Deloitte & Touche

# Accounting Roundup

The First Quarter of 2003

# Preface

## Accounting Roundup: The First Quarter of 2003

During the first quarter of 2003, accounting standards-setters and accounting regulators issued a number of final and proposed SFASs*, SOPs, IFRSs, EITF consensuses, and SEC rules (collectively, pronouncements) affecting accounting practice, financial reporting, and corporate governance.

This publication, *Accounting Roundup: The First Quarter of 2003,* presents brief descriptions of those pronouncements, as well as certain other regulatory and professional developments in accounting and financial reporting that may affect the preparation of financial statements for periods ending in 2003. The articles included herein were primarily drawn from issues of the *Accounting Roundup* newsletter dated January 20 through April 1, 2003, and have been updated where appropriate. These articles also provide links to locations where additional information can be found for each topic.

Readers seeking additional information about these topics or other activities of key accounting standards-setters and regulators should review the information referred to in the hyperlinks. Further information can be found on the websites of the organizations discussed in this publication, including the FASB, GASB, SEC, AICPA, and IASB. Readers should also consult upcoming issues of *Accounting Roundup* for reports of new developments.

*See the appendix for an explanation of abbreviations used in this publication.

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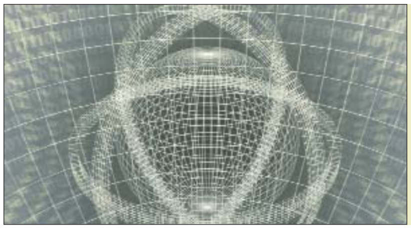



**Selected FASB Links**

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## Statement of Financial Accounting Standards Issued

### SFAS No. 148, *Accounting for Stock-Based Compensation—Transition and Disclosure*

SFAS 148 amends SFAS No. 123, *Accounting for Stock-Based Compensation,* to provide alternative methods of transition for a voluntary change from the intrinsic-value-based method of recognizing stock compensation expense under APB Opinion No. 25, *Accounting for Stock Issued to Employees,* to the SFAS 123 fair-value-based method of accounting for stock-based employee compensation. Under the fair value method, the fair value of the stock options granted to employees is recognized as compensation expense over the service period (usually the vesting period). Under the intrinsic value method, compensation expense is recognized for options that are in-the-money, thereby having intrinsic value, at the date of grant. U.S. GAAP permits either method, with the fair value method being preferable. SFAS 148 also amends SFAS 123 to require more prominent disclosures in interim and annual financial statements of the effects of all stock-based compensation.

The transition guidance and annual disclosure provisions of SFAS 148 are effective for fiscal years ended after December 15, 2002, with earlier application permitted in certain circumstances. The interim disclosure provisions are effective for financial reports containing condensed financial statements for interim periods beginning after December 15, 2002.

## FASB Interpretation Issued

### FIN No. 46, *Consolidation of Variable Interest Entities*

This Interpretation of ARB No. 51, *Consolidated Financial Statements,* was issued to address perceived weaknesses in accounting for entities commonly known as special-purpose or off-balance-sheet entities, but the guidance applies to a larger population of entities. FIN 46 provides guidance for identifying the party with a controlling financial interest resulting from arrangements or financial interests rather than from voting interests. FIN 46 defines the term "variable interest entity" (VIE) and is based on the premise

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that if a business enterprise has a controlling financial interest in a VIE, the assets, liabilities, and results of the activities of the VIE should be included in the consolidated financial statements of the business enterprise.

An enterprise that consolidates a VIE is the primary beneficiary of the VIE. The primary beneficiary is the party whose variable interest(s) absorbs a majority of the entity's expected losses, receives a majority of its expected residual returns, or both. Variable interests are the ownership, contractual, or other financial interests in an entity. An enterprise with a variable interest in a VIE must consider variable interests of related parties and de facto agents as its own in determining whether it is the primary beneficiary.

Expected losses and residual returns are to be calculated using an approach based on FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements*. The FASB has issued an article entitled "Understanding The Issues—Expected Cash Flows" which provides guidance on calculating expected losses and expected residual returns. The article is available at http://www.fasb.org/articles&reports/vol1_series1.shtml.

FIN 46 requires the primary beneficiary of a VIE, as well as other enterprises that hold a significant variable interest in a VIE, to provide certain financial statement disclosures. Some disclosures are required in all financial statements issued after January 31, 2003 if it is reasonably possible that an enterprise will consolidate or disclose information about a VIE when FIN 46 becomes effective.

### *Effective Dates*

FIN 46 applies immediately to VIEs created after January 31, 2003 and to VIEs in which an enterprise obtains an interest after that date. For variable interests in VIEs created before February 1, 2003, FIN 46 applies to public enterprises no later than the beginning of the first interim or annual period beginning after June 15, 2003 and to nonpublic enterprises no later than the end of the first annual period beginning after June 15, 2003.

This FIN may be applied prospectively with the cumulative-effect adjustment as of the date on which it is first applied or by restating previously issued financial statements for one or more years with the cumulative-effect adjustment as of the beginning of the first year restated.

The requirements of FIN 46 and its transition provisions are complex, and the full text of the Interpretation should be read before attempting to implement its guidance. FIN 46 is available on the FASB's website at http://www.fasb.org/int46.shtml. The Global Markets Group of Deloitte & Touche provided commentary on FIN 46 in the February 4, 2003 edition of the *Heads Up* newsletter, which is available at http://www.deloitte.com/dtt/cda/doc/content/Heads%20Up%20Vol%2010%20Issue%201(1).pdf.

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## FASB Exposure Draft Issued

### Proposed SFAS, *Accounting for Real Estate Time-Sharing Transactions*

This exposure draft of a proposed SFAS, which was issued on February 20, 2003, would amend SFAS No. 66, *Accounting for Sales of Real Estate*, and SFAS No. 67, *Accounting for Costs and Initial Rental Operations of Real Estate Projects*, to (1) exclude the accounting for real estate time-sharing transactions from their scope and (2) state that the accounting for such transactions is addressed in an AICPA SOP on that subject.

