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Accounting Roundup

The Year in Review—2003

February 11, 2004

Preface

Accounting Roundup: The Year in Review—2003

During 2003, accounting standard-setters and accounting regulators issued a number of final and proposed SFASs*, GASBs, FSPs, AcSEC SOPs, EITF consensuses, SEC rules, and PCAOB rules (collectively, pronouncements) affecting accounting, financial reporting, and corporate governance.

This publication, *Accounting Roundup: The Year in Review—2003*, presents brief descriptions of those pronouncements, as well as certain other regulatory and professional developments in accounting and financial reporting. The articles included herein were primarily drawn from issues of the *Accounting Roundup* newsletters published in 2003, and have been updated when appropriate. These articles also provide links to locations where additional information can be found on each topic.

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

*See the appendix for a key to abbreviations used in this publication.

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FASB Developments

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FASB STANDARD-SETTING

During 2003, the FASB continued its accelerated pace of standard-setting in response to constituents' calls for new and more comprehensive guidance in a number of high-interest areas. In addition to its traditional vehicles for issuing guidance, such as Statements of Financial Accounting Standards or Interpretations, the FASB started using a new vehicle, FASB Staff Positions (FSPs), beginning in February 2003. The FASB staff introduced FSPs to issue application guidance (like that found in FASB Staff Implementation Guides and Staff Announcements) and ensure more timely and consistent communication about the application of FASB literature. At the direction of the FASB, the FASB staff also may use FSPs to make narrow and limited revisions to existing Statements or Interpretations that would have previously been made through Technical Bulletins—for example, to delay the effective date of a pronouncement or to make technical corrections required to better convey the FASB's intent with respect to a particular issue. More than 15 FSPs were issued during the year.

Two new FASB Board members were also named during the year. Effective July 1, Leslie F. Seidman was named to a three-year term, completing the term of John K. Wulff, who resigned from the Board effective June 30. Effective August 1, George J. Batavick was appointed for a term that ends June 30, 2008. Batavick succeeded John M. "Neel" Foster, whose term ended on June 30.

Accounting areas receiving FASB focus during 2003 included the following:

FINANCIAL REPORTING—PENSION ACCOUNTING

Pension reporting has received heightened scrutiny recently since the combination of low interest rates and lower-than-projected investment returns has typically resulted in increased projected benefit obligations and deterioration in the funding status of those obligations.

SFAS No. 132 (Revised 2003), *Employers' Disclosure's about Pensions and Other Postretirement Benefits*

In December 2003, the FASB issued SFAS 132 (revised 2003) in response to requests by users of financial statements for more transparent disclosure of pension plan assets, obligations, benefit payments, contributions, and net benefit cost. In light of certain similarities between defined benefit pension arrangements and arrangements for other postretirement benefits, SFAS 132 requires similar disclosures for both.

This Statement replaces the original SFAS 132 and revises employers' disclosures about pension plans and other postretirement benefit plans to require more information about the economic resources and obligations of such plans. SFAS 132 (revised 2003) amends the disclosure requirements of SFAS 87, SFAS 88, and SFAS 106, however, the measurement and recognition guidance is not affected. SFAS 132 (revised 2003) requires the following additional disclosures:

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Plan Assets

For each major category of assets (such as, but not limited to, equity securities, debt securities, real estate):

- Percentage of total plan assets for each period in which a statement of financial position is presented
- Narrative description of investment policies, including target allocation, if used, and other factors that are pertinent to an understanding of the policies or strategies (such as investment goals, risk management practices, permitted and prohibited investments), and the relationship between plan assets and benefit obligations
- Narrative description of the basis used to select the expected long-term rate of return on assets, including the general approach used, along with the extent to which the assumption was based on historical returns, and any adjustments made to historical returns to reflect expectations of future returns, and how those adjustments were determined
- Additional asset categories and information about specific assets within a category to permit understanding of market risks and rates of return is encouraged.

Obligations

- Accumulated benefit obligation for defined benefit pension plans
- Expected future benefit payments (in each of the next five years and, in the aggregate for the next five years thereafter, using the same assumptions used to measure the projected benefit obligation), taking into account future employee service
- Best estimate of aggregate expected contributions for the next fiscal year.

Other

- On a weighted average basis, assumptions (discount rates, rates of compensation increase for pay-related plans, expected long-term rates of return on plan assets), disclosed in tabular format
- Measurement date, or dates, used for the majority of plans.

Interim Period Disclosures

- Net periodic benefit cost recognized, showing each component separately
- The total amount of employer's contributions paid and expected to be paid during the current fiscal year, if significantly different from amounts previously disclosed.

Effective Date

SFAS 132 (revised 2003) is effective for financial statements of public companies for the fiscal years ending after December 15, 2003, **except** estimated future benefit payment disclosures and disclosures of certain information about foreign plans are not required until fiscal years ending after June 15, 2004. The interim-period disclosures are effective for interim-period financial reports beginning after December 15, 2003. Disclosures for earlier annual periods presented for comparative purposes are required to be restated for: the percentages of each major category of plan assets held, the accumulated benefit obligation, and plan assumptions. The disclosures for earlier interim periods presented for comparative purposes need to be restated for the components of net benefit cost. SFAS 132 (revised 2003) is effective for financial statements of nonpublic companies for the fiscal years ending after June 15, 2004, and nonpublic entities are not subject to all of its additional disclosure requirements.

STOCK COMPENSATION

In the wake of recent corporate scandals, the issue of executive compensation, particularly stock options, reinvigorated debate about the merits of expensing stock options grants. This increased focus on stock-based compensation resulted in a number of companies electing to voluntarily change their method of accounting for stock options.

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

SFAS 148 (issued in December 2002) amends SFAS No. 123, *Accounting for Stock-Based Compensation*, to provide companies alternative methods of transition for a voluntary change from the intrinsic-value-based method of recognizing stock compensation expense under APB 25 to the SFAS 123 fair-value-based. 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. GAAP currently permits either method, with the fair value method being preferable. As an accommodation to companies changing to the fair value method, SFAS 148 provided for two alternative transition methods in addition to prospective adoption, as was originally required under SFAS 123. SFAS 148, which is effective for financial statements for fiscal years ending after December 15, 2002, does not permit the use of the original SFAS 123 prospective method of transition for changes to the fair value method made in fiscal years beginning after December 15, 2003. 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.

DERIVATIVES AND HEDGING

During 2003, accounting for derivative and hedging activities continued to be an area that generated a number of practice issues requiring additional guidance from the FASB.

SFAS No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities*

In April 2003, the FASB issued SFAS 149, which amends and clarifies accounting and reporting for derivative instruments, including certain embedded derivatives, and for hedging activities under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*.

The new guidance amends SFAS 133 for decisions made:

- To codify guidance set forth in SFAS 133 Implementation Issues that effectively required amendments to SFAS 133
- To align the guidance in SFAS 133 with decisions reached in other FASB projects dealing with financial instruments
- To clarify the application of the definition of a derivative,

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particularly with respect to the meaning of an "underlying" and the characteristics of a derivative having financing components.

SFAS 149 amendments to SFAS 133 include:

- Further guidance on determining if a contract qualifies for the normal purchases and sales exceptions
- Additional criteria to qualify for the financial guarantee contracts scope exception
- New scope exceptions for investments in life insurance, certain investment contracts, and loan commitments
- Clarification of how to determine when an embedded derivative, which has an underlying that is an interest rate or interest rate index, is not clearly and closely related
- Supplementary guidance on when embedded foreign currency derivatives do not require separate accounting
- Acknowledgment that a supply contract with clearly and closely related price caps or floors meets the definition of a firm commitment, and therefore can be designated as a hedged item in a fair value hedge
- Additional guidance on accounting for a qualifying foreign currency cash flow hedge, including both nonoption-based and option-based contracts
- Clarification of the transition provisions for intercompany derivatives
- Guidance on whether publicly traded stock, to be delivered upon settlement of a derivative, where subsequent sale or transfer of the stock is restricted, is readily convertible to cash
- Addition of a definition of a capacity contract
- Clarification of the definition of an underlying (includes the occurrence or nonoccurrence of a specified event).

