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SEC Comment Letters — Including Industry Insights
A Snapshot of Current Themes

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Preface

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

The fourth edition of *SEC Comment Letters — Including Industry Insights: A Snapshot of Current Themes*[1] provides extracts from frequently issued SEC staff comments, along with additional analysis and links to related resources that are relevant to SEC filers (including domestic registrants and foreign private issuers). This revised edition reflects new topics (e.g., core disclosures, including disclosures about risk, proxy disclosures, foreign currency, and materiality) and updates existing topics to reflect new areas on which the SEC staff has commented since the release of our third edition in December 2009. The SEC staff has continued to issue comments on all topics covered in the third edition, such as revenue recognition, segments, consolidations (with a focus on variable interest entities), loss contingencies, business combinations and financial instruments. In addition, in light of economic conditions, including troubled credit markets, the staff has continued to scrutinize goodwill, intangible and long-lived asset impairments, other-than-temporary impairments of debt and equity securities, fair value disclosures, deferred tax valuation allowances, pension liabilities, debt covenant compliance, and loan loss allowances, just to name a few. Other disclosure topics have also been the subject of SEC staff focus, including executive compensation, non-GAAP financial measures and MD&A disclosures.

In addition to revised industry sections, the fourth edition includes new sections on the following industries:

- Financial services — insurance and investment management.
- Technology and telecommunications.

Many of the trends identified in the third edition continue to apply to this fourth edition. We have therefore categorized the topics in this edition as (1) "New" (those that are new to this fourth edition); (2) "Revised" (significant changes were made since the previous edition); (3) "Updated" (changes were more than minor but not significant — each updated topic contains a "2010 Update"); and (4) "Unchanged" (only minor changes were noted).

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

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

We hope that you find the fourth edition of this publication a valuable tool for improving your disclosures. We welcome your feedback. Please send us your thoughts and suggestions.

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

[1] Previous editions were published as *SEC Comment Letters on Domestic Registrants — A Closer Look*.

What's in the Fourth Edition?

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Executive Summary

In 2010, the SEC's agenda was dominated by the enactment of the Dodd-Frank Act Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). As a result of the Dodd-Frank Act, the SEC has thus far issued rule proposals, interim rules, interpretive releases, and studies and must undertake numerous future rulemaking-related activities. The SEC staff has also focused on IFRSs, and in October 2010 it issued the first progress report on its work plan to consider global accounting standards in the U.S. financial reporting system. We expect that activities in connection with the Dodd-Frank Act and the IFRS work plan will continue to be areas of focus for the SEC in 2011.

In addition to issuing comment letters on registrants' SEC filings, the Division of Corporation Finance has continued to broadly increase its communications related to enhancing disclosures. For example, in 2010 the staff issued (1) periodic updates to the Financial Reporting Manual, (2) new and revised compliance and disclosure interpretations and (3) two "Dear CFO" letters. Registrant-specific SEC comment letters focused on accounting and disclosure topics such as revenue recognition, segments, consolidations, loss contingencies, business combinations, fair value measurements, financial instruments, impairments, income taxes, and materiality. Comments issued on other disclosure areas primarily focused on MD&A, risk factors, proxy disclosures, including executive compensation, non-GAAP financial measures, and material contracts.

Financial Statement Accounting and Disclosure Topics

The SEC staff continues to focus on accounting and disclosure related to revenue recognition in general and multiple-element arrangements and software revenue recognition in particular. Comments have addressed whether registrants have disclosed their accounting policy for each material revenue stream and whether they have discussed uncertainties affecting revenue recognition. In addition, the staff has addressed separate disclosure of product and service revenues. Registrants are often asked to explain how they identified their operating segments and to demonstrate the appropriateness of aggregating operating segments, particularly in connection with their determination of economic similarity. Comments on consolidation accounting issues have focused on variable interest entities because a new accounting model based on control was introduced during the year. Loss contingencies also represent a renewed area of comment, particularly on whether a registrant has timely provided disclosure about its potential exposure for loss.

With the gradual improvement of the economy and corresponding increase in transactions, accounting for business combinations has become a renewed area of SEC interest. The SEC staff has commented on intangible assets, including goodwill, and remains focused on ensuring that these assets are (1) appropriately identified and valued when acquired and (2) recoverable once recognized. Comments also address valuation techniques, including determining the fair value of reporting units, used in the performance of goodwill impairment tests. In addition, fair value measurement comments have focused on the completeness of GAAP-required disclosures and providing sufficient detail for market participant assumptions used in the determination of fair value.

The staff has also continued to focus on the complexities of accounting for financial instruments and the accounting and disclosure of a registrant's considerations related to other-than-temporary impairments of investments in debt and equity securities. In comments about income taxes, the staff has asked registrants to support the recoverability of their net deferred tax asset (e.g., consideration given to a valuation allowance) and to enhance the discussion of the components of the income tax rate reconciliation. When a registrant has identified an error in previously issued financial statements but has determined that the restatement of prior periods is not necessary, the staff has requested the registrant's materiality analysis to better understand the conclusions reached.

Other Disclosure Topics

The staff continues to comment on areas outside of the financial statements. Such comments touch on all areas of MD&A, such as the executive overview section, results of operations, liquidity, critical accounting policies, the contractual obligations table, and off-balance sheet arrangements. The SEC staff seeks a balanced discussion in the executive overview section of the key opportunities, challenges, and risks a registrant faces. The staff looks for early warning disclosures of uncertainties and trends that are reasonably likely to materially affect future operations or liquidity, such as factors that may lead to impairments or the realization of contingent liabilities. In addition, the staff frequently comments when a registrant identifies "boilerplate" risk factors rather than those tailored to its own facts and circumstances, or when the risk factors are inconsistent with the discussion in MD&A. Comments on critical accounting policies focus on the identification of significant estimates and judgments, such as the assumptions underlying fair value measurements, for financial instruments as well as intangible assets such as goodwill.

Comments on liquidity have focused on requests for detailed disclosure about the primary drivers of cash flows from operations and the potential for violation of debt covenants.

Proxy disclosure, including executive compensation, continues to be an area for comment by the SEC staff. The staff has questioned whether such compensation policies create risks that are reasonably likely to affect the registrant, the qualifications of directors, how board diversity is determined, and whether and why the roles of chairman and chief executive officer have been combined. Comments on executive compensation focus on the underlying analysis in the CD&A and on the use of performance targets, benchmarking, and compensation consultants.

The staff has also focused on inconsistency related to communications with investors when metrics reported in press releases are not the same as those in periodic reports filed with the Commission. Although the underlying rules governing non-GAAP measures did not change, the staff issued revised interpretive guidance on how these rules should be applied, and this revised guidance has allowed more flexibility in the use of non-GAAP measures in documents filed with the SEC. Also, the staff continues to question the completeness of exhibits filed as material contracts.

Industry

In addition to the general areas noted above, the staff also comments on topics specific to industries such as consumer and industrial products, energy and resources, financial services, health sciences, and technology and telecommunications.

Financial Statement Accounting and Disclosure Topics

Asset Retirement Obligations

Examples of SEC Comments

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

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

ASC 410-20-25-6 states that an "entity has sufficient information to reasonably estimate the fair value of an asset retirement obligation" in the following situations:

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

ASC 410-20-25-8 goes on to clarify that circumstances in which an entity has sufficient information to apply an expected present value technique include:

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

2010 Update

Example of an SEC Comment

- Please clarify why the prior year estimate of your asset retirement obligations was adjusted [during the year].

The SEC staff has commented when an entity changes its estimate of an asset retirement obligation. ASC 410-20 distinguishes between obligations incurred over several reporting periods (ASC 410-20-35-1) and changes resulting from revisions to the timing or amount of the original estimates (ASC 410-20-35-8). ASC 410-20-50-1(c) requires an entity to disclose a rollforward to reconcile the beginning and ending aggregate amount of asset retirement obligations. The reconciliation should show separately the changes to (1) liabilities incurred in the current period, (2) liabilities settled in the current period, (3) accretion expense, and (4) revisions in estimated cash flows, whenever there is a significant change in these components during a reporting period.

In addition, Section V., "Critical Accounting Estimates," in SEC Interpretative Release 33-8350 clarifies that a registrant should address material implications of uncertainties associated with the methods, assumptions, and estimates underlying the registrant's accounting policies when measurement is susceptible to change.

Business Combinations

Examples of SEC Comments

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

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

Assigning Amounts to Assets Acquired and Liabilities Assumed

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

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

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

Contingent Consideration

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

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

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

Customer-Relationship Intangible Assets

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

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

2010 Update

Examples of SEC Comments

Pro Forma Disclosures

- Please provide all of the disclosure requirements of . . . ASC 805-10-50-2 in future filings. In this regard, we cannot locate the pro forma disclosures reflecting the effects of the acquisition, which appears to be material to your historical financial statements.
- Please expand your disclosure to include the information required by . . . ASC 805-10-50-2h. In particular, disclose the following:
  - [T]he amount of revenue and earnings of the acquiree since the acquisition date included in the consolidated statement of income;
  - [T]he revenue and earnings of the combined entity for the current reporting period as though the acquisition had been as of the beginning of the annual reporting period; and
  - [T]he revenue and earnings of the combined entity for the comparable prior reporting period as though the acquisition had occurred as of the beginning of the comparable prior annual reporting period.
- If disclosure of any of the information is impracticable, then disclose that fact and explain why the disclosure is impracticable.

Pro Forma Disclosures

The SEC staff continues to comment when a registrant fails to provide pro forma disclosures, in accordance with ASC 805-10-50, about the effects of an acquisition as of the beginning of a reporting period.

Registrants may also be required to provide pro forma financial information that complies with Regulation S-X, Article 11, in a registration statement, proxy statement, or in Form 8-K, if certain criteria are met, including if a significant business combination has occurred or is probable. For additional information, see the SEC Reporting section.

Other Deloitte Resources

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

Capitalization of Costs

Examples of SEC Comments

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

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

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

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

Consolidations and Variable Interest Entities

Examples of SEC Comments

- Please tell us the factors you considered in concluding that the consolidation of [Company A] is appropriate. Refer to your basis in the accounting literature.
- We note your disclosure that "[Company A], a previously consolidated subsidiary of the Group, was deregistered and the Group ceased to consolidate [Company A] upon the completion of this deregistration." In this regard, explain to us and disclose in further detail the nature of deregistration and how the facts and circumstances enable you to cease consolidating the entity. Also, tell us and disclose the accounting for your investment in the subsidiary going forward. Support your accounting with the relevant accounting literature.
- We note . . . that you adopted ASU No. 2009-17 on January 1, 2010 and that it did not have a significant impact on your financial statements. Please discuss, supplementally and in detail, whether or how it changed any of your conclusions with respect to [Company A]. Support your conclusions regarding whether or not it constitutes a [variable interest entity (VIE)], both currently and on an ongoing basis.
- Please tell us in your response and expand your disclosure to indicate why you believe you are the primary beneficiary, as defined in [ASC 810-10], of [Company A]. Address your conclusions, supplementally and in detail, both prior to and subsequent to January 1, 2010 when the guidance in ASU 2009-17 was adopted.

The SEC staff has continued to focus on registrants' involvement with variable interest entities (VIEs). The staff issued comments inquiring about the accounting basis of registrants' conclusions on whether to consolidate or deconsolidate a VIE under ASC 810-10. As a result of the FASB's issuance (in the first quarter of 2010) of ASU 2009-17,[1] the SEC staff has asked registrants about the effect of the new guidance on their previous consolidation conclusions and has encouraged detailed disclosure.

ASU 2009-17 was effective for the first fiscal year that begins after November 15, 2009; thus, calendar-year-end entities adopted the revised consolidation guidance as of January 1, 2010. Because the amendments significantly affect the overall consolidation analysis under ASC 810-10, an enterprise needs to carefully reconsider previous conclusions, including (1) whether an entity is a VIE, (2) whether the enterprise is the VIE's primary beneficiary, and (3) what type of financial statement disclosures are required.

ASU 2009-17 modifies the approach for determining the primary beneficiary of a VIE. Under the superseded VIE model, it was often necessary to perform a quantitative analysis to determine which variable interest holder in a VIE absorbed a majority of its expected losses or residual returns and was therefore considered the primary beneficiary. Under ASU 2009-17, an enterprise determines qualitatively whether it has (1) the power to direct the activities of the VIE that most significantly affect the entity's economic performance and (2) the obligation to absorb losses of the VIE or right to receive benefits from the VIE that could potentially be significant to the VIE.

The SEC staff has indicated that accounting for VIEs will continue to be an area of focus. At the 2009 AICPA Conference,[2] James L. Kroeker, the SEC's chief accountant, reminded constituents to "remain vigilant when evaluating the substance, or lack thereof, of elements of transactions included to achieve specific accounting results."

In February 2010, the FASB issued ASU 2010-10, which defers the application of ASU 2009-17 for certain entities that meet the following conditions:

- The entity has all of the attributes specified in ASC 946-10-15-2(a)–(d) or is an entity for which it is industry practice to apply guidance that is consistent with the measurement principles of ASC 946 (including recognizing changes in fair value currently in the statement of operations) for financial reporting purposes.
- The reporting enterprise does not have an explicit or implicit reporting obligation to fund losses of the entity that could potentially be significant to the entity. An evaluation of this condition should take into account the legal structure of the reporting entity's interest, the purpose and design of the entity, and any guarantees provided by the reporting enterprise's related parties.

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

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

- The entity is not a securitization entity, an asset-backed financial entity, or an entity that was formerly considered a qualifying special-purpose entity.

In addition, the application of ASU 2009-17 is deferred for a reporting enterprise's interest in an entity that is required to comply with or operate in accordance with requirements that are similar to those in Rule 2a-7 of the Investment Company Act of 1940 for registered money market funds. ASU 2010-10 addressed concerns that the joint consolidation model under development by the FASB and the IASB may result in a different consolidation conclusion for asset managers and that an asset manager consolidating certain funds would not provide useful information to investors. For more information on ASU 2010-10, see Deloitte's July 27, 2010, *Heads Up* on the finalization of the deferral of Statement 167 for certain investment funds.

On April 9, 2010, the CAQ SEC Regulations Committee (the Committee) issued CAQ Alert #2010-20, which outlines the staff's views on certain practice issues related to ASU 2009-17, including (1) filing registration statements after the adoption of ASU 2009-17; (2) applying the transition provisions of ASU 2009-17; (3) pro forma requirements; and (4) considerations under Regulation S-X, Rules 3-05 and 3-14, and Form 8-K regarding the adoption of ASU 2009-17. For additional considerations related to Regulation S-X, Rule 3-05, see the SEC Reporting section.

Ten days later, the Committee issued CAQ Alert #2010-21, which summarizes the staff's views that VIEs consolidated upon adoption of ASU 2009-17 should be included in management's reports on ICFR. The alert also discusses the applicability of Questions 1 and 3 of the SEC staff's FAQs on management's reports on ICFR after an entity's adoption of ASU 2009-17. For additional considerations related to management's report on ICFR, see the Internal Control Over Financial Reporting section.

Other Deloitte Resources

- *Consolidation of Variable Interest Entities: A Roadmap to Applying the Variable Interest Entities Consolidation Model*.
- SEC Reporting Interpretations Manual, "Business Combinations" section (available on Technical Library: Deloitte's Accounting Research Tool).

Contingencies

Example of an SEC Comment

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

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

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

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

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

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

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

2010 Update

Examples of SEC Comments

- [W]e note . . . the discussion provided with respect [to established] reserves [for environmental and litigation related contingencies] is somewhat vague and boilerplate in nature [and] does not describe the judgments and significant assumptions that were used in determining the amounts of any reserves or accruals recognized. As outlined in SAB Topic 5Y, Question 2, the staff generally believes that product liability and environmental remediation liabilities are of such significance that detailed disclosures regarding the judgments and assumptions underlying the recognition of the liabilities are necessary to prevent the financial statements from being misleading and to inform readers fully regarding the range of possible outcomes that could have a material effect on the registrant's financial condition, results of operations or liquidity.
- [F]or each material pending legal proceeding, please ensure that you have provided the information required by Item 103 of Regulation S-K, such as the name of the court or agency in which the proceedings are pending, the date instituted, the principal parties thereto, a description of the factual basis alleged to underlie the proceedings and the relief sought (including the amount of damages sought, if any). Also include in your disclosure any proceedings required to be described as set forth in instruction 5 to Item 103.

The SEC staff has continued to comment on the level of detail and timeliness of disclosures about contingencies. In addition to referring to the disclosure requirements in ASC 450, the SEC staff has cited SAB Topic 5.Y in its comments. SAB Topic 5.Y primarily focuses on product and environmental remediation liabilities, although it also addresses general loss contingencies.

As part of the overall trend reflecting an increase in legal comments, the SEC staff also routinely addresses disclosures related to legal proceedings provided outside of the financial statements. Such disclosures are mainly provided to comply with the legal proceedings section required in periodic reports (Item 3 of Form 10-K and Item 1 of Form 10-Q), the requirements for which are in Regulation S-K, Item 103.

Disclosure of loss contingencies was discussed at the June 2010 CAQ SEC Regulations Committee Joint Meeting With the SEC Staff, at which the SEC staff reiterated its expectation that registrants comply with ASC 450 from both a recognition and disclosure perspective. The staff also indicated that it most often raises questions when registrants do not appear to comply with ASC 450. In particular, the SEC staff noted a situation in which a registrant did not disclose an estimate for possible losses or range of losses (or that an estimate could not be reasonably made) when there was a reasonable possibility that realized losses would exceed amounts accrued.

The meeting highlights note that the staff "would expect that disclosures about a loss contingency would be updated as additional information becomes available. With the passage of time, there is a greater presumption that it would be possible for the company to provide quantitative information." The highlights also note that "the disclosure can be aggregated in a logical manner vs. separate disclosure for each asserted claim . . . the staff has also issued comments when there was a large settlement with little or no disclosure in earlier periods — e.g., why wasn't there disclosure?"

This issue was also discussed at the September 2010 CAQ SEC Regulations Committee Joint Meeting With the SEC Staff, at which the staff noted its continued focus on this area and reminded registrants that "the loss contingency disclosure requirements of GAAP and [Regulation S-K,] Item 103 . . . have different objectives. . . . [A]ttempts to satisfy both objectives through an integrated set of disclosure often result in lengthy factual recitations rather than focusing on the underlying loss contingency, the related exposure and the likelihood of a loss."

FASB's Contingencies Project

In July 2010, the FASB issued a proposed ASU, *Disclosure of Certain Loss Contingencies*. The proposed guidance would (1) expand the scope of loss contingencies subject to disclosure to include certain remote contingencies; (2) increase the quantitative and qualitative disclosures entities must provide to enable users to assess "the nature, potential magnitude, and potential timing (if known)" of loss contingencies; and (3) for public entities, require a tabular reconciliation for changes in amounts recognized for loss contingencies. The FASB will discuss the effective date during redeliberations of the project.

Other Deloitte Resources

- July 20, 2010, *Heads Up*, "FASB Proposes Guidance on Expanded Disclosures for Certain Loss Contingencies."
- April 2, 2009, *Heads Up*, "FASB Amends Statement 141(R)'s Guidance on Contingencies."
- June 10, 2008, *Heads Up*, "FASB Proposes Expanding Contingencies Disclosure."

Debt

Balance Sheet Classification

Example of an SEC Comment

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

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

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

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

Debt-Related Disclosures

Examples of SEC Comments

- Please tell us what consideration you and the registrant subsidiaries gave to describing the most significant restrictions on the payment of dividends contained in financing arrangements, charter provisions and/or federal and state regulatory actions and their pertinent provisions rather than the brief disclosures presently provided. Refer to paragraph (e)(1) of Rule 4-08 of Regulation S-X. In addition, please tell us how you determine the restricted net assets of consolidated subsidiaries in assessing whether the disclosures required by paragraphs (e)(3)(i) and (ii) of Rule 4-08 of Regulation S-X and Schedule I required by Rule 5-04 of Regulation S-X should be provided.
- Please revise your disclosure in future filings, as applicable, to describe any limitations in your credit facilities that restrict your ability to fund dividend payments in accordance with Item 201(c)(1) of Regulation S-K. To the extent you believe the limitations are not material, please tell us.

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

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

Refinancing

Example of an SEC Comment

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

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

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

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

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

Financial Covenant Disclosures

Example of an SEC Comment

- We note your disclosures that certain of your financing agreements include various financial covenants and your accounts receivable securitization contains cross default provisions. If it becomes reasonably likely that you may not comply with a material covenant(s), please present the actual ratio(s) and other actual amounts versus the minimum/maximum ratios/amounts required as of each reporting date. Given that [the company] has defaulted on financial covenants, please also include actual ratios and other actual amounts versus minimum/maximum ratios/amounts where the defaults occurred. Such presentation will allow investors to more easily understand your current ability to meet your financial covenants. It may also be necessary to show specific computations used to arrive at the actual ratios.

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

At the 2008 AICPA Conference, Michael J. Fay, associate chief accountant in the SEC's Division of Corporation Finance, discussed the importance of the liquidity section of MD&A as well as factors registrants should consider in preparing for their upcoming filings. He referred to two interpretive releases[1] that provide guidance on preparing the liquidity section. He commented that in the liquidity section of MD&A, registrants frequently provide a one-sentence statement that they are in compliance with their debt covenants. Mr. Fay noted that registrants can greatly enhance these disclosures by discussing relevant circumstances that would lead to covenant violations.

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

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

Registrants often state that certain financial covenants limit their ability to incur additional indebtedness without discussing the potential effects of these limitations on their liquidity. Mr. Fay further noted that if it is reasonably likely that the covenant will affect liquidity, a registrant should discuss the amount that can be raised, the amount needed, and the implications of a shortfall. If the registrant does not expect the covenant to affect liquidity, it may explain the basis for this determination. If the covenant does not affect liquidity, a registrant may decide that reference to it is not necessary. For additional information, see Deloitte's *Heads Up* on the 2008 AICPA Conference.

Discontinued Operations, Assets Held for Sale, and Restructuring Charges

Discontinued Operations

Example of an SEC Comment

- Please explain to us how you considered the guidance in [ASC 205-20-45-1] and [ASC 205-20-50-4, ASC 205-20-50-6, and ASC 205-20-55-4 through 55-24] in determining whether the operations and gain [on] sale of [Company A] should be presented as discontinued operations.

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

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

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

Application of these two criteria can be subjective. ASC 205-20-55-3 lists the following steps for entities to perform when evaluating whether the criteria are met:

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

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

For additional information about retailers, see the Retail section.

Assets Held for Sale

Example of an SEC Comment

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

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

- The carrying amount and classification as of the balance sheet date of the assets and liabilities included in the subsequent sale.
- The gain or loss on the asset sale.

- The timeline of events leading to the asset sale.
- The sales agreement and a description of how the agreement affected the determination that held-for-sale presentation was not appropriate.

Timing of Impairments

Example of an SEC Comment

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

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

Restructuring Charges

Example of an SEC Comment

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

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

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

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

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

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

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

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

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

Proposals to Converge With IFRSs

In a joint project, the IASB and FASB are working toward convergence of (1) the definition of a discontinued operation and (2) disclosure requirements for all components that have been, or will be, disposed of. The FASB expects to issue an exposure draft of a proposed ASU in the first quarter of 2011 and a final ASU in the second half of 2011.

Earnings per Share

Two-Class Method

Example of an SEC Comment

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

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

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

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

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

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

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

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

EPS Disclosures

Examples of SEC Comments

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

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

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

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

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

Other Deloitte Resources

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

Fair Value

Economic Environment

Examples of SEC Comments

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

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

MD&A Disclosures

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

The SEC staff continues to focus on disclosures related to the turmoil in the credit markets as well as the disclosures required by ASC 820. The SEC's Division of Corporation Finance posted two "Dear CFO"[1] letters to its Web site addressing the need for more transparent disclosure in MD&A of methods and assumptions used in fair value measurements of material financial instruments affected by the credit crisis.

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

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

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

[1] See the Management's Discussion and Analysis section for additional information on "Dear CFO" letters.

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

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

- For all Level 3 measurements, a discussion of the key drivers of fair value for each significant asset or liability grouping and whether each driver is observable or unobservable.
- Tabular disclosures of collateral underlying mortgage-backed securities, collateralized debt obligations, collateralized loan obligations, and other similar securities. She suggested that these disclosures include the more detailed aspects of the collateral, such as types of loans, vintage information, and the effects of credit enhancements.
- Insight into the causes of other-than-temporary impairments on available-for-sale securities by separating such causes between (1) credit-related issues or other adverse issuer conditions and (2) other accounting consequences (e.g., an entity can no longer assert its intent and ability to hold).

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

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

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

Auction Rate Securities

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

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

Valuation Methods and Assumptions

Examples of SEC Comments

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

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

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

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

In addition to the considerations noted by Ms. Hunsaker and the disclosures required by ASC 820, registrants should consider the disclosure requirements governing (1) risks and uncertainties in ASC 275 and (2) finanical instruments under ASC 825-10-50. ASC 275 requires disclosures about assumptions or estimates that have a significant effect on a registrant's financial statements, which may include the registrant's use of unobservable inputs.

Level 2 and Level 3 Measurements

Example of an SEC Comment

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

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

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

The SEC staff has asked registrants to provide better disclosures about which significant inputs became observable and unobservable for transfers into and out of Level 3 as well as about the nature and timing of such transfers. ASC 820 requires an entity to provide information on transfers into and out of Level 3 measurements and significant transfers into or out of Level 1

and Level 2 fair value measurements and the reasons for the transfers.

Pricing Services

Example of an SEC Comment

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

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

Inactive Markets

Example of an SEC Comment

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

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

Credit Risk

Example of an SEC Comment

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

Certain of the SEC staff's comments have requested additional disclosures and clarification from registrants about the incorporation of nonperformance risk into the fair value measurement of financial assets and financial liabilities. In particular, the

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

staff seems to be concerned about liability measurements in which a registrant does not appropriately consider the issuer's own credit.

Study of Mark-to-Market Accounting

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

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

2010 Update

Market Participant Assumptions in Fair Value Measurement

At the 2009 AICPA Conference, Evan B. Sussholz, professional accounting fellow (valuation specialist) in the SEC's Office of the Chief Accountant, indicated that one of the SEC staff's key focus areas in reviewing SEC filings is the reasonableness of significant valuation assumptions. He observed that a common error relates to the use of assumptions that do not reflect views of market participants.

Mr. Sussholz provided a framework that a registrant could use to develop market participant assumptions for fair value measurements. Often for fair value measurements of assets and liabilities that trade in inactive markets, or for which a market does not exist, a registrant begins by first taking into account its own assumptions. However, he noted that reasonable judgment should be applied in the determination of whether a reporting entity's own assumptions are representative of market participant assumptions.

Mr. Sussholz suggested that in making this determination, a registrant should consider the following questions:

1. "What are the potential exit markets for an asset and what is the asset's principal or most advantageous market?"
2. "What is the highest and best use for the asset?"
3. "Who are the potential market participants and what are their distinguishing characteristics?"
4. "How do the market participant characteristics compare to the [registrant's] own characteristics?"

In addition to the questions, Ms. Sussholz provided consideration points that a registrant should assess in answering each question. See Deloitte's *Heads Up* on the 2009 AICPA Conference for a detailed listing of his suggested consideration points.

Standard Setting

In January 2010, the FASB issued ASU 2010-06 that provides guidance on improving disclosures about fair value measurements and requires entities to report information about purchases, sales, issuances, and settlements included in the Level 3 rollforward on a gross basis rather than on a net basis beginning in the first quarter 2011 for a calendar-year-end entity.

In June 2010, the FASB issued a proposed ASU, *Amendments for Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*. The proposed ASU does not currently specify an effective date and is the result of a joint project between the FASB and IASB to develop a single, converged fair value framework. The proposal retains the term "fair value" and continues to define it as an exit price notion. However, the proposed ASU contains certain amendments that would change how the fair

value measurement and disclosure guidance in ASC 820 is applied. The FASB's goal is to issue a final ASU during the first quarter of 2011.

Other Deloitte Resources

- Financial Reporting Alert 10-5, "Financial Reporting Considerations Related to Implementation of Fair Value Measurement Disclosures Required by ASU 2010-06."
- Financial Reporting Alert 09-1, "Impact of Credit Downgrades on the OTTI Analysis of Perpetual Preferred Securities."
- Financial Reporting Alert 08-17, "Accounting Considerations Related to Redemption Restrictions on Money Market Funds."
- Financial Reporting Alert 08-14, "Potential Counterparty Default and Other Accounting Considerations Related to the Credit-Market Turmoil."
- Financial Reporting Alert 08-13, "Accounting Considerations for Settlement Agreements Related to Auction Rate Securities."
- Financial Reporting Alert 08-10, "SEC Advises Registrants to Further Explain Fair Value in MD&A — An Addendum to the March 2008 SEC Letter."
- Financial Reporting Alert 08-8, "Consideration of Credit Risk in Fair Value Hedge Effectiveness Assessments."
- Financial Reporting Alert 08-4, "Turmoil in the Credit Markets: The Importance of Comprehensive and Informative Disclosures."
- November 8, 2010, *Heads Up*, "Valuation Resource Group Discusses Four Topics at November 1 Meeting."
- June 30, 2010, *Heads Up*, "FASB Proposes Guidance of Fair Value Measurement and Disclosure."
- April 19, 2010, *Heads Up*, "Valuation Resource Group Discusses Four Topics at April 12 Meeting."
- January 22, 2010, *Heads Up*, "FASB Finalizes ASU on Improving Disclosures About Fair Value Measurements."
- October 1, 2009, *Heads Up*, "FASB Issues Guidance on Measuring Fair Value of Certain Alternative Investments."
- August 28, 2009, *Heads Up*, "FASB Issues Guidance on Measuring Fair Value of Liabilities."
- April 14, 2009, *Heads Up*, "FASB Issues Guidance on Measuring Fair Value When Market Activity Declines, Other-Than-Temporary Impairments, and Interim Fair Value Disclosures."

Financial Instruments

Hedge Accounting

Example of an SEC Comment

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

In late 2006 and 2007, the SEC staff made several announcements regarding the application of hedge accounting (codified in ASC 815).

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

- *The shortcut method* — Registrants have concluded that their hedging relationships qualify for the shortcut method without meeting all of the criteria in ASC 815-20-25-102 through 25-114 (as codified).
- *The critical-terms-match method and the three methods for assessing the ineffectiveness of certain cash flow hedges involving interest rate risk described in ASC 815-30-35-10 through 35-32 (as codified)* — Registrants have inappropriately assumed no ineffectiveness in hedging relationships designated under one of these methods despite known sources of ineffectiveness.

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

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

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

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

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

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

Derivatives Embedded in Convertible Financial Instruments

Example of an SEC Comment

- Please provide us with your analysis regarding your determination not to bifurcate and account for the conversion feature as a derivative in accordance with [ASC 815-15-25-1]. Ensure your response includes your analysis of [ASC 815-10-15-74], including the guidance in [ASC 815-40].

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

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

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

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

Financial Asset Transfers

Example of an SEC Comment

- We note that effective April 1, [of your prior fiscal year] you adopted ASU 2009-16 and ASU 2009-17, which will impact the accounting for your securitization programs and factored receivables. We further note you amended the . . . asset-backed securitization program and the accounts receivable factoring program in [your current fiscal year] such that the sales of accounts receivables from these programs will continue to be removed from the balance sheet. Please describe the nature and terms of such amendments and tell us how these revisions impacted your accounting pursuant to ASC 860-10. . . . Also, tell us how you determined that transfers under this program qualify for sale accounting pursuant to ASC 860-10-40-4 and 40-5.

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

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

Disclosures

Example of an SEC Comment

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

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

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

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

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

Derivatives Disclosures

Example of an SEC Comment

- We note that you utilize derivative financial instruments, principally interest rate and currency swap agreements, as part of your risk management policy to reduce your exposure to market risks. . . . However, we note no disclosure of the line items and amounts of the gains and losses on derivative instruments recorded in your income statement. Accordingly, please tell us how your current derivative instrument disclosures comply with FASB ASC 815-10-50-4A to 50-4E and paragraph 50-4I.

In 2008, the FASB finalized a number of projects requiring enhanced derivative disclosures. The new requirements are codified in ASC 815-10-50 and include:

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

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

2010 Update

Financial Instruments and Hedge Accounting

In 2010, the FASB issued an exposure draft (ED) on accounting for financial instruments that addresses classification and measurement, impairment, and hedge accounting. The ED also proposes to eliminate the shortcut method, the critical-terms-match method, and the requirement to continually assess hedge effectiveness to qualify for hedge accounting. The comment period on the ED ended September 30, 2010, and the FASB expects to issue a final ASU in the first half of 2011.

Repurchase Agreements

Examples of SEC Comments

- Please revise your future filings . . . to disclose your accounting policy for securities sold under repurchase agreements. To the extent that you have recorded any of these transactions as sales, please quantify the amount sold at each balance sheet date and the average amount sold for the periods presented. Disclose how you calculate the average amount. Tell us how you determined that sale treatment was appropriate under the accounting guidance.
- [P]lease revise your Summary of Significant Accounting Policies footnote to include your accounting policy for repurchase agreements, which we understand from your response are all accounted for as collateralized financings.

Because of perceived abuses in the accounting for off-balance-sheet financing arrangements, the SEC staff increased its focus on such arrangements, specifically repurchase agreements. Registrants may be asked to disclose transactions that were accounted for as sales and to provide support for such accounting treatment as well as enhance their disclosures related to repurchase agreements. See also the Banking and Securities section for additional considerations.

In March 2010, the SEC staff issued a letter to certain registrants to obtain information on the accounting for repurchase agreements ("repos"), securities lending transactions, or other transactions involving the transfer of financial assets with an obligation to repurchase the transferred assets. The letter, which was later posted to the SEC's Web site as a "Dear CFO" letter, responded to concerns about so-called "Repo 105" transactions. In May 2010, in testimony before the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises of the House Committee on Financial Services, James L. Kroeker, the SEC's chief accountant, stated the following:

> In letters to 19 large public companies, the [SEC's] Division of Corporation Finance requested information regarding their use of repurchase agreements. In response, each company was asked to explain the extent to which, if any, they used repurchase agreements and how they accounted for them in their financial statements. Based on the requests, no information has come to our attention that would lead the staff to conclude that inappropriate practices were widespread. Nevertheless . . . the Division asked several companies to enhance their disclosure about their accounting for repurchase and similar transactions and to expand their discussions of off-balance sheet arrangements. . . . We will continue to review companies' accounting and reporting practices to determine if companies are complying with existing requirements and to determine whether changes to those requirements are warranted. . . . We also will continue to consider whether existing disclosure requirements are adequate to provide full and transparent disclosure.