An exposure draft of the proposed AICPA SOP was issued by AcSEC concurrently with the FASB exposure draft (See related article in this issue). The FASB exposure draft and a related announcement are available on the FASB's website at http://www.fasb.org/news/nr022003.shtml. Comments on the FASB exposure draft should be received by the FASB by April 30, 2003.

## EITF Issues for Which Consensuses Were Reached

[Note: All EITF consensuses are subject to ratification by the FASB. Issues are presented at a regular weekly FASB meeting approximately two weeks after the EITF meeting. Consensuses are not effective until ratified by the FASB.]

### Issue No. 02-9, *Accounting for Changes That Result in a Transferor Regaining Control of Financial Assets Sold*

Paragraph 55 of SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, requires a transferor to recognize in its financial statements assets previously accounted for as having been sold when one or more of the conditions in paragraph 9 (regarding control of the assets) are no longer met. The transferor recognizes those assets together with liabilities to the former transferee(s) or beneficial interest holder(s) and initially measures the assets and liabilities at fair value on the date of the change as if the transferor purchased them on that date. The issue is how to apply the accounting requirements of paragraph 55 with respect to beneficial interests held by the transferor and loans that do not meet the definition of security, including whether the transferor should recognize a gain or loss when the provisions of paragraph 55 are applied.

A consensus on the final open subissues was reached at the March 2003 meeting. The issue was ratified by the FASB at its April 2, 2003 meeting.

### Issue No. 02-18, *Accounting for Subsequent Investments in an Investee after Suspension of Equity Method Loss Recognition*

Assuming an investor has appropriately suspended equity method loss recognition in accordance with both paragraph 19(i) of APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*, and EITF Issue No. 98-13, *Accounting by an Equity Method Investor for Investee Losses When the Investor Has Loans to and Investments in Other Securities of the*

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*Investee,* the issue is whether an investor should recognize any previously suspended losses when accounting for a subsequent investment in an investee that does not result in the ownership interest increasing from one of significant influence to one of control. If it is determined that the additional investment, in whole or in part, represents the funding of prior losses, a second issue arises as to whether all previously suspended losses should be recognized or whether only the previously suspended losses equal to the portion of the investment determined to be funding prior losses should be recognized.

A consensus was reached at the January 2003 meeting and was ratified by the FASB on February 5, 2003.

### Issue No. 03-2, *Accounting for the Transfer to the Japanese Government of the Substitutional Portion of Employee Pension Fund Liabilities*

In Japan, many large corporations have Employees' Pension Fund plans (EPFs), which are defined benefit pension plans established under the Japanese Welfare Pension Insurance Law (JWPIL). In June 2001, the JWPIL was amended to permit each employer/EPF to separate a substitutional portion, which is based on the pay-related part of the old-age pension benefits prescribed by JWPIL, from its EPF and transfer the obligation and related assets to the government. This issue concerns how an employer should account for the separation of the substitutional portion of the benefit obligation of an EPF from the corporate portion and the transfer of the substitutional portion and related assets to the Japanese government.

A consensus was reached at the January 2003 meeting and was ratified by the FASB on February 5, 2003.

## Other EITF Issues Discussed

The following issues were discussed at EITF meetings held during the first quarter of 2003. The EITF did not reach final consensuses on these issues, and further discussion at future meetings is expected.

- Issue No. 01-8, *Determining Whether an Arrangement Contains a Lease*
- Issue No. 02-2, *When Certain Separate Contracts That Meet the Definition of Financial Instruments Should Be Combined for Accounting Purposes*
- Issue No. 02-9, *Accounting for Changes That Result in a Transferor Regaining Control of Financial Assets Sold*
- Issue No. 02-14, *Whether the Equity Method of Accounting Applies When an Investor Does Not Have an Investment in Voting Stock of an Investee but Exercises Significant Influence through Other Means*
- Issue No. 03-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*
- Issue 03-4, *Accounting for "Cash Balance" Pension Plans.*

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## EITF Administrative Discussions

### Revised Transition Provisions Discussed for Issue No. 00-21, *Accounting for Revenue Arrangements with Multiple Deliverables*

The EITF reached a consensus at its November 21, 2002 meeting on Issue 00-21. At the March 20, 2003 meeting, the EITF discussed a scope issue for transactions in which one deliverable in a revenue arrangement with multiple deliverables falls under guidance at a higher level of GAAP than an EITF Issue (e.g., an SFAS or an SOP). The issue concerns how to apply Issue 00-21 to those situations. EITF members raised significant concerns, and an informal working group was formed to address those concerns. Further discussion at a future meeting is expected.

### Issue No. 02-3, *Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities*

The EITF reached a consensus at its November 21, 2002 meeting on Issue 02-3. At the March 20, 2003 meeting, the FASB staff clarified that the guidance in this issue is not meant to preclude a derivative that was designated as trading from being designated as a hedging instrument under SFAS 133, provided all hedge accounting criteria are met. The issue summary will be revised to reflect this conclusion.

### Revised Transition Provisions for Issue No. 02-16, *Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor*

The transition provisions were discussed at both the January and March 2003 EITF meetings. At the March 2003 meeting, the EITF reached a consensus in favor of allowing subissue 1 of Issue 02-16, which addresses the accounting for cash consideration received from a vendor by a reseller, to be adopted either (1) prospectively, as the previous consensus announced at the January 2003 EITF meeting required, or (2) as a cumulative effect of a change in accounting principle. Entities must disclose whether they have elected to adopt prospectively or as a cumulative effect change. The EITF also reached a consensus that, to the extent that reclassification of prior-period income statements for comparative purposes would not result in a change to the net income of those periods, companies are permitted but not required to reclassify prior periods upon adoption of Issue 02-16. The SEC observer stated that, to the extent the adoption of Issue 02-16 affects income statement trends, registrants should provide adequate disclosure in MD&A.