Effective Date

- SFAS 149 is effective for contracts entered into or modified after June 30, 2003, except as stated below, and for hedging relationships designated after June 30, 2003. The guidance should be applied prospectively.
- The provisions of SFAS 149 that relate to SFAS 133 Implementation Issues that were effective for fiscal quarters that began prior to June 15, 2003 should continue to be applied in accordance with their respective effective dates. In addition, certain provisions relating to forward purchases or sales of "when issued" securities or other securities that do not yet exist should be applied to existing contracts as well as new contracts entered into after June 30, 2003.

LIABILITIES AND EQUITY/COMPLEX INSTRUMENTS

The FASB completed Phase I of its project to provide guidance on how to account for certain financial instruments having characteristics of both liabilities and equity. Phase II of the project will focus on amending and improving the definitions of liability, equity, and perhaps assets in FASB Concepts Statement No. 6, *Elements of Financial Statements*. Phase II will also address how to account for more complex instruments that are outside of the limited scope of SFAS 150.

SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*

In May 2003, the FASB issued SFAS 150. This Statement was developed to respond to concerns expressed by preparers, auditors, regulators, investors, and other users of financial statements about issuers' classification in the statement of financial position of certain financial instruments that have characteristics of both liabilities and equity but that have been presented either entirely as equity or between the liabilities section and the equity section of the statement of financial position ("mezzanine equity"). This Statement also addresses questions about the classification of certain financial instruments that embody obligations to issue equity shares. Previously, under EITF Issue No. 00-19, *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock*, an issuer of a contract to repurchase its equity shares generally accounted for that contract as equity if the issuer must or could settle it by delivering its equity shares (net share settled). Additionally, certain obligations settleable by delivery of the issuer's equity shares but not indexed to the issuer's shares may have been classified as equity. Under SFAS 150, those obligations are accounted for as liabilities.

SFAS 150 aims to eliminate diversity in practice by requiring the following types of "freestanding" financial instruments to be reported as liabilities:

- Mandatorily redeemable instruments (i.e., instruments issued in the form of shares that unconditionally obligate the issuer to redeem the shares for cash or by transferring other assets)
- Forward purchase contracts, written put options, and other financial instruments not in the form of shares that either obligate or may obligate the issuer to settle its obligation to repurchase its equity shares for cash or by transferring other assets
- Certain financial instruments that embody an obligation that (1) the issuer may or must settle by issuing a variable number of its equity shares and (2) has a "monetary value" at inception that (a) is fixed, (b) is tied to a market index or other benchmark (something other than the fair value of the issuer's equity shares), or (c) varies inversely with the fair value of the equity shares (e.g., a written put option that could be net share settled).

The most common effect of SFAS 150 has been the requirement to report mandatorily redeemable preferred stock as a liability rather than "mezzanine" equity. Preferred dividends on these instruments are now classified as interest expense. Retroactive reclassification of amounts reported in historical financial statements for periods prior to the effective date of SFAS 150 is **not** permitted.

Effective Date

The provisions of SFAS 150, which also include a number of new disclosure requirements, are effective for instruments entered into or modified after May 31, 2003 and pre-existing instruments as of the beginning of the first interim period that commenced after June 15, 2003. There is, however, a delayed effective date for private companies' mandatorily redeemable instruments.

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In addition, the FASB issued the following FSPs to clarify certain requirements of SFAS 150:

- FSP No. 150-1, *Issuer's Accounting for Freestanding Financial Instruments Composed of More Than One Option or Forward Contract Embodying Obligations under FASB Statement No. 150*
- FSP No. 150-2, *Accounting for Mandatorily Redeemable Shares Requiring Redemption by Payment of an Amount that Differs from the Book Value of Those Shares, under FASB Statement No. 150*
- FSP No. 150-3, *Effective Date, Disclosures, and Transition for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests under FASB Statement No. 150*
- FSP No. 150-4, *Issuers' Accounting for Employee Stock Ownership Plans under FASB Statement No. 150.*

UNRECORDED COMMITMENTS/UNCONSOLIDATED ENTITIES

Recent corporate scandals raised financial statement users' concerns that many companies were not recording significant financial interests and obligations on their balance sheets or disclosing the existence or potential impact of off-balance-sheet commitments in their financial statements. To respond to those concerns, the FASB issued guidance that attempted to clarify when certain obligations or financial interests should be recorded, disclosed, or consolidated in the financial statements.

FASB Interpretation (FIN) No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*

Prior to FIN 45, there was diversity in practice concerning the disclosures provided by guarantors under SFAS 5, and about the need for a guarantor to recognize an initial liability for its obligation under a guarantee. Some constituents believed that SFAS 5 prohibits a guarantor from initially recognizing a liability for a guarantee issued unless it is probable that payments will be required under that guarantee. FIN 45 clarifies the requirements of SFAS 5 relating to the guarantor's accounting and disclosures of certain guarantees issued.

FIN 45 expands the disclosures required to be made by a guarantor in its interim and annual financial statements. FIN 45 also clarifies that a guarantor is required to recognize, at the inception of a guarantee, the fair value of its liability for the obligations it has undertaken in issuing the guarantee, including its ongoing obligation to stand ready to perform over the term of the guarantee in the event that the specified triggering events or conditions occur.

FIN 45 does not apply to certain guarantee contracts, including residual value guarantees provided by lessees in capital leases, contingent rents, vendor rebates, and guarantees whose existence prevents the guarantor from recognizing a sale or the earnings from a sale. Furthermore, the liability recognition provisions of FIN 45 do not apply to certain guarantees, primarily those addressed in existing guidance (e.g., product warranties, guarantees accounted for as derivatives, etc.), although the disclosure requirements of FIN 45 are still applicable to these arrangements.

FIN 45 incorporates, without change, and supersedes the guidance in FIN No. 34, *Disclosure of Indirect Guarantees of Indebtedness of Others*. Additionally, FIN 45 clarifies that a guarantor is required to disclose:

- Nature of the guarantee, including the approximate term of the guarantee, how the guarantee arose, and the events or circumstances that would require the guarantor to perform
- Maximum potential amount of future payments
- Carrying amount of the liability, if any, for the guarantor's obligations under the guarantees
- Nature and extent of any recourse provisions or available collateral that would enable the guarantor to recover the amounts paid under the guarantee.

Effective Date

The initial recognition and initial measurement provisions of FIN 45 were applicable on a prospective basis to guarantees issued or modified after December 31, 2002. The disclosure requirements were effective for financial statements of interim or annual periods ending after December 15, 2002.

During 2003, the FASB issued two FSPs:

- FSP No. 45-1, *Accounting for Intellectual Property Infringement Indemnifications under FASB Interpretation No. 45*
- FSP No. 45-2, *Whether FASB Interpretation No. 45, Provides Support for Subsequently Accounting for a Guarantor's Liability at Fair Value.*

FIN No. 46 and FIN No. 46 (Revised 2003), *Consolidation of Variable Interest Entities*

In January 2003, the FASB issued FIN 46 to address perceived weaknesses in the accounting and financial reporting for "investments" or "interests" in entities commonly known as special-purpose or off-balance-sheet entities. However, as issued, the guidance applies to a larger population of entities. In December 2003, the FASB revised FIN 46 and codified certain FSPs previously issued for FIN 46 in FASB Interpretation No. 46, Revised December 2003 ("FIN 46R").

