrants can greatly enhance these disclosures by discussing relevant circumstances that would lead to covenant violations.

Specifically, Mr. Fay indicated that registrants should consider including a statement that compliance is expected in the near and long term and a brief basis for this conclusion. In addition, he remarked that registrants should identify and discuss any known trends or uncertainties that may affect future compliance. Furthermore, Mr. Fay noted that when a breach of a financial covenant is reasonably likely, a registrant is encouraged to discuss whether (1) the breach in the debt can be avoided or cured or (2) the debt can be refinanced. The registrant should also identify any cross-default provisions and discuss whether the breach will cast doubt on its future viability. He further noted that merely stating that there may be a material impact on liquidity is not informative; the registrant should carefully address reasonably likely implications. To the extent that a registrant must provide detailed disclosures in MD&A regarding compliance with debt covenants and that a material debt agreement calls for a non-GAAP measure as part of a covenant, the staff has asked registrants to show how the measures are calculated, with corresponding reconciliations to GAAP amounts.

Registrants often state that certain financial covenants limit their ability to incur additional indebtedness without discussing the potential effects of these limitations on their liquidity. Mr. Fay further noted that if it is reasonably likely that the covenant will affect liquidity, a registrant should discuss the amount that can be raised, the amount needed, and the implications of a shortfall. If the registrant does not expect the covenant to affect liquidity, it may explain the basis for this determination. If the covenant does not affect liquidity, a registrant may decide that reference to it is not necessary.

Disclosure Controls and Procedures

Registrants must provide quarterly discussion of their disclosure controls and procedures;[1] the language used should conform to the requirements in Rule 240.13a-15(e) of the Securities Exchange Act of 1934.[2] The SEC staff often comments when registrants do not use the proper definition of "disclosure controls and procedures" or when they omit certain language in drawing conclusions about disclosure controls and procedures. In these situations, the staff frequently requires registrants to verify that their disclosure controls and procedures are effective in the current year and to revise the disclosures in future filings.

Inappropriate Conclusion About Disclosure Controls and Procedures

Example of an SEC Comment

- We note your statement that "the disclosure controls and procedures are designed to only provide reasonable assurance of achieving the desired control objectives." Please revise future filings to state clearly, if true, your principal executive officer and principal financial officer concluded that your disclosure controls and procedures are effective at that reasonable assurance level. In the alternative, remove the reference to the level of assurance of your disclosure controls and procedures. Please refer to Section II.F.4 of Management's Reports on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports, SEC Release No. 33-8238.

The SEC staff has commented when registrants have concluded that disclosure controls and procedures are "adequate" or "adequate and effective." At the 2005 AICPA Conference, Ms. Sondra Stokes, associate chief accountant in the SEC's Division of Corporation Finance, noted that management must clearly state, without using any qualifying or alternative language, its conclusion about whether disclosure controls and procedures are either "effective" or "ineffective" as of the end of the respective quarter. Examples of unacceptable language include phrases such as "effective except for," "effective except as disclosed below," or "adequate."

The staff has also commented when registrants refer to the level of assurance of the design of their disclosure controls and procedures. Although registrants are not required to provide such a reference, the staff has requested registrants that do so to also state, if true, their conclusion that the disclosure controls and procedures are, in fact, effective at the "reasonable assurance" level.

The SEC staff has also asked registrants that conclude that their disclosure controls and procedures are ineffective to discuss changes they plan to implement to remedy the deficiencies identified, especially if these changes are different from those discussed regarding internal controls.

Incomplete Definition of Disclosure Controls and Procedures

Example of an SEC Comment

- You only refer to one aspect of disclosure controls and procedures and omit the reference to accumulation and communication to management of information. If true, please confirm supplementally that based upon the evaluation of your management, including your chief executive and chief financial officer, you also concluded that as of the end of the period covered by this report . . . your disclosure controls and procedures are also effective to ensure that information required to be disclosed in the reports that you file or submit under the Exchange Act is accumulated and communicated to management, including your principal executive and principal financial officers, to allow timely decisions regarding required disclosure. Please confirm to us that in future periodic reports you will provide a complete definition of the term disclosure controls and procedures that conforms to Rule 13a-15(e) of the Exchange Act whenever you include a definition of the term. Refer to Item 307 of Regulation S-K.

Registrants are not required to define disclosure controls and procedures in their conclusion. However, if they choose to define the term, they must include the entire definition from Rule 240.13a-15(e).

[1] Pursuant to Part I — Item 4 of Form 10-Q and Part II — Item 9 of Form 10-K.

[2] As required by Regulation S-K, Item 307.

Conclusion That Disclosure Controls and Procedures Were Effective If a Material Weakness Exists

Example of an SEC Comment

- We note your response to our comment; however, it is still not clear to us how the multiple material weaknesses you identified did not impact your assessment of the effectiveness of disclosure controls and procedures as of [year-end]. For each material weakness you identified, please tell us specifically why the weakness did not impact the effectiveness of each of the criteria established in the two sentence definition of disclosure controls and procedures as defined in the referenced Exchange Act Rule.

At the 2005 AICPA Conference, Ms. Stokes discussed the overlap between disclosure controls and procedures and internal control over financial reporting (ICFR). She indicated that a registrant could conclude that disclosure controls and procedures are effective if a material weakness exists in ICFR, although such a conclusion is highly unlikely. If management does conclude that disclosure controls and procedures are effective despite a material weakness in ICFR, the registrant must disclose the specific facts that it considered and the basis for its conclusion.

Conclusion That Disclosure Controls and Procedures Were Effective If Reports Were Not Filed in a Timely Manner

Example of an SEC Comment

- In this section, you disclose information that you failed to disclose previously in a timely manner, even though you were otherwise required to do so . . . . In future filings, please discuss the reason or reasons that you failed to disclose this information as required. Also, please explain why you believe your disclosure controls and procedures are effective at the reasonable assurance level for which they were designed given your failure to disclose this information in a timely manner.

The SEC staff has questioned management's conclusion that disclosure controls and procedures were effective when a registrant has not filed periodic reports in a timely manner. Disclosure controls and procedures should be designed to ensure that the information the registrant must disclose in the reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized, and reported within the periods specified in the SEC's rules. If the registrant does not report this information within these periods, the staff may request the registrant to supply additional information to support management's conclusion.

Conclusion That Disclosure Controls and Procedures Were Effective If Management's Report on Internal Control Over Financial Reporting Has Not Been Filed

Example of an SEC Comment

- [T]he staff has concerns about whether it is appropriate to conclude that disclosure controls and procedures were effective despite failure to provide management's report on internal control over financial reporting . . . . [A]s discussed in Compliance and Disclosure Interpretation 115.02, . . . failure to file management's report on internal control over financial reporting rendered your annual report materially deficient and also rendered the company not timely or current in its Exchange Act Reporting. In light of these facts, please consider whether assessment of effectiveness of your disclosure controls and procedures is appropriate for your amended filing.

The SEC staff has issued comments, particularly to nonaccelerated filers, on the omission of management's report on ICFR. At the 2008 AICPA Conference, Mr. Paul Beswick, deputy chief accountant for professional practice in the SEC's Office of the Chief Accountant, stated that failure to include management's report on its assessment of ICFR in a filing constitutes noncompliance with the SEC's rules and raises questions about the accuracy of a conclusion by management that its disclosure controls and procedures are effective. (For additional information, see Deloitte's *Heads Up* on the 2008 AICPA Conference.) The staff may ask management to consider whether the omission affects the previous conclusion on the effectiveness of disclosure controls and procedures and to adjust the disclosure accordingly.

Disclosures Regarding State Sponsors of Terrorism

Examples of SEC Comments

- *Disclosures Regarding Contracts* — We note that your Form 10-K does not include disclosure regarding contracts with Cuba, Iran, Sudan, and Syria. Please describe to us the nature and extent of your past, current, and anticipated contacts with the referenced countries, if any, whether through distributors, resellers, or other direct or indirect arrangements. Your response should describe any products, equipment, components, technology, or services you have provided to those countries, and any agreements, commercial arrangements, or other contracts you have had with the governments of those countries or entities controlled by those governments.
- *Disclosures Regarding Materiality of Contacts* — Please discuss the materiality of contacts with Cuba, Iran, Syria, and Sudan . . . . In your response, tell us whether those contacts constitute a material investment risk for your security holders. You should address materiality both in quantitative terms, including the approximate dollar amounts of any associated revenues, assets, and liabilities for the last three fiscal years, and in terms of qualitative factors that a reasonable investor would deem important in making an investment decision, including the potential impact of corporate activities upon a company's reputation and share value.

The U.S. Department of State has designated four countries[1] as state sponsors of terrorism — Cuba, Iran, Sudan, and Syria. These countries are subject to U.S. economic sanctions and export controls. Registrants that do business in these countries are required to disclose material operations in these locations and any agreements, commercial arrangements, or other contracts with the governments or entities controlled by those governments. The SEC staff frequently comments on this subject and believes these disclosures are important to investors in making investment decisions. The staff has asked registrants to disclose the nature and extent of these contracts (past, present, and probable) and to provide a detailed analysis of the materiality of contacts with these countries. Registrants are encouraged to disclose quantitatively revenues, assets, and liabilities associated with these countries as well as any qualitative factors that may have a significant impact on the registrant's activities.

[1] In April 2009, North Korea was removed from the list.

Discontinued Operations, Assets Held for Sale, and Restructuring Charges

Discontinued Operations Reporting

Example of an SEC Comment

- Please explain to us how you considered the guidance in [ASC 205-20-45-1 (formerly paragraph 42 of Statement 144)] and [ASC 205-20-50-4, 50-6, and 55-4 through 55-24 (formerly Issue 03-13)] in determining whether the operations and gain and sale of [Company A] should be presented as discontinued operations.

The SEC staff has questioned registrants that dispose of operations that are not presented as discontinued operations. Conversely, the staff may question why a registrant accounts for operations as discontinued when the registrant will have cash flows from or continuing involvement with the disposed operations. ASC 205-20-45-1 (formerly paragraph 42 of Statement 144) requires that the results of operations of a component of an entity that either has been disposed of or is classified as held for sale be reported in discontinued operations if:

a. The operations and cash flows of the component have been (or will be) eliminated from the ongoing operations of the entity as a result of the disposal transaction **and**

b. The entity will not have any significant continuing involvement in the operations of the component after the disposal transaction. [Emphasis added]

Application of these two criteria can be subjective. ASC 205-20-55-3 (formerly Exhibit 03-13A of Issue 03-13) lists the following steps for entities to perform when evaluating whether the criteria are met:

- Step 1: Are continuing cash flows expected to be generated by the ongoing entity?
- Step 2: Do the continuing cash flows result from a migration or continuation of activities?
- Step 3: Are the continuing cash flows significant?
- Step 4: Does the ongoing entity have significant continuing involvement in the operations of the disposed component?

Note that if an entity answers no to step 1, 2, or 3, the entity should proceed to step 4.

Assets Held for Sale

Example of an SEC Comment

- We note the Company recognized a loss on impairment of long-lived assets during the quarter. . . . We also note that these charges related to the full impairment of [equipment and leasehold improvements] at [locations A, B, and C]. With regards to these impairment charges, please tell us and revise future filings to indicate whether the charges recognized related to assets to be held and used or assets to be disposed of. If the charges relate to assets to be disposed of, please explain why the assets have not been presented as held for sale in the Company's [year-end] balance sheet in accordance with [ASC 205-20-45-10 and 50-2 (formerly paragraph 46 of Statement 144)]. Also, please ensure that the notes to your financial statements include all of the disclosures required by [ASC 360-10-50-2 and 50-3 and ASC 205-20-50-1 (formerly paragraphs 26 and 47 of Statement 144)], as applicable.

Another topic the SEC has commented on is the classification of assets as held for sale. The SEC staff frequently comments when disclosures indicate assets were sold but are unclear about when the decision to sell the assets was made. For example, the SEC staff has asked registrants that disclosed they sold assets after the balance sheet date but did not classify the assets as held for sale as of the balance sheet date to submit additional disclosures and supporting documentation to explain the nature and significance of the transaction. Registrants have been asked to supply the following types of information:

- The carrying amount and classification as of the balance sheet date of the assets and liabilities included in the subsequent sale.
- The gain or loss on the asset sale.
- The timeline of events leading to the asset sale.
- The sales agreement and a description of how the agreement affected the determination that held-for-sale presentation was not appropriate.

Timing of Impairments

Example of an SEC Comment

- We note the disclosure regarding your expectation of incurring a significant loss upon selling [Company A]. This expectation indicates that an impairment loss should be recorded at [year-end], if not earlier. Even though you disclose that you are unable to estimate a range of loss, [ASC 360-10-35 (formerly Statement 144)] requires measurement of an impairment loss. Please revise your financial statements, or tell us why such a revision is not appropriate.

The SEC staff frequently questions the appropriateness and timeliness of a registrant's impairment tests when assets or components are disposed of or discontinued. For example, the staff may ask whether assets that the registrant was expected to sell or dispose of were tested for impairment in prior periods. If the registrant performed an impairment test, the SEC staff may request a copy of the related documentation. If the registrant did not perform an impairment test, the staff may expect an explanation. See the Business Combinations, Long-Lived Assets, and Impairments section for further discussion of comments on long-lived-asset impairment testing.

Restructuring Charges

Example of an SEC Comment

- We note your disclosure that the restructuring activities primarily include reductions in staffing levels and closure of excess facilities. Please provide the disclosures required by [ASC 420-10 (formerly Statement 146)] for these activities or tell us why you believe such disclosure is not required.

Questions have arisen regarding corporate reorganization and restructurings and disclosures about such activities, if any. These comments primarily stem from workforce reductions, closing of certain facilities, or restructuring of certain operations. ASC 420-10-50-1 (formerly paragraph 20 of Statement 146) requires that an entity disclose the following information in the notes to the financial statements for the period in which an exit or disposal activity is initiated and any subsequent period until the activity is completed:

a. A description of the exit or disposal activity, including the facts and circumstances leading to the expected activity and the expected completion date

b. For each major type of cost associated with the activity (for example, one-time employee termination benefits, contract termination costs, and other associated costs), both of the following shall be disclosed:

   1. The total amount expected to be incurred in connection with the activity, the amount incurred in the period, and the cumulative amount incurred to date and

   2. A reconciliation of the beginning and ending liability balances showing separately the changes during the period attributable to costs incurred and charged to expense, costs paid or otherwise settled, and any adjustments to the liability with an explanation of the reason(s) why

c. The line item(s) in the income statement or the statement of activities in which the costs in (b) are aggregated

d. For each reportable segment, as defined in Subtopic 280-10, the total amount of costs expected to be incurred in connection with the activity, the amount incurred in the period, and the cumulative amount incurred to date, net of any adjustments to the liability with an explanation of the reason(s) why

e. If a liability for a cost associated with the activity is not recognized because fair value cannot be reasonably estimated, that fact and the reasons why.

Proposed FSP

In September 2008, the FASB issued an exposure draft of a proposed FSP that would amend the criteria for when a component of an entity "would be reported in the discontinued operations section of the income statement" and that would enhance the "disclosure requirements of [ASC 205-20 (formerly Statement 144)] for all components of an entity that either have been disposed of or are classified as held for sale regardless of whether a component of an entity is reported in the income statement as a discontinued operation or within continuing operations." Comments on the proposed FSP were due by January 23, 2009. The intent of the FSP is to develop a definition of a discontinued operation and disclosure requirements that converge with the requirements of International Financial Reporting Standards (IFRSs). The FASB and IASB continue to deliberate this definition.

Earnings per Share

Two-Class Method

Example of an SEC Comment

- We note from your disclosure, Class A and B shares are considered as one class for purposes of the earnings per share computation. Tell us what consideration you have given to the two-class method for computing basic and fully diluted earnings per share for each of your issued and registered Class A and Class B common stock. In this respect, tell us what consideration you gave to presenting Class A common stock on a fully diluted "if converted" basis reflecting the conversion of Class B common stock into Class A common stock. We refer you to [ASC 260-10-45-60B (formerly paragraph 61 of Statement 128)].

The two-class method applies to (1) securities (including convertible securities) that may participate in dividends with common stock according to a predetermined formula and (2) securities that have multiple classes of common stock with different dividend rights. When the SEC staff sees information in a registrant's filing indicating that the registrant has two classes of common stock that are treated as one class in the calculation of earnings per share (EPS), the staff often asks whether the registrant considered the two-class method in computing EPS pursuant to ASC 260-10-45-59A through 45-70 (formerly paragraphs 60 and 61 of Statement 128 and Issue 03-6).

The SEC staff may ask registrants to substantiate the method used to calculate EPS (e.g., the two-class method, the if-converted method). In such circumstances, the SEC staff may request additional information or disclosures about each of the registrant's classes of common stock, preferred stock, and common stock equivalents, such as convertible securities, warrants, or options. When the registrant has preferred shares, the SEC staff may seek to determine whether the preferred stockholders have contractual rights to share in profits and losses of the company beyond the stated dividend rate.

The SEC staff has also commented on the EPS treatment of convertible instruments. For instance, at the 2006 AICPA Conference, Ms. Cathy Cole, associate chief accountant in the SEC's Office of the Chief Accountant, stated that the SEC expects that a company with two classes of common stock will present both basic and diluted EPS for each class of common stock, regardless of conversion rights. Under ASC 260-10-45-59A through 45-70, registrants computing EPS for securities with multiple classes of common stock and convertible participating securities would use the two-class method for basic and diluted EPS.

The SEC staff has focused on understanding the terms associated with (1) the registrant's classes of common stock and (2) such stock's dividend rates. Information in filings may indicate that a registrant has excluded, in its basic EPS computation, redeemable convertible preferred stock that contains dividend rights. In these situations, the SEC staff has asked registrants (1) why the preferred stock was excluded from basic EPS, since the preferred stockholders appear to participate in earnings on the same basis as common shareholders, and (2) how the current computation of EPS complies with the requirements of ASC 260-10-45-60 through 45-70.

Ms. Cole stressed the importance of evaluating the rights associated with each class of stock, stating the following:

> [W]hen applying the two-class method to several classes of common stock, one ought to consider all of the rights and privileges of the classes in determining the allocation of undistributed earnings to the individual classes of common stock. And, for good measure, you may want to ask the staff, about the issue as well.

For additional information about Ms. Cole's remarks, see Deloitte's *Heads Up* on the 2006 AICPA Conference. The SEC staff will most likely continue to focus on understanding the rights and privileges associated with each class of stock.

EPS Disclosures

Examples of SEC Comments

- For each period for which an income statement is presented, please provide a reconciliation of the numerators and denominators of the basic and diluted per-share computations for income from continuing operations. In your reconciliation, please separately present the individual income and share amount effects of all securities that affect earnings per share. Additionally, if applicable, disclose the amount of securities that could potentially dilute basic earnings per share in the future that were not included in the computation of diluted earnings per share because to do so would have been antidilutive for the periods presented. Refer to [ASC 260-10-50-1 (formerly paragraph 40 of Statement 128)].
- Please disclose how you are treating the restricted stock you have issued in computing both your basic and diluted EPS. . . . Your disclosure should enable a reader to understand how you treat both vested and unvested restricted shares for basic EPS and for diluted EPS.

The SEC staff often requests that registrants disclose additional information about how EPS was calculated. For example, the SEC staff may request that registrants disclose:

- How unvested shares, unvested share units, unvested restricted share units, and performance shares are treated in basic and diluted EPS.
- Whether unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (paid or unpaid) are treated as participating securities and are factored into the calculation of EPS.
- How shares held in treasury are treated in determining the common shares outstanding.
- The accounting policy on earnings/loss allocations to shareholders.
- The nature of incentive distribution rights.

In addition, the SEC staff continues to comment on the disclosure requirements of ASC 260-10-50-1 (formerly paragraph 40 of Statement 128). That is, an entity must disclose, for each period in which an income statement is presented:

- A "reconciliation of the numerators and the denominators of . . . basic and diluted [EPS]."
- The "effect that has been given to preferred dividends in arriving at income available to common stockholders."
- Securities that "could potentially dilute basic EPS in the future that were not included in the computation of diluted EPS because to do so would have been antidilutive."

Other Deloitte Resources

- Summary of Issue 09-E in November 2009 *EITF Snapshot*.
- August 13, 2008, *Heads Up*, "FASB and IASB Issue Exposure Documents on Earnings per Share."
- June 17, 2008, *Heads Up*, "FASB Concludes That Certain Unvested Share-Based Payment Awards Are Participating Securities."
- Summary of Issue 07-4 in March 2008 *EITF Snapshot*.

Executive Compensation

It is no surprise that the SEC staff has frequently commented on executive compensation, given the attention this subject received throughout the credit crisis. Looking ahead to the SEC's expectations for 2010, Shelley Parratt, deputy director of the Division of Corporation Finance, in her November 9, 2009, speech at the 4th Annual Proxy Disclosure Conference, noted that because the themes identified in the comment process have been publicly discussed and entities and their advisers are expected to understand the rules and apply them thoroughly, "any company that waits until it receives staff comments to comply with the disclosure requirements should be prepared to amend its filings if it does not materially comply with the rules."

In July 2009, the SEC issued proposed rules on say-on-pay for TARP recipients (Proposed Rule 34-60218) and proxy disclosure and solicitation enhancements (Proposed Rule 33-9052). The proposed rules require (1) each TARP recipient to have an annual nonbinding shareholder vote on executive compensation as long as it has TARP loans outstanding and (2) incremental proxy disclosures, including new disclosures for executive compensation, and changes to the proxy solicitation process. The comment periods for both proposed rules ended in September 2009. Ms. Parratt encouraged entities to start thinking about how, for 2010, they would gather the additional information necessary to provide the enhanced proxy disclosures, since these disclosure requirements may be in place for the upcoming proxy season.

Compensation Discussion and Analysis (CD&A)

Example of an SEC Comment

- We believe that investors will benefit from a refocusing of your CD&A. Please evaluate your disclosure in its entirety and concentrate the core of your presentation into a balanced analytical discussion of: (i) the material elements of compensation, (ii) how you arrived at the varying levels of compensation, and (iii) why you believe your compensation practices and decisions fit within their overall objectives and philosophy. Your CD&A should be structured so as to present a concise and readable explanation of the specific factors the compensation committee considered when approving particular pieces of each named executive officers' compensation package and meaningful analysis of the reasons why the company believes that the amounts paid are appropriate in light of the various factors it considered in making specific compensation decisions. We direct your attention to the ample amount of guidance we have published on executive compensation disclosure and compliance with the SEC's new disclosure rules.

CD&A continues to be an area of SEC staff scrutiny. In 2007, the SEC staff performed a comprehensive review of the executive and director compensation disclosures of approximately 350 public companies from a wide range of industries, after which the staff issued a report summarizing the feedback that it gave these companies. The report indicated that CD&A should focus more on analyzing material principles and important factors influencing the registrant's executive compensation policies and decisions. In other words, how and why did the company arrive at its policies and decisions and how do the general policies translate into actual amounts paid? In recent comment letters, the SEC staff has also asked companies:

- Whether the named executive officers (NEOs) had been appropriately identified.
- To describe the objectives and methods for all the different elements of compensation (e.g., salary, bonus, stock options) and how they interrelate.
- To explain in their disclosures material discrepancies in compensation among the registrant's NEOs.

Note that when the SEC staff asks a registrant to enhance its analysis, the staff does not necessarily mean that the registrant should lengthen its disclosure. Rather, the staff prefers clearer and more concise disclosures with more tables and graphs. The recent SEC comments mirror this overall theme, as shown in the sample comment above.

Performance Targets

Example of an SEC Comment

- We note that you have not disclosed the specific performance targets underlying the cash bonuses paid to your named executive officers. . . . As these targets appear to be material to your compensation policy, they should be disclosed pursuant to Item 402(b)(2)(v) of Regulation S-K. If you have omitted the performance targets in reliance on Instruction 4 to Item 402(b) of Regulation S-K, please provide us with a detailed analysis supporting your conclusion that disclosure of the performance targets would cause you competitive harm. Also, please note that when providing disclosure regarding the degree of difficulty associated with achieving performance targets in accordance with Instruction 4, general statements regarding the level of difficulty or ease associated with achieving the targets are not sufficient to comply with the requirements of the instruction. For example, we note your disclosure . . . that "performance targets are established at levels that are intended to be achievable." Please consider in the future providing more detail on how difficult it will be for the company and its executives to achieve undisclosed performance targets. For example, consider disclosure that addresses the relationship between historical and future achievement and the extent to which the compensation committee set the incentive parameters based upon a probability that the company and its executive officers would achieve the performance objectives.

The SEC staff's most frequent comments were on disclosures about performance targets. The staff's comments have indicated that if a registrant uses performance targets, it needs to disclose them and provide information about their use. The executive compensation disclosure requirements allow registrants to exclude performance targets and other factors or criteria involving confidential information if the disclosure of such information would result in competitive harm. While registrants are not required to formally request confidential treatment to omit these disclosures, they must meet the confidential-treatment standard and demonstrate to the staff upon request that they have done so. Even if omission of targets or other factors or criteria is appropriate, a registrant should consider disclosing how difficult it will be for the executive, or how likely it will be for the registrant, to achieve the undisclosed target levels or other factors.

The SEC staff's comments have also indicated that more detailed disclosure, rather than vague or "boilerplate" language, may help financial statement users understand the registrant's compensation policies and decisions. For example, the staff has asked registrants to:

- Quantify the target.
- Explain how any non-GAAP measures were calculated if the performance was based on a non-GAAP measure.
- Detail the specific elements of individual performance and contribution that affected the compensation received.
- State whether the goals or objectives were achieved.
- Discuss how actual performance in relation to the targets correlated with the ultimate compensation rewarded.
- Indicate whether the compensation committee or others had discretion or additional qualitative input when determining the final amount of compensation rewarded and the factors that affected the determination.
- Describe how they weighed the various targets if more than one target was factored into the compensation calculation.

Benchmarking

Example of an SEC Comment

- You state that you determine salary and incentive levels in part by looking at comparative industry data. Please identify the peer group companies used in making your compensation decisions. Since you appear to benchmark compensation, you are required to identify the companies that comprise the benchmark group. See Item 402(b)(2)(xiv) of Regulation S-K. This disclosure should also include a discussion of where actual payments fall within targeted parameters. To the extent actual compensation awarded to each officer was outside a targeted percentile range, include an explanation of the reasons for this. Provide this disclosure in future filings and tell us how you plan to comply.

In many cases, the SEC staff commented when a registrant's disclosures suggested that the registrant engaged in benchmarking[1] (e.g., the registrant compared the compensation of a peer group within the same industry or used compensation surveys to determine compensation levels) but failed to acknowledge that it had done so. The SEC staff's comments have indicated that if a registrant engages in benchmarking of total compensation, it must identify the benchmark and the registrants that make up the benchmark group. The staff also requested that registrants enhance their analysis by providing additional details about how they used the comparison information, whether they had discretion on when and how to use it, and where payments fell with respect to the benchmark.

Other Deloitte Resources

- July 2009, Center of Corporate Governance's Hot Topics, "The Pace of Corporate Governance Reform Heats Up."
- Financial Reporting Alert 08-6, "Recent Tax Ruling Requires Entities to Reconsider Their Tax Positions Related to Executive Compensation."
- October 14, 2008, *Heads Up*, "Considerations Regarding the Emergency Economic Stabilization Act of 2008."
- October 16, 2007, *Heads Up*, "SEC Feedback on Executive Compensation Disclosures: 'Where's the Analysis?'"
- September 7, 2007, *Heads Up*, "SEC Staff Issues Comment Letters on Executive Compensation Disclosures."

[1] For the definition of "benchmarking," see Question 118.05 in the SEC's Compliance and Disclosure Interpretations of Regulation S-K.

Fair Value and the Turmoil in the Credit Markets

Current Economic Environment

Examples of SEC Comments

- Please expand MD&A to provide further discussion of recent economic events and their current and expected future impact on your operations, financial position, and liquidity. We urge you to provide ways to provide additional quantitative disclosures that convey to investors the current and ongoing risks that you face due to developments in the current business environment. We believe you should provide detailed rather than general disclosures regarding these risks and exposures.
- Given the recent turmoil in the credit markets, please tell us in more detail how you determined that these securities were available to support current operations, including telling us whether you have experienced any difficulties with the auctions for your auction rate securities. Also tell us the impact, if any, the turmoil in the credit markets has had on your valuation of these investments and how you considered addressing these matters for your investors.

As a result of the turmoil and decreased liquidity in the credit markets, many registrants are forced to rely on internal valuation models that include inputs that cannot be obtained from current market information (unobservable inputs) when determining the fair value of the financial assets recognized on their balance sheets. In addition, registrants may rely on internal valuation models in valuing many of their nonfinancial assets (e.g., goodwill, fixed assets). As the subjectivity in determining amounts recognized in the balance sheet increases, so does the need for comprehensive and transparent footnote disclosures. ASC 820 (formerly Statement 157) emphasizes the importance of transparency in the determination of fair value, especially when valuation models use unobservable inputs.

MD&A Disclosures

As discussed in the Management's Discussion and Analysis section, the deteriorating credit markets have underscored the need for transparent reporting and disclosure of a registrant's exposure to, and the effect of, potential credit losses. As the crisis has deepened, the SEC staff has focused on whether the registrant has accurately portrayed its financial position. Comment letters and various speeches and publications produced by the SEC staff reflect this increased scrutiny.

The SEC staff continues to focus on disclosures related to the turmoil in the credit markets as well as the disclosures required by ASC 820. The SEC's Division of Corporation Finance sent two letters to registrants addressing the need for more transparent disclosure in MD&A of methods and assumptions used in fair value measurements of material financial instruments affected by the credit crisis.

In March 2008, the Division of Corporation Finance sent a letter to certain financial institutions that focuses on disclosures about the use of significant unobservable inputs in fair value measurements. While the letter was sent only to financial institutions, the SEC staff indicated that the letter can apply to any registrant. The SEC suggested that disclosures focus on the following items:

- Amounts of Level 3 assets and liabilities, a detailed analysis of changes to those assets and liabilities, and the relationships of Level 3 assets and liabilities to other assets and liabilities measured at fair value.
- A discussion of how changes in the fair value of assets and liabilities affect a registrant's results of operations, liquidity, and capital resources.
- Additional disclosures about the nature and type of assets underlying asset-backed securities.
- A detailed description of the valuation techniques or models used in fair value measurements, including any changes to the valuation model, consideration of market indices, sensitivity analyses, and validation procedures.

In September 2008, the Division of Corporation Finance issued a second letter requesting more transparent disclosures in MD&A regarding fair value measurements of material financial instruments that are not traded actively. The letter encouraged registrants to disclose, when material, how credit risk affected their fair value measurements, including the gains or losses recognized on their derivative liabilities that are attributable to changes in their own credit risk. In addition, the letter asked registrants to consider disclosing the criteria used to determine whether the market is active or inactive, how they factored market illiquidity into their fair value determination, significant judgments they used in classifying fair value measurements in the ASC 820 hierarchy, and how they used brokers or pricing services in developing fair value measurements.

At the 2008 AICPA Conference, Ms. Stephanie Hunsaker, associate chief accountant in the SEC's Division of Corporation Finance, elaborated on the disclosure items discussed in the letters above and provided several examples of such disclosures. She noted that results from an informal SEC staff study suggested that registrants did increase their fair value disclosures to some extent in response to these letters and encouraged registrants to provide even more disclosures (such as sensitivity analyses, particularly when changes to estimates and assumptions used in estimating fair values of an instrument may result in materially different results) in upcoming filings.

In addition to the disclosures discussed in the letters, Ms. Hunsaker suggested that registrants provide other fair value disclosures to enhance their MD&A. See Deloitte's *Heads Up* on the 2008 AICPA Conference for a detailed listing of her suggested disclosures, which included the following:

- For all Level 3 measurements, a discussion of the key drivers of fair value for each significant asset or liability grouping and whether each driver is observable or unobservable. In August 2009, the FASB issued an exposure draft on improving disclosures about fair value measurements, which would require entities to report information about purchases, sales, issuances, and settlements included in the Level 3 rollforward on a gross basis rather than on a net basis. The FASB will continue to deliberate before issuing a final Accounting Standards Update.
- Tabular disclosures of collateral underlying mortgage-backed securities, collateralized debt obligations, collateralized loan obligations, and other similar securities. She suggested that these disclosures include the more detailed aspects of the collateral, such as types of loans, vintage information, and the effects of credit enhancements.
- Insight into the causes of other-than-temporary impairments on available-for-sale securities by separating such causes between (1) credit-related issues or other adverse issuer conditions and (2) other accounting consequences (e.g., an entity can no longer assert its intent and ability to hold).

Also at the 2008 AICPA Conference, Mr. John White, director in the SEC's Division of Corporation Finance, stated that registrants need to adequately incorporate the effects of current market conditions into MD&A. He noted that because of the pervasiveness of the market crisis, registrants should consider taking a "clean slate" approach rather than simply making edits to the prior-year MD&A. Further, registrants should incorporate into their disclosures the effects of the crisis on their suppliers, customers, etc.

In addition to Ms. Hunsaker and Mr. White, several other SEC and FASB staff members discussed fair value issues at the 2008 AICPA Conference. See Deloitte's *Heads Up* on the 2008 AICPA Conference for summaries of SEC staff comments on the challenges of measuring fair value, particularly in inactive markets, and best practices for MD&A disclosure.

Given the high-profile casualties of the credit crisis in 2008, the SEC may also request specific disclosures about exposure to affected entities. For example, registrants that have liquidity arrangements (e.g., credit facilities, repo transactions) with affected entities need to consider (1) the possibility that the liquidity arrangement will be canceled or withdrawn as a result of the bankruptcy filing and (2) the effect that such an event may have on their liquidity position.