### Modified Coinsurance Arrangements

The FASB staff announced that it will incorporate guidance on modified coinsurance arrangements into its tentative guidance in SFAS 133 Implementation Issue No. B36, *Bifurcation of Embedded Credit Derivatives.*

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This issue was posted on the FASB's website for the 35-day comment period that is customary for such SFAS 133 Implementation Issues. The comment period ended on March 10, 2003.

## FASB Staff Positions

### Background

In February 2003, the FASB approved a new type of guidance from the FASB staff called *FASB Staff Positions*. FSPs will be under category D in the GAAP hierarchy and are expected to (1) provide a consistent means of communications and guidance and (2) replace other pronouncements issued by the FASB staff (e.g., Staff Implementation Guides).

FSPs will be issued upon completion of the following process:

- The FASB staff will provide a draft FSP to Board members for review.
- The draft FSP will be discussed at a Board meeting and, provided that a majority of Board members do not object, the staff will post the draft FSP to the FASB website for a 30-day comment period.
- The FASB staff will consider the comments received and submit the final FSP to the Board for approval.
- Provided that a majority of Board members do not object, the final FSP will be posted to the FASB website.

### Proposed FSP, *Accounting for Accrued Interest Receivable Related to Securitized and Sold Receivables under Statement 140*

This first FSP was proposed to the Board in February 2003 and was posted to the FASB's website for the required 30-day comment period, which ended March 10, 2003. The proposed FSP is available at http://www.fasb.org/fasb_staff_positions/proposed_fsp.shtml.

### Proposed FSP, *Accounting for Intellectual Property Infringement Indemnifications under FASB Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*

This FSP was proposed to the Board on March 12, 2003 and was posted to the FASB's website for the required 30-day comment period, which ends on April 12, 2003. The proposed FSP is available on the FASB's website at http://www.fasb.org/fasb_staff_positions/03-12-03_prop_fsp.pdf.

## Other FASB Developments

The following is a list of on-going projects discussed at FASB meetings during the first quarter of 2003. More information on each project is available in the respective project summary maintained by the FASB staff, which can be accessed on the FASB's website at the links indicated.

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## Major Projects for Which a Final SFAS Is Expected During the Second Quarter of 2003

### *Amendment of SFAS 133*

In May 2002, the FASB issued an exposure draft, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities*, which would amend the definition of a derivative in paragraph 6(b) of SFAS 133 and would include other amendments to reflect various decisions of the FASB's Derivatives Implementation Group.

At the March 12, 2003 Board meeting, the FASB staff asked the Board to reconsider the effective date and transition provisions of the proposed SFAS.

The Board decided to revise the provisions such that the proposed SFAS would be effective as follows:

- This SFAS will be effective for contracts entered into or modified after June 30, 2003, or hedging relationships designated after June 30, 2003, and will be applied prospectively, given that it is transaction/hedging relationship based.
- Statement 133 Implementation Issues that have been cleared by the FASB as part of the Derivatives Implementation Group's process and that are effective for fiscal quarters that began prior to June 15, 2003 would continue to be effective based on their respective effective dates.
- Paragraphs relating to forward purchases or sales of when-issued or other securities that do not yet exist would be applicable to both existing transactions as well as new transactions entered into after June 30, 2003.

Further information on this project is available on the FASB's website at http://www.fasb.org/project/amend_st_133.shtml.

### *Liabilities and Equity—Phase One*

In October 2002, the FASB issued two exposure drafts: *Accounting for Financial Instruments with Characteristics of Liabilities, Equity, or Both,* and *Proposed Amendment to FASB Concepts Statement No. 6 to Revise the Definition of Liabilities*. During its redeliberations of issues identified during the comment period, the FASB decided to immediately address concerns relating to financial instruments embodying obligations that could be settled by the issuance of an entity's own shares through a limited-scope SFAS. The limited-scope SFAS is expected to address the following instruments:

- Financial instruments embodying or indexed to an obligation to repurchase an issuer's equity shares that requires or could require settlement by transfer of assets
- Mandatorily redeemable instruments

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- Financial instruments embodying an obligation that the issuer must or could settle by issuing a variable number of its equity shares if the monetary value of the obligation is based solely or predominantly on (1) a fixed monetary amount known at inception, (2) variations in something other than the fair value of the issuer's equity shares, or (3) variations in the fair value of the issuer's equity shares, but in the direction opposite to those variations.

At the March 12, 2003 Board meeting, the FASB staff indicated that several comments had been received, including comments from the SEC staff that related to the interaction between this proposed SFAS and the embedded derivative provisions of SFAS 133 and ASR No. 268, *Presentation in Financial Statements of "Redeemable Preferred Stock,"* issued by the SEC. The Board indicated that the proposed SFAS will be revised to address the interaction of the proposed SFAS with the specific guidance mentioned above. The Board also noted that the FASB website should be updated to specifically indicate the reasons for the revisions, particularly that changes are necessary to appropriately consider the interaction of the embedded derivative provisions of SFAS 133 and ASR 268. The FASB staff indicated that a meeting would be scheduled, with the SEC staff present, to discuss the revisions.

More information on this project is available on the FASB's website at http://www.fasb.org/project/liabeq.shtml.

### Other Major Projects Discussed During the First Quarter

- Business combinations—purchase method procedures
- Business combinations—combinations of not-for-profit organizations
- Business combinations between mutual enterprises
- Clarification of SFAS 140—limited scope
- Disclosures about fair value
- Employee stock options
- Financial instruments: derivatives implementation
- Financial performance reporting by business enterprises
- Pensions
- Permitted activities of qualifying special-purpose entities
- Principles-based standards
- Revenue recognition
- Short-term international convergence.

The FASB's quarterly technical plan is available on its website at http://www.fasb.org/tech/bd_projects.shtml.