In addition, in September 2010, the SEC issued (1) a proposed rule on disclosures of short-term borrowings, which would include repurchase agreements within its scope, and (2) an interpretive release on liquidity and capital resources. See the Management's Discussion and Analysis section for additional information.

In November 2010, the FASB issued an ED to solicit input on its proposal to improve the accounting for repurchase agreements and other agreements that both entitle and obligate a transferor to repurchase or redeem before their maturity financial assets accounted for under ASC 860. The FASB requests comments on the ED by January 15, 2011. The Board expects to issue a final standard in 2011.

Other Deloitte Resources

- Financial Reporting Alert 08-14, "Potential Counterparty Default and Other Accounting Considerations Related to the Credit-Market Turmoil."
- Financial Reporting Alert 08-8, "Consideration of Credit Risk in Fair Value Hedge Effectiveness Assessments."
- October 15, 2010, *Heads Up*, "FASB Addresses Troubles With Restructurings."
- September 24, 2010, *Heads Up*, "SEC to Open the Curtains on 'Window Dressing.'"
- July 22, 2010, *Heads Up*, "Board Enhances Disclosures About the Credit Quality of Financing Receivables and the Allowance for Credit Losses."
- May 28, 2010, *Heads Up*, "FASB Issues Proposed ASU on Accounting for Financial Instruments."
- March 22, 2010, *Heads Up*, "FASB Issues Guidance on ASC 815 Scope Exception for Embedded Credit Derivatives."
- November 17, 2009, *Heads Up*, "IASB Issues IFRS on Classification and Measurement of Financial Assets."
- October 20, 2009, *Heads Up*, "Guidance on Statement 167 Implementation Issues."

Other Deloitte Resources (continued)

- June 16, 2009, *Heads Up*, "FASB Issues New Standard on Transfers of Financial Assets."
- April 14, 2009, *Heads Up*, "FASB Issues Guidance on Measuring Fair Value When Market Activity Declines, Other-Than-Temporary Impairments, and Interim Fair Value Disclosures."
- January 16, 2009, *Heads Up*, "FASB Issues Amendments to OTTI Model for Certain Investments in Securitizations."

Financial Statement Classification

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

Balance Sheet Classification

Examples of SEC Comments

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

Separate Presentation

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

Current Versus Noncurrent Classification

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

Cash and Cash Equivalents

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

Income Statement Classification

Examples of SEC Comments

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

  Please show us in your supplemental response what the revisions will look like.
- *Cost of Sales* — Please disclose in future filings the line item(s) in which you include depreciation and amortization. If you do not allocate a portion of your depreciation and amortization to cost of sales, please also revise your presentation to comply with SAB Topic 11:B, which would include revising the cost of sales title and removing the gross profit subtotal throughout the filing. Please show us in your supplemental response what the revisions will look like.
- *Operating Versus Nonoperating Income* — We see that Other Expense (Income) includes the following items:
    - Stock-based compensation expense[,]
    - Gains from insurance proceeds,
    - Impairment of investment, and
    - Loss on disposal of property plant and equipment.

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

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

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

Separate Presentation

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

Cost of Sales

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

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

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

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

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

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

Operating Versus Nonoperating Income

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

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

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

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

Cash Flow Statement Classification

Examples of SEC Comments

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

Category Classification

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

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

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

Net Versus Gross Presentation

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

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

Discontinued Operations

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

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

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

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

Foreign Currency

Change in Functional Currency

Example of an SEC Comment

- We note that you changed the functional currency for certain foreign operations . . . . Please tell us and revise your future filings to explain the major changes in economic facts and circumstances that led to the change in functional currency for certain of your foreign operations.

ASC 830-10-45-7 indicates that there must be "significant changes in economic facts and circumstances" to justify a change in an entity's functional currency. In requesting support from registrants for their changes in functional currency, the SEC staff has referred to various indicators discussed in ASC 830-10-55-5 for determining the functional currency for a foreign subsidiary (i.e., cash flow, sales price, sales market, expense, and financing indicators as well as the volume and relationship of transactions between the foreign and parent entities).

Venezuela and Foreign Currency Issues

Example of an SEC Comment

- Please expand [MD&A] in future filings to provide a more comprehensive discussion of your Venezuelan operations that provides a greater level of information about the monetary assets and liabilities that are exposed to exchange rate changes and the sensitivity of your sales and cost of sales to future currency changes. Disclose the specific amount of Bolivar-denominated monetary assets and liabilities as of each balance sheet date and provide a break-out of the amounts . . . being remeasured [at each exchange rate]. Provide this disclosure at a reasonably detailed level; for example disclose amounts for cash and accounts receivable.

Recent actions taken by the Venezuelan government may affect the liquidity of a registrant's investment in its Venezuelan operations or raise questions about the appropriate accounting to apply to transactions conducted with its Venezuelan entities. Areas of ambiguity may include determination of (1) the appropriate exchange rate to use for remeasurement in light of the exchange restrictions imposed by the Venezuelan government; (2) whether such exchange restrictions create an other-than-temporary lack of exchangeablilty that may affect how a reporting entity accounts for its Venezuelan operations (e.g., perhaps warranting recognition of impairment or deconsolidation); and (3) whether the exchange restrictions should affect the classification of certain bolivar-denominated monetary assets as current. Note that the mere existence of such exchange restrictions does not in and of itself create a presumption that a registrant should deconsolidate its Venezuelan operations, nor does the ability to exchange some volume of currency create a presumption that continued consolidation of Venezuelan operations is appropriate. A registrant must make such a determination on the basis of its specific facts and circumstances.

Because of Venezuela's fluid currency exchange environment and the related accounting ambiguities that may result from this uncertainty, the SEC staff will expect registrants with material exposures to the Venezuelan economy to provide robust disclosure of the Venezuelan operations both in the notes to the financial statements and in the description of business, risk factors, and MD&A sections of their SEC filings. Deloitte's Financial Reporting Alert 10-8 describes certain disclosures registrants should consider providing in their next interim or annual filing, including:

- The government's actions regarding exchange rates, including current volume restrictions on foreign exchange imposed by the government and how such restrictions affect the registrant's ability to settle transactions at one of the permissible rates, as well as a description of how those restrictions affect application of the registrant's accounting policies.
- The exchange rate(s) used for remeasurement and the use of an exchange rate or rates that differ from those used in prior reporting periods. If multiple exchange rates are being used, the criteria used to make the distinction and information on the relative significance of the various exchange rates.
- If the exchange rate or rates used for the period differ from rates used in prior reporting periods, the impact of the different exchange rate(s) on the applicable carrying amounts in the balance sheet.
- The amount of the registrant's net monetary assets and liabilities, disaggregated by the currency (e.g., BsF,[1] U.S. dollars) in which they are denominated.

[1] Bolivar fuertes.

- Disaggregated financial information about the Venezuelan operations (e.g., summarized balance sheets, income statements, and cash flow statements) and the possible effects of Venezuela's foreign exchange restrictions on a registrant's operations, including how such restrictions may affect the registrant's liquidity and cash flows.
- The amount of BsF pending government approval for settlement at one of the permissible exchange rates and the length of time the request or requests have been pending.

These disclosures are consistent with the disclosures suggested by the SEC staff at the April 2010 CAQ SEC Regulations Committee Meeting With the SEC Staff.

Impairments of Long-Lived Assets, Including Goodwill

The SEC staff continues to comment on the recognition of and disclosures about the impairment of long-lived assets. For example, the staff may comment when a registrant's revenues decline or when its market capitalization declines below book value because such declines may indicate underlying impairments in intangible assets and goodwill. In addition, the SEC staff may ask registrants that have recorded goodwill or other asset impairment charges whether they also have considered the implications of the underlying conditions leading to the impairment on the valuation of any other assets, such as deferred tax assets. The staff may also ask questions about valuations, both those prepared by third parties and those prepared by management. For further information on goodwill and long-lived assets, see the Business Combinations and Long-Lived Assets, Including Goodwill sections.

Examples of SEC Comments

- *Goodwill Impairment Testing and Disclosure* — To the extent that any of your reporting units have estimated fair values that are not substantially in excess of the carrying values and are at potential risk of failing step one of your goodwill impairment analysis, please tell us and disclose the following in future filings:
  - The percentage by which the fair value of the reporting unit exceeded the carrying value as of the date of the most recent test;
  - The amount of goodwill allocated to the reporting unit;
  - Describe the potential events and/or changes in circumstances that could reasonably be expected to negatively affect the key assumptions used in determining fair value;
  - If you have determined that the estimated fair value substantially exceeds the carrying value for all of your reporting units, please disclose this determination. Please refer to Item 303(a)(3)(ii) of Regulation S-K and Section V of SEC Release No. 33-8350.
- *Asset Grouping for Goodwill Impairment Testing* — As [your] reportable segments [have been] realigned, explain if the reporting units for testing goodwill [are] the same or how such reorganization will impact and change your future impairment testing [and tell us] whether a [specified reporting unit] will still be separately tested for goodwill given recent event[s] specific to the industry. . . . If impairment testing will change for [the specified] reporting unit, tell [us] the impact of the change. [P]rovide also a chart showing the new reporting structure.
- *Other Long-Lived-Asset Impairment Testing* — Please revise to describe the impaired long-lived assets or asset groups, the facts and circumstances leading to the impairments and the segment in which the impaired long-lived assets or asset groups are reported.
- *Early-Warning Disclosures* — Item 303 of Regulation S-K requires MD&A disclosure of material uncertainties unless management has concluded that the uncertainty is not reasonably likely to materially impact future operating results. Potential asset write-offs are, inherently, uncertainties over the recoverability of recorded assets and require disclosure prior to the period of the impairment charge. . . . Please tell us why you have not included such disclosure in MD&A. Given the significant decline in your operating results, it would appear as though you should be explaining to investors how you determined that your tangible and intangible assets are realizable and that you do not foresee recognizing a material write-down or impairment charge in the future. Otherwise, please provide us with the disclosure you intend to include in future filings.

Goodwill Impairment Testing and Disclosure

At the 2008 AICPA Conference, Steven C. Jacobs, associate chief accountant in the SEC's Division of Corporation Finance, shared his perspective on goodwill impairment. He suggested that entities consider the following indicators or "triggering events" in addition to those in ASC 350-20-35-30:

- Cash or operating losses at the reporting unit.
- Consecutive operating results that are significantly lower than analysts' or internal forecasts.
- Significant revisions to internal or external forecasts.
- A new restructuring plan (an entity should also consider whether this constitutes a reorganization of its reporting structure and whether a reallocation of goodwill is required).

- Market capitalization that is below book value.
- A negative long-term outlook for the industry in which the reporting unit operates.
- An increase in deferred tax valuation allowances at the reporting unit, which could arise from a reduction in the reporting unit's projected taxable income.

At the September 2009 CAQ SEC Regulations Committee Joint Meeting With the SEC Staff, the staff requested that registrants disclose within MD&A the future implications, to the registrants' underlying business, of the economic conditions that led to the impairment of goodwill rather than simply the noncash nature of the charge. In addition, the SEC staff stated that registrants should disclose in MD&A the critical assumptions used in the impairment test, how these assumptions are developed, and specific events or transactions that trigger an impairment test or that could alter the assumptions and lead to an impairment charge.

During the 2009 AICPA Conference, Mark Kronforst, then deputy chief accountant in the SEC's Division of Corporation Finance, discussed the SEC staff's increased focus on critical accounting policy disclosures in MD&A about the impairment of intangible assets, including goodwill. Mr. Kronforst noted that a registrant should disclose any known material uncertainties about the potential failure of step 1 of a goodwill impairment test[1] under Regulation S-K, Item 303. He indicated that if a registrant has a reporting unit with material goodwill that is at risk for failing step 1 of the goodwill impairment test, the registrant should disclose that risk. Further, he outlined the following to enhance existing disclosures for each reporting unit whose fair value as of the impairment testing date was not substantially in excess of its carrying value:

- The percentage by which the fair value exceeded the carrying value as of the most recent step 1 test (under ASC 350-20-35-4 through 35-8).
- The amount of goodwill allocated to the reporting unit.
- A description of the key assumptions that drive fair value and a discussion of any uncertainties inherent in those assumptions.
- A discussion of potential events, circumstances, or both, that could have a negative effect on fair value.

Mr. Kronforst indicated that registrants should not rely on a set threshold or bright-line percentage in determining whether a reporting unit's fair value is "substantially" in excess of its carrying value. Instead, a registrant should consider the specific facts and circumstances, such as the nature of the assumptions, the methods used, industry considerations, and other relevant factors in determining what is substantial. Mr. Kronforst further noted that the lower the percentage excess, the higher the risk of future impairment. As a result, the SEC staff believes that if there is a narrow margin, it would be counterintuitive and more difficult for a registrant to conclude that there is not a known uncertainty that should be addressed. However, Mr. Kronforst encouraged registrants to disclose the basis for their conclusions that a known uncertainty does not exist in light of a narrow difference between a reporting unit's carrying value and fair value.

Mr. Kronforst further noted that when the fair value for all reporting units substantially exceeds the respective reporting unit's carrying value, the registrant should disclose this assertion.

Section 9510 of the SEC Financial Reporting Manual discusses the staff's views on goodwill impairment disclosures in the critical accounting estimates section of MD&A. In the discussion about the degree of uncertainty of key assumptions, entities should provide specific information when possible. For example, if "the valuation model assumes recovery from a business downturn within a defined period of time," that should be disclosed.

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

At the 2009 AICPA Conference, Evan B. Sussholz, professional accounting fellow (valuation specialist) in the SEC's Office of the Chief Accountant, noted that questions had been raised about whether the fair value of a reporting unit refers to its equity or enterprise value (commonly defined as the sum of fair value of debt and equity). He indicated that the SEC staff believes that neither approach should generally affect the result of step 1 of the impairment test. However, there could be situations in which the method selected could affect step 1 of the test, such as when the reporting unit has a negative carrying value. Mr. Sussholz noted that in such situations, using an enterprise premise may be more appropriate.

[1] ASC 350-20-35 defines step 1 of the goodwill impairment test as a comparison of the fair value of the reporting unit with the carrying value of the reporting unit, including goodwill.

Mr. Sussholz stated that in determining whether an alternative approach to a step 1 goodwill impairment test is appropriate, registrants should consider various factors including (1) their operations, (2) "market participant assumptions," and (3) "potential structure of a hypothetical sale transaction." However, Mr. Sussholz emphasized that "regardless of the approach selected, the composition of the carrying value must be the same as the composition of the fair value determination." For instance, if the carrying value is based on equity, then step 1 of the goodwill impairment test should also be at the equity level.

At its September 2010 meeting, the EITF discussed how the carrying amount of a reporting unit should be calculated in the performance of step 1 of the goodwill impairment test. The EITF reached a consensus for exposure that (1) an entity should use an equity premise when performing step 1 of the goodwill impairment test and (2) if a reporting unit has a zero or negative carrying amount, the entity must assess, on the basis of qualitative factors such as those listed in ASC 350-20-35-30 (these factors are not all-inclusive), whether it is more likely than not that a goodwill impairment exists. Step 2 must be performed if it is more likely than not that a goodwill impairment exists. For more information on the EITF discussion, see Deloitte's September 2010 *EITF Snapshot*.

Asset Grouping for Goodwill Impairment Testing

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

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

Other Long-Lived-Asset Impairment Testing

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

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

See also Industry-Specific Topics for discussion of intangible assets and impairments.

[2] The term "operating segment" is defined in ASC 280-10-50-1.

[3] For guidance on determining whether an asset group constitutes a "business," see ASC 805-10-55-4 through 55-9.

[4] ASC 350-20-55-4 contains guidance on "discrete financial information."

[5] The term "segment management" is defined in ASC 280-10-50-7 and 50-8.

Asset Grouping for Other Long-Lived-Asset Impairment Testing

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

Early-Warning Disclosures

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

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

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

Use of Valuation Experts

The SEC staff has continued to comment on the use of valuation experts (1) for assigning amounts to assets acquired and liabilities assumed and (2) in connection with an entity's impairment testing.

One of the SEC staff's focus areas relates to whether companies have used third-party valuation firms in estimating the fair value for their second step of the goodwill impairment test and if so, what type of reports the valuation firms issued and how the companies used the information (i.e., the registrant's extent of use and reliance on the third party valuation reports). The SEC staff has also often asked companies to explain any adjustments made to the fair value estimates determined by the valuation experts. See the Use of Experts and Consents section for additional information relating to SEC reporting considerations when using a third-party specialist.

Other Deloitte Resources

- *Accounting for Business Combinations and Related Topics — A Roadmap to Accounting for Business Combinations and Related Topics*.
- December 17, 2009, *Heads Up*, "Highlights of the 2009 AICPA National Conference on Current SEC and PCAOB Developments."
- December 18, 2008, *Heads Up*, "Highlights of the 2008 AICPA National Conference on Current SEC and PCAOB Developments."

Income Taxes and Uncertain Tax Positions

Valuation Allowances

Example of an SEC Comment

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

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

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

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

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

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

Uncertain Tax Positions

Examples of SEC Comments

- At a minimum, please disclose your policy on classification of interest and penalties in accordance with [ASC 740-10-45-25] and provide a tabular reconciliation of the total amounts of unrecognized tax benefits.
- Please clarify the nature of the reductions to the liability for unrecognized tax benefits for [the prior fiscal year]. If it represents settlements or lapse of statute of limitations reductions, indicate such in the disclosure. Refer to [ASC 740-10-50-15A(a)(3) and (a)(4)].

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

One of the most controversial aspects of ASC 740-10 relates to disclosures about a company's unrecognized tax benefits. ASC 740-10-50-15A(a) and (b) and 50-15(c) and (e), requires that companies disclose:

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

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

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

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

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

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

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

MD&A Considerations

Example of an SEC Comment

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

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

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

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

Repatriation of Foreign Earnings

Example of an SEC Comment

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

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

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

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

2010 Update

Income Taxes

Income Tax Disclosures and MD&A

Example of an SEC Comment

- In future filings, please revise your disclosures for the reconciling line items for income tax expense (benefit) to the statutory tax expense (benefit) to provide investors with a better understanding of the underlying components.

The SEC staff has issued comments requesting additional disclosures of the components of the rate reconciliation in the notes to the financial statements and in MD&A. This reconciliation is required by Regulation S-X, Rule 4-08(h)(2). Under these requirements, companies must reconcile, in a tabular format, the amount of reported total income tax expense (benefit) to the amount of income tax that would have been incurred by using reported pretax income at the statutory federal income tax rate. In addition, at the 2009 AICPA Conference, Jill S. Davis, associate chief accountant in the SEC's Division of Corporation Finance, highlighted these disclosure requirements. She also noted that registrants' MD&A will often only provide a comparison of amounts reported in the income statement. Ms. Davis encouraged registrants to consider the rate reconciliation information provided in the footnotes when preparing MD&A.

While discussing the rate reconciliation, Ms. Davis reminded registrants that Regulation S-X, Rule 4-08(h), requires separate disclosure of all significant reconciling items. Amounts that are significant should not be combined in an "other" category. The SEC staff may issue a comment when the "other" line item is large or if the registrant does not disclose an item that the staff would expect to see. Further, a registrant should not combine unrelated tax reconciling items into a line item that is significant on its own. Regulation S-X, Rule 4-08(h)(2), defines the threshold for reporting reconciling items in the rate reconciliation as 5 percent of the income tax expense at the statutory federal income tax rate.

In addition, Ms. Davis referred to the requirements in Regulation S-X, Rule 4-08(h)(1), regarding footnote disclosure of the components of income (loss) before income tax as either domestic or foreign in nature. If the geographic origin of income has shifted, a registrant should consider whether MD&A needs to explain the registrant's sources of pretax income in terms of domestic and foreign income, addressing any relevant changes in trends or in the focus of the registrant's business.

Undistributed Earnings of Foreign Subsidiaries

Ms. Davis discussed a potential rate reconciliation item, undistributed earnings of foreign subsidiaries. If a registrant asserts that the earnings of a foreign subsidiary are permanently reinvested in the subsidiary and will not be repatriated to the home country, the foreign earnings will not be subject to income tax and a rate reconciliation item will therefore result. Questions that the SEC staff will consider in determining whether the registrant's MD&A disclosures are adequate in this area include the following:

- Does the registrant currently have sufficient liquidity to make this assertion?
- Does the MD&A explain the cash resources that are located in the foreign countries/subsidiaries and the impact on the registrant's liquidity?

Classification of Deferred Taxes

Ms. Davis also reminded registrants that the classification of deferred taxes as current or noncurrent is based on the related assets and liabilities and not on when the income tax item will be settled. Registrants should highlight in MD&A material changes in income tax items that are not apparent from the footnote disclosure, such as when there is a difference between the balance sheet classification of deferred taxes and the settlement of those items.

Other Deloitte Resources

- December 17, 2009, *Heads Up*, "Highlights of the 2009 AICPA National Conference on Current SEC and PCAOB Developments."
- December 18, 2008, Heads Up, "Highlights of the 2008 AICPA National Conference on Current SEC and PCAOB Developments."
- Example SEC Comments — Income Taxes (July 2010).
- July 27, 2010, Uncertain Tax Positions and the IRS Transparency Initiative — No Holds Barred.

Investments and Other-Than-Temporary Impairments

Other-Than-Temporary Impairments

Examples of SEC Comments

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

Over the past several years, the SEC staff has significantly increased its focus on other-than-temporary impairment (OTTI), primarily because of the deterioration in the credit markets and the significant decline in value of many investments (e.g., asset-backed securities, mortgage-backed securities, auction rate securities, corporate debt, perpetual preferred stock, equity securities). In addition, in 2009, in response to the credit crisis, the FASB revised its impairment guidance on beneficial interests in securitization transactions and debt securities in response to the credit crisis by issuing first FSP EITF 99-20-1 (codified in ASC 325-40-35) and then FSP FAS 115-2 and FAS 124-2 (codified in ASC 320-10-35).

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

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

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

At the 2008 AICPA Conference, James L. Kroeker, then deputy chief accountant in the SEC's Office of the Chief Accountant, addressed questions about determining when an investment is other-than-temporarily impaired. He stated that because the SEC has no "bright lines" or "safe harbors," the determination must be based on individual facts and circumstances. In addition, at the 2009 AICPA Conference, Wayne E. Carnall, chief accountant in the SEC's Division of Corporation Finance, indicated that impairment of debt and equity securities continues to be an area of focus by the SEC staff.

OTTI Disclosures

Examples of SEC Comments

- While we note the factors [Company A] considers in determining whether a security is other-than-temporarily impaired, it is not clear from your current disclosure, the specific factors and changes in circumstances that lead [Company A] to record these impairment charges. Tell us how you considered enhancing your disclosures to better explain the specific factors that lead to such charges. In this regard, please consider separating your discussion of such factors between (a) credit related issues or other adverse issuer conditions and (b) other accounting consequences . . . . In addition, tell us how you considered these same factors in concluding that the remaining portion of your mortgage-backed, asset-backed and corporate bond portfolios were only temporarily impaired.
- You also disclose that you recognize investment income using the effective-yield method based on estimated cash flows. Please revise your disclosures to discuss the level of recent cash flows compared to the projected cash flows underlying your asset and mortgage-backed securities when the transactions were originated. In those cases where the monthly cash flows during the fourth quarter are materially lower than the originally projected cash flows please tell us the factors considered in concluding that the investments are not impaired. Please also enhance the disclosures related to unrealized losses on your various asset and mortgage-backed securities, to support your assertion that you will collect all of the estimated cash flows.
- It appears that the other than temporary impairment on your investments . . . significantly affected your income for the periods then ended. Since you continue to have significant unrealized losses . . ., please provide us the following information in a disclosure-type format:
    - Describe the circumstances giving rise to the loss.
    - Describe whether, and how, those circumstances impact other material investments held.
    - Explain why you believe that the fair value will increase enough for you to recover your cost.
- Your presentation of net securities gains on the face of your Consolidated Statement of Income indicates that you recognized [$X] million of other-than-temporary impairments (OTTI) on investment securities in other comprehensive income during the 1st quarter [of the current year]. It is not clear . . . where this amount is reported in your Consolidated Statement of Shareholders' Equity. Please revise your future filings to separately present amounts recognized in accumulated other comprehensive income . . . as required by [ASC 320-10-45-9A].
- [P]lease consider disclosing the amount of unrealized loss and fair value by security type by the lowest credit rating by at least one major rating agency. We believe disclosure of this level of detail is consistent with the guidance in [ASC 320-10-50-2 and 50-5].

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

Valuations

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

2010 Update

OTTI Disclosures

Examples of SEC Comments

- Please revise future filings to disclose your OTTI practices for single-issuer and pooled trust preferred securities separately. Show us what your disclosure will look like in your response.
- We note that all losses on your non-current [investments] have been determined to be other-than-temporary and attributable only to credit loss and not to other factors. For your investments within the scope of FSP FAS 115-2 and FAS 124-2 [ASC 320-10-35], please tell us how you considered the guidance in paragraphs 22 – 26 of the FSP [ASC 320-10-35-33C through 33I] in arriving at your determination that all of the losses, including previously recognized other-than-temporary impairments, on these investments were credit-related.

As evidenced by the comments above, the SEC staff continues to focus on OTTI losses and has commented on registrants' application of the revised OTTI model for debt securities. As a refresher, under the revised model for debt securities, OTTI is triggered if (1) an entity has the intent to sell the security, (2) it is more likely than not that an entity will be required to sell the security before recovery, or (3) an entity does not expect to recover the entire amortized cost basis of the security. The SEC staff comments on whether the registrant intends to sell the security or whether it is more likely than not that the registrant will be required to sell the security before the recovery of its amortized cost basis to ensure that the OTTI model is being applied appropriately.

ASC 320-10-35 also changed the presentation of OTTI of debt securities in the income statement if an entity does not expect to recover the entire amortized cost basis of the security. If the entity has the intent to sell or it is more likely than not that the entity will be required to sell the debt security, the entire impairment is recognized in earnings. Alternatively, if the entity does not have the intent to sell or it is not more likely than not that the entity will be required to sell the debt security, but the entity does not expect to recover the entire amortized cost basis of the security, the impairment loss is separated into a credit loss component, which is recorded in earnings, and a noncredit loss component, which is recorded in other comprehensive income.

On the basis of recent SEC staff comments, the staff is interested in understanding how registrants separate their OTTI losses between their credit and noncredit components, and to evaluate this bifurcation, the staff may ask questions about:

- Why unrealized losses of a longer duration are not indicative of credit losses.
- Whether the registrant continues to receive interest payments timely.
- How the registrant considered significant inputs such as:
  - The performance indicators of the underlying collateral of the security, including default rates, delinquency rates, and percentage of nonperforming assets as described in ASC 320-10-35.
  - Loan-to-collateral-value ratios.
  - Third-party guarantees.
  - Current levels of subordination.
  - Geographic concentration.
  - Credit ratings.
- Whether the registrant's cash flow projections include expectations about a lack of receipt of future interest, principal payments, or both, and if so, the basis for this assumption.
- Whether the security is considered to be investment grade, including amounts below investment grade.
- Whether there have been any changes to the rating of the security by a rating agency, and if so, when the changes occurred.
- Whether securities with unrealized losses are other-than-temporarily impaired when credit spreads are significantly greater than credit spreads in the broader market.
- The extent to which credit enhancement supports the registrant's unrealized loss judgment.

While the OTTI model has not changed for equity securities, the SEC staff does continue to issue comments on whether OTTI should be recognized depending on the length of time and extent to which the equity security is under water.

Recent Standard Setting

On May 26, 2010, the FASB issued a proposed ASU, *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging*. The proposed ASU is the result of a joint project between the FASB and IASB to significantly improve the decision usefulness of financial instrument reporting for users of financial statements by addressing (1) the classification, measurement, and impairment of financial instruments and (2) hedge accounting. The proposed ASU simplifies and improves financial reporting for financial instruments by developing a consistent, comprehensive framework for classifying financial instruments, removes the threshold for recognizing credit impairments, and makes changes to the requirements to qualify for hedge accounting, the result of which should be more consistent and transparent reporting for hedging activities.

The FASB plans to address the effective date after considering comments received on the proposal. The comment period on the proposed ASU ended on September 30, 2010.

Other Deloitte Resources

- Financial Reporting Alert 09-1, "Impact of Credit Downgrades on the OTTI Analysis of Perpetual Preferred Securities."
- May 28, 2010, *Heads Up*, "FASB Issues Proposed ASU on Accounting for Financial Instruments."
- November 17, 2009, *Heads Up*, "IASB Issues IFRS on Classification and Measurement of Financial Assets."
- November 10, 2009, *Heads Up*, "IASB Proposes New Approach to Accounting for Credit Losses."
- April 14, 2009, *Heads Up*, "FASB Issues Guidance on Measuring Fair Value When Market Activity Declines, Other-Than-Temporary Impairments, and Interim Fair Value Disclosures."
- February 3, 2009, *Heads Up*, "FASB Issues Proposal on Interim Disclosure of Financial Instruments."
- January 16, 2009, *Heads Up*, "FASB Issues Amendments to OTTI Model for Certain Investments in Securitizations."
- January 9, 2009, *Heads Up*, "Study Finalized on Mark-to-Market Accounting."

Long-Lived Assets, Including Goodwill

The majority of comments about long-lived assets are related to goodwill. The SEC staff frequently comments on goodwill when it is significant relative to a registrant's total assets. The SEC staff has also focused on disclosures related to goodwill and the effect on goodwill when a registrant disposes of a reporting unit.

For a discussion on comments about other aspects of long-lived asset, see the Business Combinations and Capitalization of Costs sections and the Industry-Specific Topics. The SEC staff also issues comments about the depreciation or amortization method selected for long-lived assets, for example, comments about the appropriateness of the use of the straight-line method as opposed to the accelerated amortization method. ASC 350-30-35-6 requires entities to amortize identifiable intangible assets by using a method based on the pattern in which the economic benefits of the assets are consumed. Consequently, the staff may challenge registrants that appear to have used the straight-line method by default.

Examples of SEC Comments

- *Goodwill Disclosure* — Please provide a table in future filings showing the beginning balances of goodwill and changes in goodwill in the aggregate and by segment to show the reallocation of goodwill to the new reporting units/segments and other changes in goodwill. Refer to FASB ASC 350-20-50-1.
- *Goodwill Impact Upon Disposal of a Reporting Unit* — We note that you closed a net of [X] stores during fiscal year 2009. It appears, however, that there was no impact on goodwill as a result of these store closures. Please explain to us your consideration of [ASC] 350-20-35-51 through 350-20-35-57 . . . in accounting for goodwill associated with such closed stores.

Goodwill Disclosure

ASC 805 amended certain disclosure requirements related to goodwill. For example, under ASC 350-20-50-1, registrants must disclose the gross amount of goodwill and the accumulated goodwill impairment losses as of the beginning and ending of a reporting period. Before this amendment, companies were only required to disclose goodwill impairment losses in the aggregate in any given period. This new requirement was effective for financial statements with annual reporting periods beginning on or after December 15, 2008. It applies to all years presented and only to annual financial statements.

Goodwill Impact Upon Disposal of a Reporting Unit

In response to recent economic conditions, many companies have downsized and consequently disposed of parts of their overall business. When a registrant with goodwill disposes of part of its operations that meet the definition of a business, the registrant must allocate the goodwill to the disposal, which affects the gain or loss on the sale. When such disposal occurs, the SEC staff often asks whether the registrant has considered the guidance in ASC 350-20-35-51 through 35-57A in accounting for the potential impact on goodwill. For additional information about retailers, see the Retail section.

To determine the allocation of goodwill among the reporting units, a registrant uses the relative fair values of (1) the portion of the business (reporting unit) to be disposed of and (2) the remaining reporting units to be retained. Under ASC 350-20-35-52 and ASC 350-20-35-57, if a portion of a reporting unit that constituted a business, rather than the entire unit, is sold, the goodwill can be allocated on the basis of relative fair values of both the business and the portion of the reporting unit to be retained.

The adjusted carrying amount is used to test the remaining goodwill not allocated to the business to be disposed for impairment in accordance with ASC 350-20-35-4 through 35-19.

In certain situations, the business to be disposed of is never integrated into the rest of the business after its acquisition. Therefore, the benefits of the acquired goodwill are not realized by the rest of the reporting units and the entire acquired goodwill associated with the acquisition is included in the carrying amount of the business unit to be disposed of. This could occur when the acquired business is disposed of soon after its acquisition or when it is operated as a stand-alone entity. In addition, if a company plans to dispose of a single reporting unit that constitutes a business, the entire goodwill of that reporting unit is included in the disposal.

When assets of a reporting unit are disposed of but do not constitute a business no amount of goodwill is included in the carrying amount of the assets. However, the sale may constitute an event that triggers the requirement to perform impairment testing of the existing goodwill of the reporting unit between annual dates.

For additional information, see the Discontinued Operations, Assets Held for Sale, and Restructuring Charges and Impairments of Long-Lived Assets, Including Goodwill sections.

Other Deloitte Resources

- *Accounting for Business Combinations and Related Topics — A Roadmap to Accounting for Business Combinations and Related Topics.*
- *SEC Reporting for Business Combinations and Related Topics: A Roadmap to Applying Regulation S-X to the Acquisition of a Business.*
- 350-20-50 (Q&A 01), "Disclosure of Accumulated Goodwill Impairment Losses" (available on Technical Library: The Deloitte Accounting Research Tool).

Materiality

Support for Materiality Conclusions

Example of an SEC Comment

- We note your revisions to the . . . financial statements to correct the [error] . . . . Considering you corrected these by restating the [year-end] financial statements without amending previously filed reports [it] appears that you looked to the guidance in SAB 108 and concluded that such revisions previously were and continue to be immaterial to the prior year's financial statements. Please confirm and if true, tell us how you determined these errors were not material to your [prior year] financial statements. In this regard, provide your SAB 99 materiality analysis that supports your conclusions. Please ensure your response addresses both the quantitative and qualitative factors outlined in SAB 99 as well as any other qualitative factors considered.