Auction Rate Securities

Many issuances of auction rate securities (ARSs) have been adversely affected by the credit crisis. Many ARS auctions began to fail in early 2008, rendering the market for these securities illiquid. The SEC staff has issued numerous comments requesting that registrants provide additional disclosures about exposure to ARSs and how the fair value of those investments was determined. For instance, the SEC staff has requested that registrants provide the following:

- Detailed descriptions of ARSs, including whether those securities experienced failed auctions.
- Detailed information about auction failure rates before and after the balance sheet date.
- An explanation of the classification of ARSs as short-term or long-term investments, including historical presentation of these securities as current assets when a registrant changes the classification to noncurrent in the current period.
- An explanation of the valuation model, including the significant inputs and assumptions used, when registrants have disclosed that the security had a failed auction or that they are classifying ARSs as noncurrent because of an inability to liquidate their holdings at par in the near term.
- If ARSs experienced a decline in fair value over their carrying amount but were not impaired, a discussion of how the registrant determined that the decline in fair value of the ARSs is only temporary.
- The impact on liquidity of the investment portfolio when auctions fail.

Valuation Methods and Assumptions

Examples of SEC Comments

- Recent market conditions have caused certain instruments to be reclassified to Level 3. As the valuation of Level 3 instruments requires significant judgment by management, please tell us what consideration you gave to providing a sensitivity analysis related to the valuation of these instruments.
- Please explain in more detail how the derivative contracts are fair valued and provide a more robust disclosure of the various inputs and assumptions used in the respective models. Please also include quantified and narrative disclosure of the impact that reasonably likely changes in the key assumptions used would have on the financial statements at the balance sheet date.
- We note in your disclosure related to your auction rate securities that you used a discounted cash-flow valuation model that relied upon certain unobservable inputs, including the holding period and discount rates applied to future cash flows, to value these securities. Provide us with the assumptions used in your cash flow model to value these auction rate securities, including how these assumptions were determined, and how these assumptions differed from your valuations of other auction rate securities held by [Company A]. Additionally, tell us how you considered providing more robust disclosure related to the differences in your valuations of each type of auction rate security held by [Company A].

The SEC staff has issued numerous comments requesting that registrants provide additional disclosures about valuation methods and assumptions associated with fair value measurements. At the 2007 AICPA Conference, Ms. Hunsaker highlighted several areas of increased scrutiny by the Division regarding fair value measurement. Ms. Hunsaker stated that the SEC staff believes that many registrants do not provide sufficient insight into how they determine fair value, especially when fair value measurements rely on unobservable data. Ms. Hunsaker stated that the SEC staff believes registrants should consider providing the following financial statement disclosures when fair value measurements rely on unobservable inputs:

- The valuation models used to determine fair value.
- The significant inputs into the models.
- The assumptions that could have the greatest impact on the valuations.
- Whether, how, and why those assumptions have changed from prior periods.

Because management must use significant judgment when valuing Level 3 fair value measurements, the SEC staff has asked registrants to explain the considerations they gave to providing a sensitivity analysis of such measurements.

In addition to the considerations noted by Ms. Hunsaker and the disclosures required by ASC 820, registrants should consider the disclosure requirements of ASC 275 (formerly SOP 94-6) and ASC 825-10-50 (formerly Statement 107). ASC 275 requires disclosures about assumptions or estimates that have a significant effect on a registrant's financial statements, which may include the registrant's use of unobservable inputs.

Level 2 and Level 3 Measurements

Example of an SEC Comment

- You state you measure your fair values for your interest rate swaps based on the use of models that consider various assumptions, including time value, yield curves, as well as other relevant economic measures. You further state that these inputs are Level 2 inputs. Please explain to us in greater detail why you believe that these represent Level 2 inputs.

Ms. Hunsaker also noted that registrants should consider enhancing their disclosures about fair value measurements that have been reclassified from Level 2 to Level 3 measurements during the year as a result of a decrease in market information. She stated that registrants should disclose the types of instruments that are reclassified to Level 3 and the nature of the inputs that are no longer observable.

In addition, the SEC staff has focused on the identification of valuation inputs within a registrant's ASC 820 disclosures that may be inconsistent with the classification (i.e., Level 2 or Level 3). For instance, the staff has challenged classification of instruments as Level 2 when a registrant has disclosed that its valuation included a significant illiquidity factor or was solely based on broker quotes.

ASC 820 requires an entity to provide information about transfers into and out of Level 3 measurements. The SEC staff has asked registrants to provide better disclosures about which significant inputs became observable and unobservable for transfers into and out of Level 3, including the nature and timing of such transfers. The FASB's exposure draft on improving disclosures about fair value measurements would expand these disclosures to significant transfers into or out of Level 1 and Level 2 fair value measurements and the reasons for the transfers.

Pricing Services

Example of an SEC Comment

- Please revise your disclosure to discuss the extent to which, and how, the information is obtained from the pricing services and used in developing the fair value measurements in the consolidated financial statements including: (a.) The nature and amount of assets you valued using broker quotes or prices you obtained from pricing services; (b.) The number of quotes or prices you generally obtained per instrument, and if you obtained multiple quotes or prices, how you determined the ultimate value you used in your financial statements; (c.) Whether, and if so, how and why, you adjusted quotes or prices you obtained from brokers and pricing services; (d.) The extent to which the brokers or pricing services are gathering observable market information as opposed to using unobservable inputs and/or proprietary models in making valuation judgments and determinations; (e.) Whether the broker quotes are binding or non-binding; and (f.) The procedures you performed to validate the prices you obtained to ensure the fair value determination is consistent with [ASC 820 (formerly Statement 157)], and to ensure that you properly classified your assets and liabilities in the fair value hierarchy.

The SEC staff has requested that registrants provide additional disclosures about how management determines fair value, including management's process for understanding the assumptions and methods used by brokers or third-party pricing services when external inputs are used in the valuation.[1] The staff has focused on determining whether a registrant has sufficiently understood the method behind broker quotes and whether the registrant has used reasonably obtainable secondary market information rather than relying exclusively on broker estimations or internal models. In addition, the staff has asked registrants to defend why measurements determined by using third-party pricing services would be classified as Level 2 instead of Level 3.

Inactive Markets

Example of an SEC Comment

- Please clarify how you determined that a market was not active. Disclose how the lack of liquidity impacted the valuation technique you used, and how you factored illiquidity into your fair value determination of those financial instruments.

The SEC staff has asked registrants for additional information about how their fair value measurements are affected by inactive markets. Specifically, the staff has asked registrants for information about how the lack of liquidity affected their valuation models and the inputs used in those models. In some cases, the staff has asked for detailed information about how a registrant concluded that a market was inactive, such as (1) the criteria used in determining that a market is inactive, including the interpretation of the definition of an inactive market, and (2) the specific date on which the registrant last considered the market active and the length of time between that date and the date of the fair value measurement.

Credit Risk

Example of an SEC Comment

- We note that you do not consider counterparty credit risk to be a significant input. Please address the following: (a.) Clarify whether you actually factor in the impact of counterparty credit risk into the value of your derivative assets but the impact is just not significant, or whether you do not consider the impact of counterparty credit risk as you have qualitatively determined the impact to be insignificant on the fair value of these instruments; (b.) Clarify whether this was a change upon the adoption of [ASC 820 (formerly Statement 157)], or whether you applied a similar methodology prior to the adoption of [ASC 820]; (c.) Tell us, and disclose in future filings, whether you factor your own credit risk into the value of your derivative liabilities, consistent with the guidance in [ASC 820-10-35-16 through 35-18 (formerly paragraph 15 of Statement 157)].

Certain of the SEC staff's comments have requested additional disclosures and clarification from registrants about the incorporation of nonperformance risk into the fair value measurement of financial assets and financial liabilities. In particular, the staff seems to be concerned about liability measurements in which a registrant does not appropriately consider the issuer's own credit.

Study of Mark-to-Market Accounting

The SEC completed its study of mark-to-market accounting in accordance with Congress's Emergency Economic Stabilization Act and delivered the results of the study to Congress on December 30, 2008. The report concludes that existing mark-to-market accounting should not be suspended, noting that because investors have indicated that fair value accounting results in transparent and timely information that is useful in making informed decisions, an abrupt removal of fair value accounting would erode investor confidence in financial reporting.

[1] See the Use of Experts and Consents section for the staff's current position on references to a third party in a filing.

Nonetheless, the report proposes improvements to existing practice. Such improvements include reconsidering the accounting for impairments and the development of additional guidance on determining the fair value of investments in inactive markets, including situations in which market prices are not readily available. In April 2009, the FASB issued three Staff Positions (FSPs) in an attempt to clarify these issues. FSP FAS 157-4 (codified in ASC 820-10) provides guidance on determining fair value when market activity has decreased; FSP FAS 115-2 and FAS 124-2 (codified in ASC 320-10) addresses other-than-temporary impairments for debt securities; and FSP FAS 107-1 and APB 28-1 (codified in ASC 825-10) discusses fair value disclosures for financial instruments in interim periods.

Other Deloitte Resources

- Financial Reporting Alert 09-5, "Financial Reporting Considerations for Pension and Other Postretirement Benefits."
- Financial Reporting Alert 09-1, "Impact of Credit Downgrades on the OTTI Analysis of Perpetual Preferred Securities."
- Financial Reporting Alert 08-17, "Accounting Considerations Related to Redemption Restrictions on Money Market Funds."
- Financial Reporting Alert 08-16 (Revised), "SEC Issues Letter Clarifying Other-Than-Temporary Impairment Guidance for Perpetual Preferred Securities."
- Financial Reporting Alert 08-14, "Potential Counterparty Default and Other Accounting Considerations Related to the Credit-Market Turmoil."
- Financial Reporting Alert 08-13, "Accounting Considerations for Settlement Agreements Related to Auction Rate Securities."
- Financial Reporting Alert 08-12 (Revised), "FASB Votes to Issue Proposed Staff Position Clarifying Fair Value Measurement Guidance."
- Financial Reporting Alert 08-11, "SEC and FASB Release Fair Value Clarifications."
- Financial Reporting Alert 08-10, "SEC Advises Registrants to Further Explain Fair Value in MD&A — An Addendum to the March 2008 SEC Letter."
- Financial Reporting Alert 08-8, "Consideration of Credit Risk in Fair Value Hedge Effectiveness Assessments."
- Financial Reporting Alert 08-7, "SEC Advises Registrants to Further Explain Fair Value in MD&A."
- Financial Reporting Alert 08-4, "Turmoil in the Credit Markets: The Importance of Comprehensive and Informative Disclosures."
- Financial Reporting Alert 08-2, "Auction Rate Securities Warrant Scrutiny for Impairment."
- Financial Reporting Alert 08-1, "SEC Issues Letter Clarifying Accounting Ramifications of Accelerated Efforts to Mitigate Subprime Crisis."
- October 1, 2009, *Heads Up*, "FASB Issues Guidance on Measuring Fair Value of Certain Alternative Investments."
- September 1, 2009, *Heads Up*, "FASB Proposes Improving Disclosures About Fair Value Measurements."
- August 28, 2009, *Heads Up*, "FASB Issues Guidance on Measuring Fair Value of Liabilities."
- July 2, 2009, *Heads Up*, "FASB Proposes Expanding Disclosures About the Credit Quality of Financing Receivables and the Allowance for Credit Losses."
- June 30, 2009, *Heads Up*, "IASB's Exposure Draft Proposes Expanded Guidance on Fair Value Measurement."
- April 14, 2009, *Heads Up*, "FASB Issues Guidance on Measuring Fair Value When Market Activity Declines, Other-Than-Temporary Impairments, and Interim Fair Value Disclosures."
- January 9, 2009, *Heads Up*, "Study Finalized on Mark-to-Market Accounting."
- October 14, 2008, *Heads Up*, "Considerations Regarding the Emergency Economic Stabilization Act of 2008."

Financial Instruments

Hedge Accounting

Example of an SEC Comment

- Given the magnitude of your derivatives, and for greater transparency and understanding of your derivatives to investors, please consider disclosing the specific methodology used to test hedge effectiveness for each type of hedge employed. In so doing, clearly describe the basis upon how effectiveness/ineffectiveness is determined.

In late 2006 and 2007, the SEC staff made several announcements regarding the application of hedge accounting under ASC 815 (formerly Statement 133 and related implementation guidance).

At the 2006 AICPA Conference, Mr. Timothy Kviz, a professional accounting fellow in the SEC's Office of the Chief Accountant, noted two ways in which registrants had misapplied hedge accounting under ASC 815:

- *The shortcut method* — Registrants have concluded that their hedging relationships qualify for the shortcut method without meeting all of the criteria in ASC 815-20-25-102 through 25-114 (formerly paragraphs 68–70 of Statement 133 and Implementation Issues E4, E6, E10, E16, E20, and G10).
- *The critical-terms-match method and the three methods for assessing the ineffectiveness of certain cash flow hedges involving interest rate risk described in ASC 815-30-35-10 through 35-32 (formerly paragraph 65 of Statement 133 and Implementation Issue G7)* — Registrants have inappropriately assumed no ineffectiveness in hedging relationships designated under one of these methods despite known sources of ineffectiveness.

Mr. Kviz indicated that the SEC staff believes that when a registrant inappropriately applies the shortcut method or otherwise ignores known sources of hedge ineffectiveness in its effectiveness assessments, there is an error equal to the entire change in fair value of the derivative (i.e., as if hedge accounting had not been applied). Mr. Kviz highlighted several scenarios in which registrants had concluded that a hedging relationship was perfectly matched when there were known sources of ineffectiveness that should have been measured.

At the March 2007 EITF meeting, Mr. Joseph McGrath, another professional accounting fellow in the SEC's Office of the Chief Accountant, revisited several of the hedge accounting issues initially discussed by Mr. Kviz. Mr. McGrath clarified the SEC staff's position that it may be acceptable for a registrant to continue to use the critical-terms-match method even if a known source of hedge ineffectiveness exists, provided that the registrant (1) evaluates and supports the reasonableness of the conclusion that the terms match and (2) performs a quantitative assessment to confirm that the hedging relationship is, in fact, highly effective and that any ineffectiveness is de minimis. Mr. McGrath suggested that one example of this might be a hedge of forecasted foreign-currency-denominated transactions if the settlement dates of the hedging instrument and the forecasted transactions occur within the same month (i.e., a hedging relationship in which a single forward contract hedges multiple forecasted transactions still might qualify for the critical-terms-match method).

These announcements triggered a number of restatements, and the SEC staff subsequently issued numerous comments requesting registrants to provide detailed information and disclosures about their hedging relationships. The SEC staff has frequently challenged a registrant's determination that a hedging relationship qualifies for the shortcut or the critical-terms-match method of accounting. For example, registrants are often asked to provide or disclose some or all of the following:

- How the registrant determined that it met the criteria of ASC 815-20-25-84 and 25-85 (formerly paragraph 65 of Statement 133 and Implementation Issue G9) to qualify for the critical-terms-match method of assessing hedge effectiveness.
- How the registrant determined that it met the criteria of ASC 815-20-25-102 through 25-114 to qualify for the shortcut method of assessing hedge effectiveness.
- The nature and terms of the hedged item (including any conversion, call, and option features) and the hedging instrument and whether such terms are exact mirrors of each other.
- The specific risk being hedged.
- How effectiveness is assessed at inception and on an ongoing basis for each type of hedge, including the specific quantitative methods used.

- How differences between estimated and actual results have affected hedging relationships (i.e., in the determination of whether hedge accounting should be discontinued).
- If effectiveness tests failed, what additional procedures the registrant performed to conclude that it was appropriate to continue applying hedge accounting.

In addition, the SEC staff has challenged the consistency with which registrants have applied methods of assessing hedge effectiveness.

In 2007, the FASB added to its agenda a project to simplify hedge accounting. The project proposed eliminating the shortcut method, the critical-terms-match method, and the requirement to continually assess hedge effectiveness to qualify for hedge accounting. The Board issued an exposure draft (ED) of a proposed Statement on accounting for hedging activities in June 2008. The majority of comments that the Board received expressed concern that the ED's proposed changes diverged from IFRSs. Therefore, this project has now been integrated into the joint FASB and IASB project on accounting for financial instruments. As part of the joint project, the FASB expects to issue an ED in the first half of 2010 that would address measurement, classification, and impairment of financial instruments, as well as hedge accounting.

Derivatives Embedded in Convertible Financial Instruments

Example of an SEC Comment

- Please provide us with your analysis regarding your determination not to bifurcate and account for the conversion feature as a derivative in accordance with [ASC 815-15-25-1 (formerly paragraph 12 of Statement 133)]. Ensure your response includes your analysis of [ASC 815-10-15-74 (formerly paragraph 11 of Statement 133)], including the guidance in [ASC 815-40 (formerly Issue 00-19)].

The accounting for convertible securities is complex, involving analysis of a security's various features. Such accounting commonly has been scrutinized by the SEC staff and has been a frequent topic of discussion at the AICPA conferences.

In May 2008, the FASB issued FSP APB 14-1 (codified in ASC 470-20), which provides guidance on the accounting for certain convertible debt instruments that may be settled in cash upon conversion (including partial cash settlement). The FSP does not apply to instruments with embedded conversion features that must be accounted for separately under ASC 815. Broadly, the FSP requires that proceeds received from the issuance of such an instrument be allocated between liability and equity components. The portion allocated to the liability is equal to the issuer's estimate of the fair value of an identical debt instrument that it could issue, excluding the conversion option.

In addition, the SEC staff revised EITF Topic D-98 to reflect this new guidance. This revision affects instruments that are currently redeemable or convertible and requires an entity to record a portion of the convertible instrument's equity component as mezzanine equity (i.e., outside of permanent equity) when the amount of cash that must be exchanged in a hypothetical settlement of the liability component (as of the balance sheet date) exceeds the current carrying amount of that liability component. The EITF also issued guidance during 2008 (Issues 07-5 and 08-8, codified in ASC 815-40-15-5 through 15-8 and ASC 815-10-15-77) that clarified whether an instrument (or an embedded feature) is indexed to an entity's own stock; this guidance factors into an entity's determination of whether an embedded conversion feature requires bifurcation.

These recent changes to the accounting requirements for such securities make it likely that this topic will continue to draw the attention of the SEC staff for the foreseeable future.

Registrants that issue convertible debt or convertible preferred stock and conclude that there is no need to bifurcate the embedded conversion option as a derivative under ASC 815 are frequently asked by the SEC staff to either disclose or provide information about the following:

- Whether the registrant has considered the need to bifurcate the conversion option as a derivative under ASC 815.
- Whether the convertible debt qualifies as conventional convertible debt.
- Specific information about the terms and features of the convertible security (e.g., a feature in a convertible security that could require the issuance of an unlimited variable number of shares).

It also is not unusual for the SEC staff to request registrants to perform additional analysis of, or provide additional information (such as copies of actual agreements) about, their convertible securities to support their accounting treatment. Furthermore, the staff may ask registrants that have disclosed that an embedded derivative has not been bifurcated because of immateriality to provide the assumptions used to value the instrument and other underlying support for the conclusion that the amount was immaterial.

Financial Asset Transfers

Example of an SEC Comment

- Please specifically address how you determined the transfer of the receivables to both the third-party qualifying special purpose entity and to the third-party banking institutions met the sales criteria of [ASC 860-10-40-4 and 40-5 (formerly paragraph 9 of Statement 140)].

The SEC staff often asks registrants that transfer financial assets to a special-purpose entity and account for the transaction as a sale to provide additional information to support sale accounting. For example, registrants that have continuing involvement with the transferred assets or the special-purpose entity may be asked to provide evidence (e.g., a legal opinion) to support their assertion that the transferred assets are legally isolated.

In addition, the SEC staff may request that registrants provide additional information in their accounting policy footnote, such as the nature and terms of asset transfers and how the accounting treatment complies with ASC 860 (formerly Statement 140). The SEC staff has challenged registrants that account for a transfer as a sale when such registrants have historically accounted for similar transfers as secured borrowings.

During 2009, the FASB issued amendments to ASC 860 and eliminated the concept of a qualifying special-purpose entity. The Board also released other amendments related to sales of partial interests in a financial asset. The amendments to ASC 860 are effective for fiscal years beginning after November 15, 2009 (e.g., January 1, 2010, for calendar-year-end companies), and for interim and annual periods thereafter.

Disclosures

Example of an SEC Comment

- Please revise your [MD&A] disclosures of market risk, commodity price risk and foreign exchange risk in future filings to provide quantitative disclosures in one of the three disclosure formats required by Item 305(a) of Regulation S-K.

Quantitative and Qualitative Disclosures About Market Risk and Off-Balance-Sheet Arrangements

In the current economic environment, investors are interested in a registrant's exposure to market-related risks. The SEC staff frequently reminds registrants to provide or clarify MD&A disclosures in accordance with Regulation S-K, Item 305, which requires disclosure of both quantitative and qualitative information for all market-risk-sensitive instruments.

The SEC staff also continues to scrutinize registrants' disclosures of off-balance-sheet arrangements and has issued comments requiring registrants to disclose how such arrangements affect their financial condition, operations, liquidity, and capital expenditures. Registrants are reminded of the importance of providing transparent disclosures in the current economic environment and complying with the requirements of Regulation S-K, Item 303(a)(4).

For more information on disclosures about market risk and off-balance-sheet arrangements, see the Fair Value and the Turmoil in the Credit Markets and Management's Discussion and Analysis sections.

Derivatives Disclosures

In 2008, the FASB finalized a number of projects requiring enhanced derivative disclosures. The new requirements are codified in ASC 815-10-50 (formerly paragraphs 44–44E of Statement 133) and include:

- Disclosures applicable to sellers of credit derivatives (including hybrid instruments that have embedded credit derivatives) and financial guarantees.
- Qualitative and quantitative disclosures about an entity's derivative instruments and hedging activities, including (1) "its objectives for holding or issuing those instruments"; (2) "the context needed to understand those objectives"; (3) "its strategies for achieving those objectives"; and (4) "information that would enable users of its financial statements to understand the volume of its derivative activity" in those instruments.

The SEC staff will most likely focus on whether registrants have fully complied with the new disclosure requirements. Moreover, the enhanced disclosures will make a registrant's derivative and hedge accounting activities more transparent and could lead the staff to ask more specific questions about the accounting treatment, financial reporting, or both, of certain derivative or hedging transactions.

Other Deloitte Resources

- Financial Reporting Alert 08-14, "Potential Counterparty Default and Other Accounting Considerations Related to the Credit-Market Turmoil."
- Financial Reporting Alert 08-8, "Consideration of Credit Risk in Fair Value Hedge Effectiveness Assessments."
- November 17, 2009, *Heads Up*, "IASB Issues IFRS on Classification and Measurement of Financial Assets."
- October 27, 2009, *Heads Up*, "An Update on the FASB and IASB's Joint Project on Financial Instruments."
- October 20, 2009, *Heads Up*, "Guidance on Statement 167 Implementation Issues."
- October 15, 2009, *Heads Up*, "FASB Proposes Guidance on ASC 815 Scope Exception for Embedded Credit Derivatives."
- August 18, 2009, *Heads Up*, "FASB Continues Deliberations on Financial Instruments and Decides on Presentation."
- July 27, 2009, *Heads Up*, "IASB Issues Exposure Draft and FASB Initiates Deliberations on New Classification and Measurement Requirements for Financial Assets and Financial Liabilities."
- July 2, 2009, *Heads Up*, "FASB Proposes Expanding Disclosures About the Credit Quality of Financing Receivables and the Allowance for Credit Losses."
- June 16, 2009, *Heads Up*, "FASB Issues New Standard on Transfers of Financial Assets."
- April 14, 2009, *Heads Up*, "FASB Issues Guidance on Measuring Fair Value When Market Activity Declines, Other-Than-Temporary Impairments, and Interim Fair Value Disclosures."
- February 3, 2009, *Heads Up*, "FASB Issues Proposal on Interim Disclosures of Financial Instruments."
- January 16, 2009, *Heads Up*, "FASB Issues Amendments to OTTI Model for Certain Investments in Securitizations."
- December 16, 2008, *Heads Up*, "FASB's New Disclosure FSP Is Effective Immediately."
- December 5, 2008, *Heads Up*, "Issue 07-5 Affects Issuers of Equity-Linked Financial Instruments (Including Debt With Embedded Conversion Options)."
- November 2008 *EITF Snapshot*.
- September 2008 *EITF Snapshot*.
- May 15, 2008, *Heads Up*, "FASB Tightens Convertible Debt Accounting for Issuers."
- March 27, 2008, *Heads Up*, "FASB Expands Disclosures About Derivative Instruments and Hedging Activities."
- January 14, 2008, *Heads Up*, "FASB Clarifies Application of the Shortcut Method."
- March 19, 2007, *Heads Up*, "Using the Critical-Terms-Match Method for Evaluating Hedges — SEC Staff Identifies Key Considerations."
- January 18, 2007, *Heads Up*, "Matching Critical Terms in Hedge Strategies."

Financial Statement Classification

The SEC staff frequently comments on a registrant's classification in the financial statements. Comments on the income statements and balance sheets tend to concentrate on ensuring compliance with the requirements of Regulation S-X, while comments on the statements of cash flows focus on compliance with ASC 230 (formerly Statement 95).

Balance Sheet Classification

Examples of SEC Comments

- *Separate Presentation* — The amount that you classify as other current liabilities is greater than [10%] of your total current liabilities in each period presented. Please tell us what consideration you have given to the requirement to state separately any items that exceed 5% of total current liabilities. Please refer to Rule 5-02 of Regulation S-X for guidance on this issue.
- *Current Versus Noncurrent Classification* — Please tell where you classify [deferred costs] on your balance sheet. To the extent you included these costs in prepaid expenses and other current assets line item, please explain to us why current classification is appropriate.
- *Cash and Cash Equivalents* — Explain to us how your policy of considering all highly liquid investments purchased with original maturities of six months or less to be cash equivalents complies with GAAP or revise. We refer you to the guidance in [ASC 230-10-20 (formerly paragraph 8 of Statement 95)].

Separate Presentation

Regulation S-X, Rule 5-02, states that (1) other current assets and other current liabilities in excess of 5 percent of total current assets and total current liabilities, respectively, and (2) other noncurrent assets and other noncurrent liabilities in excess of 5 percent of total assets and total liabilities, respectively, should be shown separately on the face of the balance sheet or disclosed in a note to the financial statements. The SEC staff may ask a registrant to confirm whether the reported balances of other current assets/liabilities or other noncurrent assets/liabilities include any items in excess of 5 percent of total current assets/liabilities or total assets/liabilities, respectively, and, if so, to state those items individually on the face of the balance sheet or in the notes.

Current Versus Noncurrent Classification

The SEC staff has also frequently commented on the classification of current and noncurrent assets and liabilities, including debt. (See the Debt section for a discussion of staff comments about balance sheet classification of debt.) When presenting a classified balance sheet, registrants should consider the guidance in ASC 210-10-45 (formerly ARB 43) and other applicable accounting literature to determine whether an item should be classified as current or noncurrent. The SEC staff may request a registrant to explain an item's classification and presentation or, alternatively, to reclassify the asset or liability appropriately.

Cash and Cash Equivalents

The SEC staff also comments on the appropriateness of classifying investments as cash equivalents. Generally, investments do not meet the definition of a cash equivalent in ASC 230-10-20 (formerly paragraph 8 of Statement 95) unless the securities are purchased very near their stated maturity. Investments with stated maturities greater than three months cannot be classified by an investor as cash equivalents under ASC 230 unless the investments are purchased three months or less before their contractual maturity.

Income Statement Classification

Examples of SEC Comments

- *Separate Presentation* — We note from your disclosure in Note 1 that the description of your business includes manufacture, rebuild, repair, sell and lease [products]. In future filings, to the extent any of the revenues from services (i.e. rebuilding and repair) or from leasing [products] exceeds 10% of total revenues, the amount of such revenues, and related cost of services, should be separately presented on the face of the statements of income. See Rule 5-03.1 of Regulation S-X.
- *Cost of Sales* — Please disclose the types of expenses that you include in the cost of goods sold line item and the types of expenses that you include in the selling, general and administrative expenses line item. Please also disclose whether you include inbound freight charges, purchasing and receiving costs, inspection costs, warehousing costs, internal transfer costs, and the other costs of your distribution network in the cost of goods sold line item. With the exception of warehousing costs, if you currently exclude a portion of these costs from cost of goods sold, please disclose:
    - In a footnote the line items that these excluded costs are included in and the amounts included in each line item for each period presented, and
    - In MD&A that your gross margins may not be comparable to those of other entities, since some entities include all of the costs related to their distribution network in cost of goods sold and others like you exclude a portion of them from gross margin, including them instead in a line item such as selling, general and administrative expenses.

  Please show us in your supplemental response what the revisions will look like.
- *Cost of Sales* — Please disclose the line item(s) in which you include depreciation and amortization. If you do allocate a portion of your depreciation and amortization to cost of sales, please also revise your presentation to comply with SAB Topic 11:B, which would include revising the cost of sales title and removing the gross profit subtotal throughout the filing. Please show us in your supplemental response what the revisions will look like.
- *Operating Versus Nonoperating Income* — We see that Other Expense (Income) includes the following items:
    - Stock-based compensation expense[,]
    - Gains from insurance proceeds,
    - Impairment of investment, and
    - Loss on disposal of property plant and equipment.

  Tell us why these items are not included in Operating Loss. Refer to [ASC 360-10-45-4 (formerly paragraph 25 of Statement 144)], Question 2 of SAB Topic 5:P, and SAB Topic 14:F.

The SEC staff's comments on income statement presentation often address how the presentation complies with the technical requirements of Regulation S-X, Rule 5-03, which lists the captions and details that commercial and industrial registrants must present in their income statements. For example, the staff may ask registrants to explain why they have excluded certain line items required by Rule 5-03 from the face of the income statement.

Because there is often no clear guidance on classification of income and expense items, classification is frequently established through practice and the SEC comment process. The SEC staff has reminded registrants that when alternative classifications are permissible, they should disclose their policies and apply them consistently in accordance with ASC 235-10 (formerly Opinion 22).

Separate Presentation

The SEC staff frequently challenges registrants that omit certain captions required by Rule 5-03 from the face of the income statement. Registrants may be asked to explain their consideration of Rule 5-03 and revise their income statement presentation accordingly. For example, the SEC staff has commented on the distinction between product and service revenue. If product or service revenue is greater than 10 percent of total revenue, the registrant must disclose the material component as a separate line item on the face of the income statement. Note that the costs and expenses related to these revenues should be presented in the same manner.

Cost of Sales

The SEC staff often asks registrants to disclose what types of expenses are included in or excluded from the cost-of-sales line item, in particular whether distribution costs are included in cost of sales. Registrants may be asked to disclose the line item in which such costs are recorded as well as whether their gross margins may not be comparable to those of other registrants.

Another aspect of cost of sales that the staff has commonly commented on is the allocation of depreciation and amortization to cost of sales. SAB Topic 11.B states, in part:

> If cost of sales or operating expenses exclude charges for depreciation, depletion and amortization of property, plant and equipment, the description of the line item should read somewhat as follows: "Cost of goods sold (exclusive of items shown separately below)" or "Cost of goods sold (exclusive of depreciation shown separately below).". . . [D]epreciation, depletion and amortization should not be positioned in the income statement in a manner which results in reporting a figure for income before depreciation.

Most of the SEC staff's comments on this matter have stemmed from registrants' lack of awareness or incorrect application of the guidance in SAB Topic 11.B, particularly their inappropriate reporting of an amount for gross profit before depreciation and amortization.

The SEC staff also frequently comments on the classification of the amortization of intangible assets. The staff often asks registrants how they determine whether intangible asset amortization should be presented as part of cost of sales or selling, general, and administrative expense. The SEC staff has indicated that such a determination should generally be based on the function of the intangible asset. Generally, the amortization of an intangible asset should be classified as a part of cost of sales if the intangible asset is a component of the entity's ongoing major or central operations (i.e., its revenue-generating activities).

For more information about appropriate income statement presentation, including intangible asset amortization, see Deloitte's *Heads Up* on the 2005 AICPA Conference for a summary of a speech by Mr. G. Anthony Lopez, associate chief accountant in the SEC's Office of the Chief Accountant.

Operating Versus Nonoperating Income

Comments on this subject primarily concern what should be included in or excluded from operating income. Under Rule 5-03, a subtotal line item for operating income is not required on the face of the income statement. However, if a subtotal for operating income is presented, the following items should generally be included in operating income (but are sometimes incorrectly excluded):

- Gains or losses on asset sales.
- Litigation settlements.
- Insurance proceeds.
- Restructuring charges.

The following items should generally be excluded from operating income (but are sometimes incorrectly included):

- Dividends.
- Interest on securities.
- Profits on securities (net of losses).
- Interest and amortization of debt discount and expense.
- Earnings from equity method investments (or unconsolidated affiliates).
- Noncontrolling interest in income of consolidated subsidiaries.

Cash Flow Statement Classification

Examples of SEC Comments

- *Category Classification* — We note from your policy disclosure on page [XX] that the restricted cash balance relates primarily to . . . performance guarantees. Please explain your basis . . . for including the changes in restricted cash as an investing, rather than an operating activity. Refer to the guidance in [ASC 230-10-20 (formerly paragraphs 15 and 21 of Statement 95)].
- *Category Classification* — We note your presentation of insurance proceeds related to repair costs as a component of cash provided by operating activities . . . . [P]lease tell us why you believe it is appropriate to classify the insurance proceeds related to repair costs as an operating activity versus an investing activity. Please note that at the 33rd Annual AICPA National Conference on Current SEC and PCAOB Developments held on December 5–7, 2005 the SEC staff noted that they believed that the receipt of any insurance proceeds should be classified in the statement of cash flows based on the nature of the insurance coverage, not the intended use of the proceeds.
- *Category Classification* — Please disclose the amounts of any book overdrafts as of each balance sheet date. Please also present changes in book overdrafts between periods as a separate line item in your statement of cash flows.
- *Net Versus Gross Presentation* — We note from the financing activities section in your statements of cash flows that you present cash flow activities for borrowings of revolving credit facilities and short-term debt on a net rather than a gross basis. Please provide us with and expand your disclosure to explain your basis for presenting cash flows from revolving credit facilities and short-term debt on a net rather than gross basis, supported by the guidance in [ASC 230-10-45-7 through 45-9 (formerly paragraphs 11–13 of Statement 95)] or revise your financial statements in future filings to present borrowings and repayments on a gross basis.
- *Discontinued Operations* — Please confirm to us that your discontinued operations (a) did not have any investing or financing cash flows or (b) that you have combined such cash flows with your investing and financing cash flows from continuing operations. Refer to [ASC 230-10-45-24 (formerly footnote 10 in paragraph 26 of Statement 95)] for guidance.