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*Note: Conclusions of the FASB are subject to change at future Board meetings and generally do not affect current accounting requirements until an official position (Statement or Interpretation) is issued. Official positions of the FASB are determined only after extensive deliberation and due process, including a formal vote by written ballot to issue a Statement or Interpretation.*

Further information about the FASB can be found on its website at http://www.fasb.org.

# GASB Developments



**Selected GASB Links**

GASB Homepage:
http://www.gasb.org

GASB News Center:
http://www.gasb.org/news/index.html

GASB Publications:
http://www.gasb.org/pub/index.html

## GASB Exposure Drafts Issued

**Proposed GASB Statements, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions,* and *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans***

The GASB issued these two related exposure drafts of proposed GASB Statements on February 14, 2003.

The first proposal would require state and local governments to:

- Measure and disclose the cost of postemployment benefits other than pensions (commonly called OPEBs) on the accrual basis in periods that approximate employees' years of service
- Disclose information about the liabilities for actuarial benefits for past services and about the funded status of such benefits, as well as certain other information that is deemed useful in assessing a government's future cash flows.

The second proposal addresses accounting and financial reporting from the perspective of the OPEB plan.

As discussed more fully in the exposure drafts, the proposed effective dates of the final GASB Statements would depend on a government's total annual revenues in the first fiscal year ending after June 15, 2003.

Both exposure drafts and a related news release are available on the GASB's website at http://www.gasb.org/news/nr022003.html. Comments should be received by the GASB by April 30, 2003.

*Note: Conclusions of the GASB are subject to change at future Board meetings and generally do not affect current accounting requirements until an official position (Statement or Interpretation) is issued. Official positions of the GASB are determined only after extensive deliberation and due process, including a formal vote by written ballot to issue a Statement or Interpretation.*

Further information about the GASB can be found on its website at http://www.gasb.org.

# SEC Developments



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## Final Rules

### Conditions for Use of Non-GAAP Financial Information

The SEC's rules under Section 401(b) of the Sarbanes-Oxley Act of 2002 apply to the public disclosure or release of material information that includes a "non-GAAP financial measure." For this purpose, a "non-GAAP financial measure" is defined as a numerical measure of a company's financial performance, financial position, or cash flows that (1) excludes amounts, or is subject to adjustments that have the effect of excluding amounts, that are included in the comparable measure calculated and presented in accordance with GAAP in the statement of income, balance sheet, or statement of cash flows (or equivalent statements) of the issuer or (2) includes amounts, or is subject to adjustments that have the effect of including amounts, that are excluded from the comparable measure so calculated and presented. Statistical and operating measures are not covered.

The SEC voted to adopt new Regulation G, which (1) applies whenever a company publicly discloses or releases material information that includes a non-GAAP financial measure, (2) prohibits material misstatements or omissions that would make the presentation of the material non-GAAP financial measure, under the circumstances in which it is made, misleading, and (3) requires a quantitative reconciliation of the differences between the non-GAAP financial measure presented and the comparable financial measure calculated and presented in accordance with GAAP. Regulation G provides a limited exception for certain foreign private issuers.

Amendments to Item 10 of Regulation S-K and Regulation S-B apply to the same categories of non-GAAP financial measures as those covered by Regulation G, but contain more detailed disclosure requirements and certain prohibitions on the use of non-GAAP financial measures in SEC filings. The SEC also decided to amend Exchange Act Form 20-F to apply these requirements to annual reports filed with the SEC by foreign private issuers.

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Regulation G applies to all subject disclosures as of March 28, 2003. The amendments to Item 10 of Regulation S-K, Item 10 of Regulation S-B, and Form 20-F apply to any annual or quarterly report filed with respect to a fiscal period ending after March 28, 2003.

The final rule is available on the SEC's website at http://www.sec.gov/rules/final/33-8176.htm.

Deloitte & Touche provided commentary on the use of non-GAAP financial information in its publication, *Conditions for Use of Non-GAAP Financial Measures*. This publication is available at http://www.deloitte.com/dtt/cda/doc/content/NGAAPup.pdf.

### Form 8-K Amendments

The SEC voted to adopt amendments to Form 8-K to require public companies to furnish to the SEC releases or announcements disclosing material nonpublic financial information about completed annual or quarterly fiscal periods. These amendments do not require the issuance of earnings releases or similar announcements. However, such releases and announcements trigger the new requirement. The new Form 8-K requirement applies regardless of whether the release or announcement included disclosure of a non-GAAP financial measure. If the release or announcement includes disclosure of a non-GAAP financial measure, the disclosures required by Item 10 of Regulation S-K and Regulation S-B apply. However, the Item 10 prohibitions on the use of certain non-GAAP financial measures are not applicable unless the registrant elects to "file" rather than "furnish" the release or announcement on Form 8-K.

Public disclosure of financial information for a completed fiscal period in a presentation that is made orally, by telephone, by webcast, by broadcast, or by similar means is not required to be filed if (1) the presentation occurs within 48 hours of a related release or announcement that is filed on Form 8-K, (2) the presentation is broadly accessible to the public, and (3) the information in the webcast is posted on the company's website.

The requirement to furnish earnings releases and similar materials to the Commission on Form 8-K applies to earnings releases and similar announcements made after March 28, 2003.

The final rule is available at http://www.sec.gov/rules/final/33-8176.htm.

### Disclosure Requirements—Financial Experts, Code of Ethics

The SEC voted to adopt rules implementing Sections 406 and 407 of the Sarbanes-Oxley Act that require public companies to disclose information about codes of ethics and corporate audit committee financial experts.

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### *Code of Ethics*

Under the rules, a company is required to disclose in its annual report whether it has a code of ethics that applies to the company's principal executive officer, principal financial officer, principal accounting officer, controller, or persons performing similar functions. The rules define a code of ethics as written standards that are reasonably necessary to deter wrongdoing and to promote (1) honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships; (2) full, fair, accurate, timely, and understandable disclosure in reports and documents that a company files with or submits to the SEC and in other public communications made by the company; (3) compliance with applicable governmental laws, rules, and regulations; (4) the prompt internal reporting of code violations to an appropriate person or persons identified in the code; and (5) accountability for adherence to the code.