Materiality analyses are performed by registrants to determine the impact of identified misstatements on their financial statements. SAB 99 (SAB Topic 1.M) and SAB 108 (SAB Topic 1.N) provide SEC staff guidance on assessing materiality for misstatements identified in the audit process or during the preparation of financial statements. SAB 99 states that "a matter is 'material' if there is a substantial likelihood that a reasonable person would consider it important." The definition of materiality is based on FASB Concepts Statement 2[1] and on legal precedent in interpretations of the federal securities laws.[2] SAB 99 indicates that registrants should consider (1) each misstatement individually and (2) the aggregate effect of all misstatements. SAB 108 provides guidance on how a registrant should consider the effects of prior-year misstatements when quantifying misstatements in current-year financial statements.

Registrants should first consider whether an individual error is material by giving consideration both to the affected financial statement line item and to the financial statements as a whole. Even if a conclusion is reached that an individual error does not cause the financial statements as a whole to be materially misstated, consideration should then be given to other errors, including offsetting errors, in the determination of whether the errors, taken as a whole, are materially misleading. In reaching this conclusion, registrants should consider individual line items, subtotals, and totals within the financial statements.

SAB 99 lists certain quantitative and qualitative factors that the SEC staff believes a registrant should consider when assessing the materiality of known errors to its financial statements. Because the materiality analysis is based on both quantitative and qualitative factors, the SEC staff understands that it is possible for quantitatively small errors to be material and for quantitatively large errors to be immaterial. The latter has been the topic of speeches given by the SEC staff in various venues, including remarks made by Todd E. Hardiman, associate chief accountant in the SEC's Division of Corporation Finance at the 2007 AICPA Conference, and Mark S. Mahar, associate chief accountant in the SEC's Office of the Chief Accountant at the 2008 AICPA Conference. For additional information, see Deloitte's *Heads Up* newsletters on the 2007 and 2008 AICPA Conferences.

At the 2008 AICPA Conference, Mr. Mahar noted that assessments of materiality require judgment and stressed that companies should perform a robust analysis that identifies factors that are significant to investors' decisions. Registrants should not rely simply on the factors in SABs 99 and 108 in performing their analysis because these factors were never intended by the staff to represent an all-inclusive list. The SEC staff expects a registrant to tailor its analysis to consider factors that are relevant to the registrant's own facts and circumstances.

Mr. Mahar noted that a registrant should consider "company specific trends and performance metrics that may influence investment decisions" in determining whether an error is quantitatively or qualitatively material. In addition, the registrant should consider the effect of an unrelated circumstance on a factor that is important to a reasonable investor, such as an error in the income statement that is magnified simply because it occurs "during a period in which net income is abnormally small" relative to historical and expected trends.

In its consideration of company-specific trends and performance metrics, a registrant should address in its materiality assessments what metrics it considered important enough to include in press releases and earnings calls as well as what analysts cover in their reports. Analysts' reports and investor calls are often considered by the SEC staff as they assess the registrant's assertion of what is important to investors.

[1] FASB Concepts Statement 2 defines materiality as the "magnitude of an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or misstatement."

[2] SAB Topic 1.M.1 indicates, "The Supreme Court has held that a fact is material if there is - a substantial likelihood that the . . . fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available" (footnote omitted).

When considering whether net income is abnormally small, management should determine whether a decline in operating performance is an abnormal event or whether it represents a new, normalized level of lower performance for the registrant. In addition, consideration should be given to whether there are "unusual" or infrequent events or transactions reflected in the results, such as an asset sale or impairment that would affect trends. Because of the economic downturn, it may no longer be reasonable for management to believe that financial performance will return to historical levels. Documentation of such considerations should be included in management's analysis.

When the SEC staff becomes aware that a registrant has reached a conclusion that an identified misstatement is immaterial, typically because the registrant has corrected an error or errors without amending previously filed reports, the staff frequently requests that the registrant provide details of the materiality assessment. The assessment should be prepared contemporaneously with the registrant's conclusion on materiality and should contain a thorough analysis of all of the relevant facts and circumstances.

On October 12, 2010, in a joint webcast between the CAQ and the SEC's Division of Corporation Finance, Wayne E. Carnall, chief accountant in the SEC's Division of Corporation Finance, discussed registrants' materiality assessments. He noted that often a registrant's analysis is presented in a "checklist" fashion in which consideration is given only to the factors in SAB 99. The registrant will often determine that certain of the SAB's considerations are "not applicable" rather than describing how the factors were considered or providing a detailed, thoughtful analysis on the basis of all factors specific to the registrant and relevant to its investors and the users of its financial statements.

While it may be appropriate to look at metrics other than net income and EPS in determining whether the financial statements, taken as a whole, are materially misstated, the SEC staff will most likely focus on those metrics until a registrant can demonstrate why other metrics are more important to its investors. If the error would be significant if measured against net income or EPS, the SEC staff may ask the company to discuss the error's significance as measured against both net income and EPS, in addition to other metrics the registrant has identified as relevant to investors, and discuss how all these items were considered in the registrant's determination that the error was not material.

Mr. Carnall also said in his October 12, 2010, remarks that registrants may acknowledge that an error is material to the GAAP financial statements but will try to argue that the GAAP financial statements or GAAP metric is not important to investors. When such an argument is made, registrants will often point to a non-GAAP financial measure or metric such as EBITDA or adjusted EBITDA as being important to an investor or user of the financial statements. Consequently, a registrant may argue that the non-GAAP basis is the context within which materiality should be evaluated. In this regard, Mr. Carnall noted, "If you have a material error in [the] GAAP [financial statements], that [error] will be material. And that non-GAAP presentation does not make a material error in the GAAP financial statements immaterial."

Mr. Carnall also said there may be circumstances in which an error that is otherwise immaterial to the GAAP financial statements taken as a whole may be material in the context of non-GAAP information, depending on the focus that management, investors, and the users of financial statements have historically placed on non-GAAP information.

Other Materiality Considerations

Example of an SEC Comment

- If as a result of the identification of the error, you have made changes in your internal control over financial reporting, please provide the disclosures required by Item 308(c) of Regulation S-K. If you have not made changes, supplementally please advise us if you are planning on making changes, and if so when. If you do not believe any changes in your internal controls over financial reporting are necessary, please explain the basis for your conclusion. Further, tell us how you and your independent auditors were able to conclude that this was not a material weakness in your internal controls over financial reporting for the periods presented.

In addition to inquiring about the registrant's SABs 99 and 108 materiality analyses, the SEC staff often asks questions related to the errors themselves. When a misstatement is identified, consideration should be given to the impact this may have on the registrant's previous conclusions on internal control over financial reporting and disclosure controls and procedures. As a result of the error, the SEC staff may also question whether a material weakness existed at the time of the initial assessment. For additional considerations, see the Internal Control Over Financial Reporting and Disclosure Controls and Procedures sections.

Once a materiality conclusion has been reached, registrants should also consider whether a Form 8-K is required to be filed. Form 8-Ks filed under Item 4.02(a) are required when a registrant has concluded that previously issued financial statements, covering either an annual or interim period, should no longer be relied upon because of an error.

Noncontrolling Interests

Example of an SEC Comment

- Please revise your future filings to provide a reconciliation at the beginning and the end of the period of the carrying amount of total equity, equity attributable to the parent, and equity attributable to the noncontrolling interest. Please show us in your supplemental response what the revisions will look like. As described in [ASC 810-10-50-1A(c)], the reconciliation should separately disclose:
  - Net income;
  - Transactions with owners acting in their capacity as owners, showing separately contributions from and distributions to owners; and
  - Each component of other comprehensive income.

ASC 810-10 requires that net income include amounts attributable to the parent and the noncontrolling interest. ASC 810-10 also requires disclosure, on the face of the consolidated statement of income, of the amounts of consolidated net income and comprehensive income that are attributable to the parent and the amounts attributable to the noncontrolling interest. In addition, disclosures should include a reconciliation of the beginning and ending balances of equity attributable to the parent and the noncontrolling interest. Finally, disclosure should include a schedule showing the effects on equity when a parent's ownership interest in a subsidiary changes. As a result, the SEC staff's comments have focused on ASC 810-10's expanded disclosure requirements.

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

- A registrant could "[p]rovide a column for redeemable noncontrolling interests in the equity reconciliation, but exclude the related amounts from any 'total' column." Thus, "the reconciliation could include a row for net income or a supplemental table identifying the allocation of net income among controlling interests, nonredeemable noncontrolling interests and redeemable noncontrolling interests."
- A registrant could "[e]xclude redeemable noncontrolling interests from the equity reconciliation [and] provide a supplemental table (e.g., in the notes to the financial statements or the 'statement of changes in equity and noncontrolling interests') reconciling the beginning and ending balance of redeemable noncontrolling interests. . . . [T]he caption 'net income' in the equity reconciliation could note parenthetically the amounts related to redeemable noncontrolling interests."

2010 Update

During the April 2010 CAQ SEC Regulations Committee Joint Meeting With the SEC Staff, the SEC staff discussed an entity's calculation of book value per share after the adoption of ASC 810-10 in connection with the filing of a Form S-4 and compliance with Regulation S-K, Item 506. For example, the staff indicated that in a Form S-4 filing to register securities issued in a business combination, book value per share calculations should not be affected by a registrant's reporting of a noncontrolling interest as a component of equity because neither the shareholders of the reporting entity nor the company being acquired has an ownership interest in the noncontrolling entity.

On January 6, 2010, the FASB issued ASU 2010-02[1] in response to practice issues entities encountered in applying the decrease-in-ownership provisions in ASC 810-10. The ASU clarifies that the decrease-in-ownership provisions and related guidance applied to:

- A "subsidiary or group of assets that is a business or nonprofit activity."
- A subsidiary or group of assets "that is a business or nonprofit activity that is transferred to an equity method investee or joint venture."
- An "exchange of a group of assets that constitutes a business or nonprofit activity for a noncontrolling interest in an entity (including an equity method investee or joint venture)."

In addition, the ASU clarifies that the decrease-in-ownership guidance does not apply to the sales of in-substance real estate or conveyances of oil and gas mineral rights, even if these transactions involve businesses. Finally, the ASU expands the disclosures required upon deconsolidation of a subsidiary. For more information, see Deloitte's January 8, 2010, *Heads Up* on ASU 2010-02.

At its September 2010 meeting, the EITF continued its discussions on Issue 10-E regarding the deconsolidation of in-substance real estate. The EITF directed the FASB staff to perform additional user outreach to understand the impact of the Issue, including the appropriate effective date and transition guidance, and bring back the results of the outreach for further EITF consideration at a future meeting. For more information on Issue 10-E, refer to Deloitte's September 2010 *EITF Snapshot*.

[1] The ASU's amendments are effective in the beginning of the period in which an entity adopts Statement 160 (codified in ASC 810-10). "If an entity has previously adopted Statement 160 as of the date the amendments . . . are included in the Accounting Standards Codification, the amendments . . . are effective beginning in the first interim or annual reporting period ending on or after December 15, 2009"; an entity should also apply the amendments "retrospectively to the first period that an entity adopted Statement 160." In addition, an entity would be required to provide the disclosures in ASC 250-10-50-1 through 50-3 in the period in which the entity adopts the ASU.

Pensions and Other Postretirement Benefits

Critical Accounting Estimates

Examples of SEC Comments

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

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

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

Liquidity and Capital Resources

Example of an SEC Comment

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

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

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

Market-Related Value of Plan Assets

Example of an SEC Comment

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

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

2010 Update

Disclosures for Non-U.S. Plans

Example of an SEC Comment

- Please tell us how you considered ASC 715-20-50-4 in deciding to aggregate your disclosures about pension plans and other postretirement benefit plans outside the United States with those for the plans inside the United States.

ASC 715-20-50-4 states, in part, that a "U.S. reporting entity may combine disclosures about pension plans or other postretirement benefit plans outside the United States with those for U.S. plans unless the benefit obligations of the plans outside the United States are significant relative to the total benefit obligation and those plans use significantly different assumptions." The SEC staff's comments have requested that registrants support the basis for combining pension and other postretirement benefit plan disclosures of U.S. and non-U.S. plans. When significant differences in trends and assumptions between the U.S. and non-U.S. plans exist, and the benefit obligation of the foreign plan is significant, the SEC staff has required registrants to provide disaggregated footnote disclosure for those U.S. and non-U.S. plans.

Standard-Setting Update

In September 2010, the FASB issued a proposed ASU that would amend ASC 715-80 to significantly increase the level of quantitative and qualitative disclosures an employer would be required to make about its participation in multiemployer plans, including the effect on its cash flows. If finalized as proposed, the disclosure requirements would be effective for reporting entities with fiscal years ending after December 15, 2010, except for nonpublic entities, which would apply the provisions for fiscal periods ending after December 15, 2011, and comparative disclosures would be required prospectively only.

Other Deloitte Resources

- Financial Reporting Alert 09-5, "Financial Reporting Considerations for Pension and Other Postretirement Benefits."
- Financial Reporting Alert 08-10, "SEC Advises Registrants to Further Explain Fair Value in MD&A — An Addendum to the March 2008 SEC Letter."
- Financial Reporting Alert 08-4, "Turmoil in the Credit Markets: The Importance of Comprehensive and Informative Disclosures."
- September 2, 2010, *Heads Up*, "FASB Proposes Disclosures About an Employer's Participation in Multiemployer Plans."
- April 9, 2010, *Heads Up*, "A Summary of the Financial Reporting and Disclosure Implications of the Health Care Reform Legislation."
- January 9, 2009, *Heads Up*, "FASB Expands Disclosures About Postretirement Benefit Plan Assets."

Revenue Recogntion

Software

The SEC staff has continued to focus on revenue recognition related to software arrangements. See the Technology section for industry-specific information.

Multiple-Element Arrangements

Example of an SEC Comment

- We note that for certain professional services arrangements, you allocate and defer revenue for the undelivered items based on objective evidence of fair value of the undelivered elements and [recognize] the difference between the total arrangement fee and the amount associated with the undelivered items as revenue. Please explain further which items in these arrangements are considered "undelivered" and tell us when you recognize revenue on the delivered portion of the arrangement. In this regard, it appears that both the subscription and consulting services would qualify as undelivered items. We further note that when sufficient objective evidence of fair value does not exist for undelivered items when subscription and professional services are combined, the entire arrangement fee is recognized ratably over the applicable performance period. Please describe the types of arrangements that qualify for separation versus those that do not and tell us how you applied the guidance in ASC 605-25-30 . . . in evaluating each deliverable to determine whether they qualify for separation.

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

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

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

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

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

Product and Service Revenue Presentation

At the 2007 AICPA Conference, Mr. Barrysmith discussed financial statement presentation of product and service revenue. SEC Regulation S-X, Rule 5-03(b), requires that product revenue and service revenue, along with other categories of revenue, be displayed separately in the income statement if they are greater than 10 percent of total revenues. (See the Financial Statement

Classification section for additional information.) Mr. Barrysmith noted that a question often arises about how a vendor can adhere to this requirement when it is "unable to separate its multiple element arrangement[s] under the applicable revenue recognition guidance," such as ASC 605-25 or ASC 985-605.

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

Revenue Recognition Disclosures

Examples of SEC Comments

- Your disclosure of your revenue recognition policy is too general. Please revise future filings to explain each significant revenue transaction and how you complied with the SAB 104 [Topic 13] guidance related to them.
- Please ensure that you have addressed all significant revenue streams within your revenue recognition accounting policy disclosure. For example, we note from your Results of Operations discussion [that your] segment generates issuance revenue, commission revenue, and investment revenue, in addition to redemption revenue. Describe the nature of these revenue-generating activities. Provide a detailed description of the related revenue recognition policy and cite the authoritative accounting literature relied upon. Indicate in which line item the related revenue is reported and why this classification is appropriate. Also, tell us how the revenue line-items are allocated among your various segments. Tell us what consideration you gave to disclosing this information in your revenue recognition accounting policy disclosure.
- We note that your deferred revenue balance represents a significant percentage of your liabilities. We further note your disclosure . . . where you state that "[a]s a result of the significant recurring revenue base, the Company's license and maintenance revenue growth rate in any period does not necessarily correlate to the growth rate of new license and maintenance contracts sold during the period." Please tell us when you invoice your customers for . . . license and maintenance contracts (i.e., monthly, quarterly, annually, etc.) and clarify whether the deferred revenue balance represents all unearned revenue for these arrangements. To the extent that you do not invoice for the entire arrangement up-front, then tell us how you considered disclosing the amount of backlog orders (bookings) resulting from your recurring revenue arrangements pursuant to Item 101(c)(viii) of Regulation S-K. Also tell us how you considered including a discussion regarding the nature and origin of deferred revenue in MD&A.

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

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

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

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

Examples of SEC Comments

- We note that you measure performance under your percentage-of-completion contracts based on the ratio of costs incurred to total estimated contract costs. Please explain how you determine that all costs incurred relate directly to contract performance and how your accounting complies with [ASC 605-35-25-75 and 25-76]. As part of your response, please clarify whether you typically incur costs, particularly in the early stages of the contract that do not directly relate to contract performance.
- Please tell us and disclose in future filings the percent of revenues that you recognized using percentage of completion accounting. Also, please confirm to us and clarify in future filings that you record contract losses when they are evident and determined.

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

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

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

Principal-Agent Considerations

Example of an SEC Comment

- Please tell us the nature and terms of each type of arrangement with third parties through which you conduct your . . . operations. Please also tell us whether the third parties are considered purchasers and resellers of your products or agents that receive fees or commissions for services provided. If the third parties are considered purchasers and resellers, tell us whether sales are accounted for on a gross or net basis and the reasons there for. If the third parties are agents please tell us how fees paid to the third parties are determined, how you account for the fees and the basis in GAAP for your accounting.

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

Proposals to Converge With IFRSs

On June 24, 2010, the FASB and IASB jointly issued an ED, *Revenue From Contracts With Customers*. The ED, released by the FASB as a proposed ASU, gives entities a single comprehensive model to use in reporting information about the amount and timing of revenue resulting from contracts to provide goods or services to customers. The proposed ASU, which would apply to any entity that enters into contracts to provide goods or services, would supersede most of the current revenue recognition guidance. The proposed ASU would be applied retrospectively in accordance with ASC 250. The FASB's project plan calls for the issuance of a final revenue recognition standard in 2011.

Industry-Specific Considerations

See the Retail, Health Plans, Life Sciences, and Telecommunications sections for industry-specific revenue considerations.

Other Deloitte Resources

- *Multiple-Element Arrangements: A Roadmap to Applying the Revenue Recognition Guidance in ASU 2009-13*.
- *Software Revenue Recognition: A Roadmap to Applying AICPA Statement of Position 97-2*.
- Financial Reporting Alert 09-6, "Material Modifications to Revenue Arrangements With Multiple Deliverables."
- June 28, 2010, *Heads Up*, "FASB Issues Proposed ASU on Revenue Recognition."
- October 23, 2009, *Heads Up*, "Reconfiguring the Scope of Software Revenue Recognition Guidance."
- October 1, 2009, *Heads Up*, "Revenue Recognition: No Longer an Issue of Separation Anxiety."

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

Example of an SEC Comment

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

SAB Topic 11.M (SAB 74) requires disclosures about the effects of recently issued accounting standards that are not yet effective "unless the impact on [the registrant's] financial position and results of operations is not expected to be material" (footnote omitted). The disclosures are required for new ASUs and SABs.

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

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

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

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

The SEC staff also expects a registrant to disclose more specific details in filings as the effective date of a new standard approaches. For example, ASU 2010-17 was issued in April 2010 and is effective prospectively as of the reporting entity's first fiscal year, including interim periods within that year, beginning on or after June 15, 2010, with early adoption permitted. The registrant will adopt ASU 2010-17 on January 1, 2011, and will be issuing its Form 10-Qs for the quarters ended June 30 and September 30, 2010, as well as its Form 10-K for the year ended December 31, 2010, before adoption. Therefore, the registrant should be able to disclose more specifics in its Form 10-Qs and Form 10-K as it moves closer to the adoption date.[1]

2010 Update

At the 2009 AICPA Conference, Steven C. Jacobs, associate chief accountant in the SEC's Division of Corporation Finance, noted that a registrants's disclosures under SAB 74 often contain a "laundry list of new standards" that will have no material impact on the financial statements upon adoption, and he reminded registrants to focus on the purpose of the disclosure. Regarding the disclosure provided in the financial statements, Mr. Jacobs recommended that companies focus on accounting changes and how they will be adopted and, in the case of a retrospective adoption, consider how the financial statements presented might be different the next time they are issued. In the context of MD&A, Mr. Jacobs urged registrants to consider the effect of adoption on the operations, financial condition, or liquidity of the registrant in future periods. The discussion in MD&A may cover the impact on debt covenants or changes in business practices and could take into account both qualitative and quantitative factors. In addition, Wayne E. Carnall, chief accountant in the SEC's Division of Corporation Finance, stated that when a registrant will adopt a new accounting standard that will not affect the reported results (i.e., it requires enhanced disclosures), SAB 74 disclosure is not required.

Other Deloitte Resources

- April 2010 *Accounting Roundup*.
- December 17, 2009, *Heads Up*, "Highlights of the 2009 AICPA National Conference on Current SEC and PCAOB Developments."

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

Segment Reporting

Identification of Operating Segments

Example of an SEC Comment

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

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

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

Aggregation of Operating Segments

Example of an SEC Comment

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

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

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

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

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

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

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

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

Changes in Reportable Segments

Example of an SEC Comment

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

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

Product and Service Revenue by Segment

Example of an SEC Comment

- Please provide the revenue disclosures by product and service group required by [ASC 280-10-50-40].

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

Operating Segments and Goodwill Impairment

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

Information About Geographic Areas

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

2010 Update

At the 2009 AICPA Conference, Michael J. Fay, associate chief accountant in the SEC's Division of Corporation Finance, discussed the proper aggregation of operating segments into reportable segments, with a focus on economic similarity.

Mr. Fay indicated that when a registrant evaluates whether economic characteristics are similar and determines that aggregation of certain operating segments is appropriate, the registrant's analysis may lead to a number of questions from the SEC staff in its efforts to understand the registrant's basis for economic "similarity in the face of indicators of dissimilarity." He advised registrants to more fully consider the totality of all the facts, including indicators of dissimilarity, as they analyze economic characteristics. Registrants might undertake a process to evaluate "the line items, measures and metrics that correlate with the future prospects of their operating segments and fully look at indicators [of] dissimilarity inherent [in their] historical results."

Mr. Fay remarked that economic factors and line items to consider "will vary by company [and] by industry" and that similar operating segments are expected to have "essentially the same future prospects." He highlighted that long-term trends in the following financial statement line items of the segments may provide good indicators of similarity or dissimilarity:

- Revenue.
- Cash flows.
- Gross profit.
- Profit or loss.
- Cost of goods sold.
- Net income.

Mr. Fay also indicated that registrants should identify the factors that best align with the future prospects of their operating segments and keep in mind that "an analysis may need to expand or evolve as circumstances change." Mr. Fay noted that there is no single way to establish long-term trends. When doing so, registrants may want to consider volatility underlying their trends as part of the totality of all the facts they consider. The evaluation of long-term trends requires considerable judgment because there are no bright lines in the definition of economic similarity or dissimilarity.

Share-Based Payments

Disclosures

Example of an SEC Comment

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

Registrants should ensure that their disclosures address the following objectives outlined in ASC 718-10-50-1:

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

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

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

In its comments about disclosures, the SEC staff frequently cites the guidance in ASC 718-10-50-2, which describes the "minimum" information needed to achieve the disclosure objectives in ASC 718-10-50-1.

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

Financial Statement Presentation

Example of an SEC Comment

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

Pursuant to SAB Topic 14.F, share-based compensation expenses should be classified in the same manner as other compensation costs and the presentation should not be driven by the form of consideration paid. Share-based compensation expense should be

allocated to cost of sales, research and development, selling and administrative expenses, etc. (as applicable), and should not be separately presented in a single share-based compensation line item. The SEC's Current Accounting and Disclosure Issues in the Division of Corporation Finance (as updated November 30, 2006) states:

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

Simplified Method

Example of an SEC Comment

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

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

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

Accelerated Vesting

Example of an SEC Comment

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

Prices of a number of equity securities traded in public markets deteriorated significantly in recent years. Many share option awards previously granted "at-the-money" became "out-of-the-money" because of declines in the value of the underlying securities, and certain securities became so severely depressed that the share option awards were considered "deep out-of-the-money." Some entities chose to accelerate the vesting of these awards because the awards did not continue to provide the appropriate retention motivation to employees.

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

2010 Update

Share-Based Payment Awards Issued in an Initial Public Offering

At the June 2010 CAQ SEC Regulations Committee Joint Meeting With the SEC Staff, in the context of initial public offerings, the staff discussed equity securities issued as compensation while a company was privately held (commonly referred to as "cheap stock" considerations). The SEC staff encouraged companies to obtain contemporaneous valuations to determine the fair value of equity securities issued. The staff indicated that the 2004 AICPA Practice Aid, *Valuation of Privately-Held-Company Equity Securities Issued as Compensation*, noted that companies should provide different disclosures depending on the type of valuation (independent contemporaneous valuation versus one performed retrospectively, or one performed by management). The SEC staff is currently evaluating its comments in this area and hopes to incorporate disclosure expectations into a future release of its Financial Reporting Manual.

Other Deloitte Resources

- Financial Report Alert 10-9, "Accounting Considerations Related to the New Policies Proposed by the Special Master for TARP Executive Compensation."
- Financial Reporting Alert 09-2, "Acceleration of the Vesting of Deep Out-of-the-Money Share Option Awards."
- Financial Reporting Alert 07-10, "SEC Extends the Use of the Simplified Method in SAB 107 Under Certain Circumstances."
- June 17, 2008, *Heads Up*, "FASB Concludes That Certain Unvested Share-Based Payment Awards Are Participating Securities."

Other Disclosure Topics

Management's Discussion and Analysis

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

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

Current Economic Environment

Example of an SEC Comment

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

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

Results of Operations

Examples of SEC Comments

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

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

- Consideration of financial, operational, and other information.

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

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

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

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

Supplemental MD&A Based on Pro Forma Financial Information

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

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

> a. When there has been a material acquisition (either the acquisition of a target entity that is significant to the registrant or predecessor/successor step-up in basis) during the period; [or]
>
> b. When pushdown accounting has been applied . . . .

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

Liquidity and Capital Resources

Example of an SEC Comment

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

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

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

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

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

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

Off-Balance-Sheet Arrangements

Example of an SEC Comment

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

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

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

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

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

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

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

Tabular Disclosure of Contractual Obligations

Example of an SEC Comment

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

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

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

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

Critical Accounting Policies

Example of an SEC Comment

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

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

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

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

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

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

2010 Update

Critical Accounting Policies

See the Impairments of Long-Lived Assets, Including Goodwill section.

Liquidity and Capital Resources

On September 17, 2010, the SEC issued a proposed rule on short-term borrowings and a companion interpretive release. In part, the measures in the proposed rule result from (1) liquidity issues caused by certain transactions involving repurchase agreements known as "Repo 105" transactions; (2) SEC inquiries in 2010 of registrants to understand the types, extent of use, and accounting for repurchase agreements and other similar transactions; and (3) the SEC's conclusion that there was insufficient disclosure related to these types of transactions and other similar arrangements. The SEC's objective in proposing the rule is to improve transparency of registrants' short-term borrowings by creating a new section within Liquidity and Capital Resources in MD&A that would contain tabular information about a registrant's short-term borrowings and narrative disclosures, and analysis of short-term borrowings. In addition, the rule would increase existing disclosures for financial companies and add a new disclosure requirement on short-term borrowings that would apply to all other public entities.

Whether the SEC will move forward, and if so, the timing of issuance and effectiveness of a final rule is unknown. The SEC will consider comments received on the proposed rule before determining next steps. The comment period on the proposed rule ends on November 29, 2010.

The interpretive release provides guidance on the current requirements within MD&A about liquidity and capital resources disclosures. The interpretive release, which was effective September 28, 2010, states that "if borrowings during the reporting period are materially different than the period-end amounts recorded in the financial statements, disclosure about the intra-

period variations is **required under current rules** to facilitate investor understanding of the registrant's liquidity position" (emphasis added). Registrants should carefully consider the guidance in the interpretive release as they prepare periodic reports filed after the effective date.

For additional information, see Deloitte's September 24, 2010, *Heads Up* on the proposed rule and interpretive release.

Executive Overview

Example of an SEC Comment

- Please consider providing a balanced, executive-level discussion that identifies the most important themes or other significant matters with which management is concerned, including economic or industry-wide factors relevant to [the company]. Also, please consider providing a degree of insight into material opportunities, challenges and risks, such as those presented by known material trends and uncertainties, on which the company's executives are most focused for both the short and long term, as well as the actions they are taking to address these opportunities, challenges and risks. . . . In this regard, we refer to your [prior year] fourth quarter earnings call. . . . We also note your discussion . . . in your [current year] first quarter earnings report and the discussion in your "risk factors" section regarding the adverse impact of current market conditions and the consolidations and failures in the . . . industry.

In an interpretive release, the SEC staff recommended that registrants consider including within MD&A an overview section containing a balanced discussion summarizing the key drivers, challenges, and risks affecting results of operations and liquidity. The SEC staff frequently asks registrants to provide an executive level overview and looks to other sections of a registrant's Form 10-K or 10-Q and other communications to determine whether key themes and metrics, significant matters, material trends, and uncertainties or risks have been identified or discussed within MD&A. See the Core Disclosures, Including Disclosures About Risk section for additional information.

"Dear CFO" Letters

The SEC staff has historically posted to its Web site letters sent to the chief financial officers of certain registrants in industries affected by current issues. Over the past several years, there has been an increase in the number of such letters issued by the SEC staff. The letters, commonly referred to as "Dear CFO" letters, allow the SEC staff to communicate to affected parties in a timely fashion. While "Dear CFO" letters are sent to specific registrants, the SEC also posts them to its Web site because the staff believes they have broader applicability and that registrants should consider them in preparing disclosures in MD&A. The "Dear CFO" letters do not replace or amend existing GAAP requirements but rather provide insight into disclosure areas on which the staff may be focused during reviews and how the staff believes disclosure could be enhanced or improved. The SEC staff issued the following "Dear CFO" letters in 2009 and 2010:

- In August 2009, a letter reminding registrants of their disclosure obligations on items related to provisions and the allowance for loan loss.
- In March 2010, a letter requesting information about repurchase agreements, securities lending transactions, or other transactions involving the transfer of financial assets with an obligation to repurchase the transferred assets.
- In October 2010, a letter reminding registrants of their disclosure obligations in light of continued concerns about potential risks and costs associated with mortgage and foreclosure-related activities or exposures.

See the Banking and Securities section for more information.

Early Warning Disclosures

Example of an SEC Comment

- Item 303 of Regulation S-K requires MD&A disclosure of material uncertainties unless management has concluded that the uncertainty is not reasonably likely to materially impact future operating results. Potential asset write-offs are, inherently, uncertainties [of] the recoverability of recorded assets and require disclosure prior to the period of the impairment charge. . . . . Please tell us why you have not included such disclosure in MD&A. Given the significant decline in your operating results, it would appear as though you should be explaining to investors how you determined that your tangible and intangible assets are realizable and that you do not foresee recognizing a material write-down or impairment charge in the future. Otherwise, please provide us with the disclosure you intend to include in future filings.

Regulation S-K, Item 303, requires disclosure of “any known trends or uncertainties that . . . the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations.” In addition, various interpretive releases have noted that one objective of MD&A is “to provide information . . . so that investors can ascertain the likelihood that past performance is indicative of future performance.” Potential impairments are an example of situations in which an uncertainty exists regarding a registrant’s ability to recover an asset’s value and in which a charge, if recognized, may be material. Early warning disclosures give investors insight into when charges may be incurred in the future; whether a charge is related to contingencies, restructuring activities, goodwill or other long-lived asset impairments, or the settlement of uncertain tax positions; when revenue growth or profit margins may not be sustainable because of underlying economic conditions; or when the registrant will be unable to comply with debt covenants. Early warning disclosures give investors insight into the underlying conditions and risks facing the company before a material charge or decline in performance is reported.

For discussions of specific early-warning disclosures, see the Banking and Securities; Core Disclosures, Including Disclosures About Risk; Impairments of Long-Lived Assets, Including Goodwill; Income Taxes and Uncertain Tax Positions; and Real Estate sections.

Other

The SEC staff has indicated that it is evaluating MD&A disclosures in other areas as well, including:

- Potential ramifications of health care reform, specifically the impact of the Patient Protection and Affordable Care Act of 2010 (see the Health Sciences section).
- The impact of foreign operations, including Venezuela (see the Foreign Currency section).

Other Deloitte Resources

- SEC Interpretation: Commission Guidance Regarding Management’s Discussion and Analysis of Financial Condition and Results of Operations. (Request a copy.)
- Financial Reporting Alert 09-3, “SEC Advises Registrants to Further Explain Provisions and Allowances for Loan Losses in MD&A.”
- Financial Reporting Alert 08-10, “SEC Advises Registrants to Further Explain Fair Value in MD&A — An Addendum to the March 2008 Letter.”
- Financial Reporting Alert 08-7, “SEC Advises Registrants to Further Explain Fair Value in MD&A.”
- Financial Reporting Alert 08-4, “Turmoil in the Credit Markets: The Importance of Comprehensive and Informative Disclosures.”
- April 9, 2010, *Heads Up*, “A Summary of the Financial Reporting and Disclosure Implications of the Health Care Reform Legislation.”