FIN 46 as originally issued, and as revised by FIN 46R, establishes consolidation criteria for entities for which "control" is not easily discernable under Accounting Research Bulletin 51, *Consolidated Financial Statements*. ARB 51 provided that, generally, consolidation should be triggered by ownership by one company directly or indirectly, of over 50 percent of the outstanding **voting shares** of another company. 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 uses the term "variable interest entity" (VIE) and states that if an entity is a VIE, an enterprise that absorbs a majority of the VIE's expected losses and/or receives a majority of its expected residual returns (measures of risk and reward), is the primary beneficiary because it is deemed to have a controlling financial interest in the VIE. It is possible that no enterprise will consolidate a VIE if the risks and rewards of the VIE are dispersed among several unrelated parties such that no single enterprise absorbs or receives a majority of the risks and rewards of the VIE. The assets, liabilities, and results of the activities of the VIE should be included in the consolidated financial statements of the primary beneficiary. Some, but not all of the revisions to FIN 46 made by FIN 46R include:

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- Business Scope Exception

  FIN 46R provides a scope exception for certain entities deemed to be a business under the definition in Appendix C of FIN 46R. This definition is based on the description in EITF Issue No. 98-3, *Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or of a Business.*

- Removal of the Decision Maker and Guarantor Bias in Determining Expected Residual Returns and the Primary Beneficiary

  FIN 46, as originally issued, required calculations that resulted in a bias that a VIE's decision maker or a guarantor of substantially all of the VIE's assets or liabilities would have to consolidate the VIE. In FIN 46R, the decision maker and guarantor bias has been removed from the required calculation of an entity's expected residual returns.

- Clarification of How to Identify a Variable Interest

  Appendix B of FIN 46R provides guidance on the identification of variable interests which is perceived as more understandable than that originally provided in FIN 46. In some cases, the clarified definition will cause a company to reverse its earlier conclusion that its position constitutes a variable interest in a potential VIE.

Additional Disclosure Issues:

Recently, the SEC staff reminded registrants that the guidance in SAB No. 74, *Disclosure of the Impact that Recently Issued Accounting Standards Will Have on the Financial Statements of the Registrant When Adopted in a Future Period*, and the SEC's disclosure rules for off-balance-sheet arrangements (FRR No. 67) are applicable to a company's adoption of FIN 46 and FIN 46R.

The SEC staff also provided its views on the types of FIN 46 and FIN 46R-related disclosures that should be included in financial statements:

- Principles of inclusion or exclusion
- Specific identification of entities that were consolidated as a result of adoption and the reason why consolidation was required
- Disclosures specifically required by FIN 46 and/or FIN 46R, including the nature and purpose of the entity and the exposures that result from consolidation
- Whether there are restrictions on a registrant's ability to use certain consolidated assets that warrant further disclosure in the notes to the financial statements.

Effective Dates

The question of when to implement FIN 46 and FIN 46R is complicated. FIN 46 featured staggered implementation dates depending on when a VIE was created and the type of enterprise implementing the standard. The fact that the implementation date has been postponed twice (first via FSP FIN 46-6 and later via FIN 46R) confuses the question even further.

Prior to FIN 46R, FIN 46 (issued in January 2003) and FSP FIN 46-6 (released in October 2003) required implementation of the accounting provisions no later than the dates indicated in the table below [changes due to FSP FIN 46-6 are shown in bold]:

FIN 46R Effective Dates Before the Issuance of FIN46R

Interest Holder is a:	Entity Being Evaluated Under FIN 46 for Consolidation	
	Created after January 31, 2003	**Created before February 1, 2003**
Public Entity	Effective immediately **No change**	Beginning of first interim or annual period beginning after June 15, 2003. Applies to all entities. **End of the first interim or annual period ending after December 15, 2003 (assuming that the public entity had not issued financial statements reporting the interest in accordance with FIN 46). The public entity can elect the deferral on a n interest-by-interest basis.**
Nonpublic Entity	Effective Immediately **No change**	End of first annual period beginning after June 15, 2003. **No change**

FIN 46R delays again the effective date of the Interpretation (except for special-purpose entities) and adds separate effective dates for a Public Entity that is a Small Business Issuer as defined in SEC Regulation S-B 228.(a)(1). The table below summarizes FIN 46R's effective dates.

FIN 46R Effective Dates

Interest Holder is a:	Entity Being Evaluated Under FIN 46R for Consolidation		
	Entity to which FIN 46 has been applied in previously issued financial statements*	**Special-purpose Entities***	**Other Entities***
Public Enterprise — nonsmall business issuer	Continue to apply FIN 46 or apply FIN 46R earlier than its required effective date. Decision is on an entity-by-entity basis.	Apply FIN 46 or FIN 46R (choice is on an entity-by-entity basis) no later than the end of the first reporting period that ends after December 15, 2003.	No later than the end of the first reporting period that ends after March 15, 2004.
Public Enterprise — small business issuer	Same as other public companies.	Same as other public companies.	No later than the end of the first reporting period that ends after December 15, 2004.
Nonpublic Enterprise	Not discussed in FIN 46R.	No special requirement—see column "Other Entities ."	Beginning of the first-annual reporting period after December 15, 2004. For entities created after December 15, 2003, FIN 46R must be applied immediately.

*FIN 46R must be applied to all entities no later than the effective date shown in the column headed "Other Entities."

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Further information on FIN 46R can be found in the *Heads Up* newsletter published by Deloitte & Touche LLP at https://techlibrary/nxt/gateway.dll?f=templates&fn=default.htm&vid=DA_tech_lib:us.
For more information about FASB-issued standards, visit the FASB's website at http://www.fasb.org/.

SFAS 133 IMPLEMENTATION ISSUES

The following lists SFAS 133 implementation issues that have been addressed by FASB during 2003:

- Implementation Issue No. A23, *Prepaid Interest Rate Swaps*—effective the first day of the first fiscal quarter beginning after August 8, 2003 and applied prospectively to all contracts entered into on or after that date
- Implementation Issue No. B36, *Embedded Derivatives: Modified Coinsurance Arrangements and Debt Instruments That Incorporate Credit Risk Exposures That Are Unrelated or Only Partially Related to the Creditworthiness of the Obligor under Those Instruments*—effective the first day of the first fiscal quarter beginning after September 15, 2003
- Implementation Issue No. C18, *Scope Exceptions: Shortest Period Criterion for Applying the Regular-Way Security Trades Exception to When-Issued Securities or Other Securities That Do Not Yet Exist*—effective the first day of the second quarter beginning after May 1, 2003
- Implementation Issue No. C20, *Scope Exceptions: Interpretation of the Meaning of "Not Clearly and Closely Related" in Paragraph 10(b) regarding Contracts with a Price Adjustment Feature*—effective the first day of the first fiscal quarter beginning after July 10, 2003
- Implementation Issue No. E22, *Hedging—General: Accounting for the Discontinuance of Hedging Relationships Arising from Changes in Consolidation Practices Related to Applying FASB Interpretation No. 46*—effective as of the date of initial application of FIN 46.

The following is a summary of SFAS 133 Implementation Issues that have been revised during 2003 as a result of the issuance of SFAS 150:

- Implementation Issue No. A18, *Definition of a Derivative: Application of Market Mechanism and Readily Convertible to Cash Subsequent to the Inception or Acquisition of a Contract*
- Implementation Issue No. C2, *Scope Exceptions: Application of the Exception to Contracts Classified in Temporary Equity*
- Implementation Issue No. G1, *Cash Flow Hedges: Hedging an SAR Obligation*
- Implementation Issue No. K3, *Miscellaneous: Determination of Whether Combinations of Options with the Same Terms Must Be Viewed as Separate Option Contracts or as a Single Forward Contract*.