A company is required to make available to the public a copy of its code of ethics or the portion of the code that applies to the company's principal executive officer, principal financial officer, principal accounting officer, controller, or persons performing similar functions.

A company, other than a foreign private issuer or registered investment company, also is required to disclose any changes to or waivers of the code of ethics within five business days, to the extent that the change or waiver applies to the company's principal executive officer or senior financial officers.

### *Audit Committee Financial Experts*

The rules expand the proposed definition of the term *financial expert* and also substitute the designation *audit committee financial expert* for *financial expert* and define *audit committee financial expert* to mean a person who has the following attributes:

- An understanding of financial statements and GAAP
- An ability to assess the general application of such principles in connection with the accounting for estimates, accruals, and reserves
- Experience in preparing, auditing, analyzing, or evaluating financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of issues that can reasonably be expected to be raised by the registrant's financial statements, or experience actively supervising one or more persons engaged in such activities
- An understanding of internal controls and procedures for financial reporting
- An understanding of audit committee functions.

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According to the rules, a person can acquire such attributes through any of the following means:

- Education and experience as a principal financial officer, principal accounting officer, controller, public accountant, or auditor or experience in one or more positions that involve the performance of similar functions
- Experience actively supervising a principal financial officer, principal accounting officer, controller, public accountant, auditor, or person performing similar functions
- Experience overseeing or assessing the performance of companies or public accountants with respect to the preparation, auditing, or evaluation of financial statements
- Other relevant experience.

An individual must possess all of the attributes listed in the above definition to qualify as an audit committee financial expert. Furthermore, the rules eliminate the proposed requirement that a person's experience applying GAAP in connection with accounting for estimates, accruals, and reserves be "generally comparable" to the estimates, accruals, and reserves used in the registrant's financial statements.

The rules also provide a safe harbor to make clear that an audit committee financial expert will not be deemed an "expert" for any purpose, including for purposes of Section 11 of the Securities Act of 1933, and that the designation of a person as an audit committee financial expert does not impose any duties, obligations, or liability on the person that are greater than those imposed on such a person as a member of the audit committee in the absence of such designation, nor does it affect the duties, obligations, or liability of any other member of the audit committee or board of directors.

### *Effective Dates*

Companies must comply with the code of ethics disclosure requirements promulgated under Section 406 of the Sarbanes-Oxley Act in their annual reports for fiscal years ending on or after July 15, 2003. They also must comply with the requirements regarding disclosure of amendments to and waivers from their ethics codes on or after the date on which they file their first annual report in which the code of ethics disclosure is required.

Companies, other than small business issuers, must comply with the audit committee financial expert disclosure requirements promulgated under Section 407 of the Sarbanes-Oxley Act in their annual reports for fiscal years ending on or after July 15, 2003. Small business issuers must comply with the audit committee financial expert disclosure requirements in their annual reports for fiscal years ending on or after December 15, 2003.

Both of the above rules are available at http://www.sec.gov/rules/final/33-8177.htm.

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### Rules Restricting Insider Trading During Pension Fund Blackout Periods

The SEC adopted new Regulation Blackout Trading Restriction (BTR) under the Securities Exchange Act of 1934 to clarify the scope and application of Section 306(a) of the Sarbanes-Oxley Act and to prevent evasion of the statutory trading prohibition.

Regulation BTR incorporates a number of concepts developed under Section 16 of the Securities Exchange Act, which enable issuers to use the well-established body of rules and interpretations concerning the trading activities of corporate insiders in interpreting how Section 306(a) operates and, with regard to directors and executive officers of domestic issuers, facilitate enforcement of the statutory trading prohibition through the monitoring of the reports publicly filed by directors and officers pursuant to Section 16(a) of the Exchange Act.

Regulation BTR defines the persons, transactions, and types of securities subject to the regulation, as well as blackout periods and remedies for violations of the rule.

This rule became effective on January 26, 2003. Issuers must comply with §245.104(b)(3)(i) and (iii) of Regulation BTR beginning March 31, 2003.

This rule is available at http://www.sec.gov/rules/final/34-47225.htm.

### Retention of Records Relevant to Audits and Reviews

The SEC approved the adoption of Rule 2-06 of Regulation S-X to implement Section 802 of the Sarbanes-Oxley Act relating to the retention of audit and review workpapers and records. The rule defines the term *workpapers* and establishes the types of documents to be retained, which include workpapers and other documents that form the basis of the audit or review, and memoranda, correspondence, communications, other documents, and records (including electronic records) that are created, sent, or received in connection with the audit or review and that contain conclusions, opinions, analyses, or financial data related to the audit or review.

The rule requires that records be retained for seven years after the auditor concludes the audit or review of the financial statements, instead of the proposed period of five years from the end of the fiscal period in which an audit or review was concluded. This change coordinates the SEC's rule with the forthcoming auditing standards from the PCAOB, which will require the retention of audit documentation for seven years.

The rule addresses "differences of opinion" between the registrant and the auditors. Auditing literature requires that records be retained only if they "support" the auditor's report; Rule 2-06(c), however, requires auditors to keep records that either support the auditor's final conclusions or contain information or data, relating to a significant matter that is inconsistent with the final conclusions of the auditor on that matter or on the audit or review.

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Rule 2-06(c) also states that the documents and records to be retained include, but are not limited to, those documenting consultations on or resolutions of differences in professional judgment.

Compliance is required for audits and reviews completed on or after October 31, 2003.

This rule is available at http://www.sec.gov/rules/final/33-8180.htm.

### Disclosure of Off-Balance-Sheet Arrangements and Aggregate Contractual Obligations

The SEC voted to adopt amendments to implement Section 401(a) of the Sarbanes-Oxley Act, which adds Section 13(j) to the Securities Exchange Act of 1934 establishing rules that require each annual and quarterly financial report required to be filed with the SEC to disclose "all material off-balance sheet transactions, arrangements, obligations (including contingent obligations), and other relationships of the issuer with unconsolidated entities or other persons, that may have a material current or future effect on financial condition, changes in financial condition, results of operations, liquidity, capital expenditures, capital resources, or significant components of revenues or expenses."