Core Disclosures, Including Disclosures About Risk

In 2009, the SEC published a draft Strategic Plan that outlines the Commission's strategic initiatives for 2010 through 2015. One objective of the plan is to ensure that investors have access to high-quality information that helps them make investment decisions. To achieve this goal, the SEC has planned a core disclosure project to comprehensively review the SEC's current disclosure requirements, modernize disclosures, and eliminate redundancy. At the 2009 AICPA Conference, the SEC staff underscored the importance of attaining simplification and consistency in communications with investors. On the subject of simplification, Meredith B. Cross, director of the SEC's Division of Corporation Finance, stated that the SEC's focus is on assuring that registrants obtain "the right disclosure, not more disclosure" and that a huge burden is imposed on investors that have "to wade through [disclosures] to see what's important." Part of the SEC staff's focus on core disclosures centers on a registrant's consistency in communications related to measures discussed in press releases and on analysts' calls because often such communications are not presented in periodic reports filed with the Commission. For additional information, see the Non-GAAP Financial Measures section.

Ms. Cross envisioned that one potential outcome of the core disclosure project would be an overarching risk analysis of (1) disclosures currently found in MD&A; (2) quantitative and qualitative market risk disclosures required by Regulation S-K, Item 305; (3) risk factor items; and (4) corporate governance disclosures. The analysis would concentrate on the primary risks facing a company and how those risks are addressed, including how the company manages risk at the enterprise level and how the board monitors this risk management. For additional discussion about proxy and corporate governance risk disclosures, see the Proxy Disclosure, Excluding Executive Compensation and Executive Compensation sections.

Critical accounting policy disclosure may also be reconsidered as part of the core disclosure project. The SEC staff has commented on risk disclosures in critical accounting policies mainly within the context of a registrant's risk of impairment to its long-lived assets, including goodwill. For additional information, see the Impairments of Long-Lived Assets, Including Goodwill section.

Risk disclosure related to credit and liquidity is also an area of focus by the SEC staff, as seen by the recent rule proposal to enhance disclosure about short-term borrowings and the interpretive release on liquidity and capital resource disclosure, both issued in September 2010. For additional information, see the Management's Discussion and Analysis section.

Risk Factors

Example of an SEC Comment

- Please provide to us and undertake to include in your future filings, revision of each risk factor to comply with the following:
    - Securities Act Release No. 33-7497 which requires that you "place any risk factor in context so investors can understand the specific risk as it applies to your company and its operations;"
    - Sample comment 34 to Staff Legal Bulletin No.7, which directs that you provide the information investors need to "assess the magnitude" of each risk and "explain why" each risk may result in a material adverse effect on you; and
    - Sample comment 38 to Staff Legal Bulletin No.7, which directs that you include "specific disclosure of how your [operations] [financial condition] [business] would be affected" by each risk.

At the 2009 AICPA Conference, Ms. Cross also identified the risk factors section required by Regulation S-K, Item 503, as an example of a substantive disclosure requirement ripe for modification. She noted that she would "like to . . . get away from mind-numbing risk factors disclosures to a more targeted discussion." The focus should not be on risks that apply to any registrant but on risks specific to the registrant and its operations. For more information, see Deloitte's *Heads Up* on the 2009 AICPA Conference.

Accordingly, SEC comment letters to registrants have increasingly concentrated on risk factors. The SEC staff routinely identifies what it considers to be "boilerplate" risks and asks registrants to discuss risks that are specific to the registrant and to tailor the discussion to the potential impact on the registrant. The SEC staff looks for consistency in disclosure between various sections of the periodic filing and other sources of information, such as press releases and earnings conference calls. In doing so, the SEC staff questions registrants about the completeness of the risk factors identified and whether there is sufficient MD&A discussion when a risk constitutes a material trend or uncertainty.

Non-GAAP Financial Measures

Examples of SEC Comments

- We note that you define [earnings before income taxes, depreciation, and amortization] EBITDA as earnings before interest expense, income taxes, depreciation and amortization. However, based on your reconciliation of net earnings to EBITDA [on page X], we note that depreciation and amortization includes asset impairment charges. Given that these charges are excluded from your non-GAAP measure, in future filings you should revise the definition of your non-GAAP performance measure as well as use a more appropriate label, such as adjusted EBITDA. Please refer to Question 103.01 of The Security and Exchange Commission's Compliance and Disclosure Interpretations [regarding] Non-GAAP Measures.
- We note that you have presented an alternative income statement which excludes certain items recorded in your GAAP-basis Statement of Operations. This represents a full non-GAAP income statement which does not appear to be consistent with Regulation G. Please confirm [that] you will remove such presentation or tell us why you believe it is appropriate. For additional guidance, refer to Question 102.10 of the Compliance and Disclosure Interpretations regarding Non-GAAP Financial Measures.
- We note that you have identified "free cash flow" [and "adjusted net income"] as a non-GAAP measure in your earnings releases and in your earnings press conference call. As management has emphasized the importance of these non-GAAP measures to investors, please tell us why they are not presented in your most recent Form 10-K.

SEC Final Rule Release 33-8176 defines a non-GAAP financial measure as a "numerical measure of a registrant's historical or future financial performance, financial position, or cash flows" that includes amounts that are not part of the most directly comparable GAAP measure (e.g., free cash flows) or excludes amounts that are part of the most directly comparable GAAP measure (e.g., EBITDA). Examples of some common non-GAAP financial measures include EBITDA or adjusted EBITDA, adjusted revenues, free cash flows, core earnings, funds from operations, and measures presented on a constant-currency basis. The SEC staff's comments on non-GAAP financial measures primarily focus on the level of a company's disclosures and whether the disclosures demonstrate the purpose of the measures and their usefulness to investors. Regulation S-K, Item 10(e)(1)(i), states that the following information should accompany a company's disclosure of non-GAAP financial measures:

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

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

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

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

As discussed in the Core Disclosures, Including Disclosures About Risk section, the SEC staff is focused on consistency in communications with investors. The SEC staff may question inconsistencies between (1) the measures identified as key metrics on a registrant's Web site and in its press releases, earnings calls, and analyst presentations and (2) the metrics in the registrant's SEC filings. The staff may issue a comment letter if a registrant discusses non-GAAP financial measures in other communications to investors that are omitted from, or contradict, the information in the registrant's filings. At the 2009 AICPA Conference, Meredith B. Cross, director of the SEC's Division of Corporation Finance, noted that registrants may be omitting non-GAAP financial measures from their filings because of concerns about future staff comments. (For additional information, see Deloitte's *Heads Up* on the 2009 AICPA Conference.)

Partially to address those concerns, in January 2010, the SEC staff replaced the interpretive guidance issued in 2003 in "Frequently Asked Questions Regarding the Use of Non-GAAP Measures" (the "FAQs") with Compliance and Disclosure Interpretations (C&DIs) of non-GAAP financial measures. The rules on non-GAAP financial measures, however, were not amended. While registrants have frequently included non-GAAP financial measures in press releases, many have been reluctant to include these

same measures in filed documents because of restrictions in the now superseded FAQs. The new guidance provides registrants with more flexibility to disclose non-GAAP financial measures in filings with the SEC. The topics covered in the C&DIs include disclosure of non-GAAP financial measures in business combination transactions; interpretive issues related to the non-GAAP liquidity and performance measure prohibitions in Item 10 (including issues related to earnings before income taxes and EBITDA and segment performance measures); and compliance issues related to the release of quarterly and annual financial information under Item 2.02 of Form 8-K. For additional information, see Deloitte's January 20, 2010, *Heads Up* on the C&DIs.

The C&DIs address disclosure issues associated with non-GAAP financial measures including:

- Lack of explanations about the non-GAAP financial measure (e.g., disclosing the usefulness of the non-GAAP financial measure).
- Title of non-GAAP financial measures (e.g., titles should not be confusingly similar to those of GAAP financial measures).
- Reconciliation issues (e.g., presentation of a non-GAAP income statement is not appropriate).
- Per-share non-GAAP financial measures (e.g., presentation of non-GAAP per-share liquidity measures is prohibited).
- Measure of operating performance versus liquidity (e.g., disclosure indicates a liquidity measure but the registrant reconciled the non-GAAP measure to a performance measure such as net income).

Non-GAAP Financial Measures C&DI 102.03 clarifies the guidance in Regulation S-K, Item 10(e), which "prohibits adjusting a non-GAAP financial measure to eliminate or smooth items identified as non-recurring, infrequent or unusual when the nature of the charge or gain is such that it is reasonably likely to recur within two years or there was a similar charge or gain within the prior two years." A charge or gain may be included as an adjustment as long as it is not inappropriately labeled or described as nonrecurring, infrequent, or unusual.

At the September 2010 CAQ SEC Regulations Committee Meeting With the SEC Staff, the staff provided a summary of recent staff comments on non-GAAP financial measures. The staff noted "it is inappropriate to present a full non-GAAP income statement in an SEC filing." The staff also stated that "the prohibition on presenting non-GAAP financial measures with greater prominence than GAAP measures encompasses both the order of presentation and the degree of emphasis" and that a registrant may receive a comment if its discussion of non-GAAP financial measures is significantly longer than its discussion of the corresponding GAAP financial measures.

A registrant should not present non-GAAP measures that are misleading. Regulation G states that "neither the requirements of Regulation G nor a person's compliance or non-compliance with the requirements of Regulation G shall in itself affect any person's liability under Exchange Act Section 10(b) or Rule 10b-5 thereunder" (footnote omitted). However, the rules on non-GAAP measures indicate that, under certain circumstances, materially deficient disclosure under Regulation G may lead the SEC to take action under Rule 10b-5. The potential for liability in connection with the disclosure of non-GAAP financial information also was addressed in the SEC's December 2001 "Cautionary Advice Regarding the Use of "Pro Forma" Financial Information in Earnings Releases." In this document, the SEC states that the "antifraud provisions of the federal securities laws apply to a company issuing 'pro forma' financial information." In November 2009, the SEC filed an enforcement action against a registrant for providing misleading pro forma reporting of non-GAAP financial measures. This was the first enforcement action brought by the SEC under Regulation G. In the action, the SEC found that the registrant and certain senior officers "represented to investors that [the registrant's] non-GAAP earnings results excluded certain non-recurring expenses, when, in fact, [the registrant] had misclassified and excluded a significant amount of recurring, operating expenses from its non-GAAP earnings results, in order to meet or exceed quarterly EPS targets."

In addition to the C&DIs, SEC resources on non-GAAP measures include Regulation S-K, Item 10(e); Regulation G; and Topic 8 of the Financial Reporting Manual.

Other Deloitte Resources

- SEC Reporting Interpretations Manual, Non-GAAP Financial Measures (available on Technical Library: The Deloitte Accounting Research Tool).

Proxy Disclosure, Excluding Executive Compensation

Proxy Enhancement

Examples of SEC Comments

- *Compensation Policies and Practices* — We note your statement . . . that your compensation policies and practices for non-executive employees are not reasonably likely to have a material adverse effect on [your] financial results. We note that you have not included any disclosure as it relates to your executive compensation policies and practices in response to Item 402(s) of Regulation S-K. Please tell us the basis for your conclusion that disclosure is not necessary, and describe the process you undertook to reach that conclusion. Refer to Item 402(s) of Regulation S-K.
- *Director Qualifications* — We note that you have included a general discussion of the qualifications, expertise and attributes of your directors. Please note that Item 401 (e) of Regulation S-K requires disclosure of the specific "experience, qualifications, attributes or skills of directors and nominees on an individual basis." Please revise your disclosure to address the requirements of Item 401 (e) on an individual director basis. Your disclosure should address the specific experience, qualifications, attributes and skills of each director or nominee. A mere listing of each director or nominee's prior work experience is not sufficient. Please revise accordingly.
- *Board Diversity* — Please provide to us and undertake to include in your future filings, revision of this section as required by Item 407(c)(2)(vi) of Regulation S-K to include the following: the process for identifying nominees for director; the process for evaluating nominees for director; and "how the nominating committee (or the board) considers diversity in identifying nominees for director" (not just the fact that "diversity is considered").
- *Leadership Structure and Risk Oversight* — We note your disclosure related to the board's leadership structure and risk oversight in response to Item 407(h) of Regulation S-K. In future filings, please also discuss the effect that the board's role in the risk oversight of the company has on the board's leadership structure.

In December 2009, the SEC approved Final Rule Release 33-9089, which prescribes new requirements for proxy disclosures.[1] SEC Chairman Mary L. Schapiro stated that "by adopting these rules, we will improve the disclosure around risk, compensation, and corporate governance, thereby increasing accountability and directly benefiting investors." The new requirements were effective for registrants with fiscal years ending on or after December 20, 2009, who file their Form 10-Ks or definitive proxies on or after February 28, 2010.[2]

Compensation Policies and Practices

Regulation S-K, Item 402, was amended to require "a company to address its compensation policies and practices for all employees, including non-executive officers, if the compensation policies and practices create risks that are reasonably likely to have a material adverse effect on the company." The "reasonably likely" disclosure threshold should be similar to that a registrant uses in preparing MD&A to help focus the disclosure on items that are most relevant to investors and shareholders and risks that are material to the registrant.

The final rule lists examples of general scenarios and issues that may trigger the need for disclosure. Examples of such scenarios include compensation policies and practices at a business unit that:

- "[C]arries a significant portion of the company's risks profile."
- Has a significantly different compensation structure than other units in the company.
- Has a "compensation expense [that] is a significant percentage of the unit's revenues."
- Is significantly more profitable than other units.
- Varies "significantly from the overall risk and reward structure of the [registrant]."

[1] Note that on July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act into law. Although the majority of the Act focuses on the regulation of financial institutions, there are also sections that address executive compensation and corporate governance provisions, which apply to most U.S. publicly traded companies. The legislation may affect a registrant's corporate governance policies, including committee structures and the amount of influence that shareholders may have in director elections. Numerous provisions in the Act require rulemaking by the SEC.

[2] For specific transition guidance, see the Proxy Disclosure Enhancements Transition Compliance and Disclosure Interpretations, released on December 22, 2009, and updated on January 20, 2010, by the SEC's Division of Corporation Finance.

In addition, the final rule indicated that registrants should consider the following list of issues related to disclosures:

- The general design of compensation policies for employees whose behavior would be most affected by incentives, and the manner of their implementation.
- "[R]isk assessment or incentive considerations, if any, in structuring . . . compensation policies and . . . in awarding and paying compensation."
- How "compensation policies . . . relate to the realization of risks resulting from the actions of employees [over] both the short term and the long term."
- "[P]olicies regarding adjustments to [the registrant's] compensation policies and practices to address changes in its risk profile."
- Material adjustments made to compensation policies to address changes in risk profile, and policies regarding adjustments.
- "The extent to which the [registrant] monitors its compensation policies . . . to determine whether its risk management objectives [regarding incentives] are being met."

Registrants with incentive plans or compensation policies that are reasonably likely to create material adverse risk should consider providing the following disclosure in a new section of the proxy:

- The compensation philosophy for employees affected by these plans or policies.
- How the registrant factors such risk-taking into the design of the plans or policies.
- Any mitigation strategies, such as holdbacks or deferrals, that have been incorporated into the plans.
- Any material adjustments to the registrant's compensation policies that are made to address changes in the company's risk profile.
- "The extent to which the registrant monitors its compensation policies and practices to [ensure they remain within the] risk management objectives" of the registrant.

The SEC has made it clear that it will not accept a "generic statement" or "boilerplate language" about a registrant's need for incentive plans to attract or retain employees. Registrants should clearly identify their rationale for maintaining high-risk incentive plans.

Smaller reporting companies as defined in Regulation S-K, Item 10(f), are exempt from the requirements of Item 402(s).

Refer to the Executive Compensation section for further discussion of proxy rules and related SEC comments.

Director Qualifications

Regulation S-K, Item 401(e), was amended to enhance the information investors receive about the background and experience of directors and director nominees. The SEC felt that such additional and more specific disclosure would help investors make voting decisions about a registrant's board composition.

Specifically, registrants are required to annually "disclose for each director and any nominee for director the particular experience, qualifications, attributes, or skills that [lead the board to conclude that the person should] serve as a director of the company."

To allow registrants flexibility in determining the criteria or qualities that benefit them, the final rule does not specify what type of qualifications should be disclosed. In addition, the new disclosures apply to all the registrants' nominees and directors, including those individuals that are not up for reelection in a given year.

Disclosure about "any directorships at public companies and registered investment companies held by each director and nominee at any time" must now include all such positions held within the past five years (previously, only those positions currently held were required to be disclosed). Broadening the period covered is intended to provide investors with additional background on a director's or nominee's past board experience, including information about potential relationships resulting from past memberships on boards that could pose a potential conflict of interest (e.g., past membership on the board of a major customer).

In addition, the requirement extends the look-back period for disclosure of legal matters in which the director was involved from five to ten years and expands the list of legal proceedings that must be disclosed under Item 401(f).

Board Diversity

Regulation S-K, Item 407(c), was amended to require registrants to disclose "whether, and if so, how a nominating committee or the board considers diversity in connection with identifying and evaluating persons for consideration as nominees for a position on the board of directors." If a policy is in place regarding the board's consideration of diversity in selecting director nominees, the registrant should disclose how the policy is implemented and how its effectiveness is assessed by the committee.

There is no specified definition of diversity. Registrants may conceptualize and define diversity in different ways; some registrants may view diversity as work experience, education, or skills or attributes, whereas others may view diversity as cultural background, race, ethnicity, and gender.

Leadership Structure and Risk Oversight

A new disclosure requirement was added to Item 407, along with a corresponding amendment to Schedule 14A, Item 7. The new rule requires disclosure about the extent of the board's role in the registrant's risk oversight, the board's leadership structure, and the reasons why registrants believe that the structure is most appropriate. The disclosures are intended to improve investors' understanding of the board's role in the registrant's risk management practices and to allow investors to compare such practices.

There are no requirements governing how the risk oversight function is administered by the board. Accordingly, disclosure of how this is accomplished is key. For instance, the entire board may be involved in risk oversight or the function may be executed by a particular committee. In such cases, registrants may be required to disclose the individuals responsible for risk management and whether they report directly to the board. Registrants may also disclose whether and how the board or committee receives information from individuals in charge of the day-to-day risk management function and whether these individuals report to the board as a whole or to a committee of the board.

To increase the transparency of board functions, registrants are required to disclose whether and why they have chosen to combine the chief executive officer and the chairman role. Furthermore, registrants that have combined such roles should disclose whether and why a lead independent director has been designated and provide specific information on the roles and responsibilities of the position.

Related-Party Transactions

Examples of SEC Comments

- *Completeness* — We note your disclosure that you "purchase products and services from and/or sell products and services to companies of which certain of the directors and/or executive officers of [registrant] are directors and/or executive officers." In future filings, please provide the disclosure required by Item 404(a) with respect to all transactions since the beginning of your last fiscal year that exceeded $120,000 in which any person had or will have a direct or indirect material interest. Such transactions include those that you enter into with a company where a related person serves as an executive officer of such company.
- *Policies and Procedures* — Please expand your disclosure to describe your policies and procedures for review, approval, or ratification of related party transactions. We note your discussion . . . that your directors and officers fill out an annual questionnaire and are required to report related party transactions, but you do not describe how those questionnaires and/or reports are reviewed, approved or ratified or how you otherwise go about considering such transactions for approval. Refer to Item 404(b) of Regulation S-K.
- *Transactions Involving Indebtedness* — We note the disclosure that banking transactions with related persons were made on substantially the same terms as those prevailing at the time for comparable transactions with "non-affiliated persons." Please confirm, and revise future filings to disclose, if true, that any loans were made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable loans with persons not related to the lender. Refer to Instruction 4.c. to Item 404(a) of Regulation S-K.

Completeness

Regulation S-K, Item 404(a), requires disclosure of transactions that the registrant did or will participate in with related parties in which the amount involved exceeds $120,000 and the related party had or will have a direct or indirect material interest. ASC 850, however, does not establish a quantitative threshold but rather requires disclosure in the financial statements when the information "would make a difference in decision making." In addition, Regulation S-X, Rule 4-08(k), requires disclosure in the financial statements of related-party transactions that affect the financial statements and, when material, separate presentation of amounts on the face of the balance sheet, income statement, or statement of cash flows.

The SEC staff frequently comments on the completeness of a registrant's related-party disclosures in proxy statements. Registrants have been asked to provide additional disclosure to address all of the following requirements of Item 404(a):

- The name of the related party and the basis on which the person or entity is a related party.
- The related party's interest in the transaction with the registrant, including the related party's position(s) or relationship(s) with, or ownership in the entity that is a party to, or has an interest in, the transaction.
- The approximate dollar value of the amount involved in the transaction.
- The approximate dollar value of the amount of the related party's interest in the transaction, which is computed without regard to the amount of profit or loss.
- Any other information regarding the transaction that is material to investors.

Registrants should consider consulting with legal counsel and the guidance in the Instructions to Item 404(a) to better understand the definition of a "related person" and the types of transactions that need to be considered for disclosure.

Policies and Procedures

In certain of their comments, the SEC staff has requested additional disclosure about the review, approval, or ratification of transactions with related persons as required by Regulation S-K, Item 404(b). Registrants often disclose the existence of such policies and procedures but fail to disclose their material features and the persons or group of persons responsible for monitoring them.

Transactions Involving Indebtedness

The SEC staff has also asked registrants to improve the disclosure required in the case of related-party transactions involving indebtedness, including information on both principal and interest due and outstanding and the amount of principal and interest paid during the period for which the disclosure is provided.

For related-party transactions with a bank or savings and loan association in which the loans are not disclosed as troubled (i.e., on nonaccrual status, past due, restructured, or having potential problems), disclosure may consist of a statement that the loans:

- Were made in the ordinary course of business.
- Were made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable loans with entities not related to the lender.
- Did not involve more than the normal risk of collectability or present other unfavorable features.

Other Deloitte Resources

- August 2010, Center of Corporate Governance's Hot Topics, Special Edition, "Dodd-Frank Wall Street Reform and Consumer Protection Act — Abstracts and Observations."
- February 2010, Center of Corporate Governance's Hot Topics, "Considerations for Navigating the SEC's New Proxy Disclosure Rules."
- January 2010, Center of Corporate Governance's Hot Topics, "SEC's New Rules Raise the Bar on Proxy Disclosure in 2010."
- August 12, 2010, *Heads Up*, "The Final Act: Financial Reporting Implications of the Dodd-Frank Wall Street Reform and Consumer Protection Act."

Executive Compensation

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

Compensation Discussion and Analysis

Example of an SEC Comment

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

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

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

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

Performance Targets

Example of an SEC Comment

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

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

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

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

Benchmarking

Example of an SEC Comment

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

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

2010 Update

Regulatory Update

In December 2009, the SEC issued Final Rule 33-9089 on proxy disclosure enhancements. The new requirements, which include incremental proxy disclosures, new disclosures for executive compensation, and changes to the proxy solicitation process, became effective for issuers with fiscal years that ended on or after December 20, 2009, that filed their Forms 10-K or definitive proxies on or after February 28, 2010. In January 2010, the SEC issued Final Rule 34-61335 on say-on-pay for Troubled Asset Relief Program (TARP) recipients. The final rule requires each TARP recipient to have an annual nonbinding shareholder vote on executive compensation as long as it has TARP loans outstanding.

In July 2010, the SEC voted to issue a concept release to obtain public comment on issues related to the mechanics of communications and voting under the proxy rules (often referred to as "proxy plumbing"). The SEC sought input on three general topics: (1) the accuracy, transparency, and efficiency of the proxy voting system; (2) communications with shareholders and shareholder voting; and (3) the relationship between voting power and economic interest. Comments were due on October 20, 2010. Because this was a concept release, any regulatory changes the SEC determines to make as a result of this effort will have to be separately released for notice and comment.

In August 2010, the SEC voted to issue Final Rule 33-9136 to allow shareholders to include director nominees on the company's proxy statement in certain circumstances (often referred to as "proxy access"). The rule was to become effective 60 days after its publication in the Federal Register, and therefore companies that mailed their 2010 proxy materials on or after March 15, 2010, were expected to have been subject to it for the upcoming proxy season. However, on October 2, 2010, the SEC announced it would delay the effective date of the new rule to await resolution of a legal challenge filed by the U.S. Chamber of Commerce and the Business Roundtable on September 29, 2010.

In October 2010, the SEC released a proposed rule for public companies subject to the federal proxy rules that would require that shareholders be provided with advisory votes on executive compensation and "golden parachute" arrangements. A second proposed rule would also require that institutional investment managers report their votes on executive compensation at least annually. The SEC issued the proposed rules in a response to a requirement under the Dodd-Frank Wall Street Reform and Consumer Protection Act.

See the Proxy Disclosure, Excluding Executive Compensation section for further discussion of proxy rules and related SEC comments.

Compensation Consultants

Example of an SEC Comment

- We note your statement . . . that your Compensation Committee's executive compensation consulting firm "provides services only as directed by the Committee." However, your disclosure does not address the nature or scope of the assignment or the instructions given to the consulting firm. See Item 407(e)(3)(iii) of Regulation S-K. Please provide this information in future filings, as applicable. Also, please provide us with draft disclosure based on last year's proxy.

Because it has become more common for registrants to use compensation consultants, the SEC staff has commented on the adequacy of related disclosure required by Regulation S-K, Item 407(e)(3)(iii).

The SEC staff's comments have focused on eliciting from registrants more detailed, company-specific disclosure, particularly:

- The precise nature and scope of what the compensation consultations were hired to do.
- The material components of the instructions and directions given to the consultants as they performed their assignment.

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

This disclosure should enable an investor to better understand the corporate governance structure of the compensation committee as well as the involvement of, and interaction with, compensation consultants.

Other Deloitte Resources

- September 2010, Center of Corporate Governance's Hot Topics, "Proxy Access — Coming Soon to a Public Company Near You."
- February 2010, Center of Corporate Governance's Hot Topics, "Considerations for Navigating the SEC's New Proxy Disclosure Rules."
- January 2010, Center of Corporate Governance's Hot Topics, "SEC's New Rules Raise the Bar on Proxy Disclosure in 2010."
- July 2009, Center of Corporate Governance's Hot Topics, "The Pace of Corporate Governance Reform Heats Up."
- Financial Reporting Alert 08-6, "Recent Tax Ruling Requires Entities to Reconsider Their Tax Positions Related to Executive Compensation."
- October 14, 2008, *Heads Up*, "Considerations Regarding the Emergency Economic Stabilization Act of 2008."
- October 16, 2007, *Heads Up*, "SEC Feedback on Executive Compensation Disclosures: 'Where's the Analysis?'"
- September 7, 2007, *Heads Up*, "SEC Staff Issues Comment Letters on Executive Compensation Disclosures."

Disclosure Controls and Procedures

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

Inappropriate Conclusion About Disclosure Controls and Procedures

Example of an SEC Comment

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

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

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

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

Incomplete Definition of Disclosure Controls and Procedures

Example of an SEC Comment

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

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

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

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

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

Example of an SEC Comment

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

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

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

Example of an SEC Comment

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

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

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

Example of an SEC Comment

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

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

Internal Control Over Financial Reporting

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

Disclosure of Attestation Report of the Registered Public Accounting Firm

Example of an SEC Comment

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

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

Disclosure of Significant Changes in Internal Control Over Financial Reporting

Example of an SEC Comment

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

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

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

Example of an SEC Comment

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

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

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

Disclosures of the Impact and the Remediation of Material Weaknesses

Examples of SEC Comments

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

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

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

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

2010 Update

Several speakers at the 2009 AICPA Conference also addressed various ICFR considerations, including trends in reported material weaknesses, evaluating the design and operation of controls, and the inclusion of consolidated VIEs in management's report on ICFR. Steven C. Jacobs, associate chief accountant in the SEC's Division of Corporation Finance, discussed required disclosures about material changes in ICFR and reminded the audience that the remediation of a material weakness is a material change in ICFR that the SEC staff would expect to be disclosed. He also indicated that if a registrant changes its conclusion from ineffective to effective without ever disclosing a change in its ICFR, the SEC staff would most likely comment on the registrant's lack of disclosures in the quarterly filings as well as its conclusion about the effectiveness of ICFR. He also noted that if the registrant cannot identify specific changes made to its ICFR, the SEC staff may challenge its conclusion that the material weakness was, in fact, remediated.

See Deloitte's *Heads Up* on the 2009 AICPA Conference for additional information on these topics, and see the Consolidations and Variable Interest Entities section for additional discussion of VIEs and management's report on ICFR.

Auditor Attestation Reports Related to Nonaccelerated Filers

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). Among its numerous provisions, the Dodd-Frank Act permanently exempts nonaccelerated filers from Section 404(b) of the Sarbanes Oxley Act of 2002.

On September 15, 2010, the SEC issued Final Rule 33-9142, which states that under Section 404(c) of the Sarbanes-Oxley Act, Section 404(b) does not apply to "any audit report prepared for an issuer that is neither an accelerated filer nor a large accelerated filer as defined in Rule 12b-2 under the Securities Exchange Act of 1934."

The final rule also made conforming changes that:

- Limit the applicability of management's annual-report disclosure about including an attestation report to situations in which management includes an attestation report.
- Amend Regulation S-X, Rule 2-02, to clarify that audit reports of nonaccelerated filers are not required to include an evaluation of the issuer's ICFR.

Accordingly, nonaccelerated filers are exempt from the requirement to obtain an external audit on the effectiveness of ICFR; however, management's assessment of and report on ICFR under Section 404(a) of the Sarbanes-Oxley Act continue to be required for all issuers, including smaller public entities.

In October 2010, the SEC issued a request for comment related to a study on how the Commission could reduce the burden of complying with Section 404(b) of the Sarbanes-Oxley Act for companies with a public float between $75 and $250 million, while maintaining investor protection. The study is required by the Dodd-Frank Act and must be submitted to Congress no later than nine months after its enactment date. Comments are due to the SEC on December 6, 2010.

Domestic Companies With a Majority of Operations Outside the United States

The SEC staff is interested in understanding the credentials of the individuals preparing the U.S. GAAP financial statements for domestic registrants with a substantial amount of their operations in foreign countries. At the June 2010 CAQ SEC Regulations Committee Joint Meeting With the SEC Staff, the staff indicated that it may begin to inquire about the experience of these individuals and their knowledge of U.S. GAAP. The SEC staff further stated that the "objective of the questions is to evaluate management's assertion that it has effective internal control over financial reporting."

Incomplete Definition of ICFR

Example of an SEC Comment

- We note your description of the definition of internal control over financial reporting. . . . This description appears to be based on the definition of internal control over financial reporting set forth in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. As described, however, the description does not fully conform to the definition set forth in those rules. . . . Please confirm that your [management's conclusion regarding effectiveness is based on the full definition of internal control over financial reporting set forth in the applicable rules] and revise accordingly in future filings. Alternatively, you may simply state in future filings that your management concluded on the applicable dates that your internal control over financial reporting was effective[in accordance with Rules 13a-15(f) and 15d-15(f) of the Exchange Act].

As similar comments in the Disclosure Controls and Procedures section indicate, the SEC staff has remarked when a registrant has included an incomplete definition of ICFR in management's assessment. Registrants are not required to define ICFR in their conclusion. However, if they choose to define the term, they must include the entire definition from Regulation S-K, Rules 13a-15(f) and 15d-15(f).

Certifications

Example of an SEC Comment

- Please file the certifications exactly as set forth in Item 601(b)(31)(i) of Regulation S-K and refrain from: (i) replacing the word "registrant" with "Corporation" throughout the certification, (ii) omitting "(the registrant's fourth fiscal quarter in the case of an annual report") in paragraph 4(d), (iii) omitting "(or persons performing the equivalent functions)" in paragraph 5 and (iv) replacing the word "control" with "controls" in paragraph 5(b).

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

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

In addition to the guidance in C&DI 246.14, the SEC staff has also routinely commented on registrants' certifications when they have not appeared "exactly as set forth in Regulation S-K, Item 601(b)(31)" and has often noted that a registrant's inclusion of a certifying officer's title constitutes an inappropriate modification.

Use of Experts and Consents

Example of an SEC Comment

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

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

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

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

Periodic Reports

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

Registration Statements

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

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

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

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

Question 233.02 also gives the following example:

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

2010 Update

Certain issuers of asset-backed securities[2] ("asset-backed issuers") are required to include in registration statements the minimum credit rating that must be assigned to the securities being issued and the identity of each credit rating agency. Before July 21, 2010, the Securities Act of 1933 exempted such disclosures from requiring the credit rating agency to be named as an expert and the registrant to obtain their consent. However, on July 21, 2010, President Obama signed the Dodd-Frank Act, which eliminated this exemption. Therefore, as of that date, an issuer that included a credit rating and the issuing credit rating agency in a registration statement would have been subject to the requirement to obtain a consent from the credit rating agency.

However, since asset-backed issuers may have had difficulty complying with the Act's requirement to obtain credit rating agency consents and thus issuing securities, on July 22, 2010, the SEC staff issued a "no action" letter allowing asset-backed issuers to omit, until January 24, 2011, credit ratings from registration statements filed with the SEC.

In addition, on July 27, 2010, the SEC's Division of Corporation Finance issued C&DIs of the Securities Act rules[3] on the use of credit ratings. The C&DIs provide interpretive guidance on when a registrant would be required to name a credit rating agency as an expert and obtain its consent in conjunction with the use of credit rating information in a registration statement. For example, C&DI 233.04 indicates that "some [nonasset-backed] issuers note their ratings in the context of a risk factor discussion regarding the risk of failure to maintain a certain rating and the potential impact a change in credit rating would have on the registrant." In that case, and in disclosing other "issuer disclosure-related ratings information" (e.g., changes to a credit rating, the liquidity of the registrant, the cost of funds for a registrant, or the terms of agreements that refer to credit ratings), the nonasset-backed registrant would not be required to obtain a consent from the credit rating agency.

The C&DIs addressing consents from credit rating agencies were discussed at the September 2010 CAQ SEC Regulations Committee Joint Meeting With the SEC Staff. The SEC staff encouraged registrants (1) to consult with their legal counsel in determining whether a reference to a credit rating agency in a registration statement, or in a periodic filing that will be incorporated into a registration statement, will trigger the requirement to obtain a consent and (2) to consult the Division's Office of Chief Counsel as necessary.

Other Deloitte Resources

- August 12, 2010, *Heads Up*, "Financial Reporting Implications of the Dodd-Frank Wall Street Reform and Consumer Protection Act."

[2] As defined in Regulation AB, Item 1101.

[3] C&DIs 198.08, 233.04, 233.05, 233.06, 233.07, and 233.08.