Category Classification

Many of the SEC staff's cash flow comments relate to misclassification among the three cash flow categories: operating, investing, and financing. A recurring comment pertains to changes in restricted cash. See Deloitte's *Heads Up* on the 2006 AICPA Conference for a summary of a speech by Ms. Carol Stacey, chief accountant in the SEC's Division of Corporation Finance, on the SEC staff's position on changes in restricted cash. Ms. Stacey noted that for most entities, changes in restricted cash represent investing activities; however, in certain instances, the nature of an entity's business operations may indicate that another cash flow classification is appropriate. The SEC staff may ask a registrant to explain the classification or revise it appropriately.

The SEC staff also frequently comments on the classification of insurance proceeds. At the 2005 AICPA Conference, Mr. Joel Levine, associate chief accountant in the SEC's Division of Corporation Finance, stated that insurance proceeds should be classified according to what the insurance was covering, not what the proceeds are used for (i.e., property-damage proceeds would be "investing" and business interruption proceeds would be "operating"), as discussed in ASC 230-10-45-16(c) (formerly paragraph 22(c) of Statement 95).

The SEC staff has also commented on the presentation of book overdrafts in the statement of cash flows. Because a book overdraft is a liability presented separately on the face of the balance sheet, a change in a book overdraft during a period should be presented separately on the face of the statement of cash flows. It is acceptable to show the net change in the book overdraft during the period as either an operating activity or a financing activity in the statement of cash flows, as long as the registrant has a positive bank account balance. This presentation is an accounting policy decision that the registrant should apply consistently. Note that if the registrant has a bank overdraft, the registrant should always show the net change as a financing activity.[1]

Net Versus Gross Presentation

The SEC staff may challenge whether it is appropriate to report the net amount of certain cash receipts and cash payments on the face of the statement of cash flows. ASC 230-10-45-7 through 45-9 (formerly paragraphs 11–13 of Statement 95) state that although reporting gross cash receipts and cash payments provides more relevant information, in certain instances, financial statement users may not need gross reporting to understand certain activities. The SEC staff may ask a registrant to explain why certain cash flows are reported on a net basis rather than a gross basis in accordance with ASC 230 or to revise the presentation.

[1] For more information about this topic, see TIS Section 1300.15.

Discontinued Operations

Another topic the SEC staff has often commented on is the presentation of discontinued operations in the statement of cash flows. Registrants are not required to present cash flows related to discontinued operations separately from cash flows related to continuing operations. Cash flows related to discontinued operations that a registrant chooses to present separately must be reported as "operating," "investing," or "financing." See Deloitte's *Heads Up* on the 2005 AICPA Conference for a summary of a speech by Mr. Joel Levine regarding appropriate presentation alternatives. See also AICPA CPCAF Alert #98, *Update to the SEC Staff Position Regarding Changes to the Statement of Cash Flows Relating to Discontinued Operations* (an addendum to CPCAF Alert #90).

The SEC staff has also commented on the presentation of proceeds from the sale of discontinued operations. Some preparers have included such proceeds in cash flows from continuing operations, since they will be used to fund outflows of continuing operations. As discussed in the Category Classification section above, in commenting on the proper classification of insurance proceeds in the statement of cash flows, the SEC staff clarified that it does not believe classification should be affected by how a company intends to spend the receipts. This logic could also apply by analogy to the classification of proceeds from the sale of discontinued operations.

Although ASC 205-20 (formerly Statement 144) does not explicitly address the presentation of discontinued operations in the statement of cash flows, ASC 205-20-45-3 (previously paragraph 43 of Statement 144) requires that gains or losses from discontinued operations be presented separately from gains or losses from continuing operations in the income statement. Likewise, proceeds from the sale of a disposed-of asset that are associated with discontinued operations should be presented separately in the statement of cash flows as cash provided by investing activities of discontinued operations.

Registrants should describe how cash flows pertaining to discontinued operations are reported in the statement of cash flows. If these cash flows are not separately disclosed in the statement of cash flows, the amounts should be quantified, by category, in MD&A.

Income Taxes and Uncertain Tax Positions

Valuation Allowances

Example of an SEC Comment

- Given your net losses in fiscal 2008 and 2007 as well as your disclosure on page 3 that the current depressed economic conditions could continue and perhaps worsen during 2009 and beyond, please revise your disclosure in future filings to include a more specific and comprehensive discussion regarding how you determined that your remaining deferred tax assets are realizable. In this regard, please quantify your reliance on future taxable income. If you are also relying on tax-planning strategies, please disclose their nature and any uncertainties, risk, or assumptions related to these tax-planning strategies.

ASC 740-10-30-16 through 30-23 (formerly paragraphs 20–25 of Statement 109) require that deferred tax assets be reduced by a valuation allowance "if, based on the weight of available evidence, it is more likely than not (a likelihood of more than 50 percent) that some portion or all of the deferred tax assets will not be realized. The valuation allowance shall be sufficient to reduce the deferred tax asset to the amount that is more likely than not to be realized."

In the current economic environment, the SEC staff has frequently commented on registrants' assessment of the realizability of deferred tax assets. At the 2008 AICPA Conference, Mr. Steven Jacobs, associate chief accountant in the SEC's Division of Corporation Finance, recommended that entities disclose, in the critical accounting estimates section of MD&A, a discussion about the effect that the current economic environment is having on the realization assessments of their deferred tax asset balances. Specifically, Mr. Jacobs recommended that entities disclose:

- How cumulative losses in recent years, or cumulative losses expected in future periods, affect the realizability of deferred tax assets.
- Factors that were considered in each foreign, federal, or state jurisdiction (e.g., a certain jurisdiction may have a unique rule on the carryforward of net operating losses).
- New evidence obtained (either positive or negative) that affects the valuation of deferred tax assets (e.g., new tax-planning strategies).
- Uncertainties that could affect the realization of deferred tax assets.

Mr. Jacobs advised that when an entity adjusts a valuation allowance for a deferred tax asset, the entity should disclose the triggering event or new evidence leading to the adjustment as well as the effect on current and future results. He also stated that entities should consider providing early-warning disclosures in MD&A (see Regulation S-K, Item 303(a)(3)(ii)) and in the notes to the financial statements (see ASC 275-10-50, formerly SOP 94-6) if an increase to the valuation allowance is reasonably likely in the near future. (For additional information, see Deloitte's *Heads Up* on the 2008 AICPA Conference.)

The SEC staff has also been issuing comments when a registrant's disclosures about its valuation allowance seem inconsistent with other disclosures in the filing. For example, the staff has commented when a registrant has not recognized a valuation allowance for its deferred tax assets but has had cumulative losses or has recognized an impairment loss for its goodwill or long-lived assets. The SEC staff has also asked that registrants confirm that the forecasts used to assess the realizability of deferred tax assets are consistent with those used to test goodwill and other tangible and intangible assets for impairment.

Uncertain Tax Positions

Example of an SEC Comment

- At a minimum, please disclose your policy on classification of interest and penalties in accordance with [ASC 740-10-45-25 (formerly paragraph 19 of Interpretation 48)] and provide a tabular reconciliation of the total amounts of unrecognized tax benefits.

Under ASC 740-10-25-6 (formerly paragraph 6 of Interpretation 48), companies cannot recognize a tax benefit related to a tax position unless it is "more likely than not" that tax authorities will sustain the tax position solely on the basis of the position's technical merits. The tax benefit recognized is measured at the largest amount of the tax benefit that is more than 50 percent likely to be realized. Differences between a tax position taken or expected to be taken in a tax return and the benefit recognized and measured pursuant to the Interpretation are referred to as "unrecognized tax benefits." A liability is recognized (or the amount of net operating loss carryforward or amount refundable is reduced) for the amount of unrecognized tax benefit.

One of the most controversial aspects of the Interpretation relates to disclosures about a company's unrecognized tax benefits. ASC 740-10-50-15 (formerly paragraph 21 of Interpretation 48) requires that companies disclose:

> a. A tabular reconciliation of the total amounts of unrecognized tax benefits . . .
>
> b. The total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate
>
> c. The total amounts of interest and penalties recognized in the statement of operations and . . . the statement of financial position . . .
>
> e. A description of tax years that remain subject to examination by major tax jurisdictions.

In addition, ASC 740-10-50-15(d) (formerly paragraph 21(d) of Interpretation 48) requires that for tax positions "for which it is reasonably possible that the total amounts of unrecognized tax benefits will significantly increase or decrease within 12 months of the reporting date," companies must disclose:

> 1. The nature of the uncertainty
>
> 2. The nature of the event that could occur in the next 12 months that would cause the change
>
> 3. An estimate of the range of the reasonably possible change or a statement that an estimate of the range cannot be made.

The SEC staff has commented when a registrant does not provide the tabular reconciliation of unrecognized tax benefits. A registrant either that has no unrecognized tax benefits or for which such benefits are immaterial should consider disclosing that fact. In addition, the SEC staff expects registrants to provide more transparent disclosures about reasonably possible changes in unrecognized tax benefits. The guidance on the acceptable level of aggregation of information for these disclosures is not prescriptive and allows for judgment. Therefore, the SEC staff is evaluating registrants' level of disclosure on a case-by-case basis.

Examples of what registrants should disclose pursuant to ASC 740-10-50-15(d) include the following:

- *Information related to scheduled expiration of the tax position's statute of limitations* — A registrant should disclose this information if (1) the statute of limitations is scheduled to expire within 12 months of the financial statement's date and (2) management believes it reasonably possible that the statute's expiration will cause the total amounts of unrecognized tax benefits to significantly increase or decrease.
- *Significant unrecognized tax benefits for tax positions that the registrant believes will be effectively settled in accordance with ASC 740-10-25-9 (formerly paragraph 3 of FSP FIN 48-1).*

The SEC staff is expected to continue to closely scrutinize the application of and disclosures related to unrecognized tax benefits and to issue comments on this topic.

MD&A Considerations

Example of an SEC Comment

- We note you indicate that [Company A] has projected that no payments would be made during the next twelve months for any contingent obligation arising from your unrecognized tax benefits. You also indicate that [Company A] is unable to accurately estimate the timing of such payment and accordingly, you have excluded the unrecognized tax benefits from your contingent obligation table. Please note while management may apply its judgment in determining what items should be included or excluded from the table, if management's judgment results in items being excluded then the accompanying footnotes should describe the nature of the items excluded and why they are excluded. Please revise your disclosures in future filings to include a discussion of [Company A's] contingent obligations arising from your unrecognized tax benefits and the reasons such amounts were excluded from your contractual obligation table.

Registrants must include in the MD&A section a tabular disclosure of all known contractual obligations.[1] According to discussions at the April 17, 2007, SEC Regulations Committee Joint Meeting With the SEC Staff, a registrant should include liabilities for unrecognized tax benefits in the tabular disclosure of contractual obligations in MD&A if it can make reasonably reliable estimates about the liabilities' period of cash settlement. For example, if any liabilities for unrecognized tax benefits are classified as current liabilities in the registrant's balance sheet, a registrant should include that amount in the "less than 1 year" column of its contractual obligations table. Similarly, the contractual obligations table should include any noncurrent liabilities for unrecognized tax benefits for which the registrant can make a reasonably reliable estimate of the amount and period of related future payments (e.g., uncertain tax positions subject to an ongoing examination by the respective taxing authority for which settlement is expected to occur after the next operating cycle).

Often, however, the timing of future cash outflows associated with some liabilities for unrecognized tax benefits is highly uncertain. For such liabilities, a registrant might be unable to make reasonably reliable estimates of the period of cash settlement with the respective taxing authority (e.g., unrecognized tax benefits for which the statute of limitations might expire without examination by the respective taxing authority). In such cases, a registrant could exclude liabilities for unrecognized tax benefits from the contractual obligations table or disclose such amounts within an "other" column added to the table. If any liabilities for unrecognized tax benefits are excluded from the contractual obligations table, a footnote to the table should disclose the amounts excluded and the reason for the exclusion.

Registrants should also consider the adequacy of their critical accounting policy disclosures about income taxes. The SEC staff defines a critical accounting policy as one that (1) "is important to the portrayal of the company's financial condition and results" and (2) "requires management's most difficult, subjective, or complex judgments." The SEC staff focuses on the "importance of providing investors with an understanding about how management forms its judgments about future events, including the variables and assumptions underlying the estimates, and the sensitivity of those judgments to different circumstances."

Repatriation of Foreign Earnings

Example of an SEC Comment

- Foreign earnings indefinitely reinvested overseas reduced your effective tax rate by 15% in 2008 compared to 2% in 2007 and 2006. Under Risk Factors . . . you disclose that you may be required to record additional income taxes on a future distribution of any unremitted foreign earnings and that such a distribution could have an adverse effect on your financial position, results of operations and cash flows. Please disclose the following:
  - o The impact, if material, from earnings that are taxed at rates other than the U.S. statutory rate;
  - o Specific plans for the reinvestment of the undistributed earnings in accordance with [ASC 740-30-25-17 and 25-19 (formerly paragraph 12 of Opinion 23)];
  - o A description of the types of temporary differences for which a deferred tax liability has not been recognized and the types of events that would cause those differences to become taxable in accordance with [ASC 740-30-50-2(a) (formerly paragraph 44(a) of Statement 109)]; and
  - o The factors management considered in concluding that there is sufficient evidence that your foreign subsidiaries have invested or will invest the undistributed earnings indefinitely.

In the current economic environment, entities may need to repatriate cash from foreign subsidiaries. ASC 740-30-25-19 (formerly paragraph 12 of Opinion 23) states that "[i]f circumstances change and it becomes apparent that some or all of the undistributed earnings of a subsidiary will be remitted in the foreseeable future but income taxes have not been recognized by the parent entity, it shall accrue **as an expense of the current period income taxes attributable to that remittance**" (emphasis added).

At the 2008 AICPA Conference, Mr. Steven Jacobs, associate chief accountant in the SEC's Division of Corporation Finance, warned that the repatriation of foreign earnings may trigger a tax accounting consequence. He recommended disclosure of the current and anticipated effects of the repatriation of foreign earnings on the entity. In addition, he recommended MD&A disclosure if the entity's need to repatriate foreign earnings is uncertain. Such disclosure might include the likelihood that repatriation of foreign earnings will occur and the likely effect on future earnings.

Other Deloitte Resources

- April 9, 2009, *Heads Up*, "IASB Proposes Changes to Income Tax Accounting."

[1] In accordance with Regulation S-K, Item 303(a)(5).

Internal Control Over Financial Reporting

Registrants must annually provide management's report on internal control over financial reporting (ICFR) and the attestation report of their registered public accounting firm,[1] and must, on a quarterly basis, provide a discussion of changes in ICFR.[2]

Disclosure of Attestation Report of the Registered Public Accounting Firm

Example of an SEC Comment

- Your management report on internal control over financial reporting should contain a statement that your registered public accounting firm has issued an attestation report on your internal control over financial reporting. Refer to Item 308(a)(4) of Regulation S-K.

A registrant must, in accordance with Regulation S-K, Item 308(a)(4), state in management's annual report on ICFR that it has obtained and included in the filing the attestation report issued by the registered public accounting firm that audited its financial statements. The SEC staff has issued comments to registrants that have omitted this statement.

Disclosure of Significant Changes in Internal Control Over Financial Reporting

Example of an SEC Comment

- We note your disclosure that "[t]here has been no other change in your internal control over financial reporting." In future filings, please revise to state clearly, if true, that there were changes in your internal control over financial reporting that occurred during the period covered by this report that have materially affected, or are reasonably likely to materially affect, your internal control over financial reporting and disclose those changes.

The SEC staff has also commented when a registrant has not explicitly and clearly asserted whether there has been a change in ICFR in the last fiscal quarter that had or could have a material effect on its ICFR, as required by Regulation S-K, Item 308(c). Registrants should state clearly either that there were no changes in ICFR for the quarter or that there were changes and disclose the nature of the changes accordingly.

Disclosure of the Framework Used to Evaluate Internal Control Over Financial Reporting

Example of an SEC Comment

- Please tell us what framework you used to evaluate your internal control over financial reporting. In this connection, please confirm in future filings you will identify the framework used by management to evaluate the effectiveness of your internal controls over financial reporting in accordance with Item 308(a)(2) of Regulation S-K.

The SEC staff often comments when registrants do not disclose the framework used to evaluate the effectiveness of ICFR. At the 2008 AICPA Conference, Mr. Paul Beswick, deputy chief accountant for professional practice in the SEC's Office of the Chief Accountant, cited specific examples in which management's statement referring to the framework used to evaluate the effectiveness of ICFR was omitted, as well as instances in which management inappropriately referred to the SEC's management guidance or COSO's small-company guidance as the framework used for the evaluation. The SEC staff may ask a registrant to advise the staff of the appropriate framework used in the current year and to revise the disclosures in current and future filings.

[1] On October 2, 2009, the SEC announced that it will allow nonaccelerated filers an additional six-month deferral (from years ending on or after December 15, 2009, to years ending on or after June 15, 2010) from complying with SEC rules requiring that a registrant's annual reports include an auditor's attestation report on the registrant's internal control over financial reporting.

[2] Pursuant to Part I — Item 4 of Form 10-Q and Part II — Item 9A of Form 10-K.

Disclosures of the Impact and the Remediation of Material Weaknesses

Examples of SEC Comments

- Please tell us the potential impact of the material weakness disclosed in the last paragraph on internal control over financial reporting and your plans to remediate the weakness.
- You disclose the measures implemented during the applicable quarter to improve your internal control over financial reporting and indicate that this material weakness had not been remedied as of the end of the applicable periods. In future filings, please provide an estimated timetable for remediation and any associated material costs.

Also at the 2008 AICPA Conference, Mr. Marc Panucci, associate chief accountant in the SEC's Office of the Chief Accountant, indicated that management's disclosures of material weaknesses should go beyond merely identifying the existence of one or more material weaknesses or providing only a limited description. Rather, he indicated that in making such disclosures, registrants should provide enough information to allow investors to understand the cause of a material weakness and determine the pervasiveness of its effect on ICFR. Therefore, the SEC staff may request additional disclosure.

The staff has also issued comments specifically on management's plans to remediate weaknesses identified. The staff has asked registrants that have identified a material weakness to discuss (1) management's plans to remediate the weakness, (2) the estimated timing of its remediation efforts, and (3) the related material costs.

At the 2008 AICPA Conference, Mr. Panucci further noted that in certain instances, the SEC has observed that management's discussion of the remediation plans has called into question the validity and completeness of management's material weakness disclosures. Sometimes the remediation plans are broader than the material weakness, which would seem to indicate that the material weakness is actually more pervasive than disclosed or that another material weakness may exist that was not identified and disclosed. Mr Panucci suggested that while the SEC staff encourages robust disclosure of remediation plans, registrants should consider the root cause of an issue and whether it has a broader impact or highlights a more pervasive issue in the entity's ICFR.

Investments

Other-Than-Temporary Impairment (OTTI)

Examples of SEC Comments

- The discussion of how the company accounts for its [investments] when they are considered to be [temporarily] impaired should be expanded to address how the company assesses whether or not there has been an other-than-temporary impairment of the [investments] and if such is identified, the subsequent accounting.
- We note the significant amount of . . . unrealized losses of 12 months or more and the significance of the total of unrealized losses in this category of available for sale investments. Please tell us . . . how you considered the duration and severity of these losses in determining that the securities were not other-than-temporarily impaired.

Last year, the SEC staff significantly increased its focus on OTTI, primarily because of the prolonged deterioration in the credit markets and the significant decline in value of many investments (e.g., asset-backed securities, mortgage-backed securities, auction rate securities, corporate debt, perpetual preferred stock, equity securities). In the current year, OTTI continues to be a focus for the SEC staff as well as for standard setters. In response to the credit crisis, the FASB revised its impairment guidance by issuing first FSP EITF 99-20-1 (codified in ASC 325-40-35), then FSP FAS 115-2 and FAS 124-2 (codified in ASC 320-10-35).

The staff may request a registrant to support its conclusion that unrealized losses are temporary. Moreover, the staff has requested that registrants disclose how they determined the fair value of their investments, including the amount of any impairment loss (if not disclosed separately). In addition, the staff has asked what factors, negative and positive, the registrant used in determining whether the investment was other-than-temporarily impaired. The staff may also question whether the impairment was recorded in the appropriate period and may ask what factors have changed since the last reporting period and how the registrant has considered these changes.

Note that the OTTI model for equity securities has not changed. Accordingly, entities should continue to apply the impairment guidance for equity securities in SAB Topic 5.M. Under SAB Topic 5.M, an entity should consider the following factors, either individually or in combination with other factors, when evaluating an equity security for OTTI:

- Length of time and extent of impairment.
- Financial condition and near-term prospects of the issuer.
- Ability and intent to hold the security until recovery.

At the 2008 AICPA Conference, James Kroeker, deputy chief accountant (now chief accountant) in the SEC's Office of the Chief Accountant, addressed questions about determining when an investment is other-than-temporarily impaired. He stated that because the SEC has no "bright lines" or "safe harbors," the determination must be based on individual facts and circumstances.

OTTI Disclosures

Examples of SEC Comments

- While we note the factors you consider in determining whether a security is other-than-temporarily impaired, it is not clear from your current disclosure, the specific factors and changes in circumstances that lead you to record these impairment charges. Tell us how you considered enhancing your disclosures to better explain the specific factors that lead to such charges. In this regard, please consider separating your discussion of such factors between (a) credit related issues or other adverse issuer conditions and (b) other accounting consequences. . . . In addition, tell us how you considered these same factors in concluding that the remaining portion of your mortgage-backed, asset-backed and corporate bond portfolios were only temporarily impaired.
- You also disclose that you recognize investment income using the effective-yield method based on estimated cash flows. Please revise your disclosures to discuss the level of recent cash flows compared to the projected cash flows underlying your asset and mortgage-backed securities when the transactions were originated. In those cases where the monthly cash flows during the fourth quarter are materially lower than the originally projected cash flows please tell us the factors considered in concluding that the investments are not impaired. Please also enhance the disclosures related to unrealized losses on your various asset and mortgage-backed securities, to support your assertion that you will collect all of the estimated cash flows.

Examples of SEC Comments (continued)

- It appears that the other-than-temporary impairment on your investments . . . significantly affected your income for the periods then ended. Since you continue to have significant unrealized losses . . ., please provide us the following information in a disclosure-type format: (1) describe the circumstances giving rise to the loss, (2) describe whether, and how, those circumstances impact other material investments held, and (3) explain why you believe that the fair value will increase enough for you to recover your cost.
- Your presentation of net securities gains on the face of your consolidated statement of income indicates that you recognized [$XX million] of other-than-temporary impairments (OTTI) on investment securities in other comprehensive income during the first quarter of 2009. It is not clear . . . where this amount is reported in your consolidated statement of shareholders' equity. Please revise your future filings to separately present amounts recognized in accumulated other comprehensive income . . . as required by [ASC 320-10-45-9A (formerly paragraph 16C of FSP FAS 115-1 and FAS 124-1, as amended by FSP FAS 115-2 and FAS 124-2)].
- [P]lease consider disclosing the amount of unrealized losses and fair value by security type by the lowest credit rating by at least one major rating agency. We believe disclosure of this level of detail [is] consistent with the guidance in [ASC 320-10-50-2 and 50-5 (formerly paragraph 19 of Statement 115, as amended by FSP FAS 115-2 and FAS 124-2)].

The SEC staff has frequently asked registrants to disclose (or to provide documentation supporting) how they concluded that an investment with a fair value below amortized cost is not other-than-temporarily impaired. In certain cases, the staff has requested detailed supporting documentation, including the (1) nature and characteristics of the investment, (2) circumstances or reasons for the loss, and (3) methods the registrant used and factors the registrant considered in concluding that the investment is only temporarily impaired. Because of the revised debt impairment model under ASC 320-10-35 (formerly Statement 115 and FSP FAS 115-1 and FAS 124-1), the SEC staff provided, at the June 23, 2009, CAQ SEC Regulations Committee Joint Meeting With the SEC Staff, its observations about the disclosures furnished by early adopters. The staff indicated that its comments have focused on income statement presentation of OTTI (i.e., the portion of the OTTI recognized in other comprehensive income and the portion recognized in earnings). In addition, the staff has sought to understand, through disclosures, how entities measured the credit losses recognized in earnings under ASC 320-10-35 and the related inputs and assumptions by major security type.

Valuations

In conjunction with its comments on OTTI, the SEC staff continues to comment on a registrant's valuation methods, specifically the inputs and assumptions the registrant used to determine a security's fair value. See the Fair Value and the Turmoil in the Credit Markets section for more information about valuation-related comments.

Other Deloitte Resources

- Financial Reporting Alert 09-1, "Impact of Credit Downgrades on the OTTI Analysis of Perpetual Preferred Securities."
- November 17, 2009, *Heads Up*, "IASB Issues IFRS on Classification and Measurement of Financial Assets."
- August 18, 2009, *Heads Up*, "FASB Continues Deliberations on Financial Instruments and Decides on Presentation."
- July 27, 2009, *Heads Up*, "IASB Issues Exposure Draft and FASB Initiates Deliberations on New Classification and Measurement Requirements for Financial Assets and Financial Liabilities."
- April 14, 2009, *Heads Up*, "FASB Issues Guidance on Measuring Fair Value When Market Activity Declines, Other-Than-Temporary Impairments, and Interim Fair Value Disclosures."
- February 3, 2009, *Heads Up*, "FASB Issues Proposal on Interim Disclosure of Financial Instruments."
- January 16, 2009, *Heads Up*, "FASB Issues Amendments to OTTI Model for Certain Investments in Securitizations."
- January 9, 2009, *Heads Up*, "Study Finalized on Mark-to-Market Accounting."

Management's Discussion and Analysis

The SEC has repeatedly stressed the importance of MD&A to an investor's evaluation of his or her investment. In a speech on October 2, 2009, at the 48th Annual Corporate Counsel Institute of the Northwestern University School of Law, SEC Commissioner Elisse B. Walter stated:

> [The SEC's] efforts have been extensive, but, in my view, corporate MD&As are still not where they should be. I would like to see [registrants] recognize trends and uncertainties sooner; make reasonable likelihood determinations before they become more likely than not; and disclose this information to investors so that they can make their own, fully-informed investment decisions. And these disclosures should be made in a way that communicates to shareholders. I call on [registrants] to do everything that [they] can to assure that [they] provide disclosure that enables their owners, the shareholders, to view the [registrant] and its prospects through the eyes of its insiders.

Current Economic Environment

Example of an SEC Comment

- Please expand MD&A to provide a discussion of recent economic events and their current and expected future impact on your operations, financial position, and liquidity. This disclosure should provide detailed information regarding your customers, recent order activity, expected trends, management's response to managing these events, potential future actions by management, and any other detailed information that would help investors better understand how your operations, financial position, and liquidity are being impacted by the current economic environment. Expand your liquidity discussion to address the expected impact to current and future cash flows and how you expect recent economic events, including the credit shortage, may affect other sources of liquidity.

At the 2008 AICPA Conference, several SEC staff members discussed the need for registrants to adequately address in MD&A how the current market environment is affecting their results of operations, liquidity and capital resources, and critical accounting policies. In addition, registrants should thoroughly discuss the expected impact of the current economic environment on their business as well as any material opportunities, risks, and uncertainties. At the 2008 Conference, the staff addressed several items registrants should consider in preparing their filings, including impairments, pension funding requirements, and the realization of any deferred tax assets. (For more information, see Deloitte's *Heads Up* on the 2008 Conference. Also see the Business Combinations, Long-Lived Assets, and Impairments section for more information about MD&A disclosures regarding goodwill and long-lived-asset impairments, the Pensions and Other Postretirement Benefits section for more information about MD&A disclosures regarding pension funding requirements, and the Income Taxes and Uncertain Tax Positions section for more information about MD&A disclosures regarding a registrant's assessment of the realizability of deferred tax assets.)

Results of Operations

Examples of SEC Comments

- Please revise the discussion of your results of operations to indicate whether the changes represent trends expected to continue into the future. Also discuss any other known trends, demands, commitments, events or uncertainties that will, or are reasonably likely to have, a material effect on financial condition and/or operating performance.
- Your discussion regarding results of operations should not consist merely of numeric dollar and percentage changes measured from period to period of various line items on the income statement. You should address the underlying reasons for changes in the price versus volume mix. . . . The focus should be on an analysis of the factors that caused these changes to occur. In providing this analysis, you may find it helpful to include a discussion of key variables and financial measures management is utilizing in managing the business. These variables may be non-financial in nature or may represent industry specific metrics.

Regarding the "results of operations" section of MD&A, the SEC staff frequently comments on how registrants can improve their discussion and analysis of known trends, demands, commitments, events, and uncertainties, as well as on how they can provide better forward-looking information. This discussion and analysis is crucial to understanding the quality of, and potential variability in, a company's earnings and cash flows, as well as the extent to which reported results are indicative of future performance. A determination of whether such disclosure is required generally should include:

- Consideration of financial, operational, and other information.

- Identification of known trends and uncertainties.
- Assessment of whether these trends and uncertainties will have, or are reasonably likely to have, a material impact on the company's financial condition and operating performance.

Quantitative disclosure of the effects of known trends and uncertainties should be considered if such information is material and reasonably available. The discussion should offer insight into management's short-term and long-term focus (i.e., material opportunities, challenges, and risks) and the actions management intends to take.

Many of the SEC staff's comments on the results of operations section of MD&A deal with such quantitative analyses. The staff expects registrants to quantify, in their narrative explanations, specific reasons for the fluctuations for year-to-year or period-to-period changes, particularly when multiple factors are contributing to such changes. The SEC staff encourages registrants to do the following to enhance their disclosures:

- Increase the use of tables, when appropriate, to present dollar and percentage changes to support the narrative text and to quantify material individual factors contributing to such changes.
- Focus the narrative disclosure on an analysis of the underlying business reasons for the individual factors in the tables.
- Quantify the effects of changes in both price and volume on revenue and expense categories.

Supplemental MD&A Based on Pro Forma Financial Information

While supplemental disclosures based on pro forma financial information are not required, at the 2007 AICPA Conference, Mr. Steven Jacobs, associate chief accountant in the SEC's Division of Corporation Finance, stated that supplemental MD&A may more relevantly and fully address trends and changes in registrants' results of operations.[1]

In a manner consistent with Mr. Jacobs's remarks,[2] paragraph 9220.5 of the SEC Financial Reporting Manual indicates that registrants should consider using supplemental MD&A disclosures based on pro forma financial information in the following circumstances:

> a. When there has been a material acquisition (either the acquisition of a target entity that is significant to the registrant or predecessor/successor step-up in basis) during the period;
>
> b. When pushdown accounting has been applied; or
>
> c. When the registrant has adopted fresh-start accounting upon its emergence from bankruptcy.

Paragraph 9220.6 highlights that in determining whether to include supplemental pro forma MD&A, registrants should consider all the facts and circumstances associated with the transaction, the nature of pro forma adjustments, and the overall relevance of the supplemental discussion.

Liquidity and Capital Resources

Example of an SEC Comment

- We remind you that Item 303(a)(1) and (2) of Regulation S-K states that you should discuss known trends or any known demands, commitments, events or uncertainties that will result in or are reasonably likely to impact your liquidity in any material way as well as any material changes in the mix or relative cost of your capital resources. Given the market developments . . . please expand your disclosures to address the current and potential future impact of these developments on your liquidity and capital resources.

The SEC staff frequently requests more meaningful analysis, in a registrant's MD&A, of material cash requirements, historical sources and uses of cash, and material trends and uncertainties so that investors can understand the registrant's ability to generate cash and meet cash requirements. In addition, registrants must disclose significant developments in liquidity or capital resources that occur after the balance sheet date.

Rather than repeating items that are reported in the cash flow statements, a registrant should concentrate on disclosing the primary drivers of cash flows and the reasons for material changes in specific items underlying the major captions reported in the registrant's financial statements. Registrants should also consider whether they need to provide enhanced disclosures about significant debt instruments, guarantees, and covenants. See the Debt section for more information about financial covenant disclosures in MD&A.

[1] The supplemental MD&A presentation is in addition to, and not in lieu of, the historical MD&A discussion.

[2] For additional information about Mr. Jacobs's remarks, see Deloitte's *Heads Up* on the 2007 AICPA Conference.

Given the current economic environment, registrants should also discuss the current and future impact of market developments on their liquidity and capital resources.

Off-Balance-Sheet Arrangements

Example of an SEC Comment

- We do not see where you have provided the information required by Item 303(a)(4) of Regulation S-K. Please tell us if you have any off-balance-sheet arrangements that have or are reasonably likely to have a current or future effect on your financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources. Revise future filings to include the disclosures required by Item 303(a)(4) of Regulation S-K.

The SEC staff continues to focus on the requirement that registrants include a discussion of off-balance-sheet arrangements [3] in a separately captioned section in MD&A. The discussion should contain information that the registrant believes investors must understand concerning the material effects of these arrangements, including the following:

- The nature and business purpose of the arrangement.
- The importance of the arrangement.
- The financial impact of the arrangement and exposure to risk as a result of the arrangement.
- Known events, demands, commitments, trends, or uncertainties that affect the availability or benefit of the arrangement.

Paragraph 9230.2 of the SEC Financial Reporting Manual notes that "[t]hese requirements are intended to elicit disclosure about why the registrant engages in the off-balance sheet arrangement, the magnitude and importance of the arrangement and the circumstances that would cause the registrant to recognize material liabilities or losses related to the arrangement."

In December 2007, the Division of Corporation Finance sent a letter requesting that registrants' MD&A contain additional disclosures about exposures to off-balance-sheet entities. Some themes that the Division suggested these disclosures focus on include the following:

- Any material difficulties that off-balance-sheet entities are experiencing (including asset write-downs or credit downgrades) and the effect on the registrant.
- Detailed disclosure of support the registrant has provided, or is obligated to provide, to off-balance-sheet entities (including obligations to provide liquidity).
- The potential effect on debt covenants, capital ratios, credit ratings, or dividends, should the registrant have to consolidate or incur losses associated with the entities.

In the letter, the SEC staff also provided specific disclosure considerations for the "critical accounting policies" section of MD&A (discussed below) for registrants that have identified as a critical accounting policy the accounting for consolidation of variable interest entities.