The amendments approved by the SEC require a registrant to provide an explanation of its off-balance-sheet arrangements in a separately captioned subsection of the MD&A section in its disclosure documents. The amendments also require registrants (other than small business issuers) to provide an overview of certain known contractual obligations in a tabular format.

The amendments include a definition of *off-balance-sheet arrangements* that has been refined from the proposal to encompass only the following categories of contractual arrangements:

- Certain guarantee contracts as defined in FIN No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*
- Retained or contingent interests in assets transferred to an unconsolidated entity
- Derivative instruments that are classified as equity
- Material variable interests, defined by reference to FIN No. 46, *Consolidation of Variable Interest Entities*, in unconsolidated entities that conduct certain activities.

#### *Disclosure Requirements*

The amendments require disclosure of off-balance-sheet arrangements that either have or are *reasonably likely* to have a current or future effect on the registrant's financial condition, changes in financial condition, revenues or

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expenses, results of operations, liquidity, capital expenditures, or capital resources that is material to investors. The *reasonably likely* threshold for disclosure in the final rule differs significantly from the proposal, which required disclosure of off-balance-sheet arrangements unless the likelihood of material effect was *remote*. The *reasonably likely* threshold is consistent with the existing standard that governs other disclosures in MD&A.

The amendments require disclosure of the following specified information to the extent necessary for an understanding of off-balance-sheet arrangements and their material effects:

- The nature and business purpose of the registrant's off-balance-sheet arrangements
- The importance to the registrant for liquidity, capital resources, market risk or credit risk support, or other benefits
- The financial impact and exposure to risk
- Known events, demands, commitments, trends, or uncertainties that affect the registrant's ability to benefit from its off-balance-sheet arrangements.

Consistent with the existing MD&A requirements, the amendments contain a principles-based requirement that a registrant provide such other information that it believes is necessary for an understanding of its off-balance-sheet arrangements and their specified material effects.

In addition, the amendments include a requirement for registrants to disclose, in a tabular format, the amounts of payments due under specified contractual obligations, aggregated by category of contractual obligation, for specified time periods. Certain of the categories of contractual obligations to be included in the table are defined by reference to the applicable accounting literature.

The proposed rule included disclosure requirements for contingent liabilities and commitments; however, that requirement has been deleted because a number of new accounting and disclosure requirements, including FIN 45, FIN 46, and these amendments, address disclosure of a registrant's contingent liabilities and commitments.

### *Effective Dates*

Registrants are required to comply with the disclosure requirements for off-balance-sheet arrangements in SEC filings that are required to include financial statements for the fiscal years ending on or after June 15, 2003. Registrants are required to comply with the disclosure requirements for the table of contractual obligations in SEC filings that are required to include financial statements for the fiscal years ending on or after December 15, 2003. Registrants may voluntarily comply with the new disclosure requirements before the compliance dates.

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The rule is available at http://www.sec.gov/rules/final/33-8182.htm.

### Rules Strengthening Auditor Independence

The SEC voted to adopt rules to fulfill the mandate of Title II of the Sarbanes-Oxley Act to strengthen auditor independence and require additional disclosures to investors about the services provided to issuers by the independent accountant.

The SEC approved measures that:

- Revise the rules related to the nonaudit services that, if provided to an audit client, would impair an accounting firm's independence
- Require that certain partners on the audit engagement team rotate after no more than five or seven consecutive years, depending on the partner's involvement in the audit, except that certain small accounting firms may be exempt from this requirement
- Establish rules that an accounting firm would not be independent if certain members of management of that issuer had been members of the accounting firm's audit engagement team within the one-year period preceding the commencement of audit procedures
- Establish rules that an accountant would not be independent of an audit client if any "audit partner" received compensation based on the partner's procurement of engagements with that client for services other than audit, review, and attest services
- Require the auditor to report certain matters to the issuer's audit committee, including "critical" accounting policies used by the issuer
- Require the issuer's audit committee to preapprove all audit and nonaudit services provided to the issuer by the auditor
- Require disclosures to investors of information related to audit and nonaudit services provided by the auditor and fees paid to the auditor.

The rules become effective as of May 6, 2003. The rules, which provide detailed transition provisions, are available at http://www.sec.gov/rules/final/33-8183.htm.

## Proposed Rules

### Standards Relating to Listed Company Audit Committees

The SEC proposed a rule that would direct the national securities exchanges and national securities associations to prohibit the listing of any security of an issuer that is not in compliance with the audit committee requirements established by the Sarbanes-Oxley Act. This proposed rule would implement the requirements of Section 10A(m)(1) of the Securities Exchange Act of 1934, as added by Section 301 of the Sarbanes-Oxley Act.

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Under the proposed rule, national securities exchanges and national securities associations would be required to prohibit the listing of any security of an issuer that is not in compliance with the following:

- Each member of the audit committee of the issuer must be independent according to the specified criteria in Section 10A(m).
- The audit committee must be directly responsible for the appointment, compensation, retention, and oversight of the work of any registered public accounting firm engaged for the purpose of preparing or issuing an audit report or related work or performing other audit, review, or attest services for the issuer, and the registered public accounting firm must report directly to the audit committee.
- The audit committee must establish procedures for the receipt, retention, and treatment of complaints regarding accounting, internal accounting controls, or auditing matters, including procedures for the confidential, anonymous submission by employees of concerns regarding questionable accounting or auditing matters.
- The audit committee must have the authority to engage independent counsel and other advisors, as it determines necessary to carry out its duties.
- The issuer must provide appropriate funding for the audit committee.

