Accounting Roundup

Year in Review — 2005

The purpose of this publication is to briefly describe key regulatory and professional developments that have recently occurred in the field of accounting and to provide links to locations where additional information can be found on each topic. Readers seeking additional information about a topic should review the information referred to in the hyperlinks and not rely solely on the descriptions included in this communication.

To our clients, colleagues, and other friends,

Welcome to the 2005 edition of Accounting Roundup Year in Review. In 2005, standard setters worked on a number of projects. Although several are still in progress, many were finalized and are summarized in this issue.

A few of the more important standards that the FASB expects to issue in 2006 are:

- Fair Value Measurements
- Uncertain Tax Positions
- Business Combinations and Noncontrolling Interests
- The Fair Value Option
- Amendments to Statement 140

In addition, the FASB recently added to its agenda a new project on pension accounting that is expected to be deliberated in 2006. In early 2006, the FASB may also consider whether to add a lease accounting project to its agenda. Look for information about these and other developments in upcoming monthly editions of Accounting Roundup.

In Accounting Roundup Year in Review, we have summarized the **final** guidance issued by standard setters through November of 2005. See the box on the right for guidance issued in December. Many of these items are currently effective or will be effective in the near future. Companies should consider whether disclosures are required for the financial statement impact of new accounting pronouncements that are not yet effective (i.e., SEC Staff Accounting Bulletin Topic 11.M for public companies). Appendix A includes a summary of the provisions of SAB Topic 11.M.

Readers seeking additional information about these topics or other activities of key standard setters and regulators should use the resources available via the hyperlinks. Hyperlinks within the text appear in blue. Hyperlinked titles are marked with the symbol. Further information can be found on the Web sites of the organizations discussed in this publication, including the FASB, GASB, SEC, PCAOB, AICPA, and IASB.

We hope that Accounting Roundup Year in Review will prove to be a valuable tool for your financial reporting purposes. We value your feedback and would love to hear from you. Please send comments on this issue, or any other in the Accounting Roundup series, to accountingstandards@deloitte.com.

Sincerely,

Deloitte & Touche LLP

Deloitte & Touche LLP

This Just In:

The following guidance was finalized in December 2005. See the December 2005 Accounting Roundup for summaries of these items and proposed guidance issued in December.

FASB Finalizes FSP SOP 94-6-1 on Concentration of Credit Risk

FASB Issues Final FSP AAG INV-1 and SOP 94-4-1 on the Reporting of Fully Benefit-Responsive Investment Contracts

SEC Extends Filing Deadlines for Accelerated Filers

SEC Updates Current Accounting and Disclosure Issues Document

AICPA Issues SAS 102 on Defining Professional Requirements

AICPA Issues SAS 103 on Audit Documentation

AICPA Issues TPAs on SOP 03-3 on Loan and Debt Securities Acquired in a Transfer

GASB Publishes Implementation Guide to Statement 44 on the Statistical Section

IASB Amends IAS 21 for Net Investments in Foreign Operations

IASB Updates Implementation Guide to IFRS 4 on Insurance Contracts

Don't Miss:

Deloitte & Touche's *Heads Up*: Accounting Highlights of the AICPA's December 5–7, 2005 SEC & PCAOB Conference

Deloitte & Touche's *Heads Up*: More Highlights of the AICPA's December 5–7, 2005 SEC & PCAOB Conference

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Share-Based Payment

In December 2004, the FASB issued Statement 123 (revised 2004), *Share-Based Payment*, which requires companies to record in their statements of operations the cost associated with share-based payment awards. The topic continued to be a focus of standard-setting attention throughout 2005. Early in the year the SEC deferred the effective date for certain public companies. The FASB responded to requests for implementation guidance during 2005 by issuing a series of FSPs, and the SEC issued SAB 107,[1] which provides guidance on valuation of share-based payment awards and a variety of other issues. We have summarized Statement 123(R), as well as the FSPs, SAB 107, and the amendment to Rule 4-01(a) of Regulation S-X,[2] below.

FASB Statement 123(R), *Share-Based Payment*

AFFECTS: Companies that grant stock or options (including cash payments that are linked to share price) to employees, and companies that acquire goods or services by issuing share-based payment awards or incurring liabilities either (a) based on the price of their equity instruments or (b) that may require settlement in their equity instruments.