Tabular Disclosure of Contractual Obligations

Example of an SEC Comment

- Please revise the table of contractual obligations to include estimated interest payments on your debt and post retirement benefit payments. Because the table is aimed at increasing transparency of cash flow, we believe these payments should be included in the table. Please also disclose any assumptions you made to derive these amounts.

The SEC staff continues to issue comments on the contractual obligations table and the associated notes and disclosures. Such comments typically focus on (1) a registrant's omission of material obligations, such as interest payments on debt, pension obligations, and uncertain tax position liabilities, and (2) omission of disclosures about the terms of obligations, such as purchase obligations. (See the Income Taxes and Uncertain Tax Positions section and the Pensions and Other Postretirement Benefits section for more information about ASC 740-10 (formerly Interpretation 48) liabilities and pension funding obligations, respectively, and the contractual obligations table.)

[3] See Regulation S-K, Item 303(a)(4)(ii), for the definition of off-balance-sheet arrangements for these purposes.

To the extent that the obligations cannot be quantified, the SEC staff expects registrants to disclose information that investors and users need to understand the nature and extent of the registrant's obligations. As indicated in paragraph 9240.6 of the SEC Financial Reporting Manual, registrants may include footnotes "to describe provisions that create, increase or accelerate obligations, or other pertinent data to the extent necessary for an understanding of the timing and amount of the registrant's specified contractual obligations."

Critical Accounting Policies

Example of an SEC Comment

- We believe your disclosure regarding critical accounting estimates could be improved to better explain the judgments and uncertainties surrounding each estimate and the potential impact on your financial statements. We believe in order to meet the principal objectives of MD&A you should revise your disclosure to enable an investor to understand 1) management's method for establishing the estimate; 2) to what extent and why management has adjusted its assumptions used to determine the estimate from the assumptions used in the immediately preceding period and 3) the potential variability in the most recent estimate and the impact this variability may have on reported results, financial condition and liquidity. If the changes in estimates have not historically been material, disclose this fact.

This section of MD&A should focus only on those financial statement items that require significant management estimates and judgment. Registrants should not simply copy their accounting policy disclosure from the footnotes to the financial statements. Instead, the SEC staff expects discussion and analysis of material uncertainties associated with the methods and assumptions underlying each critical accounting estimate.

To provide comprehensive and meaningful disclosures, management should consider disclosing the following items in the "critical accounting policies" section of MD&A:

- How critical accounting estimates are determined.
- How accurate the estimates or assumptions have been in the past.
- How much the estimates or assumptions have changed.
- What drivers are affecting variability.
- What estimates or assumptions are reasonably likely to change in the future.

In addition, registrants should include an analysis of the sensitivity of estimates to change on the basis of outcomes that are reasonably likely to occur and that would have a material effect. The sensitivity analysis should be quantitative if such information is reasonably available.

See the Fair Value and the Turmoil in the Credit Markets section for information about letters sent by the SEC's Division of Corporation Finance in March and September 2008 to certain registrants concerning additional MD&A disclosure considerations regarding fair value.

Other Deloitte Resources

- *SEC Interpretation: Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations.* (Request a copy.)
- Financial Reporting Alert 09-3, "SEC Advises Registrants to Further Explain Provisions and Allowances for Loan Losses in MD&A."
- Financial Reporting Alert 08-10, "SEC Advises Registrants to Further Explain Fair Value in MD&A — An Addendum to the March 2008 Letter."
- Financial Reporting Alert 08-7, "SEC Advises Registrants to Further Explain Fair Value in MD&A."
- Financial Reporting Alert 08-4, "Turmoil in the Credit Markets: The Importance of Comprehensive and Informative Disclosures."

Material Contracts

Examples of SEC Comments

- Please file complete copies of material agreements, including all exhibits, schedules and attachments. See Item 601(b)(10) of Regulation S-K.
- Please file as an exhibit a copy of your lease agreement with [ABC Company] regarding your new corporate headquarters, or advise us why you are not required to do so. Please refer to Item 601(b)(10)(ii)(D) of Regulation S-K.
- You indicate in [the Business] section that [XX%] of the revenue earned . . . was obtained from customers of [XYZ Company]. In your response letter, please describe your contractual arrangements with . . . its clients. Please provide your analysis as to whether any such agreements should be filed as exhibits to your Form 10-K. See Item 601(b)(10)(ii)(B) of Regulation S-K.
- Please tell us why you have not filed the following agreements as exhibits to your Form 10-K pursuant to Item 601(b)(10) of Regulation S-K. . . . It appears that the [annual incentive plan] is a compensatory plan in which your named executive officers participate which is deemed material and required to be filed pursuant to Item 601(b)(10)(iii)(A) of Regulation S-K.

Regulation S-K, Item 601, requires that registrants file, as an exhibit, material contracts that are executed, amended, or modified, or that become effective, during a reporting period. The SEC staff often comments when registrants omit certain material agreements.

Item 601(b)(10) requires a registrant to file:

- Every material contract that is "not made in the ordinary course of business."
- Any material contract "made in the ordinary course of business":
  - With certain parties, such as directors, officers, promoters, voting trustees, certain security holders, or underwriters, other than contracts involving only the purchase or sale of current assets at a price that equals a determinable market price.
  - On which the registrant's business is substantially dependent.
  - For the acquisition or disposition of any property, plant, or equipment for consideration exceeding 15 percent of the registrant's total consolidated fixed assets.
  - For a lease under which part of the property is held by the registrant.
- Generally,[1] any management contract or compensatory plan, contract, or arrangement in which a director or named executive officer of the registrant participates (such contracts are considered material) and any other material management contract or any other compensatory plan, contract, or arrangement in which any other executive officer of the registrant participates.
- Any other material compensatory plan, contract, or arrangement "adopted without the approval of security holders pursuant to which equity may be awarded" in which any employee of the registrant (i.e., regardless of whether the employee is an executive officer) participates.

Registrants may be asked to explain why a contract is not material and should not be filed as an exhibit.

[1] For examples of management contracts or compensatory plans, contracts, or arrangements that are exempt from this filing requirement, see Item 601(b)(10)(iii)(C).

Noncontrolling Interests

Example of an SEC Comment

- Please revise your future filings to provide a reconciliation at the beginning and the end of the period of the carrying amount of total equity, equity attributable to the parent, and equity attributable to the noncontrolling interest. Please show us in your supplemental response what the revisions will look like. As described in [ASC 810-10-50-1A(c) (formerly paragraph 38(c) of ARB 51, as amended by Statement 160)], the reconciliation should separately disclose: (1) net income, (2) transactions with owners acting in their capacity as owners, showing separately contributions from and distributions to owners, and (3) each component of other comprehensive income.

The SEC staff has begun commenting on registrants' adoption of Statement 160 (codified in ASC 810-10)[1] for their quarterly filings. Comments thus far have focused on the Statement's expanded disclosure requirements. Statement 160 requires that net income include amounts attributable to the parent and the noncontrolling interest. In a change from ARB 51 (codified in ASC 810-10), Statement 160 also requires disclosure, on the face of the consolidated statement of income, of the amounts of consolidated net income and comprehensive income that are attributable to the parent and the amounts attributable to the noncontrolling interest. Disclosures should also include a reconciliation of the beginning and ending balances of equity attributable to the parent and the noncontrolling interest. Finally, disclosure should include a schedule showing the effects on equity when a parent's ownership interest in a subsidiary changes.

ASC 810-10-50-1A (formerly paragraph 38 of ARB 51, as amended by Statement 160) requires "a parent with one or more less-than-wholly-owned subsidiaries to disclose either in the consolidated statement of changes in equity, if presented, or in the notes to consolidated financial statements, a reconciliation at the beginning and the end of the period of the carrying amount of total equity (net assets), equity (net assets) attributable to the parent, and equity (net assets) attributable to the noncontrolling interest." However, as noted at the June 23, 2009, CAQ SEC Regulations Committee Joint Meeting With the SEC Staff, SEC rules continue to prohibit including redeemable equity in a caption titled "total equity." Thus, registrants with redeemable noncontrolling interests, redeemable preferred stock, or other redeemable equity classified outside of permanent equity should not include these items in any total or subtotal caption titled "total equity." Further, changing the caption in the statement of changes in shareholders' equity from "total equity" to "total" does not make the inclusion of this redeemable equity acceptable. The following are acceptable alternatives for complying with the disclosure requirements:

- A registrant could provide a column for redeemable noncontrolling interests in the equity reconciliation but exclude amounts from any total column. Thus, the reconciliation could include a row for net income. Alternatively, the registrant could provide a supplemental table to show the allocation of net income among controlling interests, nonredeemable noncontrolling interests, and redeemable noncontrolling interests.
- A registrant could exclude redeemable noncontrolling interests from the equity reconciliation and provide a supplemental table, either in the notes to the financial statements or the statement of changes in equity and noncontrolling interests, that reconciles beginning and ending balances of redeemable noncontrolling interests. The "net income" caption in the equity reconciliation could note parenthetically amounts allocated to redeemable equity.

[1] Statement 160 (codified in ASC 810-10) is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008 (i.e., January 1, 2009, for calendar-year-end registrants). Statement 160 must be applied prospectively as of the beginning of the fiscal year in which it is initially applied, except for the presentation and disclosure requirements, which must be applied retrospectively for all periods presented. (See the SEC Reporting section for reporting considerations regarding the retrospective presentation and disclosure requirements of Statement 160.)

Non-GAAP Measures

Disclosures

Example of an SEC Comment

- We appreciate your response to prior comment [X]. However, it continues to appear to us that the non-GAAP measure you present does not comply with the guidance in Item 10 of Regulation S-K and Question 8 of the SEC "Frequently Asked Questions Regarding the Use of Non-GAAP Financial Measures." Therefore, if you choose to continue to present this measure, please revise your disclosure in future filings to address the following:
    - o Include a comprehensive discussion regarding how management uses the measure to evaluate the business;
    - o Discuss the material limitations associated with the measure and how management compensates for these limitations; and
    - o Provide a more specific and comprehensive discussion regarding why management believes the measure provides useful information to investors.

A non-GAAP financial measure is a "numerical measure of a registrant's historical or future financial performance, financial position, or cash flows" that includes amounts that are not part of the most directly comparable GAAP measure (e.g., free cash flows) or excludes amounts that are part of the most directly comparable GAAP measure[1] (e.g., EBITDA[2]).Examples of some common non-GAAP measures include EBITDA/adjusted EBITDA, adjusted revenues, free cash flows, core earnings, and funds from operations. The SEC staff's comments on non-GAAP measures primarily focus on the level of a company's disclosures and whether the disclosures demonstrate the purpose of the measures and their usefulness to investors. Regulation S-K, Item 10(e)(1)(i), states that the following information should accompany a company's disclosure of non-GAAP measures:

(A) A presentation, with equal or greater prominence, of the most directly comparable financial measure or measures calculated and presented in accordance with Generally Accepted Accounting Principles (GAAP);

(B) A reconciliation (by schedule or other clearly understandable method), which shall be quantitative for historical non-GAAP financial measures presented, and quantitative, to the extent available without unreasonable efforts, for forward-looking information, of the differences between the non-GAAP financial measure disclosed or released with the most directly comparable financial measure or measures calculated and presented in accordance with GAAP[;]

(C) A statement disclosing the reasons why the registrant's management believes that presentation of the non-GAAP financial measure provides useful information to investors regarding the registrant's financial condition and results of operations; and

(D) To the extent material, a statement disclosing the additional purposes, if any, for which the registrant's management uses the non-GAAP financial measure that are not [otherwise] disclosed.

Section 8160 of the SEC Financial Reporting Manual (FRM)[3] provides guidance on common disclosure issues associated with non-GAAP measures. These issues include:

- Lack of explanations regarding the non-GAAP measure (e.g., not disclosing the manner in which management uses the non-GAAP measure to conduct or evaluate its business).
- Undue authority or prominence of non-GAAP measures (e.g., not presenting the most directly comparable GAAP measure in reasonable proximity to the non-GAAP measure).
- Title of non-GAAP measures (e.g., titles should not be confusingly similar to those of GAAP measures).
- Reconciliation issues (e.g., presentation of a non-GAAP income statement is not appropriate).
- Measures not comparable (e.g., a registrant should alert investors to the fact that the measure presented may not be comparable to similarly titled measures reported by other registrants).
- Measure of operating performance versus liquidity (e.g., disclosure indicates a liquidity measure but the registrant reconciled the non-GAAP measure to a performance measure, such as net income).

[1] As defined in Final Rule 33-8176.

[2] Earnings before income taxes, depreciation, and amortization.

[3] The FRM, issued in December 2008 (updated in April and July 2009), extensively revised the guidance on non-GAAP measures from its predecessor, the SEC Staff Training Manual.

In addition to SEC staff interpretations in the FRM, other resources on non-GAAP measures include Regulation S-K, Item 10(e); Regulation G; SEC Final Rule 33-8176; and the SEC's *Frequently Asked Questions Regarding the Use of Non-GAAP Financial Measures*.

Recently, the SEC staff has informally indicated that it expects consistency between (1) the measures identified as key metrics on a registrant's Web site and in its press releases, earnings calls, and analyst presentations, and (2) the metrics provided in the registrant's SEC filings. We understand that the SEC staff may listen to analyst calls in certain circumstances. The staff may issue a comment letter if, during such an analyst call, a registrant discusses a non-GAAP financial measure that is omitted from, or contradicts, the information provided in the registrant's filings.

Other Deloitte Resources

- Booklet, *Conditions for Use of Non-GAAP Financial Measures* (available on Technical Library: The Deloitte Accounting Research Tool).

Pensions and Other Postretirement Benefits

Critical Accounting Estimates

Examples of SEC Comments

- Please expand your disclosure in future filings to explain the basis for the assumed rates of return for the investment categories in each plan. Explain how you have considered the recent adverse performance in the equity markets.
- Please expand your sensitivity analysis of critical accounting estimates to disclose changes based on other outcomes that are reasonably likely to occur and would have a material effect. For example, if . . . changes in the discount rate used in accounting for pension and other post-retirement benefits would have a material effect on income and/or financial position, disclose the impact that could result given the range of reasonably likely outcomes.

The SEC staff continues to comment on registrants' disclosures about key assumptions that represent critical inputs for calculating the pension obligation and fair value of plan assets. Given the recent volatility in the financial markets, comments this past year have focused on increased disclosures about (1) how registrants considered recent market performance in determining their key assumptions, (2) the impact of recent market performance on net periodic benefit cost and an entity's financial position, and (3) the impact of funding requirements on an entity's liquidity.

In addition, in recent comment letters, the SEC staff has been requesting sensitivity analyses for critical accounting estimates associated with an entity's pension obligations. These disclosures should focus on changes in key assumptions that are reasonably likely to occur and that could be material to an entity (e.g., changes in the discount rate used to calculate an entity's benefit obligation).

Liquidity and Capital Resources

Example of an SEC Comment

- We note at December 31, 2008 that approximately [X%] of your pension plan assets were represented by equity securities. In future filings please expand your discussion to include the impact market conditions have had on plan assumptions and the net periodic benefit cost, as well as the expected impact on future operations from a decrease in plan assets, change in expected return and amortization of actuarial loss. Please also address potential funding requirements relative to your accumulated benefit obligation and the implications to current and future liquidity resulting from potential incremental cash payments required to maintain funding requirements.

Regulation S-K, Item 303(a)(1), requires that management identify, and disclose in MD&A, known trends and uncertainties that affect liquidity. In the past, the SEC staff has requested that registrants expand their discussion about the impact of future pension funding requirements on liquidity. More recently, the staff has requested increased disclosure about the impact of the current volatility in the financial markets on a registrant's current and future liquidity that may result from increased payments and funding associated with its pension obligations. Such expanded disclosures may include information about the impact of reduced plan assets and changes in the assumption related to the long-term rate of return on funding requirements in light of recent market performance.

The SEC staff has also commented when registrants have omitted information about their pension and other postretirement benefit funding obligations from their contractual obligations table in MD&A if material contributions will be required. Registrants that exclude such information from the table should, at a minimum, disclose material pension funding obligations and explain why these amounts are not included in the table.

Market-Related Value of Plan Assets

Example of an SEC Comment

- Please explain to us and disclose how you calculate the market related value of plan assets as that term is defined in [ASC 715-30 (formerly Statement 87)]. Since there is an alternative to how you can calculate this item, and it has a direct effect on pension expense, we believe you should disclose how you determine this amount in accordance with [ASC 235-10-50-3 (formerly paragraph 12 of Opinion 22)].

In light of the impact on pension expense, the SEC staff has issued comments requesting entities to disclose their accounting policy election for calculating the market-related value of plan assets (e.g., either fair value or a calculated value, which allows asset-related gains and losses to be recognized in a systematic and rational manner over a period of no more than five years).

Other Deloitte Resources

- *A Roadmap to the Accounting and Regulatory Aspects of Postretirement Benefits: Including an Overview of Statement 158*.
- Financial Reporting Alert 09-5, "Financial Reporting Considerations for Pension and Other Postretirement Benefits."
- Financial Reporting Alert 08-10, "SEC Advises Registrants to Further Explain Fair Value in MD&A — An Addendum to the March 2008 SEC Letter."
- Financial Reporting Alert 08-4, "Turmoil in the Credit Markets: The Importance of Comprehensive and Informative Disclosures."
- January 9, 2009, *Heads Up*, "FASB Expands Disclosures About Postretirement Benefit Plan Assets."

Revenue Recognition

Multiple-Element Arrangements

Example of an SEC Comment

- Tell us how your separation of the installation services as a separate unit of accounting complies with [ASC 605-25 (formerly Issue 00-21)]. As part of your response, clarify how you have determined there is objective and reliable evidence of fair value of the hardware installation services; we refer you to [ASC 605-25-25-5 (formerly paragraph 9 of Issue 00-21)]. Further explain the basis for your revenue and expense recognition and timing for installation services.

The SEC staff often asks registrants about the nature of, and accounting for, their multiple-element arrangements and whether they evaluated these arrangements under ASC 605-25 (formerly Issue 00-21). The staff typically requests more extensive disclosures, and sometimes supplemental information, for multiple-element arrangements, including the following:

- The nature of the elements involved.
- The registrant's accounting policy for each element, including how revenue is allocated to it.
- The registrant's method for determining whether certain deliverables in an arrangement qualify as separate units of accounting.
- The registrant's support for its conclusion that the delivered item has stand-alone value.
- The timing of revenue recognition for each element.

The FASB recently issued ASU 2009-13 (formerly Issue 08-1), which reflects the EITF consensus and amends ASC 605-25. ASU 2009-13 significantly changes the accounting for revenue recognition for arrangements with multiple deliverables and expands the disclosures required by ASC 605-25. The ASU must be applied prospectively to revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, unless an entity elects retrospective application in accordance with ASC 250 (formerly Statement 154). Early adoption is permitted.

At the 2007 AICPA Conference, Mr. Mark Barrysmith, a professional accounting fellow in the SEC's Office of the Chief Accountant, discussed deliverables in the context of collaborative research and development arrangements. (For additional information, see Deloitte's *Heads Up* on the 2007 AICPA Conference.) He pointed out that the issues associated with these arrangements may also apply to other types of revenue arrangements. For example, Mr. Barrysmith noted that while the term "deliverable" is not defined in the accounting literature, "some have considered a deliverable to be an item that 1) is explicitly referred to as an obligation of the vendor in a contractual arrangement, 2) requires a distinct action by the vendor, 3) if not completed by the vendor would result in a significant contractual penalty, or 4) if included or excluded from the arrangement would cause the arrangement fee to vary by more than an insignificant amount."

Mr. Barrysmith said that when evaluating whether a vendor's obligations under an arrangement rise "to the level of a deliverable," entities should focus on their obligations under the arrangements and use the above criteria as a starting point. Collectively, these criteria, along with his remarks and the discussion of inconsequential or perfunctory deliverables in SAB 104, constitute a general principle that should be applied in multiple-element arrangements.

Software Revenue Recognition

Examples of SEC Comments

- We note your disclosures . . . and your reference to [ASC 985-605-15-3 (formerly Issue 03-5)]. Do the Company's products include software that is more than incidental . . . ? If so, please explain how your accounting for such product sales complies with [ASC 985-605-15-3] and [ASC 985-605 (formerly SOP 97-2)]. If not, then please explain the reference to this guidance in your disclosures.
- For multiple-element arrangements for which the PCS renewal rates are not stated in the contract, tell us how you determine VSOE for such arrangements pursuant to paragraph [ASC 985-605-25-6 (formerly paragraph 10 of SOP 97-2)]. Further, if your VSOE varies from customer to customer, explain how you can reasonably estimate fair value.

Applicability of ASC 985-605

ASC 985-605 (formerly SOP 97-2) provides guidance on when and how an entity should recognize revenue for software transactions. The SEC staff has increased its scrutiny in this area because it has recently seen a trend in which registrants that are not considered to be traditional software companies should be recognizing revenue under ASC 985-605 but are not. That is, these registrants are selling products that include software that is more than incidental to the arrangement, so the software-related elements are within the scope of ASC 985-605.

The SEC staff has focused on identifying situations in which these registrants should recognize revenue in accordance with ASC 985-605. If information in a registrant's filing indicates that the registrant's products or services include software, the staff typically asks the registrant to clarify whether the software is more than incidental and how the registrant is recognizing revenue for the deliverables. The staff has also requested registrants to discuss the applicability of ASC 985-605-15-3 (formerly Issue 03-5) to their arrangements. (ASC 985-605-15-3 clarifies which elements in an arrangement are within the scope of ASC 985-605.)

The FASB recently issued ASU 2009-14 (formerly Issue 09-3), which reflects the EITF consensus and amends ASC 985-605 (including ASC 985-605-15-3) to exclude from its scope certain tangible products that contain software that functions together with nonsoftware deliverables to deliver the tangible product's essential functionality. The ASU must be applied prospectively to revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, unless an entity elects retrospective application in accordance with ASC 250 (formerly Statement 154). Early adoption is permitted.

Vendor-Specific Objective Evidence (VSOE)

The establishment of VSOE of fair value can have a significant impact on revenue recognition in a software arrangement. If a vendor can establish VSOE of fair value for undelivered elements in an arrangement (e.g., postcontract support (PCS), specified upgrades), the vendor can separate the delivered elements (e.g., a software license) and recognize revenue when those elements are delivered. A vendor that cannot establish VSOE of fair value for an undelivered element must defer revenue in accordance with ASC 985-605-25-9 and 25-10 (formerly paragraph 12 of SOP 97-2).

Therefore, the SEC staff frequently asks registrants to provide detailed information about how VSOE is determined in software arrangements. Such information may include the following:

- If contractually stated renewal rates for PCS are used to establish VSOE, the percentage of customers that renew at these rates and how the rates are substantive in accordance with ASC 985-605-25-67 (formerly paragraph 57 of SOP 97-2).
- If PCS renewal rates are not contractually stated, or if a registrant does not use stated renewal rates to establish VSOE, an explanation of how the registrant determined VSOE.
- The impact that subsequent price negotiations with customers have on the registrant's ability to establish VSOE.
- A description of the process used to evaluate various factors that affect VSOE.
- A quantitative description of the volume and range of stand-alone sales used to establish VSOE and how the registrant accounts for contracts outside that range.
- If the registrant does not separate the deliverables in its software arrangements and therefore accounts for them ratably, an explanation of why the entity believes it is unable to determine VSOE for its undelivered elements.

Product and Service Revenue Presentation

At the 2007 AICPA Conference, Mr. Barrysmith discussed financial statement presentation of product and service revenue. SEC Regulation S-X, Rule 5-03(b), requires that product revenue and service revenue, along with other categories of revenue, be displayed separately in the income statement if they are greater than 10 percent of total revenues. (See the Financial Statement Classification section for additional information.) Mr. Barrysmith notes that a question often arises about how a vendor can adhere to this requirement when it is unable to separate its multiple-element arrangements under applicable revenue recognition guidance, such as ASC 605-25 or ASC 985-605.

Mr. Barrysmith indicated that because investors find the disaggregation of this information useful, the staff does not believe that the inability to separate deliverables for recognition purposes necessarily precludes separate display of product and service revenue. As long as there is a reasonable basis for the separation method and it is consistently applied, clearly disclosed, and not misleading, the SEC would not, according to Mr. Barrysmith, object to the separate presentation of product and service revenue. For example, for transactions within the scope of ASC 985-605, a comparison to third-party evidence of fair value for similar products or services may be appropriate. Likewise, the use of the residual method when a vendor customizes its products may also be appropriate. However, Mr. Barrysmith cautioned that a systemic allocation that is based solely on consistency or on contractually stated amounts would not be acceptable. He further noted that this view would apply to other revenue categories besides product and service revenue.

Revenue Recognition Disclosures

Examples of SEC Comments

- Your disclosure of your revenue recognition policy is too general. Please revise future filings to explain each significant revenue transaction and how you complied with the SAB Topic 13 guidance related to them.
- Please provide us in disclosure type format the amounts of estimated rebates, returns and chargebacks that are included in deferred revenues from product shipments. Regarding the amount of returns, tell us why you believe your estimate is reasonable considering the reason for deferring the revenue is due to your inability to reasonably estimate future returns.

The SEC staff often asks registrants to expand or clarify revenue recognition disclosures. Specifically, the staff requests registrants to include the following in their disclosures:

- The type, nature, and terms of significant revenue-generating transactions.
- The specific revenue recognition policy (including the manner in which revenue is recognized) for each type of transaction.
- An explanation of how the registrant's revenue recognition policy complies with SAB Topic 13 and other revenue recognition literature.
- Details of discounts, return policies, post-shipment obligations, customer acceptance, warranties, credits, rebates, and price protection or similar privileges and how these affect revenue recognition.

Depending on the complexity or subjectivity of entities' revenue recognition policies, the SEC staff's disclosure requests may be more specific. For example, the staff often requests additional or more detailed information when a registrant uses a proportional performance method to recognize revenue. Such information may include (1) the timing of revenue recognition on the basis of the performance of services or specific milestones; (2) the amount of revenue recognized under proportional performance models, including how amounts were allocated to different line items in the statement of operations; (3) details of obligations and agreement terms that require proportional performance; and (4) the specific accounting literature used.

Revenue Recognition for Long-Term Construction-Type and Production-Type Contracts

Example of an SEC Comment

- We note that you measure performance under percentage-of-completion contracts based on the ratio of costs incurred to total estimated contract costs. Please explain how you determine that all costs incurred relate directly to contract performance and how your accounting complies with [ASC 605-35-25-75 and 25-76 (formerly paragraph 50 of SOP 81-1)]. As part of your response, please clarify whether you typically incur costs, particularly in the early stages of the contract, that do not directly relate to contract performance.

ASC 605-35 (formerly SOP 81-1) provides guidance on how and when to recognize revenue and costs for certain long-term construction-type and production-type contracts. The SEC staff frequently asks entities to clarify their treatment of these contracts under ASC 605-35. For instance, the staff may ask a registrant to provide the following information:

- How the entity determined contract costs, and how those costs relate directly to contract performance.
- How the entity treats precontract and early-stage contract costs, which should normally be expensed.
- A description of the nature and type of change orders and claims and how the entity accounted for them.
- Policy disclosures, including which contract accounting method was used (i.e., percentage-of-completion or completed-contract) and which method was used to measure progress toward completion (e.g., cost-to-cost, units of work).
- If there were changes in estimates during the period, ASC 250 (formerly Statement 154) disclosures.

The SEC staff also asks registrants to clarify that they did not account for service arrangements in accordance with ASC 605-35, since service arrangements are outside the scope of ASC 605-35 (see ASC 605-35-15-6(j)).

Principal-Agent Considerations

Example of an SEC Comment

- Please expand your disclosures to state the specific factors that you consider when determining whether to record . . . fees on a gross or net basis pursuant to [ASC 605-45 (formerly Issue 99-19)].

The SEC staff often inquires about principal-agent considerations. The staff has asked registrants to explain how they determined gross or net reporting to be appropriate for certain revenue transactions under ASC 605-45 (formerly Issue 99-19). ASC 605-45 discusses factors that an entity should consider in determining whether it acts as a principal (and records revenue and the related costs on a gross basis) or as an agent (and nets the revenue and related costs). Registrants may be asked to provide expanded disclosures that describe the nature of these transactions and the factors they considered when determining whether revenue from such transactions should be recorded on a gross or a net basis.

Other Deloitte Resources

- *Software Revenue Recognition: A Roadmap to Applying AICPA Statement of Position 97-2*.
- Financial Reporting Alert 09-6, "Material Modifications to Revenue Arrangements With Multiple Deliverables."
- October 23, 2009, *Heads Up*, "Reconfiguring the Scope of Software Revenue Recognition Guidance."
- October 1, 2009, *Heads Up*, "Revenue Recognition: No Longer an Issue of Separation Anxiety."
- January 6, 2009, *Heads Up*, "FASB and IASB Issue Discussion Paper on Revenue Recognition."

SAB Topic 11.M (SAB 74) — Disclosures on the Impact of Recently Issued Accounting Pronouncements

Example of an SEC Comment

- Please include disclosure in management's discussion and analysis regarding the impact that recently issued accounting standards will have on the financial statements when adopted. Refer to the requirements of SAB Topic 11:M.

SAB Topic 11.M (SAB 74) requires disclosures about the effects of recently issued accounting standards that are not yet effective. The disclosures are required for new Accounting Standards Updates (ASUs)[1] and SEC Staff Accounting Bulletins (SABs). For example, calendar-year-end registrants should include SAB 74 disclosures for Statements 166 and 167[2] in their 2009 Forms 10-K unless the effect of adoption will be immaterial.[3]

The disclosures should help financial statement users assess the impact the new standard will have once adopted. According to SAB 74, a registrant should consider the following disclosures:

- A brief description of the new standard, the date that adoption is required and the date that the registrant plans to adopt, if earlier.
- A discussion of the methods of adoption allowed by the standard and the method expected to be utilized by the registrant, if determined.
- A discussion of the impact that adoption of the standard is expected to have on the financial statements of the registrant, unless not known or reasonably estimable. In that case, a statement to that effect may be made.
- Disclosure of the potential impact of other significant matters that the registrant believes might result from the adoption of the standard (such as technical violations of debt covenant agreements, planned or intended changes in business practices, etc.) is encouraged.

A registrant should disclose this information both in MD&A and in the footnotes to the financial statements.

The SEC staff sometimes issues comments if the disclosures do not meet the above requirements. It may also review information outside of the financial statements for indicators of whether a new accounting pronouncement affects a registrant, and will expect adequate disclosures about these effects.

The SEC staff also expects a registrant to disclose more specific details in filings as the effective date of a new standard approaches. For example, Statement 167 was issued in June 2009 and is effective as of the beginning of a reporting entity's first fiscal year beginning after November 15, 2009. A calendar-year-end registrant may not have been able to reasonably estimate whether the ASU's impact on its financial statements would be material with respect to SAB 74 disclosures in its September 30, 2009, Form 10-Q. The registrant will adopt Statement 167 on January 1, 2010, and will be issuing its December 31, 2009, Form 10-K after that date. Therefore, the registrant should be able to disclose more specifics in its December 31, 2009, Form 10-K.

Other Deloitte Resources

- November 2009 *Accounting Roundup*.

[1] ASUs update the FASB Codification for new authoritative U.S. GAAP issued by the FASB, regardless of the form in which the guidance was issued previously (e.g., FASB Statements and Interpretations, FSPs, and EITF abstracts). ASUs will also be issued for amendments to the SEC content in the FASB Codification. For more information about the Codification, see the Other Areas of SEC Comment section.

[2] The FASB will issue ASUs for these Statements to amend ASC 860 and ASC 810-10, respectively.

[3] See Deloitte's monthly *Accounting Roundup* for an appendix of significant upcoming adoption dates for new accounting guidance.

SEC Reporting

SEC authoritative literature includes a number of requirements that govern the form and content of a registrant's financial statements and other information that must be included in filings with the SEC. The SEC staff often comments on these form and content issues.

Significant Business Acquisitions (Rule 3-05)

Example of an SEC Comment

- In 2008, you acquired [two businesses] for combined cash purchase prices of [$X.X billion]. Please tell us what consideration you gave to providing financial statements of [the businesses]. Please provide us with your significance tests under Rule 3-05 of Regulation S-X. If any of these acquisitions are significant, in excess of the 20% level, separate financial statements are required to be filed for the applicable periods.

When a registrant consummates, or it is probable that it will consummate, a significant business acquisition, the SEC staff may require the filing of certain financial statements for the acquired or to be acquired business (acquiree) under Regulation S-X, Rule 3-05, in a Form 8-K, registration, or proxy statement. The following factors govern whether, and for what period, financial statements for the acquiree are required:

- Whether the acquired or to be acquired assets and liabilities meet the definition of a business for SEC reporting purposes.
- The significance of the acquired or to be acquired business. The significance is calculated on the basis of three tests: the investment (purchase price) test, the asset test, and the income test.
- Whether consummation of the business acquisition is probable or has recently occurred.

Registrants may file inappropriate financial statements because they:

- Do not perform the significance calculations correctly. Some of the most common mistakes are misapplications of the income test, such as using income averaging in the year of a loss or excluding unusual gains or losses from the test.
- Incorrectly determine that the acquired or to be acquired assets and liabilities do not meet the definition of a business for SEC reporting purposes. The definition of a business for SEC reporting purposes under Regulation S-X, Article 11, is not the same as the definition under ASC 805 (formerly Statement 141(R)) for U.S. GAAP purposes.
- Do not realize that Rule 3-05 also applies, in a registration statement, to probable acquisitions whose significance is greater than 50 percent.
- Do not consider, in a registration statement, the cumulative significance of previously consummated individually insignificant acquisitions.

SEC Reporting Considerations Related to the Adoption of ASC 805 (Formerly Statement 141(R)) and ASC 810-10-65-1 (Formerly Statement 160)

There are a variety of SEC reporting considerations related to the adoption of ASC 805 and ASC 810-10-65-1. The SEC's Financial Reporting Manual (FRM) provides views on several of these considerations. For example, transaction costs incurred in connection with an acquisition (e.g., due diligence fees, legal fees) were considered part of the purchase price under Statement 141. Therefore, under Rule 3-05, transaction costs were also included in the investment in the acquiree for the purpose of the investment (purchase price) test. Under ASC 805, such costs are expensed. As indicated in paragraph 2015.5 of the FRM, after the adoption of ASC 805, such costs should be excluded from the investment in the acquiree for the purpose of the investment test under Rule 3-05.