The following is a summary of SFAS 133 Implementation Issues that have been withdrawn during 2003 as a result of the issuance of SFAS 149:

- Implementation Issue No. A20, De*finition of a Derivative—Application of Paragraph 6(b) regarding Initial Net Investment*
- Implementation Issue No. C19, *Contracts Subject to Statement 35, Statement 110, or Statement of Position 94-4*
- Implementation Issue No. D2, *Recognition and Measurement of Derivatives—Applying Statement 133 to Beneficial Interest in Securitized Financial Assets (a Resolution of the Issues Raised in Implementation Issue D1)*
- Implementation Issue No. E21, *Hedging—General—Continuing the Shortcut Method After a Purchase Business Combination*.

For more information about DIG issues, visit the FASB's website at http://www.fasb.org/derivatives/.

PROPOSED STATEMENTS OF FINANCIAL ACCOUNTING STANDARDS

Listed below are FASB exposure drafts that have been issued for comment, proposed FASB Staff Positions, and ongoing projects.

Exposure Drafts

- Proposed SFAS, *Qualifying Special Purpose Entities and Isolation of Transferred Assets*, an amendment of FASB Statement 140
- Proposed SFAS, *Accounting for Real Estate Time-Sharing Transactions*—an amendment of FASB Statements No. 66 and 67
- Proposed SFASs on Short-Term Convergence (See exposure drafts in the IASB section).

Proposed FSPs

- Proposed FSP No. 106-a, *Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003* (Final FSP 106-1 issued in January 2004)
- Proposed FSP, Applicability of FASB Statement No. 143, *Accounting for Asset Retirement Obligations, to Legislative Requirements on Property Owners to Remove and Dispose of Asbestos or Asbestos-Containing Materials*.

Ongoing FASB Projects

- Business Combinations
- Equity-based Compensation
- Fair Value Measurement
- Financial Instruments: Liabilities and Equity (Phase II)
- Financial Performance Reporting by Business Enterprise
- Revenue Recognition
- Short-Term International Convergence
- Criteria for Liability Extinguishment
- Interpretation of SFAS 87
- Loan Commitments.

For more information about FASB-issued exposure drafts, proposed FSPs, and projects, visit the FASB's website at http://www.fasb.org/.

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Emerging Issues Task Force (EITF) Developments

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The following table is a summary of consensuses reached on EITF Issues in 2003. In addition, Deloitte & Touche LLP publishes the *EITF Roundup* newsletter, which provides an overview of consensuses reached and discussions held at EITF meetings. Recent issues of this newsletter can be viewed at http://www.deloitte.com/us/eitfroundup.

A number of EITF Issues were modified during the year to conform to guidance included in SFAS 150. Details of these changes are available at http://www.fasb.org/eitf/eitf_affected_by.shtml. For more information about EITF issues, visit http://www.fasb.org/eitf/.

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Issue	Effective Date(s)	Summary of Consensus
EITF Issue No. 03 -7, *Accounting for the Settlement of the Equity-Settled Portion of a Convertible Debt Instrument That Permits or Requires the Conversion Spread to Be Settled in Stock*	For transactions entered into after the beginning of the first reporting period after August 13, 2003.	Upon settlement of the debt, only the cash payment should be included in the computation of gain or loss on extinguishment of the liability. Shares transferred to settle the embedded equity instrument (referred to as the excess conversion spread in Issue 90-19) would not be considered in the settlement of the debt.
EITF Issue No. 03 -8, *Accounting for Claims-Made Insurance and Retroactive Insurance Contracts by the Insured Entity*	Not applicable as this is a codification of previous issues.	The consensus is a codification and reconciliation of the guidance contained in the following Issues, which address the accounting by the insured entity for claims-made insurance and retroactive insurance contracts: (1) Issue No. 86-12, *Accounting by Insureds for Claims-Made Insurance Policies* (2) Issue No. 03-3, *Applicability of Topic No. D-79 to Claims-Made Insurance Policies* (3) Topic No. D-79, *Accounting for Retroactive Insurance Contracts Purchased by Entities Other Than Insurance Enterprises.*
EITF Issue No. 03 -10, *Application of EITF Issue No. 02-16,* Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor, *by Resellers to Sales Incentives Offered to Consumers by Manufacturers*	Effective for new arrangements, including modifications to existing arrangements, entered into or redeemed in fiscal periods beginning after November 25, 2003. If determinable, pro forma disclosure of the impact of this consensus on prior periods presented is encouraged.	Consideration received by a reseller from a vendor in exchange for "vendor sales incentives" tendered by consumers should NOT be reported as a reduction of the cost of the reseller's purchases from the vendor. Vendor sales incentives are limited to a vendor's incentive (a) that can be tendered by a consumer at resellers that accept manufacturers' incentives in partial (or full) payment of the price charged by the reseller for the vendor's product, (b) for which the reseller receives a direct reimbursement from the vendor based on the face amount of the incentive, (c) for which the terms of reimbursement to the reseller for the vendor's sales incentive offered to the consumer must not be influenced by or negotiated in conjunction with any other incentive arrangements between the vendor and the reseller but, rather, may only be determined by the terms of the incentive offered to consumers, and (d) whereby the reseller is subject to an agency relationship with the vendor, whether expressed or implied, in the sales incentive transaction between the vendor and the consumer.
EITF Issue No. 03 -11, *Reporting Realized Gains and Losses on Derivative Instruments That Are Subject to FASB Statement No. 133,* Accounting for Derivative Instruments and Hedging Activities, and Not Held for Trading Purposes	For transactions entered into after the beginning of the first reporting period after August 13, 2003.	Determining whether realized gains and losses on physically settled derivative contracts not "held for trading purposes" should be reported on a gross or net basis is a matter of judgment that depends on the relevant facts and circumstances. A determination should be made in the context of the various activities of the entity rather than based solely on the terms of the individual contracts. The determination should be made based on: (1) the economic substance of the transaction, as well as (2) the nonmonetary exchange guidance in APB Opinion No. 29, and (3) the gross versus net reporting indicators provided in Issue 99-19.
EITF Issue No. 03 -12, *Impact of FASB Interpretation No. 45,* Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, *on EITF Issue No. 95-1,* Revenue Recognition on Sales with a Guaranteed Minimum Resale Value	For transactions entered into during the first reporting period beginning after November 25, 2003.	FIN 45 does not affect Issue 95-1. FIN 45 does not apply to a guarantee for which the underlying is related to an asset of the guarantor (i.e., the manufacturer records the amount as net investment in the lease). A FIN 45 guarantee liability should not be recorded by the manufacturer.

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GASB Developments

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During 2003, the GASB formally reviewed its existing standards as part of its strategic plan to evaluate the continuing usefulness of current accounting and reporting requirements. As a result of these efforts, the GASB issued and proposed several standards addressing reporting and accounting issues affecting governmental entities. Certain existing standards, including GASB Statement No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements* and *GASB Statement No. 34, Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, were amended to improve the understandability and usefulness of governmental financial statements. Other guidance was issued to enhance disclosures relating to derivative transactions. In addition, a number of exposure drafts were issued to clarify financial reporting for other postemployment benefits, and to improve the use of statistical information in financial statements.

FINAL STANDARDS

Deposits and investments of state and local governments, which often represent a significant amount of assets and are essential to the delivery of governmental services and programs, can be exposed to risks that can lead to significant losses for an entity. To make these risks more transparent to users of the financial statements, in March 2003, the GASB issued Statement No. 40, *Deposit and Investment Risk Disclosures—an amendment of GASB Statement No. 3* (GASB 40). GASB 40 focuses on common deposit and investment risks related to credit risk, interest rate risk, and foreign currency risk and requires certain disclosures of investments that have fair values that are highly sensitive to changes in interest rates. Deposit and investment policies related to the risks identified in the Statement are also required to be disclosed. The provisions of GASB 40 are effective for periods beginning after June 15, 2004.