SUMMARY: Statement 123(R) replaces Statement 123[3] and supersedes Opinion 25.[4] It requires compensation costs related to share-based payment transactions to be recognized at fair value as an expense (i.e., pro forma disclosure is no longer an alternative). With limited exceptions, the amount of compensation cost is measured based on the grant-date fair value of the equity instruments issued. In addition, liability awards are remeasured to fair value each reporting period, except that nonpublic companies may choose to use intrinsic value at inception and for subsequent remeasurements.

Compensation cost is recognized over the period that an employee provides service in exchange for the award (i.e., the requisite service period). Forfeitures must be estimated at each reporting period and no compensation cost is recognized for awards that do not vest because the service or performance conditions are not satisfied. Market conditions (e.g., target stock prices) that affect the exercisability of an award reduce the grant-date fair value of an award; compensation cost is recorded regardless of whether the market condition is ever met (as long as the requisite service has been provided).

The excess tax benefits (i.e., the excess of the tax deductible amount over the expense recognized for book purposes) are recognized as an addition to paid-in capital and should be reported as financing cash inflows rather than a reduction of taxes paid.

DISCLOSURES: For each type of share-based payment award, disclose: (1) the nature and terms of the arrangements existing during the period and the potential effects on shareholders, (2) the income statement effect of compensation cost from the arrangements, (3) the method of estimating the fair value of the goods/services received or the fair value of equity instruments granted during the period, and (4) the cash flow effects resulting from the arrangements.

In the period of adoption, companies should disclose the effect of the change from applying the original provisions of Statement 123 on income from continuing operations, income before taxes, net income, cash flow from operations and from financing activities, and basic and diluted earnings per share. For any employee awards accounted for under the Opinion 25 intrinsic value method for which an income statement is presented, public companies should continue to provide the tabular presentation required by paragraph 45 of Statement 123.

EFFECTIVE: For public entities (other than those filing as small business issuers): in the first interim or annual reporting period of the registrant's first fiscal year that begins after June 15, 2005. For public entities that file as small business issuers: in the first interim or annual reporting period of the registrant's first fiscal year that begins after December 15, 2005. For nonpublic entities: in the first annual reporting period that begins after December 15, 2005. The effective dates reflect the SEC's amendment to Rule 4-01(a) of Regulation S-X, which deferred the adoption dates for certain public entities.

1 SEC Staff Accounting Bulletin No. 107, *Share-Based Payment*.

2 SEC Regulation S-X, Rule 4-01, "Form, Order, and Terminology."

3 FASB Statement No. 123, *Accounting for Stock-Based Compensation*.

4 APB Opinion No. 25, *Accounting for Stock Issued to Employees*.

TRANSITION: Nonpublic companies that measured compensation cost at fair value under Statement 123 and public companies may choose between a modified-prospective or modified-retrospective transition. Nonpublic companies that used the minimum-value method under Statement 123 (whether for recognition or for pro forma disclosure) must use the prospective transition method.

OTHER RESOURCES: Deloitte & Touche's *Heads Up* on Statement 123(R), Deloitte & Touche's *Roadmap* on Statement 123(R), SEC Statements Regarding Use of Market Instruments in Valuing Employee Stock Options.

FSP FAS 123(R)-1, "Classification and Measurement of Freestanding Financial Instruments Originally Issued in Exchange for Employee Services Under FASB Statement No. 123(R)"

AFFECTS: Companies that issue freestanding financial instruments originally subject to Statement 123(R).

SUMMARY: FSP FAS 123(R)-1 preserves the initial Statement 123(R) classification (liability versus equity) of an award by indefinitely deferring the requirement in Statement 123(R) for freestanding financial instruments to become subject to other GAAP when the rights conveyed by the instrument are no longer dependent upon employment. An issuer applies other GAAP to these instruments only if a modification occurs after the time the conveyed rights are no longer dependent on employment.

EFFECTIVE: Upon initial adoption of Statement 123(R). For an entity that adopted Statement 123(R) prior to August 31, 2005, the FSP is effective for either (a) the first reporting period beginning after August 31, 2005, or (b) an earlier period, if the financial statements for that period have not been issued.

TRANSITION: If a reclassification is necessary, companies may choose between either (a) retrospective application or (b) a manner similar to a cumulative effect of a change in accounting principle except that the effect on retained earnings should be determined as of the beginning of the reporting period in which the FSP is adopted rather than the beginning of the fiscal year.

FSP FAS 123(R)-2, "Practical Accommodation to the Application of Grant Date as Defined in FASB Statement No. 123(R)"

AFFECTS: Companies that issue share-based payment awards, but do not immediately communicate the key terms and conditions of the awards upon approval.

