

SEC Comment Letters on Domestic Registrants *A Closer Look*



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Preface

Section 408(c) of the Sarbanes-Oxley Act of 2002 requires the SEC staff to review every issuer's disclosures, including financial statements, at least once every three years. The SEC staff's comments and registrants' responses are posted on the SEC's Web site and provide valuable insight into areas of SEC staff focus. Registrants can incorporate a review of the comments into their financial reporting process to help improve their financial statements and disclosures.

The second edition of "SEC Comment Letters on Domestic Registrants: A Closer Look" provides extracts from frequently issued SEC staff comments, along with additional analysis and links to related resources. This revised edition reflects both new topics and new areas within existing topics that the SEC staff has commented on since the release of the first edition in January 2008. The SEC staff has continued to issue comments on all topics included in the first edition, such as revenue recognition, business combinations, segment reporting, financial instruments, and impairments. However, in light of the troubled credit markets, the staff has been more closely scrutinizing goodwill and intangible asset impairments, other-than-temporary impairments, deferred tax valuation allowances, compliance with debt covenants, fair value, and the allowances for loan losses, just to name a few. (See [What's New in the Second Edition?](#) for a complete list of new, revised, and updated topics, not including minor changes.)

Like the first edition, this revised edition includes, where relevant, excerpts from and links to Deloitte's annual *Heads Up* on the AICPA National Conference on Current SEC and PCAOB Developments (the "Conference") as well as other publications. At the Conference, held 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. A complete listing of all our publications is available at www.deloitte.com.

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

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

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

Members of the following Deloitte teams contributed to this second edition: Accounting Standards and Communications, SEC Services, and Accounting Consultation.

What's New in the Second Edition?

New Topics

Capitalization of Costs

Debt

Loan Loss Reserves

Significantly Revised Topics

Disclosure Controls and Procedures and Internal Control Over Financial Reporting

Investments

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

Share-Based Payments¹

Use of Experts and Consents

Updated Topics²

Business Combinations, Long-Lived Assets, and Impairments

Contingencies

Discontinued Operations and Assets Held for Sale

Earnings per Share

Executive Compensation

Fair Value and the Turmoil in the Credit Markets

Financial Instruments

Financial Statement Classification

Income Taxes and Uncertain Tax Positions

Management's Discussion and Analysis

Non-GAAP Measures

Pensions

Revenue Recognition

SEC Reporting (Regulation S-X Misapplication)

¹ This topic is updated only for examples of recent SEC comments.

² Updates are located at the end of each topic.

Business Combinations, Long-Lived Assets, and Impairments

Examples of SEC Comments

- *Purchase Price Allocations* — We note that the excess of the purchase price over the net assets acquired . . . resulted in goodwill of approximately [\$XXX million]. In future filings where you discuss a material acquisition, please include a discussion of the factors that contributed to a purchase price that resulted in recognition of a significant amount of goodwill. Refer to paragraph 51(b) of SFAS 141.
- *Intangible Assets: Customer Relationships* — It is unclear from your disclosures whether you amortize your customer relationship intangible assets on a straight-line basis or accelerated basis. Please tell us and disclose the method used. Further, paragraph 12 of SFAS 142 requires companies to amortize identifiable intangible assets using a method that reflects the pattern in which the economic benefits of the assets will be consumed. The straight-line method of amortization should be used if the company cannot reliably determine that pattern. We believe the benefits from acquisition of customer relationships within a large group of accounts tend to dissipate more rapidly in the earlier years after a company acquires the contracts. The rate of decrease of benefits will slow until relatively few customers . . . remain. In these situations, we believe that an accelerated method of amortization is the most appropriate way to allocate the cost of the customer relationship to the periods that will benefit from the relationship. The straight-line method is appropriate only if the estimated life of the intangible asset is shortened to ensure that recognition of the cost of the revenues better corresponds with the distribution of expected revenues.
- *Impairments* — Taking into consideration the circumstances that caused you to recognize an impairment charge on the . . . goodwill, tell us whether you first tested your long-lived assets pursuant to SFAS 144. If you did test your long-lived assets for impairment, explain to us why an impairment charge was not recognized. If you have not tested your long-lived assets for impairment, explain to us why not. Please also tell us how you group your long-lived assets for purposes of testing your long-lived assets for impairment using the guidance of paragraphs 10–12 of SFAS 144.

Purchase Price Allocations

The SEC staff frequently asks questions about purchase price allocations for business combinations. In particular, the staff has asked registrants that have recorded significant goodwill why they have not attributed value to specified intangible assets. The SEC staff has also been reminding registrants that paragraph 51(b) of Statement 141¹ requires disclosure of the factors contributing to a purchase price that results in the recognition of goodwill, especially if the goodwill is significant.

The SEC staff has often commented when a registrant indicates in a filing or press release that an intangible asset was acquired but the asset was not recorded in the purchase price allocation. For example, registrants that disclosed in their Management's Discussion and Analysis (MD&A) that they acquired contracts with customers in a business combination, but that they did not recognize a customer-related intangible asset, have been asked why not.

In addition, the SEC staff often asks detailed questions about material revisions to an initial purchase price allocation. For example, the staff has asked what significant assumptions have changed that support a revision to the value of intangible assets.

Intangible Assets — Customer Relationships

Another area the SEC staff has addressed is the accounting for customer relationships. The staff has asked 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 staff has also issued comments about the use of straight-line versus accelerated amortization methods. Paragraph 12 of Statement 142 requires entities to amortize identifiable intangible assets by using a method based on the pattern in which the economic benefits of the assets are consumed and prohibits defaulting to the use of the straight-line

¹ Throughout this publication, the short forms of the standards are used. For the full titles, see [Appendix E](#).

method unless the pattern cannot be determined. Consequently, the SEC staff has challenged registrants that use the straight-line method, even when useful lives are short. The staff has requested such registrants to support assertions about their inability to 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 acquisition and that it is more appropriate to amortize these assets on an accelerated basis.

Statements 141(R) and 160

In December 2007, the FASB issued Statements No. 141(R), *Business Combinations*, and No. 160, *Noncontrolling Interests in Consolidated Financial Statements*. Statements 141(R) and 160 are effective for 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. An entity is required to provide SAB 74 disclosures about the effects of these recently issued accounting pronouncements before the adoption date.

Impairments

In a report on restatements,² the Center for Audit Quality indicated that approximately 10 percent of the 1,876 restatements during 2006 related to property, plant, and equipment impairments or to intangible asset impairments. Although Statements 142 and 144 have been around since 2001, they continue to be an area of focus for both the SEC and the PCAOB. 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 goodwill or other long-lived assets may not be recoverable.
- The methods and assumptions used in impairment tests.
- A sensitivity analysis that shows how fair value would fluctuate on the basis of hypothetical changes in assumptions.
- The timing of the impairment, especially if events that could result in impairments occurred in periods before the registrant recorded the impairment. Under these circumstances, the SEC staff may ask registrants to justify why the impairment was not recorded in the previous period.
- How many reporting units the registrant has and whether any have declining fair values.
- The types of events that could result in impairments.
- Comprehensive disclosure in the critical accounting policies section of MD&A regarding the registrant's process for assessing impairments.
- The facts and circumstances leading to impairments, along with a reminder that a registrant may be required to disclose in MD&A risks and uncertainties associated with the recoverability of assets in the periods before an impairment is recorded.

The SEC staff also frequently asks questions about how a registrant groups assets for impairment tests, especially when the registrant's disclosure is not clear that goodwill is tested at the reporting-unit level or that long-lived assets are tested for impairment at the asset-group level. Further, the staff encourages registrants to disclose (1) how reporting units are identified, (2) the allocation of goodwill to reporting units, and (3) whether there have been any relevant changes in the critical accounting policies section of MD&A.

² Center for Audit Quality Report, "Offsetting Fluctuations Cause 2006 Financial Statement Restatement Increase of 17%; Non-Accelerated Filer Restatements Rise by 25%; Accelerated Filer Restatements Decline by 8%."

Asset Grouping for Testing Long-Lived Assets for Impairment

Statement 144 defines an asset group as the “lowest level for which identifiable cash flows are largely independent of the cash flows of other assets and liabilities.” The SEC staff has frequently issued comments to registrants that have tested long-lived assets at an operating-segment, a reportable-segment, or a reporting-unit level, since there are often identifiable cash flows below such a level. Registrants should begin at the lowest level of cash flows in the organization and should group assets at a higher level only if it is appropriate to do so. In determining whether to group assets at a higher level, registrants should consider the following factors: (1) the existence of shared costs, (2) the interdependence of assets, and (3) the extent to which purchases are made on a combined basis.

Asset Grouping for Testing Goodwill for Impairment

Statement 142 indicates that goodwill should be tested for impairment at the reporting-unit level. A reporting unit is defined as (1) an operating segment (as defined in Statement 131) or (2) “one level below an operating segment (referred to as a component).” A component is a reporting unit if it “constitutes a **business** [footnote omitted] for which **discrete financial information** is available and **segment management** [footnote omitted] **regularly reviews the operating results** of that component”³ (emphasis added). Paragraph 10 of Statement 131 and Questions 3 and 4 of the related FASB staff implementation guide discuss “discrete financial information,” and paragraph 14 of Statement 131 defines “segment management.” Paragraph 30 of Statement 142 states that when determining reporting units, a registrant must 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 paragraph 17 of Statement 131. The *SEC’s Current Accounting and Disclosure Issues in the Division of Corporation Finance* (as updated November 30, 2006) contains additional information on aggregating the components of an operating segment:

While the components of an operating segment may be aggregated for the purposes of goodwill impairment testing and considered a single reporting unit if the components have similar economic characteristics, it is not permissible to aggregate separate operating segments into one reporting unit. At a minimum, each operating segment is a reporting unit under SFAS 142 that should be tested separately. Additionally, registrants should not aggregate components from different operating segments that share similar economic characteristics into a single reporting unit.

SEC Staff Remarks at the AICPA Conference

SEC staff members frequently provide insights on business combinations and impairments at the AICPA Conference. See Deloitte’s *Heads Up* on the 2007 Conference for summaries of SEC staff comments on the use of a replacement cost approach for valuing intangible assets and determining the acquirer in a business combination.

³ Statement 141(R) is effective for business combinations whose acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. After the effective date of Statement 141(R), see paragraphs A4–A9 for the definition of a business for U.S. GAAP purposes. Before the effective date of Statement 141(R), see Issue 98-3 for this definition. Because Statement 141(R) broadens the definition of a business, a component that did not qualify as a reporting unit before the Statement’s effective date may qualify after its effective date. Upon the effective date of Statement 141(R), an entity should immediately consider whether additional components of an operating segment (i.e., reporting units) exist, even though the Statement’s transition provisions do not explicitly state to do so. If the entity identifies a new reporting unit or units, it must reassign its previously recorded goodwill to these units in accordance with paragraph 36 of Statement 142. On this same date, the entity should also consider assessing whether the relative fair value of each reporting unit (used to reallocate goodwill) is greater or less than the carrying amount of the affected reporting units. That is, the entity should evaluate whether the reporting unit is impaired and whether it must perform step 2 of the goodwill impairment test.

2008 Update

Examples of Recent SEC Comments

- *Impairments* — This decline in the Company’s market capitalization, coupled with declines in various categories of the Company’s revenues . . . may be indicative of a potential impairment of the Company’s recorded investment in its intangible assets and goodwill. Based on the guidance in SFAS 142, and in light of the fact that the Company’s market capitalization has been steadily declining . . . advise us what consideration was given to recognizing an impairment of the Company’s recorded investment in goodwill and other intangible assets. As part of your response, specifically address the reasons you believe these intangible assets are more valuable than the market’s valuation of the entire company as a whole, and provide us with a detailed analysis of significant assumptions involved.
- *Impairments* — There is a concern that investors may have been surprised by this \$[XX] million impairment charge Item 303 of Regulation S-K require[s] 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 may require specific disclosure prior to the period of the impairment charge. See the guidance in Sections 501.02 and 501.12.b.3 of the Financial Reporting Codification, as well as in SAB Topic 5:P.4. Also, Section 216 of the Financial Reporting Codification states that “registrants have an obligation to forewarn public investors of the deteriorating conditions which, unless reversed, may result in a subsequent write-off. This includes an obligation to provide information regarding the magnitude of exposure to loss.” . . . Therefore, please clarify for us why there was no specific, prior disclosure regarding a material uncertainty over the recoverability of the . . . asset. Describe the specific factors considered by management in assessing the likelihood of future impairments.
- *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 . . . that during 2007 and 2006, the company paid \$[XX] million and \$[XX] million, respectively, of additional purchase price consideration for acquisitions completed in prior years and the accrued additional purchase consideration was recorded as goodwill. Please tell us and revise the notes to your financial statements in future filings to explain in further detail the nature and terms of the conditions which must occur for this contingent consideration to become payable. As part of your response, please specifically address whether any of these payments are or were contingent upon the former shareholders of the acquired entities remaining employed with the company. Your response should also explain in further detail why you believe it is appropriate to account for the accruals and payments made as part of the purchase price for the acquisitions rather than as compensation expense. Refer to the guidance outlined in paragraphs 25 through 34 of SFAS No. 141 and EITF 95-8.

Impairments

The SEC staff has been questioning whether declines in a registrant’s revenues or market capitalization indicate impairments in recorded intangible assets and goodwill, especially if market capitalization declines below book value. The SEC staff has also been asking registrants to expand their disclosures in the following areas:

- Their policies for impairment testing.
- The organization of their reporting units.
- The methods and significant assumptions used in the impairment analysis, including the methods used to estimate the fair value of reporting units.
- The results of the most recently completed impairment tests.

At the 2008 AICPA Conference, Mr. Robert Fox III, a professional accounting fellow in the SEC’s Office of the Chief Accountant, acknowledged that given the recent market decline, the SEC staff is expecting to see “more goodwill impairments than in prior years.” He also raised several points about goodwill impairment. For example, he remarked that the market capitalization of a registrant may not fully reflect the aggregate fair values of all the registrant’s reporting units. Mr. Fox pointed to paragraph 23 of Statement 142, noting that “an entity might derive ‘substantial value’ from the ability to obtain control.” Accordingly, this control premium may cause the fair value of all the registrant’s reporting units to

exceed the registrant's market capitalization. He also indicated that while it would be "prudent" for an entity to reconcile the aggregate fair value of its reporting units to its market capitalization, an entity should also consider other factors when assessing goodwill for impairment.

Also at the 2008 AICPA Conference, Mr. Steven Jacobs, associate chief accountant in the SEC's Division of Corporation Finance, shared his perspective on goodwill impairment in the current economic environment, a topic that the Division has focused on recently. He suggested that entities consider the following indicators or "triggering events" in addition to those in paragraph 28 of Statement 142:

- Cash or operating losses at the reporting unit.
- Consecutive operating results that are significantly lower than analysts' or internal forecasts.
- Significant revisions to internal or external forecasts.
- A new restructuring plan (an entity should also consider whether this constitutes a reorganization of its reporting structure and whether a reallocation of goodwill is required).
- Market capitalization that is below book value.
- A negative long-term outlook for the industry in which the reporting unit operates.
- An increase in deferred tax valuation allowances at the reporting unit, which could arise from a reduction in the reporting unit's projected taxable income.

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

The SEC staff has also been commenting that possible asset write-offs may require disclosure in filings before the period of the impairment charge. Mr. Jacobs urged entities to provide early-warning disclosures in MD&A (see Item 303(a)(3)(ii) of Regulation S-K) and in the notes to the financial statements (see SOP 94-6) when any of the following occur:

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

In addition, Section 216 of the 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.

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 occur for the arrangement to become payable. Statement 141(R) will change the way a registrant accounts for contingent consideration. Under Statement 141, contingent consideration is generally not recognized until the contingency is resolved and the consideration becomes issuable. Statement 141(R)

will require that registrants recognize contingent consideration at fair value as of the acquisition date. Once an entity adopts Statement 141(R), the staff will most likely continue asking for additional disclosure about the nature and terms of contingent consideration arrangements. The staff will also most likely look for disclosure about how the registrant determined the fair value of the arrangement. The SEC staff has also been asking that registrants provide more detail about the appropriateness of accounting for the arrangement as part of the purchase price for the acquisition rather than as compensation expense. For example, Issue 95-8 provides factors to consider in determining whether an arrangement represents compensation for services, use of property, or profit sharing. Issue 95-8 states that an “arrangement in which the payments are automatically forfeited if employment terminates is a strong indicator that the arrangement is compensation for postcombination services.” The SEC staff has been requesting that registrants specifically disclose whether any of the arrangements are contingent upon the continuing employment of the selling shareholders. Issue 95-8 was incorporated into Statement 141(R). For that reason, the SEC staff may continue to ask questions about whether the arrangement constitutes compensation expense or compensation for services even after an entity adopts Statement 141(R).

Use of Valuation Experts

The SEC staff has been commenting on the use of valuation experts for purchase price allocations and impairment testing. See the [Use of Experts and Consents](#) section for the staff’s current position on this topic.