For additional SEC staff interpretations of Rule 3-05, see Section 2000 of the FRM.

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

Example of an SEC Comment

- We note that you have a 50% joint venture in [ABC Company], and that in 2008 your equity in its earnings increased significantly . . . from the prior year. . . . Given that you have reported a net loss of [$XX.X million] and a loss before income taxes and equity in earnings of joint venture of [$XX.X million] in 2008, it appears that this is a significant equity method investee. As such, please tell us what consideration you gave to Rule 3-09 of Regulation S-X and filing separate financial statements for your investment in [ABC Company].

When a registrant has a significant equity method investment, the registrant may be required to provide separate financial statements of the investee, summarized financial information of the investee, or both under Regulation S-X, Rules 3-09 and 4-08(g). Significance is calculated for equity method investees on the basis of two tests: the investment test and the income test. This rule is particularly important since the separate financial statements are required in Form 10-K; therefore, failure to file them may cause a registrant to become a delinquent filer and lose Form S-3 eligibility.

Registrants may make mistakes when performing the significance tests under Rules 3-09 and 4-08(g), such as:

- Not documenting the tests each year. This is most common when an equity investee has been clearly insignificant in the past. In certain situations, such as a near-break-even year for the registrant or a large income or loss at the investee level, the current year's significance may change, making the equity investee significant for the first time.
- Not updating the tests each year. The significance tests should be updated and reassessed for all years presented in a Form 10-K after a registrant reports a retrospective change, such as a change in accounting principle or classification of a component as a discontinued operation.

For additional SEC staff interpretations of Rules 3-09 and 4-08(g), see Section 2400 of the FRM.

Guarantors of Registered Securities (Rule 3-10)

Example of an SEC Comment

- It appears that the senior subordinated notes issued by [Subsidiary A] are guaranteed by you and other subsidiaries. Tell us why you did not include the condensed consolidating financial information and required disclosures, in a note to the financial statements, in accordance with Rule 3-10 (d) of Regulation S-X.

Regulation S-X, Rule 3-10, requires a registrant to provide separate financial statements for each subsidiary issuer or guarantor of debt securities registered or being registered. The information required by Rule 3-10 must be presented in registration and proxy statements and Forms 10-K and 10-Q. Therefore, a registrant should consider the requirements of Rule 3-10 if (1) the registrant registers debt and one or more of its subsidiaries guarantees the debt or (2) one of the registrant's subsidiaries registers debt and the parent company or one or more of its other subsidiaries guarantees the debt. However, Rule 3-10 also contains certain exceptions under which a registrant may provide more limited financial information in lieu of full financial statements. Therefore, depending on the facts and circumstances, a registrant may be able to provide, in a footnote to the parent company's financial statements, either of the following in lieu of separate financial statements:

- Condensed consolidating financial information.
- Narrative disclosures about each subsidiary issuer or guarantor.

A common error is for the registrant to incorrectly assume that certain exceptions in the rule are met and, therefore, conclude that it does not have to provide separate financial statements or condensed consolidating financial information. In addition, a registrant may incorrectly prepare required condensed consolidating financial information by, for example, not presenting subsidiaries under the equity method of accounting in the condensed consolidating information.

For additional SEC staff interpretations of Rule 3-10, see Section 2500 of the FRM.

Issuers of Securities That Collateralize Registered Securities (Rule 3-16)

Regulation S-X, Rule 3-16, requires a registrant to file full audited financial statements for each of the registrant's affiliates whose securities constitute a "substantial portion of the collateral" for any class of securities registered or being registered. The registrant must provide these financial statements in its Forms 10-K and certain registration statements. Registrants often look at the tests under Rules 3-10 and 3-16 as one test or related tests, but should be aware that these tests are separate and distinct and must be assessed individually. Rule 3-16 includes its own specific tests and "bright-line" requirements. Unlike Rule 3-10, Rule 3-16 does not allow for condensed consolidating financial information in lieu of full financial statements. Therefore, Rule 3-16 requires full audited financial statements of each affiliate whose securities constitute a substantial portion of the collateral of a security.

For additional SEC staff interpretations of Rule 3-16, see Section 2600 of the FRM.

Pro Forma Financial Information (Article 11)

Example of an SEC Comment

- It appears that pro forma adjustment . . . is not factually supportable or may not have a continuing impact. Please remove this adjustment or tell us how this adjustment meets the requirement of Rule 11-02(b)(6) of Regulation S-X.

Registrants must often provide pro forma information for significant consummated or probable transactions, such as a business combination or disposition, the acquisition of one or more real estate operations, and certain roll-up transactions. Article 11 pro forma financial information may be required in a registration or proxy statement or a Form 8-K, but is not required in a Form 10-K or 10-Q. Pro forma financial statements should generally be presented in columnar form, with separate columns for historical financial information, pro forma adjustments, and pro forma results. In certain limited circumstances, a registrant may present narrative disclosures in lieu of pro forma financial statements. Article 11 requires that pro forma adjustments be "(i) directly attributable to the transaction, (ii) expected to have a continuing impact on the registrant, and (iii) factually supportable." The SEC staff has commented on certain form and content issues, such as when a registrant fails to clearly explain each financial statement adjustment or does not clearly indicate how the above requirements are met.

Section 3300 of the FRM summarizes special problems and issues that are often associated with pro forma financial information.

SEC Reporting Considerations for Material Changes That Require Retrospective Application

Example of an SEC Comment

- Please explain to us whether or not the adoption of accounting standards in 2009 require retrospective application to prior fiscal years. If this is the case, please file the financial statements reported in your Form 10-K for the fiscal year ended December 31, 2008 with the retrospective application of the accounting standards adopted in 2009 that require retrospective application on Form 8-K under Item 9.01. This Form 8-K then needs to be incorporated into your registration statement(s).

After the registrant has issued its annual financial statements, an event may occur that requires the registrant to make a material retrospective change (e.g., the initial adoption of certain accounting pronouncements, a segment change, the classification of a component as a discontinued operation). If the registrant files a new registration statement after it has filed interim financial statements for the period of such a change, the registrant generally must file updated financial statements and other financial information (e.g., MD&A, selected financial data) to reflect the retrospective adjustments for periods before adoption of the change. These filings are typically made on Form 8-K. The SEC staff has allowed an exception to this requirement for certain retrospective changes. CAQ Alert #2009-53 gives the SEC's views on filing registration statements after the adoption of Statement 160 (codified in ASC 810), FSP APB 14-1 (codified in ASC 470-20), and FSP EITF 03-6-1 (codified in ASC 260-10).

There are different considerations for (1) currently effective registration statements (see Regulation S-K, Item 512(a)), (2) registration statements on Form S-8 (see the note to Section 13100 of the FRM), and (3) retrospective changes to provisional amounts recorded in a business combination (see the minutes of the June 23, 2009, CAQ SEC Regulations Committee Joint Meeting With the SEC Staff).

Topic 13 of the FRM provides additional information about the effects of retrospective changes on financial statements required in registration statements.

Other Deloitte Resources

- The Deloitte U.S. SEC Reporting Interpretations Manual includes Q&As and interpretive guidance on Regulation S-X issues. The manual is available on Technical Library: The Deloitte Accounting Research Tool. See Appendix D for further details.
- *SEC Reporting for Business Combinations and Related Topics — A Roadmap to Applying SEC Regulation S-X to the Acquisition of a Business*. See Appendix D for further details.

Segment Reporting

Identification of Operating Segments

Example of an SEC Comment

- Please tell us (i) the operating segments you have identified in accordance with [ASC 280-10-50-1 through 50-9 (formerly paragraphs 10–15 of Statement 131)], (ii) the factors used to identify reportable segments, and (iii) the basis for aggregating identified operating segments into two reportable segments given the aggregation criteria in [ASC 280-10-50-11 (formerly paragraph 17 of Statement 131)] and quantitative thresholds in [ASC 280-10-50-12 (formerly paragraph 18 of Statement 131)]. Please address these matters in detail.

The SEC staff frequently asks registrants to explain in detail how operating segments were determined and what information the chief operating decision maker (CODM) receives and reviews.

When a CODM regularly receives a component's discrete financial information, the component may be an operating segment. The SEC staff may request the financial information reviewed by the CODM. In addition, the SEC staff may review the information in the forepart of the Form 10-K, such as the business section and MD&A, and information from public sources, such as the registrant's Web site, analysts' reports, and press releases, for consistency with a company's segment disclosures.

Aggregation of Operating Segments

Example of an SEC Comment

- We note [in] your disclosure that you have only one reportable segment. Please explain to us in detail how the aggregation of all of the activities described in your filing . . . into one reportable segment complies with the aggregation requirements of [ASC 280-10-50-11 (formerly paragraph 17 of Statement 131)] and [ASC 280-10-50-13 (formerly Issue 04-10)].

ASC 280-10 (formerly Statement 131) permits a company to aggregate operating segments if the aggregation is "consistent with the objective and basic principles [of ASC 280-10 and] if the segments have similar economic characteristics." Because ASC 280-10 does not define the term "similar" or provide much guidance on the aggregation criteria, the determination of whether two or more operating segments are similar depends on the individual facts and circumstances. The staff may request a copy of the registrant's comprehensive analysis of economic characteristics, products, production processes, customers, distribution methods, and regulatory environment by operating segment.

ASC 280-10-50-11 (formerly paragraph 17 of Statement 131) mentions that segments with similar economic characteristics would be expected to have similar long-term average gross margins, but does not give any other examples of what an entity may use to evaluate economic characteristics. An entity may decide to look to other performance measures (e.g., sales growth, operating cash flows, returns on assets). In addition, an entity may consider competitive, operating, and financial risks related to each business or industry type when determining whether two operating segments have similar economic characteristics. If operating segments are located in different geographical areas, registrants may need to evaluate factors such as economic and political conditions, currency risks, and foreign-exchange control regulations. For economic characteristics, the staff may request an analysis of revenues and segment profit or loss (e.g., gross profit or operating profit) by operating segment for the last three to five years and the current interim period that demonstrates that aggregated operating segments exhibit similar economic characteristics (e.g., similar sales trends, similar gross margin percentages).

ASC 280-10-50-11 also notes that the segments must be similar in each of the following respects:

- *The nature of the products and services* — ASC 280-10 does not provide guidance on how to interpret this criterion. However, paragraph 100(a) of Statement 14 (not codified) employed a similar concept, stating that "[r]elated products or services have similar purposes or end uses. Thus, they may be expected to have similar rates of profitability, similar degrees of risk, and similar opportunities for growth."
- *The nature of the production processes* — Paragraph 100(b) of Statement 14 (not codified) stated, "Sharing of common or interchangeable production or sales facilities, equipment, labor force, or service group or use of the same or similar basic raw materials may suggest that products or services are related. Likewise, similar degrees of labor intensiveness or similar degrees of capital intensiveness may indicate a relationship among products or services."

- *The type or class of customer for the segments' products and services* — This criterion may be evaluated on the basis of how management views the customer (e.g., similar marketing and promotional efforts, common or interchangeable sales forces, and customer demographics).
- *The methods used to distribute their products or provide their services* — This criterion may be evaluated on the basis of the nature of the distribution channels used (e.g., retail outlets, mail order, Web site) and the nature of the products sold (e.g., component parts, finished goods).
- *If applicable, the nature of the regulatory environment (e.g., banking, insurance, or public utilities)* — This criterion applies only if part of the entity's business is in a unique regulatory environment.

The SEC staff has indicated that it views aggregation as a "high hurdle." Registrants should maintain detailed analyses of their operating segments and consideration of the aggregation criteria. Regarding the evaluation of the aggregation of operating segments, the SEC staff believes that investors are interested in reviewing the same information that the registrant's management reviews.

ASC 280-10-50-12 through 50-18 (formerly paragraphs 18–24 of Statement 131) provide quantitative thresholds and guidance that a company should use to evaluate which operating segments it should report separately. One subject that the SEC continues to comment on is quantitatively immaterial segments. Registrants may believe they can aggregate such segments with a reportable segment because they do not meet the threshold for separate presentation. However, quantitatively immaterial segments should not be aggregated with reportable segments unless they share all of the aggregation criteria. Otherwise, quantitatively immaterial segments should be classified in the "other" category.

Changes in Reportable Segments

Example of an SEC Comment

- We note that you changed the composition of your reportable segments. . . . Please tell us the changes in the structure of your organization that caused the composition of your reportable segments to change. . . . In addition, if segment information for earlier periods is not restated please disclose segment information for the current periods under both the old basis and the new basis of segmentation unless it is impracticable to do so. Please refer to [ASC 280-10-50-32 through 50-35 (formerly paragraphs 33–35 of Statement131)].

ASC 280-10-50-34 and 50-35 (formerly paragraphs 34–35 of Statement 131) discuss the requirement to recast prior-period information for consistency with current reportable segments. If a company changes or reevaluates the structure of its business after year-end, the new segment structure should not be presented in financial statements until operating results managed on the basis of that structure are reported (typically in a periodic filing such as a Form 10-K or 10-Q). However, disclosure of the future effects of the change may be useful. The SEC's *Current Accounting and Disclosure Issues in the Division of Corporation Finance* (as updated November 30, 2006) (the "report") indicates that "[i]f annual financial statements are required in a registration or proxy statement that includes subsequent periods managed on the basis of the new organizational structure, the annual audited financial statements should include a revised segment footnote that reflects the new reportable segments." A registrant either can include the revised (recasted) financial statements in the registration or proxy statement or can recast them in a Form 8-K, which can be incorporated by reference.

Product and Service Revenue by Segment

Example of an SEC Comment

- Please provide the revenue disclosures by product and service group required by [ASC 280-10-50-40 (formerly paragraph 37 of Statement 131)].

The report reminds registrants to "remember to identify the products and services from which each reportable segment derives its revenues, and to report the total revenues from external customers for each product or service or each group of similar products and services," in accordance with ASC 280-10-50-40 (formerly paragraph 37 of Statement 131). Regarding the determination of what constitutes "similar" products and services, the SEC "has objected to overly broad views."

Operating Segments and Goodwill Impairment

As discussed in the Business Combinations, Long-Lived Assets, and Impairments section, registrants should be aware that incorrectly identifying operating segments can have an impact on goodwill impairment testing. Goodwill is tested at the reporting-unit level, according to ASC 350-10 (formerly Statement 142), and reporting units are identified as either operating segments or one level below. If a registrant has not correctly identified its operating segments, it could be testing goodwill for impairment at the wrong level.

Information About Geographic Areas

The SEC staff has frequently asked registrants to include in future filings disclosures about geographic information, in accordance with ASC 280-10-50-41 (formerly paragraph 38 of Statement 131), unless it is impracticable to do so.

Share-Based Payments

Disclosures

Example of an SEC Comment

- In future filings please provide all of the disclosures required by [ASC 718-10-50-1 and 50-2 (formerly paragraphs 64, 65, and A240 of Statement 123(R))], including the following:
  - o Significant assumptions underlying your Black Scholes valuations such as expected term, expected volatility, and the risk-free rate;
  - o For each year for which an income statement is presented, present total compensation cost for share-based payment arrangements recognized in income as well as the total recognized tax benefit related thereto and the total compensation cost capitalized as part of the cost of an asset; and
  - o Disclose, as of the latest balance sheet date presented, the total compensation cost related to non-vested awards not yet recognized and the weighted-average period over which you expected to recognize these costs.

Registrants should ensure that their disclosures address the following objectives outlined in ASC 718-10-50-1 (formerly paragraph 64 of Statement 123(R)):

- The "nature and terms" of share-based payment arrangements.
- The "effect of [the related] compensation cost . . . on the income statement."
- The "method [for determining] the fair value of the equity instruments granted."
- The "cash flow effects [of] share-based payment arrangements."

The SEC staff's comments on share-based payment disclosures have focused on items such as:

- The nature of and reason for a modification in the share-based payment award's terms and how the registrant accounted for that modification.
- The terms and conditions of awards, including whether award holders are entitled to dividends or dividend equivalents.
- The number of options that are expected to vest and the assumptions used in developing those expectations.
- The registrant's valuation method, including significant assumptions used.
- The compensation cost capitalized.

In its comments about disclosures, the SEC staff frequently cites the guidance in ASC 718-10-50-2 (formerly paragraph A240 of Statement 123(R)), which describes the "minimum" information needed to achieve the disclosure objectives in ASC 718-10-50-1 (formerly paragraph 64 of Statement 123(R)).

The SEC staff has also frequently commented on the disclosure of stock-based compensation expense on a per-share basis. The transition guidance in Statement 123(R) allowed for the per-share disclosure of stock-based compensation expense only in the year of adoption. The staff is therefore asking registrants to remove such disclosures in future filings.

Financial Statement Presentation

Example of an SEC Comment

- In future filings, please revise your presentation of stock-based compensation to include such amounts in the same line or lines of the financial statements as cash compensation paid to the same individuals is presented. For reference, see SAB Topic 14.F.

Pursuant to SAB Topic 14.F, share-based compensation expenses should be classified in the same manner as other compensation costs and the presentation should not be driven by the form of consideration paid. Share-based compensation expense should be allocated to cost of sales, research and development, selling and administrative expenses, etc. (as applicable), and should not be separately presented in a single share-based compensation line item. The SEC's *Current Accounting and Disclosure Issues in the Division of Corporation Finance* (as updated November 30, 2006) states:

Registrants should avoid presentations on the face of the financial statements that give the impression that the nature of the expense related to share-based compensation is different from cash compensation paid to the same employees (for example by creating one or more separate line items for share-based compensation or by adding a table totaling the amount of share-based compensation included in various line item[s]).

Simplified Method

Example of an SEC Comment

- With a view towards future disclosure, please tell us when or if you expect to discontinue your use of the "simplified method" to calculate the expected holding periods of your options.

The SEC staff has recently been commenting on registrants' continued use of the "simplified method" to calculate the expected term of employee share options. Under ASC 718, the term that an option is expected to be outstanding is a key factor in measuring its fair-value-based amount and the related compensation cost. Question 6 of Section D.2 of SAB Topic 14 sets forth the "simplified method" of estimating the expected term of "plain vanilla" share options, but was due to expire on December 31, 2007. In December 2007, the SEC staff issued SAB 110, which permits entities, under certain circumstances, to continue to use the simplified method. SAB 110 amends and replaces Question 6 of Section D.2 of SAB Topic 14.

There are no hard-and-fast rules in SAB 110's revisions to SAB Topic 14; an entity may use the simplified method if it concludes that it is not reasonable to base its estimate of expected term on its historical share option exercise experience. In certain instances, however, the SEC staff has asked registrants to explain why they believe the historical share option experience does not provide a reasonable basis for estimating expected term. Previously, under SAB Topic 14, an entity could avail itself of the simplified method's safe harbor regardless of whether the entity had enough information to refine its estimate of expected term.

Accelerated Vesting

Example of an SEC Comment

- We note . . . you accelerated the vesting of $[X] "out-of-the-money" stock options previously awarded to your non-officer and non-director employees and that you will record the related . . . unrecognized stock-based compensation over the remainder of the original vesting period. . . . As we note that your accounting would only be applicable to the acceleration of deep out-of-the-money stock options, please tell us and revise future filings to describe to us your policy for identifying a stock option as "deep out-of-the-money." In addition, tell us and revise future filings to disclose whether all of the options for which you accelerated vesting were "deep out-of-the-money" and if not, explain how you accounted for the acceleration of those stock options that were not.

In the current economic environment, prices of a number of equity securities traded in public markets have significantly deteriorated. Many share option awards previously granted "at-the-money" are currently "out-of-the-money" because of declines in the value of the underlying securities. Certain securities may be so severely depressed that the share option awards are considered "deep out-of-the-money." Some entities have chosen to accelerate the vesting of these awards, since the awards do not continue to provide the appropriate retention motivation to employees.

The SEC staff has recently commented on the acceleration of such awards, asking registrants to disclose how they determined whether awards were deep out-of-the-money as well as how they accounted for the acceleration of the vesting of the awards. In informal discussions, the SEC staff has indicated that the guidance in ASC 718-10-55-67 (formerly footnote 69 of Statement 123(R)) applies to modifications of share option awards that are deep out-of-the-money. That is, the acceleration of the vesting of a deep out-of-the-money award is not substantive because the explicit service period is replaced with a derived service period. Accordingly, any remaining unrecognized compensation cost should not be recognized immediately. In addition, the staff indicated that because the acceleration of the vesting of the award is not substantive, an entity should generally continue to recognize the compensation cost over the remaining original service period.

Other Deloitte Resources

- *FASB Statement No. 123(R), Share-Based Payment: A Roadmap to Applying the Fair Value Guidance to Share-Based Payment Awards.*
- Financial Reporting Alert 09-2, "Acceleration of the Vesting of Deep Out-of-the-Money Share Option Awards."
- Financial Reporting Alert 07-10, "SEC Extends the Use of the Simplified Method in SAB 107 Under Certain Circumstances."
- June 17, 2008, *Heads Up*, "FASB Concludes That Certain Unvested Share-Based Payment Awards Are Participating Securities."

Use of Experts and Consents

Example of an SEC Comment

- We note your reference to an independently prepared actuarial report. Please tell us the nature and extent of the involvement of [the] third party and tell us whether you believe they are acting as experts as defined in the Securities Act of 1933.

The SEC staff continues to see a number of registrants that have chosen to refer to an independent valuation firm or other third party in both registration statements under the Securities Act of 1933 and periodic reports under the Securities Exchange Act of 1934 (i.e., Forms 10-K and 10-Q). Some common examples include references to:

- A valuation firm about the valuation of a registrant's common and preferred stock in an initial public offering.
- A valuation firm about the fair value determination of goodwill and assets acquired and liabilities assumed in a business combination.
- A valuation firm about the determination of goodwill impairment.
- A valuation firm about the determination of asbestos liability.
- An independent actuary about the estimation of workers' compensation liability.
- Petroleum engineers about the evaluation of oil and gas reserves.
- Pricing services or brokers that provide information used to determine the fair values of financial assets or liabilities.

The SEC staff has said that registrants are not required to refer to an independent valuation firm or other expert in registration statements or periodic reports. If a registrant does not refer to the expert, the registrant is not required to name the expert or provide the expert's consent unless the consent is required in the registration statement.[1] However, registrants that choose to refer to an expert should consider the following:

Periodic Reports

Consents are not required in connection with a Form 10-K or 10-Q. However, if registrants choose to refer to an independent valuation firm or other expert in periodic reports, and if the registrant incorporates such a periodic report by reference in a registration statement, the below requirements apply.

Registration Statements

Historically, the SEC staff has asked registrants to provide consents from many third-party experts that were referred to in a registration statement. However, on the basis of informal discussions with the SEC staff, we understand that the key to assessing when a consent will be required is the degree to which management takes responsibility for the reference to the third party in the disclosure. That is, if the registrant essentially "outsourced" the services to the third party and management is not taking responsibility for the ultimate conclusion, management must obtain the consent of the third-party provider to be a named expert under the Securities Act. The SEC staff indicated that it would look to the totality of the disclosure provided in determining whether management appears to be taking responsibility for the conclusion.

Registrants may also look to Question 233.02 of the Compliance and Disclosure Interpretations of the Securities Act Rules, issued by the SEC staff in November 2008, which provides new guidance on when a consent would be required. Question 233.02 states, in part:

> The consent requirement in Securities Act Section 7(a) applies only when a report, valuation or opinion of an expert is included or summarized in the registration statement and attributed to the third party and thus becomes "expertised" disclosure. . . . If the registrant determines to make reference to a third party expert, the disclosure should make clear whether any related statement included or incorporated in a registration statement is a statement of the third party expert or a statement of the registrant. If the disclosure attributes a statement to a third party expert, the registrant must comply with the requirements of Securities Act Rule 436 [i.e., provide a consent] with respect to such statement.

[1] Independently of consideration of the consent requirement in Section 7(a) of the Securities Act, a registrant that uses or relies on a third-party expert's report, valuation, or opinion should consider whether it is required to include or summarize that report, valuation, or opinion in the registration statement to comply with specific disclosure requirements, such as those in Regulation M-A, Item 1015, or Regulation S-K, Item 601(b), or the general disclosure requirements in Rule 408 of the Securities Act.

Question 233.02 also gives the following example:

> [I]f a registrant discloses purchase price allocation figures in the notes to its financial statements and discloses that these figures were taken from or prepared based on the report of a third party expert, or provides similar disclosure that attributes the purchase price allocation figures to the third party expert and not the registrant, then the registrant should comply with Rule 436 [of Regulation C] with respect to the purchase price allocation figures. On the other hand, if the disclosure states that management or the board prepared the purchase price allocations and in doing so considered or relied in part upon a report of a third party expert, or provides similar disclosure that attributes the purchase price allocation figures to the registrant and not the third party expert, then there would be no requirement to comply with Rule 436 with respect to the purchase price allocation figures as the purchase price allocation figures are attributed to the registrant.

Other Areas of SEC Comment

Certifications

Registrants must provide quarterly and annual certifications in the form specified by Regulation S-K, Item 601(b)(31). An amendment of an **entire** periodic filing is often required when these certifications contain errors. Registrants may look to Interpretation 246.14 of the Compliance and Disclosure Interpretations of Regulations S-K, issued by the SEC staff in July 2008, which states:

> The following errors in a certification required by Item 601(b)(31) are examples of errors that will require the company to file a corrected certification that is accompanied by the entire periodic report: (1) the company identifies the wrong periodic report in paragraph 1 of the certification; (2) the certification omits a conformed signature above the signature line at the end of the certification; (3) the certification fails to include a date; and (4) the individuals who sign the certification are neither the company's principal executive officer nor the principal financial officer, or persons performing equivalent functions.

eXtensible Business Reporting Language (XBRL)

In January 2009, the SEC issued Final Rule Release 33-9002, which requires most registrants to provide XBRL-tagged financial reports and schedules (an "interactive data file") as an exhibit to certain periodic filings, registration statements, and transition reports that contain financial statements. The requirement is phased in over three years; registrants from the first phase-in group must provide interactive data files for periods ending on or after June 15, 2009.

Some registrants from the first phase-in group have encountered issues that have led them to amend their filings. These issues include (1) technical errors with the XBRL exhibit, (2) materially inaccurate or missing information in the interactive data file, and (3) inability to complete XBRL submissions in a timely manner.

The SEC has established processes to ensure compliance with its interactive data rules. These processes include:

- Tests incorporated into EDGAR to validate the technical requirements of interactive data filings while those filings are being processed. Filings that do not comply may be rejected.
- Reviews of interactive data files performed by the SEC's Office of Interactive Disclosure. These reviews may result in future comments to registrants.

In 2009, the staff of the SEC's Division of Corporation Finance issued Compliance and Disclosure Interpretations of the interactive data rules on the SEC's Web site, which are updated periodically. In addition, on October 6, 2009, the staff of the SEC's Office of Interactive Disclosure issued a summary of observations based on its review of certain interactive date files that were submitted by registrants in the first phase-in group. Although these interpretations and observations are not rules, regulations, or statements of the SEC, registrants are encouraged to consider this guidance when preparing future submissions.

Other Deloitte Resources

- *XBRL — Frequently Asked Questions (FAQ)*.
- *eXtensible Business Reporting Language — Moving to a Global Standard for Electronic Business Reporting*.
- February 6, 2009, *Heads Up*, "SEC Publishes Final Rule Mandating Use of 'Interactive Data.'"

FASB's Accounting Standards Codification (ASC)

On July 1, 2009, the FASB launched the ASC, which became the single source of nongovernmental authoritative U.S. GAAP for interim and annual periods ending after September 15, 2009. In August 2009, the SEC issued Interpretive Release 33-9062A, which clarifies that the ASC is not the authoritative source for SEC content and does not replace specific SEC rules and interpretive releases.

At the June 23, 2009, CAQ SEC Regulations Committee Joint Meeting With the SEC Staff, Wayne Carnall, chief accountant of the SEC's Division of Corporation Finance, encouraged registrants to avoid including specific GAAP references in their financial statement disclosures; rather, he recommended that registrants' disclosures more clearly explain the accounting concepts applied. The staff believes that references included in financial statements for periods after the ASC's effective date should refer to the Codification for all periods presented. See CAQ Alert #2009-76 for more information about the SEC's views on the ASC.

Other Deloitte Resources

- May 20, 2009, *Heads Up*, "What Preparers Need to Know About the FASB Codification."

Going-Concern Disclosures

At the April 3, 2009, SEC Regulations Committee Joint Meeting With the SEC Staff, Wayne Carnall, chief accountant of the SEC's Division of Corporation Finance, noted that the staff would review going-concern disclosures to determine "whether they are 1) complete (comply fully with applicable professional standards) and 2) consistent with MD&A discussions of liquidity and capital resources." The staff may also ask about inconsistencies between an independent auditor's going-concern conclusion and the registrant's disclosures.

Risks and Uncertainties

The SEC staff often comments on a registrant's compliance with the disclosure requirements of ASC 275-10-50 (formerly SOP 94-6). ASC 275-10-50 requires disclosure of certain information about risks and uncertainties "that could significantly affect the amounts reported in the financial statements in the near term or the near-term functioning of the reporting entity." The disclosures should, at a minimum, address the following:

- The nature of the entity's operations.
- Management's use of estimates in preparing the entity's financial statements.
- Certain significant estimates.
- An entity's current vulnerability because of certain concentrations.

To address the requirements of ASC 275-10-50, the SEC staff has asked registrants to expand their disclosures about the likely material impact of known trends or events on their results of operations or liquidity. (See the Business Combinations, Long-Lived Assets, and Impairments section, the Income Taxes and Uncertain Tax Positions section, and the Management's Discussion and Analysis section for examples of comments on disclosures about risk and uncertainty.)

Industry-Specific Topics

Consumer and Industrial Products

Retail

The SEC staff's comments to registrants from the retail industry have focused on topics such as revenue recognition, segment reporting, income statement classification, and critical and significant accounting policies. (See the Business Combinations, Long-Lived Assets, and Impairments section for information about SEC comments on impairments.)

Revenue Recognition

Gift Cards

Examples of SEC Comments

- Please tell us the method you use to determine the estimated amount of gift card breakage and whether breakage is recognized over a period of time, and the time period, or at the end of a specified period, and the number of years in the period. In addition, tell us whether your gift cards have an expiration date and whether you are subject to state escheatment laws. Finally, since breakage represents an adjustment of sales prices or another source of operating income, tell us your rationale for classifying breakage as a reduction of operating, general and administrative expenses.
- We note that you recognize gift card breakage over the estimated gift card redemption period. Please tell us and disclose if you recognize estimated breakage on a straight-line basis over the breakage period or if you recognize the estimated breakage proportionally over the period of performance, that is, as the remaining gift card values are redeemed. Please also provide evidence that demonstrates to us that the demand for future performance with respect to the estimated breakage recognized as revenue is remote and that the estimate is based on a large population of homogeneous transactions.

In some arrangements, customer payment is made in advance of vendor performance (e.g., gift cards and phone cards) and is recorded as a deferred revenue liability. In some cases, the customer does not demand full performance for various reasons. This is often referred to as "breakage." At the 2005 AICPA Conference, Pamela R. Schlosser, a professional accounting fellow in the SEC's Office of the Chief Accountant, reminded registrants of the SEC's previously stated position that it is appropriate for a vendor to apply the liability derecognition guidance in ASC 405-20-40-1 (formerly paragraph 16 of Statement 140) to these circumstances. However, breakage can also be recognized in earnings before the vendor is legally released from its obligation if the vendor can demonstrate that the likelihood that the customer will require performance is remote.

The SEC staff emphasized that registrants should not recognize breakage as revenue immediately upon the receipt of payment, even if historical evidence suggests that for a certain percentage of transactions, performance will not be required. The SEC staff has objected to registrants' recognizing, on the basis of historical redemption rates, a portion of the prepayment as revenue and the remainder as deferred revenue upon the sale of a gift card, since performance had not yet occurred.

The SEC staff has described two acceptable approaches to recognition of breakage as revenue:

- *Specific identification* — Vendors can recognize gift card breakage on a card-by-card basis as the vendor is legally released from its obligation, such as at redemption, at expiration, or at the point redemption becomes remote.
- *Homogeneous pool* — Vendors can recognize gift card breakage in proportion to actual redemptions if redemption of a certain amount of homogeneous transactions is remote. Under this approach, the estimated value of gift cards expected to go unused in a homogeneous pool sold over a certain period would be recognized as the remaining gift cards are redeemed. The company would need to reasonably and objectively determine both the estimated period of actual gift card redemption and the amount of breakage.

While not specifically addressed in the SEC staff's speech, the following conditions should be met for a registrant to have the ability to make a reasonable and reliable estimate:

- The estimate is related to a large pool of homogeneous transactions.
- A reliable and objective estimate can be made on a timely basis, and the likelihood that a registrant will make material adjustments to previous amounts recognized as revenue is remote. There should not be recurring significant differences between actual experience and estimated rates or amounts of breakage.

- The registrant has sufficient experience upon which it can base its estimation of breakage, the registrant believes that such experience is predictive of future events, and no changing circumstances indicate that the registrant would not be able to apply such experience. Footnote 55 of SAB Topic 13.A.4(a) also specifies that a start-up company, a company introducing new services, or a company introducing services to a new class of customer should have at least two years of experience before it can make reasonable and reliable estimates.
- All other revenue recognition criteria have been met.

The SEC staff often asks registrants to expand or clarify disclosures about revenue recognition. For more information, see the Revenue Recognition section.

Segment Reporting

Examples of SEC Comments

- Please tell us in more detail how you determined that you have only one reportable segment. It would appear you have different distribution channels. Please supplement your response by providing us with examples of current internal reports that management uses to assess the performance of your business such as budgets and internal financial statements.
- Based on the information you provided it seems that you have structured your business in five specific geographic regions and may have more than one operating segment. Please clarify whether you believe each of the regions identified . . . are operating segments as defined in [ASC 280-10-50-1 (formerly paragraph 10 of Statement 131)] and whether the regions are aggregated since they exhibit similar economic characteristics and meet the aggregation criteria in [ASC 280-10-50-11 (formerly paragraph 17 of Statement 131)]. If each region represents an operating segment, please provide us with support that they have similar economic characteristics.