In an effort to clarify budgetary presentation requirements for governmental entities, on May 20, 2003, the GASB issued Statement No. 41, *Budgetary Comparison Schedules—Perspective Differences—an amendment of GASB Statement No. 34* (GASB 41). This Statement requires governments with significant budgetary perspective differences that result in their inability to present budgetary comparison information for their general fund and major special revenue funds to present budgetary comparison schedules as required supplementary information based on the fund, organization, or program structure that the government uses for its legally adopted budget. The provisions of GASB 41 should be implemented simultaneously with GASB 34.

To establish accounting and financial reporting standards for impairment of capital assets, the GASB issued Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries* (GASB 42), on November 18, 2003. Under GASB 42, governments are required to evaluate prominent events or changes in circumstances affecting capital assets to determine whether impairment of a capital asset has occurred. In addition, GASB 42 requires impaired capital assets that are idle to be

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disclosed, and those that will no longer be used by the government to be reported at the lower of carrying value or fair value. GASB 42 improves financial reporting by requiring governments to report the effects of capital asset impairments in their financial statements when they occur rather than as a part of the ongoing depreciation expense for the capital asset or upon disposal of the capital asset. This Statement also enhances comparability of financial statements between governments by requiring all governments to account for insurance recoveries in the same manner. The provisions of GASB 42 are effective for fiscal periods beginning after December 15, 2004.

PROPOSED GUIDANCE

In an effort to improve disclosures associated with the risks and nature of derivative contracts, GASB issued, on April 14, 2003, proposed Technical Bulletin, *Disclosure Requirements for Derivatives Not Reported at Fair Value on the Statement of Net Assets*, which requires more comprehensive reporting by state and local governments. These requirements will allow users of financial statements to be better informed about the risks assumed in derivative contracts. A final Technical Bulletin would be effective for periods ending after June 15, 2003.

Many state and local governments provide other postemployment benefits (OPEB) to their employees, including postemployment health care, as well as other forms of postemployment benefits, such as life insurance. For this reason, the GASB desired to establish an employers' reporting standard for the measurement, recognition, and display of OPEB benefits and related obligations. Two exposure drafts were issued on February 14, 2003, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions, and Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, to address accounting and financial reporting issues and to establish uniform governmental financial reporting standards for OPEB. The proposals would require OPEB to be measured using the accrual basis and governments to disclose the costs associated with the plans, in addition to providing actuarial and other information deemed useful. The GASB expects the guidance to produce greater transparency for decision-makers who rely on state and local governments' financial statements.

GASB issued an exposure draft, *Economic Condition Reporting: The Statistical Section* on September 11, 2003 to address shortcomings identified in presenting statistical information in financial statements. The proposed Statement would improve the understandability and usefulness of statistical information by addressing the comparability problems that have developed in practice and by adding information from the new financial reporting model for state and local governments required by GASB 34. The proposed Statement establishes the objectives of the statistical information for five categories: financial trends, revenue capacity, debt capacity, demographic and economic, and operating.

For more information about GASB-issued standards, exposure drafts, and projects, visit the GASB's website at http://www.gasb.org/.

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AICPA Developments

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During 2003, AICPA standard-setting primarily focused on industry-specific accounting and auditing guidance and continued efforts to create principles-based U.S. accounting standards. Through AcSEC, the AICPA issued several SOPs, exposure drafts, and TPAs in 2003.

INDUSTRY GUIDANCE

Not-For-Profits

In 2003, the AICPA staff issued a group of nonauthoritative TPAs related to SFAS No. 136, *Transfers of Assets to a Not-for-Profit Organization or Charitable Trust That Raises or Holds Contributions for Others*, to assist not-for-profit organizations, including health care organizations, in the application of SFAS 136. Additionally, TPA Section 6400.44, *Other-Than-Temporary Impairment Losses on Investments by Not-For-Profit Health Care Organizations*, was issued to address determining other-than-temporary impairment for investments in debt and equity securities having readily determinable fair values held by a not-for-profit health care organization.

Insurance Enterprises

During 2003, AcSEC issued SOP 03-1, *Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts*. This SOP, which addresses a number of issues that had been encountered in practice, is effective for financial statements for fiscal years beginning after December 15, 2003, with earlier adoption encouraged.

AcSEC also issued a proposed SOP, *Accounting by Insurance Enterprises for Deferred Acquisition Costs on Internal Replacements Other Than Those Specifically Described in FASB Statement No. 97*, which proposes accounting guidance on the treatment of deferred acquisition costs on certain internal replacements. This proposed SOP would be applied prospectively and would be effective for internal replacements occurring in years beginning after December 15, 2004. AcSEC approved the proposed SOP for final issuance in September 2003, subject to clearance by the FASB. The proposed SOP was sent to the FASB for final clearance in November 2003 and a clearance meeting with the FASB is expected in the first quarter of 2004.

Investment Companies

In December 2003, AcSEC issued two SOPs which provide disclosure guidance for investment companies: (1) SOP 03-4, *Reporting Financial Highlights and Schedule of Investments by Nonregistered Investment Partnerships: An Amendment to the Audit and Accounting Guide* Audits of Investment Companies and AICPA Statement of Position 95-2, *Financial Reporting by Nonpublic Investment Partnerships*, and (2) SOP 03-5, *Financial Highlights of Separate Accounts: An Amendment to the Audit and Accounting Guide* Audits of Investment Companies. Both SOPs are effective for annual fiscal years ending after December 15, 2003, and for interim reporting after initial application.

AcSEC also deliberated on a proposed SOP, *Clarification of the Scope of the Audit and Accounting Guide* Audits of Investment

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Companies *and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies*. The SOP proposes guidance for determining whether an entity is within the scope of the AICPA Audit and Accounting Guide *Audits of Investment Companies* (the Guide). For those entities that are investment companies, the proposed SOP also addresses whether the specialized industry accounting principles of the Guide should be retained by a parent company in consolidation or by an investor that applies the equity method of accounting to its investment in the entity. AcSEC approved the proposed SOP in September 2003, subject to clearance by the FASB. The proposed SOP will be sent to the FASB for final clearance in the first quarter of 2004.

Real Estate Entities

In February 2003, AcSEC issued a proposed SOP, *Accounting for Real Estate Time-Sharing Transactions*, in order to provide guidance on a seller's accounting for real estate time-sharing transactions. This SOP proposes criteria for a time-sharing transaction to be accounted for as a sale and details how the seller should recognize revenue in the transaction and also addresses the accounting treatment of certain sales incentives and certain other costs incurred. This proposed SOP would be effective for financial statements for fiscal years beginning after December 15, 2004. In addition, this proposed SOP was issued concurrently with a FASB exposure draft on time-sharing transactions that would amend SFAS 66 and SFAS 67.

AcSEC approved the proposed SOP for final issuance in September 2003, subject to clearance by the FASB. In January 2004, the FASB discussed whether it should clear the proposed SOP and decided that the proposed SOP should not provide revenue recognition guidance. The FASB will continue to discuss the clearance of the proposed SOP, subject to AcSEC making the required revisions.

OTHER GUIDANCE AND PROJECTS

Transferred Loans or Debt Securities

In December 2003, AcSEC issued SOP 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer*, which addresses accounting for differences between contractual cash flows and cash flows expected to be collected from an investor's initial investment in loans or debt securities (loans) acquired in a transfer if those differences are attributable, at least in part, to credit quality. SOP 03-3 applies to loans acquired in purchase business combinations and applies to all nongovernmental entities, including not-for-profit organizations. This SOP limits the yield that may be accreted to the excess of the investor's estimate of undiscounted expected principal, interest, and other cash flows over the investor's initial investment in the loan. This SOP is effective for loans acquired in fiscal years beginning after December 15, 2004, with early adoption encouraged.