Other Deloitte Resources

- [Accounting for Business Combinations and Related Topics: A Roadmap to Applying FASB Statements 141\(R\), 142, and 160.](#)
- [Financial Reporting Alert 08-18, “Effect of Statement 141\(R\) on Income Tax Accounting.”](#)
- [November 2008 EITF Snapshot.](#)
- [December 17, 2008, Heads Up, “FASB’s Contingency Plan — FASB Proposes FSP to Amend Statement 141\(R\)’s Guidance on Contingencies.”](#)
- [April 29, 2008, Heads Up, “FASB Issues Guidance on Intangible Assets Subject to Renewal or Extension.”](#)
- [December 12, 2007 \(revised December 19, 2007\), Heads Up, “Major Changes to Business Combination Accounting as FASB and IASB Substantially Converge Standards.”](#)
- [Accounting for Business Combinations, Goodwill, and Other Intangible Assets: A Roadmap to Applying Statements 141 and 142.](#)

Contingencies

Example of an SEC Comment

- Please revise to provide the disclosures required by paragraphs 8, 9 and 10 of SFAS 5, or tell us why you believe such disclosures are not required. Specifically, please disclose the nature of accrual(s) made pursuant to paragraph 8 of SFAS 5 and if material, the amount of such accrual(s). If no accrual is made because one or both of the conditions in paragraph 8 are not met, or if an exposure to loss exists in excess of the amount(s) accrued, disclosure of the contingency shall be made when there is at least a reasonable possibility that a loss or additional loss may have been incurred. The disclosure should provide an estimate of the possible loss or range of loss or state that such an estimate cannot be made.

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 deficiencies in 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 and why they believe that the contingency's outcome would not materially affect their financial results.

2008 Update

In June 2008, the FASB issued an [Exposure Draft](#) of a proposed Statement that it believes would enhance contingency disclosure requirements by (1) expanding disclosures of the types of loss contingencies to include certain remote loss contingencies, (2) specifying disclosure of certain quantitative and qualitative information, and (3) requiring a tabular reconciliation of changes in amounts recognized for loss contingencies. The FASB is addressing issues raised in the many comment letters it received on the Exposure Draft. The proposed Statement would be effective no sooner than for fiscal years ending after December 15, 2009.

Other Deloitte Resources

- [Financial Reporting Alert 08-13, "Accounting Considerations for Settlement Agreements Related to Auction Rate Securities."](#)
- [December 17, 2008, *Heads Up*, "FASB's Contingency Plan — FASB Proposes FSP to Amend Statement 141\(R\)'s Guidance on Contingencies."](#)
- [June 10, 2008, *Heads Up*, "FASB Proposes Expanding Contingencies Disclosure."](#)

Debt

Examples of Recent SEC Comments

- *Balance Sheet Classification* — We note you were in violation of your loan covenants Your disclosures do not indicate you have received waivers from your lenders to cure the non-compliance. In accordance with SFAS 78, it appears your long-term debt should be classified as a current liability in its entirety on your balance sheet. Please revise your balance sheet and disclosures accordingly, or addressing the relevant accounting literature, tell us why you believe the classification of long-term debt is appropriate.
- *Debt-Related Disclosures* — We note that your senior credit facility contains restrictions on the payment of dividends. Please disclose the pertinent provisions of the restrictive covenants regarding payment of dividends and the amount of retained earnings or net income restricted or free of restrictions. Refer to Item 4-08(e)(1) of Regulation S-X.
- *Refinancing* — Please tell us how you determined the proper accounting treatment related to your issuance of \$[XXX] million of [X]% senior notes Specifically, address how you determined whether the termination of the [X]% junior subordinated debt qualified as a debt extinguishment with a gain or loss on termination under EITF 96-19. Please reference any and all additional accounting guidance used in your analysis.
- *Financial Covenant Disclosures* — We note your disclosure . . . regarding the risks that your substantial level of indebtedness places on your business. We further note your disclosure that you expect to take additional loans under your senior credit facility to pay your expenses and the interest on your debt. Given your reliance on your debt availability, please revise future filings to include a discussion regarding any circumstances that may limit the level of borrowings available to you under your senior credit facility. In addition, please include a tabular presentation of your actual ratios and other actual amounts versus the minimum/maximum ratios/amounts permitted under your financial covenants for your senior credit facility, Senior Subordinated Notes, and Senior Discount Notes. Such presentation will allow an investor to easily understand your current status in meeting your financial covenants. Such disclosure should only be excluded if you believe that the likelihood of default is remote. Refer to Section 501.03 of the Financial Reporting Codification for guidance.
- *Financial Covenant Disclosures* — We noted your discussion regarding financial covenants. . . . Please revise future filings to discuss your compliance with your debt covenants.

Balance Sheet Classification

The SEC staff has frequently commented on the appropriate balance sheet classification of outstanding debt amounts. When presenting a classified balance sheet, registrants must consider a number of accounting standards to determine whether outstanding debt should be classified as current or noncurrent. In accordance with Chapter 3A of ARB 43 and Statement 6, an entity should ensure that short-term obligations expected to be refinanced are classified as current liabilities, unless the entity has both the intent to refinance and the ability to consummate the refinancing.

In addition, the SEC staff has focused on whether registrants have considered the guidance in Statement 78 and Issue 86-5 when debt arrangements include provisions that result in the debt's being due on demand (i.e., callable by the creditor). Entities should also consider Technical Bulletin 79-3 and Issue 95-22 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 the 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

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

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

Refinancing

Over the past few years, the SEC and FASB staffs have focused on the accounting for debt modifications. At both the 2004 and 2003 AICPA Conferences, Mr. Robert J. Comerford, a professional accounting fellow in the SEC's Office of the Chief Accountant, discussed a number of debt modification issues, including the application of Issue 96-19 and modifications of convertible debt instruments. In addition, the EITF reached a consensus on Issue 06-6 regarding the evaluation of modifications of conversion features embedded in debt instruments.

In accordance with Issue 96-19, an issuer that modifies a debt instrument must compare the present value of the original debt instrument's cash flows with the present value of the cash flows of the modified debt. If the present value of those cash flows differs by more than 10 percent, the modification is considered significant and extinguishment accounting is applied to the original debt. Further, in accordance with Issue 06-6, modifications to any embedded conversion features should be analyzed separately when the analysis under Issue 96-19 does not result in a conclusion that a significant modification has occurred.

The SEC staff's recent comments on this topic have focused on (1) the registrant's conclusion that a transaction should be accounted for as a debt extinguishment under Issues 96-19 and 06-6 and (2) disclosures about the significant components of the gains or losses recorded on a debt extinguishment, including how the components were calculated.

Financial Covenant Disclosures

At the 2008 AICPA Conference, Mr. Michael Fay, associate chief accountant in the SEC's Division of Corporation Finance, discussed the importance of the liquidity section of MD&A as well as factors registrants should consider in preparing for their upcoming filings. He referred to two interpretive releases¹ that provide guidance on preparing the liquidity section. 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 in the financial covenant section.

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

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

discuss whether the breach will cast doubt on its future viability. Merely stating that there may be a material impact on liquidity is not informative; the registrant should carefully address reasonably likely implications.

In addition, 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. 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.

In responding to a question asking how much detail should be provided about debt covenants, Ms. Pamela A. Long, assistant director in the SEC's Division of Corporation Finance, indicated that when registrants disclose the covenants, they should generally provide numerical disclosures of the required and actual ratios in MD&A.

Disclosure Controls and Procedures and Internal Control Over Financial Reporting

Examples of Recent SEC Comments

Disclosure Controls and Procedures

- *Inappropriate Conclusion About Disclosure Controls and Procedures* — We note that you performed an evaluation of the effectiveness of the design and operations of your disclosure controls and procedures and concluded they were adequate [Y]ou must conclude whether your disclosure controls and procedures are effective or ineffective. Tell us how you complied with such requirements or advise us.
- *Incomplete Conclusion About Disclosure Controls and Procedures* — We note your conclusion that “the disclosure controls and procedures were effective in providing such reasonable assurance during the period covered in these annual reports.” In future filings, please revise to state clearly, if true, that your disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives and that your Principal Executive Officer and Principal Financial Officer concluded that your disclosure controls and procedures are effective at that reasonable assurance level. In the alternative, remove the reference to the level of assurance of your disclosure controls and procedures. Please refer to Section II.F.4 of SEC Release No. 33-8238, available on our website at www.sec.gov. Additionally, please confirm to us that your conclusion regarding effectiveness would not change had such statements been included in this filing.
- *Incomplete Definition of Disclosure Controls and Procedures* — If you choose to disclose the definition of the term disclosure controls and procedures in management’s evaluation, please include the entire definition of the term, as provided in Rule [240.]13a-15(e) of the Securities Exchange Act of 1934.
- *Conclusion That Disclosure Controls and Procedures Were Effective If a Material Weakness Existed* — We note that you concluded that your company did not maintain effective internal control over financial reporting . . . due to the deficiency in your controls We note that this deficiency in your controls resulted in audit adjustments to your . . . consolidated financial statements. Given the identified “material weakness” in your controls over financial reporting, please tell us how your Chief Executive Officer and Chief Financial Officer concluded that your disclosure controls and procedures were effective
- *Conclusion That Disclosure Controls and Procedures Were Effective If Reports Were Not Filed in a Timely Manner* — We note that you have not timely filed some of your reports during the last 12 months. Please advise as to how you considered these late filings with respect to management’s effectiveness conclusion about your disclosure controls and procedures.
- *Conclusion That Disclosure Controls and Procedures Were Effective If Management’s Report on Internal Control Over Financial Reporting Has Not Been Filed* — It does not appear that your management has performed its assessment of internal control over financial reporting as of [the period end] Please consider whether management’s failure to perform or complete its report on internal control over financial reporting impacts its conclusions regarding the effectiveness of your disclosure controls and procedures as of the end of the fiscal year covered by the report and revise your disclosure as appropriate.

Internal Control Over Financial Reporting

- *Disclosure of the Framework Used to Evaluate Internal Control Over Financial Reporting* — We noted that Management’s Report on Internal Control over Financial Reporting does not include a statement identifying the framework used by management to evaluate the effectiveness of your internal control over financial reporting as required by Item [229.]308T of Regulation S-K. Please advise and further amend the 10-KSB to include the appropriate statement.
- *Disclosure of the Impact of Material Weaknesses* — We note that you disclose an identified material weakness. It is unclear from your disclosure what specific impact the material weakness has on your internal controls over financial reporting. Please address each of the following:
 - Expand your disclosure to address, in greater specificity, the nature and causes of identified material weaknesses, the affected controls and financial reporting functions, the degree to which a material weakness is pervasive or isolated, and the impacted financial statements, line items, and disclosures.
 - Expand your disclosure to include detailed and actionable remediation measures that you intend to undertake to address your deficiencies.

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. 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

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

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

Incomplete Definition of Disclosure Controls and Procedures

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).

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

Also 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, while highly unlikely, a registrant could conclude that disclosure controls and procedures are effective if a material weakness exists in ICFR. 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

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 Commission’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

The SEC staff recently issued comments, particularly to nonaccelerated filers, on the omission of management’s report on ICFR. At the 2008 AICPA Conference, Mr. Paul Beswick, deputy chief accountant for professional practice in the SEC’s Office of the Chief Accountant, stated that failure to include management’s report on its assessment of ICFR in the filings

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.

of nonaccelerated filers constitutes noncompliance with Commission 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 appropriately.

Internal Control Over Financial Reporting

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

Mr. Beswick also 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 request registrants to advise the staff of the appropriate framework used in the current year and to revise the disclosures in current and future filings.

Disclosure of the Impact of Material Weaknesses

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

Discontinued Operations and Assets Held for Sale

Examples of SEC Comments

- *Discontinued Operations Reporting* — Please tell us why these store closures were recorded as restructurings rather than presented as discontinued operations. Since [Company X] was historically a reportable segment, it appears that this would meet the criteria as a component of an entity, and therefore, be reported as discontinued operations. Refer to SFAS 144 and EITF 03-13.
- *Discontinued Operations Reporting* — Please tell us the significance of the . . . contracts that are part of your disposal strategy [related to the disposed entity.] In this regard, please tell us if the contracts constitute significant continuing involvement in the operations of the disposed entity as the term is described in paragraph 42 of SFAS No. 144. Furthermore, please tell us how this was considered when you reported the component as a discontinued operation.
- *Assets Held for Sale* —We note from your disclosure . . . that in [December 2006] you announced a plan to sell [five plants]. Please tell us if the assets of these [five plants] have been classified as held-for-sale as of [December 31, 2006,] in accordance with paragraph 30 of SFAS No. 144. If the assets have not been classified as held-for-sale, please explain to us why not.
- *Expense Allocation* — Please tell us how and whether you allocated interest expense associated with the discontinued operations. We assume you allocated actual expense of assumed debt. Please tell us whether any other allocations of interest expense were made and the method you utilized. Please note the disclosure requirements of EITF 87-24. As a final note, to the extent interest allocations of discontinued operations affected interest expense of continuing operations, this should be analyzed in management’s discussion and analysis of interest expense.

Discontinued Operations Reporting

The SEC staff may question a registrant that disposes of operations that are not presented as discontinued operations. Conversely, it 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. Paragraph 42 of Statement 144 requires companies to report their results related to disposed-of or held-for-sale components as discontinued operations when the following conditions exist:

- (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 the criteria in Statement 144 can be subjective. Issue 03-13 provides guidelines for determining:

- Whether the registrant expects continuing direct cash flows from the disposed-of component after the disposal transaction. Questions to consider include the following:
 - Has there been a migration of revenues or costs from the disposed-of component?
 - Is there a continuation of activities of the disposed-of component?
 - Has the significance of continuing cash flows been measured by comparing the expected continuing cash flows with the cash flows that would have been recognized in the absence of the disposal transaction?
- Whether the registrant has the ability to exert significant influence over the disposed-of component’s operating and financial policies after the disposal transaction. Questions to consider include the following:
 - Are there considerations other than risks and rewards in the determination of whether the ongoing entity has significant continuing involvement?

- Are there retained interests, contracts, and other arrangements that may indicate significant continuing involvement?

Frequently, the SEC staff seeks to understand whether the registrant has continuing involvement with the disposed-of component. The staff may refer to information included in a filing that indicates possible continuing involvement. For instance, the staff may ask detailed questions about the nature and significance of contracts with the discontinued component that the registrant has disclosed (e.g., a contract to continue to manufacture or market the component's products).

Assets Held for Sale

Another area that the SEC has commented on is the classification of assets as held for sale. The SEC staff frequently comments when disclosures indicate that assets were sold but are unclear about when the decision to sell the assets was made. For example, the staff has asked registrants that have disclosed that they sold assets after the balance sheet date, but that did not classify the assets as held for sale as of that 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

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 were expected to be sold or disposed of by the registrant 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 will most likely expect an explanation. See the [Business Combinations, Long-Lived Assets, and Impairments](#) section for further discussion.

Expense Allocation

The SEC staff will sometimes ask for additional information about the allocation of expenses, such as interest expense, in the reporting of discontinued operations. The staff may ask how the method for allocating interest expense complies with Issue 87-24.

Preservation of Discontinued Operations in the Statement of Cash Flows

The SEC staff will also frequently challenge inappropriate presentation of discontinued operations in the statement of cash flows. See the [Financial Statement Classification](#) section for further discussion.

2008 Update

In September 2008, the FASB issued an [Exposure Draft](#) of a proposed FSP that would amend the criteria for when a component of an entity “would be reported in the discontinued operations section of the income statement” and would enhance the “disclosure requirements of Statement 144 for all components of an entity that either have been disposed of or are classified as held for sale regardless of whether a component of an entity is reported in the income statement as a discontinued operation or within continuing operations.” Comments on the proposed FSP were due by January 23, 2009.

Earnings per Share

Examples of SEC Comments

- *Two-Class Method* — Tell us what consideration you gave to computing earnings per share for both Class A and Class B common shares pursuant to the two-class method. Refer to paragraphs 60 and 61 of SFAS 128. We note from your disclosure . . . that each class of common stock participates equally, however, it appears that you may have a material number of dilutive securities in Class A common stock, which may result in different diluted EPS for the two classes.
- *Impact of Convertible Instruments on EPS* — We note from 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 paragraph 61.d of SFAS 128.
- *EPS Disclosures* — Please revise future filings to disclose the number of securities that could potentially dilute EPS in the future, but which were not included in the calculation of diluted EPS because to do so would have been antidilutive for the periods presented. See paragraph 40 of SFAS No. 128.

Two-Class Method

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 Issue 03-6 and paragraphs 60–61 of Statement 128.

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 relating to each of the registrant’s classes of common stock, preferred stock, and common stock equivalents, such as convertible securities, warrants, or options. When the registrant has preferred shares, the SEC staff may seek to determine whether the preferred stockholders have contractual rights to share in profits and losses of the company beyond the stated dividend rate.

The SEC staff has also commented on the EPS treatment of convertible instruments. For instance, at the 2006 AICPA Conference, Ms. Cathy Cole, associate chief accountant in the SEC’s Office of the Chief Accountant, stated that the SEC expects that a company with two classes of common stock will present both basic and diluted EPS for each class of common stock, regardless of conversion rights. As indicated by Statement 128 and clarified by Issue 03-6, 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. The SEC has asked such 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 Issue 03-6.

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 of each class of stock.

EPS Disclosures

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 stock, unvested stock units, unvested restricted stock units, and performance shares are treated in basic and diluted EPS.
- Whether stock options containing rights to dividend equivalents are treated as participating securities, and how participating securities are factored into the calculation of EPS.
- How stock held in treasury is treated in determining the common shares outstanding.
- The accounting policy on earnings/loss allocations to shareholders.
- The nature of incentive distribution rights.

2008 Update

Example of a Recent SEC Comment

- 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 paragraph 40 of SFAS 128.