Material Contracts

Examples of SEC Comments

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

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

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

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

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

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

2010 Update

Examples of SEC Comments

- We note that for the [current] year ended, revenue from [Company A] and . . . subsidiaries accounted for $[X] million and that revenues from [Company B] and . . . subsidiaries were $[X] million, or approximately [over 50%] and [over 15%] of total revenues, respectively. Please tell us whether you are substantially dependent upon any agreements with [A or B] or any of their subsidiaries for purposes of Item 601(b)(10)(ii)(B) of Regulation S-K. In addition, please specifically advise whether 10% or more of your revenues is generated under any one or more of these agreements.
- We note your disclosure on page [X] . . . that [over 60%] of [your] revenues were from your top ten [customers]. To the extent that you were substantially dependent on any of these . . . , please identify them, describe the material terms of any agreements with them and file the agreements as exhibits. If you do not believe you were substantially dependent on any of these parties, tell us the basis for your belief.

The SEC staff continues to focus on compliance with Regulation S-K, Item 601(b)(10), as reflected in the comments above. Registrants were asked either (1) to file the material agreements in their entirety as exhibits to Form 10-K or separately on a Form 8-K or (2) to provide reasons why they believed the agreements did not need to be filed. In addition, the staff often asks registrants to explicitly identify and disclose material terms of material agreements in the filings.

When a registrant's operating results appear to substantially depend on material contracts or on a few customers, particularly on customers from which 10 percent or more of the registrant's revenues are derived, the SEC staff often requests identification of these customers. In addition, registrants are often requested to provide an analysis of their decision not to file the related contracts as exhibits under Rule 601(b)(10)(ii)B; that is, registrants are asked to support their conclusion that they were not materially dependent on the contract(s) or customer(s).

Disclosures Regarding State Sponsors of Terrorism

Examples of SEC Comments

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

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

Interactive Data — eXtensible Business Reporting Language (XBRL)

In January 2009, the SEC issued Final Rule Release 33-9002, which requires most registrants to provide XBRL-tagged financial reports and schedules (an "interactive data file") as an exhibit to certain periodic filings, registration statements, and transition reports that contain financial statements. The requirement is phased in over three years; registrants in the first phase-in group first provided interactive data files for periods ended on or after June 15, 2009. For filings that included financial statements for periods ending on or after June 15, 2010, registrants in the first phase-in group were required to submit interactive data files with detailed tagging applied to all amounts in the notes to the financial statements and financial statement schedules (as well as block tagging applied to each table included in the notes and to each significant accounting policy). All other large accelerated filers in the second phase-in group were required to submit interactive data files with filings that included financial statements for periods ending on or after June 15, 2010; however, such registrants will not be required to submit interactive data files with detailed tagging until those filings include financial statements for a period ending on or after June 15, 2011. Most other registrants that follow U.S. GAAP, or foreign private issuers that prepare financial statements in accordance with IFRSs as issued by the IASB, will first be required to submit an interactive data file with those filings that that contain financial statements for a period that ends on or after June 15, 2011.

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

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

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

Registrants also should become familiar with informational and interpretive materials provided by the SEC staff and ensure that they stay abreast of current developments. Most of these materials are available in the Interactive Data section of the SEC's Web site and include C&DIs of the interactive data rules issued by the staff of the SEC's Division of Corporation Finance, Interpretations and FAQs on XBRL issued by the SEC's Office of Interactive Disclosure, and the EDGAR Filer Manual. This information is updated periodically. In addition, (1) on October 6, 2009, the staff of the SEC's Office of Interactive Disclosure issued a summary of observations based on its review of certain interactive data files that were submitted by registrants in the first phase-in group (see Deloitte's December 4, 2009, *Heads Up* on lessons learned from the review of initial submissions of XBRL) files; and (2) on November 1, 2010, staff from the SEC's Division of Risk, Strategy, and Financial Innovation completed a review of interactive data file submissions from June to August 2010 that included the first group of detailed tagged submissions and initial filings from registrants in the second phase-in group and posted additional observations. Although these interpretations and observations are not rules, regulations, or statements of the SEC, registrants are encouraged to consider this guidance when preparing future submissions.

In 2010, a number of registrants amended their Form 10-Q and Form 10-K filings to provide corrected interactive data files or to provide interactive data files that were omitted from the initial filings. Under the SEC's rules, such entities were deemed not to be timely filers (and consequently lost eligibility to access the markets using short Forms S-3, F-3, or S-8) until they furnished the required interactive data. Registrants must allow sufficient time in their financial reporting process for timely preparation and review of their interactive data file submissions. Adequate review is critical, even when registrants retain a third party to produce their interactive data files. Also, registrants should not underestimate the additional effort required to prepare and submit accurate interactive data filings with detailed tagging.

The SEC staff also has clarified that registrants need to reassess their phase-in group annually to determine whether they may be required to change groups at their year-end and to plan accordingly. According to minutes from the April 2010 CAQ SEC Regulations Committee Meeting With the SEC Staff:

> The SEC staff stressed that a company must follow the specific rule text in assessing its XBRL compliance requirements and not the general commentary in the SEC's adopting release. The SEC staff stated that an increase in a company's public float could require a registrant to accelerate its XBRL implementation, i.e., require that it join an earlier XBRL phase-in group. . . . The SEC staff stressed that worldwide public float must be measured annually, and such measurement determines the XBRL

phase-in group to which the company belongs. This annual determination supersedes any previous conclusions and affects the company's periodic reporting prospectively. . . . [The SEC staff] stated that when an increase in worldwide public float causes a company to join an earlier phase-in group, a company must begin detail tagging in the same SEC filing as if it had always been part of that phase-in group. [The staff] acknowledged that in some cases, a registrant could be required to detail tag its initial XBRL filing.

Other Deloitte Resources

- XBRL/Interactive Data File Submissions — Frequently Asked Questions.
- eXtensible Business Reporting Language — Moving to a Global Standard for Electronic Business Reporting.
- February 6, 2009, *Heads Up*, "SEC Publishes Final Rule Mandating Use of 'Interactive Data.'"
- Top Nine Interactive Data File (XBRL) Filing and Tagging Errors.

SEC Reporting

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

Significant Business Acquisitions (Rule 3-05)

Example of an SEC Comment

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

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

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

Registrants may file inappropriate financial statements because they:

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

SEC Reporting Considerations Related to the Adoption of ASC 805 and ASC 810-10-65-1

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

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

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

Example of an SEC Comment

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

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

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

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

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

Guarantors of Registered Securities (Rule 3-10)

Example of an SEC Comment

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

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

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

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

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

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

Regulation S-X, Rule 3-16, requires a registrant to file full audited financial statements for each of the registrant's affiliates whose securities constitute a "substantial portion of the collateral" for any class of securities registered or being registered. The registrant must provide these financial statements in its Forms 10-K and certain registration statements. Registrants often look at the tests under Rules 3-10 and 3-16 as one test or related tests, but should be aware that these tests are separate and distinct and must

be assessed individually. Rule 3-16 includes its own specific tests and "bright-line" requirements. Unlike Rule 3-10, Rule 3-16 does not allow for condensed consolidating financial information in lieu of full financial statements. Therefore, Rule 3-16 requires full audited financial statements of each affiliate whose securities constitute a substantial portion of the collateral of a security.

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

Pro Forma Financial Information (Article 11)

Example of an SEC Comment

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

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

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

SEC Reporting Considerations for Material Changes That Require Retrospective Application

Example of an SEC Comment

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

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

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

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

2010 Update

On April 9, 2010, the CAQ SEC Regulations Committee issued an Alert that outlines the staff's views on certain practice issues related to ASU 2009-17, including reporting considerations under Regulation S-X, Rules 3-05 and 3-14, as well as Form 8-K. See the Consolidations and Variable Interest Entities section for additional information.

Guarantors of Registered Securities (Rule 3-10)

Example of an SEC Comment

- Please revise your future filings to classify intercompany loan activity as financing cash flows in the condensed consolidating Statements of Cash Flows.

If registrants meet certain criteria, Rule 3-10 allows them to disclose in an audited footnote condensed consolidating financial information in a columnar format, including certain or all of the following, as applicable: the parent, subsidiary issuer(s) of the security, subsidiary guarantor(s), nonguarantor subsidiaries, and consolidating adjustments. When condensed consolidating financial information is provided, each column should be prepared in accordance with GAAP. In addition, Rule 3-10(i)(1) states that the financial information should be presented in "sufficient detail to allow investors to determine the assets, results of operations, and cash flows of each of the consolidating groups." The SEC staff will issue comments if it does not believe that the condensed consolidating information has been appropriately prepared and presented. In particular, the SEC staff has identified issues in the statement of cash flows related to the appropriate classification of intercompany amounts as operating, investing, or financing activities.

Other Deloitte Resources

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

Industry-Specific Topics

Consumer and Industrial Products

Retail

The SEC staff's comments to registrants from the retail industry have focused on topics such as revenue recognition, segment reporting, income statement classification (including discontinued operations) and presentation, and inventory valuation. In addition, in comment letters the staff has addressed the allocation of goodwill to individual stores and consideration of goodwill impairment for closed stores. Registrants in the retail industry commonly receive comments on impairments and income taxes. See the Long-Lived Assets, Including Goodwill; Impairments of Long-Lived Assets, Including Goodwill; and Income Taxes and Uncertain Tax Positions sections for additional information about such comments.

Revenue Recognition

Gift Cards

Examples of SEC Comments

- Please tell us the method you use to determine the estimated amount of gift card breakage and whether breakage is recognized over a period of time, and the time period, or at the end of a specified period, and the number of years in the period. In addition, tell us whether your gift cards have an expiration date and whether you are subject to state escheatment laws. Finally, since breakage represents an adjustment of sales prices or another source of operating income, tell us your rationale for classifying breakage as a reduction of operating, general and administrative expenses.
- We note your disclosure that unused gift card balances are recognized into income when the likelihood of redemption is determined to be remote and there is no requirement for remitting balances to government agencies under unclaimed property laws. Please tell us and revise to disclose the period of inactivity that occurs prior to recognition.

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

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

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

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

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

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

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

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

Segment Reporting

Example of an SEC Comment

- According to your . . . Annual Report, there are approximately [X] regional vice-presidents who manage clusters of stores on a geographical basis with responsibilities that apparently include assessing operating performance and identification of operational and capital expenditure requirements with respect to the stores in their region. . . . In this regard, please revise your disclosure to identify each region as a separate operating segment as defined by [ASC 280-10-50], or explain to us why you do not believe the regions meet the qualifications of operating segments.

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

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

Income Statement Classification and Presentation (Including Discontinued Operations)

Examples of SEC Comments

- We note that revenue received from shipping and handling fees is reflected in net sales. Please tell us and revise future filings to also disclose your policy relating to shipping and handling costs. Refer to [ASC 605-45-50-2].
- Please disclose your revenue recognition policy for sales of online advertising services. Please also clarify whether your policy disclosure with respect to product sales and shipping revenues is applicable to both your online and offline sales channels, and to both drop-ship and stock-and-ship orders.
- Please disclose the number of closed stores whose historical results continue to be classified within continuing operations. For each closed store included in continuing operations, explain to us in detail and disclose why such classification is appropriate under GAAP. Please also address this comment as it relates to your interim filing on Form 10-Q . . . as we are particularly interested in understanding why the results of operations of the retail segment reported in continuing operations remain so significant given that you closed all remaining retail store locations during the first nine months of fiscal year. . . . Refer to [ASC 205] and [ASC 205-20- 55], as applicable.

The SEC staff's comments on income statement presentation often address how the presentation complies with the technical requirements of Regulation S-X, Rule 5-03, which lists the captions and details that commercial and industrial registrants must present in their income statements. See the Financial Statement Classification section for additional information about comments on (1) the separate presentation of items in the income statement, (2) the cost-of-sales line item, (3) discontinued operations, and (4) what constitutes operating income versus nonoperating income.

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

In addition, the SEC staff has focused on the reporting of the operating results for closed stores as discontinued operations. The closure of a retail store would not necessarily result in the historical operations being classified in discontinued operations from the date of the store closure. In accordance with ASC 205-20, the elimination of a component of an entity in a disposal transaction requires the entity to analyze whether reporting discontinued operations for the component disposed of is necessary. As part of the assessment under ASC 205-20-45-1 and ASC 205-20-55, entities must determine whether the operations and direct cash flows from the closed store have been eliminated from the entity's ongoing operations and cash flows. In this determination, registrants should consider the migration of customers and cash flows to other open and operating stores. For more information, see the Discontinued Operations, Assets Held for Sale, and Restructuring Charges section.

Inventory Valuation

Examples of SEC Comments

- Please state your accounting policy for identifying and recording inventory shrinkage. If there are sensitivity aspects to this area which require management's judgment, please consider adding a description of this policy to your critical accounting policies section within MD&A.
- We note your estimates inherent in the retail method calculation of inventories can significantly impact your ending inventory valuation at cost and resulting gross profit. In future filings please expand your discussion to indicate how your estimates are arrived and how accurate the estimates have been in the past. Include for example how often you take physical inventory counts, and triggers for markdowns. Refer to our Release 33-8350.
- Please tell us what the inventory reserves represent. A reduction in the carrying amount of an inventory item from cost to market value represents a new cost basis for that item. The write-down can be recovered only through sale or disposition of the item and cannot be restored if the market value recovers prior to sale or disposition. Thus, it is unclear what your inventory reserves relate to and why you have utilized a contra-asset account to capture the credit balance. Please explain in detail.

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

The SEC staff has commented on the reasonableness of estimates related to inventory and registrants' disclosures about these estimates (e.g., shrinkage). In addition, SEC Interpretation Release 33-8350 states that when "the nature of the estimates or assumptions is material due to the levels of subjectivity and judgment necessary to account for highly uncertain matters or the susceptibility of such matters to change; and the impact of the estimates and assumptions on financial condition or operating performance is material," these estimates should be disclosed within MD&A. The disclosures should provide additional information about the variability and quality of the estimates, and companies "should provide quantitative as well as qualitative disclosure when quantitative information is reasonably available and will provide material information for investors."

The SEC staff has also commented on the use of a contra-asset account for inventory reserves. In accordance with ASC 330-10-35-14, if inventory is written down below cost as a result of certain considerations, including lower of cost of market or excess and obsolescence conditions, a new carrying amount and basis is established for the inventory. In addition, the write-down can be recovered only through sale or disposition of the item and cannot be restored if the market value recovers before sale or disposition.

Goodwill Impairment Considerations

There are specific considerations for registrants assessing the impairment of goodwill at the store level. For additional information, see the Long-Lived Assets, Including Goodwill and Impairments of Long-Lived Assets, Including Goodwill sections.

Example of an SEC Comment

- [I]t appears to us that each of your individual stores represent [a business as defined] in the glossary of ASC 810-10-20. We base this on: (1) you generate revenues from customers directly through your stores; (2) each store consists of inputs . . . and processes applied to those inputs . . . that have the ability to create outputs; (3) it does not appear that the operation of an individual store is dependent upon the operation of one or more of your other stores. Moreover, we believe that consideration of factors related to separation of the stores appears to be relevant only in the context of exchange, transfer or business combination transactions. . . . Therefore, upon closing a store you effectively disposed of a business, and we believe a portion of goodwill should be allocated to the stores closed. Please advise.

ASC 810-10-20 significantly changed the definition of a business. Before the changes, all of the inputs and processes necessary to conduct normal operations needed to be present for a set of activities and assets to be considered a business. Under the new definition, a business need not include all the inputs and processes if market participants are capable of integrating the business with their own inputs and processes. Entities need to carefully consider the new definition and the implications for goodwill allocation if a closed store is considered a business.

Energy and Resources

Oil and Gas

The SEC staff's comments to registrants from the oil and gas industry have focused on new reporting requirements, proved undeveloped (PUD) reserves, proved reserves impairment testing, significant changes in reserves and standardized measures, unproved property costs, environmental risks and liabilities, and nonmonetary exchanges of oil and gas properties.

New Oil and Gas Reporting Requirements

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

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

On January 6, 2010, the FASB issued ASU 2010-03, which aligns the current reserve estimation and disclosure requirements of ASC 932 with the requirements in the SEC's final rule. Under the ASU, an entity must consider equity method investments when determining whether it has significant oil- and gas-producing activities and must disclose consolidated and equity method investments separately and in the same level of detail. The ASU is effective for annual reporting periods ending on or after December 31, 2009.

Technology

Examples of SEC Comments

- Based on your disclosures in the table of changes in proved reserves . . . , it appears you have experienced material additions to your proved reserves during [the current] fiscal year. . . . In this regard, please expand your discussions in this section to address the specific technologies used to establish the appropriate level of certainty for your material additions to your reserve estimates. Please refer to Item 1202(a)(6) of Regulation S-K for further guidance.
- You state that you recognized additional [PUD] reserves totaling [X] thousand barrels of oil and [Y] million cubic feet of natural gas resulting from the application of reliable technologies in determining proved reserves. However, you do not indicate what those technologies were or why they are reliable. Please expand your disclosure to include in more detail the actual technologies utilized and why you believe they are reliable in the geological environment they were applied. In addition, disclose if you used any alternative methods and technologies instead of production flow tests in determining material amounts of proved reserves that you added in [the current fiscal year] and why those methods or technologies are considered reliable in the geological environment they were used. Please tell us how many of your proved reserves were determined by these alternative methods and technologies.

The SEC staff has commented on registrants' disclosures provided to comply with the new oil and gas requirements and asked them to explain how they have applied the new definition of "proved reserves" and used new technologies to classify reserves as proved. Specifically, the SEC staff has asked registrants to:

- Describe the technologies used to establish the appropriate level of certainty for reserves estimates from material properties, including the methods and specific technologies used to establish reasonable certainty of economic producibility of the incremental PUD reserves.
- Supplementally provide (1) the type curve used to forecast the proved reserves for each field, (2) the indicated estimated ultimate recovery based on that type curve and how each type curve was derived, and (3) the decline factors for each curve, including explanations of how they were derived.

- Identify any alternative methods and technologies used to determine material amounts of proved reserves added and why those methods or technologies are considered reliable in the geological environment they were used.

Reserve Reports

Examples of SEC Comments

- We note the two reports from [reserve engineers] included in Exhibit [X], consisting of a letter . . . regarding proved reserves and a letter . . . regarding probable and possible reserves. Each of these letters includes the following language, which could be interpreted to limit reliance by investors: "This letter was prepared for the exclusive use of [the Registrant]. Third parties should not rely on it without the written consent of the above and [reserve engineers]." As Item 1202(a)(8) of Regulation S-K requires these reports, please obtain and file a revised version of each such report which retains no language that could suggest either a limited audience or a limit on potential investor reliance.
- We note that the Board of Directors has established an independent committee to oversee the process of selection and engagement of the independent engineering firm. Please tell us whether the engineering firm reports directly to the committee or to an individual. Also, clarify what other role, if any, the committee has in accepting the reserves estimate prepared by the engineering firm. Finally, for each member of the committee, as well as any individuals to whom the firm reports at the company, provide the disclosure of qualifications required by Item 1202(a)(7) of Regulation S-K that form the basis for your statement that they "have experience in energy company reserve evaluations."

The SEC staff has asked registrants to obtain a modified report issued by the reserve engineer that removes any qualifying language that could suggest either a limited audience or a limit on potential investor reliance and file this revised report. The SEC staff has requested that a registrant amend its Form 10-K to provide such revisions.

The SEC staff has also asked registrants to clarify their disclosures related to the persons preparing the reserves estimates or conducting the reserves audit in accordance with Regulation S-K, Item 1202. Specifically, the SEC staff has asked registrants to:

- Provide the disclosure of qualifications required by Regulation S-K, Item 1202(a)(7).
- Identify whether the reserve engineering team or another individual is responsible for the selection of the third-party engineering firms that calculate reserves.
- Disclose the nature and years of experience in oil and gas reserve estimation of the primary technical person overseeing the reserve reporting process.

Well and Acreage Data

Example of an SEC Comment

- [Your response] indicates that you have significant undeveloped acreage expiry over the next three years. Please disclose these figures as prescribed by Item 1208(b) of Regulation S-K.

The SEC staff has also focused on registrants' disclosure of well and acreage data in accordance with Regulation S-K, Items 1205 and 1206. The SEC staff has asked registrants to amend filings to disclose:

- Significant undeveloped acreage expiry over the next three years.
- The minimum remaining terms of leases and concessions for material acreage concentrations.
- The total gross and net productive wells expressed separately for oil and gas by geographic area.
- The number of wells that the entity operates.
- Drilling activities by geographic areas as required by Regulation S-K, Item 1205(a).
- New field discoveries or new reservoir discoveries, their locations, and the volumes of oil and gas these wells produced.

PUD Reserves

Examples of SEC Comments

- Your [current fiscal year] PUD reserve conversion rate . . . implies a much longer period for full PUD development than 5 years. Please explain the circumstances causing this outcome and disclose your PUD conversion information for each of the last three years.
- Because your prior year's conversion rate of [PUD] to proved developed reserves was much lower than that necessary to convert all of your [PUD] reserves to proved developed reserves within five years, more history of your prior record of conversions is necessary as we believe this is material information to investors. Please expand your disclosure, either here or under Management's Discussion and Analysis, to include the amount of [PUD] reserves that were developed in each of the last three years. Please see Section V. of Securities Act Release 33-8995.
- In part, your response . . . indicates a significant portion of your [PUD] locations are 2 or more offsets removed from a producing well(s). Tell us the statistics of your drilling history for such similarly situated locations, including the success rate by distance/location removed from production.

Under Regulation S-X, Rule 4-10(a)(2), when estimating proved reserves, a registrant should be reasonably certain that the reserves can be recovered in future years under existing economic conditions. In accordance with Regulation S-X, Rule 4-10(31)(ii), "undrilled locations can be classified as having undeveloped reserves only if a development plan has been adopted indicating that they are scheduled to be drilled within five years, unless the specific circumstances, justify a longer time." The SEC staff often asks registrants to justify PUD reserves that are booked but that will remain undeveloped for more than five years because this may indicate uncertainty regarding development and ultimate recoverability. A registrant may be asked to explain why the reserves have not been or will not be developed and why it believes that the reserves are still appropriate and how the registrant plans to develop the reserves within five years. In addition, the staff may ask a registrant to:

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

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

Proved Reserves Impairment Testing

Example of an SEC Comment

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

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

Significant Changes in Reserves and Standardized Measures

Examples of SEC Comments

- You have disclosed how many [PUD] reserves you have as of [the current year ended]; however, you have not disclosed any information with regard to the changes in [PUD] reserves balance during the year. Please revise your disclosure to discuss the changes that correspond to the line item reserve changes found in [ASC 932-235-50-5] and provide the disclosures required by Item 1203(b) and (c) of Regulation S-K.
- Please . . . explain the circumstances that led to the additions of proved reserves in [the current fiscal year] due to improved recovery and the negative revisions in [the prior two fiscal years]. Address the revisions due to performance separately from those due to price reductions. [See ASC 932-235-50-5.]
- We note you include 'Development costs incurred' as a source of change in the standardized measure and that these amounts equate to that presented in your costs incurred for the year table on page [X]. Based on these identical amounts, please tell us how the amounts reflected in your aggregate changes presentation complies with . . . ASC 932-235-50-35(g) which requires disclosure of previously estimated development costs incurred during the period. See also ASU 2010-[0]3, Example 6.

The SEC staff has commented on registrants' disclosures about (1) changes in proved reserves and standardized measures and (2) their compliance with ASC 932-235-50. Specifically, the SEC staff has asked registrants to:

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

Unproved Property Costs

Examples of SEC Comments

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

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

Rule 4-10(c)(4) requires a registrant to use the lower of cost or estimated fair value (i.e., a cost ceiling) to account for unproved property costs that are subject to amortization. However, costs that are not subject to amortization should be recorded initially at cost, regardless of fair value estimates. The SEC staff has questioned registrants that do not clearly distinguish, in their disclosures, between (1) unproved property costs that are excluded from costs to be amortized and (2) those that are subject to amortization. Registrants have been asked to explain how their accounting policy for unproved property costs complies with Rule 4-10(c) and to submit disclosures clarifying the costs included in the amortization base.

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

Environmental Liabilities and Risks

Example of an SEC Comment

- In light of recent events involving the Gulf of Mexico, please review your disclosure to ensure that you have disclosed all material information regarding your potential liability in the event that one of your rigs is involved in an explosion or similar event in any of your offshore locations. For example, and without limitation, please address the following:
  - Disclose the applicable policy limits related to your insurance coverage;
  - Disclose whether your existing insurance would cover any claims made against you by or on behalf of individuals who are not your employees in the event of personal injury or death, and whether your customers would be obligated to indemnify you against any such claims;
  - Clarify your insurance coverage with respect to any liability related to any resulting negative environmental effects; and
  - Clarify the "specified monetary limits" referenced at page [X] with respect to your obligations to indemnify customers or business partners in connection with legal and financial consequences of spills of industrial waste and other liquids. In this regard, discuss what remediation plans or procedures you have in place to deal with the environmental impact that would occur in the event of an oil spill or leak from your offshore operations.

As a result of the oil spill in the Gulf of Mexico, the staff has focused on registrants' disclosures about the environmental risks to which the entity would be exposed and its potential liabilities in the event of an explosion or spill. The SEC has asked registrants to expand their disclosures to address the following:

- Any pending environmental legislation that would affect exploration or development operations.
- Material information regarding potential liability if a rig is involved in an explosion or similar event, including policy limits related to insurance coverage; insurance coverage with respect to any liability related to negative environmental effects; contractual obligations to indemnify customers or business partners in connection with legal and financial consequences of spills of industrial waste and other liquids; remediation plans or procedures in place to deal with the environmental impact that would occur in the event of any oil spill or leak from offshore operations.
- The amount of insurance maintained for pollution and environmental risks, and to quantify what would constitute a "significant" event that could adversely affect the entity's financial situation.
- The monetary limitation with respect to obligations to indemnify customers or business partners in connection with legal and financial consequences of spills of industrial waste and other liquids.

Nonmonetary Exchanges

Examples of SEC Comments

- Please describe the properties received and given in the asset exchange transaction at the time of the exchange, including the following:
  - Are the properties involved proven or unproven?
  - Are the properties producing or non-producing?
  - Was a partial or entire interest in the properties received or given?
- Tell us the facts and circumstances you considered and the specific section of [ASC] 805 under which you concluded the asset exchange transaction gain should be recognized based on the fair value of property received over the book basis of the properties given up.
- [Y]ou described how you estimated the fair value of the property received, to record the gain compared to the book value of the property given up. Tell us why you concluded that the fair value of the property received was more clearly evident than the fair value or cost of the assets given up.

The determination of the fair value and the appropriate gain/loss is one of the most significant assessments a registrant makes in recording of nonmonetary oil and gas asset exchanges. The staff frequently poses questions about significant exchanges and has asked registrants to:

- Clarify disclosures to describe the properties received and given in the asset exchange transaction.
- Provide the staff with the specific section of ASC 805 under which the registrant concluded that the asset exchange transaction gain should be recognized on the basis of the fair value of property received over the book basis of the properties given up.
- Provide support for the conclusion that the fair value of the property received was more clearly evident than the fair value or cost of the assets given up.

Other Deloitte Resources

- Energy & Resources SEC Comment Letter Database — November 2009. (Request a copy.)
- January 7, 2010, *Heads Up*, "FASB Updates Oil and Gas Reserve Estimation and Disclosure Requirements."

Power and Utilities

The SEC staff's comments to registrants from the power and utilities industry have focused on (1) subsidiary and equity investee dividend restrictions and the requirement to provide condensed financial information for the parent company ("Schedule I"), (2) accounting for the impact of rate making, and (3) pension and postretirement plans.

Subsidiary and Equity Investee Dividend Restrictions and the Schedule I Requirement

Example of an SEC Comment

- Please tell us what consideration you and the registrant subsidiaries gave to describing the most significant restrictions on the payment of dividends contained in financing arrangements, charter provisions and/or federal and state regulatory actions and their pertinent provisions rather than the brief disclosures presently provided. Refer to paragraph (e)(1) of Rule 4-08 of Regulation S-X. In addition, please tell us how you determine the restricted net assets of consolidated subsidiaries in assessing whether the disclosures required by paragraphs (e)(3)(i) and (ii) of Rule 4-08 of Regulation S-K and Schedule I required by Rule 5-04 of Regulation S-X should be provided. In doing so, please discuss in detail the restrictions imposed by the Federal Power Act and state public utility regulators, the leverage restrictions contained in subsidiary credit agreements and any restrictions related to the spent nuclear fuel and decommissioning trust assets.

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

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

- Footnote disclosure of the restriction or limitation (Rule 4-08(e)).
- Presentation of condensed parent-company financial data in a financial statement schedule (Schedule I).
- Both footnote and Schedule I disclosures.

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

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

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

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

For additional considerations regarding dividend restrictions, see the Debt section.

Accounting for the Impact of Rate Making

Examples of SEC Comments

- Explain how [the company's] current regulated rates are *currently* designed to recover its specific costs of providing service.
- Please disclose a description of the regulatory treatment of your other postretirement benefit costs and the period over which any deferred amounts are expected to be recovered in rates. Refer to FASB ASC 980-715-50-1.
- Please tell us and disclose how and when the regulatory assets will be recovered. Further, revise your disclosure to clarify which regulatory assets are included in your rate base. Lastly, please disclose the recovery period for those assets not earning a return. See FASB ASC 980-340-50-1.

The SEC staff continues to request that regulated utilities disclose (1) how their current regulated rates are designed to recover their specific costs of providing service (see ASC 980-10-15-2), (2) the nature of all material regulatory assets and liabilities, (3) the anticipated recovery period of regulatory assets, and (4) a statement on whether a particular regulatory asset is earning a rate of return.

Also, comments have continued to focus on the guidance in ASC 980-340-50-1, which requires companies whose regulatory asset balance includes amounts on which they do not earn a current return to disclose the nature and amount of each asset and the remaining recovery period applicable to them.

The SEC may request that a regulated entity describe the consideration it gave to the use of a cost-of-service format for the company's income taxes. The SEC staff has historically been specifically interested in why a company does not classify income taxes as an operating expense on the consolidated statements of income even though income taxes are being recovered in rates.

Pension and Postretirement Plans

Examples of SEC Comments

- Please explain to us how you determined your long-term expected return assumption on plan assets of [>8%] and concluded that the rate used is reasonable. Please be detailed in your analysis and include a summary for us by asset class of your actual long-term returns for the life of such assets. Please tell us whether you used a geometric or arithmetic mean to compute your expected long-term return. Contrast your returns with benchmarks for similar asset classes. See FASB ASC 715-30-35-47.
- Please tell us whether the registrant subsidiaries account for their participation in the [Company's] sponsored pension and OPEB plans as multiple-employer plans. Please also tell us whether the actuarially computed obligation and plan assets and net periodic pension cost for each of the registrant subsidiaries is based on actuarial computations and return on plan assets. In addition, please explain to us why each of the registrant subsidiaries does not provide the same disclosures as the sponsor of a single-employer plan. Specifically address disclosure of: (i) reconciliations of the beginning and ending balances of benefit obligations; (ii) reconciliations of the beginning and ending balances of the fair value of plan assets; (iii) the funded status and the amounts recognized in the balance sheets; (iv) the accumulated benefits obligation for defined benefit plans; and (v) contributions expected to be paid to the plans during the next five years.

SEC staff comments challenging the reasonableness of the rate used for the long-term expected rate of return assumption on plan assets have become more frequent, especially when the long-term rate of return exceeds 8 percent. In light of the current economic environment, the SEC is interested in the method a utility used to develop the long-term rate of return and particularly in the utility's reliance on historical returns and how those historical returns were converted into projected returns.

Also, several utilities have received comments about pension-plan and postretirement-plan disclosures in which the SEC challenged whether the utility participates in a multiemployer or a multiple-employer plan. The disclosure requirements for companies with multiple-employer plans are much more extensive than those for multiemployer plans. Utilities should ensure that they have determined the proper accounting treatment and are following the related disclosure requirements for their multiemployer or multiple-employer pension or postretirement benefit plans.

See the Pensions and Other Postretirement Benefits section for addition information.

Financial Services

Banking and Securities

The SEC staff's comments to registrants from the banking and securities industry have focused on topics such as loan modifications and troubled debt restructurings (TDRs), asset quality issues, FDIC assisted transactions, recourse liabilities and repurchase reserves on mortgage loan sales, purchased impaired loans, repurchase agreements, and investments in Federal Home Loan Bank stock.

Loan Modifications and TDRs

Examples of SEC Comments

- Please tell us and revise your future filings to disclose the following information related to your [TDR's]: TDRs quantified by loan type classified separately as accrual/non-accrual; Policy regarding how many payments the borrower needs to make on restructured loans before returning loans to accrual status; and Quantification of the types of concessions made (e.g. rate reductions, payment extensions, forgiveness of principal, forbearance or other actions) and discussion of your success with the different types of concessions.
- Please revise your disclosure in future filings to provide a more comprehensive discussion of your restructured loans and related modification programs, including a discussion of how you determine whether a loan modification should be classified as a [TDR]. With respect to those short term modifications discussed in your response, please disclose the following:
  - Provide a more granular discussion of these loan modifications and explain how you determined they should not be classified as TDRs;
  - Quantify the amount of loan modifications that you do not consider to be TDRs due to the short term nature of the concessions granted;
  - State whether you believe your impairment measurements for these short term loan modifications are materially consistent with the relevant accounting guidance in ASC 310-10-35.

Various government and private loan modification programs, such as the Home Affordable Modification Program (HAMP) and the Home Affordable Refinance Program (HARP), have helped spur an increase in the number of loan modifications and refinancing transactions. As a result of this trend, the SEC staff has requested that companies enhance their disclosures about loan restructurings and has questioned whether such restructurings should be accounted for as TDRs and therefore included in the Risk Element disclosures required by SEC Industry Guide 3, "Statistical Disclosure by Bank Holding Companies" ("Guide 3").