The proposed rule would apply to both domestic and foreign listed issuers. Several provisions have been included in the proposed rule that seek to address the special circumstances of particular foreign jurisdictions. These provisions include:

- Allowing nonmanagement employees to serve as audit committee members, consistent with "codetermination" and similar requirements in some countries
- Allowing shareholders to select or ratify the selection of auditors, also consistent with requirements in many foreign countries
- Allowing alternative structures, such as boards of auditors, to perform auditor oversight functions where such structures are provided for under local law
- Addressing the issue of foreign government shareholder representation on audit committees.

The proposed rule would also make several updates to the SEC's current disclosure requirements regarding audit committees, including (1) disclosure of the use of any exemptions to the recommendations, (2) the identification of the audit committee in annual reports, and (3) updates to the audit committee independence disclosure in proxy statements.

The proposed new requirements are to be operative no later than the first anniversary of the publication of the SEC's final rule.

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http://www.sec.gov/news.shtml

The proposed rule is available at http://www.sec.gov/rules/proposed/34-47137.htm.

### SEC Proposes Amendments Regarding CEO and CFO Certifications

The SEC proposed amendments to its rules and forms that would require companies to provide the corporate officer certifications required by Sections 302 and 906 of the Sarbanes-Oxley Act as exhibits to the periodic reports to which they relate. The SEC also is publishing interim guidance regarding the filing procedures for the certifications required by Section 906, pending the adoption of final rules.

The proposed amendments are expected to make it easier for investors to access the certifications more efficiently. They would also enable the SEC staff and, with regard to Section 906 certifications, the Department of Justice to search periodic reports more expeditiously to verify that the required certifications have been included in the reports and to review the certifications.

Section 302 of the Sarbanes-Oxley Act requires the principal executive and financial officers of a company filing periodic reports to certify in each quarterly and annual report, among other things, that the report does not (1) contain any untrue statement of a material fact or (2) omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which such statements were made, not misleading, and the financial statement and other financial information included in the report fairly present in all material respects the financial condition and results of operations of the company.

Section 906 of the Sarbanes-Oxley Act adds a provision to the U.S. criminal laws that contains a separate certification requirement. This provision expressly creates new criminal penalties for a knowingly or willfully false certification. The amendments proposed by the SEC affect rules and forms under the Securities Exchange Act of 1934 and the Investment Company Act of 1940.

The proposed rule is available on the SEC's website at http://www.sec.gov/rules/proposed/33-8212.htm.

# AICPA Developments



**Selected AICPA Links**

AICPA Homepage: http://www.aicpa.org/index.htm

AcSEC Homepage: http://www.aicpa.org/members/div/acctstd/index.htm

## AcSEC SOP Issued

### SOP No. 02-2, *Accounting for Derivative Instruments and Hedging Activities by Not-for-Profit Health Care Organizations, and Clarification of the Performance Indicator*

This SOP amends the AICPA Audit and Accounting Guide, *Audits of Health Care Organizations*, to:

- Address how nongovernmental, not-for-profit health care organizations should report gains or losses on hedging and nonhedging derivative instruments under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended
- Clarify that the performance indicator (earnings measure) of such organizations is analogous to income from continuing operations of for-profit enterprises.

The SOP is effective for fiscal years beginning after June 15, 2003. The announcement of the SOP's issuance appears on the AICPA's website at http://www.aicpa.org/pubs/jofa/feb2003/news.htm#accounting.

## AcSEC SOP Withdrawn

### SOP No. 92-3, *Accounting for Foreclosed Assets*

AcSEC announced that it has rescinded SOP 92-3 which is effectively superseded by SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*.

This announcement appears on the AICPA's website at http://www.aicpa.org/pubs/jofa/jan2003/news.htm#ACCOUNTING.

### Selected AICPA Links

AICPA Homepage: http://www.aicpa.org/index.htm

AcSEC Homepage: http://www.aicpa.org/members/div/acctstd/index.htm

## Exposure Drafts of Proposed AcSEC SOPs

### *Accounting by Insurance Enterprises for Deferred Acquisition Costs on Internal Replacements Other Than Those Specifically Described in FASB Statement No. 97*

This exposure draft, issued on March 14, 2003, provides guidance to life insurance companies on accounting for deferred acquisition costs related to insurance contracts that are replaced by other contracts. The applicable accounting would largely depend on whether a replacement contract is considered to be a new contract or the continuation of an original contract, based on specified criteria.

The exposure draft is available on the AICPA website at http://www.aicpa.org/members/div/acctstd/edo/acctg_for_DAC_2003_03.asp. Comments should be received by the AICPA by May 14, 2003.

### *Accounting for Real Estate Time-Sharing Transactions*

On February 20, 2003, AcSEC and the FASB issued related exposure drafts: (1) a proposed SOP, *Accounting for Real Estate Time-Sharing Transactions,* and (2) a proposed SFAS, *Accounting for Real Estate Time-Sharing Transactions*, respectively.

The proposed SOP addresses the accounting for the sale of real estate time-sharing interests, including how revenue should be recognized, how allowances for uncollectible receivables should be determined, and what kinds of selling costs may be deferred.

The proposed SFAS would amend SFAS No. 66, *Accounting for Sales of Real Estate*, and SFAS No. 67, *Accounting for Costs and Initial Rental Operations of Real Estate Projects*, to (1) exclude the accounting for real estate time-sharing transactions from their scope and (2) state that the accounting for such transactions is addressed in the AICPA SOP on that subject.

Provisions of any final pronouncements would be effective for financial statements issued for fiscal years beginning after June 15, 2004, with earlier application encouraged.

Both exposure drafts and a related announcement are available on the AICPA's website at http://www.aicpa.org/members/div/acctstd/edo/timeshare_2003_0204.asp and on the FASB's website at http://www.fasb.org/news/nr022003.shtml. Comments on each exposure draft should be received by its respective issuer by April 30, 2003.