During 2008, the SEC staff continued to issue comments on EPS disclosures. Under paragraph 40 of Statement 128, an entity must disclose, for each period in which an income statement is presented, (1) "[a] reconciliation of the numerators and the denominators of basic and diluted" EPS, (2) "[t]he effect that has been given to preferred dividends in arriving at income available to common stockholders[,]" and (3) "[s]ecurities . . . 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

- [March 2008 EITF Snapshot.](#)
- [August 13, 2008, *Heads Up*, "A Common Denominator — 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."](#)

Executive Compensation

In 2007, the SEC staff performed a comprehensive review of the executive and director compensation disclosures of 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 Compensation Discussion and Analysis (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? According to the report, when the SEC staff asks a company to enhance its analysis, the staff does not necessarily mean that the company should lengthen its disclosure. Rather, the staff prefers clearer and more concise disclosures with more tables and graphs.

2008 Update

Example of a Recent SEC Comment

- We note that you have not disclosed the necessary targets to be achieved in order for your named executive officers to earn their annual cash incentive To the extent you believe that disclosure of the information, on a historical basis, would result in competitive harm such that the information could be excluded under instruction 4 to Item [229.]402(b) of Regulation S-K, please provide us with a detailed explanation supporting your conclusion In discussing how difficult or likely it will be to achieve the target levels or other factors, you should provide as much detail as necessary without disclosing information that poses a reasonable risk of competitive harm.

On October 21, 2008, John White, director of the SEC's Division of Corporation Finance, in his speech "[Executive Compensation Disclosure: Observations on Year Two and a Look Forward to the Changing Landscape for 2009](#)," addressed both the current market events and the second year of disclosure under the new executive compensation disclosure requirements. Mr. White emphasized that a company "should be carefully considering if and how recent economic and financial events affect [its] compensation program." He also discussed the Emergency Economic Stabilization Act of 2008, which contains various provisions regarding executive compensation for participating financial institutions. Regarding the second year of disclosure, Mr. White discussed the three primary areas of SEC comments: "(1) the need for more analysis, (2) disclosure of performance targets, and (3) disclosure relating to benchmarking."

In addition, Mr. White indicated that in 2009 the SEC staff will "review the annual reports of all of the very largest financial institutions in the U.S. that are public companies." The reviews will include both the financial statements and the executive compensation disclosures. The SEC staff will also monitor the quarterly reports and Forms 8-K filed by these companies.

Recent SEC comments indicate that the SEC staff continues to ask for more meaningful discussion in CD&A. In addition, the staff frequently asks for disclosures related to the basis for compensation decisions and compensation issuable upon a change in control of the company. The SEC staff's comments have indicated that if a company uses performance targets, it needs to disclose them and provide information about their use. The executive compensation disclosure requirements allow companies to exclude performance targets and other factors or criteria involving confidential information if the disclosure of such information would result in competitive harm. While companies are not required to formally request confidential treatment to omit these disclosures, they must meet the confidential-treatment standard and demonstrate to the staff upon request that they have done so. Even if omission of targets or other factors or criteria is appropriate, registrants must disclose 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.

Other Deloitte Resources

- 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."

Fair Value and the Turmoil in the Credit Markets

Examples of SEC Comments

- *Fair Value Measurement* — Please tell us what impact the recent turmoil in the credit market has had on your valuation and accounting for this investment.
- *Fair Value Measurement* — Please provide a detailed description of whether [the company] believes its financial condition, results of operations, or liquidity will be adversely affected by its involvement with subprime lending, including:
 - If an adverse impact is considered remote, support for that conclusion; or
 - If an adverse impact is not considered remote, a detailed description of potential disclosures considered.
- *Off-Balance-Sheet Exposure* — Please address all involvement with special purpose entities and variable interest entities and quantify the sub-prime exposure related to such entities, regardless of whether they are consolidated for the purposes of generally accepted accounting principles.

Overview

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

Fair Value Measurement

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. As the subjectivity in determining amounts recognized in the balance sheet increases, so does the need for comprehensive and transparent footnote disclosures. The issuance of Statement 157 has further emphasized the importance of transparency in the determination of fair value, especially when valuation models use unobservable inputs.

The SEC staff has issued numerous comments requesting that registrants provide additional disclosures about valuation methods and assumptions. At the 2007 AICPA Conference, Ms. Stephanie Hunsaker, associate chief accountant in the SEC's Division of Corporation Finance, 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.

In addition to the considerations noted by Ms. Hunsaker and the disclosures required by Statement 157, registrants should consider the disclosure requirements of SOP 94-6 and Statement 107. SOP 94-6 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.

Ms. Hunsaker also noted that registrants should consider enhanced disclosure regarding 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.

Off-Balance-Sheet Exposure

The SEC staff has also commented on disclosure of off-balance-sheet exposures. (This topic was also discussed at the 2007 AICPA Conference.) In December 2007, the Division of Corporation Finance sent a [letter](#) requesting that registrants' MD&A contain additional disclosure of exposures to off-balance-sheet entities.¹ The Division suggested that these disclosures focus on the following themes:

- Detailed descriptions of the assets and funding of off-balance-sheet entities.
- Any material difficulties that off-balance-sheet entities are experiencing (including asset write-downs or credit downgrades) and the effect on the registrant.
- Types of variable interests that the registrant holds in off-balance-sheet entities.
- 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 provides specific disclosure considerations for the critical accounting estimates section of MD&A for registrants that have identified as a critical accounting policy the accounting for consolidation and variable interest entities. Such registrants should consider including the following disclosures in the critical accounting policies section of the footnotes:

- The scenarios in which the registrant would have to consolidate off-balance-sheet entities and the expectation of the likelihood of such an event.
- The frequency with which the registrant reconsiders, and the typical triggers that require reconsideration of, whether the registrant is the primary beneficiary of the entity.

The letter also reminds registrants that Regulation S-K, Item 303, requires disclosure of any known trends or uncertainties that the registrant reasonably expects to have a material favorable or unfavorable effect on income from operations, liquidity, and capital resources.

SEC Issues Letter Clarifying Accounting Ramifications of Accelerated Efforts to Mitigate Subprime Crisis

In January 2008, SEC Chief Accountant Conrad Hewitt issued a [letter](#) addressing the Statement 140 accounting implications of the American Securitization Forum's [Streamlined Foreclosure and Loss Avoidance Framework](#) ("ASF Framework").² The ASF, coordinating with the Department of the Treasury, developed the Framework to encourage mortgage loan servicers

¹ See Regulation S-K, Item 303(a)(4)(ii), for the definition of off-balance-sheet entities for these purposes.

² "Streamlined Foreclosure and Loss Avoidance Framework for Securitized Subprime Adjustable Rate Mortgage Loans."

to refinance or modify classes of adjustable-rate subprime mortgage loans with certain risk characteristics that make them susceptible to default. However, a potential hurdle has been whether the modifications of mortgage loans violate qualifying special-purpose entity (QSPE) status under Statement 140.

The SEC's letter, addressed to both the Financial Executive International's Committee on Corporate Reporting and the Center for Audit Quality's Professional Practice Executive Committee, indicates that the Office of the Chief Accountant (OCA) "will not object to continued status as a QSPE if Segment 2 subprime ARM loans are modified pursuant to the specific screening criteria in the ASF Framework." The letter also states that the "OCA believes that it would be reasonable to conclude that Segment 2 subprime ARM loans are 'reasonably foreseeable' of default in absence of a modification based upon a qualitative consideration of the expectation of defaults."³ Appendix A of the letter sets forth disclosures that the SEC staff generally expects will be included in registrants' MD&A and notes to the financial statements.

2008 Update

Examples of Recent SEC Comments

- *Fair Value Measurements* — 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.
- *Pricing Services* — Please revise your disclosure to discuss the extent to which, and how, the information is obtained from the pricing services and used in developing the fair value measurements in the consolidated financial statements including: (a.) The nature and amount of assets you valued using broker quotes or prices you obtained from pricing services; (b.) The number of quotes or prices you generally obtained per instrument, and if you obtained multiple quotes or prices, how you determined the ultimate value you used in your financial statements; (c.) Whether, and if so, how and why, you adjusted quotes or prices you obtained from brokers and pricing services; (d.) The extent to which the brokers or pricing services are gathering observable market information as opposed to using unobservable inputs and/or proprietary models in making valuation judgments and determinations; (e.) Whether the broker quotes are binding or non-binding; and (f.) The procedures you performed to validate the prices you obtained to ensure the fair value determination is consistent with SFAS 157, *Fair Value Measurements*, and to ensure that you properly classified your assets and liabilities in the fair value hierarchy.
- *Credit Risk* — We note that you do not consider counterparty credit risk to be a significant input. Please address the following: (a.) Clarify whether you actually factor in the impact of counterparty credit risk into the value of your derivative assets but the impact is just not significant, or whether you do not consider the impact of counterparty credit risk as you have qualitatively determined the impact to be insignificant on the fair value of these instruments; (b.) Clarify whether this was a change upon the adoption of SFAS 157, or whether you applied a similar methodology prior to the adoption of SFAS 157; (c.) Tell us, and disclose in future filings, whether you factor your own credit risk into the value of your derivative liabilities, consistent with the guidance in paragraph 15 of SFAS 157.
- *Auction Rate Securities* — Please describe to us your experience with auctions subsequent to your year end. Specifically, quantify for us the par value of your auction rate securities that have had at least one auction since your fiscal year end, and tell us the results of those auctions, separately discussing and quantifying those that failed and those that were successful.
- *Auction Rate Securities* — 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.

Fair Value Measurements

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. See the [Use of Experts and Consents](#) section for the SEC staff's

³ The letter describes limitations on the availability of representative quantitative data for these types of loans.

current position on this matter. The staff has focused on learning 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 focused on the identification of valuation inputs within a registrant's Statement 157 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.

Certain of the 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.

Auction Rate Securities

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

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

MD&A Disclosures

During 2008, the SEC staff continued to focus on disclosures related to the turmoil in the credit markets as well as new disclosures required by Statement 157. The Division of Corporation Finance sent two letters to registrants addressing the need for more transparent disclosure in MD&A of methods and assumptions used in fair value measurements of material financial instruments affected by the credit crisis.

In March 2008, the Division of Corporation Finance issued a [letter](#) to certain financial institutions that focuses on disclosures relating to 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 be applicable to any company." The SEC suggested that the disclosures focus on the following items:

- Amounts of Level 3 assets and liabilities, 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.
- 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 of the nature and type of assets underlying asset-backed securities.

- 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 analysis, 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 Statement 157 hierarchy, and how they used brokers or pricing services in developing fair value measurements.

At the 2008 AICPA Conference, Ms. Hunsaker 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 disclosure (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 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 Conference, Mr. John White, director in the SEC's Division of Corporation Finance, stated that registrants need to adequately incorporate the effects of current market conditions into MD&A. He noted that because of the pervasiveness of the market crisis this year, 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 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 of exposure to affected entities. For example, entities 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.

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 provides 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.

Other Deloitte Resources

- [Financial Reporting Alert 08-19, "Pension and Other Postretirement Benefits Affected by Turmoil in the Credit Markets."](#)
- [Financial Reporting Alert 08-17, "Accounting Considerations Related to Redemption Restrictions on Money Market Funds."](#)
- [Financial Reporting Alert 08-16 \(Revised\), "SEC Issues Letter Clarifying Other-Than-Temporary Impairment Guidance for Perpetual Preferred Securities."](#)
- [Financial Reporting Alert 08-14, "Potential Counterparty Default and Other Accounting Considerations Related to the Credit-Market Turmoil."](#)
- [Financial Reporting Alert 08-13, "Accounting Considerations for Settlement Agreements Related to Auction Rate Securities."](#)
- [Financial Reporting Alert 08-12 \(Revised\), "FASB Votes to Issue Proposed Staff Position Clarifying Fair Value Measurement Guidance."](#)
- [Financial Reporting Alert 08-11, "SEC and FASB Release Fair Value Clarifications."](#)
- [Financial Reporting Alert 08-10, "SEC Advises Registrants to Further Explain Fair Value in MD&A — An Addendum to the March 2008 SEC Letter."](#)
- [Financial Reporting Alert 08-8, "Consideration of Credit Risk in Fair Value Hedge Effectiveness Assessments."](#)
- [Financial Reporting Alert 08-7, "SEC Advises Registrants to Further Explain Fair Value in MD&A."](#)
- [Financial Reporting Alert 08-4, "Turmoil in the Credit Markets: The Importance of Comprehensive and Informative Disclosures."](#)
- [Financial Reporting Alert 08-2, "Auction Rate Securities Warrant Scrutiny for Impairment."](#)
- [Financial Reporting Alert 08-1, "SEC Issues Letter Clarifying Accounting Ramifications of Accelerated Efforts to Mitigate Subprime Crisis."](#)
- [Financial Reporting Alert 07-5, "CAQ Update — Key Accounting Issues and the Credit Environment: Center for Audit Quality Issues Final White Papers."](#)
- [Financial Reporting Alert 07-4, "Key Accounting Issues and the Current Credit Environment."](#)
- [January 9, 2009, *Heads Up*, "Study Finalized on Mark-to-Market Accounting."](#)
- [October 14, 2008, *Heads Up*, "Considerations Regarding the Emergency Economic Stabilization Act of 2008."](#)
- [October 13, 2008, *Heads Up*, "FASB Issues Guidance on Measuring Fair Value of Financial Assets in an Inactive Market."](#)
- [February 15, 2008, *Heads Up*, "FASB Partially Defers and Limits Scope of Statement on Fair Value Measurements."](#)
- [August 29, 2007, *Heads Up*, "Accounting Consequences of Subprime Loan Modifications."](#)

Financial Instruments

Examples of SEC Comments

- *Hedge Accounting* — Please address the following with respect to these hedges:
 - Tell us all of the terms in the hedged item and the hedging instrument which were not exact mirrors of each other, whether defined as critical or not; and
 - With respect to cash flow hedges . . . tell us how you performed and documented an assessment of hedge effectiveness at inception of the hedging relationship and on an ongoing basis.
- *Embedded Derivatives* — Explain to us how you have considered the guidance in SFAS 133 and EITF 00-19 in determining that you are not required to bifurcate the conversion feature from the host instrument and account for it as a derivative.
- *Financial Asset Transfers* — Please specifically address how you determined the transfer of the receivables to both the third-party qualifying special purpose entity and to the third-party banking institutions met the sales criteria of paragraph 9 of SFAS 140.

Hedge Accounting

Although hedge accounting under Statement 133 has been around for several years, in late 2006 and 2007, the SEC staff made several announcements regarding its application. The announcements were followed by some restatements and many SEC staff comments on the application of Statement 133.

At the 2006 AICPA Conference, Mr. Timothy Kviz, a professional accounting fellow in the SEC's Office of the Chief Accountant, noted that the following are two ways in which registrants have misapplied hedge accounting under Statement 133:

- *The shortcut method* — Registrants have concluded that their hedging relationships qualify for the shortcut method without meeting all the criteria listed in Statement 133.
- *The critical-terms-match method and methods based on Statement 133 Implementation Issue G7* — Registrants have inappropriately assumed no ineffectiveness in hedging relationships designated under a critical-terms-match method or one of the methods in Implementation Issue G7 despite known sources of ineffectiveness.

Mr. Kviz indicated that the SEC staff believes that when a company inappropriately applies the shortcut method or otherwise ignores known sources of hedge ineffectiveness in performing hedge effectiveness assessments, an error exists for the entire change in fair value of the derivative as if hedge accounting had not been applied. Specifically, Mr. Kviz highlighted several scenarios in which registrants had concluded that a hedging relationship was perfectly matched when known sources of ineffectiveness existed that should have been measured.

At the March 2007 EITF meeting, Mr. Joseph McGrath, another professional accounting fellow in the SEC's Office of the Chief Accountant, revisited several of the hedge accounting issues initially discussed by Mr. Kviz. In that meeting, Mr. McGrath clarified that it was 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 ineffectiveness exists, provided that the registrant (1) evaluates and supports the reasonableness of the conclusion that the terms match and (2) makes 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 a forecasted foreign-currency-denominated transaction if the settlement dates of the hedging instrument and the forecasted transaction occur within the same month. For example, a hedging relationship in which a single forward contract hedges multiple forecasted transactions still might qualify for the critical-terms-match method.

In the wake of these announcements, the SEC staff has issued many comments requesting registrants to provide detailed information and disclosures about their hedging relationships. The SEC staff has frequently challenged a registrant's determination that the instrument 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 paragraph 65 of Statement 133 to qualify for the critical-terms-match method of assessing hedge effectiveness.
- How the registrant determined that it met the criteria of paragraph 68 of Statement 133 to qualify for the shortcut method of assessing hedge effectiveness.
- The nature and terms of the hedged item (including conversion, call, and option features) and the hedging instrument and whether such terms are exact mirrors of each other.
- The specific risk being hedged.
- How effectiveness is assessed at inception and on an ongoing basis for each type of hedge, including the specific quantitative methods used.
- How differences between estimated and actual results have affected hedging relationships (i.e., in the determination of whether hedge accounting should be discontinued).
- If effectiveness tests failed, what additional procedures the registrant performed to conclude that it was appropriate to continue applying hedge accounting.

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

During 2007, the FASB added to its agenda a project to simplify hedge accounting under Statement 133. The project proposes eliminating the shortcut method, the critical-terms-match method, and the requirement to continually assess hedge effectiveness to qualify for hedge accounting. While any final guidance may relieve registrants from performing detailed quantitative analyses to support conclusions about hedge accounting, it could be a year or more before such guidance is issued. (See [Hedge Accounting](#) in the 2008 Update section below for the status of this project.)