SUMMARY: FSP FAS 123(R)-2 clarifies that for purposes of determining grant date, a mutual understanding between the employer and employee is presumed to exist at the date the award is approved by the board of directors or management with relevant authority, if the following conditions are met: (a) the recipient does not have the ability to negotiate the key terms and conditions of the award with the employer, (b) the key terms and conditions are expected to be communicated to all recipients within a relatively short time period from the approval date, and (c) all other criteria for determining the grant date have been met.

EFFECTIVE: Upon initial adoption of Statement 123(R). For an entity that adopted Statement 123(R) prior to October 18, 2005, the FSP is effective for the first reporting period after October 18, 2005, for which financial statements or interim reports have not been issued.

FSP FAS 123(R)-3, "Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards"

AFFECTS: Companies that are calculating their APIC pool upon transition to Statement 123(R).

SUMMARY: FSP FAS 123(R)-3 provides a simplified, elective transition alternative to (a) calculating the beginning APIC pool available to absorb future tax deficiencies and (b) determining the subsequent impact on the APIC pool from the tax benefits of awards that are fully vested and outstanding upon the adoption of Statement 123(R). Under this alternative, the beginning balance of a company's APIC pool is calculated as follows:

- The sum of all net increases of APIC recognized in an entity's annual financial statements related to tax benefits from stock-based employee compensation during fiscal periods subsequent to the adoption of Statement 123 but prior to the adoption of Statement 123(R), less

- The cumulative incremental pretax employee compensation costs that would have been recognized if Statement 123 had been used to account for stock-based employee compensation costs, multiplied by the entity's blended statutory tax rate upon adoption of Statement 123(R), inclusive of federal, state, local, and foreign taxes.

The FSP also addresses the cash flow classification of the tax benefits related to awards that are either fully or partially vested upon the adoption of Statement 123(R) when the transition alternative is elected.

EFFECTIVE: After November 10, 2005. Companies may take up to one year from the later of the initial adoption of Statement 123(R) or the effective date of the FSP to make the election.

TRANSITION: Companies that elect the alternative transition method and have previously reported cash flows or results of operations under paragraphs 68 and 81 of Statement 123(R), should report the effect of applying the transition method as a change in accounting principle in accordance with Statement 154[5] (i.e., retrospective application).

SEC Staff Accounting Bulletin 107, *Share-Based Payment*

AFFECTS: Public companies that issue share-based payments subject to Statement 123(R).

SUMMARY: SAB 107 provides views of the SEC staff regarding the interaction between Statement 123(R) and certain SEC rules and regulations and provides the staff's views regarding the valuation of share-based payment arrangements for public companies. In particular, the SAB provides guidance related to:

- Transactions with nonemployees,
- Transition from nonpublic to public entity status,
- Valuation methods and assumptions,
- Accounting for certain redeemable financial instruments issued in conjunction with share-based payment arrangements,
- Classification of compensation expense,
- Non-GAAP financial measures,
- First-time adoption of Statement 123(R) in an interim period,
- Capitalization of compensation cost,
- Accounting for income tax effects of share-based payment arrangements upon adoption of Statement 123(R),
- Modification of employee share options prior to adoption of Statement 123(R), and
- Disclosures in MD&A subsequent to adoption of Statement 123(R).

DISCLOSURES: The SAB includes disclosure requirements on various topics related to Statement 123(R), such as:

- How a company determines the expected volatility used in estimating the fair value of an award (i.e., only implied volatility, historical volatility, or a combination of both),
- The method used for calculating the expected term of stock options,
- Disclosures related to the use of non-GAAP measures (e.g., net income before share-based payment charges),
- Disclosures related to modifications to accelerate vesting of stock options, and
- Disclosures to consider in MD&A to highlight (1) the effects of differences between the accounting for share-based payment arrangements before and after adoption of Statement 123(R) and (2) changes to share-based payment arrangements.

OTHER RESOURCES: Deloitte & Touche's *Heads Up* on SAB 107.

[5] FASB Statement No. 154, *Accounting Changes and Error Corrections* — a replacement of APB Opinion No. 20 and FASB Statement No. 3.

Revisions to Statement 133 Implementation Issues C3, E19, and G1 Due to the Issuance of Statement 123(R)

AFFECTS: Companies that issue derivative instruments in connection with share-based payment arrangements.