As discussed in the Segment Reporting section, the SEC staff frequently asks questions about the identification and aggregation of operating segments. The retail industry uses multiple distribution channels (e.g., stores, catalogs, the Internet), customer segments, geographical areas, store concepts and brands, etc. Registrants need to evaluate all of these items in each reporting period when analyzing their segments.

ASC 280-10 (formerly Statement 131) permits an entity to aggregate operating segments if the aggregation is "consistent with the objective and basic principles [of ASC 280-10 and] if the segments have similar economic characteristics." The determination of whether two or more operating segments are similar depends on the individual facts and circumstances. Because the SEC staff may challenge a conclusion that two or more operating segments are similar, each registrant should have adequate documentation to support its conclusion. The staff often requests a copy of the registrant's comprehensive analysis of economic characteristics, products, production processes, customers, and distribution methods by operating segment. See the Segment Reporting section for additional information.

Income Statement Classification

Example of an SEC Comment

- We note that revenue received from shipping and handling fees is reflected in net sales. Please tell us and revise future filings to also disclose your policy relating to shipping and handling costs. Refer to [ASC 605-45-50-2 (formerly paragraph 6 of Issue 00-10)].

The SEC staff's comments on income statement presentation often address how the presentation complies with the technical requirements of Regulation S-X, Rule 5-03, which lists the captions and details that commercial and industrial registrants must present in their income statements. See the Financial Statement Classification section for additional information about comments on (1) the separate presentation of items in the income statement, (2) the cost-of-sales line item, and (3) what constitutes operating income versus nonoperating income.

For the retail industry in particular, the SEC staff has also focused on the classification of shipping costs and fees. ASC 605-45 (formerly Issue 00-10) indicates that all amounts related to shipping and handling that are billed to a customer in a sale transaction represent revenues earned for the goods provided and should be classified as revenue. The classification of shipping and handling costs is an accounting policy decision that should be disclosed pursuant to ASC 235-10 (formerly Opinion 22). An entity may adopt a policy of including shipping and handling costs in cost of sales. However, if shipping costs or handling costs are significant and are not included in cost of sales (i.e., if those costs are accounted for together or separately in other income statement line items), an entity should disclose both the amount(s) of such costs and the line item or items in the income statement that include them.

Critical Accounting/Significant Accounting Policies

Examples of SEC Comments

- Your disclosure relating to the self-insured workers' compensation, automobile and general liability estimates involves a significant amount of variability and changes in numerous factors used to arrive at the amounts recorded by management. Please revise your disclosure of critical accounting policies and estimates relating to the self-insured liability and reserve estimates to discuss and quantify the accuracy of your estimates and assumptions in prior years and whether they are likely to change in the future.
- Given your references to the weakening economic and market conditions in your MD&A discussion and noting your inventory approximates one-third of your total assets, please tell us what consideration was given to providing a critical accounting policy on inventory impairment.

As discussed in the Management's Discussion and Analysis section, the SEC staff frequently comments on the disclosure of critical accounting policies in MD&A and the disclosure of significant accounting policies in the footnotes to the financial statements. In general, such disclosure should incorporate important judgments about the appropriateness of principles relating to revenue recognition and the allocation of asset costs to current and future periods.

Energy and Resources

Power and Utilities

The SEC staff's comments to registrants from the power and utilities industry have focused on subsidiary and equity investee dividend restrictions and the Schedule I requirement, accounting for the impact of rate making, and the separate presentation of regulated and nonregulated operations.

Subsidiary and Equity Investee Dividend Restrictions and the Schedule I Requirement

Examples of SEC Comments

- Please confirm for us that none of your wholly-owned subsidiary companies have restrictions regarding the ability to pay dividends, make cash distributions, or otherwise transfer funds to you or your subsidiaries. In this regard, please explain to us if there are any regulatory restrictions or debt covenants which could limit the amount of dividends of your utility subsidiaries.
- In future filings please disclose the amount of retained earnings or net income of [Entity X] restricted or free of restriction as required by Rule 4-08(e)(1) of Regulation S-X. Also, please tell us the amounts of restricted net assets of [Entity X] as defined in Rule 4-08(e)(3) of Regulation S-X as of the end of the most recently completed year and how you compute the amounts. In doing so, please describe the restrictions which limit the payment of dividends by [Entity X] pursuant to the provisions of the Federal Power Act. In addition, if restricted net assets of [Entity X] exceed 25 percent of its consolidated net assets please provide the disclosures required by paragraphs 3(i) and (ii) of Rule 4-08(e) of Regulation S-X and file Schedule I prescribed by Rule 12-04 of Regulation S-X as required by rule 5-04 of Regulation S-X.

The financial flexibility of registrants from the energy and resources industry and the nature of their relationships with affiliated parties, including the parent company, could be subject to regulatory constraints. Subsidiaries often enter into financing agreements that may restrict (1) the transfer of funds to a parent or other affiliated party or (2) other types of transactions with affiliates. In addition, holders of significant noncontrolling interests in a subsidiary may influence the operations of that subsidiary.

In situations in which the transfer or dividend of assets (cash or other funds) to the parent company/registrant by its subsidiary (or subsidiaries) or 50 percent or less owned affiliates is restricted or limited or requires third-party approval, Regulation S-X, Rules 4-08(e), 5-04, and 12-04 may require (depending on the materiality of the restriction or limitation):

- Footnote disclosure of the restriction or limitation.
- Presentation of condensed parent-company financial data in a financial statement schedule (Schedule I).
- Both footnote and Schedule I disclosures.

A Schedule I must be filed when the restricted net assets of consolidated subsidiaries exceed 25 percent of consolidated net assets as of the end of the most recently completed fiscal year.

Rule 4-08(e) footnote disclosure is required if the total restricted net assets of subsidiaries, plus the parent's equity in the undistributed earnings of 50 percent or less owned entities, exceed 25 percent of consolidated net assets. SAB Topic 6.K provides further guidance on determining the restricted net assets of subsidiaries.

Last year, the SEC discussed these requirements with various public utilities. The discussions included debate over whether these registrants have adequately considered the provisions of the Federal Power Act and Federal Energy Regulatory Commission as well as state regulatory orders that restrict, in the absence of additional regulatory approvals, the transfer of assets from subsidiaries to the parent company through dividends, loans, advances, or returns of capital.

As a result of these discussions, several energy and resources companies either were required to, or agreed to, prospectively (1) expand their disclosures regarding potential dividend restrictions and (2) provide a Schedule I as part of their annual Form 10-K filing.

Accounting for the Impact of Rate Making

Examples of SEC Comments

- Explain how the company's current regulated rates are designed to recover its specific costs of providing service.
- If any portion of the regulatory asset balance includes amounts on which the company does not earn a current return, disclose the nature and amount of each asset and its remaining recovery period. We believe the best practice approach regarding regulatory assets is to affirmatively indicate whether a particular regulatory asset is earning a rate of return and the anticipated recovery period. Refer to the requirements of [ASC 980-340-50-1 (formerly paragraph 20 of Statement 71)].

The SEC staff continues to request that regulated utilities disclose how their current regulated rates are designed to recover their specific costs of providing service (see ASC 980-10-15-2, formerly paragraph 5(b) of Statement 71), the nature of all material regulatory assets and liabilities, the anticipated recovery period of regulatory assets, and a statement regarding whether a particular regulatory asset is earning a rate of return.

The SEC staff's comments have also focused on the guidance in ASC 980-340-50-1 (formerly paragraph 20 of Statement 71), which requires that entities whose regulatory asset balances include amounts on which they do not earn a current return disclose the nature and amount of each asset and its remaining recovery period.

Separate Presentation of Regulated and Nonregulated Operations

Examples of SEC Comments

- Prospectively, disclose the depreciation rates for your non-regulated generation property separately from your regulated PP&E.
- Please separately disclose the balances for unregulated versus regulated property, plant and equipment and accumulated depreciation.
- Please revise to separately present fuel used in electric generation and purchased power expenses for both your regulated and non-regulated electric operations. See Rule 5-03.2 of Regulation S-X.

SEC staff comments requesting additional separate disclosures about regulated and nonregulated operations and assets have become more frequent. For example, the staff has requested separate disclosures about the following (even though some of this information can be derived from segment disclosures):

- Revenues from public utility operations and other product and service revenues, in accordance with Regulation S-X, Rule 5-03(b)(1).
- Fuel, purchased power, and other operating expenses.
- Property, accumulated depreciation, and depreciable lives.

Oil and Gas

The SEC staff's comments to registrants from the oil and gas industry have focused on proved undeveloped (PUD) reserves, proved reserves impairment testing, significant changes in reserves and standardized measures, and unproved property costs.

PUD Reserves

Examples of SEC Comments

- It appears that many of these proved undeveloped reserves have been classified as proved for several years. Please explain to us why you believe the reserves that you estimate will remain undeveloped. Please explain how reserves that you estimate will remain undeveloped by 2013 . . . meet the SEC requirement of reasonable certainty to be produced required for proved reserves.
- With a view towards possible disclosure, please tell us the constraints specific to your circumstances that prevent your completion of these projects within five years of booking the associated proved reserves.
- You state that by their nature undeveloped reserves are less certain. The SEC definition of proved reserves found in Rule 4-10(a) of Regulation S-X requires that you be reasonably certain that the reserves you classify as proved will be recovered. This means that the ultimate recovery of reserves is more likely to equal or exceed your estimates than to be less than your estimates. The definition does not contemplate there being less than reasonable certainty in reserve estimates pertaining to properties that are undeveloped. Your risk factor disclosure saying that undeveloped reserves are less certain than apparently proved developed reserves seem to be contradicting, or mitigating, the criteria of reasonable certainty that is necessary for reserves to be classified as proved. If you are not reasonably certain of recovering all or a portion of your reported reserves, please remove the associated volumes of reserves from your estimates of proved reserves that are disclosed in your filing. If you are reasonably certain that you will recover your reported reserves, please revise your risk factor and any similar disclosure in the document to not imply that proved reserves are not reasonably certain to be recovered and that there is less certainty for proved undeveloped reserves as compared to proved developed reserves.

Under Regulation S-X, Rule 4-10(a)(2), when estimating proved reserves, a registrant should be reasonably certain that the reserves can be recovered in future years under existing economic conditions. The SEC staff often asks registrants to justify PUD reserves that are booked but that will remain undeveloped for more than five years, since this may indicate uncertainty regarding development and ultimate recoverability. A registrant may be asked to explain why the reserves have not been or will not be developed and why it believes the reserves are still appropriate. In addition, the staff may ask a registrant to:

- Provide a table by year of the number of PUD wells to be drilled and the related PUD reserves.
- Provide a development plan for PUD reserves, including the planned timeline for complete development.
- Disclose the estimated remaining capital associated with each project after the five-year period.
- Disclose the portion and volumes of total PUD reserves that were converted to proved developed status and the capital expenditures used over the past five years.
- Disclose restrictions on or limitations to developing PUD reserves within five years.

The SEC staff has also reviewed disclosures for consistency. The staff has challenged the classification of reserves as PUD when a registrant has included a risk-factor disclosure indicating that the recoverability of PUD reserves is less certain than the recoverability of proved developed reserves, since such a disclosure contradicts the reasonable-certainty criteria included in the definition of proved reserves. The staff has asked registrants to remove PUD reserves from estimates of proved reserves if recovery is not reasonably certain. However, if recovery is reasonably certain, registrants have been asked to revise the risk factor and any similar disclosure in the filing to exclude the contradictory language. The staff has made the same requests when a registrant has disclosed in MD&A or another section that it has no intention of drilling or developing a project but maintains an associated PUD reserve for it.

Proved Reserves Impairment Testing

Example of an SEC Comment

- We understand from your disclosure . . . that you are following the guidance in [ASC 360-10-35 (formerly Statement 144)] when evaluating your proved oil and natural gas properties for impairment; and that no impairment charges have been recognized. . . . We would like to understand how your impairment testing as of [year-end] had taken into account the [adverse] circumstances described in [your] disclosures. . . . Please submit details of your impairment testing as at [year-end], including an explanation of how you have overcome these adverse circumstances in estimating future cash flows, and a description of the assumptions used in your calculations.

The SEC staff often asks registrants to disclose the details of impairment testing of proved reserves as of year-end, including a description of the assumptions used in the testing. Furthermore, a registrant may be asked to explain how the assumptions used took into consideration certain adverse circumstances, such as a decrease in commodity prices or an increase in operating costs. Registrants may be asked to further explain how they manage such adverse circumstances and to disclose, in particular, the use and effect of derivative instruments that hedge the risks associated with expected future production, if any. See the Business Combinations, Long-Lived Assets, and Impairments section for more information about impairment testing for long-lived assets.

Significant Changes in Reserves and Standardized Measures

Example of an SEC Comment

- Please explain the circumstances that led to the additions of proved reserves in [200X] due to improved recovery and the negative revisions in [200Y] and [200Z]. Address the revisions due to performance separately from those due to price reductions. See [ASC 932-235-50-5 (formerly paragraph 59F of Statement 19)].

The SEC staff has commented on registrants' disclosures about changes in proved reserves and standardized measures and their compliance with ASC 932-235-50 (formerly paragraphs 59A–59CC of Statement 19). Specifically, the staff has asked registrants to:

- Describe the technical factors (i.e., the activities, findings, and circumstances) that led to significant changes in proved reserves.
- Indicate the extent to which changes in proved reserves correlate with development costs.
- Address negative revisions to previous estimates due to performance separately from those due to price reductions.
- Explain significant changes in extensions and discoveries.
- Disclose incurred development costs that were previously estimated as part of the standardized measure calculation.
- Explain the lack of changes to proved reserves due to certain disclosed activities, findings, or circumstances.

Unproved Property Costs

Examples of SEC Comments

- Tell us how the results of your accounting for costs of unproved properties, which you disclose as being ". . . withheld from the depletion base until such time as they are either developed or abandoned," compare to those that would arise following the guidance in Rule 4-10(c)(3)(ii) of Regulation S-X, which generally requires such costs to be included in the pool of costs subject to amortization once it is determined whether or not proved reserves can be assigned to the properties, with a few exceptions.
- We understand from your disclosure about the full cost ceiling test that among the costs aggregated to compare to the present value of estimated future net revenues, you include either the cost or fair value of unproved properties, whichever is lower. This particular measure should be used for costs of unproved properties that are subject to amortization, following the guidance in Rule 4-10(c)(4)(i)(C) of Regulation S-X, while costs of unproved properties not subject to amortization should be included without regard to estimates of fair value. However, costs of unproved properties not subject to amortization must be net of any impairment assessed under Rule 4-10(c)(3)(ii)(A) of Regulation S-X, whereas such impairment is included in the pool of costs subject to amortization. Tell us how your accounting and disclosure would need to change to reflect proper accounting for such amounts, to comply with the ceiling test requirements.

The SEC staff has challenged a registrant's application of the full-cost method under Regulation S-X, Rule 4-10(c). Unproved property costs directly associated with acquisition, exploration, and development activities should generally be capitalized into a pool under the full-cost method if a registrant determines that proved reserves can be assigned to the property. The full-cost pool is depleted and amortized under the unit-of-production basis in accordance with Rule 4-10(c)(3). If a registrant determines that proved reserves cannot be assigned to the property, the associated unproved property costs should be excluded from the amortization base.

Rule 4-10(c)(4) requires a registrant to use the lower of cost or estimated fair value (i.e., a cost ceiling) to account for unproved property costs that are subject to amortization. However, costs that are not subject to amortization should be recorded, regardless of fair value estimates. The SEC staff has questioned registrants that do not clearly distinguish, in their disclosures, between unproved property costs that are excluded from costs to be amortized and those that are subject to amortization. Registrants have been asked to explain how their accounting policy for unproved property costs complies with Rule 4-10(c) and to submit disclosures clarifying the costs included in the amortization base.

The SEC staff has also reminded registrants of the Rule 4-10(c)(7)(ii) requirement to disclose the current status of unproved properties for which costs are excluded from amortization, the anticipated timing of the inclusion of such costs in amortization, and a table indicating the nature of costs by category and identifying the periods in which the costs were incurred. In addition, the staff has requested registrants to disclose the frequency[1] of impairment testing for unproved property costs that are excluded from amortization, since such costs should be accounted for net of impairment.

New Oil and Gas Reporting Requirements

On December 31, 2008, the SEC issued Final Rule 33-8995, which modernizes and updates the SEC's requirements for an entity's calculation and disclosure of oil and gas reserves and related definitions to align them with current practices and improvements in technology.[2] The final rule is effective for registration statements filed on or after January 1, 2010, and for annual reports on Form 10-K for fiscal years ending on or after December 31, 2009.

In addition to updating definitions, the final rule makes other key revisions, including changes to the pricing used to estimate reserves, the ability to include nontraditional resources in reserves, the use of new technology for determining reserves, and permitting disclosure of probable and possible reserves. The final rule also (1) clarifies the level of detail required for certain disclosures provided by oil and gas companies regarding their reserves, properties, production, and operations, including the geographic areas by which disclosures of reserves should be provided, and (2) provides formats for tabular presentation. Note that the SEC staff's view is that accounting changes resulting from the changes in definitions and pricing assumptions should be treated as a change in accounting principle that is inseparable from a change in accounting estimate and should be applied prospectively.

In September 2009, the FASB issued a proposed Accounting Standards Update (ASU) on oil and gas reserve estimation and disclosures to align the current reserve estimation and disclosure requirements of ASC 932 (formerly Statements 19 and 69) with the requirements in the SEC's final rule. The ASU would avoid an entity's having to perform two reserve calculations and provide differing disclosures under the final rule and ASC 932. One additional revision proposed by the FASB was to clarify disclosures required for equity method investments. An entity would be required to consider equity method investments when determining whether it has significant oil- and gas-producing activities and to disclose consolidated and equity method investments separately and in the same level of detail. The FASB is expected to finalize the ASU in the fourth quarter of 2009. The ASU would be effective for annual reporting periods ending on or after December 31, 2009.

Other Deloitte Resources

- Energy & Resources SEC Comment Letter Database — November 2009. (Request a copy.)
- *Energy & Resources Sector 2009 Accounting, Financial Reporting, and Tax Update*.
- September 16, 2009, *Heads Up*, "FASB Proposes to Modernize Oil and Gas Company Reporting."
- January 20, 2009, *Heads Up*, "SEC Modernizes Oil and Gas Company Reporting."

[1] Rule 4-10(c)(3)(ii)(A) requires an annual assessment.

[2] The SEC's Division of Corporation Finance has issued new C&DIs of the oil and gas rules.

Financial Services

Banking and Securities

The SEC staff's comments to registrants from the banking and securities industry have focused on topics such as loan underwriting and credit risk management, loan loss reserves, interest reserves, and litigation settlement and valuation of auction rate securities (ARSs).

Loan Underwriting and Credit Risk Management

Example of an SEC Comment

- Please revise future filings to provide a discussion of your underwriting policies and procedures for the major loan products in each lending category. Discuss lending requirements such as loan-to-value ratios, credit requirements and documentation requirements. Discuss the terms of your variable rate loans, including whether or not they are underwritten at fully indexed rates. Also, disclose if you have underwritten any hybrid loans, such as payment option ARM's, and or sub-prime loans, including how you define that term.

Given the recent economic turmoil, the SEC staff continues to request registrants to provide additional information to enhance their disclosures about loan underwriting policies, risks in the loan portfolio, and management of such risks, since such information is important to understanding a registrant's business. Registrants have been asked to:

- Describe the significant terms of each type of loan product offered, including underwriting standards used for each product (e.g., maximum loan-to-value ratios, minimum covenant requirements).
- Clarify how underwriting polices might vary for different products.
- Describe changes, during the periods presented, to underwriting policies for major types of originated loans.
- Provide detailed disclosures about their risk management practices for commercial real estate lending.
- Disclose the associated loan products and how the increased credit risks associated with interest rate reset are monitored.
- Disclose the specific strategies used to reduce risk, such as insurance arrangements, credit default agreements, and credit derivatives, and the impact that such mitigation strategies have had on the financial statements.

Loan Loss Reserves

Examples of SEC Comments

- *Method for Determining the Allowance for Loan Losses* — Please revise to provide a description of the accounting policies and methodology used to estimate your allowance for loan losses and doubtful accounts, including an identification of the factors that influence management's judgment. To the extent your allowance includes both specific allowances for troubled accounts and a general reserve on the remaining portfolio, please address each separately. Please also revise to disclose your policy for placing loans and receivables on nonaccrual status, recording payments received on nonaccrual loans and receivables, and resuming accrual of interest. In addition, revise to disclose your policy for determining past due or delinquency status. Refer to [ASC 310-10-50-9 (formerly paragraph 13 of SOP 01-6)]. Please provide us with a copy of your intended revised disclosure.
- *Modifications to the Method for Determining the Allowance for Loan Losses* — We note that . . . you modified your methodology for determining your allowance for loan losses. Please . . . clearly disclose the specific modifications made to your methodology and quantify the impact that such a change had on the level of your allowance.
- *Changes in Loss Assumptions* — Please tell us why you increased your credit loss assumptions from [X%] to [Y%]. Please provide us with a timeline of events that occurred that caused you to increase the loss rate and the circumstances that led you to reevaluate your credit losses. To the extent your prior credit loss assumption was revealed to be low by subsequent charge-offs, please explain why the credit loss assumption was not adjusted prior to [the] charge-off.

Examples of SEC Comments

- *Considerations of Negative Trends* — We note the continued deterioration in the credit quality of your loan portfolio over the past several years and the first quarter . . . which has resulted in your ratio of non-performing loans to total gross loans increasing in each. . . . We also note your disclosures . . . regarding contractions in the availability of business and consumer credit, increases in corporate borrowing rates, falling home prices, increasing home foreclosures, rising levels of unemployment and recent changes in your expectations surrounding the foreclosure process as a result of the current recessionary cycle. Please tell us in more detail, and disclose in future filings, the impact that these negative factors and trends had on your determination of the allowance for loan losses, including your appraisal and valuation process. In addition, provide us with the information necessary, and enhance disclosures in future filings, to explain the apparent directional inconsistency between the significant increase in non-performing loans and the coverage ratio for these loans.
- *Continued Deterioration in the Credit Quality of Loan Portfolios* — We note the continued deterioration in the credit quality of your loan portfolio. Please revise your disclosure in future filings to comprehensively bridge the gap between the significant increases in your non-performing and impaired loans. Discuss the relationship between your non-performing and impaired loans and the allowance for loan losses and link this information to the increase in your allowance for loan losses and discuss in detail the extent to which your non-performing and impaired loans are collateralized. Also, clearly discuss how the specific change in delinquencies impacts your calculation of the allowance for loan losses.
- *Individual Loan Loss Reserves* — We note on page [X] that your non-performing loans have increased in part due to a [$X] loan secured by a completed condominium development project that defaulted during the year. As a result of this default, you recorded a [$X] provision for loan loss during 2008. We also note in Form 10-Q . . . that you recorded an additional [$X] provision as a result of continued deterioration in the market, as evidenced by the lack of unit sales in the project. Please provide us with a comprehensive response which provides a detailed analysis and timeline of events supporting your decisions to record provisions for loan losses for this particular loan relationship and the carrying value of this loan.
- *Reserves for Loans That Are Not Individually Impaired* — We note that . . . there were no loans subject to delinquent principal or interest and you have not recorded a provision for probable loan losses. Please tell us how loans that are determined not to be individually impaired, are considered in the assessment of an allowance under [ASC 450 (formerly Statement 5)], SAB 6L and EITF Topic D-80, Question 10. In that regard, explain how you considered the referenced guidance in determining that no allowance is required for probable credit losses inherent in the remaining portion of your loan portfolio that was not identified as individually impaired.

Method for Determining the Allowance for Loan Losses

Determining the appropriate amount to recognize as an allowance for loan losses is one of the most significant and subjective estimates in the financial statements of registrants that lend to or finance the activities of others. Consequently, registrants are expected to employ a systematic and well-documented method for maintaining the appropriate level of allowance for loan losses. The SEC staff regularly questions registrants about the method and assumptions they used in estimating the allowance for loan losses. ASC 310-10-50-9 (formerly paragraph 13(b) of SOP 01-6) requires that a registrant disclose “a description of the accounting policies and methodology [that the registrant] used to estimate its allowance for loan losses . . . . Such a description should identify the factors that influenced management’s judgment (for example, historical losses and existing economic conditions) and may also include discussion of risk elements relevant to particular categories of financial instruments.”

Modifications to the Method for Determining the Allowance for Loan Losses

The SEC’s interpretive response to Question 14 of SAB Topic 6.L states, “The staff normally would expect that, if the methodology [for determining the allowance for loan losses] is changed . . . , documentation that describes and supports the change would be maintained.” In a manner consistent with SAB Topic 6.L, the SEC staff commonly requests that the registrant provide the following information when the method for determining the allowance for loan losses is modified:

- The nature of and reason for the modification.
- The specific modification(s) made.
- The support for why the modification is necessary.
- The support for why the modification is expected to result in a more appropriate allowance.
- The impact of the modification on the level of the allowance for loan losses.

In its comments on modifications to the method for determining the allowance for loan losses, the SEC staff commonly cites the guidance in SAB Topic 6.L and Chapter 9 of the AICPA Audit and Accounting Guide *Depository and Lending Institutions*.

Changes in Loss Assumptions

The SEC staff frequently asks registrants to disclose more detailed information about changes in loss assumptions. In particular, registrants are commonly requested to tell the staff, or disclose in the notes to the financial statements, why loss assumptions changed, including what events or circumstances occurred that caused the change. If a registrant adjusts a loss assumption for changes in environmental factors (e.g., increased delinquency rates within a particular geographic region), the SEC staff expects the registrant to maintain sufficient, objective evidence that supports the adjustment (including support of the amount of the adjustment(s)) and that explains why the adjustment is necessary to reflect current information, events, and circumstances.[1] Registrants have been asked to:

- Provide the analysis that resulted in the adjustment to the loss rates for the affected loan portfolio.
- Furnish the timeline of events or circumstances that led to the change in loss assumptions.
- Describe the specific assumptions that changed in connection with performing the impairment analysis.

In addition to asking questions about changes in loss assumptions, to the extent that a prior-period loss assumption was revealed to be low on the basis of subsequent charge-offs, the SEC staff commonly requests registrants to explain in detail why the loss assumption was not adjusted before the actual charge-off. In particular, the SEC staff often is interested in understanding what caused the charge-off to exceed the original loss assumptions and why the charge-off was taken in the current period rather than in a prior period.

Considerations of Negative Trends

As a result of the deterioration in the credit markets, the SEC staff expects registrants to disclose the effect of negative trends (e.g., a downturn in a particular industry or geographic region) on their impairment analysis. In particular, the staff commonly requests registrants to more clearly explain the effect of current trends on specific loan loss assumptions. Registrants have been asked to:

- Explain how the allowance and provisions are directionally consistent with changes in asset quality.
- Quantify and explain how actual changes and expected trends in nonperforming loans affected the allowance for loan losses.
- Disclose the impact geographic concentration has on the portfolio, considering the recent decline in the real estate market.

SAB Topic 6.L addresses current trends in the determination of the appropriate loan loss assumptions. Specifically, the interpretive response to Question 2 of SAB Topic 6.L.4 states:

> In developing loss measurements, registrants should consider the impact of current environmental factors and then document which factors were used in the analysis and how those factors affected the loss measurements. Factors that should be considered in developing loss measurements include the following: [footnote omitted]
>
> - Levels of and trends in delinquencies and impaired loans;
> - Levels of and trends in charge-offs and recoveries;
> - Trends in volume and terms of loans;
> - Effects of any changes in risk selection and underwriting standards, and other changes in lending policies, procedures, and practices;
> - Experience, ability, and depth of lending management and other relevant staff;
> - National and local economic trends and conditions;
> - Industry conditions; and
> - Effects of changes in credit concentrations.

Continued Deterioration in the Credit Quality of Loan Portfolios

As a result of continued deterioration in the credit quality of loan portfolios, the SEC staff expects registrants to include discussions of relationships between nonperforming loans, impaired loans, and the allowance for loan losses to help users understand the expected charge-off trends.

[1] See the interpretive response to Question 2 of SAB Topic 6.L.4.

In addition to asking questions about relationships between the allowance for loan losses and nonperforming and impaired loans, the SEC staff has requested registrants to explain trends and fluctuations depicted by asset quality ratios between periods, in some instances requesting a chronology of events and explanations of directional inconsistencies among relationships.

Individual Loan Loss Reserves

The SEC staff has asked registrants to provide a detailed analysis and timeline of events supporting provisions, or the lack thereof, for loans that are subject to the impairment considerations of ASC 310. The staff may also ask a registrant to provide such details for individually large loans. Registrants have been asked to:

- Describe when a loan was originated; became nonaccrual, impaired, or both; and was foreclosed on.
- Describe how the amount of the provision was determined.
- Describe how the period in which the provision was recorded was determined.
- Disclose whether a loan is collateral-dependent and, if so, whether an independent appraisal (or appraisals) was obtained to determine the provision recorded as of period-end.
- Describe the underlying collateral supporting a loan and any other pertinent information deemed necessary to understand the review of and related accounting for the loan as of period-end and through the date of registrants' responses.

Reserves for Loans That Are Not Individually Impaired

In situations in which no impairment has been assessed under ASC 310 (formerly Statement 114), the SEC staff requests registrants to explain their application of available guidance, such as ASC 450 (formerly Statement 5), SAB Topic 6.L, and EITF Topic D-80.

Question 10 in Exhibit D-80A of EITF Topic D-80 discusses the allowance for loan losses in situations in which an individual loan is determined not to be impaired under ASC 310. The response to Question 10 states, in part:

> Under [ASC 450], a loss is recognized if characteristics of a loan indicate that it is probable that a group of similar loans includes some losses even though the loss could not be identified to a specific loan. However, the loss would be recognized only if it is probable that the loss has been incurred at the date of the financial statements and the amount of loss can be reasonably estimated.

The answer to Question 12 of the same exhibit further explains that if a loan is assessed as impaired under ASC 310, "no additional loss recognition is appropriate under [ASC 450] even if the measurement of impairment under [ASC 310] results in no allowance."

In addition to the above, the SEC's interpretive response to Question 4(c) of SAB Topic 6.L states that the staff would expect a registrant, in determining its loan loss allowance under ASC 450, to document its decision to include loans that are not impaired under ASC 310. Documentation should include "specific characteristics of the loans that were the basis for grouping these loans with other loans"; the registrant should "maintain documentation to support its method of estimating loan losses." Furthermore, the same interpretive response notes:

> [The registrant] should take steps to prevent layering loan loss allowances. Layering is the inappropriate practice of recording in the allowance more than one amount for the same probable loan loss.

Loan Loss Reserves Disclosures

In August 2009, the SEC's Division of Corporation Finance sent a sample letter to certain public companies regarding disclosures in MD&A about provisions and allowances for loan losses. The letter suggests that a registrant disclose, to the extent relevant and material:

- *Additional information about higher-risk loans* — Because some loans are at greater risk for noncollection than others, a registrant should consider providing additional disclosures about these risks and any known trends or uncertainties that could affect the registrant's results of operations. These disclosures may include:
    - The carrying value and allowance of higher-risk loans by loan type.
    - The "current loan-to-value ratios by higher-risk loan type, further segregated by geographic location to the extent the loans are concentrated in any areas," and how the ratios were calculated.
    - The "amount and percentage of refinanced or modified loans by higher-risk loan type."
    - The asset quality information and measurements by higher-risk loan type.

- o The policy for classifying loans as nonaccrual "when a loan's terms allow for a minimum monthly payment that is less than interest accrued on the loan," and how this policy affects statistics about nonperforming loans.
- o The "expected timing of adjustment of option [adjustable-rate mortgage (ARM)] loans and the effect of the adjustment on future cash flows and liquidity."
- o The "amount and percentage of customers that are making the minimum payment on their option ARM loans."

- *Additional information about why the registrant changed its practices for determining the allowance for loan losses and a quantification of the effects of those changes* — A registrant should consider disclosing:
  - o The historical loss data used to estimate current losses.
  - o How incorporated economic factors affect loan quality in the allowance estimate.
  - o The level of specificity the registrant uses to group loans when estimating losses.
  - o The nonaccrual and charge-off policies.
  - o How loss factors are applied to graded loans.
  - o Any other estimation methods and assumptions used.
- *Additional information about declines in collateral value* — Because declines in collateral value may affect loan collectibility, a registrant should consider disclosing:
  - o The "approximate amount (or percentage) of residential mortgage loans as of the end of the reporting period with loan-to-value ratios above 100%."
  - o How housing price depreciation and a homeowner's loss of equity in the collateral is considered in the "allowance for loan losses for residential mortgages."
  - o The "timing and frequency of appraisals and . . . the sources of those appraisals for collateral-dependent loans."

Interest Reserves

Examples of SEC Comments

- With a view towards enhanced disclosures in your next Form 10-K, please tell us whether any of your residential spot construction loans or other loan products have established loan-funded interest reserves. If so, please tell us the following:
  - o The amount of such loans and the accompanying interest reserves as of [year-end] and the three subsequent quarter ends.
  - o How you monitor such projects throughout their lives to make sure the properties are moving along as planned such that it is appropriate to continue to capitalize the interest to the loan.
  - o Whether you have ever extended, renewed or restructured terms of the related loans, and the reasons for the changes.
  - o Your underwriting process for loans with interest reserves, and any specific differences in how you underwrite loans with interest reserves and loans that do not have interest reserves.
  - o Whether any of your loans with interest reserves are currently on non-accrual or are impaired.
- Given the current economic environment discussed . . . related to your residential construction and commercial loan portfolios, please tell us and revise future filings to disclose whether you evaluate interest income accrued on loans with interest reserves for collectability prior to maturity. Please tell us and revise your future filings to disclose how you monitor these loans on an ongoing basis for deterioration in credit quality.

Loans with interest reserves have attracted the attention of both the SEC staff and banking regulators. The interest reserve account allows a lender to periodically advance loan funds to pay interest charges on the outstanding balance of the loan. The interest is capitalized and added to the loan balance. In the current environment, borrowers may find it difficult to service such loans.