Derivatives Embedded in Convertible Financial Instruments

As registrants have issued more convertible securities, the SEC staff has issued more comments on such securities. The accounting for convertible securities is complex, requiring analysis of a security's various features under numerous accounting pronouncements. The SEC's *Current Accounting and Disclosure Issues in the Division of Corporation Finance* (as updated November 30, 2006) (the "report") summarizes some of the accounting considerations:

Embedded conversion features that meet the criteria for bifurcation under SFAS 133 may qualify for the paragraph 11(a) scope exception in SFAS 133. In analyzing whether the conversion feature meets the paragraph 11(a) scope exception, one of the things the registrant must determine is whether the conversion feature would be classified within stockholders' equity. To determine classification, the conversion feature must be analyzed under EITF 00-19. The first step of the EITF 00-19 analysis for these features is to determine whether the host contract is a conventional convertible instrument (paragraph 4 of EITF 00-19 and EITF 05-2, The Meaning of "Conventional Convertible Debt Instrument" in EITF Issue 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock"). One of the common features that prevents the convertible instrument from qualifying as "conventional" is a reset provision in the instrument where, if a company issues an instrument in the future that has a price less than the conversion price in the convertible instrument, the conversion price in the convertible instrument is reset. If the instrument is a conventional convertible instrument, the embedded conversion option would qualify for equity classification under EITF 00-19, qualify for the scope exception in SFAS 133 and not be bifurcated from the host instrument.

In that case, the convertible instrument should be accounted for in accordance with APB 14; ASR 268 and EITF Topic D-98 should be considered for the classification and measurement of the instrument; and EITFs 98-5 and 00-27 should be considered for any beneficial conversion feature.

If the instrument does not qualify as a conventional convertible, paragraphs 7–32 of EITF 00-19 must be analyzed to determine whether the conversion feature should be accounted for as a liability or equity. If the feature is classified as a liability under EITF 00-19, it would not qualify for the paragraph 11 scope exception in SFAS 133 and therefore the feature would be accounted for as a derivative at fair value, with changes in fair value recorded in earnings. If the feature is classified as equity under EITF 00-19 and meets the other criterion in the SFAS 133 paragraph 11 scope exception, the embedded conversion option is not bifurcated from the host instrument. The registrant should assess whether the convertible preferred stock instrument should be classified in permanent equity or temporary equity by reference to ASR 268 and EITF D-98. Additionally, registrants should assess whether there is a beneficial conversion feature that must be accounted for under EITFs 98-5 and 00-27.

The report identifies convertible securities that require the issuance of an unlimited variable number of shares as one cause of improper accounting. The issuer of such securities usually is required to bifurcate the conversion option because the issuer is unable to exclude such securities from the scope of Statement 133.¹

At the 2006 AICPA Conference, Ms. Stephanie Hunsaker, associate chief accountant in the SEC's Division of Corporation Finance, stated that the SEC staff will continue to focus on the classification of convertible instruments and the registrant's accounting for such instruments.

The SEC staff frequently asks questions about the accounting for, and the nature and terms of, convertible instruments. For example, the staff often requests that a registrant that has issued convertible debt, but that has not accounted for the conversion feature or other features as derivatives separate from the debt, either disclose or provide information about the following:

- Whether the registrant has considered whether the convertible debt includes an embedded derivative.
- Whether the convertible debt qualifies as conventional convertible debt under Issue 05-2.

The SEC staff has requested that registrants that have disclosed that they have an embedded derivative, but that did not record the bifurcated amount because of immateriality, provide the assumptions used to value the instrument and how they concluded that the amount was immaterial.

The SEC staff has also issued a number of comments about convertible preferred stock. The staff has asked registrants whether they have evaluated their convertible preferred stock under Issue 00-19. Registrants have also been asked to perform additional analysis or provide additional information (such as the actual agreement). This request is common when some or all of the preferred stock is not convertible into a fixed number of shares or contains a reset provision.

Financial Asset Transfers

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 (such as a legal opinion) to support an 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 Statement 140. The SEC staff has challenged registrants that account for a transfer as a sale when they have historically accounted for similar transfers as secured borrowings.

¹ Because the conversion option requires the issuance of an unlimited number of shares, the issuer could be forced to cash-settle the conversion option because the number of shares into which the security is potentially convertible exceeds the number of currently authorized but unissued shares. Since the issuer could be forced to settle the conversion option in cash rather than shares, the conversion option would not qualify for the scope exception in Statement 133 for items classified in equity.

2008 Update

Example of a Recent SEC Comment

- *Market Risk* — Please revise your 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

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 disclosures in accordance with Regulation S-K, Item 305, which requires disclosure of both quantitative and qualitative information for all market-risk-sensitive instruments.

Hedge Accounting

The Board issued an Exposure Draft of a proposed Statement on accounting for hedging activities on June 6, 2008. Comments on the proposed Statement were due by August 15, 2008. In addition, in January 2008, the FASB issued Implementation Issue E23, which clarifies application of the shortcut method.

Derivatives Disclosures

In September 2008, the FASB issued FSP FAS 133-1 and FIN 45-4, which amends and enhances the disclosure requirements for sellers of credit derivatives (including hybrid instruments that have embedded credit derivatives) and financial guarantees. The new disclosures are required for reporting periods (annual or interim) ending after November 15, 2008, although earlier application is encouraged.

In addition, in March 2008, the FASB released Statement 161, which expands the qualitative and quantitative disclosure requirements in Statement 133 for an entity's derivative instruments and hedging activities. Statement 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008; early application is encouraged. Statement 161's disclosure provisions apply to all entities with derivative instruments subject to Statement 133 and its related interpretations. The provisions also apply to related hedged items, bifurcated derivatives, and nonderivative instruments that are designated and qualify as hedging instruments.

Derivatives Embedded in Convertible Financial Instruments

In May 2008, the FASB issued FSP APB 14-1, which will have a major impact on the financial statements of issuers of convertible debt securities that may be settled fully or partially in cash. Under the FSP, an entity must separate these securities into (1) a debt component, representing the issuer's contractual obligation to pay principal and interest, and (2) an equity component, representing the holder's option to convert the debt security into equity of the issuer or, if the issuer so elects, an equivalent amount of cash. The FSP is effective for fiscal years (and interim periods) beginning after December 15, 2008 (i.e., January 1, 2009, for a calendar-year-end entity), and should be applied retrospectively to all past periods presented — even if the instrument has matured, has been converted, or has otherwise been extinguished as of the FSP's effective date. The FSP does not apply if the embedded conversion feature must be accounted for separately from the rest of the instrument.

During 2008, the SEC staff made a number of revisions to Topic D-98. One of these revisions is an amendment to communicate the staff's views on applying Topic D-98 to the classification and measurement of convertible debt instruments within the scope of FSP APB 14-1. This revision requires an entity to record a portion of the equity component for convertible debt instruments as mezzanine (i.e., outside of permanent equity) if the instruments are currently redeemable or convertible for cash or other assets and the amount of cash that must be exchanged in a hypothetical settlement (as of the balance sheet date) exceeds the current carrying amount of the liability-classified component. Another revision clarifies the SEC staff's views on the interaction between Topic D-98 and Statement 160.

In addition, during 2008, the EITF reached a consensus on two Issues that could affect the accounting for convertible debt: Issues 07-5² and 08-8. Issue 07-5 deals with whether instruments (or embedded features) containing certain provisions would be considered indexed to the entity's own stock and could be exempt from the requirements of Statement 133. Issue 08-8 addresses the accounting for freestanding financial instruments (or embedded features) for which the payoff to the counterparty is indexed, in whole or in part, to the stock of a consolidated subsidiary.

Financial Asset Transfers

In recent comment letters, the SEC staff has requested additional information about the calculation of the gains/losses on the sale of loans, the classification of these gains/losses in the income statement, and the disclosures of these gains/losses in the cash flow statement. The SEC staff has also questioned whether registrants' disclosures about servicing assets and liabilities, including how they are measured, are complete.

During 2008, the FASB discussed eliminating the concept of a qualifying special-purpose entity from Statement 140. The Board also discussed making other amendments related to sales of partial interests in a financial asset. The Board issued a revised [Exposure Draft](#) of a proposed Statement on accounting for transfers of financial assets on September 15, 2008. Comments on the proposed Statement were due by November 14, 2008. In addition, the Board issued FSP FAS 140-4 and FIN 46(R)-8 in December 2008. The FSP accelerates certain of the disclosures proposed in the Exposure Draft, requiring that calendar-year-end companies include them in their annual filings for the period ended December 31, 2008.

Other Deloitte Resources

- [Financial Reporting Alert 08-16 \(Revised\), "SEC Issues Letter Clarifying Other-Than-Temporary Impairment Guidance for Perpetual Preferred Securities."](#)
- [Financial Reporting Alert 08-14, "Potential Counterparty Default and Other Accounting Considerations Related to the Credit-Market Turmoil."](#)
- [Financial Reporting Alert 08-10, "SEC Advises Registrants to Further Explain Fair Value in MD&A — An Addendum to the March 2008 SEC Letter."](#)
- [Financial Reporting Alert 08-8, "Consideration of Credit Risk in Fair Value Hedge Effectiveness Assessments."](#)
- [Financial Reporting Alert 08-7, "SEC Advises Registrants to Further Explain Fair Value in MD&A."](#)
- [January 16, 2009, *Heads Up*, "Beneficial Guidance — FASB Issues Amendments to OTTI Model for Certain Investments in Securitizations."](#)
- [December 22, 2008, *Heads Up*, "FASB Proposes Guidance on Other-Than-Temporary Impairments and Discusses Plans for Other Financial Instrument Projects."](#)
- [December 16, 2008, *Heads Up*, "FASB's New Disclosure FSP Is Effective Immediately."](#)
- [December 5, 2008, *Heads Up*, "Issue 07-5 Affects Issuers of Equity-Linked Financial Instruments \(Including Debt With Embedded Conversion Options\)."](#)
- [September 22, 2008, *Heads Up*, "FASB Issues Exposure Documents That Eliminate QSPEs, Modify the Consolidation Model in Interpretation 46\(R\), and Expand Required Disclosures."](#)
- [September 18, 2008, *Heads Up*, "FASB Issues FSP Requiring Enhanced Disclosure for Credit Derivative and Financial Guarantee Contracts."](#)
- [June 11, 2008, *Heads Up*, "FASB Trims Hedging Requirements — Changes Proposed to Accounting for Hedging Activities."](#)
- [May 15, 2008, *Heads Up*, "Top Down on Convertibles? — FASB Tightens Convertible Debt Accounting for Issuers."](#)
- [April 2, 2008, *Heads Up*, "Making the Complex Less Complex — FASB Invites Comments on IASB's Financial Instruments Discussion Paper."](#)
- [March 27, 2008, *Heads Up*, "FASB Expands Disclosures About Derivative Instruments and Hedging Activities."](#)

² See Deloitte's [Heads Up](#) on the 2008 AICPA Conference for a summary of a speech by Mr. Adam Brown, a professional accounting fellow in the SEC's Office of the Chief Accountant, regarding the potential impact of Issue 07-5 on registrants that issue call options on their own stock (whether these call options are freestanding or embedded in other instruments, such as convertible debt). Mr. Brown noted that Issue 07-5 could have a significant effect on the accounting for certain convertible debt instruments.

Other Deloitte Resources (continued)

- February 26, 2008, *Heads Up*, "The Missing Link — Repurchase Financing Transactions May Be Derivatives Under FASB's New FSP."
- February 15, 2008, *Heads Up*, "FASB Partially Defers and Limits Scope of Statement on Fair Value Measurements."
- January 14, 2008, *Heads Up*, "FASB Clarifies Application of the Shortcut Method."
- March 19, 2007, *Heads Up*, "Using the Critical-Terms-Match Method for Evaluating Hedges — SEC Staff Identifies Key Considerations."
- January 18, 2007, *Heads Up*, "Matching Critical Terms in Hedge Strategies."

Financial Statement Classification

Examples of SEC Comments

Income Statement Classification

- *Revenue and Cost of Sales* — Please revise your consolidated statements of earnings in future filings to separately present revenue and cost of sales . . . for your product sales and services. You may only aggregate these revenues if both classes of revenue are less than ten percent of total revenues. Refer to Rule 5-03(b) of Regulation S-X.
- *Cost of Sales* — The line item ‘Depreciation and Amortization’ in the income statement appears to include all depreciation and amortization expense. Tell us the amounts of depreciation and amortization included in this amount that relate to products and services provided to customers and why you have not included these amounts in costs of revenue. That is, tell us how you considered the guidance in SAB Topic 11.B.
- *Cost of Sales* — Please . . . tell us 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. . . . If you currently exclude a portion of these costs from cost of goods sold, please disclose . . . the line items that these excluded costs are included in and the amounts included in each line item, and in MD&A that your gross margins may not be comparable to those of other entities, since some entities include all of the costs related to their distribution network in cost of goods sold and others like you exclude a portion of them from gross margin, including them instead in a line item, such as distribution, selling, or general and administrative expenses.
- *Operating Versus Nonoperating Income* — We note you exclude settlement expense from income from operations. It does not appear that this presentation is appropriate considering the nature of these expenses as disclosed in the notes to your financial statements. Please revise to include these expenses in operations or tell us why a revision is unnecessary.

Statement of Cash Flows Classification

- Please explain to us in greater detail the nature and timing of the insurance reimbursement cash flows for claim payments classified as investing activity.

The SEC staff frequently comments on classification in the financial statements, particularly the income statement and the statement of cash flows. Comments on income statement classification tend to concentrate on ensuring compliance with both general and industry-specific requirements of Regulation S-X as well as on analyzing what is included in or excluded from each line item. Although still numerous, comments on the statement of cash flows have decreased as registrants have improved their presentation.

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 Opinion 22.

Revenue

The SEC staff’s comments on revenue have focused on two main themes. The first is revenue components. The SEC staff may challenge the inclusion of items in revenue that do not directly result from selling a company’s products or delivering its services, such as equity in earnings of unconsolidated affiliates or interest income.

The second theme is the distinction between product and service revenues. If product or service revenues are greater than 10 percent of total revenues, the registrant is required to disclose this fact as a separate line item on the face of the income statement.¹ This same rule applies to product and service costs in the “cost of sales” line item.

¹ According to Regulation S-X, Rule 5-03(b).

Cost of Sales

The SEC staff sometimes challenges registrants that omit a “cost of sales” or “cost of revenues” line item. The staff believes that many companies and industries have these types of expenses and should show them separately on the face of the income statement.

Another aspect of cost of sales that the staff has commonly commented on is the allocation of amortization and depreciation 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).” . . . depreciation, 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.

In addition, the SEC staff often asks registrants whether they include distribution costs in cost of sales. Registrants may be asked to disclose the line item in which such costs are recorded as well as whether their cost of sales is comparable to that of other registrants.

Gross Profit

Regulation S-X does not require presentation of gross profit on the face of the annual income statement. However, Regulation S-K, Item 302, requires disclosure of gross profit in selected quarterly data. The SEC staff has issued comments requesting that a registrant include gross profit in the quarterly presentation, which, in turn, may result in a registrant’s presenting such information on the face of the annual income statement.

Operating Versus Nonoperating Income

Comments on this subject primarily concern what should be included in or excluded from operating income (if a subtotal for operating income is presented, which is not required). 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.
- Recapitalization expenses (e.g., legal fees, due diligence expenses).

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).
- Minority interest in income of consolidated subsidiaries.

Statement of Cash Flows

Many of the SEC staff's cash flow comments relate to misclassification among the three cash flow categories: operating, investing, and financing. A recurring comment pertains to changes in restricted cash. See Deloitte's [Heads Up](#) on the 2006 AICPA Conference for a summary of a speech by Ms. Carol Stacey, chief accountant in the SEC's Division of Corporation Finance, on the SEC staff's position on changes in restricted cash. The SEC staff also frequently comments on the classification of insurance proceeds, which 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").

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

2008 Update

Examples of Recent SEC Comments

Balance Sheet Classification

- Please tell us how presenting both the deferred cost of sales and the deferred gross revenue within the deferred income liability caption of the balance sheet complies with paragraph 5 of FIN 39, which permits the offsetting of assets and liabilities only when a legal right of setoff exists.
- Please tell us why you classify spare parts stock as a current asset or reclassify the portion you estimate you will not use in the near term as a non-current asset.
- We note you were in violation of your loan covenants. . . . Your disclosures do not indicate you have received waivers from your lenders to cure the non-compliance. In accordance with SFAS 78, it appears your long-term debt should be classified as a current liability in its entirety on your balance sheet. Please revise your balance sheet and disclosures accordingly, or addressing the relevant accounting literature, tell us why you believe the classification of long-term debt is appropriate.

Income Statement Classification

- We note that amortization of software development costs are included in . . . expenses in your consolidated statements of operations as opposed to a cost of revenue. Tell us how you considered including the amortization of acquired technology as a cost of revenue. Refer by analogy to FASB Staff Implementation Guide, SFAS 86, Question 17.
- We note that you consider all expenses other than interest and income taxes to be costs of revenue. Please explain to us how you determined that these expenses should all be classified as costs of revenue under Rule 5-03(2). In addition, explain how you determined that none of these expenses should be classified as the line items referred to in Rule 5-03(3) through (6), particularly selling, general and administrative expenses.

Statement of Cash Flows Classification

- We believe that the classification of proceeds from sale of discontinued operations should be presented on a basis consistent with the classification of gains and losses on sale of discontinued operations in the consolidated statements of income. Please revise to present proceeds from the sale of business operations classified in discontinued operations in accordance with SFAS 144 as cash provided by investing activities of discontinued operations or tell us why a revision is unnecessary.