The SEC staff has suggested that registrants consider disclosing the following:

- How modifications affect the timing of the recording of the allowance for loan losses.
- A description of the key features of their loan modification programs, including whether they are government- or company-sponsored, and whether they are short term or long term.
- Quantification of the types of concessions made (e.g., rate reductions, payment extensions, forgiveness of principal, forbearance) and discussion of success with the different types of concessions.
- The accounting policy for restructured loans, including how and when a restructured loan is determined to be nonaccrual or accrual (i.e., non-interest accruing or interest accruing); the factors the registrant considered in determining whether the loan should accrue interest; the anticipated period and number of borrower payments for a restructured loan to return to accrual status; and whether any loan loss allowance has been recorded or any portion of the loan has been charged off.
- Confirmation that loan restructurings are considered TDRs under ASC 310-40 and, if so, separate disclosure of the loans in the nonperforming assets table under Guide 3, Item III(C)(1).
- TDRs by loan type, classified separately as accrual or nonaccrual.

When a registrant has a material amount of loan modifications not accounted for as TDRs, the SEC staff often requests disclosures that explain the following:

- Triggers and factors the registrant considered to identify loans for modifications and to support its conclusion that modifications are not TDRs.
- Key features of the modification programs, including a description of the significant terms modified and the typical length of each modified term.
- Success rates of the modification programs.
- The amount of loans modified in each period presented.
- Whether these loans are included in the company's impairment analysis of the general reserve (ASC 450-20) or individual reserve (ASC 310-10) and, if included in the general reserve analysis, whether a materially different amount would have resulted if the loan were included in the individual reserve analysis.

For additional information see Deloitte's October 15, 2010, *Heads Up* on the FASB's recently issued proposed ASU, *Clarifications to Accounting for Troubled Debt Restructurings by Creditors*, which clarifies when a loan modification or restructuring is considered a TDR.

Asset Quality Issues

Examples of SEC Comments

- *Commercial Real Estate* — We note the Company has significant exposure to [commercial real estate loans]. So that we may have a better understanding of your lending processes as well as considerations evaluated in the determination of the allowance for loan losses, please address the following:
  - Tell us whether you have any commercial loans that have been extended at or near original maturity, for which you have not considered impaired due to the existence of guarantees. If so, please tell us about the types of extensions being made, whether loan terms are being adjusted from the original terms, and whether you consider these types of loans as collateral-dependent.
- *Continued Deterioration in Credit Quality and Negative Trend Considerations* — We note the continued deterioration in the credit quality of your loan portfolio as evidenced by the significant increase in nonperforming assets over recent periods. Please revise your disclosure in future filings to more clearly bridge the gap between the significant changes in your recent credit experience and evidence of changes in your overall credit environment with the increase in your allowance for loan losses. [P]rovide a more robust discussion explaining the causal factors that you attribute to the increase in nonperforming loans.
- *Method for Determining the Fair Value of Collateral and Reserves for Loans That Are Not Individually Impaired* — Please revise to quantify the amount of collateral underlying your non-performing and impaired loans . . . , and with respect to your significant non-homogenous loan balances please revise to explain how the fair value of the underlying collateral was determined and used in determining the specific component of your allowance for loan losses as of the end of the periods presented.
- *Qualitative and Quantitative Factors Used in Evaluating the Allowance for Loan Losses* — [P]lease provide an expanded analysis of the specific and general components of your allowance for loan losses detailing how you determined that changes in each component were directionally consistent with changes in the underlying credit quality of the applicable loan portfolio. Please be as specific and detailed as needed to provide an investor with a clear understanding of the changes in credit quality in each applicable loan portfolio and its effect on each component of the allowance for loan loss.

Commercial Real Estate

Concentrations in commercial real estate (CRE) loans have been a significant factor in recent bank failures. Therefore, the SEC staff is interested in enhanced disclosures about CRE loans in which registrants explain the following:

- Circumstances in which there are large fluctuations in charge-offs or nonperforming CRE loans.
- How workout programs are used, with an explanation of the types of programs and details about number and amount of loans modified and whether these types of loans are considered to be collateral dependent.

The staff is also interested in situations in which loans have been restructured into A/B note structures (i.e., the loan is split in two) and has suggested additional disclosures, including:

- The amount of loans that have been restructured that use this type of workout strategy in each period presented.
- The benefits of the workout strategy, including the impact on interest income and credit classification.
- The general terms of the new loans and how the A note and B note differ, particularly whether the A note is underwritten in accordance with the institution's customary underwriting standards and at market rates.
- Discussion of charge-off policies for A/B note structures.
- Whether A/B notes are accounted for on a nonaccrual basis and are included in impaired loans within the footnotes (and whether these are disclosed as a TDR in Guide 3).

Further, for banking industry registrants experiencing a significant increase in CRE charge-offs, the SEC staff expects enhanced disclosures about how the trend of increasing charge-offs has affected the allowance. Some disclosure considerations include:

- Whether a significant increase in the nonperforming loans is due to a few large credits or a large number of small credits.
- If the allowance has not proportionally followed the levels of nonperforming loans, a discussion of the reasons why.
- A discussion of the steps taken to monitor and evaluate collateral values of nonperforming loans as part of the allowance method, and the trends experienced in that area in recent periods.

Continued Deterioration in the Credit Quality of Loan Portfolios and Negative Trend Considerations

As a result of the continued deterioration in the credit quality of loan portfolios, the SEC staff frequently asks registrants to include discussions of relationships between nonperforming loans, impaired loans, and the allowance for loan losses to help users understand the expected charge-off trends. In addition, the SEC staff continues to request that registrants explain trends and fluctuations depicted by asset-quality ratios between periods, in some instances requesting a chronology of events and explanations of directional inconsistencies among relationships.

Registrants have been requested to:

- Disclose charge-off policies for each loan type and discuss how registrants determine that a loss event has occurred that warrants a charge-off.
- Discuss triggering events or other facts and circumstances that affect a decision to charge off a portion of a loan as opposed to recording a specific or general reserve.
- Explain how the allowance and provisions are directionally consistent with changes in asset quality.
- Quantify and explain how actual changes and expected trends in nonperforming loans affected the allowance for loan losses.
- Disclose the effect of geographic concentration on the portfolio given the recent decline in the real estate market.
- Explain how, in the determination of the allowance, consideration was given to significant deterioration in credit quality over recent periods as well as to exposure to certain higher-risk loans, such as construction and development loans, second mortgages, and home equity loans and lines of credit.
- Describe the look-back period used to develop historical loss rates in the determination of the general reserve component of the allowance.
- Describe how partial charge-offs on nonperforming loans affect the coverage ratio and other credit-loss statistics and trends.

Method for Determining the Fair Value of Collateral and Reserves for Loans That Are Not Individually Impaired

Determining the Fair Value of Collateral

The SEC staff frequently asks for the disclosure of more detailed information about the processes and procedures industry registrants use to determine the fair value of collateral. In particular, registrants are commonly requested to disclose, in the notes to the financial statements, how the fair value of the underlying collateral was (1) determined and (2) used in establishing the specific component of the allowance for loan losses.

For companies that have a significant amount of loans for which the fair value of collateral has been used to measure the allowance, the following disclosures have been suggested by the SEC staff:

- How and when updated third-party appraisals are obtained, whether this varies by loan type, and how this affects the amount and timing of recording the loan loss provision and charge-offs.
- Type of appraisal, such as "retail value" or "as is" value.
- Description of any adjustments made to appraised values, including those made as a result of outdated appraisals, as well as how the potential for outdated appraisal values in the determination of the allowance for loan losses is considered.
- How partially charged-off loans measured for impairment on the basis of collateral value are classified and accounted for after receipt of an updated appraisal (e.g., when loans are returned to performing status or whether they remain as nonperforming).
- How the amount to charge-off is determined.

The SEC staff has also recommended that registrants disclose (1) the procedures they performed to update previous appraisal information to ensure that the allowance is measured properly, (2) how they determined the amount to charge off, and (3) the typical timing of the recognition of a loan as nonaccrual and the recording of any charge-off or provision.

Reserves for Loans That Are Not Individually Impaired

The staff has also been interested in how reserves are established for pools of homogenous loans. Of particular interest has been how loss rates have been developed and how those may have been updated to reflect current market conditions. Accordingly, the staff has requested some registrants to disclose the following:

- How loans are grouped to derive historic loss rates.
- The periods they used to determine historic loss rates (both number of periods and amount of time; e.g., 12-month loss rates based on rolling 4 quarters of charge-offs during the last 16 quarters); whether there were changes made during the current period and, if so, a description of the changes and an explanation of why they were made.
- Any portion of the allowance for nonimpaired loans that is not calculated on the basis of the application of loss rates to the outstanding balance as well as a description of how it is calculated and whether and how that calculation has changed during the period.

Qualitative and Quantitative Factors Used in the Allowance for Loan Losses

Estimating the allowance for losses is an inherently subjective process that requires registrants to consider both quantitative and qualitative factors related to the loan loss reserve as well as the tendency of such reserves to change frequently. Registrants have been asked to provide a more robust discussion of how each element of the allowance for loan losses is determined, including how general and unallocated components are derived.

SEC staff comments suggest that registrants disclose the following:

- How loans with similar characteristics are grouped to be evaluated for loan collectability (such as loan type, past-due status, and risk).
- How loss rates are determined (e.g., on the basis of historical loss rates that are adjusted for environmental factors or migration analysis), and what factors the registrant should consider when establishing appropriate time frames over which loss experience is evaluated.
- The qualitative factors (e.g., industry, geographical, economic, and political) that have affected loss rates or other loss measurements.

- How housing price depreciation and homeowners' loss of equity in the collateral are considered in the determination of the allowance for loan losses for residential mortgages and other loans collectively evaluated for impairment.
- The basis for assumptions used about housing price depreciation.

The SEC's interpretive response in ASC 310-10-S99-4 states that the "staff normally would expect that, if the methodology [for determining the allowance for loan losses] is changed . . . , documentation that describes and supports the change would be maintained." The SEC staff commonly requests that registrants provide the following information when the method for determining the allowance for loan losses is modified:

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

In its comments on modifications to the method for determining the allowance for loan losses, the SEC staff commonly cites the guidance in ASC 310-10-S99-4 and Chapter 9 of the AICPA Audit and Accounting Guide *Depository and Lending Institutions*.

To the extent that a company experiences significant changes in the credit quality of its loans, the SEC staff expects enhanced disclosures to be provided that would bridge the gap between (1) the changes in credit quality (e.g., provision for loan loss, net charge-offs, nonperforming loans, and the related allowance for loan losses) for each period and (2) how this is reflected in the financial statements. Also, any other relevant information that clearly explains the reasons for the change in credit quality during the period (e.g., significant charge-offs recorded as a direct result of a regulatory exam), and how these amounts were determined, should be disclosed so that financial statement users can understand the reasons for changes in the credit quality.

New Disclosures About Loan Loss Reserves

In July 2010, the FASB issued ASU 2010-20, which amends ASC 310 by requiring more robust and disaggregated disclosures about the credit quality of an entity's financing receivables and its allowance for credit losses. In enhancing these disclosure requirements, the FASB's objective was to improve financial statement users' understanding of (1) the nature of an entity's credit risk associated with its financing receivables and (2) the entity's assessment of that risk in estimating its allowance for credit losses as well as changes in the allowance and the reasons for those changes.

For public entities, the new and amended disclosures that relate to information as of the end of a reporting period will be effective for the first interim or annual reporting periods ending on or after December 15, 2010. That is, for calendar-year-end public entities, most of the new and amended disclosures in the ASU would be effective for this year-end reporting season. However, the disclosures that include information for activity that occurs during a reporting period will be effective for the first interim or annual periods beginning after December 15, 2010. Those disclosures include (1) the activity in the allowance for credit losses for each period and (2) modifications of financing receivables. For calendar-year-end public entities, those disclosures would be effective for the first quarter of 2011.

For additional information, see Deloitte's July 22, 2010, *Heads Up* on ASU 2010-20.

FDIC Assisted Transactions — Loss Sharing Arrangements

Example of an SEC Comment

- We note your disclosure relating to your FDIC-assisted transaction with [Company A]. Please revise your future filings . . . to address the following:
    - Present your estimated loss reimbursement from the FDIC as a separate asset on your balance sheet and within . . . loans pursuant to [ASC 805].
    - Please distinguish between covered loans and non-covered loans on your balance sheet, your MD&A disclosures, and all Guide 3 disclosures.
    - Clearly state your accounting policies for determining your allowance for loan losses on covered loans acquired from [Company A]. Please refer to SAB Topic 11N.
    - Please ensure you have included all of the required [ASC 310-30] disclosures relating to these covered loans.

The FDIC has commonly used loss sharing arrangements (LSAs) to protect purchasers of failed institutions from incurring further losses from assets they acquire from the FDIC. The SEC staff encourages disclosures to clarify these arrangements as follows:

- The assets covered by the LSA should be recorded in the appropriate balance sheet categories (i.e., loans, other real estate owned (OREO), or securities). Separate subheadings for "covered" and "noncovered" assets are acceptable.
- If the transaction is a business combination, the indemnification asset arising from the LSA should be recorded at fair value and, to the extent material, should be separately disclosed on the face of the balance sheet.
- The registrant should determine the allowance without taking into account the LSA (e.g., the allowance should be determined on a gross basis).
- The provision for loan losses may be net of changes in amount of receivable from the LSA, with appropriate disclosure of the effects of the LSA on the provision.
- The Guide 3 disclosures should include the assets subject to the LSA, with separate footnote disclosure about the special nature of the assets. These assets may also be presented separately in Guide 3 disclosures.

Recourse Liabilities and Repurchase Reserves on Mortgage Loan Sales

Examples of SEC Comments

- We note that you have recourse exposure related to the sale of residential mortgage loans and related to loss sharing agreements on commercial loans serviced for others.
- Please revise future filings to:
  - Disclose the methodology used to estimate the reserves related to the above exposures.
  - Discuss the level and type of recourse claims you have received, any trends identified, and your "success rate" in avoiding paying claims.
  - Discuss your methods for settling recourse claims. Specifically, disclose whether you repurchase loans outright or whether you simply make a settlement payment to them. If the former, discuss any significant effects or trends on your nonperforming loan statistics. If the latter, discuss any trends in terms of the average settlement amount by loan type.
  - Provide a roll forward of your reserves for the periods presented.

Because of findings in recent years of mortgage fraud and underwriting deficiencies in the mortgage origination process, institutions have experienced an increase in the number of repurchase demands being made by the loan purchasers and private mortgage insurers. Accordingly, the staff has focused on disclosures about such transactions and has requested that registrants discuss the following:

- Level and type of repurchase requests the company is receiving.
- Method used to estimate the reserves related to recourse exposures.
- Level of allowances established related to the repurchase.
- Method of settling claims.
- Time limit of recourse obligation and trends by loan vintage.
- Rollforward of reserves for periods presented.

In October 2010, the SEC's Division of Corporation Finance posted to its Web site a sample letter issued to registrants on accounting and disclosure issues related to potential risks and costs associated with mortgage and foreclosure-related activities or exposures. The letter asks registrants to consider providing enhanced disclosures about the impact, obligations, and potential losses as a result of representations and warranties to purchasers of whole mortgage loans or through a securitization (as part of asset-backed securities).

Purchased Impaired Loans

Examples of SEC Comments

- We note that you acquired loans and receivables as part of the [X] acquisition that were not considered impaired at the acquisition date and that such loans were recognized at their estimated fair values. Please tell us and revise your future filings to clearly [disclose] how interest income on non-impaired loans acquired in a business combination is recognized. For example, clearly disclose whether the effective yield used to recognize interest income on these loans is calculated based on the contractually required payments receivable (consistent with ASC 310-20) or expected cash flows (consistent with ASC 310-30). In addition, to the extent that you have elected to recognize interest income on a basis consistent with ASC 310-30, please provide the disclosures required by ASC 310-30-50-2 for this portfolio of acquired non-impaired loans.
- We note you increased your allowance for loan losses by $[X] during [the prior year] due to the addition of [X] allowance for loan losses. Please tell us the composition of the loan portfolio acquired and how you applied the guidance of [ASC 310-30].

Acquisitions of troubled institutions have also resulted in a more widespread application of ASC 310-30 to acquired loans with a fair value that is less than the contractual amounts owed and for which it has been determined that (1) there has been deterioration in the credit quality since origination and (2) it is not probable that the acquirer will collect all contractual loan amounts. In some circumstances, acquired loans receivable may individually only meet the credit deterioration condition. In addition, although there is evidence of credit losses inherent in a pool of acquired loans receivable that each individually meets the first condition, the investor cannot specifically determine the individual loans receivable within such pool for which it is probable that it will not collect all contractual principal and interest amounts due. In these circumstances, it may be acceptable for the acquirer to elect to apply either ASC 310-20 or ASC 310-30 as an accounting policy choice.

The AICPA's Depository Institutions Expert Panel and representatives from the AICPA's Accounting Standards Executive Committee have discussed this issue with the staff of the SEC's Office of the Chief Accountant. As noted in a letter dated December 18, 2009, the SEC staff indicated that it would not object to a registrant's selection of either ASC 310-20 or ASC 310-30 as an accounting policy provided that (1) the accounting policy selected is consistently applied and disclosed and (2) for registrants that elect to apply ASC 310-30 to the loan pool, all of the accounting and disclosure requirements of ASC 310-30 are applied. Notwithstanding the letter, in a speech at the September 2010 AICPA National Conference on Banks and Savings Institutions, Stephanie L. Hunsaker, associate chief accountant in the SEC's Division of Corporation Finance, noted that the SEC staff had seen a broad application of ASC 310-30 and stressed that at least part of the fair value mark for acquired loans should be attributed to credit risk.

The SEC staff has requested that registrants:

- Disclose their basis for considering the purchased loan portfolio in the same manner as the originated portfolio in the determination of the allowance for loan loss.
- Disclose how the expected loss component of the purchased loans was established when fair value was determined at that time and whether the expected loss component of the fair value adjustment to these loans was considered in the calculation of the relevant allowance for loan loss.

Repurchase Agreements

Examples of SEC Comments

- For those repurchase agreements you account for as collateralized financings, please quantify the average quarterly balance for each of the past three years. In addition, quantify the period end balance for each of those quarters and the maximum balance at any month-end. Explain the causes and business reasons for significant variances among these amounts.
- You state here that "Securities sold under agreements to repurchase are reflected at the amount of cash received in connection with the borrowing." You also state on page [X] that "Securities sold under agreements to repurchase are borrowings collateralized primarily by securities of the U.S. government or its agencies." If true, please revise to confirm in your future filings that you account for all securities sold under repurchase agreements as collateralized borrowings. [If not, please provide us with the details of any such transactions you accounted for as sales.] Please revise [your future filings] to quantify the amount [of any transactions accounted for as sales] at each balance sheet date and the average amount sold for the periods presented. Disclose how you calculated the average amount.

In March 2010, the SEC staff issued a letter to certain registrants to obtain information on the accounting for repurchase agreements ("repos"). The letter, which was later posted to the SEC's Web site as a "Dear CFO" letter, responded to concerns about so-called "Repo 105" transactions. Since the issuance of the letter, the SEC staff has requested registrants to enhance disclosures about repurchase transactions and to explicitly state whether transactions are being accounted for as financings or sales.

Partially as a result of the liquidity issues associated with Repo 105 transactions and the SEC's conclusion that the disclosure of repurchase agreements could be enhanced after reviewing responses to its "Dear CFO" letter, on September 17, 2010, the SEC issued a proposed rule, on short-term borrowings. For financial companies (as the term is defined in the proposed rule), the disclosure requirements within the Liquidity and Capital Resources section of MD&A will be increased from those required under Guide 3. On the same day, the SEC also issued an interpretive release, to provide clarity on liquidity and capital resource disclosures in MD&A. The interpretive release was effective September 28, 2010, and accordingly, registrants should consider it in preparing periodic reports filed after that date. For additional information, see the Management's Discussion and Analysis section.

In November 2010, the FASB issued an exposure draft to solicit input on its proposal to improve the accounting for repurchase agreements and other agreements that both entitle and obligate a transferor to repurchase or redeem financial assets before their maturity. The FASB requests comments on the ED by January 15, 2011.

Investments in Federal Home Loan Bank Stock

Example of an SEC Comment

- Please revise future filings to present your investment in Federal Home Loan Bank stock outside of securities available for sale. Refer to ASC 942-325-45.

The SEC staff has issued comments reminding registrants that in accordance with ASC 942-325-45, investments in Federal Home Loan Bank (FHLB) stock should be disclosed separately from other securities on the balance sheet.

In addition, the SEC staff has noted that an inappropriate impairment policy has been applied to such cost method investments. The staff has therefore directed registrants to follow the guidance in ASC 942-325-35, which requires the impairment to be determined relative to the ultimate recoverability of the par value of the security. The SEC staff has suggested that registrants consider:

- The significance of the decline in net assets of the FHLB as compared with the FHLB capital stock amount and the length of time this situation has persisted.
- Commitments by the FHLB to make payments required by law or regulation and the level of such payments relative to the FHLB's operating performance.
- The impact of legislative and regulatory changes on institutions and, accordingly, on the customer base of the FHLB.
- The liquidity position of the FHLB.

The SEC staff has also asked registrants to provide a detailed impairment policy for their investment in the FHLB stock, including all positive and negative evidence considered in reaching a conclusion about impairment.

Insurance

The SEC staff's comments to registrants from the insurance industry have focused on reserves for loss and loss-adjustment expenses (LAE), deferred acquisition costs (DAC) for property and casualty (P&C) and life insurers, filing material contracts as exhibits, and investments, including other-than-temporary impairment (OTTI).

In September 2010, the FASB issued a discussion paper, *Preliminary Views on Insurance Contracts*, to give its constituents the opportunity to comment on an insurance accounting model proposed by the IASB in its August 2010 exposure draft (ED), *Insurance Contracts*. If adopted in the United States, the ED would result in sweeping changes to the existing U.S. model by including within its scope all contracts meeting the ED's definition of an insurance contract — regardless of the entity that issues such contracts. Among other items, the proposed changes would affect recognition of insurance liabilities and DAC. The changes would also significantly affect presentation and disclosure.

Reserves for Loss and LAE (P&C and Life Insurers)

Examples of SEC Comments

- *Sensitivity Analysis* — We acknowledge your expansion of the sensitivity analysis to include a [X]% hypothetical measure. However, we continue to believe that an explanation and quantification of reasonably likely variances from the initial expected loss ratio and future pattern of reported losses, as assumed in your estimate of unpaid losses and LAE [in the prior year], should be disclosed. Please revise your disclosure to include this information. Ensure that it describes the difference (if any) between the reasonably likely amounts reflected in your revised sensitivity analysis and the actual loss development that you experienced [in the current year]. In particular, ensure that your revised disclosure explains the likelihood that the magnitude of [loss and LAE] reserve releases experienced during [previous years] will continue in future periods.
- *Additional or Bulk Reserves* — Please revise the [incurred but not reported (IBNR)] reserving methodology disclosure to describe the additional IBNR and to disclose:
  - [T]he amount of additional IBNR included in IBNR in total and by line of business . . . ; and
  - [T]he specific facts and circumstances that caused you to record the additional IBNR in total and for each line. . . .

  In addition, please integrate a discussion of the amounts and reasons for changes in the additional IBNR in your prior period reserve development disclosure.
- *Reference to Expert*s — You indicate that reserves are partly based on information obtained from the appointed actuary. This reference suggests to an investor that you are placing reliance on the firm, which requires the firm to be named in a '34 Act filing. Please advise.

Sensitivity Analysis

The SEC staff continues to focus on the sensitivity analysis in registrants' disclosures in the critical accounting policy section of MD&A about reserves for loss and LAE. The staff often requests that disclosures include the dollar-amount impact on reserves due to hypothetical changes in key assumptions as well as a discussion of why the hypothetical changes selected are appropriate. Hypothetical changes in key assumptions discussed should be reasonably likely to occur and take into account the registrant's past experience. See the Management's Discussion and Analysis section for more information on critical accounting policies.

Additional or Bulk Reserves

The SEC staff has asked registrants to disclose additional information in their periodic filings when they record a type of additional or bulk reserve. Registrants record additional or bulk reserves for a number of reasons, some of which include: additional uncertainty not reflected in the IBNR reserving process, uncertainty related to recorded case reserves, and uncertainty related to claims in transit (i.e., claims reported to the registrant for which case reserves have not yet been recorded). In particular, registrants that record such a reserve should consider adding disclosure related to those reserves by line of business and accident year as well as the reserving methods used to determine such reserves. For registrants that establish bulk reserves in total, the SEC staff has further asked how the registrant is able to allocate loss reserves to prior years when preparing its disclosures under ASC 944-40-50-3.

Reference to Experts

Insurance registrants frequently use actuaries and other third parties to assist management in determining the appropriate level of reserves for loss and LAE. The need to name and obtain a consent from the third party depends on the extent to which management uses and relies upon the work of the third party specialist and the degree to which management takes responsibility for the ultimate conclusions reached. Insurance industry registrants that use third parties (e.g., actuaries) need to consider the extent of use and reliance on third parties and the manner in which the work performed and conclusions reached are characterized in the disclosures in determining whether a consent will be necessary. See further discussion of this topic as it relates to valuation experts in the Use of Experts and Consents section.

DAC (P&C)

Example of an SEC Comment

- You disclose loss and loss expense ratios of [X% and Y% for certain lines of business]. In the absence of disclosure to the contrary, we assume that these trends will continue. If this is not reasonably likely, please revise your disclosure to explain. Also, taking into consideration underwriting expenses the combined ratios for these lines of business would be higher. Please explain to us why you did not apparently record a premium deficiency related to these lines of business. Please separately reference for us the authoritative literature you relied upon to support your accounting. As required by [ASC 944-60-50-1], please revise your accounting policy note to your financial statements to indicate whether or not you include anticipated investment income in your premium deficiency computation.

Costs that vary with and are primarily related to the acquisition of new and renewal insurance contracts are considered acquisition costs. Entities should use a method similar to that used for amortizing unearned premiums to capitalize and subsequently amortize such costs. If DAC can no longer be recovered (i.e., the policy is no longer profitable), a premium deficiency exists. A premium deficiency should be recognized if the sum of expected claim costs and claim adjustment expenses, expected dividends to policyholders, unamortized acquisition costs, and maintenance costs exceed related unearned premiums and anticipated investment income. Insurance contracts are grouped in a manner consistent with the enterprise's manner of acquiring, servicing, and measuring the profitability of its insurance contracts to determine whether a premium deficiency exists. Further, an insurance entity should disclose whether it considers anticipated investment income in determining whether a premium deficiency related to short-duration contracts exists.

A loss ratio or combined ratio greater than 100 percent can be an indication that a premium deficiency exists. The SEC staff has recently requested companies to explain, and potentially add additional disclosure related to, why a premium deficiency does not exist on lines of business for which the loss ratio or combined ratio is greater than 100 percent. Insurance industry registrants are also asked to disclose the timing of the DAC impairment analysis and the method used to determine the impairment when a premium deficiency exists.

DAC (Life)

Examples of SEC Comments

- Please revise your policy disclosure to indicate how you amortize acquisition costs associated with your traditional life insurance policies, including your term and group products. In addition, please clarify how much of your capitalized balance relates to your traditional life insurance policies as compared to the amount associated with your investment and universal life-type contracts. Please ensure your revised disclosure clarifies whether the quarterly DAC Unlock is associated with your traditional life insurance policies. Otherwise, please tell us where you have made these disclosures in your filing or why they are not warranted.
- You disclose that recoverability of [DAC] is based on a number of factors, including investment returns and policy persistency. For the [current year] nine months ended Sept[ember] 30 . . . you reported $[X] billion in realized capital losses and increases in policy surrender activity. Also, you expect continued adverse policy persistency experience in the fourth quarter of the [current year] due to certain large group surrenders. If a known uncertainty regarding the recoverability of your deferred acquisition costs exists, please revise to disclose the events or circumstances that are reasonably likely to lead to a future write-down of deferred acquisition costs and your estimate of the amount or range of amounts. If you believe that a known uncertainty does not exist, please tell us the factors that you considered in reaching this conclusion.

DAC for life insurers is amortized on the basis of two accounting models. For traditional life products, like term or whole life, entities generally amortize DAC over the premium payment period by using assumptions that are established at policy issuance unless a recoverability issue is identified. For nontraditional products, like universal life and investment products, entities amortize DAC on the basis of estimated gross profits (EGPs). EGPs are updated each reporting date to reflect the company's current best estimate. When changes to these EGPs are made, the resulting impact on DAC is referred to as "unlocking." The SEC staff has requested a more specific analysis and discussion of these two methods, and if there has been unlocking, whether those same conditions would have resulted in a recoverability issue related to DAC on traditional products. The staff also continues to probe areas identified in MD&A or other areas of the filing that may affect assumptions underlying DAC.

Material Contracts (P&C and Life Insurers)

Examples of SEC Comments

- We note that [Company A] and [Company B] individually accounted for 10% or more of gross premiums written. Please clarify whether you have agreements with these parties. To the extent you have agreements with these parties, please describe the material terms of the agreements and file the agreements as exhibits. Alternatively, provide us with an analysis supporting your determination that you are not substantially dependent on these agreements.
- Your risk factors indicate that your business could be materially adversely impacted by failure to obtain sufficient reinsurance and inability to collect reinsurance receivables from reinsurers. We also note that [X] reinsurers appear to owe you a substantial amount of reinsurance receivables. In light of these disclosures, please revise your disclosure to identify your material reinsurers and quantify the percentage of premiums ceded to them. In addition, please consider disclosing the terms of all material reinsurance agreements and filing these agreements as exhibits to your filing. If you do not believe that the disclosure of material terms and the filing of your reinsurance agreements as exhibits are necessary, please provide a comprehensive analysis in support of your position.

Regulation S-K, Item 601, requires that registrants file, as an exhibit, material contracts that are executed, amended, modified, or become effective during a reporting period. The SEC staff often comments when registrants omit certain agreements that the staff believes may meet the definition of a material contract. For insurance registrants, material contracts could include reinsurance and agency agreements. See the Material Contracts section for additional information.

Investments, Including OTTI (P&C and Life Insurers)

Given the significance of the investment portfolios for most insurance registrants, the SEC staff also focuses its attention on investments, including fair value and other than temporary impairments. See the Fair Value and Investments and Other-Than-Temporary Impairments sections for additional considerations in these areas.

Other Deloitte Resources

- October 8, 2010, *Heads Up*, "FASB Issues Discussion Paper on Insurance Contracts."
- August 24, 2010, *Heads Up*, "IASB Issues Exposure Draft on Insurance Contracts."

Investment Management

The SEC staff's comments to registrants from the investment management industry have focused on topics such as assets under management (AUM), executive compensation, performance or incentive fees, fair value disclosures, and non-GAAP measures.

Assets Under Management

Examples of SEC Comments

- If the AUM for any individual long-term fund or separate account are material to understanding your results of operations or cash flows, you should supplement your table on page [X] with an AUM roll-forward for that individual fund or separate account as well. For example, if the investment advisory and administration fees, distribution fees, or service fees you earn have been materially impacted by any single investment fund (or it is anticipated that such fees will be materially impacted in the foreseeable future) a roll-forward for that particular fund should be provided. To the extent that you provide an AUM roll-forward for an individual fund or separate account, please also provide a reasonably detailed analysis of the impact that the fund's performance had on your results of operations and cash flows.
- Some of your material revenue streams are based on the value of [AUM]. Please disclose how you calculate the value of your [AUM]. If significant judgment is involved in the calculation of AUM and this directly impacts the calculation of your revenue recognition, please tell us how you considered the need to identify [AUM] as a critical accounting policy. We believe the following disclosures may be useful to investors:
  - Explanation of each of the models/techniques used to estimate fair value of the underlying [AUM];
  - Detailed discussion of the material estimates and assumptions used in each of the models; and
  - Sensitivity analysis of the material estimates and assumptions for each of the models used on the fair value of the [AUM].

The SEC staff continues to request that registrants provide additional information to enhance their disclosures about AUM. In doing so, registrants have also been asked to:

- Include a rollforward of AUM by product type or sector.
- Include more specific and comprehensive discussions of the valuation methods employed regarding AUM and to clarify the significance of Level 3 investments under the fair value hierarchy.
- Include a discussion about how decreases in AUM may affect liquidity.
- Quantify, to the extent possible, information about any known changes in AUM occurring after the latest balance sheet date but before the date of the filing, such as known redemptions or notices of expected redemptions.
- Provide a specific and comprehensive discussion of the underlying reasons for changes in AUM on a gross basis.
- Revise the table of changes in AUM for both interim and annual periods to divide net flows into inflows and outflows.
- Provide investors with more information about the overall performance history of the funds; for example, disclose the percentage of AUM that exceeded certain benchmark returns or the returns for peer groups.

In its comments on AUM, the SEC staff commonly cites the guidance in Section 501 of the SEC Financial Reporting Codification.

Executive Compensation

The SEC staff continues to request that investment company registrants provide additional information to enhance their disclosures about compensation in accordance with Regulation S-K, Rule 402. Registrants have been asked to:

- Describe the performance targets used in determining compensation amounts.
- Clarify the nature of benchmarking activities when compensation at other public firms is used as a benchmark.
- For each named executive officer, describe how the amounts to be awarded were determined.
- Consider discussing and disclosing expenses, such as compensation, relative to the percentage of revenues.
- Provide appropriate analytical disclosure regarding the correlation between performance factors and payouts under incentive compensation plans, including more specific disclosure of performance objectives during the last fiscal year, and describe how consideration of each of these objectives contributed to payout determinations.
- Disclose over what period payments and benefits would be paid to named executive officers under each termination of employment scenario.

For additional information, see the Executive Compensation and Proxy Disclosure, Excluding Executive Compensation sections.

Performance or Incentive Fees

The SEC staff has also commented on the presentation and disclosure of performance or incentive fees, particularly to quantify and discuss amounts related to revenue earned from performance fees. For instance, the staff has asked registrants to explain the extent to which they participate in any incentive or performance fee arrangements whereby management has the opportunity to earn additional incentive income if funds exceed specified performance thresholds. Registrants have also been asked to:

- Disclose the frequency with which performance or incentive fees are recognized.
- Provide a detailed description of the accounting policy as it relates to recognizing performance and incentive fees, as there is more than one permitted method of recognition under ASC 605-20-S99.
- Disclose whether there are any situations that require repayment of amounts received by the adviser.
- Disclose the amount of performance incentive fees subject to clawback that have been recognized and such fees that have been distributed.
- Disclose the total amount of performance incentive fees distributed, and quantify related amounts held in segregated and/or collateralized accounts.
- Disclose the total amount of any deferred incentive fees.
- Separately quantify distributed and undistributed incentive fees.