Property, Plant, and Equipment

In 2003, AcSEC continued to deliberate on a proposed SOP, *Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment*, which was issued in June 2001. The SOP proposes accounting and disclosure requirements for costs incurred and activities related to property, plant, and equipment (PP&E). The proposed SOP requires component accounting for PP&E. In order for a replacement to be capitalized, the replaced item needs to have been previously separately accounted for as a component. The proposed SOP also establishes a project stage or timeline framework to determine which costs should be charged to expense as incurred and which costs should be capitalized. This proposed SOP would be effective for fiscal years beginning after December 15, 2004.

AcSEC approved the proposed SOP for final issuance in September 2003, subject to clearance by the FASB. The proposed SOP was sent to the FASB for final clearance in December 2003 and a clearance meeting with the FASB is expected to occur in April 2004.

Allowance for Credit Losses

In June 2003, AcSEC issued a proposed SOP, *Allowance for Credit Losses*, to provide guidance on how creditors should determine the allowance for credit losses related to all loans in accordance with SFAS 5, SFAS 114, and FIN 14. The proposed guidance would apply to *all* creditors of loans (except for governmental entities) and not just financial institutions. Certain provisions proposed were controversial, as evidenced by AcSEC's receipt of over 300 comment letters on the proposal. AcSEC began its deliberations of the comments and will continue to deliberate the proposed SOP in 2004. Based on informal discussions with the FASB in early 2004, AcSEC decided to revise the scope of the proposed SOP to provide guidance related to disclosures only.

Software Revenue Recognition

The AICPA staff issued several nonauthoritative TPAs, related to SOP 97-2, *Software Revenue Recognition*, in order to address technical questions and answers related to financial reporting issues for software revenue recognition.

Valuation of Privately Issued Securities Practice Aid

In 2003, AcSEC also discussed drafts of the proposed Practice Aid, *Valuation of Privately-Held-Company Equity Securities Issued in Other Than a Business Combination*. This Practice Aid proposed best practices for valuation and disclosures related to issuance of privately-held-company equity securities in other than a business combination. The proposed Practice Aid provides overviews of the hierarchy of valuation alternatives, various valuation methods, consideration of stages of enterprise development, factors considered by valuation specialists in performing valuations, effects of initial public offerings on enterprise value, allocation of fair value to various equity classes of an enterprise, and valuation reports. Additionally, recommended disclosures are proposed.

For more information about AICPA-issued standards, exposure drafts, technical practice aids, and projects, visit the AICPA's website at http://www.aicpa.org/members/div/acctstd/index.htm.

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SEC Developments

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Throughout 2003, the SEC continued its heightened pace of rulemaking and issuing interpretive guidance.

RULEMAKING TO COMPLY WITH THE REQUIREMENTS OF THE SARBANES-OXLEY ACT OF 2002

The Sarbanes-Oxley Act of 2002 (the "Act") required the SEC to promulgate rules to address a number of areas including the following:

Conditions for Use of Non-GAAP Financial Information—In January 2003, the SEC adopted a new rule under Section 401(b) of the Act which addresses public companies' disclosure or release of information that includes a "non-GAAP financial measure" as defined by the SEC. As part of its rulemaking, the SEC adopted a new Regulation G and made amendments to Item 10 of Regulation S-K, Regulation S-B, and Exchange Act Form 20-F. Essentially, the new rules require the presentation of the most directly comparable GAAP financial measure, a quantitative reconciliation of the non-GAAP financial measure to the comparable GAAP measure, and statements disclosing the reasons management believes the non-GAAP measure provides useful information to investors. Regulation G applies to all subject disclosures made on or after March 28, 2003. Amendments to Item 10 and Form 20-F apply to any annual or interim report filed for 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, LLP provided commentary on the use of non-GAAP financial measures in our publication, *Conditions for Use of Non-GAAP Financial Measures*, which is available at http://www.deloitte.com/dtt/cda/doc/content/Non-gaap.pdf.

Form 8-K Amendments—In conjunction with the issuance of the non-GAAP financial measures rules, in January 2003, the SEC adopted amendments to Form 8-K to bring earnings information into the SEC's reporting system by requiring registrants to furnish to the SEC all releases or announcements disclosing material, nonpublic financial information about completed annual or quarterly fiscal periods. The amendments do not require companies to issue earnings releases or similar announcements. However, such releases and announcements, if issued, will trigger the Form 8-K reporting requirements. The new Form 8-K requirements apply to earnings releases and similar announcements made after March 28, 2003. The rule is available at http://www.sec.gov/rules/final/33-8176.htm.

Disclosure Requirement—Financial Experts, Code of Ethics—In January 2003, the SEC adopted rules implementing Sections 406 and 407 of the Act that require public companies to disclose information about their codes of ethics and audit committee financial experts. The code of ethics rules require each public company to disclose in its Form 10K whether it has a code of ethics for the company's principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions, and if not, why not. Registrants are also required to either: (1) file a copy of its code of ethics as an exhibit to its annual report on Form 10-K; (2) post the text of its code of ethics on its Internet website and disclose in its annual report on Form 10-K its Internet address and the fact that the code of

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ethics can be found there; or (3) undertake in its annual report on Form 10-K to provide a copy of its code of ethics to any person upon request, without charge, and explain how such a request may be made. A registrant (other than foreign private issuers or registered investment companies) must disclose any changes to or waivers of its 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. This disclosure may be made on Form 8-K or on the company's website. The code of ethics disclosure requirements were effective for annual reports on Form 10-K for fiscal years ending on or after July 15, 2003. Disclosures of amendments to and waivers from the code of ethics must be made on or after the date on which the registrant files its first annual report on Form 10-K with the required code of ethics disclosures.

The rule regarding financial experts has expanded the definition and substituted the designation "audit committee financial expert" for "financial expert." Moreover, the rule listed the attributes that an audit committee financial expert should possess, and the means by which a candidate could acquire those attributes. A registrant is required to disclose whether it has at least one "audit committee financial expert," identify that individual and state whether he or she is independent, as defined. A registrant that does not have at least one audit committee financial expert must disclose why not. Companies were required to comply with the audit committee financial expert disclosure requirements in annual reports for fiscal years ending on or after July 15, 2003 (December 15, 2003 for small business issuers). (The required audit committee financial expert disclosures may alternatively be provided in the registrant's proxy statement if that statement is incorporated by reference into the annual report on Form 10-K.) Both rules are available at http://www.sec.gov/rules/final/33-8177.htm.

Restriction of Insider Trading During Pension Fund Blackout Periods—In January 2003, the SEC adopted a new Regulation Blackout Trading Restriction (BTR) to clarify the application and prevent evasion of Section 306(a) of the Act. Section 306(a) prohibits any director or executive officer of an issuer of any equity security from, directly or indirectly, purchasing, selling, or otherwise acquiring or transferring any equity security of the issuer during a pension plan blackout period that temporarily prevents plan participants or beneficiaries from engaging in equity securities transactions through their plan accounts, if the director or executive officer acquired the equity security in connection with his or her service or employment as a director or executive officer. In addition, the rules specify the content and timing of the notice that issuers must provide to their directors and executive officers and to the Commission about a blackout period. The rule became effective on January 26, 2003, and registrants must comply with the regulation beginning March 31, 2003. The final rule is available at http://www.sec.gov/rules/final/34-47225.htm.