Related Parties

- Please disclose all amounts earned and all costs and expenses incurred from transactions with related parties on the face of your statement of operations and statement of cash flows. Refer to Article 5-03(b) and 4-08(k) of Regulation S-X.

The SEC staff continues to issue comments on classification in the financial statements, including the balance sheet. Income statement and balance sheet comments tend to focus on specific requirements of Regulation S-X, while comments on the statement of cash flows focus on compliance with Statement 95.

Balance Sheet

The SEC staff may challenge whether it is appropriate to offset assets and liabilities and report the net amount on the face of the balance sheet. In accordance with Interpretation 39, assets and liabilities should not be offset unless a legal right of setoff exists. Further, Regulation S-X, Rule 5-02, states that other current assets and other current liabilities in excess of 5 percent of total current assets and total current liabilities, respectively, and 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.

The SEC staff has also frequently commented on the appropriate 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 ARB 43 and other applicable accounting literature to determine whether an item should be classified as current or noncurrent. The SEC staff may request a registrant to provide clarifying disclosures in the footnotes to the financial statements regarding an item's classification and presentation.

Income Statement

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

The SEC staff also frequently comments on the classification of 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. If the intangible asset is a component of the entity's ongoing major or central operations (i.e., revenue-generating activities), it should generally be classified as a part of cost of sales.

For more information about appropriate income statement presentation, see Deloitte's [Heads Up](#) on the 2005 AICPA Conference for a summary of a speech by Mr. G. Anthony Lopez, associate chief accountant in the SEC's Office of the Chief Accountant.

Statement of Cash Flows

The SEC staff continues to comment on the presentation of discontinued operations in the statement of cash flows. As noted above, registrants are not required to present cash flows related to discontinued operations separately from cash flows related to continuing operations. However, when registrants elect to present cash flows from discontinued operations separately, the SEC staff has commented on the presentation of proceeds from the sale of discontinued operations. Some preparers have included the proceeds from the sale of a discontinued operation in cash flows from continuing operations since these proceeds will be used to fund outflows of continuing operations. However, in commenting on the proper classification of insurance proceeds in the statement of cash flows, the staff of the SEC's Division of Corporation Finance clarified that it does not believe the classification should be affected by how a company intends to spend the receipts. This logic could also apply to the classification of proceeds from the sale of discontinued operations.

Although Statement 144 does not explicitly address the presentation of discontinued operations in the statement of cash flows, paragraph 43 of this Statement 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 Management's Discussion and Analysis (MD&A).

Related Parties

Rules 5-03 and 4-08(k) state that related-party transactions should be identified, and the amounts disclosed, on the face of the financial statements. The terms of these arrangements should be discussed further in the notes to the financial statements and MD&A. Registrants should also consider Statement 57's guidance and disclosure requirements.

Income Taxes and Uncertain Tax Positions

Examples of SEC Comments

- *Disclosures of Unrecognized Tax Benefits* — We note your disclosures regarding . . . various . . . uncertain tax positions related to federal taxes Tell us how you have met each of the disclosure requirements of paragraph 21d of FIN 48 for each significant uncertain tax position.
- *MD&A Considerations* — We note that no disclosure was made regarding material changes in contractual obligations from the amounts that were previously reported in your Form 10-K for the year ended December 31, 2006. Please tell us how you evaluated Instruction 7 to Item 303(b) of Regulation S-K with respect to contractual obligations relating to FIN 48. We note that it does not appear that your prior disclosure of contractual obligations included amounts relating to uncertain tax positions, and we believe that such amounts represent contractual obligations that should be included in the disclosures made under Item 303(a)(5) of Regulation S-K.

Calendar-year-end registrants adopted Interpretation 48 at the beginning of 2007. The Interpretation introduces a new approach that significantly changes how companies recognize and measure tax benefits and disclose income tax uncertainties in their financial statements. Under Interpretation 48, companies cannot recognize a tax benefit related to a tax position unless it is “more likely than not” that tax authorities will sustain the tax position solely on the basis of the position’s technical merits. The tax benefit recognized is measured at the largest amount of the tax benefit that is greater than 50 percent likely to be realized. Differences between a tax position taken or expected to be taken in a tax return and the benefit recognized and measured pursuant to the Interpretation are referred to as “unrecognized tax benefits.” A liability is recognized (or the amount of net operating loss carryforward or amount refundable is reduced) for the amount of unrecognized tax benefit.

The Interpretation presents numerous accounting and reporting challenges for registrants. For example, financial statements must include disclosures about unrecognized tax benefits. (See below for consideration of inclusion of unrecognized tax benefits in the Management’s Discussion and Analysis (MD&A) schedule of contractual obligations.) The SEC staff is expected to continue to closely scrutinize the application of and disclosures related to Interpretation 48 and to issue a significant number of comments on this topic.

Disclosures of Unrecognized Tax Benefits

One of the most controversial aspects of the Interpretation relates to disclosures of a company’s unrecognized tax benefits. Paragraph 21(d) of the Interpretation 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 expects registrants to provide more transparent disclosures about reasonably possible changes in unrecognized tax benefits. However, the FASB has not provided further guidance on the acceptable level of aggregation of information for these disclosures. Therefore, the SEC staff is evaluating registrants’ level of disclosure on a case-by-case basis.

Examples of what registrants should disclose pursuant to paragraph 21(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 on the basis of the guidance in FSP FIN 48-1.*

The SEC staff may also ask about tax positions disclosed in prior years to verify the registrant's compliance with Interpretation 48. For example, the staff may refer to disclosures in prior filings indicating that the registrant had tax contingency reserves and ask the registrant how it applied Interpretation 48 to those tax contingencies.

Registrants should not forget the other disclosure requirements in Interpretation 48, including the following disclosures from paragraph 21:

- 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
- d. A description of tax years that remain subject to examination by major tax jurisdictions.

In addition, paragraph 20 of the Interpretation requires a company to disclose its "policy on classification of interest and penalties."

MD&A Considerations

Registrants are required to include in the MD&A section a tabular disclosure of all known contractual obligations.¹ According to discussions at the April 17, 2007, SEC Regulations Committee meeting, 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 Interpretation 48 liabilities 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 Interpretation 48 liabilities 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 Interpretation 48 liabilities 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 Interpretation 48 liabilities from the contractual obligations table or disclose such amounts within an "other" column added to the table. If any Interpretation 48 liabilities are excluded from the contractual obligations table or included in an "other" column, a footnote to the table should disclose the amounts excluded and the reason for the exclusion.

¹ SEC Regulation S-K, Item 303(a)(5).

Registrants should also consider the adequacy of their critical accounting policy disclosures relating to 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.” Given Interpretation 48’s recent issuance and the expected increased scrutiny associated with the accounting for income taxes, now may be a good time to look at whether the MD&A clearly portrays the significance of management’s assumptions about future events.

2008 Update

Example of a Recent SEC Comment

- *Realization of Deferred Tax Asset* — We note that pre-tax income significantly declined during fiscal year 2007 from fiscal year 2006 pre-tax income and from fiscal year 2005 pre-tax income We further note that you have recognized a pre-tax loss of \$[XXX] million for the nine-months ended September 30, 2008. In future filings, please revise your disclosure here or in critical accounting policies to provide a more detailed explanation as to how you determined it is more likely than not that you will realize total deferred tax assets.

Income Taxes

The SEC staff frequently issues comments to registrants regarding their assessment of the realizability of deferred tax assets. Statement 109 requires 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 should be sufficient to reduce the deferred tax asset to the amount that is more likely than not to be realized.”

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

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

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

Uncertain Tax Positions

In addition to commenting on the sufficiency of Interpretation 48 paragraph 21(d) disclosures, the staff is continuing to closely scrutinize registrants' disclosures under paragraph 21(c). Paragraph 21(c) requires registrants to disclose "[t]he total amounts of interest and penalties recognized in the statement of operations and the total amounts of interest and penalties recognized in the statement of financial position"

For more information about disclosures required under paragraph 21(d) of Interpretation 48, see the [Disclosures of Unrecognized Tax Benefits](#) section above.

Other Deloitte Resources

- *Uncertainty in Income Taxes: A Roadmap to Applying Interpretation 48.*
- Financial Reporting Alert 08-18, "Effect of Statement 141(R) on Income Tax Accounting."
- Financial Reporting Alert 08-6, "Recent Tax Ruling Requires Entities to Reconsider Their Tax Positions Related to Executive Compensation."
- Financial Reporting Alert 08-5, "FASB Expands the Scope of the Interpretation 48 Deferral."
- January 29, 2008, *Heads Up*, "Tax Accrual Workpapers — Caught Between a Rock and a Hard Place."

Investments

Examples of Recent SEC Comments

- *OTTI* — For each security that experienced credit declines, please tell us the specific factors that led to your conclusion that the unrealized losses were not other-than-temporary
- *OTTI* — Please give us a detailed understanding of how you reached the determination that such securities have not been impaired under the guidance in SFAS 115 and in light of recent events in the market which includes significant pricing pressure on lesser quality securities as well as illiquidity.
- *OTTI* — Please tell us and revise future filings to describe in greater detail: (1) the specific nature and credit risk characteristics of the mortgage-backed securities that were impaired, (2) the reasons for the timing of the recognition of an impairment charge in [2007] and why [an impairment was] not [recognized] in prior annual or interim periods, and (3) the methodology used to determine there were no additional other-than-temporary impairments charges related to other securities with similar risk characteristics in the remaining portfolio.
- *OTTI* — 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.
- *OTTI* — It appears that the other-than-temporary impairment on your investments . . . significantly affected your income for the periods then ended. Since you continue to have significant unrealized losses . . . , please provide us the following information in a disclosure-type format: (1) describe the circumstances giving rise to the loss, (2) describe whether, and how, those circumstances impact other material investments held, and (3) explain why you believe that the fair value will increase enough for you to recover your cost.
- *OTTI* — [Please] disclose the following as it relates to securities with an unrealized loss: (1) describe the risks and uncertainties inherent in the [other-than-temporary impairment] assessment methodology, including the impact on future earnings and financial position should management later conclude that the decline is other-than-temporary, (2) disclose the percentage of the fair value of securities and unrealized losses that are non-investment grade and the securities that are not rated, and (3) identify the type, carrying value, and unrealized loss of individual material underwater securities.
- *OTTI* — Please explain to us the basis for your belief that, as of [the balance sheet date], your auction-rate-securities were not impaired. If part of your support is that a decline in fair value below amortized cost basis of the securities was judged to be temporary, explain to us how you made this determination.
- *OTTI: Intent and Ability* — Tell us the basis for your conclusion that you had the intent and ability to hold these securities to the earlier of the recovery of the losses or maturity.
- *OTTI: Intent and Ability* — Please tell us the significant events that occurred subsequent to [the balance sheet date] which changed your intentions to hold available-for-sale securities in an unrealized loss position to the earlier of recovery of losses or maturity.
- *OTTI: Intent and Ability* — Please provide us with a timeline of facts and circumstances related to your decision to sell . . . available-for-sale securities [at a loss]. Please provide us the applicable presentations and minutes of all applicable board of directors meetings, asset and liability committee meetings and any other pertinent meetings in which the decision to sell the securities was discussed.
- *OTTI: Intent and Ability* — For securities that you sold during the year at a loss, disclose: (1) the amount of the loss recorded and the fair value at the sales date, (2) facts and circumstances giving rise to the loss and the sale, (3) the period of time that the security had been continuously in an unrealized loss position, and (4) why that sale does not contradict your assertion regarding your ability and intent to hold securities with unrealized losses until they mature or recover in value.

On the subject of investments, the SEC staff often comments on a registrant's analysis of whether unrealized losses on cost, available-for-sale, or held-to-maturity securities represent other-than-temporary impairments (OTTIs). The staff may request a registrant to provide support for 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 requested disclosure of whether the investments have been subsequently sold and, if so, the gain or loss recognized upon sale. The staff may also ask whether the impairment was recorded in the appropriate period. See SAB Topic 5.M for more information about other-than-temporary losses and important factors that a company should consider when evaluating impairment of investments in securities.

The SEC staff has significantly increased its focus on OTTI, primarily because of the prolonged deterioration in the credit markets (see the [Fair Value and Turmoil in the Credit Markets](#) section for more information about SEC comments related to the credit crisis) and the significant decline in value of many investments over the past 18 months (e.g., asset-backed securities, mortgage-backed securities, auction rate securities, corporate debt, perpetual preferred stock, equity securities).

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, as illustrated in the examples above, the SEC 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. In recent months, the SEC staff has particularly focused on impairment considerations related to investments in auction rate securities and debt backed by subprime mortgage loans.

At the 2008 AICPA Conference, James Kroeker, deputy chief accountant in the SEC's Office of the Chief Accountant, addressed questions on 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. He referred participants to the September 30, 2008, [press release](#) from the SEC's Office of the Chief Accountant and the FASB staff, "Clarifications on Fair Value Accounting," for further guidance on the SEC's views. (For additional information, see Deloitte's [Heads Up](#) on the 2008 AICPA Conference.)

Under Statement 115 and SAB Topic 5.M, when a registrant believes that an impaired investment will recover in value (i.e., the decline in value of the security is not related to deterioration in the credit quality of the issuer), the registrant must, to avoid recognizing an OTTI, have the intent and ability to continue holding the investment for a sufficient period to allow for an anticipated recovery in market value. Because this assertion often is subjective and depends on management's representation, the SEC staff has commonly asked a registrant that sells an impaired investment at a loss to describe what occurred after its previous assertion that constitutes a change in its intent or ability to continue holding an investment until recovery.

Other Deloitte Resources

- [Financial Reporting Alert 08-17, "Accounting Considerations Related to Redemption Restrictions on Money Market Funds."](#)
- [Financial Reporting Alert 08-16, "SEC Issues Letter Clarifying Other-Than-Temporary Impairment Guidance for Perpetual Preferred Securities."](#)
- [Financial Reporting Alert 08-15, "The Impact of the Emergency Economic Stabilization Act on the Assessment of Other-Than-Temporary Impairment."](#)
- [Financial Reporting Alert 08-13, "Accounting Considerations for Settlement Agreements Related to Auction Rate Securities."](#)
- [Financial Reporting Alert 08-2, "Auction Rate Securities Warrant Scrutiny for Impairment."](#)
- [January 16, 2009, *Heads Up*, "Beneficial Guidance — FASB Issues Amendments to OTTI Model for Certain Investments in Securitizations."](#)
- [January 9, 2009, *Heads Up*, "Study Finalized on Mark-to-Market Accounting."](#)
- [December 22, 2008, *Heads Up*, "FASB Proposes Guidance on Other-Than-Temporary Impairments and Discusses Plans for Other Financial Instrument Projects."](#)
- [October 14, 2008, *Heads Up*, "Considerations Regarding the Emergency Economic Stabilization Act of 2008."](#)

Loan Loss Reserves

Examples of Recent SEC Comments

- *Modifications to the Method Used in Determining the Allowance for Loan Losses* — We note that . . . you modified your methodology for determining your allowance for loan losses. Please . . . clearly disclose the specific modifications made to your methodology and quantify the impact that such a change had on the level of your allowance.
- *Changes in Loss Assumptions* — Please tell us why you increased your credit loss assumptions from [X]% to [Y]%. Please provide us with a timeline of events that occurred that caused you to increase the loss rate and the circumstances that led you to reevaluate your credit losses. To the extent your prior credit loss assumption was revealed to be low by subsequent charge-offs, please explain why the credit loss assumption was not adjusted prior to [the] charge-off.
- *Consideration of Negative Trends* — We note that [XX]% of your loan portfolio is concentrated in X, however, your discussion in MD&A with regards to your allowance for loan losses does not address your consideration of the deteriorating market, tightening of credit standards and decrease in shipments on your loan portfolio or your allowance for loan losses. We further note that there have been significant declines in sales in your [other] markets, however, it is unclear how much of your loan portfolio is concentrated in those states. Please tell us and disclose the impact this geographic concentration in X has on your portfolio, considering the recent decline in the real estate market, how much of your portfolio is concentrated in [those states] and how the decline in these states has impacted your loan portfolio and related allowance and how you plan to mitigate any risk to reduce your exposure to these concentrations and the recent decline in the real estate market.

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

Modifications to the Method for Determining the Allowance for Loan Losses

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

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

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

Changes in Loss Assumptions

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

- Please provide your analysis that resulted in the adjustment to the loss rates for the affected loan portfolio.
- Please provide us with a timeline of events or circumstances that led you to change your loss assumptions.
- Please include a discussion of the specific assumptions that have changed in connection with performing your impairment analysis.

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

Considerations of Negative Trends

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

- Please tell us and revise future filings to explain how your allowance and provisions are directionally consistent with changes in asset quality.
- Please quantify and explain how actual changes and expected trends in nonperforming loans affected your allowance for loan losses.
- Please tell us and disclose the impact geographic concentration has on your portfolio, considering the recent decline in the real estate market.

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

In developing loss measurements, registrants should consider the impact of current environmental factors and then document which factors were used in the analysis and how those factors affected the loss measurements. Factors that should be considered in developing loss measurements include the following:

- Levels of and trends in delinquencies and impaired loans;
- Levels of and trends in charge-offs and recoveries;
- Trends in volume and terms of loans;

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

- Effects of any changes in risk selection and underwriting standards, and other changes in lending policies, procedures, and practices;
- Experience, ability, and depth of lending management and other relevant staff;
- National and local economic trends and conditions;
- Industry conditions; and
- Effects of changes in credit concentrations.