SUMMARY: *Implementation Issue C3*[6] — Originally Implementation Issue C3 clarified that the scope exception for contracts issued in connection with stock-based compensation arrangements within paragraph 11(b) of Statement 133[7] applied to equity instruments granted to nonemployees as compensation for goods and services. The revisions to Implementation Issue C3 limit the scope exception to only those share-based payment contracts with nonemployees that are subject to Statement 123(R). Therefore, a contract no longer qualifies for the scope exception and may need to be accounted for as a derivative under Statement 133 if it ceases to be subject to Statement 123(R) in accordance with FSP FAS 123(R)-1. See page 2 for a summary of FSP FAS 123(R)-1.

Implementation Issue E19[8] — Implementation Issue E19 provides guidance on assessing hedge effectiveness in hedging relationships that involve an option contract designated as the hedging instrument. The revisions to Implementation Issue E19 consist of updating the references within the guidance to Statement 123(R) without substantive changes to the existing accounting guidance.

Implementation Issue G1[9] — Implementation Issue G1 provides guidance for hedging unrecognized, non-vested stock appreciation rights (SARs). Under Statement 123(R), public companies are required to remeasure SARs at fair value each reporting period until the date of settlement. In contrast, Statement 123 required companies to remeasure SARs at intrinsic value. The revised Implementation Issue G1 will continue to allow entities to enter into cash flow hedges of the exposure to variability in expected future cash flows associated with SARs; however, hedge effectiveness typically will be assessed based on changes in the entire fair value of the purchased option instead of based on the changes in the intrinsic value of the purchased option. Implementation Issue G1 also is being revised to clarify that the Issue applies to public companies.

EFFECTIVE: Revisions are effective the first day of the fiscal quarter in which the entity initially adopts Statement 123(R).

Consolidations

Although Interpretation 46(R)[10] was issued late in 2003, it continued to affect standard setting activity related to consolidations in 2005. The guidance in Interpretation 46(R) regarding substantive kick out rights renewed the debate over what rights held by limited partners should overcome consolidation by a general partner of a limited partnership. Legally, a general partner in a limited partnership must shoulder broad responsibilities for the operations and liabilities of the entity — even though it may have a relatively small economic interest in the partnership. Questions abounded concerning whether a general partner's broad responsibilities constitute accounting control, thereby requiring consolidation of the partnership's accounts. Issue 04-5[11] provides a new model. Prior to Issue 04-5, GAAP did not offer clear answers to these questions. In practice, entities had analogized to guidance contained in SOP 78-9,[12] Issue 96-16,[13] and Interpretation 46(R); however, there were inconsistencies between these documents. Once the EITF reached consensus on Issue 04-5, the FASB issued conforming amendments to Issue 96-16 and SOP 78-9 to make the guidance related to substantive kick out rights and participating rights consistent. In addition, the FASB issued an FSP on implicit variable interests to put companies on notice that in applying Interpretation 46(R) they should consider both their implicit and explicit variable interests.

[6] Statement 133 Implementation Issue No. C3, "Scope Exceptions: Exception Related to Share-Based Payment Arrangements."

[7] FASB Statement No. 133, *Accounting for Derivatives Instruments and Hedging Activities*.

[8] Statement 133 Implementation Issue No. E19, "Hedging — General: Methods of Assessing Hedge Effectiveness When Options Are Designated as the Hedging Instrument."

[9] Statement 133 Implementation Issue No. G1, "Cash Flow Hedges: Hedging an SAR Obligation."

[10] FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities*.

[11] EITF Issue No. 04-5, "Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights."

[12] AICPA Statement of Position 78-9, *Accounting for Investments in Real Estate Ventures*.

[13] EITF Issue No. 96-16, "Investor's Accounting for an Investee When the Investor Has a Majority of the Voting Interest but the Minority Shareholders Have Certain Approval or Veto Rights."

EITF Issue 04-5, "Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights"

AFFECTS: Companies that serve as general partners in limited partnerships, especially real estate and investment limited partnerships, and managing members of limited liability companies governed like partnerships. The consensus does not apply if the partnership or similar entity is a variable interest entity (VIE) accounted for under Interpretation 46(R).

SUMMARY: A general partner of a limited partnership is presumed to control the limited partnership unless the limited partners have substantive kick-out rights (i.e., the ability to dissolve the limited partnership or otherwise remove the general partner without cause) or participating rights (e.g., establishing operating and capital decisions in the ordinary course of business).