The SEC staff has asked registrants to provide information about the use of interest reserves in their portfolios and the existence of any additional incremental risk. Registrants have been encouraged to:

- Discuss the loan types for which interest reserves are required and the purpose of the interest reserves.
- Disclose the principal amount of loans subject to interest reserves and the remaining interest reserves.

- Discuss the underwriting process for loans with interest reserves as well as any specific differences between loans with interest reserves and loans without interest reserves.

In addition to requesting these enhanced disclosures, the SEC staff sometimes asks registrants to clarify the procedures they used to monitor the collectibility of the interest capitalized and whether it is appropriate to continue to recognize income.

Auction Rate Securities

Examples of SEC Comments

- *Litigation Settlement* — You disclose that [during the year] you entered into a settlement in principle with [Entity X] regarding auction rate securities. . . . Please tell us how you accounted for the settlement and the accounting guidance that you relied upon.
- *Valuation* — We note that you utilize various inputs to determine the fair value of certain auction rate and mortgage backed securities (determined under Level 2 and/or Level 3 of the fair value hierarchy). Please provide us with a more detailed description of the models. Provide us with a detailed description of the inputs (for example, the discount rates used) and information used to develop those inputs for your models. Tell us how your approach complies with [ASC 820-10-35-52 through 35-55 (formerly paragraph 30 and the related appendixes of Statement 157)].

Litigation Settlement

The SEC staff has focused on a registrant's disclosures about the accounting for settlement agreements related to ARSs. During the third quarter of 2008, several large financial institutions entered into settlement agreements with state and federal regulators regarding the marketing and selling of ARSs. The settlement agreements were in response to the intense scrutiny by regulators and investors in the wake of significantly deteriorating conditions in the ARS market and indemnified certain investors for losses on their ARS portfolios. The SEC staff may ask a registrant to provide additional information about the settlement and its accounting, including reference to the specific accounting guidance applied.

In some cases in which a registrant's customers held ARSs and the registrant has not been required to either settle or repurchase the securities, the SEC has inquired whether the registrant considered a need for a contingent liability for the potential exposure.

Valuation

As discussed in the Fair Value and the Turmoil in the Credit Markets section, the SEC continues to comment on the valuation of ARSs and has requested registrants to further explain their valuation models, including key assumptions used, terms of the ARSs such as maturity dates, reset provisions, and interest rate provisions. The SEC has also requested quantitative information, such as the number and value of failed auctions, and for securities sold during the year, the gains or losses realized on the sale.

Real Estate

The SEC staff's comments to registrants from the real estate industry have focused on topics such as impairments, risk factors, non-GAAP measures, and use of appraisals.

Impairments

Examples of SEC Comments

- *Impairment Disclosures* — Please expand your critical accounting policy to provide additional insight on how you perform your impairment analysis under [ASC 360-10-35 (formerly Statement 144)] for each inventory category reflected on your consolidated balance sheets, as well as your investments in unconsolidated entities. We believe it is important to provide investors with information to help them evaluate the current assumptions underlying your impairment assessments relative to your current market conditions and your peers to enable them to attempt to assess the likelihood of potential future impairments. For example, please consider including the following:
    - Please disclose the number of communities tested for impairment during each period presented, the number of communities you determined to be impaired during each period presented, and the total number of communities which exist at the end of each period presented.
    - Please expand the discussion of the significant estimates and assumptions used to determine estimated future cash flows and fair value to provide more detailed information regarding the underlying assumptions. For example, disclose the basis for your assumptions of the timing of home sales and selling prices and costs and the process you use to develop these assumptions. . . .
    - Discuss how sensitive the fair value estimates are to each of these significant estimates and assumptions used, as well as whether certain estimates and assumptions are more subjective than others.
    - Provide specific quantified disclosure regarding significant communities or sub-areas within your regions that have been impacted severely by the downturn in the housing market, where inventory is moving at a slower than anticipated pace, or whose sales prices or margins are trending downward.
- *Impairment Charges on Condominiums Under Development* — The disclosure indicates that for-sale condominium assets under development are evaluated for impairment using the held for investment model (using projected undiscounted cash flows) until construction is completed. . . . Please describe the methodology the company utilizes to arrive at the projected undiscounted cash flows including the number of years subsequent to the completion of development the cash flows are projected for. Clarify to what extent current sale prices for developed condominiums are utilized in arriving at the projected undiscounted cash flows.
- *Impairment Charges on Condominiums Under Development* — Please clarify whether the company expects to record impairment charges on for-sale condominium assets that are currently under development once they are completed and are then required to be evaluated under the held for sale model. For example, clarify if projected development costs per unit upon completion are expected to be in excess of selling price per unit less costs to sell, based on current sale transactions.
- *Other Early-Warning Disclosures* — We note your discussion of the homebuilding environment and the impact that developments in the homebuilding industry and your various ongoing investigations have had on your results of operations. We urge you to find ways to provide additional quantitative disclosures that convey to investors the current and ongoing risks related to the recoverability of your homebuilding assets as well as the risk that additional charges may need to be recorded. . . . For example, if you have significant amounts of inventory for which you determine the fair value is close to your book value, you should consider how you can constructively convey the potential risk associated with these inventory amounts. We believe that it is important to provide investors with information to help them evaluate the current assumptions underlying your impairment assessment relative to your current market conditions and your peers to enable them to attempt to assess the likelihood of potential future impairments. We believe that detailed rather than general disclosures regarding these risks and exposures would provide investors with the appropriate information to make this evaluation. You should consider providing these additional disclosures related to each type of potential charge including impairment charges related to inventories held for development, land held for sale, option contract abandonments, and goodwill, as well as charges related to investments in joint ventures. Please also consider whether these types of disclosures would be more meaningful if provided at the segment level.

The residential housing market continued to deteriorate in 2009. As a result, homebuilders, owners, and operators have recorded significant charges for impairment of their real estate inventories, investments in joint ventures, goodwill, and other intangibles. There are also signs that the commercial real estate market is under stress, and several real estate investment trusts have recorded material impairment charges. As discussed in the Business Combinations, Long-Lived Assets, and Impairments section, the SEC staff continues to issue a significant number of comments on impairments.

Impairment Disclosures

The SEC staff has frequently requested registrants to provide more transparent disclosures about their process for evaluating their real estate for impairment and the methods used to determine the impairment charges recorded. Such disclosures might include:

- The number of properties evaluated in each period.
- The number of properties for which impairment was indicated.
- The extent of involvement of third-party specialists (appraisers) in determining fair value.
- The extent of reliance on internally developed models in the fair value estimates.
- The specific discount rates, or range of rates, used.
- A sensitivity analysis of the impact of changes to key assumptions.

Impairment Charges on Condominiums Under Development

The impairment model for long-lived assets to be held and used under ASC 360-10-35 (formerly Statement 144) requires an impairment loss only if the carrying amount of a long-lived asset is not recoverable from its undiscounted expected future cash flows. A condominium project that is under development is evaluated for impairment by using the "held-and-used" impairment model. The staff may ask a registrant to describe the method and assumptions used to determine undiscounted expected future cash flows, such as the sales prices and projected number of years after the condominium project is completed.

Once the condominium project is completed and the condominiums are ready for sale in their current condition, the "held-for-sale" model is used to evaluate them for impairment. Under this model, an impairment loss must be recognized if the carrying amount of the long-lived asset exceeds its fair value less cost to sell. Because of these two models, it is possible for a condominium project that is under development to be deemed not impaired until completion, then immediately impaired and requiring a write-down upon completion. Therefore, the SEC staff has asked developers to provide early-warning disclosures if current sales transactions indicate that the projected carrying amount of the condominiums under development is expected to exceed their fair values less costs to sell once the condominiums are completed.

Other Early-Warning Disclosures

The timing of impairment charges continues to be frequently challenged by regulators and others, so early-warning disclosures in MD&A should be thorough and specific if there are potential losses on the horizon. We understand that the SEC staff will be asking for more disclosures in MD&A about what the conditions that resulted in impairments mean to the registrant's business as well as for more forward-looking information about the risk of future impairments. Any known trends or uncertainties that registrants reasonably expect to result in a material impact on impairment losses before the actual charges are announced should be disclosed as soon as they are known. For more information about early-warning disclosures, see the Business Combinations, Long-Lived Assets, and Impairments section.

Risk Factors

Examples of SEC Comments

- Please add a risk factor to discuss the particular risks currently associated with rising vacancy rates for commercial property, particularly in large metropolitan areas. The risk factor should describe actual trends in the current market for commercial real estate as well as the risks of higher vacancy rates, such as lower revenues, reduced rental rates, and increased tenant improvements or concessions. In the alternative, please discuss . . . why such risks are not applicable to your business.
- Please provide a schedule of lease expirations for each of the next 10 years, including:
  - The number of tenants whose leases will expire;
  - The net rentable square feet covered by such leases;
  - The annual rental represented by such leases; and
  - The percentage of gross annual rental represented by such leases.

  Please provide this disclosure in future filings and tell us how you plan to respond.

The SEC staff is clearly aware that current economic conditions may make the leasing of vacant space more difficult, and thus has been requesting more detailed disclosures about the risks associated with vacant space, such as rising vacancy rates and the amounts and timing of lease expirations.

Non-GAAP Measures

Example of an SEC Comment

- We are unclear how your calculation of FFO [funds from operations] complies with the requirements of Item 10(e) of Regulation S-K and the Frequently Asked Questions Regarding the Use of Non-GAAP Financial Measures. Specifically it appears that you have adjusted FFO for certain recurring items. . . . Explain to us how these adjustments are appropriate in accordance with Item 10(e) of Regulation S-K and tell us how you have met all the disclosure requirements of Item 10(e) of Regulation S-K and question 8 of the Frequently Asked Questions Regarding the Use of Non-GAAP Financial Measures.

A number of registrants in the real estate industry have been adjusting standard industry metrics, such as funds from operations (FFO), to eliminate recurring expenses, such as impairment charges or acquisition costs. The staff has commented on disclosures about the usefulness of non-GAAP measures, how they are used by management to evaluate enterprise performance, and whether the metrics are primarily operating or liquidity measurements under Regulation S-K, Item 10(e)(1). See the Non-GAAP Measures section for additional information.

Use of Appraisals

Example of an SEC Comment

- We note you use information contained in the independent appraisal obtained upon acquisition of each property as the primary basis for the allocation to Land and Buildings and improvements. Please tell us the nature and extent of the third party's involvement in management's decision making process with respect to determining the fair value of these instruments.

Third-party valuation specialists are frequently used to help management analyze impairment or allocate the purchase price of a property to its various tangible and intangible components. The SEC staff has said that registrants are not required to refer to an independent valuation firm or other expert in registration statements or periodic reports. However, registrants that choose to refer to an expert may be required to provide consents from the expert. On the basis of informal discussions with the SEC staff, we understand that the key to assessing when a consent will be required is the degree to which management takes responsibility for the ultimate conclusion. The SEC staff has indicated that it would look to the totality of the disclosure provided in determining whether management appears to be taking responsibility for the conclusion. See the Use of Experts and Consents section for further discussion.

Other Deloitte Resources

- Financial Reporting Alert 09-3, "SEC Advises Registrants to Further Explain Provisions and Allowances for Loan Losses in MD&A."
- Financial Reporting Alert 08-13, "Accounting Considerations for Settlement Agreements Related to Auction Rate Securities."
- Financial Services Industry 2009 Accounting, Financial Reporting, Tax and Regulatory Update, December 5, 2009. (Request a copy.)

Health Sciences

Health Care

The SEC staff's comments to registrants from the health care industry have focused on topics such as revenue recognition, adequate disclosure about significant judgments and estimates regarding medical cost development, the contractual obligations table, and references to third parties.

Health Plans

Revenue Recognition — Medicare Part D Program

Example of an SEC Comment

- It appears that your accounting for the subsidies received from [the Centers for Medicare and Medicaid Services (CMS)] related to the member responsibility amounts differs from the accounting for the insurance premiums and beneficiary premiums. Please revise your disclosure to clarify the reason for the different accounting and discuss how the receipt and payment activity related to the CMS subsidies are accumulated and recorded in the balance sheet.

A number of health plans participate in the federal government's Medicare Part D program. The SEC staff has requested registrants to disclose in sufficient detail, for each key payment received as part of the program, whether there is insurance risk and how each payment is accounted for as either premium revenue or deposits.

ASC 720-20-25-1 (formerly paragraph 44 of Statement 5) states, in part:

> To the extent that an insurance contract or reinsurance contract does not, despite its form, provide for indemnification of the insured or the ceding entity by the insurer or reinsurer against loss or liability, the premium paid less the amount of the premium to be retained by the insurer or reinsurer shall be accounted for as a deposit by the insured or the ceding entity.

The determination of whether a paid insurance premium represents a payment for the transfer of risk or a deposit is a matter of judgment based on all relevant facts and circumstances. The "transfer-of-risk" criteria in ASC 944-20-15-41 through 15-54 (formerly paragraphs 9–11 of Statement 113 and EITF Topics D-34 and D-35) provide useful guidance on making this determination.

Medical Cost Development

Example of an SEC Comment

- Please revise your disclosure to identify and quantify each of the factors that contributed to favorable development of medical costs of [$XXX million] during the quarters ended March 31, 20X8 and March 31, 20X9.

The SEC staff's comments on this topic have focused on disclosures about medical cost development from one period to the next and the underlying factors contributing to changes in medical cost estimates. The establishment of incurred-but-not-reported claim reserves in the health care industry relies heavily on estimates and assumptions related to medical cost and utilization trends. Analysis of medical cost development can provide insight into the accuracy of these reserves and trends. Such analysis also allows investors and analysts to determine the quality of earnings for a given period, since it enables them to understand the swing of income statement activity from one period to the next along with the underlying drivers for the change.

Contractual Obligations

Examples of SEC Comments

- Please revise your contractual obligations table to include all insurance and policy holder fund payments you are obligated to make in the future. For those amounts that a payment may be claimed immediately, include them as "due within a year" and provide a footnote thereto. If you are unable to estimate when the payments may become due, tell us how you were able to estimate the amount of your obligations despite that fact. In addition, provide a footnote to explain the differences between the amounts presented here and the balance sheet.
- Please revise your contractual obligations table to present the liability for future policy benefits, unpaid claims and policyholders' funds gross of reserves for contracts subject to reinsurance or tell us why your current presentation is considered appropriate. It would appear that the reserves for contracts subject to reinsurance represent future legal obligations of [Company A] and are material in the aggregate. We note your disclosure on page [XX] where you state that your ceded reinsurance arrangements do not discharge your primary liability as direct insurer for the liabilities under contracts subject to reinsurance.

Regulation S-K, Item 303, requires registrants to include a table of contractual obligations in MD&A. The SEC staff has commented that a registrant should include in this table all insurance and policyholder fund payments it is obligated to make in the future. Further, the SEC staff has pointed out that for contracts subject to reinsurance, the contractual obligations table amounts should be presented gross of reserves, as long as the reinsurance represents future legal obligations of the registrant. This concept is the same as that in ASC 944 (formerly Statement 113) in that reinsurance contracts in which a ceding enterprise is not relieved of the legal liability to its policyholder do not result in removal of the related assets and liabilities from the ceding enterprise's financial statements. See the Management's Discussion and Analysis section for more information about the contractual obligations table.

Reference to Independent Actuaries

Example of an SEC Comment

- We note your reference to an independently prepared actuarial report. Please tell us the nature and extent of the involvement of [the] third party and tell us whether you believe they are acting as experts as defined in the Securities Act of 1933.

Many health care companies use independent actuaries to help them develop various management judgments and estimates. The SEC staff has said that registrants are not required to refer to an independent valuation firm or other expert in registration statements or periodic reports. However, registrants that choose to refer to an expert may be required to provide consents from the expert. On the basis of informal discussions with the SEC staff, we understand that the key to assessing when a consent will be required is the degree to which management takes responsibility for the ultimate conclusion. The staff has indicated that it would look to the totality of the disclosure provided in determining whether management appears to be taking responsibility for the conclusion. For more information, see the Use of Experts and Consents section.

Providers

Professional and General Liability Claims Not Covered by Insurance

Example of an SEC Comment

- Please disclose the following as they relate to the professional and general liability claims not covered by insurance: [t]he amount of case reserves and incurred but not reported claims reserves at each balance sheet date; [t]he description of the method used to estimate the incurred but not reported claims reserves; [t]he percentage of the estimate, representing unsettled claims; [t]he roll-forward of beginning to ending balance for the periods presented. The roll-forward should separately quantify the amounts incurred/paid relating to the current period from the prior periods; and, [s]ince you discount the professional and general liability claims, to the extent you materially adjust the prior period adjustments during the periods presented, please demonstrate to us that the amount and timing of cash payments for the liability are fixed or reliably determinable.

Many health care organizations are self-insured for professional and general liability claims. The SEC staff has requested additional disclosures about risk exposures related to the registrant's self-insurance, to the extent these exposures are material. These disclosures are in addition to those under ASC 450 (formerly Statement 5).

Malpractice Claims Experience

Example of an SEC Comment

- Malpractice expense decreased to [$XXX million] in 2008 from [$XXX million] in [20XX]. You disclosed that the [$XX million] decrease in the malpractice expense during [20XX] is primarily attributable to improved claims experience. Please revise your discussion to clarify whether the improvement is attributable to frequency or severity. To the extent it is attributable to both frequency and severity, quantify separately.

Malpractice claims expense may be a significant cost and can be subject to significant variability for many providers. Regulation S-K, Item 303, requires registrants to describe any unusual or infrequent events or transactions or any significant economic changes that materially affect income from continuing operations and to quantify the impact of such events. The SEC staff has continually commented that when attributing fluctuations to more than one factor, a registrant should quantify each factor.

Allowance for Doubtful Accounts

Example of an SEC Comment

- You disclose other accounts receivable with a net realizable value of [$XXX million] on page [XX]. Please disclose the nature of other accounts receivables, the hospital-specific goals and benchmarks for these receivables and trends in hospital-specific goals and benchmarks for these receivables. Please also enhance your disclosures as to how you determine the allowance for doubtful accounts for these receivables.

For most health care providers, establishment of the allowance for doubtful accounts relies heavily on estimates and assumptions that are material by nature given their high degree of subjectivity and that are or could be material to the provider's financial condition or operating performance. The SEC staff has commented on insufficient disclosures about material uncertainties associated with the methods and assumptions underlying the allowance, including the factors used to develop the estimate and why the estimate or assumptions may change. The focus of these comments is on improving investors' understanding of the quality of, and potential variability in, earnings and cash flows as well as the extent to which reported results are indicative of future performance.

Life Sciences

The SEC staff's comments to registrants from the life sciences industry have focused on revenue recognition, research and development (R&D) expenses, capitalized prelaunch inventory, business combinations, and intangible assets.

Revenue Recognition

Examples of SEC Comments

- *Product Sales* — We believe that your disclosure related to estimates of items that reduce gross revenue such as returns, chargebacks, customer rebates and other discounts and allowances could be improved to include a roll forward of the accrual for each estimate for each period presented. Please revise your disclosure to include the following:
  - Beginning balance,
  - Current provision related to sales made in current period,
  - Current provision related to sales made in prior periods,
  - Actual returns or credits in current period related to sales made in current period,
  - Actual returns or credits in current period related to sales made in prior periods, and
  - Ending balance.
- *Sales Returns* — Please provide us in disclosure type format the amounts of estimated rebates, returns, and chargebacks that are included in deferred revenues from product shipments. Regarding the amount of returns, tell us why you believe your estimate is reasonable considering the reason for deferring the revenue is due to your inability to reasonably estimate future returns.
- *Collaborative Arrangements* — For revenue arrangements with multiple deliverables, discuss your basis for how the deliverables are divided into separate units of accounting, how the consideration received under the arrangement is allocated to the separate units of accounting, and the applicable revenue recognition criteria for each.

Product Sales

The recognition of product sales in the pharmaceutical industry relies heavily on estimates and assumptions related to returns and other potential adjustments to revenue (i.e., chargebacks, customer rebates, shelf-stock adjustments, product returns and allowances, and other discounts and allowances). A number of factors may affect the timing and amount of revenue recognized. ASC 605-15 (formerly Statement 48) and SAB Topic 13 list factors for registrants to consider when accounting for potential adjustments to revenue.

To better understand these gross-to-net adjustments, the SEC staff may request registrants to provide improved disclosures about adjustments to revenue. Registrants may be asked to disclose the following:

- The nature and amount of each accrual as of the balance sheet date and the effect of using reasonably likely assumptions other than those used to arrive at each accrual.
- The factors (e.g., historical returns, estimated sales subject to a rebate, estimated remaining shelf life) considered in estimating each accrual.
- A discussion of the extent to which information (qualitative, quantitative, or both) was from external sources (e.g., end-customer prescription demand, third-party market research data).
- If applicable, a discussion of any shipments that are made as a result of incentives, that are in excess of ordinary-course-of-business inventory levels, or both, and the revenue recognition policy for such shipments.
- A rollforward of the liability for each estimate for each period presented.
- A discussion of the amount of, and reason for fluctuations in, each type of reduction of gross revenue, including the effect that changes in estimates of these items had on revenues and operations.

The SEC staff has also asked registrants to disclose the products or therapeutic areas from which revenue is derived, in accordance with ASC 280-10-50-40 (formerly paragraph 37 of Statement 131), or to explain why they believe no disclosure is necessary. See the Segment Reporting section for more information.

Sales Returns

The product sales agreements of pharmaceutical and biotech companies generally allow the buyer to return the product. ASC 605-15 specifies how companies should account for sales of products when the buyer has a return privilege, whether this privilege is contractual or is based on existing practice. Reserves for returns of pharmaceutical and biotech companies may be difficult to estimate. These reserves can be based on the outcome of future events and the long period over which products can be returned (e.g., product expirations can take place up to 30 months or more from the date of product manufacturing). In addition, with reserves, entities generally lack direct visibility into, or have less ability to determine or observe, the levels of inventory in a distribution channel as well as the current level of sales to end customers.

The SEC staff may request pharmaceutical and biotech registrants to expand or clarify disclosures about their ability to estimate returns. Registrants may be asked to disclose the following:

- Details of return policies and how they affect revenue recognition.
- The factors considered in estimating returns (e.g., susceptibility of the product to external factors, current stage in the product's life cycle, registrant's experience with similar types of sales of similar products or inability to apply such experience to changing circumstances, absence of a large volume of relatively homogeneous transactions, changes in the levels of inventory in a distribution channel, expected introductions of new products or newness of the product).

The registrant may also be asked to explain how its return policy complies with SAB Topic 13 and other revenue recognition literature, and how the registrant is able to recognize revenue if a reasonable estimate of returns cannot be made. Such disclosure might be particularly relevant for new product launches.

Collaborative Arrangements

Collaborative arrangements are common at biotech and pharmaceutical companies. ASC 808-10-15 (formerly Issue 07-1) provides guidance on how companies should recognize revenue for collaborative arrangements and what disclosures a participant in a collaborative arrangement should provide in the notes to the financial statements.

The SEC staff often asks biotech and pharmaceutical registrants about the nature of, and accounting for, their collaborative arrangements. The staff typically expects registrants to disclose the material terms of the collaborative arrangements, such as each party's rights and obligations under the arrangement, all payments made and received to date, all potential payments, the existence of royalty provisions, and duration and termination provisions. The staff may also request more extensive disclosures for collaborative arrangements, including the following:

- The basis for how the deliverables are divided into separate units of accounting and the applicable revenue recognition criteria for each.
- The accounting for each payment received or paid over each arrangement year, including how each is allocated to the separate unit of accounting.
- For initial payments received, an indication of a future performance obligation, events that will trigger revenue recognition, and the periods over which revenue is recognized.
- The accounting for any contingent milestone payments to be made under each collaborative arrangement.

Registrants may also be asked to file a material collaborative arrangement as an exhibit to the registration statement, in accordance with Regulation S-K, Item 601(b)(10).

The SEC staff has also focused on disclosures about licensing agreements that may be material to a registrant's operations. The staff has requested additional disclosures about the material terms of the agreement, including payment provisions, the existence of royalty obligations, aggregate milestones, usage restrictions, exclusivity provisions, and other rights obtained or obligations that must be met to maintain the agreement.

R&D Expenses

Example of an SEC Comment

- Please disclose the following information for each of your major active research and development projects:
  - The costs incurred during each period presented and to date on the project;
  - The nature, timing and estimated costs of the efforts necessary to complete the project;
  - The anticipated completion dates;
  - The risks and uncertainties associated with completing development on schedule, and the consequences to operations, financial position and liquidity if the project is not completed timely; and,
  - The period in which material net cash inflows from significant projects are expected to commence.

The SEC staff has often commented to registrants that have significant internal R&D expenses, significant acquired in-process research and development (IPR&D) assets, or both. For further discussion of the staff's comments on acquired IPR&D assets, see the Business Combinations and Intangible Assets section below.

The SEC staff may request disclosures about internal R&D expenses and estimated future expenses in addition to those required by ASC 730-10 (formerly Statement 2). Along with disclosing the types of activities and elements included in R&D expenses and the amount of R&D expenses incurred during each reporting period, a registrant may be asked to revise its MD&A and business section to disclose information about each major R&D project. Such information may include:

- The nature of each project, including its current status.
- The amount or range of estimated completion costs.
- The estimated timing to complete the phase in process and each future phase.
- The costs incurred to date on each project.
- The risks and uncertainties associated with completion.

The SEC staff may also issue comments asking a registrant to include, in its contractual obligations table in MD&A, commitments to make payments under R&D arrangements. See the Management's Discussion and Analysis section for more information about the contractual obligations table.

Capitalized Prelaunch Inventory

Example of an SEC Comment

- We note in certain circumstances you may commence the manufacture and inventory of commercial quantities of products that have not received final regulatory approval. Please provide us, in disclosure-type format, an expanded accounting policy for capitalization of unapproved products . . . to address the following:
  - o For each product with inventory capitalized prior to FDA approval, specifically state the point during the FDA approval process that management determines a probable future benefit exists.
  - o Disclose the status of the FDA's consideration of the safety and efficacy of the drug and evaluation of the manufacturing process at that point.
  - o Disclose how you apply the lower of cost or market principle to pre-launch inventory.

The SEC staff has also focused on the capitalization of prelaunch inventory that has not been approved by the Food and Drug Administration (FDA). The staff has asked registrants to quantify the total amount of capitalized unapproved inventory and clarify in their disclosures their accounting policy for the capitalization of unapproved products. In addition, the staff may request a registrant to indicate the point during the FDA approval process at which it determines a probable future benefit exists and the status of the FDA's consideration of the safety and efficacy of the product and evaluation of the manufacturing process at that point. Registrants may be asked to explain how the costs meet the definition of inventory in ASC 330-10-20 (formerly Statement 1 of Chapter 4 of ARB 43) and the definition of an asset in paragraph 26 of Concepts Statement 6.

The SEC staff may also request additional disclosures, including the following:

- A brief description of the overall FDA approval process.
- The current status of the approval process, the risks affecting the probability of obtaining FDA approval, and the estimated timing of obtaining approval.
- The specific nature of any issues outstanding and why the registrant does not believe those issues affect its conclusion about probable future benefits.
- The remaining shelf life of each capitalized product, as of each balance sheet date presented, and why the registrant believes it will be able to realize the asset's benefit before the expiration of the shelf life.
- The risks and uncertainties associated with market acceptance of the product, once it is approved, and how these risks and uncertainties will affect the realization of the asset.

Business Combinations and Intangible Assets

As discussed in the Business Combinations, Long-Lived Assets, and Impairments section, the SEC staff frequently asks questions about purchase price allocations for business combinations, the nature and terms of contingent consideration arrangements, and impairment disclosures. For registrants from the life sciences industry, the staff has also inquired specifically about significant IPR&D costs acquired during a business combination.

Statement 141 required that acquired IPR&D assets be valued in the purchase price allocation and then immediately expensed. However, ASC 805 (formerly Statement 141(R)) changed the accounting for acquired IPR&D. Under ASC 805, acquired IPR&D assets are not immediately expensed. Rather, acquired IPR&D is accounted for as an indefinite-lived intangible asset until completion or abandonment of the associated R&D efforts. Therefore, such assets would not be amortized, but would be tested for impairment at least annually. Once the R&D activities are completed, the assets would be amortized over the related product's useful life. If the project is abandoned, the assets would be written off if they have no alternative future use.

Historically, the SEC staff has requested extensive disclosures about significant acquired IPR&D costs, including the following:

- The specific nature and fair value of each significant IPR&D project acquired for each acquisition.
- The completeness, complexity, and uniqueness of the projects as of the acquisition date.
- The nature, timing, and estimated costs of the efforts necessary to complete the projects, and the anticipated completion dates.
- The valuation method that was used to measure the IPR&D projects acquired at fair value.

- The significant valuation assumptions.
- In periods after the acquisition, the status of efforts to complete the projects, and the impact of any delays on expected investment return, results of operations, and financial condition.

Although the comments above relate to acquisitions accounted for under Statement 141, the SEC staff also will most likely inquire about significant acquired IPR&D costs and look for expanded disclosures for acquisitions accounted for under ASC 805. In addition to requesting that registrants provide disclosures similar to those in ASC 350-30-50-1 through 50-3 (formerly paragraphs 44–46 of Statement 142), the staff may ask registrants to disclose (1) the amount of acquired IPR&D accounted for as intangible assets and the basis for determining that amount, (2) how the estimated useful life is determined for acquired IPR&D associated with completed R&D activities, and (3) the nature of impairments and impairment testing for acquired IPR&D.

Appendix A: SEC Staff Review Process

The SEC's Division of Corporation Finance selectively reviews filings made under the Securities Act of 1933 and the Securities Exchange Act of 1934. In January 2009, the SEC staff issued an overview that explains its filing review and comment letter process.[1] The overview aims to increase transparency in the review process and expresses the staff's willingness to discuss issues with registrants. For example, the overview indicates that the "[staff] views the comment process as a dialogue with a company about its disclosure" and that a "company should not hesitate to request that the staff reconsider a comment it has issued or reconsider a staff member's view of the company's response to a comment at any point in the filing review process."

The overview is divided into two main sections:

- *The Filing Review Process* — This section explains that the Division comprises 11 offices staffed by experts in specialized industries, accounting, and disclosures. The section includes background on the different types (required and selective) and levels of review and covers the comment process, indicating that "[m]uch of the [staff's] review [process] involves reviewing the disclosure from a potential investor's perspective and asking questions that an investor might ask when reading the document." The section also addresses how to respond to staff comments and close a filing review.
- *The Reconsideration Process* — This section emphasizes that "staff members, at all levels, are available to discuss disclosure and financial statement presentation matters with a company and its legal, accounting, and other advisors." In addressing a registrant's potential request for the SEC staff to reconsider a staff member's comment or view on a registrant's response, the staff emphasizes that registrants do not have to "follow a formal protocol." However, the staff explains where registrants should start and the steps involved in the normal course of the reconsideration process. The staff also specifies contact information for each office for both accounting and financial disclosure matters and legal and textual disclosure matters.

Registrants may involve the SEC's Office of Chief Accountant (OCA) during any stage of the review process. Unlike the Division's role, which is to address matters related to the age, form, and content of registrants' financial statements that are required to be filed, the OCA's role is to address questions concerning a registrant's application of GAAP. Guidance on consulting with the OCA is available on the SEC's Web site.

A registrant that receives an SEC comment letter should generally respond within the time frame indicated in the letter. See Appendix B for more information about responding to SEC comment letters. The registrant should continue to respond to any requests for more information until it receives a letter from the Division stating that the Division has no further comments. A registrant that does not receive a completion letter within a reasonable amount of time after submitting a response letter should call its SEC staff reviewer (named in the letter) to ask about the status of the review. If the review is complete, the registrant should request a completion letter.

To increase the transparency of the Division's review process, comment letters are made public, via the SEC's Web site, no more than 45 days after the review is completed. See Appendix C for tips on searching the SEC's comment letter database.

[1] An overview of the legal and regulatory policy offices is also available on the SEC's Web site.

Appendix B: Best Practices for Managing Unresolved SEC Comment Letters

The best practices below are intended to help registrants resolve any staff comment letters in a timely manner. Unresolved comments may affect a registrant's ability to issue financial statements and an auditor's ability to issue the current-year audit report. A registrant should do the following:

- Consider the impact the comment letter may have on its ability to issue the financial statements.
- Consult with its SEC legal counsel about the impact the comment letter may have on the certifications contained in its Form 10-K.
- Consult with its auditors to discuss the impact the comment letter may have on their ability to issue the current-year audit report.
- Review the comment letter immediately and respond to the SEC staff reviewer (named in the letter) within the time indicated in the comment letter (usually 10 business days). If possible, the registrant should not request an extension, since this may delay resolution of the comment letter. However, in certain circumstances, the registrant should consider requesting an extension to provide a more thorough and complete response that addresses all of the staff's comments.
- If the registrant does not fully understand any specific comment, the registrant should contact its SEC staff reviewer quickly for clarification so that it can provide an appropriate response.
- Include in the response a discussion of supporting authoritative accounting literature and references to the specific paragraph(s) from the standard(s).
- Because some comments may request disclosure in future filings, the registrant should consider including such disclosure in the response letter to potentially eliminate additional requests from its SEC staff reviewer.
- If an immaterial disclosure is requested, the registrant should consider explaining why the disclosure is immaterial instead of including the immaterial disclosure in future filings.
- Maintain contact with its SEC staff reviewer and make the reviewer aware of the registrant's required timing (on the basis of its current-year filing deadlines).
- If the registrant has not received a follow-up letter or been contacted within two weeks of filing the initial response letter, the registrant should contact its SEC staff reviewer to determine the status of the comments. The registrant should promptly address any follow-up questions.
- If the registrant is uncertain about whether its review has been completed without further comments, it should ask the SEC staff reviewer about the status of the review. If the review is complete, the registrant should ask the reviewer for a completion letter.