Management's Discussion and Analysis

Examples of SEC Comments

- *Results of Operations* — Please revise your disclosure to quantify the various reasons given for changes in your revenue and expense line items.
- *Results of Operations* — 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.
- *Contractual Obligations* — 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.
- *Critical Accounting Policies* — We see no discussion of any specific judgments or uncertainties associated with your critical accounting policies that would assist readers in assessing the predictive value of your reported financial information.

See the [Fair Value and the Turmoil in the Credit Markets](#) section for information about a sample letter the SEC staff sent to several registrants that have exposure to off-balance-sheet entities. The letter includes disclosures that registrants may want to consider in preparing their MD&A.

Results of Operations

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.

In addition, many SEC staff comments on the results of operations section of MD&A deal with 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.

Liquidity and Capital Resources

The SEC staff has commented that registrants often have not included insightful, forward-looking disclosure in MD&A. The comments frequently request registrants to provide more meaningful analysis of historical sources and uses of cash. In addition, registrants must disclose significant developments in liquidity or capital resources that occur after the balance sheet date.

Contractual Obligations

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 disclosure of the terms of obligations, such as purchase obligations. (See the [Income Taxes and Uncertain Tax Positions](#) section for more information about Interpretation 48 liabilities and the contractual obligations table.) To the extent that the obligations cannot be quantified, the SEC staff expects registrants to disclose information necessary for investors and users to understand the nature and extent of the registrant's obligations.

Critical Accounting Policies

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.

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.

Supplemental MD&A Based on Pro Forma Financial Information

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

- When a registrant acquires a large business.
- When a change in a registrant's basis because of push-down accounting results in the presentation of predecessor and successor results.
- When a newly formed entity acquires an operating company in a leveraged buyout transaction.

Mr. Jacobs indicated 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. For additional information about Mr. Jacobs's remarks, see Deloitte's [Heads Up](#) on the 2007 AICPA Conference. See also [SEC Interpretive Release, Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations](#).

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

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Examples of Recent SEC Comments

- *Critical Accounting Policies* — 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.
- *Off-Balance-Sheet Arrangements* — 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.

Critical Accounting Policies

The SEC staff continues to comment on registrants' critical accounting policy disclosures. 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.

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

Off-Balance-Sheet Arrangements

The SEC staff continues to focus on the requirement that registrants include a discussion of off-balance-sheet arrangements 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:

- Nature and business purpose of the arrangement.
- Importance of the arrangement.
- 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.

SEC Staff Remarks at the 2008 AICPA Conference

At the 2008 AICPA Conference, several SEC staff members discussed the importance of the liquidity and critical accounting policies sections of MD&A in the current market environment as well as factors registrants should consider in preparing their upcoming filings. For additional information about MD&A-related comments made at the Conference, see the following sections of this publication:

- 2008 Update of Business Combinations, Long-Lived Assets, and Impairments.
- Debt.
- 2008 Update of Fair Value and the Turmoil in the Credit Markets.
- Income Taxes and Uncertain Tax Positions.

Also see Deloitte's *Heads Up* on the 2008 AICPA Conference.

Other Deloitte Resources

- 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 08-7, "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."

Non-GAAP Measures

As defined in SEC Final Rule Release 33-8176, a non-GAAP financial measure is a “numerical measure of a registrant’s historical or future financial performance, financial position, or cash flows that” includes or excludes amounts that are not part of the most directly comparable GAAP measure. The SEC staff’s comments on this topic primarily focus on the level of a company’s disclosure. While the staff may question the inclusion of non-GAAP measures in filings, it does not prohibit such inclusion provided that a company has also included the required disclosures, particularly disclosures demonstrating the purpose of the measures and their usefulness to investors. Paragraph (e)(1)(i) of Regulation S-K, Item 10, states that the following information should accompany a company’s disclosure of non-GAAP measures:

- 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);
- 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 . . . ;
- 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
- 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.

2008 Update

Examples of Recent SEC Comments

- We note that you refer to certain non-GAAP financial information as “pro forma” results. The pro forma terminology has very specific meaning in accounting literature, as indicated by Article 11 of Regulation S-X. In future filings, please do not use titles or descriptions for your non-GAAP financial measures that are the same as, or confusingly similar to, titles or descriptions used for GAAP financial measures.
- We note that you present your non-GAAP measures in the form of a statement of operations. This format may be confusing to investors as it reflects several non-GAAP measures, including but not limited to non-GAAP cost of sales, non-GAAP gross profit, non-GAAP operating expenses, and non-GAAP operating income which have not been identified or described to investors. In fact, it appears that management does not use all of these non-GAAP measures but they are shown here as a result of the presentation format To eliminate investor confusion, please remove the non-GAAP statements of operations format from all future filings. Instead, only disclose those non-GAAP measures used by management and which you intended to provide to investors (such as, adjusted operating income, adjusted net earnings, and adjusted earnings per share) with the appropriate reconciliations to the most directly comparable GAAP measure.

The SEC staff has been asking registrants to change any reference to a non-GAAP measure that states “pro forma,” since the pro forma terminology has specific meaning in Regulation S-X, Article 11, and is not appropriate for describing non-GAAP measures. The staff has also been requesting revised presentations when a registrant presents a full non-GAAP income statement or other financial statement, since such a presentation creates the inappropriate impression that the multiple non-GAAP measures are being presented on a comprehensive basis of accounting, which is not the case.

Other Deloitte Resources

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

Revenue Recognition

Examples of SEC Comments

- *Multiple-Element Arrangements* — Tell us how your separation of the installation services as a separate unit of accounting complies with EITF 00-21. As part of your response, clarify how you have determined there is objective and reliable evidence of fair value of the hardware installation services; we refer you to paragraph 9 of EITF 00-21. Further explain the basis for your revenue and expense recognition and timing for installation services.
- *Software Revenue Recognition* — We note your disclosures . . . and your reference to EITF 03-5. Do the Company's products include software that is more than incidental . . . ? If so, please explain how your accounting for such product sales complies with EITF 03-5 and SOP 97-2. If not, then please explain the reference to this guidance in your disclosures.
- *Gift Card Revenue* — In future filings please provide more detailed disclosures regarding your accounting policies for estimating, recognizing and classifying gift card breakage. Also, to the extent that breakage is a material source of income please disclose the amount of breakage for each year presented.

Multiple-Element Arrangements

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

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

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

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

Software Revenue Recognition

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

The SEC staff has focused on identifying situations in which these registrants should recognize revenue in accordance with the SOP. If information in a registrant's filing indicates that the registrant's products or services include software, the staff typically asks the registrant to clarify whether the software is "more than incidental" and how the registrant is recognizing revenue for the deliverables. The staff has also requested registrants to discuss the applicability of Issue 03-5 to their arrangements. (Issue 03-5 clarifies which elements in an arrangement are within the scope of SOP 97-2.)

At the 2007 AICPA Conference, Ms. Sandie Kim, a professional accounting fellow in the SEC's Office of the Chief Accountant, discussed revenue recognition for hardware deliverables in software arrangements. She pointed out that as a result of "exponential advances in technology . . . more and more hardware deliverables" are being included in the scope of SOP 97-2. Applying SOP 97-2 to multiple units of hardware delivered over a long period can be difficult, especially when "vendor-specific objective evidence (VSOE) of fair value does not exist for such hardware." Ms. Kim noted that SOP 97-2 appears to require deferral of all revenue in such arrangements until VSOE is established or all hardware elements are delivered. However, she explained that SOP 97-2 "does contain exceptions to the general rule on revenue deferral," specifically when the only undelivered elements are postcontract customer support (PCS) or certain services. This would allow for proportional recognition of revenue for multiple units of hardware delivered over a period in which VSOE of fair value does not exist for the hardware. Such accounting would be similar to ratable recognition of a fee over a PCS period or over a period during which services are expected to be performed.

Ms. Kim also emphasized that when the only undelivered elements in a software arrangement are PCS and services, in practice, recognition of the entire fee is allowed over the longer of the PCS or service period. She noted that the basis for this view is that there is "no inappropriate front-loading of revenue since revenue, including any significant discount that may be included in the arrangement, is recognized over the longest period of performance."

By analogy to PCS and services under SOP 97-2, Ms. Kim believes that a "reasonable application of the provisions of SOP 97-2 can result in proportionate recognition of revenue for hardware without VSOE of fair value if the remaining deliverables are multiple units of the same product." She used the following example to illustrate her point:

[A] company has an arrangement in which the remaining deliverables are 100 units of Hardware Product A and 200 units of Hardware Product B. VSOE of fair value does not exist for either hardware product and both hardware products are in the scope of SOP 97-2. In this fact pattern, the staff would not object if revenue were recognized based on a consistent ratio of both products (that is, one unit of Product A for every two units of Product B).⁶ This methodology ensures that revenue is not prematurely recognized and that any discount in the arrangement is recognized proportionately.

⁶ Continuing on with the example, if four units of Product A were delivered at \$10 per unit and four units of Product B were delivered at \$15 per unit in a particular period, revenue would be limited to two units of Product A (\$20) and four units of Product B (\$60). If instead, two units of Product A were delivered and six units of Product B were delivered, revenue would likewise be limited to two units of Product A (\$20) and four units of Product B (\$60).

Gift Card Revenue

The SEC staff has also focused on the reporting of gift card revenue, probably because of the subjectivity of estimating gift card breakage (the amount that is never redeemed). At the 2005 AICPA Conference, Ms. Pamela Schlosser, a professional accounting fellow in the SEC's Office of the Chief Accountant, mentioned that the SEC staff's primary concern about breakage is that companies may inappropriately recognize breakage as revenue at the time payment is received. The SEC

staff has requested additional disclosures or explanations of the registrant's process for estimating breakage and its policy for recognizing breakage (i.e., upon sale of gift cards or over the performance period). In certain instances, the SEC staff has also requested supporting documentation, such as:

- Historical information supporting the estimate of breakage and whether it is based on a large pool of homogeneous transactions.
- The estimated gift card breakage rate.

The SEC staff may also request information about the nature of the registrant's gift card arrangements — for example, whether the registrant's cards are redeemable for cash or carry expiration dates.

Product and Service Revenue Presentation

At the 2007 AICPA Conference, Mr. Barrysmith discussed financial statement presentation of product and service revenue. SEC Regulation S-X, Rule 5-03(b), requires that product revenue and service revenue, along with other categories of revenue, be displayed separately in the income statement if they are greater than 10 percent of total revenues. (See the [Financial Statement Classification](#) section for additional information.) Mr. Barrysmith notes that a question often arises about how a vendor can adhere to this requirement when it is unable to separate its multiple-element arrangements under applicable revenue recognition guidance, such as Issue 00-21 or SOP 97-2.

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 SOP 97-2, 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.

2008 Update

Examples of Recent SEC Comments

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

The SEC staff often comments that registrants should expand or clarify disclosures about revenue recognition. Specifically, the SEC 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 specific 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.

Other Deloitte Resources

- *Software Revenue Recognition: A Roadmap to Applying AICPA Statement of Position 97-2.*
- January 6, 2009, *Heads Up*, “FASB and IASB Issue Discussion Paper on Revenue Recognition.”

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

Examples of SEC Comments

- 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.
- Please provide to us your evaluation of the impact of adopting FIN 48. Furthermore, please explain why there appears to be no disclosure regarding the impact that FIN 48 will have on your 2007 financial statements, in particular when the Interpretation was issued in June of 2006. See SAB Topic 11:M.

SAB Topic 11.M (SAB 74) requires disclosures about the effects of recently issued accounting standards that are not yet effective. The disclosures are required for new FASB Statements and Interpretations, FSPs, EITF consensuses, and SEC SABs. For example, calendar-year-end registrants should include SAB 74 disclosures for Statements 141(R), 160, 161, 162, and 163 in their 2008 Forms 10-K unless the effect of adoption will be immaterial. (See Deloitte’s *Accounting Roundup: Year in Review — 2008* for summaries of these Statements and other guidance issued during the year.)

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 in both 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, FSP APB 14-1 was issued in May 2008 and is effective as of the beginning of a reporting entity’s first fiscal year beginning after December 15, 2008. (See the [Financial Instruments](#) section for additional information about FSP APB 14-1.) A calendar-year-end registrant may not have been able to reasonably estimate whether FSP APB 14-1’s impact on its financial statements would be material with respect to SAB 74 disclosures in its June 30, 2008, Form 10-Q. The registrant will adopt FSP APB 14-1 on January 1, 2009, and will be issuing its December 31, 2008, Form 10-K after that date. Therefore, the registrant should be able to disclose more specifics in its December 31, 2008, Form 10-K.

SEC Reporting (Regulation S-X Misapplication)

Examples of SEC Comments

- *Significant Business Acquisitions* — It appears that you may have an acquisition that is currently deemed probable and that would be significant at greater than 50% based on pre-tax income. If our understanding is correct, please revise to provide the information required by Rules 3-05 and 11-01 of Regulation S-X concerning this probable acquisition. Otherwise, please explain to us why you do not believe that this information is required.
- *Investments in Equity Method Investees* — We note that you include in your Form 10-K for the year ended December 31, 2006 the financial statements of Equity Method Investee [X] for 2005 and 2004 under Rule 3-09 of Regulation S-X. We also note that you began consolidating [X] in June of 2006 and classified the investment as a discontinued operation in November 2006. Please explain your basis for not including the financial statements of [X] for 2006 up to the date of consolidation in your filing. See Rule 3-09(b) of Regulation S-X. Please also advise as to why you have not filed pro forma financial statements disclosing the effect of the divestiture under Article 11 of Regulation S-X.

The SEC staff often comments on form and content issues regarding the separate financial statements of other entities or pro forma information that registrants must provide under Regulation S-X.

Significant Business Acquisitions (Rule 3-05)

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. The number of financial statement periods of the acquiree that a registrant is required to present primarily depends on the significance of the acquiree to the registrant. The significance is calculated on the basis of three tests: the investment (purchase price) test, the asset test, and the income test. 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.
- Significance of the acquired or to be acquired business.
- 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 Statement 141(R)¹ 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.

¹ Statement 141(R) is effective for business combinations whose acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Before the effective date of Statement 141(R), see Issue 98-3 for the definition of a business for U.S. GAAP purposes.

Investments in Equity Method Investees (Rule 3-09)

When a registrant has a significant equity method investment, the SEC requires the filing of certain financial statements for the investee under Regulation S-X, Rule 3-09. 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 Rule 3-09 significance tests, such as:

- Not updating or 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 be changed, making the equity investee significant for the first time. In addition, the significance tests should be updated and reassessed for all years presented in a Form 10-K after a registrant reports discontinued operations.
- Not including a gain or loss on a partial disposal of an equity method investee in the annual significance calculation when the registrant retains an interest in the entity and continues to account for this interest under the equity method.

Guarantors of Registered Securities (Rule 3-10) and Issuers of Securities That Collateralize Registered Securities (Rule 3-16)

Registrants often look at Regulation S-X, Rules 3-10 and 3-16, as one test or related tests, but should be aware that the tests in Rule 3-10 and Rule 3-16 are separate and distinct and must be assessed individually. Rule 3-10 may require a company to provide separate financial statements or condensed consolidating financial information for guarantors of registered debt. A common error is for the registrant to incorrectly assume that certain exceptions in the rule are met, and therefore to conclude that it does not have to provide separate financial statements or condensed consolidating financial information. In addition, registrants may incorrectly prepare required condensed consolidating financial information by, for example, not presenting subsidiaries under the equity method in the separate columns in the condensed consolidating information. Similar issues related to compliance with Rule 3-16 may arise. In such cases, financial statements of a parent company's affiliate that collateralizes its public debt may be required. Rule 3-16 does not allow for condensed consolidating financial information in lieu of full financial statements. Both rules include specific tests and "bright-line" requirements.

Pro Forma Financial Information (Article 11)

Registrants must often provide pro forma information for significant transactions, such as a business combination or disposition. Regulation S-X, 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 issued comments to registrants for failing to clearly explain each financial statement adjustment or not clearly indicating how the requirements above are met.

2008 Update

New Financial Reporting Manual

On December 9, 2008, the SEC's Division of Corporation Finance issued the [Financial Reporting Manual](#) (FRM). The FRM replaces the *Division of Corporation Finance: Accounting Disclosure Rule and Practices: An Overview* (the "staff training manual"), which was last updated in 2000. It provides the staff's interpretations of portions of Regulation S-X and S-K, including guidance on topics such as the form and content of a registrant's financial statements, providing separate financial statements of acquired businesses under Rule 3-05, pro forma financial information, and non-GAAP measures.

The FRM contains roughly twice the information that was in the staff training manual and is easier to read and more user-friendly. According to Wayne Carnall, chief accountant of the Division of Corporation Finance, the FRM does not significantly change the SEC staff's views or conclusions. Instead, it updates the staff training manual content for several new rules and interpretations that have been published since 2000, such as SEC Final Rule Releases, SEC Regulations Committee meeting minutes, and new FASB standards. For example, the FRM updates the staff training manual for items such as:

- The revised filing deadlines applicable to large accelerated, accelerated, and nonaccelerated filers, and SEC reporting considerations for well-known seasoned issuers.
- Revised filing deadlines for Form 8-K.
- SEC reporting considerations for the adoption of Statements 141(R) and 160 (see below for additional information).
- SEC reporting considerations for foreign private issuers and domestic companies that acquire or have an investment in a foreign business.
- SEC reporting considerations for smaller public companies.
- SEC reporting considerations for shell companies.