- Quantify the existence of any material "high water marks" whereby incentive fees will not be earned even if the fund has positive returns until it surpasses the previous high water mark.
- Discuss and quantify the amount of carried interest that may be subject to repayment, and specifically address the terms and conditions that may cause repayment.

Fair Value Disclosures

Example of an SEC Comment

- [C]onsider explaining further details about the manner in which you value your investments. Please show us . . . how you intend to revise your filing to address each of the items noted below or explain why you believe further disclosure is not warranted in light of your specific facts and circumstances and the current economic environment. . . .
  - The amount of assets you valued using broker quotes, along with the classification in fair value hierarchy;
  - The number [of] quote[s] or prices you generally obtained per instrument, and if you obtained multiple quotes or prices, how you determined the ultimate value you used in your financial statements;
  - Whether, and if so, how and why, you adjusted quotes or prices you obtained from brokers or pricing services;
  - The extent to which the brokers or pricing services are gathering observable market information as opposed to using unobservable inputs and/or proprietary models in making valuation judgments and determinations;
  - Whether the broker quotes are binding or non-binding; and
  - The procedures you performed to validate the prices you obtained to ensure the fair value determination is consistent with [ASC 820] and to ensure that you properly classified your assets and liabilities in the fair value hierarchy.

Investment management registrants typically have significant portfolios of investments. As a result, fair value measurement and related disclosures continue to be areas of focus for the SEC staff. For more information, see the Financial Instruments and Fair Value sections.

Non-GAAP Measures

Example of an SEC Comment

- We note your non-GAAP disclosure . . . regarding net "economic investments." Please tell us why you believe this presentation and measure provides useful information to investors. See [I]tem 10(e)(i)(C) of Regulation S-K. Confirm that you will provide similar disclosure in future filings.

The SEC staff's comments on non-GAAP measures primarily focus on the company's definition of the non-GAAP measures and whether the disclosures demonstrate the measures usefulness to investors. For more information, see the Non-GAAP Financial Measures section.

Real Estate

The SEC staff's comments to registrants from the real estate industry have focused on topics such as impairments, risk factors, non-GAAP measures, liquidity and capital resources, financial statement presentation, and use of industry jargon.

Impairments

Examples of SEC Comments

- *Impairment Indicators* — We note that you have recorded impairment losses of $[X], $[Y,] and $[Z] in [each of your last three fiscal years]. In light of the current economic environment and your knowledge of the bankruptcy of a few of your lessees, and the decrease in stabilized net operating income for [the current fiscal year] as compared with the corresponding amount for [the prior fiscal year], please expand your disclosure in future filings and tell us in greater detail how you determine if events or circumstances have occurred that indicate that there may be an impairment to your properties. In your response, please specifically address the properties being rented to tenants that have entered bankruptcy as well as . . . how your assumptions for impairment testing may have been adjusted in response to your consideration of the current economic environment.
- *Impairment Indicators* — We note that many . . . tenants negotiate co-tenancy clauses into their lease agreements which allow them to reduce their rents or close their stores [if] a certain number of co-tenants close their stores or if overall occupancy declines below a certain level. Given that the company has experienced a reduction in its occupancy of retail properties due to bankruptcies and store closings, tell us how the co-tenancy clauses impact your impairment analysis of your properties.
- *Long-Lived Assets Under Development* — Please expand your disclosure in future filings to address your impairment policy for properties under development. Specifically address your impairment policy for:
  - Substantially completed real estate projects that are to be sold, if any.
  - Real estate property to be developed in the future.
  - Property currently under development.
  - Real estate projects that are substantially completed and that are to be held and used.

  Refer to ASC 970-360-35-3 and -4.
- *Long-Lived Assets Under Development* — Please clarify whether the company expects to record impairment charges on for-sale condominium assets that are currently under development once they are completed and are then required to be evaluated under the held for sale model. For example, clarify if projected development costs per unit upon completion are expected to be in excess of selling price per unit less costs to sell, based on current sale transactions.
- *Impairment Disclosures* — You indicate that significant unobservable inputs (Level 3) were used to determine the fair value and measure the impairment of two properties. Please tell us how you complied with the guidance in FASB ASC 360-10-50-2 to provide descriptions of the facts and circumstances leading to the impairment charges.
- *Impairment Disclosures* — [T]ell us your consideration of the guidance in . . . ASC 820-10-50-5 to provide the valuation technique used to measure fair value, the significant unobservable inputs, the information used to develop the inputs and any changes in the method of valuation when compared to prior periods.
- *Early-Warning Disclosures* — We note your discussion of the homebuilding environment and the impact that developments in the homebuilding industry and your various ongoing investigations have had on your results of operations. We urge you to find ways to provide additional quantitative disclosures that convey to investors the current and ongoing risks related to the recoverability of your homebuilding assets as well as the risk that additional charges may need to be recorded. . . . We believe that it is important to provide investors with information to help them evaluate the current assumptions underlying your impairment assessment relative to your current market conditions and your peers to enable them to attempt to assess the likelihood of potential future impairments. We believe that detailed rather than general disclosures regarding these risks and exposures would provide investors with the appropriate information to make this evaluation. You should consider providing these additional disclosures related to each type of potential charge including impairment charges related to inventories held for development, land held for sale, option contract abandonments, and goodwill, as well as charges related to investments in joint ventures. Please also consider whether these types of disclosures would be more meaningful if provided at the segment level.

Real estate owners and operators have recorded and may continue to record material impairment charges. As discussed in the Impairments of Long-Lived Assets, Including Goodwill section, the SEC staff continues to issue a significant number of comments in this area.

Impairment Indicators

The SEC staff has continued to ask registrants to provide more transparent disclosures about properties with indicators of impairment. Such disclosures might include:

- The process registrants used to identify such properties.
- How current factors affecting the entity's business, such as tenant bankruptcies, co-tenancy clauses, and upcoming debt maturities, are evaluated in the registrant's assessment of such properties.
- The number of properties identified with impairment indicators and the number of properties for which impairment was recorded.

Long-Lived Assets Under Development

Under ASC 360-10-35, the impairment model for long-lived assets to be held and used requires that an impairment loss be recognized when the carrying amount of a long-lived asset is not recoverable and exceeds its fair value. The carrying amount of a long-lived asset is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset. Registrants use this "held-and-used" impairment model to test long-lived assets under development for impairment. The SEC staff may ask a registrant to describe the method and assumptions it used to estimate future cash flows, including the timing and amount of future asset sales.

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

Impairment Disclosures

In light of the long-lived asset impairment disclosure requirements in ASC 360-10-50-2 and ASC 820-10-50-5, the SEC staff has frequently requested that registrants provide robust disclosure of the (1) facts and circumstances that led to impairment, (2) the valuation technique and inputs registrants used in determining fair value, and (3) the level of the input used within the fair value hierarchy.

Such disclosures might include:

- The specific facts and circumstances that occurred during the current period that resulted in the identification of an impairment indicator and the determination that the long-lived asset tested for impairment was not recoverable.
- The extent of involvement of third-party specialists (appraisers) in determining fair value.
- The extent of reliance on internally developed models in the fair value estimates.
- The specific discount rates, or range of rates, used.
- A sensitivity analysis of the impact of changes to key assumptions.

Early-Warning Disclosures

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

Risk Factors

Examples of SEC Comments

- Please add a risk factor to discuss the particular risks currently associated with rising vacancy rates for commercial property, particularly in large metropolitan areas. The risk factor should describe actual trends in the current market for commercial real estate as well as the risks of higher vacancy rates, such as lower revenues, reduced rental rates, and increased tenant improvements or concessions. In the alternative, please discuss . . . why such risks are not applicable to your business.
- We note your disclosure throughout the Risk Factors section regarding current economic conditions and the negative impact that defaults by your tenants could have on your future operations. Please consider expanding your disclosure regarding the credit and liquidity risks you may face related to the collectability of your rent receivables and financing activities. Please provide us your analysis as to your considerations regarding the materiality of such additional disclosure.

The SEC staff has requested that registrants expand their current risk factors to include more discussion of the impact the current economic environment has had or is expected to have on the registrant's business. This should include disclosures about the risks associated with vacant space, such as rising vacancy rates and the amounts and timing of lease expirations. For additional information, see the Core Disclosures, Including Disclosures About Risk section.

Non-GAAP Measures

Examples of SEC Comments

- It appears your economic occupancy rates are calculated using non-GAAP financial measures. Please provide the disclosure required by Item 10(e) of Regulation S-K in future filings and tell us how you intend to comply.
- It appears you have excluded impairment charges in your calculation of a non-GAAP measure in footnote [X] to your table. Please provide the disclosure required by Item 10(e)(1)(i)(C) of Regulation S-K in future filings and tell us how you intend to comply.

Non-GAAP Financial Measures C&DIs 102.01 and 102.02 provide additional guidance on funds from operations (FFO), a common metric in the real estate industry. C&DI 102.01 indicates that FFO, as defined by the National Association of Real Estate Investment Trusts (NAREIT), is a performance measure and may be presented on a per-share basis, subject to the requirements of Regulation G and of Regulation S-K, Item 10(e). C&DI 102.02 indicates that a registrant may present FFO on a basis other than that defined by NAREIT provided that the title of the measure is not misleading and the adjustments comply with Regulation S-K, Item 10(e); this is further clarified by C&DI 102.03.

The SEC staff continues to question whether non-GAAP financial measures meet all the disclosure requirements of Regulation S-K, Item 10(e). SEC registrants need to make certain that their disclosures of non-GAAP measures include robust discussion of the usefulness of such measures and whether the metrics are primarily performance or liquidity measurements under Regulation S-K, Item 10(e)(1).

The SEC staff has informally indicated that it may comment on inconsistencies between (1) the measures identified as key metrics on a registrant's Web site and in its press releases, earnings calls, and analyst presentations and (2) the metrics in the registrant's SEC filings. Real estate industry registrants should be mindful of this when including in press releases non-GAAP measures that are not in other SEC filings.

See the Non-GAAP Financial Measures section for additional information on this topic.

Liquidity and Capital Resources

Examples of SEC Comments

- Please provide us with a comprehensive quantitative analysis of your off-balance sheet arrangements related to your unconsolidated joint ventures . . . that could have a material impact on your future liquidity, particularly in the event that your joint venture partners were unable to meet any of their financial commitments. [Address] the financial condition of any significant joint venture partners.
- We note that your distributions to shareholders and noncontrolling interest holders exceeded cash flows from operations for the current year. Please tell us the sources of cash used to fund these distributions. Additionally, please revise the liquidity section of your MD&A to include a discussion of the sources of cash used to fund distributions.

The SEC staff has continued to ask registrants to expand their disclosures about liquidity and capital resources. Material commitments and contingencies associated with off-balance-sheet arrangements should be clearly disclosed in filings. If dividend distributions are in excess of operating cash flows, registrants should include adequate disclosure of the sources of cash used to fund dividend payments. Further, to the extent that a registrant has restrictions in the amount or timing of current or future dividend payments, the registrant should disclose such restrictions to meet the requirements of Regulation S-K, Item 201(c)(1). See the Debt and Management's Discussion and Analysis sections for discussions about limitations on credit facilities, disclosure of off-balance-sheet arrangements, and liquidity and capital resources.

Financial Statement Presentation

Examples of SEC Comments

- We note that you classify deferred leasing costs as investing activities within your statement of cash flows. In future filings, please disclose your classification policy and basis for that policy.
- Please tell us how you[r] presentation of interest income within revenues complies with Rule 5-03 of Regulation S-X.

Accounting policy disclosures should include a discussion of how activity is presented in the financial statements along with the basis for such presentation. To the extent that registrants have material interest income associated with lending activities, they should refer to Regulation S-X, Rule 5-03, when determining whether to present interest income as revenue or as an operating or nonoperating income financial statement line item. For additional information on financial statement presentation, see the Financial Statement Classification section.

Use of Industry Jargon

Example of an SEC Comment

- The prospectus contains jargon and technical terms that make it difficult for investors who are not familiar with your business to understand your offering. . . . Please revise your document and replace technical jargon with descriptions so that an ordinary investor can better understand your disclosure. Instead of using industry jargon, explain these concepts in concrete, everyday language. If you must use industry-specific terms, please explain the meaning of the terms the first time they are used.

The SEC staff continues to promote "plain English" disclosure and consequently questions registrants that use industry or technical jargon in their filings. The SEC staff's comments consistently state that registrants should describe industry or technical jargon in a way that "an ordinary investor" can comprehend. When industry-specific terms are used, registrants should appropriately describe and define each term the first time it is used.

Health Sciences

The health sciences industry includes registrants from the health plan, life sciences, and health provider sectors. The SEC staff may comment on filings that will be submitted by registrants from the health sciences industry disclosing the potential impact of the Patient Protection & Affordable Care Act and the Health Care and Education Reconciliation Act of 2010 (collectively, the “Act”). Some of the Act’s measures could change the dynamics of the health care industry and the role of employers in the provision of benefits. Changes may include (1) the creation of state-level exchanges that would serve as a distribution mechanism and (2) additional regulatory structure for certain segments of the health care market. Registrants may also be affected by changes to medical coverage through possible expansion of eligibility under existing public programs, imposed or revised minimum medical benefit ratios for health plans, and mandatory issuance of insurance coverage. The Act includes requirements that would (1) limit the ability of health plans to vary premiums on the basis of assessments of underlying risk and (2) create new taxes and assessments specific to health care insurers and certain benefit plan designs. In addition, the Act’s potential implications and effect on pharmaceutical companies may be quite significant. Areas of note are expected to include, among others, the increase in minimum Medicaid rebates, expansion of participants in the 340B Drug Pricing Program, the Medicare coverage gap discount program, and an annual fee to be imposed by the federal government.

Health Plans

The SEC staff’s comments to health plan registrants have focused on topics such as revenue recognition, adequate disclosure about significant judgments and estimates regarding medical cost development, the contractual obligations table, and references to independent actuaries.

Revenue Recognition

Examples of SEC Comments

- *Medicare Part D Program* — It appears that your accounting for the subsidies received from [the Centers for Medicare and Medicaid Services (CMS)] related to the member responsibility amounts differs from the accounting for the insurance premiums and beneficiary premiums. Please revise your disclosure to clarify the reason for the different accounting and discuss how the receipt and payment activity related to the CMS subsidies are accumulated and recorded in the balance sheet.
- *Medicare Risk-Adjusted Revenue* — Please disclose the amount of change in estimate related to the prior periods for CMS risk adjustment revenue, CMS audit reserves, [Office of the Inspector General] OIG audit reserves and other contract adjustments and performance based revenue recorded to results of operations for each period presented.

Medicare Part D Program

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

ASC 720-20-25-1 states, in part:

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

The determination of whether a paid insurance premium represents a payment for the transfer of risk or a deposit is a matter of judgment based on all relevant facts and circumstances. The “transfer-of-risk” criteria in ASC 944-20-15-41 through 15-54 provide useful guidance on making this determination.

Medicare Risk-Adjusted Revenue

CMS uses a risk-adjustment model to determine premium payments made to Medicare Advantage health plans. Entities estimate risk-adjusted revenues on the basis of the individual member diagnosis data (risk score) submitted to CMS. Estimated amounts are periodically updated as additional diagnosis code information is reported to CMS and are adjusted to actual amounts when the entity receives notification from CMS of the ultimate settlements. As a result of this process, the actual amount of CMS’s risk-adjusted revenue could be more or less than the registrant’s original estimates. Consequently, the registrant’s estimate of its risk

scores for any period and its accrual of settlement premiums related thereto may result in favorable or unfavorable adjustments to its premium revenue and, accordingly, its profitability. Registrants should consider whether any changes in estimates of risk-adjusted revenues are material and would therefore warrant disclosure in the notes to the financial statements or MD&A.

CMS periodically performs audits and may seek return of premium payments made to entities if risk-adjustment factors are not properly supported by underlying medical record data. Depending on facts and circumstances, registrants may record revenue reserves for risk-adjusted revenues that are not reasonably assured of being earned; these reserves are based on prior audit history, the historical nature and level of findings, changes in CMS requirements, and the specific facts and circumstances of the entity that affect prior estimates. Registrants should consider whether any such revenue reserves are material and therefore would warrant disclosure in the notes to the financial statements or MD&A.

Medical Cost Development

Examples of SEC Comments

- *Changes to Medical Cost Estimates* — Please revise your disclosure to identify and quantify each of the factors that contributed to favorable development of medical costs of [$X] million during the quarters ended March 31, [of the current and prior fiscal years].
- *Provision for Moderately Adverse Conditions* — You disclose the existence of a provision for moderately adverse conditions and that you ensure that your assumptions appropriately consider these conditions. Please revise your disclosure to quantify and describe your provision for moderately adverse conditions. Tell us how reflecting it in your medical benefits complies with GAAP. You also disclose that when "a portion of the development related to the prior year incurred claims is offset by an increase determined appropriate to address moderately adverse conditions for the current year incurred claims, we do not consider that offset amount as having any impact on net income during the period." Please revise your disclosure to quantify the amount of the offset and why it has no impact on net income.

Changes to Medical Cost Estimates

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

Provision for Moderately Adverse Conditions

The SEC staff's comments focus on the accounting for and disclosure of the provision for moderately adverse conditions (often referred to as a reserve for known environmental factors) recorded as part of the liability for unpaid claims. ASC 944-40-30-1 states, "The liability for unpaid claims shall be based on the estimated **ultimate cost of settling the claims** (including the effects of inflation and other societal and economic factors), using past experience adjusted for current trends, and any other factors that would modify past experience" (emphasis added). Registrants often record these reserves for known environmental factors to capture the potential adverse development from factors such as entry into new geographical markets, provision of services to new populations, the variations in utilization of benefits and increasing medical cost, changes in provider reimbursement arrangements, variations in claims-processing speed and patterns, claims payment, the severity of claims, and known outbreaks of disease such as the flu. Registrants should consider quantifying and describing in the notes to the financial statements the provision for moderately adverse conditions, when material. Also, registrants should consider disclosing in either MD&A or the notes to the financial statements the underlying reason for favorable or unfavorable development of the underlying provision for moderately adverse conditions.

Contractual Obligations

Examples of SEC Comments

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

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

Reference to Independent Actuaries

Many health plan registrants use independent actuaries to help them develop various management judgments and estimates. On the basis of informal discussions with the SEC staff, we understand that the key to assessing when a consent would be required is the degree to which management takes responsibility for the ultimate conclusion. The staff has indicated that it would look to the totality of the disclosure provided in determining whether management appears to be taking responsibility for the conclusion. For more information, see the Use of Experts and Consents section.

Life Sciences

The SEC staff's comments to registrants from the life sciences sector have continued to focus on revenue recognition, R&D expenses, capitalized prelaunch inventory, business combinations and intangible assets, and patent exclusivity.

Revenue Recognition

Examples of SEC Comments

- *Product Sales* — We believe that your disclosure related to estimates of items that reduce gross revenue such as product returns, chargebacks, customer rebates and other discounts and allowances [should include] information about the historical accuracy of these accounting estimates, a quantification of their sensitivity to changes in key assumptions and the expected likelihood of material changes in the future.
- *Sales Returns* — We note you estimate your sales returns and allowances on a specific identification basis. Please tell us in more detail how you estimate the reserve [using this] basis [and] when you record the reserve estimate . . . in relation to the related sales.
- *Collaborative Arrangements* — For revenue arrangements with multiple deliverables, discuss your basis for how the deliverables are divided into separate units of accounting and the basis for determining them, how the consideration received under the arrangement is allocated to the separate units of accounting, and the accounting for each unit of account, including each unit of accounts performance period and the basis for its determination.
- *Collaborative Arrangements* — We note that your discussion of material collaboration agreements does not include certain material terms. Please expand your disclosure to include the following material terms: quantification of payments made to date, potential milestone payments, any patent expirations and ranges of royalty payments.

Product Sales

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

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

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

The SEC staff has also asked registrants to disclose the products or therapeutic areas from which revenue is derived, in accordance with ASC 280-10-50-40, or to explain why they believe no disclosure is necessary. See the Segment Reporting section for more information. In addition, the staff has asked registrants to expand MD&A disclosure on trends and uncertainties that may have a material impact on revenues or operating results (under Item 303(a)(3) of Regulation S-K).

Sales Returns

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

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

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

A registrant may also be asked to explain how its return policy complies with ASC 605 and other revenue recognition literature as well as how the registrant is able to reasonably estimate returns. Such disclosure might be particularly relevant for new product launches.

Collaborative Arrangements

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

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

The staff has also commented on disclosures involving multiple-element arrangements and milestone recognition, as discussed below.

- *Multiple-Element Arrangements* — ASC 605-25 (as amended by ASU 2009-13) provides guidance on arrangements that contain multiple revenue-generating activities. Under ASC 605-25, a delivered item or items are considered to be a separate unit of accounting if both the delivered item or items have value to the customer on a stand-alone basis and, if the arrangement includes a general right of return relative to the delivered item, delivery or performance of the undelivered item or items is considered probable and substantially in the control of the vendor. Once it is determined that the arrangement should be divided into separate units of accounting, the arrangement consideration is then allocated at inception to all deliverables on the basis of their relative selling price. Entities use the following hierarchy, based on availability, to determine relative selling price: vendor-specific objective evidence of selling price, third-party evidence of selling price, or the vendor's best estimate of selling price. Specifically, the SEC staff will look for the disclosures outlined in ASC 605-25-50-2, which are:
    a. The nature of its multiple-deliverable arrangements
    b. The significant deliverables within the arrangements
    c. The general timing of delivery or performance of service for the deliverables within the arrangements
    d. Performance-, cancellation-, termination-, and refund-type provisions
    e. A discussion of the significant factors, inputs, assumptions, and methods used to determine selling price . . . for the significant deliverables
    f. Whether the significant deliverables in the arrangements qualify as separate units of accounting, and the reasons that they do not qualify as separate units of accounting, if applicable
    g. The general timing of revenue recognition for significant units of accounting
    h. Separately, the effect of changes in either the selling price or the method or assumptions used to determine selling price for a specific unit of accounting if either one of those changes has a significant effect on the allocation of arrangement consideration.
- *Milestone Method* — Under ASC 605-28 (as added by ASU 2010-17), a milestone is an event (1) in which there is substantive uncertainty as of the date the arrangement is entered into that the event will be achieved; (2) that can only be achieved, in whole or in part, on the basis of either the vendor's performance or a specific outcome resulting from the vendor's performance; and (3) that, if achieved, would result in additional payments being due to the vendor. In considering whether a milestone is substantive, registrants should use judgment in considering the following: (1) whether the event is commensurate with either the vendor's performance or the enhancement of the delivered item; (2) whether the event relates solely to past performance; and (3) whether the event is reasonable relative to all of the deliverables and payment terms (including other potential milestone consideration) within the arrangement. The staff will look for the disclosures outlined in ASC 605-28-50-2, which are:
    a. A description of the overall arrangement
    b. A description of each milestone and related contingent consideration
    c. A determination of whether each milestone is considered substantive
    d. The factors that the entity considered in determining whether the milestone or milestones are substantive
    e. The amount of consideration recognized during the period for the milestone or milestones.

In accordance with Regulation S-K, Item 601(b)(10), registrants may also be asked to file a material collaborative arrangement as an exhibit to the registration statement. For additional information see the Material Contracts section.

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

R&D Expenses

Example of an SEC Comment

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

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

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

Registrants will need to carefully consider whether such projects incur costs that are significant enough to require disclosure and whether it is possible to reasonably estimate the timing of such costs. Registrants involved in late-stage clinical trials should consider detailed disclosures for such projects because of the uncertainties inherent in them.

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

Capitalized Prelaunch Inventory

Examples of SEC Comments

- We note in certain circumstances you may commence the manufacture and inventory of commercial quantities of products that have not received final regulatory approval. Please provide us, in disclosure-type format, an expanded accounting policy for capitalization of unapproved products . . . to address the following:
  - For each product with inventory capitalized prior to FDA approval, specifically state the point during the FDA approval process that management determines a probable future benefit exists.
  - Disclose the status of the FDA's consideration of the safety and efficacy of the drug and evaluation of the manufacturing process at that point.
  - Disclose how you apply the lower of cost or market principle to pre-launch inventory.
- [If there is] uncertainty of events with the FDA, please revise your disclosure to quantify the amount of inventory related to materials purchased for [these] products [and] quantify the estimated impact on future results of operations and financial position regarding the unresolved FDA's concerns. In this regard, please consider all aspects of your operations and financial position, including, but not limited to legal expenses, general and administrative expenses, inventory, sales, returns.

The SEC staff has also focused on the capitalization of prelaunch inventory that has not been approved by the U.S. Food and Drug Administration (FDA). The staff has asked registrants to quantify the total amount of capitalized unapproved inventory and clarify in their disclosures their accounting policy for the capitalization of unapproved products. In addition, the staff may request a registrant to indicate the point during the FDA approval process at which it determines a probable future benefit exists and the status of the FDA's consideration of the safety and efficacy of the product and evaluation of the manufacturing process at that point. Registrants may be asked to explain how the costs meet the definition of inventory in ASC 330-10-20 and the definition of an asset in paragraph 25 of FASB Concepts Statement 6.

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

- The remaining shelf life of each capitalized product, as of each balance sheet date presented, and why the registrant believes it will be able to realize the asset's benefit before the expiration of the shelf life.
- The risks and uncertainties associated with market acceptance of the product, once it is approved, and how these risks and uncertainties will affect the realization of the asset.

Business Combinations and Intangible Assets

As discussed in the Business Combinations and Impairments of Long-Lived Assets, Including Goodwill sections, the SEC staff frequently asks questions about purchase price allocations for business combinations, the nature and terms of contingent consideration arrangements, and impairment disclosures. For registrants from the life sciences industry, the staff has also inquired specifically about a registrant's determination of whether a transaction is an asset purchase or a business combination. Further, for those transactions determined to be a business combination, the staff has inquired about the registrant's identification of significant IPR&D costs acquired during the business combination.

Acquired IPR&D through business combinations is accounted for as an indefinite-lived intangible asset until completion or abandonment of the associated R&D efforts. Therefore, such assets would not be amortized but would be tested for impairment at least annually. Once the R&D activities are completed, the assets would be amortized over the related product's useful life. If the project is abandoned, the assets would be written off if they have no alternative future use.

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

- The specific nature and fair value as of the acquisition date of each significant IPR&D project acquired.
- The nature, timing, and estimated costs of the efforts necessary for the registrant to complete the projects, and the anticipated completion dates.
- The valuation method and unit of account assumptions that the registrant used to measure the IPR&D projects acquired at fair value.
- The significant valuation assumptions, such as:
  - The period in which material net cash inflows from the project are expected to commence.
  - Material anticipated changes from historical expense levels.
  - The risk adjusted discount rate applied to each project's cash flows.
- In periods after the acquisition, the status of efforts to complete the projects and the impact of any delays on expected investment return, results of operations, and financial condition.

In addition to requesting that registrants provide disclosures similar to those in ASC 350-30-50-1 through 50-3, the staff may ask registrants to disclose (1) the amount of acquired IPR&D accounted for as intangible assets and the basis for determining that amount, (2) how the estimated useful life is determined for acquired IPR&D associated with completed R&D activities, and (3) the nature of impairments and impairment testing for acquired IPR&D.

Patent Exclusivity

Example of an SEC Comment

- [Please discuss your material owned patents, including the expiration date of each patent.] In addition, . . . [p]lease revise your disclosure to discuss in quantitative and qualitative terms, the impact that expirations of each of the materially important patents have had and will have on your results of operations and liquidity in the periods presented and in future periods.

The SEC staff has also commented on registrants' disclosure of patent exclusivity of their products and the impact of such exclusivity on revenues and overall operations. Patent expiration and challenges can not only affect a registrant's current period earnings but can also affect future operations and liquidity, particularly if the patents are for core products. Registrants should look to Regulation S-K, Items 101 and 503(c), respectively, for guidance on the inclusion of patent information in the Business Sections (Item 1) and possibly as a Risk Factor (Item 1A) of their annual reports.

Health Providers

The SEC staff's comments to registrants from the provider sector have focused on adequate disclosure about significant judgments and estimates regarding professional and general liability claims not covered by insurance, malpractice claims experience, and allowance for doubtful accounts.

Professional and General Liability Claims Not Covered by Insurance

Example of an SEC Comment

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

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

Malpractice Claims Experience

Example of an SEC Comment

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

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

Allowance for Doubtful Accounts

Example of an SEC Comment

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

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

Technology and Telecommunications

Technology

The SEC staff's comments to registrants from the technology industry have frequently focused on revenue recognition and goodwill impairment (including disclosure concerning testing, asset grouping, and significant judgments and estimates).

Revenue Recognition — Software Arrangement

Examples of SEC Comments

- *Applicability of ASC 985-605* — We note your disclosures . . . and your reference to [ASC 985-605-15-3]. Do the Company's products include software that is more than incidental . . . ? If so, please explain how your accounting for such product sales complies with [ASC 985-605]. If not, then please explain the reference to this guidance in your disclosures.
- *Vendor Specific Objective Evidence* — We note that for . . . contracts entered into after [the prior fiscal year], PCS services include unspecified upgrades for which you have established VSOE of fair value. Tell us how you determine VSOE of fair value for PCS (i.e. separate sales or stated renewal rates) for each PCS term (one year, two years and three years). Also, describe the process you use to evaluate the various factors that affect your VSOE including customer type and other pricing factors. Further address the issue that if your VSOE varies from customer to customer, how you can reasonably estimate fair value. We refer you to ASC 985-605-25-6 and 985-605-25-69, as applicable

Applicability of ASC 985-605

ASC 985-605 provides guidance on when and how an entity should recognize revenue for software transactions. The SEC staff has increased its scrutiny in this area because certain registrants that are not considered traditional software companies may be within the scope of ASC 985-605 but not following that guidance for their revenue recognition policy. That is, these registrants are selling products that include software that is more than incidental to the arrangement, so the software-related elements are within the scope of ASC 985-605.

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

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

Vendor-Specific Objective Evidence

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

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

- If contractually stated renewal rates for PCS are used to establish VSOE, the percentage of customers that renew at these rates and how the rates are substantive in accordance with ASC 985-605-25-67.
- If PCS renewal rates are not contractually stated, or if a registrant does not use stated renewal rates to establish VSOE, an explanation of how the registrant determined VSOE.

- The impact that subsequent price negotiations with customers have on the registrant's ability to establish VSOE.
- A description of the process used to evaluate various factors that affect VSOE.
- A quantitative description of the volume and range of stand-alone sales used to establish VSOE and how the registrant accounts for contracts outside that range.
- If the registrant does not separate the deliverables in its software arrangements and therefore accounts for them ratably, an explanation of why the entity believes it is unable to determine VSOE for its undelivered elements.

See the Revenue Recognition section for other revenue-related considerations.

Goodwill Impairment Testing and Related Disclosure

For a period of time, mergers and acquisitions have been common in the technology industry, and their impact on business and accounting continues to be significant to many registrants. Goodwill impairment is one of the material by-products of such activities.

Overall economic conditions and constant evolution in technology have made goodwill impairment a hot topic of SEC reviews. The SEC staff has reviewed disclosures about the step 1 goodwill impairment test (i.e., a comparison of the fair value of the reporting unit to the carrying value of the reporting unit including goodwill) from various registrants' filings as well as studied a significant number of SEC comment letters and related response letters. Because the review revealed that the nature of disclosures is diverse, the SEC staff refined its expectations of what registrants should disclose about potential material goodwill impairments.

The volatility in the technology industry adds to the complexity in the fair valuation calculation of goodwill impairment testing. The SEC staff often asks registrants questions about the application of ASC 350 in the calculation of the fair value of a reporting unit in step 1 of a goodwill impairment test. ASC 350-20-35-22 states that the "fair value of a reporting unit refers to the price that would be received to sell the unit as a whole in an orderly transaction between market participants at the measurement date." A frequent question that arises in the application of this guidance is whether the fair value of a reporting unit refers to the reporting unit's equity value or its enterprise value. See further discussion in the Impairments of Long-Lived Assets, Including Goodwill section.

Telecommunications

The SEC staff's comments to registrants from the telecommunications industry have focused on topics such as segment reporting, intangible asset impairment analysis, capitalization of interest, and revenue recognition.

Segment Reporting

Example of an SEC Comment

- You disclose that you have [X number of] reportable segments. . . . It appears that you may have more than one operating segment in the . . . business since you provide various services that appear to have different economic characteristics . . . as disclosed in MD&A. Tell us how you applied the guidance in [ASC 280] in evaluating your management approach to determine whether you have operating segments. If you have aggregated operating segments, disclose this in Note [x] and provide us with your analysis of the aggregation criteria in [ASC 280-10-50-11] for the various products and services you provide. Also, provide us with a copy of the report that the chief operating decision maker uses to allocate resources and assess segment performance.

As discussed in the Segment Reporting section, the SEC staff frequently asks questions about the identification and aggregation of operating segments. Registrants in the telecommunications industry often operate in multiple geographies or regions. Many such registrants also offer multiple services and frequently introduce new services that are a focus of investors. The SEC staff reviews public statements made by executives (e.g., earnings calls) and comments on inconsistencies between public statements and segment disclosures made in financial statements. When industry registrants operate in multiple geographies with multiple product or service lines, the SEC staff may ask to see the internal segment reporting that was provided to the chief operating decision maker (CODM). The SEC staff's comments have focused on multiple aspects of registrants' conclusions about segments and have included requests for information such as (1) the identification of the CODM (under ASC 280-10-50-5), (2) how resources are allocated and performance is assessed within service lines, and (3) a detailed analysis for all periods presented that supports conclusions that economic characteristics of segments are similar and that aggregation is appropriate.

In addition to maintaining comprehensive information to support segment conclusions, registrants should ensure that processes are implemented to monitor changes in the business or in reporting to the CODM that would require reassessment of the registrant's segment conclusions. See the Segment Reporting section for additional information.