Retention of Records Relevant to Audits and Reviews—In January 2003, the SEC approved the adoption of Rule 2-06 of Regulation S-X to implement Section 802 of the Act relating to the retention of audit and review workpapers and records. This rule requires the records be retained for seven years after the auditor concludes its audit or review of the financial statements. In addition, the rule 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. 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 in Management's Discussion and Analysis About Off-Balance-Sheet Arrangements and Aggregate Contractual Obligations—In January 2003, the SEC adopted amendments to implement Section 401(a) of the Act and added Section 13(j) to the Securities Exchange Act of 1934 establishing rules that require each annual and quarterly report filed with the SEC to disclose, in a separately captioned section of MD&A, specified information about 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. Registrants are also required to provide an overview of certain known contractual obligations in a tabular format. Limited relief is provided to small business issuers. Registrants are required to comply with the disclosure requirements for off-balance-sheet arrangements in SEC filings which include financial statements for the fiscal years ending on or after June 15, 2003. Disclosures for the table of contractual obligations must be included in SEC filings that are required to include financial statements for fiscal years ending on or after December 15, 2003. The rule is available at http://www.sec.gov/rules/final/33-8182.htm.

Rules Strengthening Auditor Independence—In January 2003, the SEC adopted rules to comply with Title II of the Act that strengthen auditor independence and require additional disclosures to investors about the services provided to registrants by their independent accountants. The rules became effective May 6, 2003 and are available at http://www.sec.gov/rules/final/33-8183.htm. In August 2003, the SEC's Office of the Chief Accountant provided responses to 35 frequently asked questions regarding application of the SEC's rules on auditor independence to assist registrants and their audit committees, audit firms, and other market participants in understanding and complying with the new regulations. The FAQ document is available at http://www.sec.gov/info/accountants/ocafaqaudind080703.htm. Information included in the FAQ document does not constitute rules, regulations, or statements of the SEC, and the SEC has neither approved nor disapproved the answers.

Electronic Filing and Website Posting—In May 2003, the SEC adopted a final rule and amendment to mandate electronic filing and website posting by issuers with corporate websites, of beneficial ownership reports (Forms 3, 4, and 5) filed by officers, directors, and principal security holders under Section 16(a) of the Securities Exchange Act of 1934, generally as required by Section 403 of the Act. The rule and amendment changes are effective June 30, 2003, and are available at http://www.sec.gov/rules/final/33-8230.htm.

Management's Reports on Internal Control over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports—In May 2003, the SEC adopted rules requiring management to report on internal control over financial reporting in their company's annual reports. The internal control report must include: a statement of management's responsibility for establishing and maintaining adequate internal control over financial reporting for

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the company; management's assessment of the effectiveness of the company's internal control over financial reporting as of the end of the company's most recent fiscal year; a statement identifying the framework used by management to evaluate the effectiveness of the company's internal control over financial reporting; and a statement that the registered public accounting firm that audited the company's financial statements included in the annual report has issued an attestation report on management's assessment of the company's internal control over financial reporting. Under the new rules, a company is required to file the registered public accounting firm's attestation report as part of the annual report. The rules also require management to disclose any material internal control weaknesses in its report. Registrants, other than foreign private issuers, meeting the Exchange Act definition of an "accelerated filer" are required to comply with the management report on internal control reporting requirement for fiscal years ending on or after June 15, 2004, and all other registrants, including small business issuers and foreign private issuers, will be required to comply with the rules for their fiscal years ending on or after April 15, 2005.

The final rules also amend the exhibit requirements for periodic reports to add the certifications required by Sections 302 and 906 of the Act to the list of required exhibits for reports filed with the SEC. The rules are available at http://www.sec.gov/rules/final/33-8238.htm.

Improper Influence on Conduct of Audits—In May 2003, the SEC issued this rule, as directed by Section 303 of the Act, to prohibit officers and directors of a registrant, and persons acting under the direction of an officer or director, from taking any action to coerce, manipulate, mislead, or fraudulently influence the auditor of the registrant's financial statements if that person knew, or should have known, that such action, if successful, could result in rendering the financial statement materially misleading. The rule is effective as of June 27, 2003, and is available at http://www.sec.gov/rules/final/34-47890.htm.

Exchange Listing Standards for Audit Committees—In April 2003, the SEC adopted a rule directing 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 Act. The new rules and amendments implement the requirements of Section 10A(m) of the Securities Exchange Act of 1934, as added by Section 301 of the Act. The rule became effective on April 25, 2003. The final rule is available at http://www.sec.gov/rules/final/33-8220.htm.

OTHER RULEMAKING

Staff Accounting Bulletin (SAB) No. 103, *Update of Codification of Staff Accounting Bulletins*—In May 2003, the SEC staff issued this SAB, which revises or rescinds interpretive guidance included in the SAB codification to ensure consistency between the guidance in the codification and authoritative professional accounting literature. SAB 103 is available on the SEC's website at http://www.sec.gov/interps/account/sab103.htm.

Staff Accounting Bulletin No. 104, *Revenue Recognition, Corrected Copy*—In December 2003, the SEC staff issued this SAB, which revises or rescinds portions of the revenue recognition interpretive guidance included in the SAB codification to make it consistent with current authoritative accounting and auditing guidance and SEC rules and regulations. The principal revisions relate to revenue recognition guidance no longer necessary due to developments in U.S. GAAP. SAB 104 also rescinds the Frequently Asked Questions and Answers document issued in conjunction with the release of SAB 101. SAB 104 is available on the SEC's website at http://www.sec.gov/interps/account/sab104.pdf.

Rules Adopted by the New York Stock Exchange (NYSE) and the Nasdaq Stock Market Requiring Shareholder Approval of Equity Compensation Plans—In June 2003, the SEC approved new rules proposed and adopted by the NYSE and the Nasdaq Stock Market requiring shareholder approval of equity compensation plans, including stock option plans. The new rules also require approval for repricings and material plan changes, and changed the NYSE rules for voting shares held in "street name" on equity compensation plans. Transition provisions are detailed in the final rule, which is available at http://www.sec.gov/rules/sro/34-48108.htm.

Updated EDGAR Filer Manual—In July 2003, the SEC adopted revisions to the EDGAR Filer Manual to reflect updates to the EDGAR system made primarily to improve the functionality of the SEC's Online Forms website. The rule was effective on July 31, 2003 and is available at http://www.sec.gov/rules/final/33-8255.htm.

As a result of this final rule, the SEC implemented EDGAR release 8.6, which permits registrants to electronically file or furnish (as appropriate) Items 11 and 12 of Form 8-K in accordance with earlier final rule adoptions. This EDGAR release also permits registrants to file or furnish (as appropriate) the certifications required by Sections 302 and 906 of the Sarbanes-Oxley Act of 2002 as exhibits to their periodic reports. Further information and instructions regarding this EDGAR release are available at http://www.sec.gov/info/edgar/filermanual86.htm.

Rules on Disclosure of Nominating Committee Functions and Communications Between Security Holders and Boards of Directors—In November 2003, the SEC adopted rules regarding the nominating committee processes of public companies and the ways by which security holders may communicate with directors of the companies in which they invest. These rules became effective January 1, 2004, and are available at http://www.sec.gov/rules/final/33-8340.htm.

NYSE, Nasdaq Strengthening of Corporate Governance Standards for Listed Companies—In November 2003, the SEC approved new rules that were proposed and adopted by the NYSE and Nasdaq, requiring corporate governance standards for listed companies to be strengthened and establishing a stricter, more-detailed definition of independence for directors. All board members for listed companies will be required to comply with the new standard. Listed companies have until the earlier of their first annual meeting after January 15, 2004, or October 31, 2004 to comply with the new standard. These rules are available at http://www.sec.gov/rules/sro/34-48745.htm.

The NYSE has also issued an FAQ document regarding corporate governance standards that can be found on their website at http://www.nyse.com/pdfs/section303Afaqs.pdf.

OTHER SEC DEVELOPMENTS

Guidance Regarding MD&A—In December 2003, the SEC issued an interpretive release that provides guidance regarding Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) included in registrants' disclosure

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documents. This guidance emphasizes that MD&A should allow investors to see the company through the eyes of management, and should not be merely a recitation of the financial statements in narrative form. The release encourages top-level management to be involved in the drafting of MD&A and provides additional guidance regarding how to present MD&A. The release, which is available at http://www.sec.gov/rules/interp/33-8350.htm under "Regulatory Actions/Interpretive Releases," does not create new legal requirements, nor does it modify existing legal requirements.