SEC Reporting Considerations for the Adoption of Statements 141(R) and 160

There are a variety of SEC reporting considerations for the adoption of Statements 141(R) and 160.² The 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 to be part of the purchase price under Statement 141. Therefore, under Rule 3-05, transaction costs were also included in the investment in the acquiree for the purpose of the investment (purchase price) test. Under Statement 141(R), such costs are expensed. As indicated in paragraph 2015.5 of the FRM, after the adoption of Statement 141(R), such costs should be excluded from the investment in the acquiree for the purposes of the investment test under Rule 3-05.

Investments in Equity Method Investees (Rule 3-09)

The SEC staff has historically required registrants to include gains or losses from a full or partial disposition of an interest in an equity method investee in the calculation of significance. However, the staff has revised its view. Paragraph 2410.2(d) of the FRM states that a registrant must include the following in the income test of significance:

[A]ny gains or losses of the registrant in the most recently completed fiscal year stemming from **dispositions** of an interest in the tested equity method investee, provided that the investee was accounted for using the equity method immediately prior to the disposition and continues to be accounted for by the equity method immediately after the disposition. All other gains or losses stemming from dispositions of interests in the tested equity method investee may be excluded.

Other Deloitte Resources

The Deloitte U.S. SEC Reporting Interpretations Manual includes Q&As and interpretive guidance on Regulation S-X issues. The manual is available on [Technical Library: The Deloitte Accounting Research Tool](#). See [Appendix D](#) for further details.

Also see Deloitte's [January 20, 2009, Heads Up, "SEC Modernizes Oil and Gas Company Reporting,"](#) and [December 22, 2008, Heads Up, "SEC Approves Rules Requiring Registrants to Submit Interactive Data."](#)

² Statement 141(R) is effective for business combinations whose acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Statement 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008.

Segment Reporting

Examples of SEC Comments

- *Identification and Aggregation of Operating Segments* — We note that you have one reportable operating segment. It appears from your disclosures elsewhere in the filing . . . that you may have aggregated multiple operating segments into one reportable segment. Please provide us with a detailed explanation of how you determined both your operating segments and your reportable segment.
- *Aggregation of Operating Segments* — Please provide us with net revenue and net segment margins, along with any other information you believe would be useful . . . for each of the five years . . . to help us understand how the aggregated operating segments are economically similar.
- *Changes in Reportable Segments* — We note that you changed the composition of your reportable segments. . . . Please tell us the changes in the structure of your organization that caused the composition of your reportable segments to change. . . . In addition, if segment information for earlier periods is not restated please disclose segment information for the current periods under both the old basis and the new basis of segmentation unless it is impracticable to do so. Please refer to paragraphs 33–35 of SFAS 131.
- *Information About Products and Services* — Please provide the revenue disclosures by product and service group required by paragraph 37 of SFAS 131.

Identification of Operating Segments

Much of the SEC staff's focus on this topic is on what financial information the chief operating decision maker (CODM) receives and reviews. The SEC 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 company's Web site, analysts' reports, and press releases, for consistency with a company's segment disclosures.

Aggregation of Operating Segments

Statement 131 permits a company to aggregate operating segments if the aggregation is "consistent with the objective and basic principles [of Statement 131 and] if the segments have similar economic characteristics." The Statement also notes that the segments must be similar in each of the following respects:

- a. The nature of the products and services
- b. The nature of the production processes
- c. The type or class of customer for their products and services
- d. The methods used to distribute their products or provide their services
- e. If applicable, the nature of the regulatory environment, for example, banking, insurance, or public utilities.

The SEC staff has indicated that it views aggregation as a "high hurdle." Companies 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 company's management reviews.

Paragraphs 18–24 of Statement 131 provide quantitative thresholds and guidance that a company should use to evaluate which operating segments it should report separately. One subject that the SEC continues to comment on is quantitatively immaterial segments. Companies 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

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

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

Operating Segments and Goodwill Impairment

Companies 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 Statement 142, and reporting units are identified as either operating segments or one level below. If a company has not correctly identified its operating segments, it could be testing goodwill at the wrong level.

Share-Based Payments

Examples of Recent SEC Comments

- *Disclosures* — We note that . . . your current disclosures do not appear to provide all the disclosures required by FAS 123(R), including comparative disclosures required for each year an income statement is provided. Please tell us your consideration for the disclosure requirements of paragraphs 64–65, 84 and A240–A242 of SFAS 123(R).
- *Valuation Methods and Assumptions* — [P]lease disclose the following . . . the method you used to determine the expected term, expected volatility and risk-free rate as required by paragraph A240 (e)(2) of SFAS 123R.
- *Financial Statement Presentation of Share-Based Payment Awards* — We note that you present stock-based compensation as a separate component of general and administrative expense. Please modify your presentation to include the expense related to share-based payment arrangements in the same line item or lines as cash compensation paid to the same employees. Refer to Topic 14:F of SAB 107 for further guidance.

The SEC staff frequently comments on the disclosures, valuation methods, accounting, and financial statement presentation associated with share-based payments.

Disclosures

Registrants should ensure that their disclosures address the following objectives outlined in paragraph 64 of Statement 123(R):

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

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

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

In its comments about disclosures, the SEC staff frequently cites the guidance in paragraph A240 of Statement 123(R), which describes the “minimum” information needed to achieve paragraph 64’s disclosure objectives.

Valuation Methods and Assumptions

The SEC staff frequently asks registrants to disclose more specific information about the valuation methods they use for share-based awards, including significant assumptions. The staff is particularly interested in how registrants determine

the expected volatility and the expected term. Assumptions about these matters are subjective and can significantly affect the award's fair-value-based amount. Sometimes, the staff may question whether the assumptions are based on the best available information. For example, if registrants disclose that they have employee and director options and use the same assumptions to determine the expected life and volatility for both types of options, the staff may question why this is appropriate.

In addition, the SEC staff often asks about the valuation of share-based awards made before a registrant's initial public offering. Examples of common questions are:

- Whether the valuation was a contemporaneous or retrospective valuation of the stock on the issuance date of the award.
- Whether an unrelated valuation specialist did the valuation.
- Whether the registrant used the best practices identified in the AICPA Practice Aid *Valuation of Privately-Held-Company Equity Securities Issued as Compensation*.

The SEC may also request a copy of the valuation.

At the December 2007 AICPA Conference, Mr. Mark Barrysmith discussed issues entities should consider when using market instruments to measure the fair-value-based amount of share-based payments. (See Deloitte's *Heads Up* on the 2007 AICPA Conference for additional details about Mr. Barrysmith's remarks.) In addition, Ms. Sandie Kim discussed assumptions that registrants should use in valuing share-based payments. While Statement 157 does not apply to share-based payment arrangements, Ms. Kim noted that Statement 123(R) provides for the use of valuations and assumptions that are consistent with the fair value measurement objective. She explained that when valuing share-based payment arrangements, entities should use assumptions specific to the security rather than assumptions a "specific holder of the security would consider." This concept is similar to Statement 157's concept of the use of market participant assumptions or attributes that would transfer to the market participant. Ms. Kim gave the following examples to illustrate the staff's view on this topic:

- *Example in which reduction is appropriate* — "For example, one common term we see in share-based payment arrangements is a restriction that prohibits the transfer or sale of securities. If the security contains such a restriction that continues after the requisite service period, that post-vesting restriction may be factored as a reduction in the value of the security."
- *Example in which reduction is not appropriate* — "For example, we have heard arguments that a significant discount should be taken on certain share-based payment awards because the securities were issued to a group of executives that were subject to higher taxes than other employees. The staff does not believe this assumption is consistent with a fair value measurement objective."

Ms. Kim reminded companies that if a discount is appropriate, the use of "general rules of thumb" in determining the discount is not appropriate, and that the calculation of any discount should be based on information specific to the security.

SEC Staff Issues Guidance on Expected Term

Under Statement 123(R), 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; a company 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. Previously, under SAB Topic 14, a company could avail itself of the simplified method's safe harbor regardless of whether the company had enough information to refine its estimate of expected term.

Financial Statement Presentation of Share-Based Payment Awards

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]).

Other Deloitte Resources

- *FASB Statement No. 123(R), Share-Based Payment: A Roadmap to Applying the Fair Value Guidance to Share-Based Payment Awards.*
- Financial Reporting Alert 08-6, "Recent Tax Ruling Requires Entities to Reconsider Their Tax Positions Related to Executive Compensation."
- Financial Reporting Alert 07-10, "SEC Extends the Use of the Simplified Method in SAB 107 Under Certain Circumstances."
- Financial Reporting Alert 07-9, "Accounting for Reimbursement of India's Fringe Benefit Tax on Stock Option Compensation From Employees."
- June 17, 2008, *Heads Up*, "FASB Concludes That Certain Unvested Share-Based Payment Awards Are Participating Securities."

Use of Experts and Consents

Example of a Recent SEC Comment

- You made references . . . to the use of independent third-party appraisers and valuation specialists. Please tell us the nature and extent of the independent third parties' involvement in the valuation of certain tangible and intangible assets acquired and liabilities assumed. Also, tell us whether you believe the independent third parties were acting as experts as defined in the Securities Act of 1933.

The SEC staff has indicated that it has seen an increase in the number of companies 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 other intangible assets in a business combination.
- A valuation firm about the determination of goodwill impairment.
- A valuation firm about the determination of asbestos liability.
- An independent actuary about the estimation of workers' compensation liability.
- Petroleum engineers about the evaluation of oil and gas reserves.
- Pricing services or brokers that provide information used to determine the fair values of financial assets or liabilities.

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

Periodic Reports

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

Registration Statements

In the past, 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.

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 Item 1015 of Regulation M-A or Item 601(b) of Regulation S-K, or the general disclosure requirements in Rule 408 of the Securities Act.

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.

Question 233.02 also gives the following example:

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

Other Areas of Frequent SEC Comment

Asset Retirement Obligations

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 asset retirement obligations. A registrant that includes disclosures such as “settlement dates are unknown at this time,” or other similar language concerning the inability to reasonably estimate the fair value of asset retirement obligations, may receive an SEC staff comment asking for more detail about how the registrant reached this conclusion and the extent of the registrant’s uncertainty. Registrants must disclose (1) that they have not recorded asset retirement obligations that cannot be reasonably estimated and (2) the reason they could not be reasonably estimated under paragraph 22 of Statement 143.

Disclosures Regarding State Sponsors of Terrorism

The U.S. Department of State has designated five countries as state sponsors of terrorism — Cuba, Iran, North Korea, 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 contacts 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. On November 16, 2007, the SEC issued a [concept release](#) on how to make these disclosures more accessible to investors through its [Web site](#).

Pensions

SEC staff comments on pensions focus primarily on accounting policy decisions and other required disclosures. One such comment relates to the calculation of the market-related value of plan assets (as that term is defined in Statement 87). The SEC staff expects registrants to disclose their accounting policy election for the method used to determine the market-related value of plan assets, since this method directly affects pension expense. The staff also comments on the absence of required disclosures for key assumptions, such as the discount rate and other actuarial assumptions used to value a company’s pension plan. (See the [Pensions](#) section in the 2008 Update below for related remarks made at the 2008 AICPA Conference.)

2008 Update

Capitalization of Costs

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

- Describe the types of costs that are capitalized as a component of deferred costs in the accounting policy footnote.
- For each period presented, provide a rollforward schedule of the beginning and ending balance of the deferred costs to include any additions (e.g., the amount of periodic deferrals) and amounts amortized in the accounting policy footnote.
- 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.

- Separately state the amount of deferred costs in the balance sheet or in a note thereto, if the amount is greater than 5 percent of total assets, 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 condition, 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 and MD&A, as appropriate.

Pensions

At the 2008 AICPA Conference, Mr. James Kroeker, deputy chief accountant in the SEC's Office of the Chief Accountant, addressed questions about pension plan accounting. He stated that the SEC staff realizes that much of the work related to measuring the benefit obligation may be done in advance and rolled forward to year-end. He also remarked that a rollforward approach would not be appropriate for plan assets with readily determinable fair values. He observed that an entity should be able to measure plan assets with readily determinable fair values at year-end without much difficulty.

He also cautioned that an entity should use a discount rate that reflects reasonable assumptions as of the measurement date. Specifically, he discussed the following:

- Given the current economic environment and volatility in the market, an entity using a rollforward approach for pension obligations should be aware that a discount rate that was reasonable one or two months ago might not be reasonable as of the measurement date.
- Companies that use hypothetical bond portfolios to support the discount rate when measuring their postretirement benefit obligations should evaluate the impact of current market conditions on both bond pricing and bond selection. Companies should consider excluding "outliers" from their hypothetical bond portfolios when developing their postretirement plan discount rates. Outliers include bonds that have high yields because (1) the issuer is on review for possible downgrade by one of the major rating agencies or (2) recent events have caused significant price volatility and the rating agencies have not yet reacted.
- When a company develops a hypothetical bond portfolio, it should consider whether there are enough bonds at a particular rating available (i.e., "capacity") in the market to cover the pension obligation. If an entity is using certain indices to select a discount rate, the capacity of some of the bonds in the index may not be sufficient to cover the pension obligation of many plans in the current environment. Capacity constraints alone would not (1) preclude an entity from considering those bonds as inputs in developing the discount rate or (2) require an entity to default to using a treasury rate or AAA-rated securities, but it is important to consider whether the entity has met the overall objective of developing a reasonable high-credit-quality rate.

See Deloitte's *Heads Up* on the 2008 AICPA Conference for additional information.

Other Deloitte Resources

- [A Roadmap to the Accounting and Regulatory Aspects of Postretirement Benefits: Including an Overview of Statement 158.](#)
- [Financial Reporting Alert 08-19, "Pension and Other Postretirement Benefits Affected by Turmoil in the Credit Markets."](#)
- [January 9, 2009, *Heads Up*, "FASB Expands Disclosures About Postretirement Benefit Plan Assets."](#)

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 June 2008, the SEC staff issued an [overview](#) that explains its filing review and comment letter process.¹ The overview increases transparency in the review process and expresses the staff's willingness to discuss issues with companies. 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 staff 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 companies' potential requests for reconsideration of a staff member's comment or view on a company's response, the staff emphasizes that there is no formal protocol to follow. However, the staff explains where companies 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.

A company 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 company 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 company 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 company should request a completion letter.

To increase 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 following best practices are intended to help SEC 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.

- Consider the impact the comment letter may have on your ability to issue the financial statements.
- Consult with your SEC legal counsel about the impact the comment letter may have on the certifications contained in your Form 10-K.
- Consult with your 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, do not request an extension, since this may delay resolution of the comment letter. However, in certain circumstances, a registrant may consider requesting an extension to provide a response that addresses all of the staff's comments.
- If you do not fully understand any specific comment, contact your SEC staff reviewer for clarification so that you can provide an appropriate response.
- Because some comments may require disclosures in future filings, consider including such disclosures in the response letter to potentially eliminate additional requests from your SEC staff reviewer.
- Maintain contact with your SEC staff reviewer and make the reviewer aware of your required timing (on the basis of your current-year filing deadlines).
- If you have not received a follow-up letter or been contacted within two weeks of filing the initial response letter, contact your SEC staff reviewer to determine the status of the comments. Promptly address any follow-up questions.
- If you are uncertain about whether your review has been completed without further comments, ask the SEC staff reviewer about the status of the review. If the review is complete, ask the reviewer for a completion letter.

Disclosure Requirements

In addition, under the Securities Offering Reform,¹ 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.

¹ The SEC adopted final rules, effective as of December 1, 2005, which modified the registration, communications, and offering processes under the Securities Act of 1933.

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 completed. 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

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.

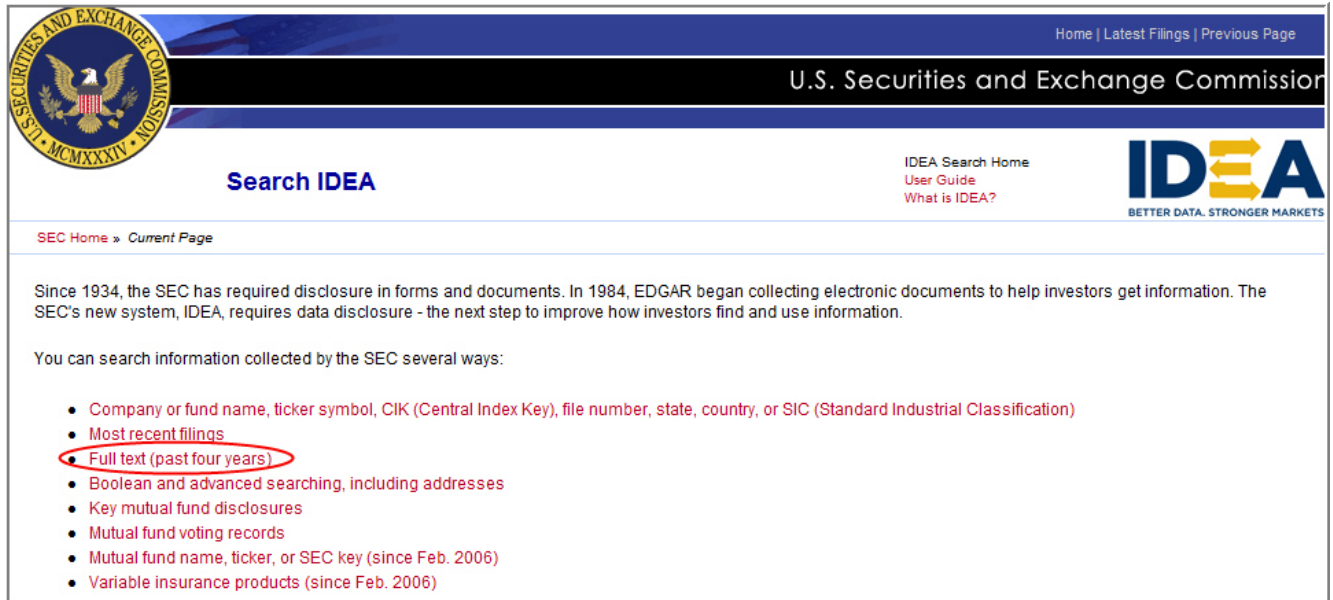
To access the advanced search feature:

- (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.)