Intangibles — Impairment Analysis

Example of an SEC Comment

- We note that your wireless spectrum licenses accounted for [X]% of your total assets [at the end of the prior fiscal year] . . . . Although you incurred no impairment, we expect robust and comprehensive disclosure in your critical accounting policies regarding your impairment testing policy due to the significance of your [license] balance. This disclosure should provide investors with sufficient information about management's insights and assumptions with regard to the recoverability of your licenses.
  - Describe the nature of the valuation techniques you employed in performing the impairment tests. If you used a discounted cash flow methodology, addressing [ASC 805-20-S99-3], describe the method you used to isolate the cash flows associated with the intangible asset.
  - Quantitatively and qualitatively describe in detail the changes in the estimates used in your assumptions to determine the fair value of your licenses since your last impairment test.
  - Provide a sensitivity analysis showing the impact on your impairment test resulting from a one percent change in each of your significant assumptions.
  - Provide a sensitivity analysis that discloses the impairment amount that would have resulted from hypothetical reductions in the fair value of your licenses at the time of your impairment testing.

  For further guidance, refer to Release No. 33-8350.

Wireless licenses often comprise a significant portion of a registrant's assets. Accordingly, the SEC staff frequently asks about the method and assumptions used in the impairment analysis performed on these indefinite-lived intangibles under ASC 350, including the identification of the units of accounting under ASC 350-30. Registrants that operate in multiple jurisdictions (i.e., various states) typically have state or regulatory reporting requirements in those jurisdictions. The SEC staff has requested that registrants reconcile information provided in regulatory or state reporting to the registrant's reporting units. The Federal Communications Commission (FCC) initially divides the wireless spectrum into geographic areas; wireless carriers then build their wireless license portfolios in a variety of ways, whether through FCC auctions or other private transactions. Registrants should carefully evaluate whether they meet the criteria outlined in ASC 350-30-35-23 to qualify for impairment testing of wireless licenses as a single unit of accounting.

Because wireless licenses are sometimes a significant portion of registrants' balance sheets, the SEC staff has asked that registrants disclose more information regarding:

- The factors registrants considered in determining that no interim impairment testing under ASC 350 was required.
- A qualitative and quantitative description of the significant estimates and assumptions used in the valuation model.
- Any changes to units of accounting or allocations of wireless licenses by unit of accounting and the reasons for such changes.
- The carrying value and the fair value of each unit of accounting.
- If the fair value of any of the units of accounting does not exceed its carrying value by a significant amount, a sensitivity analysis of the most recent impairment test assumptions for the related units of accounting.

At a November 2010 FASB meeting, the use of the Greenfield[1] or multi-period excess earnings[2] methods to value intangible assets was discussed. At that meeting, it was reaffirmed that (1) both methods are acceptable to use in determining the value of intangible assets, (2) neither represented a preferable method, and (3) the appropriate method to be used should be based upon a consideration of the applicable facts and circumstances. When a discounted cash flow model is used, the SEC staff has commented that disclosures should include (1) the discount rates for each unit of accounting and how those discount

[1] Under the Greenfield method, it is assumed that the only asset owned by the entity on the valuation date is the individual intangible asset (the wireless license). Future cash inflows and outflows are estimated as a viable business is created around the wireless license. Any cash flows associated with tangible or intangible assets, including goodwill, are assumed to be "paid for" in the start-up costs of the new business that are captured in the discounted cash flow analysis.

[2] Under the multi-period excess earnings method, an entity determines the value of an intangible asset by using the net present value of the cash flows attributable to the subject intangible asset after excluding the proportion of the cash flows that are attributable to other assets.

rates were determined; (2) how cash flows were determined, including growth rates; (3) the period of assumed cash flows and determination of terminal value; (4) consideration of any market risk premiums; and (5) changes to the assumptions and methods, if any, since the last impairment test. See further discussion in the Impairments of Long-Lived Assets, Including Goodwill section.

Intangibles — Capitalized Interest

Example of an SEC Comment

- Tell us your rationale under the accounting literature for capitalizing interest expense incurred while qualifying wireless licenses are developed. Tell us in detail about the processes that are performed to develop licenses, and show us [your support for your conclusions].

The SEC staff has asked telecommunications industry registrants to provide information that supports their decision to capitalize costs, including interest capitalized in connection with certain intangible assets. For these registrants, wireless licenses typically represent a significant component of their intangible assets. Certain telecommunications industry registrants have historically capitalized interest on these wireless licenses during build-out and construction of their networks. As a result, the SEC staff may question whether intangible assets, including wireless licenses, are "qualifying assets" under ASC 835. SEC staff comments have also focused on the nature of technology deployed in connection with categories of licenses and when capitalization of interest begins and ends. Registrants should maintain detailed records and analysis supporting their capitalized interest calculations and methods. For additional information, see the Capitalization of Costs section.

Revenue Recognition — Multiple-Element Transactions

Registrants in the telecommunications industry are subject to comments that often focus on the application of ASC 605-25 or ASC 605-985. Delivery of products or services by industry registrants to customers may include a combination of equipment, services, long-term contracts, and activation fees requiring evaluation under ASC 605-25. In addition, when equipment that includes software is delivered to a customer, a registrant needs to evaluate whether ASC 605-985 applies.

The SEC staff often asks registrants to expand or clarify disclosures about revenue recognition. The comments received by telecommunications industry registrants are often similar to those received by registrants in other industries, including the technology-related industries. For more information on revenue-related considerations, see the Revenue Recognition section.

Appendix A: SEC Staff Review Process

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

The overview is divided into two main sections:

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

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

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

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

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

Appendix B: Best Practices for Managing Unresolved SEC Comment Letters

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

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

Oral Comments

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

Disclosure Requirements

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

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

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

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

Full-Text Search Feature

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

To access the advanced search feature:

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

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

Home | Latest Filings | Previous Page

U.S. Securities and Exchange Commission

Search the Next-Generation EDGAR System

Search Home

SEC Home » *Current Page*

Note: EDGAR Search Changes (see below)

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

You can search information collected by the SEC several ways:

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

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

Home | FAQ

U.S. Securities and Exchange Commission

Full-Text Search

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

Search For Text: Advanced Search Page

Search Reset

4. This brings up the following Web page.

Home | FAQ

U.S. Securities and Exchange Commission

Full-Text Search

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

Search For Text: Basic Search Page

In Form Type: All Forms Results Per Page: 10

Sort By: Date (Latest First) Use Stemming:

For Company Name:

Or Central Index Key (CIK):

Or Standard Industrial Classification: All SICs

Between These Dates:

Start Date: mm/dd/yyyy End Date: mm/dd/yyyy

Search Reset

The following are tips for using this page:

Form Types

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

Performing Searches

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

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

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

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

Modifications to Searches

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

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

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

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

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

Other Search Criteria

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

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

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

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

Example

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

Displaying Search Results

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

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

Example of Benefits of Using Full-Text Search

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

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

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

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

Finding Search Terms Within the Filing Document

HTML or Text Documents

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

PDF Documents

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

Additional Help on Using Full-Text Search

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

Appendix D: Deloitte Resources

Deloitte Publications

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

Heads Up Newsletters:

- SEC Issues First Progress Report on Consideration of Incorporating IFRSs Into U.S. System
- SEC to Open the Curtains on "Window Dressing"
- SEC Publishes Work Plan for Moving Forward With IFRSs for U.S. Issuers
- SEC Issues Interpretive Guidance on Disclosures Related to Climate Change
- SEC Issues Compliance and Disclosure Interpretations on Non-GAAP Measures
- Highlights of the 2009 AICPA National Conference on Current SEC and PCAOB Developments
- SEC Issues Financial Reporting Manual
- SEC Publishes Final Rule Mandating Use of "Interactive Data"
- SEC Modernizes Oil and Gas Company Reporting
- Study Finalized on Mark-to-Market Accounting
- SEC Approves Rules Requiring Registrants to Submit Interactive Data
- Highlights of the 2008 AICPA National Conference on Current SEC and PCAOB Developments
- SEC Issues Proposed IFRS Roadmap
- SEC Proposes to Give Certain U.S. Issuers the Option to Use IFRSs and Proposes a Roadmap to a Mandatory Transition Date for All U.S. Issuers
- SEC Holds Fourth Roundtable on IFRSs
- SEC Advisory Committee Releases Final Report
- SEC Staff Explains the Filing Review and Comment Letter Process
- SEC Proposes Mandating XBRL Use to Make Financial Data Interactive
- Regulations Committee and SEC Staff Hold First Meeting of 2008
- SEC Advisory Committee Releases Progress Report
- Highlights of the 2007 AICPA National Conference on Current SEC and PCAOB Developments
- SEC Holds Roundtables on IFRSs
- Major Changes to Business Combination Accounting as FASB and IASB Substantially Converge Standards
- XBRL U.S. GAAP Taxonomy Made Available for Public Comment
- SEC Removes Reconciliation Requirement, Approves Smaller Public Company Rules
- SEC Regulations Committee and SEC Staff Hold Third Meeting of 2007
- SEC OKs Use of a Surrogate to Value Employee Share Options
- SEC Feedback on Executive Compensation Disclosures: "Where's the Analysis?"
- SEC Staff Issues Comment Letters on Executive Compensation Disclosures
- The Shift Toward IFRSs and Its Impact on U.S. Companies
- SEC Regulations Committee and SEC Staff Hold Second Meeting of 2007
- SEC Provides Further Relief for Smaller Public Companies
- SEC Proposes Easing Requirements for Foreign Filings
- SEC Tackles a Wide Range of Topics

SEC and PCAOB Approve New Section 404 Guidance: No Additional Delay for Non-Accelerated Filers

Expected SEC Actions Will Increase Relevance of IFRSs in the U.S.

SEC Regulations Committee and SEC Staff Hold First Meeting of 2007

SEC Discusses Improvements to Section 404 of the Sarbanes-Oxley Act

SEC Clarifies Views on the Design of Market-Based Employee Stock Option Valuation Model

Matching Critical Terms in Hedge Strategies — Major Accounting Firms Discuss Ramifications With SEC Staff

SEC and PCAOB Update

Financial Reporting Alerts:

10-10: SEC Advises Registrants to Enhance Disclosure About Mortgage and Foreclosure-Related Activities or Exposures

10-9: Accounting Considerations Related to the New Policies Proposed by the Special Master for TARP Executive Compensation

10-8: Foreign Currency Exchange Accounting Implications of Recent Government Actions in Venezuela

10-7: Effect of ASUs 2009-16 and 2009-17 on Presentation of Trade Receivable Financing

10-5: Financial Reporting Considerations Related to Implementation of Fair Value Measurement Disclosures Required by ASU 2010-06

10-4: SEC Staff Announcement on Foreign Currency Issues Related to Venezuela's Highly Inflationary Status

10-2: SEC Issues Technical Corrections to Proxy Disclosure Enhancements

09-4: SEC Further Defers Section 404(b) Requirement for Nonaccelerated Filers

09-3: SEC Advises Registrants to Further Explain Provisions and Allowances for Loan Losses in MD&A

09-1: Impact of Credit Downgrades on the OTTI Analysis of Perpetual Preferred Securities

08-16 (Revised): SEC Issues Letter Clarifying Other-Than-Temporary Impairment Guidance for Perpetual Preferred Securities

08-11: SEC and FASB Release Fair Value Clarifications

08-10: SEC Advises Registrants to Further Explain Fair Value in MD&A — An Addendum to the March 2008 SEC Letter

08-7: SEC Advises Registrants to Further Explain Fair Value in MD&A

08-1: SEC Issues Letter Clarifying Accounting Ramifications of Accelerated Efforts to Mitigate Subprime Crisis

07-10: SEC Extends the Use of the Simplified Method in SAB 107 Under Certain Circumstances

07-5: CAQ Update — Key Accounting Issues and the Credit Environment

07-4: Key Accounting Issues and the Current Credit Environment

Other Publications:

Energy & Resources SEC Comment Letter Database — November 2009. (Request a copy.)

Example SEC Comments — Income Taxes (July 2010)

Deloitte's National SEC Services Group

Christine Q. Davine, Partner-in-Charge	202-879-4905	Lisa M. Mitrovich	202-220-2815
Diana J. Cravotta	412-338-7371	Joanne M. Mooney	203-761-3173
Frank J. Dudek	203-761-3230	Jeanne B. Riggs	202-370-2212
Kathleen M. Malone	203-761-3770	Howard E. Slagter	203-761-3461
Mark E. Miskinis	203-761-3451	Sondra L. Stokes	202-370-2221

Did You Know . . . ?

Deloitte's SEC Reporting Interpretations Manual includes interpretive guidance and more than 225 Q&As on the following topics:

- *Understanding the SEC.*
- *Business combinations* — Providing financial statements of an acquired business required under Regulation S-X, Rule 3-05.

- *Unconsolidated subsidiaries and equity method investees* — Providing financial information of unconsolidated subsidiaries and equity method investees required under Regulation S-X, Rules 3-09 and 4-08(g).
- *Pro forma financial information.*
- *Real estate operations* — Providing financial information of acquired real estate operations required under Regulation S-X, Rule 3-14.
- *Registrant's financial statements.*
- *Guarantor financial statements* — Providing guarantor financial statements required under Regulation S-X, Rule 3-10.
- *Non-GAAP financial measures.*

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

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

Appendix E: Glossary of Standards and Other Literature

FASB Accounting Standards Codification Topic 205, *Presentation of Financial Statements*

FASB Accounting Standards Codification Subtopic 205-20, *Presentation of Financial Statements: Discontinued Operations*

FASB Accounting Standards Codification Subtopic 210-10, *Balance Sheet: Overall*

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

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

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

FASB Accounting Standards Codification Topic 250, *Accounting Changes and Error Corrections*

FASB Accounting Standards Codification Subtopic 250-10, *Accounting Changes and Error Corrections: Overall*

FASB Accounting Standards Codification Subtopic 260-10, *Earnings per Share: Overall*

FASB Accounting Standards Codification Topic 275, *Risks and Uncertainties*

FASB Accounting Standards Codification Subtopic 275-10, *Risks and Uncertainties: Overall*

FASB Accounting Standards Codification Topic 280, *Segment Reporting*

FASB Accounting Standards Codification Subtopic 280-10, *Segment Reporting: Overall*

FASB Accounting Standards Codification Topic 310, *Receivables*

FASB Accounting Standards Codification Subtopic 310-10, *Receivables: Overall*

FASB Accounting Standards Codification Subtopic 310-20, *Receivables: Nonrefundable Fees and Other Costs*

FASB Accounting Standards Codification Subtopic 310-30, *Receivables: Loans and Debt Securities Acquired With Deteriorated Credit Quality*

FASB Accounting Standards Codification Subtopic 320-10, *Investments — Debt and Equity Securities: Overall*

FASB Accounting Standards Codification Subtopic 325-40, *Investments — Other: Beneficial Interests in Securitized Financial Assets*

FASB Accounting Standards Codification Subtopic 330-10, *Inventory: Overall*

FASB Accounting Standards Codification Topic 350, *Intangibles — Goodwill and Other*

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

FASB Accounting Standards Codification Subtopic 350-20, *Intangibles — Goodwill and Other: Goodwill*

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

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

FASB Accounting Standards Codification Topic 405, *Liabilities*

FASB Accounting Standards Codification Subtopic 410-20, *Asset Retirement and Environmental Obligations: Asset Retirement Obligations*

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

FASB Accounting Standards Codification Topic 450, *Contingencies*

FASB Accounting Standards Codification Subtopic 450-20, *Contingencies: Loss Contingencies*

FASB Accounting Standards Codification Subtopic 470-10, *Debt: Overall*

FASB Accounting Standards Codification Subtopic 470-20, *Debt: Debt with Conversion and Other Options*

FASB Accounting Standards Codification Subtopic 470-50, *Debt: Modifications and Extinguishments*

FASB Accounting Standards Codification Topic 605, *Revenue Recognition*

FASB Accounting Standards Codification Subtopic 605-15, *Revenue Recognition: Products*

FASB Accounting Standards Codification Subtopic 605-20, *Revenue Recognition: Services*

FASB Accounting Standards Codification Subtopic 605-25, *Revenue Recognition: Multiple-Element Arrangement*s

FASB Accounting Standards Codification Subtopic 605-28, *Revenue Recognition: Milestone Method*

FASB Accounting Standards Codification Subtopic 605-35, *Revenue Recognition: Construction-Type and Production-Type Contracts*

FASB Accounting Standards Codification Subtopic 605-45, *Revenue Recognition: Principal Agent Considerations*

FASB Accounting Standards Codification Subtopic 605-985, *Revenue Recognition: Software*

FASB Accounting Standards Codification Subtopic 715-20, *Compensation — Retirement Benefits: Defined Benefit Plans — General*

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

FASB Accounting Standards Codification Topic 718, *Compensation — Stock Compensation*

FASB Accounting Standards Codification Subtopic 715-80, *Compensation — Retirement Benefits: Multiemployer Plans*

FASB Accounting Standards Codification Subtopic 718-10, *Compensation — Stock Compensation: Overall*

FASB Accounting Standards Codification Subtopic 720-20, *Other Expenses: Insurance Costs*

FASB Accounting Standards Codification Subtopic 730-10, *Research and Development: Overall*

FASB Accounting Standards Codification Subtopic 740-10, *Income Taxes: Overall*

FASB Accounting Standards Codification Subtopic 740-30, *Income Taxes: Other Considerations or Special Areas*

FASB Accounting Standards Codification Topic 805, *Business Combinations*

FASB Accounting Standards Codification Subtopic 805-10, *Business Combinations: Overall*

FASB Accounting Standards Codification Subtopic 805-20, *Business Combinations: Identifiable Assets and Liabilities, and Any Noncontrolling Interest*

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

FASB Accounting Standards Codification Subtopic 808-10, *Collaborative Arrangements: Overall*

FASB Accounting Standards Codification Topic 810, *Consolidation*

FASB Accounting Standards Codification Subtopic 810-10, *Consolidation: Overall*

FASB Accounting Standards Codification Topic 815, *Derivatives and Hedging*

FASB Accounting Standards Codification Subtopic 815-10, *Derivatives and Hedging: Overall*

FASB Accounting Standards Codification Subtopic 815-15, *Derivatives and Hedging: Embedded Derivatives*

FASB Accounting Standards Codification Subtopic 815-20, *Derivatives and Hedging: Hedging —General*

FASB Accounting Standards Codification Subtopic 815-30, *Derivatives and Hedging: Cash Flow Hedges*

FASB Accounting Standards Codification Subtopic 815-40, *Derivatives and Hedging: Contracts in Entity's Own Equity*

FASB Accounting Standards Codification Topic 820, *Fair Value Measurements and Disclosures*

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

FASB Accounting Standards Codification Subtopic 825-10, *Financial Instruments: Overall*

FASB Accounting Standards Codification Topic 835, *Interest*

FASB Accounting Standards Codification Topic 850, *Related Party Disclosures*

FASB Accounting Standards Codification Topic 860, *Transfers and Servicing*

FASB Accounting Standards Codification Subtopic 860-10, *Transfers and Servicing: Overall*

FASB Accounting Standards Codification Topic 932, *Extractive Activities — Oil and Gas*

FASB Accounting Standards Codification Subtopic 932-235, *Extractive Activities — Oil and Gas: Notes to the Financial Statements*

FASB Accounting Standards Codification Subtopic 942-10, *Financial Services — Depository and Lending: Overall*

FASB Accounting Standards Codification Subtopic 942-325, *Financial Services — Depository and Lending: Investments — Other*

FASB Accounting Standards Codification Topic 944, *Financial Services — Insurance*

FASB Accounting Standards Codification Subtopic 944-20, *Financial Services — Insurance: Insurance Activities*

FASB Accounting Standards Codification Subtopic 944-40, *Financial Services — Insurance: Claim Costs and Liabilities for Future Policy Benefits*

FASB Accounting Standards Codification Subtopic 944-60, *Financial Services — Insurance: Premium Deficiency and Loss Recognition*

FASB Accounting Standards Codification Topic 946, *Financial Services — Investment Companies*

FASB Accounting Standards Codification Subtopic 946-10, *Financial Services — Investment Companies: Overall*

FASB Accounting Standards Codification Subtopic 970-360, *Real Estate — General: Property, Plant, and Equipment*

FASB Accounting Standards Codification Subtopic 980-10, *Regulated Operations: Overall*

FASB Accounting Standards Codification Subtopic 980-340, *Regulated Operations: Other Assets and Deferred Costs*

FASB Accounting Standards Codification Subtopic 980-715, *Regulated Operations: Compensation — Retirement Benefits*

FASB Accounting Standards Codification Subtopic 985-605, *Software: Revenue Recognition*

FASB Accounting Standards Update No. 2010-20, *Disclosures About the Credit Quality of Financing Receivables and the Allowance for Credit Losses*

FASB Accounting Standards Update No. 2010-10, *Amendments for Certain Investment Funds*

FASB Accounting Standards Update No. 2010-06, *Improving Disclosures About Fair Value Measurements*

FASB Accounting Standards Update No. 2010-03, *Oil and Gas Reserve Estimation and Disclosures*

FASB Accounting Standards Update No. 2010-02, *Accounting and Reporting for Decreases in Ownership of a Subsidiary — a Scope Clarification*

FASB Accounting Standards Update No. 2009-17, *Improvements to Financial Reporting by Enterprises Involved With Variable Interest Entities*

FASB Accounting Standards Update No. 2009-16, *Accounting for Transfers of Financial Assets*

FASB Accounting Standards Update No. 2009-14, *Certain Revenue Arrangements That Include Software Elements — a Consensus of the FASB Emerging Issues Task Force*

FASB Accounting Standards Update No. 2009-13, *Multiple-Deliverable Revenue Arrangements — a Consensus of the FASB Emerging Issues Task Force*

Proposed FASB Accounting Standards Update, *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging*

Proposed FASB Accounting Standards Update, *Amendments for Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*

Proposed FASB Accounting Standards Update, *Disclosure of Certain Loss Contingencies*

FASB Statement No. 167, *Amendments to FASB Interpretation No. 46(R)*

FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements* — an amendment of ARB No. 51

FASB Statement No. 141(R), *Business Combinations*

FASB Statement No. 141, *Business Combinations*

FASB Statement No. 123(R), *Share-Based Payment*

FASB Statement No. 14, *Financial Reporting for Segments of a Business Enterprise*

FASB Concepts Statement No. 6, *Elements of Financial Statements*

FASB Concepts Statement No. 2, *Qualitative Characteristics of Accounting Information*

FASB Staff Position No. FAS 157-4, "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly"

FASB Staff Position No. FAS 115-2 and FAS 124-2, "Recognition and Presentation of Other-Than-Temporary Impairments"

FASB Staff Position No. FAS 107-1 and APB 28-1, "Interim Disclosures About Fair Value of Financial Instruments"

FASB Staff Position No. EITF 99-20-1, "Amendments to the Impairment Guidance of EITF Issue No. 99-20"

EITF Issue No. 10-E, "Accounting for Deconsolidation of a Subsidiary That Is In-Substance Real Estate"

EITF Issue No. 09-E, "Accounting for Stock Dividends, Including Distributions to Shareholders with Components of Stock and Cash"

EITF Issue No. 09-3, "Certain Revenue Arrangements That Include Software Elements"

EITF Issue No. 07-4, "Application of the Two-Class Method under FASB Statement No. 128 to Master Limited Partnerships"

EITF Topic No. D-101, "Clarification of Reporting Unit Guidance in Paragraph 30 of FASB Statement No. 142"

AICPA Audit and Accounting Guide *Depository and Lending Institutions*

AICPA Technical Practice Aids, TIS Section 1300.15, "Statement of Cash Flows: Presentation of Cash Overdraft on Statement of Cash Flows"

Center for Audit Quality (CAQ) Alert No. 2010-21, "New Standard on Accounting for Variable Interest Entities — Section 404 Considerations"

Center for Audit Quality (CAQ) Alert No. 2010-20, "New Standard on Accounting for Variable Interest Entities — Transition Questions for SEC Registrants"

Center for Audit Quality (CAQ) Alert No. 2009-53, "Time Sensitive Issues From CAQ SEC Regulations Committee Meeting With SEC Staff"

AICPA Center for Public Company Audit Firms (CPCAF) Alert No. 98, "Update to SEC Staff Position Regarding Changes to the Statement of Cash Flows Relating to Discontinued Operations (Addendum to CPCAF Alert #90)"

SEC Staff Accounting Bulletin Topic 1.M, "Materiality" (SAB 99)

SEC Staff Accounting Bulletin Topic 1.N, “Considering the Effects of Prior Year Misstatements When Quantifying Misstatements in Current Year Financial Statements” (SAB 108)

SEC Staff Accounting Bulletin Topic 5.M, “Other Than Temporary Impairment of Certain Investments in Debt and Equity Securities” (SAB 59)

SEC Staff Accounting Bulletin Topic 5.Y, “Accounting and Disclosures Relating to Loss Contingencies” (SAB 92)

SEC Staff Accounting Bulletin Topic 6.K, “Accounting Series Release 302 — Separate Financial Statements Required by Regulation S-X” (SAB 43 and SAB 44)

SEC Staff Accounting Bulletin Topic 6.L, “Financial Reporting Release 28 — Accounting for Loan Losses by Registrants Engaged in Lending Activities” (SAB 102)

SEC Staff Accounting Bulletin Topic 11.B, “Depreciation and Depletion Excluded From Cost of Sales” (SAB 1)

SEC Staff Accounting Bulletin Topic 11.M, “Disclosure of the Impact That Recently Issued Accounting Standards Will Have on the Financial Statements of the Registrant When Adopted in a Future Period” (SAB 74)

SEC Staff Accounting Bulletin Topic 13, “Revenue Recognition” (SAB 101 and SAB 104)

SEC Staff Accounting Bulletin Topic 13.A, “Selected Revenue Recognition Issues” (SAB 101 and SAB 104)

SEC Staff Accounting Bulletin Topic 14, “Share-Based Payment” (SAB 107 and SAB 110)

SEC Staff Accounting Bulletin Topic 14.F, “Classification of Compensation Expense Associated With Share-Based Payment Arrangements” (SAB 107)

SEC Securities Exchange Act of 1934, Part 244, Regulation G, “Disclosure of Non-GAAP Financial Measures”

SEC Financial Reporting Manual — Division of Corporation Finance

Topic 8, “Non-GAAP Measures of Financial Performance, Liquidity, and Net Worth”

Topic 9, “Management’s Discussion and Analysis of Financial Position and Results of Operations (MD&A)”

SEC Regulation S-X, Rule 2-02, “Accountants’ Reports and Attestation Reports”

SEC Regulation S-X, Rule 3-05, “Financial Statements of Businesses Acquired or to Be Acquired”

SEC Regulation S-X, Rule 3-09, “Separate Financial Statements of Subsidiaries Not Consolidated and 50 Percent or Less Owned Persons”

SEC Regulation S-X, Rule 3-10, “Financial Statements of Guarantors and Issuers of Guaranteed Securities Registered or Being Registered”

SEC Regulation S-X, Rule 3-14, “Special Instructions for Real Estate Operations to Be Acquired”

SEC Regulation S-X, Rule 3-16, “Financial Statements of Affiliates Whose Securities Collateralize an Issue Registered or Being Registered”

SEC Regulation S-X, Rule 4-08, “General Notes to Financial Statements”

SEC Regulation S-X, Rule 4-10, “Financial Accounting and Reporting for Oil and Gas Producing Activities Pursuant to the Federal Securities Laws and the Energy Policy and Conservation Act of 1975”

SEC Regulation S-X, Rule 5-02, “Balance Sheets”

SEC Regulation S-X, Rule 5-03, “Income Statements”

SEC Regulation S-X, Rule 5-04, “What Schedules Are to Be Filed”

SEC Regulation S-X, Rule 12-04, “Condensed Financial Information of Registrant”

SEC Regulation S-X, Article 11, “Pro Forma Financial Information”

SEC Regulation S-K, Subpart 229, “General”

SEC Regulation S-K, Item 10, "General"

SEC Regulation S-K, Item 101, "Description of Business"

SEC Regulation S-K, Item 101(c), "Description of Business: Narrative Description of Business"

SEC Regulation S-K, Item 103, "Legal Proceedings"

SEC Regulation S-K, Item 201, "Market Price of and Dividends on the Registrant's Common Equity and Related Stockholder Matters"

SEC Regulation S-K, Item 303, "Management's Discussion and Analysis of Financial Condition and Results of Operations"

SEC Regulation S-K, Item 305, "Quantitative and Qualitative Disclosures About Market Risk"

SEC Regulation S-K, Item 307, "Disclosure Controls and Procedures"

SEC Regulation S-K, Item 308, "Internal Control Over Financial Reporting"

SEC Regulation S-K, Item 308(a), "Internal Control Over Financial Reporting: Management's Annual Report on Internal Control Over Financial Reporting"

SEC Regulation S-K, Item 308(c), "Internal Control Over Financial Reporting: Changes in Internal Control Over Financial Reporting"

SEC Regulation S-K, Item 401, "Directors, Executive Officers, Promoters and Control Persons"

SEC Regulation S-K, Item 402, "Executive Compensation"

SEC Regulation S-K, Item 404, "Transactions With Related Persons, Promoters and Certain Control Persons"

SEC Regulation S-K, Item 407, "Corporate Governance"

SEC Regulation S-K, Item 503, "Prospectus Summary, Risk Factors, and Ratio of Earnings to Fixed Charges"

SEC Regulation S-K, Item 503(c), "Prospectus Summary, Risk Factors, and Ratio of Earnings to Fixed Charges: Risk Factors"

SEC Regulation S-K, Item 506, "Dilution"

SEC Regulation S-K, Item 512, "Undertakings"

SEC Regulation S-K, Item 601, "Exhibits"

SEC Regulation S-K, Item 1202, "Disclosure of reserves"

SEC Regulation S-K, Item 1203, "Proved Undeveloped Reserves"

SEC Regulation S-K, Item 1205, "Drilling and Other Exploratory and Development Activities"

SEC Regulation S-K, Item 1206, "Present Activities"

SEC Regulation S-K, Item 1208, "Oil and Gas Properties, Wells, Operations, and Acreage"

SEC Regulation M-A, Item 1015, "Reports, Opinions, Appraisals and Negotiations"

SEC Regulation A-B, Item 1101, "Definitions"

SEC Final Rule Release No. 33-8176, *Conditions for Use of Non-GAAP Financial Measures*

SEC Final Rule Release No. 33-8238, *Management's Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports*

SEC Final Rule Release No. 33-8350, *Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations*

SEC Final Rule Release No. 33-8995, *Modernization of Oil and Gas Reporting*

SEC Final Rule Release No. 33-9002, *Interactive Data to Improve Financial Reporting*

SEC Final Rule Release No. 33-9089, *Proxy Disclosure Enhancements*

SEC Final Rule Release No. 33-9136, *Facilitating Shareholder Director Nominations*

SEC Final Rule Release No. 33-9142, *Internal Control Over Financial Reporting in Exchange Act Periodic Reports of Non-Accelerated Filers*

SEC Final Rule Release No. 34-61335, *Shareholder Approval of Executive Compensation of TARP Recipients*

SEC Interpretive Release No. 33-8350, *Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations*

SEC Interpretive Release No. 33-9144, *Commission Guidance on Presentation of Liquidity and Capital Resources Disclosures in Management's Discussion and Analysis*

SEC Concept Release No. 34-62495, *Concept Release on the U.S. Proxy System*

SEC Compliance and Disclosure Interpretations

- Regulation S-K
- Exchange Act Sections
- Exchange Act Rules
- Non-GAAP Financial Measures

SEC Securities Act Industry Act Guide 3, "Statistical Disclosure by Bank Holding Companies"

SEC Investment Company Act of 1940, Rule 2a-7, "Money Market Funds"

SEC Financial Reporting Codification

- Section 216, "Disclosure of Unusual Charges and Credits to Income"
- Section 501, "Management's Discussion and Analysis"

Appendix F: Abbreviations

Abbreviation	Description
AICPA	American Institute of Certified Public Accountants
AICPA Conference	The annual AICPA National Conference on Current SEC and PCAOB Developments
ARS	auction rate security
ASC	FASB Accounting Standards Codification
ASU	FASB Accounting Standards Update
AUM	assets under management
BsF	bolivar fuertes
CAQ	Center for Audit Quality
C&DI	SEC Compliance and Disclosure Interpretation
CD&A	compensation discussion and analysis
CFO	chief financial officer
CIK	central index key
CMS	Centers for Medicare and Medicaid Services
CODM	chief operating decision maker
CPCAF	AICPA's Center for Public Company Audit Firms
CRE	commercial real estate
DAC	deferred acquisition costs
EBITDA	earnings before income taxes, depreciation, and amortization
ED	exposure draft
EDGAR	SEC's Electronic Data Gathering, Analysis, and Retrieval System
EGP	estimated gross profit
EITF	Emerging Issues Task Force
EPS	earnings per share
FAQ	frequently asked question
FASB	Financial Accounting Standards Board
FCC	Federal Communications Commission
FDA	Food and Drug Administration
FDIC	Federal Deposit Insurance Company
FFO	funds from operations

FHLB	Federal Home Loan Bank
FPI	foreign private issuer
FSP	FASB Staff Position
FRM	SEC Financial Reporting Manual
GAAP	generally accepted accounting principles
HAMP	Home Affordable Modification Program
HARP	Home Affordable Refinance Program
IASB	International Accounting Standards Board
IBNR	incurred but not reported
ICFR	internal control over financial reporting
IFRS	International Financial Accounting Standard
IPR&D	in-process research and development
LAE	loss adjustment expense
LSA	loss sharing arrangement
MD&A	Management's Discussion and Analysis
NAREIT	National Association of Real Estate Investment Trusts
NEO	named executive officer
OCA	SEC's Office of the Chief Accountant
OIG	Office of Inspector General
OPEB	other postemployment benefit
OREO	other real estate owned
OTTI	other-than-temporary impairment
P&C	property and casualty
PCAOB	Public Company Accounting Oversight Board
PCS	postcontract customer support
PUD	proved undeveloped
R&D	research and development
repo	repurchase agreement
SAB	SEC Staff Accounting Bulletin
SEC	Securities and Exchange Commission
SIC	standard industrial classification
TARP	Troubled Asset Relief Program
TDR	troubled debt restructuring

TIS	AICPA Technical Questions and Answers
VIE	variable interest entity
VSOE	vendor-specific objective evidence
XBRL	eXtensible Business Reporting Language

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