## Other AcSEC Developments

AcSEC has a number of projects in various stages of deliberations, including the following. Further information about each project is available in the most

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AICPA Homepage: http://www.aicpa.org/index.htm

AcSEC Homepage: http://www.aicpa.org/members/div/acctstd/index.htm

recent *AcSEC Update* newsletter, which is available on the AICPA's website at http://www.aicpa.org/members/div/acctstd/acsec/index.htm.

### *Final SOP Expected to Be Issued in the Second Quarter*

- *Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts,* subject to clearance of a final draft by AcSEC and the FASB.

### *Other AcSEC Projects in Progress*

- Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment. However, the final SOP would exclude certain issues that were addressed in the exposure draft of the proposed SOP.
- Allowance for Credit Losses.
- Clarification of the Scope of the Audit and Accounting Guide, Audits of Investment Companies, and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies.
- Loans and Certain Debt Securities Acquired in a Transfer.

Further information about AcSEC can be found on the AICPA's website at http://www.aicpa.org/members/div/acctstd/index.htm.

## Technical Practice Aids Issued by the AICPA Staff

### *Software Revenue Recognition*

The AICPA staff released two TPAs on certain financial accounting and reporting issues relating to SOP No. 97-2, *Software Revenue Recognition*:

- TPA No. 5100.75, *Fair Value of PSC Renewals Based on Users Deployed and Software Revenue Recognition*, provides illustrations of when specified annual postcontract customer support (PSC) renewal rates would and would not constitute "vendor-specific objective evidence" of fair value under SOP 97-2.
- TPA No. 5100.76, *Fair Value in Multiple-Element Arrangements That Include Contingent Usage-Based Fees and Software Revenue Recognition*, provides several scenarios to illustrate how revenue would be recognized for the various elements (e.g., perpetual license, PCS, and contingent usage-based fee) of multiple-element arrangements.

Those two TPAs, along with previous TPAs relating to SOP 97-2, are available at http://www.aicpa.org/download/acctstd/sop97_2_QA.pdf.

## Proposed Practice Aid

***Valuation of Privately-Held-Company Equity Securities Issued in Other Than a Business Combination***

An AICPA task force is seeking comments on a preliminary draft of this proposed practice aid, which provides suggested best practices on this topic.

The proposed practice aid is available on the AICPA website at http://www.aicpa.org/members/div/acctstd/vpes_021803.asp. Comments should be received by April 30, 2003, as discussed more fully in the draft.



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AICPA Homepage:
http://www.aicpa.org/index.htm

AcSEC Homepage:
http://www.aicpa.org/members/div/acctstd/index.htm

# International Developments



### Selected International Links

IASB Homepage: http://www.iasb.org.uk

Deloitte & Touche IAS Plus Website: http://www.iasplus.com

## IASB Projects

The IASB has a number of projects in various stages of deliberations, including the following. Further information about each project is available on the IASB website at http://www.iasb.org.uk/cmt/0001.asp?s=6831722&sc={56C0E2A9-658C-4E06-86C4-46A1B7924BE9}&n=66 and on Deloitte & Touche's IAS Plus website at http://www.iasplus.com/agenda/timetabl.htm.

### Final IFRS Expected to Be Issued in the Second Quarter

- *Improvements to Existing IAS*
- *First-Time Application of IFRS*

### Exposure Drafts of Proposed IFRS Expected to Be Issued in the Second Quarter

- *Business Combinations (phase two)*
- *Insurance Contracts (phase one)*

### Other IASB Projects in Progress

- Activities of Financial Institutions: Disclosures and Presentation
- Amendments to IAS No. 32, *Financial Instruments: Disclosure and Presentation*, and IAS No. 39, *Financial Instruments: Recognition and Measurement*
- Business Combinations (phase one)
- Convergence Topics
- Consolidations
- Income Statements
- Insurance Contracts (phase two)
- Revenue Recognition and Liabilities
- Share-based Payment

**Selected International Links**

IASB Homepage:
http://www.iasb.org.uk

Deloitte & Touche IAS Plus Website:
http://www.iasplus.com

*Note: Conclusions of the IASB are subject to change at future Board meetings and generally do not affect current accounting requirements for entities that apply IASB standards until an official position (IFRS or Interpretation) is issued. Official positions of the IASB are determined only after extensive deliberation and due process, including a formal vote by written ballot to issue an IFRS or Interpretation.*

Further information about the IASB can be found on its website at http://www.iasb.org.uk/cmt/0001.asp and on the IAS Plus website at http://www.iasplus.com/index.htm.

# Appendix: Abbreviations

| | |
|---|---|
| AcSEC | Accounting Standards Executive Committee |
| AICPA | American Institute of Certified Public Accountants |
| APB | Accounting Principles Board |
| ARB | Accounting Research Bulletin |
| ASR | Accounting Series Release |
| EITF | Emerging Issues Task Force |
| FASB | Financial Accounting Standards Board |
| FIN | FASB Interpretation |
| FSP | FASB Staff Position |
| GAAP | Generally Accepted Accounting Principles |
| GASB | Governmental Accounting Standards Board |
| IAS | International Accounting Standard |
| IASB | International Accounting Standards Board |
| IFRS | International Financial Reporting Standard |
| MD&A | Management's Discussion and Analysis |
| PCAOB | Public Company Accounting Oversight Board |
| SEC | Securities and Exchange Commission |
| SFAS | Statement of Financial Accounting Standards |
| SOP | Statement of Position |
| TPA | Technical Practice Aid |

### Deloitte Accounting Research Tool Available

Deloitte & Touche is making available, on a subscription basis, access to its online library of accounting and financial disclosure literature. Called the Deloitte Accounting Research Tool (DART), the library includes material from the FASB, the EITF, the AICPA, and the SEC, in addition to Deloitte & Touche's own accounting manual and other interpretative accounting guidance.

Updated every business day, DART has an intuitive design and navigation system that, together with its powerful search features, enables users to quickly locate information anytime, from any computer. Additionally, DART subscribers receive periodic e-mails highlighting recent additions to the DART library.

For more information, including subscription details and an online DART demonstration, visit www.deloitte.com/us/dart.

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