The image shows a screenshot of the SEC website's navigation menu. The menu is organized into several columns and sections. The 'Filings & Forms' section is highlighted, and the link 'Search for Company Filings' is circled in red. Other sections include 'About the SEC', 'Investor Information', 'News & Public Statements', 'Information for:', and 'Divisions/Offices'.

Credit Rating Agency Examination Report ... 21st Century Disclosure Initiative	About the SEC What We Do Commissioners Upcoming Events Laws & Regulations 2008 PAR Office of Inspector General more...	Investor Information 2008 Annual Report File a Tip or Complaint Check Out Brokers & Advisers Publications en Español For Seniors PAUSE more...	Information for: Accountants Broker Dealers Broker-Dealer CCOs EDGAR Filers Funds & Advisers Fund/Adviser CCOs International Municipal Markets NRSROs Small Business
Enforcement Tips	Filings & Forms Quick EDGAR Tutorial Search for Company Filings Descriptions of SEC Forms Requesting Public Documents more...	News & Public Statements News Digest Press Releases What's New Webcasts Special Studies Speeches & Public Statements Testimony more...	Divisions/Offices Corporation Finance Enforcement Investment Mgmt. Trading & Markets Compliance International Affairs
	Regulatory Actions Proposed Rules Final Rules Interim Final Temporary Rules		

(2) On the "Search IDEA" Web page, select "Full text (past four years)."



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User Guide
What is IDEA?

IDEA
BETTER DATA. STRONGER MARKETS

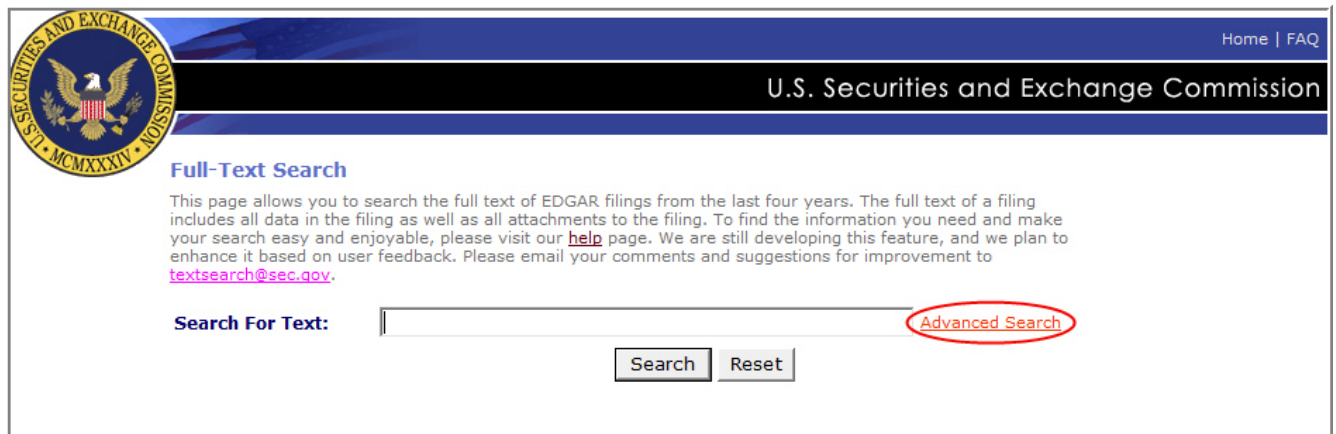
SEC Home » Current Page

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, IDEA, 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."



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 [help](#) 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

Search Reset

(4) This brings up the following Web page.

Home | FAQ

U.S. Securities and Exchange Commission

Full-Text Search

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Search For Text: [Basic Search](#)

In Form Type: All Forms **Results Per Page:** 10

For Company Name:

Or Central Index Key (CIK):

Or Standard Industrial Classification: All SICs

Between These Dates:

Start Date: End Date:

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.

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.

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

Date Filed Title

09/14/2006 [EX-10.1 of 10SB12G for AOB BIOTECH INC](#)

COMPANY NAME(s) - [AOB BIOTECH INC (CIK - 1363449 /SIC - 6022)]

shall be responsible for conducting all necessary testing as well as determining what, if any, government approvals are required for the use and sale of Products developed hereunder and shall comply with all such requirements prior to and following the sale or distribution of such Products. 8.

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.

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

[SEC Modernizes Oil and Gas Company Reporting](#)

[Study Finalized on Mark-to-Market Accounting](#)

[SEC Approves Rules Requiring Registrants to Submit Interactive Data](#)

[Highlights of the 2008 AICPA National Conference on Current SEC and PCAOB Developments](#)

[SEC Issues Proposed IFRS Roadmap](#)

[SEC Proposes to Give Certain U.S. Issuers the Option to Use IFRSs and Proposes a Roadmap to a Mandatory Transition Date for All U.S. Issuers](#)

[SEC Holds Fourth Roundtable on IFRSs](#)

[Complexity DeCIFIred — SEC Advisory Committee Releases Final Report](#)

[Something to Talk About — SEC Staff Explains the Filing Review and Comment Letter Process](#)

[Great “X”pectations — SEC Proposes Mandating XBRL Use to Make Financial Data Interactive](#)

[Regulations Committee and SEC Staff Hold First Meeting of 2008](#)

[DeCIFIring Complexity — SEC Advisory Committee Releases Progress Report](#)

[Highlights of the 2007 AICPA National Conference on Current SEC and PCAOB Developments](#)

[SEC Holds Roundtables on IFRSs](#)

[Major Changes to Business Combination Accounting as FASB and IASB Substantially Converge Standards](#)

[XBRL U.S. GAAP Taxonomy Made Available for Public Comment](#)

[SEC Removes Reconciliation Requirement, Approves Smaller Public Company Rules](#)

[SEC Regulations Committee and SEC Staff Hold Third Meeting of 2007](#)

[ESOARS Take Off — SEC OKs Use of a Surrogate to Value Employee Share Options](#)

[SEC Feedback on Executive Compensation Disclosures: “Where’s the Analysis?”](#)

[SEC Staff Issues Comment Letters on Executive Compensation Disclosures](#)

[The Shift Toward IFRSs and Its Impact on U.S. Companies](#)

[SEC Regulations Committee and SEC Staff Hold Second Meeting of 2007](#)

[SEC Provides Further Relief for Smaller Public Companies](#)

[SEC Proposes Easing Requirements for Foreign Filings](#)

[SEC Tackles a Wide Range of Topics](#)

[SEC and PCAOB Approve New Section 404 Guidance: No Additional Delay for Non-Accelerated Filers](#)

[Expected SEC Actions Will Increase Relevance of IFRSs in the U.S.](#)

SEC Regulations Committee and SEC Staff Hold First Meeting of 2007
SEC Discusses Improvements to Section 404 of the Sarbanes-Oxley Act
SEC Clarifies Views on the Design of Market-Based Employee Stock Option Valuation Model
Matching Critical Terms in Hedge Strategies — Major Accounting Firms Discuss Ramifications With SEC Staff
SEC and PCAOB Update

Financial Reporting Alerts

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
07-2: Error Made by Companies in Adopting Statement 158's Recognition Provisions

Accounting Alerts

07-5: SEC Expresses Concerns About Financial Reporting of Certain Strategies Related to the Adoption of Statement 159

SEC Alerts

07-1: SEC Issues Letter on Filing Restated Financial Statements for Errors in Accounting for Stock Option Grants

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Did You Know . . . ?

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

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

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

Appendix E: Glossary of Standards

FASB Statement No. 163, *Accounting for Financial Guarantee Insurance Contracts* — an interpretation of FASB Statement No. 60

FASB Statement No. 162, *The Hierarchy of Generally Accepted Accounting Principles*

FASB Statement No. 161, *Disclosures About Derivative Instruments and Hedging Activities* — an amendment of FASB Statement No. 133

FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements* — an amendment of ARB No. 51

FASB Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* — an amendment of FASB Statements No. 87, 88, 106, and 132(R)

FASB Statement No. 157, *Fair Value Measurements*

FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*

FASB Statement No. 143, *Accounting for Asset Retirement Obligations*

FASB Statement No. 142, *Goodwill and Other Intangible Assets*

FASB Statement No. 141(R), *Business Combinations*

FASB Statement No. 141, *Business Combinations*

FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* — a replacement of FASB Statement 125

FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*

FASB Statement No. 131, *Disclosures About Segments of an Enterprise and Related Information*

FASB Statement No. 128, *Earnings per Share*

FASB Statement No. 123(R), *Share-Based Payment*

FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*

FASB Statement No. 109, *Accounting for Income Taxes*

FASB Statement No. 107, *Disclosures About Fair Value of Financial Instruments*

FASB Statement No. 95, *Statement of Cash Flows*

FASB Statement No. 87, *Employers' Accounting for Pensions*

FASB Statement No. 78, *Classification of Obligations That Are Callable by the Creditor* — an amendment of ARB No. 43, Chapter 3A

FASB Statement No. 57, *Related Party Disclosures*

FASB Statement No. 6, *Classification of Short-Term Obligations Expected to Be Refinanced* — an amendment of ARB No. 43, Chapter 3A

FASB Statement No. 5, *Accounting for Contingencies*

FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* — an interpretation of FASB Statement No. 109

FASB Interpretation No. 39, *Offsetting of Amounts Related to Certain Contracts* — an interpretation of APB Opinion No. 10 and FASB Statement No. 105

FASB Technical Bulletin No. 79-3, *Subjective Acceleration Clauses in Long-Term Debt Agreements*

FASB Staff Implementation Guide (Statement 131), "Segment Information: Guidance on Applying Statement 131"

FASB Staff Implementation Guide (Statement 86), "Computer Software: Guidance on Applying Statement 86"

FASB Staff Position No. FAS 140-4 and FIN 46(R)-8, "Disclosures by Public Entities (Enterprises) About Transfers of Financial Assets and Interests in Variable Interest Entities"

FASB Staff Position No. FAS 133-1 and FIN 45-4, "Disclosures About Credit Derivatives and Certain Guarantees: An Amendment of FASB Statement No. 133 and FASB Interpretation No. 45; and Clarification of the Effective Date of FASB Statement No. 161"

FASB Staff Position No. FIN 48-1, "Definition of *Settlement* in FASB Interpretation No. 48"

FASB Staff Position No. APB 14-1, "Accounting for Convertible Debt Instruments That May Be Settled in Cash Upon Conversion (Including Partial Cash Settlement)"

Statement 133 Implementation Issue No. G7, "Cash Flow Hedges: Measuring the Ineffectiveness of a Cash Flow Hedge Under Paragraph 30(b) When the Shortcut Method Is Not Applied"

Statement 133 Implementation Issue No. E23, "Hedging — General: Issues Involving the Application of the Shortcut Method Under Paragraph 68"

EITF Issue No. 08-8, "Accounting for an Instrument (or an Embedded Feature) With a Settlement Amount That Is Based on the Stock of an Entity's Consolidated Subsidiary"

EITF Issue No. 07-5, "Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity's Own Stock"

EITF Issue No. 06-6, "Debtor's Accounting for a Modification (or Exchange) of Convertible Debt Instruments"

EITF Issue No. 05-2, "The Meaning of 'Conventional Convertible Debt Instrument' in Issue No. 00-19"

EITF Issue No. 03-13, "Applying the Conditions in Paragraph 42 of FASB Statement No. 144 in Determining Whether to Report Discontinued Operations"

EITF Issue No. 03-6, "Participating Securities and the Two-Class Method Under FASB Statement No. 128"

EITF Issue No. 03-5, "Applicability of AICPA Statement of Position 97-2 to Non-Software Deliverables in an Arrangement Containing More-Than-Incidental Software"

EITF Issue No. 00-27, "Application of Issue No. 98-5 to Certain Convertible Instruments"

EITF Issue No. 00-21, "Revenue Arrangements With Multiple Deliverables"

EITF Issue No. 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock"

EITF Issue No. 98-5, "Accounting for Convertible Securities With Beneficial Conversion Features or Contingently Adjustable Conversion Ratios"

EITF Issue No. 98-3, "Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or of a Business"

EITF Issue No. 96-19, "Debtor's Accounting for a Modification or Exchange of Debt Instruments"

EITF Issue No. 95-22, "Balance Sheet Classification of Borrowings Outstanding Under Revolving Credit Agreements That Include Both a Subjective Acceleration Clause and a Lock-Box Arrangement"

EITF Issue No. 95-8, "Accounting for Contingent Consideration Paid to the Shareholders of an Acquired Enterprise in a Purchase Business Combination"

EITF Issue No. 87-24, "Allocation of Interest to Discontinued Operations"

EITF Issue No. 86-5, "Classifying Demand Notes With Repayment Terms"

EITF Topic No. D-101, "Clarification of Reporting Unit Guidance in Paragraph 30 of FASB Statement No. 142"

EITF Topic No. D-98, "Classification and Measurement of Redeemable Securities"

APB Opinion No. 22, *Disclosure of Accounting Policies*

APB Opinion No. 14, *Accounting for Convertible Debt and Debt Issued With Stock Purchase Warrants*

Accounting Research Bulletin No. 43, Chapter 3A, "Working Capital: Current Assets and Liabilities"

AICPA Statement of Position 01-6, *Accounting by Certain Entities (Including Entities With Trade Receivables) That Lend to or Finance the Activities of Others*

AICPA Statement of Position 97-2, *Software Revenue Recognition*

AICPA Statement of Position 94-6, *Disclosure of Certain Significant Risks and Uncertainties*

SEC Staff Accounting Bulletin Topic 14.F, "Classification of Compensation Expense Associated With Share-Based Payment Arrangements" (SAB 107)

SEC Staff Accounting Bulletin Topic 14.D, "Certain Assumptions Used in Valuation Methods" (SAB 110)

SEC Staff Accounting Bulletin Topic 13, "Revenue Recognition" (SAB 101 and SAB 104)

SEC Staff Accounting Bulletin Topic 11.M, "Disclosure of the Impact That Recently Issued Accounting Standards Will Have on the Financial Statements of the Registrant When Adopted in a Future Period" (SAB 74)

SEC Staff Accounting Bulletin Topic 11.B, "Depreciation and Depletion Excluded From Cost of Sales"

SEC Staff Accounting Bulletin Topic 6.L, "Financial Reporting Release 28 — Accounting for Loan Losses by Registrants Engaged in Lending Activities"

SEC Staff Accounting Bulletin Topic 5.P, "Restructuring Charges"

SEC Staff Accounting Bulletin Topic 5.M, "Other Than Temporary Impairment of Certain Investments in Debt and Equity Securities"

SEC Staff Accounting Bulletin Topic 5, "Miscellaneous Accounting"

SEC Regulation S-X, Article 11, "Pro Forma Financial Information"

SEC Regulation S-X, Rule 11-01, "Presentation Requirements"

SEC Regulation S-X, Rule 5-04, "What Schedules Are to Be Filed"

SEC Regulation S-X, Rule 5-03, "Income Statements"

SEC Regulation S-X, Rule 5-02, "Balance Sheets"

SEC Regulation S-X, Rule 4-08, "General Notes to Financial Statements"

SEC Regulation S-X, Rule 3-16, "Financial Statements of Affiliates Whose Securities Collateralize an Issue Registered or Being Registered"

SEC Regulation S-X, Rule 3-10, "Financial Statements of Guarantors and Issuers of Guaranteed Securities Registered or Being Registered"

SEC Regulation S-X, Rule 3-09, "Separate Financial Statements of Subsidiaries Not Consolidated and 50 Percent or Less Owned Persons"

SEC Regulation S-X, Rule 3-05, "Financial Statements of Businesses Acquired or to Be Acquired"

SEC Regulation S-K, Item 601, "Exhibits"

SEC Regulation S-K, Item 402, "Executive Compensation"

SEC Regulation S-K, Item 308, "Internal Control Over Financial Reporting"

SEC Regulation S-K, Item 307, "Disclosure Controls and Procedures"

SEC Regulation S-K, Item 305, "Quantitative and Qualitative Disclosures About Market Risk"

SEC Regulation S-K, Item 303, "Management's Discussion and Analysis of Financial Condition and Results of Operations"

SEC Regulation S-K, Item 302, "Supplementary Financial Information"

SEC Regulation S-K, Item 10, "General"

SEC Regulation M-A, Item 1015, "Reports, Opinions, Appraisals and Negotiations"

SEC Rule 240.13a-15, "Controls and Procedures"

SEC Final Rule Release No. 33-8238, *Management's Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports*

SEC Final Rule Release No. 33-8176, *Conditions for Use of Non-GAAP Financial Measures*

SEC Financial Reporting Release No. 72, *Interpretation: Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations*

SEC Financial Reporting Release No. 36, *Management's Discussion and Analysis of Financial Condition and Results of Operations; Certain Investment Company Disclosure*

SEC Financial Reporting Codification Section 501, "Management's Discussion and Analysis"

SEC Financial Reporting Codification Section 216, "Disclosure of Unusual Charges and Credits to Income"

SEC Accounting Series Release No. 268 (FRR Section 211), *Presentation in Financial Statements of 'Redeemable Preferred Stocks'*