Further information on MD&A Guidance can be found in the *Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operation, an SEC Interpretation,* published by Deloitte & Touche LLP at http://www.deloitte.com/dtt/article/0%2C2297%2Ccid%25253D37069%2C00.html.

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PCAOB Developments

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The Public Company Accounting Oversight Board (PCAOB) was established by the Sarbanes-Oxley Act of 2002 (the "Act"), and under the Act, the PCAOB was given the mandate of overseeing the audits of public companies. The responsibilities of the PCAOB include setting auditing, quality control, ethics, and independence standards for audits of issuers, performing inspections of registered public accounting firms, carrying out investigations and disciplinary proceedings with regard to registered public accounting firms, and enforcing compliance with the Act, PCAOB rules, professional standards and securities laws.

The PCAOB is subject to the oversight and enforcement authority of the SEC. Each rule and standard issued by the PCAOB, in addition to being subject to a public comment period, is required to be approved by the SEC.

RULEMAKING

Since its inception, the PCAOB has adopted and the SEC has approved rules regarding the following:

- PCAOB By-laws
- Registration System for Public Accounting Firms
- PCAOB Funding: Establishment of Accounting Support Fees
- Ethics Code for Board Members, Staff, and Designated Contractors and Consultants
- Compliance with Auditing and Related Professional Practice Standards and Advisory Groups
- Temporary Hearing Rules Related to Disapproved Registration Applications.

The PCAOB has also finalized additional rules that have been sent to the SEC for approval, which is pending. These proposed rules relate to the following:

- Withdrawal from Registration
- Inspections of Registered Public Accounting Firms
- Investigations and Adjudications
- References in Auditors' Reports to the Standards of the Public Company Accounting Oversight Board
- Technical Amendments to Interim Standards Rules.

Additionally, the following proposed rules and auditing standards are under consideration by the PCAOB:

- Audits of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of Financial Statements
- Establishment of Interim Professional Auditing Standards
- Certain terms used in Auditing and Related Professional Practice Standards
- Oversight of Non U.S. Firms (PCAOB public comment period ends January 26, 2004).

For a full description of these rules, visit http://www.pcaobus.org/pcaob_rulemaking.asp.

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IASB Developments

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The past year saw a movement toward International Financial Reporting Standards (IFRS) as they reference GAAP outside the United States. During 2003, the International Accounting Standards Board (IASB) continued its course toward the three objectives stated in its constitution, as discussed below:

OBJECTIVE: PROMOTE THE USE OF IFRS GLOBALLY

Europe. During 2003 the European Commission amended its accounting directives to require listed companies to comply with IFRS beginning January 1, 2005. This change will impact approximately 7,000 European domiciled companies. Moreover, several EU Member States either have passed or are in the process of passing legislation that would permit or require IFRS for local reporting purposes.

Elsewhere. Australia and New Zealand took steps toward requiring the use of IFRS as the basis of their national GAAP beginning in 2005. In addition, all listed companies in South Africa will be required to follow IFRS in 2005.

OBJECTIVE: WORK TOWARD CONVERGENCE

Short-term International Convergence. During 2003 the IASB and the FASB worked together towards converging IFRS and U.S. GAAP. In December, the FASB issued four exposure drafts that would change U.S. GAAP to converge with IFRS as follows:

- Accounting changes and error corrections would be accounted for retrospectively rather than by cumulative effect adjustment (APB 20 and FASB 3 to converge with IAS 8).
- Three changes are proposed for calculating earnings per share (FASB 128 to converge with IAS 33).
- A gain or loss would be recognized on the exchange of similar productive assets based on the fair value of the exchange unless the exchange lacks commercial substance (APB 29 to converge with IAS 16).
- Abnormal amounts of idle capacity and spoilage costs would be excluded from the cost of inventory and expensed as incurred (ARB 43 to converge with IAS 2).

Also during 2003, the IASB issued ED4, *Disposal of Non-current Assets and Presentation of Discontinued Operations*, which proposes to converge IFRS with U.S. GAAP (FASB 144) on accounting for assets held for disposal and discontinued operations. A final IFRS is expected to be issued in the first quarter of 2004.

Joint and Concurrent Project. During 2003, the IASB continued its progress towards completing its final standard on share-based payments; the IFRS would require entities to expense stock options at fair value, measured at the grant date. The IFRS is expected to be finalized during first quarter of 2004. Concurrently, the FASB voted to expose for public comment an exposure draft that reaches the same conclusion as the IASB in accounting for stock options.

The IASB and FASB have worked jointly on a business combinations project (*Business Combinations, Phase II*). This project focuses on the application of the purchase method. In addition, the IASB is expected

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to issue a final IFRS during the first quarter of 2004 that will converge with many aspects of FASB 141 and 142.

OBJECTIVE: DEVELOP HIGH-QUALITY STANDARDS

In June 2003, the IASB issued IFRS 1, *First-time Adoption of International Financial Reporting Standards* (IFRS 1). IFRS 1 provides a comprehensive and practical "road map" for entities adopting IFRS for the first time.

In December 2003, the IASB issued 15 revised International Accounting Standards (IAS) and withdrew one other. The revised standards mark the near-completion of the IASB's "Improvements" project. The project addressed concerns, questions, and criticisms raised by securities regulators and other interested parties about existing IAS.

The Improvements project was a central element of the IASB's strategy to raise the quality and consistency of financial reporting generally and of the body of existing IAS in particular. In the interests of better reporting through convergence, the project has drawn on best practices from around the world. One of the primary goals of the project is to remove a number of options on accounting treatment contained in IAS, which have caused uncertainty and reduced comparability. The project benefited from input received from a broad range of participants, including regulators through the International Organization of Securities Commissions (IOSCO), national standard-setters, the IASB's Standards Advisory Council, and other commentators.

The completion of the improved standards brought the IASB closer to its commitment to have a platform of high-quality, improved standards in place by the end of March 2004. Below is the list of standards that have been revised:

- IAS 1, *Presentation of Financial Statements*
- IAS 2, *Inventories*
- IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*
- IAS 10, *Events after the Balance Sheet Date*
- IAS 16, *Property, Plant and Equipment*
- IAS 17, *Leases*
- IAS 21, *The Effects of Changes in Foreign Exchange Rates*
- IAS 24, *Related Party Disclosures*
- IAS 27, *Consolidated and Separate Financial Statements*
- IAS 28, *Investments in Associates*
- IAS 31, *Interests in Joint Ventures*
- IAS 32, *Financial Instruments: Presentation and Disclosure*
- IAS 33, *Earnings per Share*
- IAS 39, *Financial Instruments: Recognition and Measurement*
- IAS 40, *Investment Property.*

Withdrawn:

- IAS 15, *Information Reflecting the Effects of Changing Prices.*

For more information about IASB issued standards, exposure drafts, and projects, visit the IASB's website at http://www.iasb.org.uk/.

Appendix: Abbreviations

AcSEC	Accounting Standards Executive Committee
AICPA	American Institute of Certified Public Accountants
APB	Accounting Principles Board
ARB	Accounting Research Bulletin
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
IFAC	International Federation of Accountants
IFRIC	International Financial Reporting Interpretations Committee
IFRS	International Financial Reporting Standard
MD&A	Management's Discussion and Analysis of Financial Condition and Results of Operations
PCAOB	Public Company Accounting Oversight Board
SAB	Staff Accounting Bulletin
SEC	Securities and Exchange Commission
SFAS	Statement of Financial Accounting Standards
SOP	Statement of Position
TPA	Technical Practice Aid

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