Oral Comments

In limited circumstances, the SEC staff may provide oral comments to a registrant instead of a written comment letter. The registrant should ask the SEC staff reviewer how he or she would like to receive the registrant's response to the oral comments. If the reviewer requests a response via EDGAR, a registrant should respond with a written letter. If the reviewer requests an oral response or identifies no preference, a registrant should still, although it is not required to do so, consider responding to the staff's comments with a letter to formally document the registrant's understanding of the staff's comments and the discussions held as well as the registrant's response.

Disclosure Requirements

Under the Securities Offering Reform, large accelerated filers, accelerated filers, and well-known seasoned issuers must disclose in their Forms 10-K the substance of any material unresolved SEC staff comments that were issued 180 or more days before the end of the current fiscal year.

Appendix C: Tips for Searching the SEC's Database for Comment Letters

The SEC releases comment letters and responses on its Web site no earlier than 45 days after the review of the filing is complete. Users can search the database on a quarterly basis as part of their financial statement review process. Registrants and nonregistrants can use these comments to improve their accounting and overall disclosure.

The guide below contains tips for using the "Full-Text Search" feature to find relevant comment letters on the SEC's database.

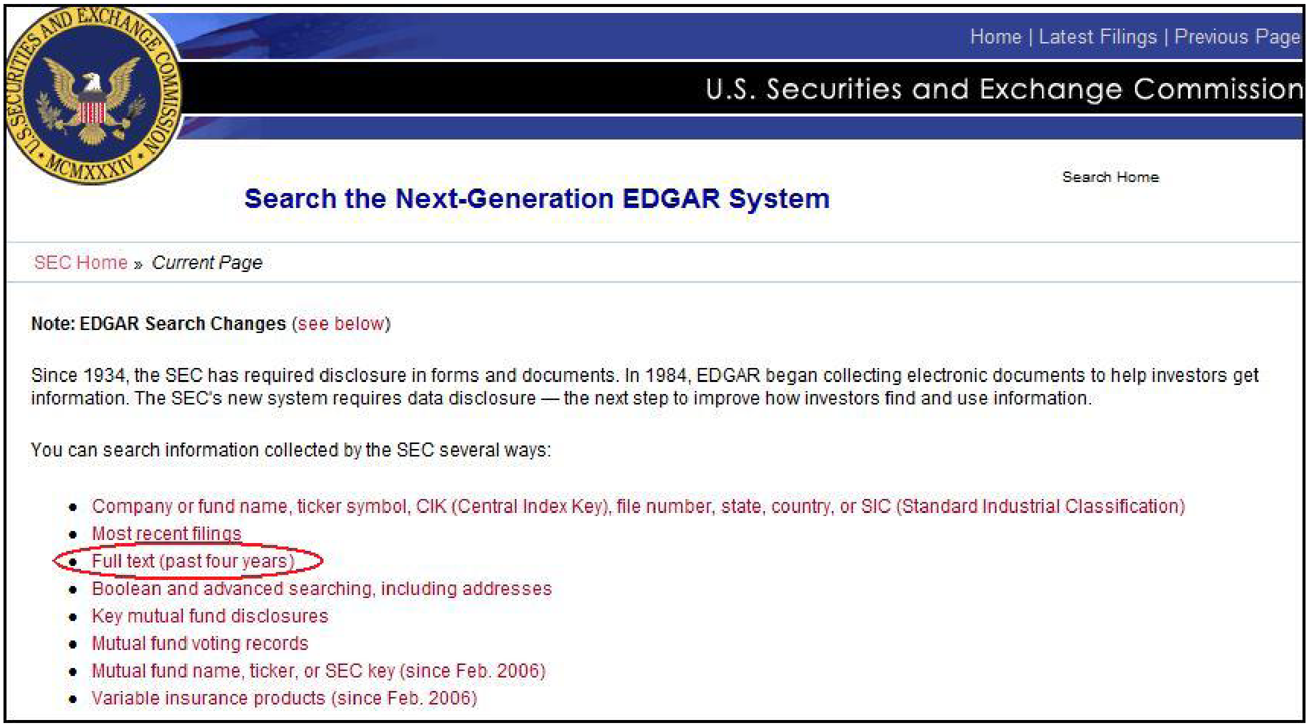
Full-Text Search Feature

This is one of the more helpful tools for finding relevant comment letters on the SEC's Web site. The Full-Text Search feature allows users to search the complete text of all filings posted electronically within the last four years. It performs two types of searches: basic and advanced. The basic search looks for all form types, while the advanced search can limit search results to specific filings.

To access the advanced search feature:

1. On the SEC's home page (www.sec.gov), select "Search for Company Filings" under "Filings & Forms." (Note: You may need to scroll down to find these selections.)

2. On the "Search the Next-Generation EDGAR System" Web page, select "Full text (past four years)."


Home | Latest Filings | Previous Page

U.S. Securities and Exchange Commission

Search Home

Search the Next-Generation EDGAR System

SEC Home » *Current Page*

Note: EDGAR Search Changes (see below)

Since 1934, the SEC has required disclosure in forms and documents. In 1984, EDGAR began collecting electronic documents to help investors get information. The SEC's new system requires data disclosure — the next step to improve how investors find and use information.

You can search information collected by the SEC several ways:

- Company or fund name, ticker symbol, CIK (Central Index Key), file number, state, country, or SIC (Standard Industrial Classification)
- Most recent filings
- Full text (past four years)
- Boolean and advanced searching, including addresses
- Key mutual fund disclosures
- Mutual fund voting records
- Mutual fund name, ticker, or SEC key (since Feb. 2006)
- Variable insurance products (since Feb. 2006)

3. On the "Full-Text Search" Web page, select "Advanced Search Page."


Home | FAQ

U.S. Securities and Exchange Commission

Full-Text Search

This page allows you to search the full text of EDGAR filings from the last four years. The full text of a filing includes all data in the filing as well as all attachments to the filing. To find the information you need and make your search easy and enjoyable, please visit our FAQ page. We are still developing this feature, and we plan to enhance it based on user feedback. Please email your comments and suggestions for improvement to textsearch@sec.gov.

Search For Text: Advanced Search Page

Search Reset

4. This brings up the following Web page.

The following are tips for using this page:

Form Types

To limit the search results to comment letters, use the drop-down menu next to "In Form Type:" and choose "CORRESP" for the registrant's response to the SEC (which usually includes the text of the SEC's comments) or "UPLOAD" for the comments only. To search for other items (e.g., sample disclosures in Forms 10-K and 10-Q), select the relevant form.

Performing Searches

Searches are performed by entering text into the "Search for Text" field. Full-Text Search features both "natural-language" and Boolean searching. With natural-language searching, one can search for a concept by using the language that would be used to express that concept to another person (e.g., fluctuations in interest rates). Full-Text Search will find all comment letters that include at least one of the words entered into the "Search for Text" field and will automatically find variations of the key word(s).

To search for a specific phrase, enclose the words in the search box within quotations (e.g., "management's discussion and analysis"). Full-Text Search will find all comment letters that include the exact phrase or a similar phrase, such as "managerial discussion and analysis."

Boolean searching includes the use of Boolean operators to make a search more precise. Some commonly used Boolean operators are AND, OR, and NOT (capitalization of these terms is required). For the operator to work effectively, a key word or phrase generally must be included before and after the operator (e.g., investments AND temporary).

- AND — Using AND in a search will find documents that include all terms connected by the AND operator (but not necessarily in the same sentence or paragraph). These terms can appear in any order in the document.
- OR — Using OR in a search will find documents containing any of the terms connected by the OR operator.
- NOT — Using NOT in a search will find documents that contain one term but not another term.

Modifications to Searches

Full-Text Search also allows a user to narrow search results by employing additional tools within the "Search for Text" field. Depending on the search criteria used, the results of the search could range from broad to more specific. These tools include Wildcard and Nearness searches.

Wildcard — While Full-Text Search automatically finds certain variations of a key word within comment letters, a user can ensure that all variations are considered by using a wildcard. An asterisk (*) is a wildcard that can be used in place of missing character(s) of the key word(s) to find all comment letters that include a variation of the word indicated (e.g., impair* would search for impair, impaired, impairing, impairment, and impairs).

Nearness — A user can search for key words or phrases within a certain proximity of each other by stipulating a range. The range is determined by using the term "NEARn" with the "n" as the maximum number of words within the range (e.g., "impair NEAR5 down" would find comment letters with impair and down within five words of each other).

Many of these tools can be combined. For example, the use of quotations to find a specified phrase can be combined with the use of the Boolean operators (e.g., investments AND "temporary decline").

Full-Text Search does not index numbers; therefore, numbers included within a query will be ignored. For example, a search for the terms route 66 hotels will locate documents that contain the terms "route" and "hotels" but will not identify any documents containing the number "66." The advanced search function can, however, limit searches to filings associated with certain special kinds of numbers, such as CIK numbers, dates, and filing types (see "Other Search Criteria" below for additional information).

Other Search Criteria

In addition to particular words or phrases, comment letters can be searched by:

- Company name.
- Central index key (CIK).[1]
- Standard industrial classification (SIC) code.[2]
- Date range.

The search engine includes specific boxes for each of these items, allowing further customization of results.

Note: A user can see a list of additional companies that have the same SIC code as the one in a list of search results by clicking on the SIC Code appearing in the list of search results.

Example

09/14/2006 EX-10.1 of 10SB12G for AOB BIOTECH INC
COMPANY NAME(s) - [**AOB BIOTECH INC (CIK - 1363449 (SIC - 6022)**
Exhibit 10.1 DEVELOPMENT AGREEMENT In this Agreement AOB BIOTECH INC. ("Developer"), a California registered company, doing business at 301 North Lake Ave., Pasadena and SuperMax USA, INC. ("Contractor"), located at Japan, agrees that on August, 2005. AOB BIOTECH INC. is to develop five formulas

Displaying Search Results

A user can select the number of results to include on each page by adjusting the "Results per page" drop-down list on the right side of the page. The most recent filings are listed first.

To open the comment letters, click on the underlined title of the form to the right of the date. The comment letters will include any attachments or exhibits.

Example of Benefits of Using Full-Text Search

Assume that a user in the hotel industry was interested in recent SEC comments on the determination of operating segments. By searching for the words "operating segments" in all forms, for all dates, a user would get 8,000+ results, many of which are not relevant.

We recently tried narrowing our search to the form type CORRESP by using the specific phrase in quotations, "operating segments"; using the industry code for the hotel/motel industry (SIC 7011); and providing a date range spanning only the last two years. We got a much lower number of results, all of which are relevant and are more manageable to review.

[1] According to the SEC's Web site, "a CIK is the unique number that the SEC's computer system assigns to individuals and corporations who file disclosure documents with the SEC. All new electronic and paper filers, foreign and domestic, receive a CIK number."

[2] A SIC code is an industry designation. Note that some of the SIC code descriptions are similar, so narrowing results by SIC code may not include certain issuers that are in a similar industry yet have a different assigned SIC code.

Finding Search Terms Within the Filing Document

HTML or Text Documents
Once the comment letter is opened, the user can find search terms by pressing the Ctrl and F keys simultaneously, then typing one or more of the key words into the box and clicking Find.

PDF Documents
Once the comment letter is opened, the user can find search terms by clicking on the binocular icon and typing one or more of the key words into the box and clicking Search.

Additional Help on Using Full-Text Search

The Full-Text Search Frequently Asked Questions (FAQ) page includes a valuable list of FAQs and answers. One of the FAQs indicates that if a user is having trouble, he or she may "[s]end an e-mail to the textsearch@sec.gov mailbox, telling . . . what [he or she is] trying to find and how [he or she has] been searching for it."

Appendix D: Deloitte Resources

Deloitte Publications

In addition to this publication, Deloitte has a range of publications to assist with SEC-related matters. These include:

Heads Up Newsletters:

- SEC Issues Financial Reporting Manual
- SEC Publishes Final Rule Mandating Use of "Interactive Data"
- SEC Modernizes Oil and Gas Company Reporting
- Study Finalized on Mark-to-Market Accounting
- SEC Approves Rules Requiring Registrants to Submit Interactive Data
- Highlights of the 2008 AICPA National Conference on Current SEC and PCAOB Developments
- SEC Issues Proposed IFRS Roadmap
- SEC Proposes to Give Certain U.S. Issuers the Option to Use IFRSs and Proposes a Roadmap to a Mandatory Transition Date for All U.S. Issuers
- SEC Holds Fourth Roundtable on IFRSs
- Complexity DeCIFiRed — SEC Advisory Committee Releases Final Report
- Something to Talk About — SEC Staff Explains the Filing Review and Comment Letter Process
- Great "X"pectations — SEC Proposes Mandating XBRL Use to Make Financial Data Interactive
- Regulations Committee and SEC Staff Hold First Meeting of 2008
- DeCIFiRing Complexity — SEC Advisory Committee Releases Progress Report
- Highlights of the 2007 AICPA National Conference on Current SEC and PCAOB Developments
- SEC Holds Roundtables on IFRSs
- Major Changes to Business Combination Accounting as FASB and IASB Substantially Converge Standards
- XBRL U.S. GAAP Taxonomy Made Available for Public Comment
- SEC Removes Reconciliation Requirement, Approves Smaller Public Company Rules
- SEC Regulations Committee and SEC Staff Hold Third Meeting of 2007
- ESOARS Take Off — SEC OKs Use of a Surrogate to Value Employee Share Options
- SEC Feedback on Executive Compensation Disclosures: "Where's the Analysis?"
- SEC Staff Issues Comment Letters on Executive Compensation Disclosures
- The Shift Toward IFRSs and Its Impact on U.S. Companies
- SEC Regulations Committee and SEC Staff Hold Second Meeting of 2007
- SEC Provides Further Relief for Smaller Public Companies
- SEC Proposes Easing Requirements for Foreign Filings
- SEC Tackles a Wide Range of Topics
- SEC and PCAOB Approve New Section 404 Guidance: No Additional Delay for Non-Accelerated Filers
- Expected SEC Actions Will Increase Relevance of IFRSs in the U.S.
- SEC Regulations Committee and SEC Staff Hold First Meeting of 2007
- SEC Discusses Improvements to Section 404 of the Sarbanes-Oxley Act
- SEC Clarifies Views on the Design of Market-Based Employee Stock Option Valuation Model
- Matching Critical Terms in Hedge Strategies — Major Accounting Firms Discuss Ramifications With SEC Staff
- SEC and PCAOB Update

Financial Reporting Alerts:

- 09-4: SEC Further Defers Section 404(b) Requirement for Nonaccelerated Filers
- 09-3: SEC Advises Registrants to Further Explain Provisions and Allowances for Loan Losses in MD&A
- 08-16 (Revised): SEC Issues Letter Clarifying Other-Than-Temporary Impairment Guidance for Perpetual Preferred Securities
- 08-11: SEC and FASB Release Fair Value Clarifications
- 08-10: SEC Advises Registrants to Further Explain Fair Value in MD&A — An Addendum to the March 2008 SEC Letter
- 08-7: SEC Advises Registrants to Further Explain Fair Value in MD&A
- 08-1: SEC Issues Letter Clarifying Accounting Ramifications of Accelerated Efforts to Mitigate Subprime Crisis
- 07-10: SEC Extends the Use of the Simplified Method in SAB 107 Under Certain Circumstances
- 07-5: CAQ Update — Key Accounting Issues and the Credit Environment
- 07-4: Key Accounting Issues and the Current Credit Environment

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Did You Know . . . ?

Deloitte's SEC Reporting Interpretations Manual includes interpretive guidance and more than 125 Q&As on the following topics:

- *Understanding the SEC.*
- *Business combinations* — Providing financial statements of an acquired business required under Regulation S-X, Rule 3-05.
- *Unconsolidated subsidiaries and equity method investees* — Providing financial information of unconsolidated subsidiaries and equity method investees required under Regulation S-X, Rules 3-09 and 4-08(g).
- *Real estate operations* — Providing financial information of acquired real estate operations required under Regulation S-X, Rule 3-14.
- *Registrant's financial statements.*
- *Guarantor financial statements* — Providing guarantor financial statements required under Regulation S-X, Rule 3-10.

The SEC Reporting Interpretations Manual is available on Technical Library: The Deloitte Accounting Research Tool. For more information, including subscription details and an online demonstration, visit www.deloitte.com/us/techlibrary.

In addition, in August 2009, Deloitte added *SEC Reporting for Business Combinations and Related Topics — A Roadmap to Applying SEC Regulation S-X to the Acquisition of a Business* to its Roadmap series. When a registrant acquires, or it is probable that it will acquire, a significant business or real estate operation (acquiree), it may be required to provide separate financial statements of the acquiree and pro forma financial information in a Form 8-K, registration statement, or proxy statement. This new roadmap is a valuable tool for understanding the related SEC reporting considerations. In addition, the roadmap covers how certain provisions of ASC 805 (formerly Statement 141(R)) affect the SEC reporting considerations for business combinations. The codified roadmap features an executive summary as well as over 100 Deloitte interpretive Q&As.

Appendix E: Glossary of Standards

FASB Accounting Standards Codification Subtopic 205-20, *Presentation of Financial Statements: Discontinued Operations* (Statement 144; EITF Issue 03-13)

FASB Accounting Standards Codification Subtopic 210-10, *Balance Sheet: Overall* (ARB 43)

FASB Accounting Standards Codification Topic 230, *Statement of Cash Flows* (Statement 95)

FASB Accounting Standards Codification Subtopic 230-10, *Statement of Cash Flows: Overall* (Statement 95)

FASB Accounting Standards Codification Subtopic 235-10, *Notes to Financial Statements: Overall* (Opinion 22)

FASB Accounting Standards Codification Topic 250, *Accounting Changes and Error Corrections* (Statement 154)

FASB Accounting Standards Codification Subtopic 260-10, *Earnings per Share: Overall* (Statement 128; EITF Issue 03-6)

FASB Accounting Standards Codification Topic 275, *Risks and Uncertainties* (SOP 94-6)

FASB Accounting Standards Codification Subtopic 275-10, *Risks and Uncertainties: Overall* (SOP 94-6)

FASB Accounting Standards Codification Subtopic 280-10, *Segment Reporting: Overall* (Statement 131)

FASB Accounting Standards Codification Subtopic 320-10, *Investments — Debt and Equity Securities: Overall* (Statement 115; FSP FAS 115-1 and FAS 124-1)

FASB Accounting Standards Codification Subtopic 325-40, *Investments — Other: Beneficial Interests in Securitized Financial Assets* (FSP EITF 99-20-1)

FASB Accounting Standards Codification Subtopic 330-10, *Inventory: Overall* (Statement 1 of Chapter 4 of ARB 43)

FASB Accounting Standards Codification Subtopic 350-10, *Intangibles — Goodwill and Other: Overall* (Statement 142)

FASB Accounting Standards Codification Subtopic 350-20, *Intangibles — Goodwill and Other: Goodwill* (Statement 142; EITF Topic D-101)

FASB Accounting Standards Codification Subtopic 350-30, *Intangibles — Goodwill and Other: General Intangibles Other Than Goodwill* (Statement 142)

FASB Accounting Standards Codification Subtopic 360-10, *Property, Plant, and Equipment: Overall* (Statement 144)

FASB Accounting Standards Codification Subtopic 410-20, *Asset Retirement and Environmental Obligations: Asset Retirement Obligations* (Statement 144; Statement 143; Interpretation 47)

FASB Accounting Standards Codification Subtopic 420-10, *Exit or Disposal Cost Obligations: Overall* (Statement 146)

FASB Accounting Standards Codification Subtopic 450-20, *Contingencies: Loss Contingencies* (Statement 5)

FASB Accounting Standards Codification Subtopic 470-10, *Debt: Overall* (Statement 6; EITF Issue 86-05; paragraph 7 of ARB 43, Chapter 3A; Technical Bulletin 79-3)

FASB Accounting Standards Codification Subtopic 470-20, *Debt: Debt with Conversion and Other Options* (FSP APB 14-1)

FASB Accounting Standards Codification Subtopic 470-50, *Debt: Modifications and Extinguishments* (EITF Issue 96-19)

FASB Accounting Standards Codification Subtopic 605-15, *Revenue Recognition: Products* (Statement 48)

FASB Accounting Standards Codification Subtopic 605-25, *Revenue Recognition: Multiple-Element Arrangements* (EITF Issue 00-21)

FASB Accounting Standards Codification Subtopic 605-35, *Revenue Recognition: Construction-Type and Production-Type Contracts* (SOP 81-1)

FASB Accounting Standards Codification Subtopic 605-45, *Revenue Recognition: Principal Agent Considerations* (EITF Issue 00-10; EITF Issue 99-19)

FASB Accounting Standards Codification Subtopic 715-30, *Compensation — Retirement Benefits: Defined Benefit Plans — Pension* (Statement 87)

FASB Accounting Standards Codification Subtopic 730-10, *Research and Development: Overall* (Statement 2)

FASB Accounting Standards Codification Subtopic 740-10, *Income Taxes: Overall* (Statement 109; FSP FIN 48-1; Interpretation 48)

FASB Accounting Standards Codification Subtopic 740-30, *Income Taxes: Other Considerations or Special Areas* (Statement 109; Opinion 23)

FASB Accounting Standards Codification Topic 805, *Business Combinations* (Statement 141(R))

FASB Accounting Standards Codification Subtopic 805-10, *Business Combinations: Overall* (Statement 141(R); EITF Issue 95-8)

FASB Accounting Standards Codification Subtopic 805-30, *Business Combinations: Goodwill or Gain From Bargain Purchase, Including Consideration Transferred* (Statement 141(R))

FASB Accounting Standards Codification Subtopic 808-10, *Collaborative Arrangements: Overall* (EITF Issue 07-1)

FASB Accounting Standards Codification Topic 810, *Consolidation* (Statement 160)

FASB Accounting Standards Codification Subtopic 810-10, *Consolidation: Overall* (Statement 160; FSP FAS 140-4 and FIN 46(R)-8; ARB 51; Interpretation 46(R))

FASB Accounting Standards Codification Topic 815, *Derivatives and Hedging* (Statement 133; Implementation Issues E4, E6, and E10)

FASB Accounting Standards Codification Subtopic 815-10, *Derivatives and Hedging: Overall* (Statement 133; Statement 107; EITF Issue 07-5)

FASB Accounting Standards Codification Subtopic 815-15, *Derivatives and Hedging: Embedded Derivatives* (Statement 133)

FASB Accounting Standards Codification Subtopic 815-20, *Derivatives and Hedging: Hedging — General* (Statement 133; Implementation Issue G9)

FASB Accounting Standards Codification Subtopic 815-30, *Derivatives and Hedging: Cash Flow Hedges* (Statement 133; Implementation Issue G7)

FASB Accounting Standards Codification Subtopic 815-40, *Derivatives and Hedging: Contracts in Entity's Own Equity* (Statement 133; EITF Issue 08-8; EITF Issue 00-19)

FASB Accounting Standards Codification Topic 820, *Fair Value Measurements and Disclosures* (Statement 157; FSP FAS 157-4)

FASB Accounting Standards Codification Subtopic 820-10, *Fair Value Measurements and Disclosures: Overall* (Statement 157)

FASB Accounting Standards Codification Subtopic 825-10, *Financial Instruments: Overall* (Statement 107)

FASB Accounting Standards Codification Topic 860, *Transfers and Servicing* (Statement 140)

FASB Accounting Standards Codification Subtopic 860-10, *Transfers and Servicing: Overall* (Statement 140)

FASB Accounting Standards Codification Subtopic 985-605, *Software: Revenue Recognition* (EITF Issue 03-5; SOP 97-2)

FASB Accounting Standards Update No. 2009-14, *Certain Revenue Arrangements That Include Software Elements — a Consensus of the FASB Emerging Issues Task Force* (EITF Issue 09-3)

FASB Accounting Standards Update No. 2009-13, *Multiple-Deliverable Revenue Arrangements — a Consensus of the FASB Emerging Issues Task Force* (EITF Issue 08-1)

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

FASB Statement No. 166, *Accounting for Transfers of Financial Assets* — an amendment of FASB Statement No. 140

FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements* — an amendment of ARB No. 51

FASB Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* — an amendment of FASB Statements No. 87, 88, 106, and 132(R)

FASB Statement No. 157, *Fair Value Measurements*

FASB Statement No. 154, *Accounting Changes and Error Corrections* — a replacement of APB Opinion No. 20 and FASB Statement No. 3

FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*

FASB Statement No. 143, *Accounting for Asset Retirement Obligations*

FASB Statement No. 142, *Goodwill and Other Intangible Assets*

FASB Statement No. 141(R), *Business Combinations*

FASB Statement No. 141, *Business Combinations*

FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* — a replacement of FASB Statement 125

FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*

FASB Statement No. 131, *Disclosures About Segments of an Enterprise and Related Information*

FASB Statement No. 128, *Earnings per Share*

FASB Statement No. 123(R), *Share-Based Payment*

FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*

FASB Statement No. 114, *Accounting by Creditors for Impairment of a Loan* — an amendment of FASB Statements No. 5 and 15

FASB Statement No. 113, *Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts*

FASB Statement No. 109, *Accounting for Income Taxes*

FASB Statement No. 107, *Disclosures About Fair Value of Financial Instruments*

FASB Statement No. 95, *Statement of Cash Flows*

FASB Statement No. 87, *Employers' Accounting for Pensions*

FASB Statement No. 14, *Financial Reporting for Segments of a Business Enterprise*

FASB Statement No. 6, *Classification of Short-Term Obligations Expected to Be Refinanced* — an amendment of ARB No. 43, Chapter 3A

FASB Statement No. 5, *Accounting for Contingencies*

FASB Statement No. 2, *Accounting for Research and Development Costs*

FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* — an interpretation of FASB Statement No. 109

FASB Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations* — an interpretation of FASB Statement No. 143

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

FASB Technical Bulletin No. 79-3, *Subjective Acceleration Clauses in Long-Term Debt Agreements*

FASB Staff Position No. FAS 157-4, "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly"

FASB Staff Position No. FAS 140-4 and FIN 46(R)-8, "Disclosures by Public Entities (Enterprises) About Transfers of Financial Assets and Interests in Variable Interest Entities"

FASB Staff Position No. FAS 115-2 and FAS 124-2, "Recognition and Presentation of Other-Than-Temporary Impairments"

FASB Staff Position No. FAS 115-1 and FAS 124-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments"

FASB Staff Position No. FAS 107-1 and APB 28-1, "Interim Disclosures About Fair Value of Financial Instruments"

FASB Staff Position No. FIN 48-1, "Definition of *Settlement* in FASB Interpretation No. 48"

FASB Staff Position No. APB 14-1, "Accounting for Convertible Debt Instruments That May Be Settled in Cash Upon Conversion (Including Partial Cash Settlement)"

FASB Staff Position No. EITF 03-6-1, "Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities"

FASB Staff Position No. EITF 99-20-1, "Amendments to the Impairment Guidance of EITF Issue No. 99-20"

Statement 133 Implementation Issue No. G10, "Cash Flow Hedges: Need to Consider Possibility of Default by the Counterparty to the Hedging Derivative"

Statement 133 Implementation Issue No. G9, "Cash Flow Hedges: Assuming No Ineffectiveness When Critical Terms of Hedging Instruments and Hedged Transaction Match in a Cash Flow Hedge"

Statement 133 Implementation Issue No. G7, "Cash Flow Hedges: Measuring the Ineffectiveness of a Cash Flow Hedge Under Paragraph 30(b) When the Shortcut Method Is Not Applied"

Statement 133 Implementation Issue No. E20, "Hedging — General: The Strike Price for Determining When a Swap Contains Mirror-Image Call Provision"

Statement 133 Implementation Issue No. E16, "Hedging — General: Application of the Shortcut Method for an Interest Rate Swap-in-Arrears"

Statement 133 Implementation Issue No. E10, "Hedging — General: Application of the Shortcut Method to Hedges of a Portion of an Interest-Bearing Asset or Liability (or Its Related Interest) or a Portfolio of Similar Interest-Bearing Assets or Liabilities"

Statement 133 Implementation Issue No. E6, "Hedging — General: The Shortcut Method and the Provisions That Permit the Debtor or Creditor to Require Prepayment"

Statement 133 Implementation Issue No. E4, "Hedging — General: Application of the Shortcut Method"

EITF Issue No. 09-E, "Accounting for Stock Dividends, Including Distributions to Shareholders With Components of Stock and Cash"

EITF Issue No. 08-8, "Accounting for an Instrument (or an Embedded Feature) With a Settlement Amount That Is Based on the Stock of an Entity's Consolidated Subsidiary"

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

EITF Issue No. 07-4, "Application of the Two-Class Method Under FASB Statement No. 128, *Earnings per Share*, to Master Limited Partnerships"

EITF Issue No. 07-1, "Accounting for Collaborative Arrangements"

EITF Issue No. 04-10, "Determining Whether to Aggregate Operating Segments That Do Not Meet the Quantitative Thresholds"

EITF Issue No. 03-13, "Applying the Conditions in Paragraph 42 of FASB Statement No. 144 in Determining Whether to Report Discontinued Operations"

EITF Issue No. 03-6, "Participating Securities and the Two-Class Method Under FASB Statement No. 128"

EITF Issue No. 03-5, "Applicability of AICPA Statement of Position 97-2 to Non-Software Deliverables in an Arrangement Containing More-Than-Incidental Software"

EITF Issue No. 00-27, "Application of Issue No. 98-5 to Certain Convertible Instruments"

EITF Issue No. 00-21, "Revenue Arrangements With Multiple Deliverables"

EITF Issue No. 00-19, “Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company’s Own Stock”

EITF Issue No. 00-10, “Accounting for Shipping and Handling Fees and Costs”

EITF Issue No. 99-19, “Reporting Revenue Gross as a Principal Versus Net as an Agent”

EITF Issue No. 98-3, “Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or of a Business”

EITF Issue No. 96-19, “Debtor’s Accounting for a Modification or Exchange of Debt Instruments”

EITF Issue No. 95-8, “Accounting for Contingent Consideration Paid to the Shareholders of an Acquired Enterprise in a Purchase Business Combination”

EITF Topic No. D-101, “Clarification of Reporting Unit Guidance in Paragraph 30 of FASB Statement No. 142”

EITF Topic No. D-98, “Classification and Measurement of Redeemable Securities”

APB Opinion No. 23, *Accounting for Income Taxes — Special Areas*

APB Opinion No. 22, *Disclosure of Accounting Policies*

Accounting Research Bulletin No. 43, Chapter 3A, “Working Capital: Current Assets and Liabilities”

AICPA Statement of Position 01-6, *Accounting by Certain Entities (Including Entities With Trade Receivables) That Lend to or Finance the Activities of Others*

AICPA Statement of Position 97-2, *Software Revenue Recognition*

AICPA Statement of Position 94-6, *Disclosure of Certain Significant Risks and Uncertainties*

AICPA Statement of Position 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*

AICPA Technical Practice Aids, TIS Section 1300.15, “Statement of Cash Flows: Presentation of Cash Overdraft on Statement of Cash Flows”

SEC Staff Accounting Bulletin Topic 14.F, “Classification of Compensation Expense Associated With Share-Based Payment Arrangements” (SAB 107)

SEC Staff Accounting Bulletin Topic 14.D, “Certain Assumptions Used in Valuation Methods” (SAB 110)

SEC Staff Accounting Bulletin Topic 14, “Share-Based Payment” (SAB 107 and SAB 110)

SEC Staff Accounting Bulletin Topic 13, “Revenue Recognition” (SAB 101 and SAB 104)

SEC Staff Accounting Bulletin Topic 11.M, “Disclosure of the Impact That Recently Issued Accounting Standards Will Have on the Financial Statements of the Registrant When Adopted in a Future Period” (SAB 74)

SEC Staff Accounting Bulletin Topic 11.B, “Depreciation and Depletion Excluded From Cost of Sales”

SEC Staff Accounting Bulletin Topic 6.K, “Accounting Series Release 302 — Separate Financial Statements Required by Regulation S-X”

SEC Staff Accounting Bulletin Topic 6.L, “Financial Reporting Release 28 — Accounting for Loan Losses by Registrants Engaged in Lending Activities”

SEC Staff Accounting Bulletin Topic 5.P, “Restructuring Charges”

SEC Staff Accounting Bulletin Topic 5.M, “Other Than Temporary Impairment of Certain Investments in Debt and Equity Securities”

SEC Regulation S-X, Rule 12-04, “Condensed Financial Information of Registrant”

SEC Regulation S-X, Article 11, “Pro Forma Financial Information”

SEC Regulation S-X, Rule 11-01, “Presentation Requirements”

SEC Regulation S-X, Rule 11-02, “Preparation Requirements”

SEC Regulation S-X, Rule 5-04, "What Schedules Are to Be Filed"

SEC Regulation S-X, Rule 5-03, "Income Statements"

SEC Regulation S-X, Rule 5-02, "Balance Sheets"

SEC Regulation S-X, Rule 4-10, "Financial Accounting and Reporting for Oil and Gas Producing Activities Pursuant to the Federal Securities Laws and the Energy Policy and Conservation Act of 1975"

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

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

SEC Regulation S-X, Rule 3-14, "Instructions for Real Estate Operations to Be Acquired"

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

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

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

SEC Regulation S-K, Item 601, "Exhibits"

SEC Regulation S-K, Item 512, "Undertakings"

SEC Regulation S-K, Item 402, "Executive Compensation"

SEC Regulation S-K, Item 308, "Internal Control Over Financial Reporting"

SEC Regulation S-K, Item 307, "Disclosure Controls and Procedures"

SEC Regulation S-K, Item 305, "Quantitative and Qualitative Disclosures About Market Risk"

SEC Regulation S-K, Item 303, "Management's Discussion and Analysis of Financial Condition and Results of Operations"

SEC Regulation S-K, Item 10, "General"

SEC Regulation M-A, Item 1015, "Reports, Opinions, Appraisals and Negotiations"

SEC Rule 240.13a-15, "Controls and Procedures"

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

SEC Final Rule Release No. 33-8238, *Management's Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports*

SEC Final Rule Release No. 33-8176, *Conditions for Use of Non-GAAP Financial Measures*

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

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

SEC Interpretive Release No. 33-9062A, *Commission Guidance Regarding the Financial Accounting Standards Board's Accounting Standards Codification*

SEC Financial Reporting Codification Section 501, "Management's Discussion and Analysis"

SEC Financial Reporting Codification Section 216, "Disclosure of Unusual Charges and Credits to Income"