DISCLOSURES: If using Transition Method A (i.e., cumulative-effect type adjustment), the effect on the opening balance sheet of adopting the new accounting principle should be disclosed in the year of adoption. If using Transition Method B (i.e., retrospective application), provide the disclosures required by paragraph 17 of Statement 154 in the period of adoption.

EFFECTIVE: After June 29, 2005, for new limited partnership agreements and for pre-existing limited partnership agreements that are modified; otherwise, effective no later than the beginning of the first reporting period in fiscal years beginning after December 15, 2005.

TRANSITION: For existing limited partnership agreements that are not modified, companies can choose between the following methods:

Transition Method A — Record the cumulative effect, if any, at the beginning of the period in which Issue 04-5 is first applied. The financial statements for prior years should be presented as previously reported, and the cumulative effect, if any, should be included in opening retained earnings in the period of the change.

Transition Method B — Retrospective application, except to those investments in limited partnerships for which the entity is no longer a general partner as of the date Issue 04-5 is adopted.

OTHER RESOURCES: Deloitte & Touche's *Heads Up* on Issue 04-5.

Amendment to EITF Issue 96-16, "Investor's Accounting for an Investee When the Investor Has a Majority of the Voting Interest but the Minority Shareholders Have Certain Approval or Veto Rights"

AFFECTS: Companies that hold a majority voting interest in investees that are corporations or analogous entities. Does not apply to (1) companies that carry substantially all of their assets, including investments in controlled entities, at fair value with changes in value reported in the income statement; (2) investments in noncorporate entities; or (3) investments in variable-interest entities accounted for under Interpretation 46(R).

SUMMARY: Issue 96-16 was amended to conform to Issue 04-5. The ability of the investor to block certain acquisitions or dispositions of assets is a protective right that would not prevent the investor with the majority voting right from consolidating. The amendment changes the threshold required for a right to be considered protective from the ability to block acquisitions or dispositions of assets greater than 20 percent of the fair value of the investee's assets to the ability to block acquisitions or dispositions of assets that are not in the ordinary course of business.

EFFECTIVE: For new investments and investment agreements modified after June 29, 2005.

FSP SOP 78-9-1, "Interaction of AICPA Statement of Position 78-9 and EITF Issue No. 04-5"

AFFECTS: Companies that invest in real estate ventures.

SUMMARY: FSP SOP 78-9-1 amends the consolidation guidance in SOP 78-9 to conform to Issue 04-5. For limited partnerships, the FSP eliminates the concept of "important rights" from SOP 78-9 and replaces it with the concepts of "kick-out rights" and "substantive participating rights" as defined in Issue 04-5. For general partnerships, the FSP amends SOP 78-9 to indicate that a general partner who is a majority holder in a general partnership may not control the entity if one or more of the other partners have substantive participating rights.

DISCLOSURES: If using Transition Method A (i.e., cumulative-effect type adjustment), the effect on the opening balance sheet of adopting the new accounting principle should be disclosed in the year of adoption. If using Transition Method B (i.e., retrospective application), provide the disclosures required by paragraph 17 of Statement 154 in the period of adoption.

EFFECTIVE: After June 29, 2005, for new limited partnership agreements and for pre-existing limited partnership agreements that are modified; otherwise, effective no later than the beginning of the first reporting period in fiscal years beginning after December 15, 2005.

TRANSITION: For existing partnership agreements that are not modified, companies can choose between the following methods:

Transition Method A — Record the cumulative effect, if any, at the beginning of the period in which the FSP is first applied. The financial statements for prior years should be presented as previously reported, and the cumulative effect, if any, should be included in opening retained earnings of the period of the change, not in the net income of the period of change.

Transition Method B — Retrospective application, except that retrospective application is not required for investments in partnerships for which the company is no longer a general partner as of the date FSP SOP 78-9-1 is adopted.

FSP FIN 46(R)-5, "Implicit Variable Interests Under FASB Interpretation No. 46 (revised December 2003), Consolidation of Variable Interest Entities"

AFFECTS: Companies that have relationships with a VIE or potential VIE.

SUMMARY: The FSP indicates that a reporting enterprise should consider whether it holds an implicit variable interest in a VIE or potential VIE. Implicit variable interests are implied financial interests in an entity that change with changes in the fair value of the entity's net assets exclusive of variable interests. An implicit variable interest acts the same as an explicit variable interest except it involves absorbing and/or receiving variability indirectly from the entity, rather than directly.

The determination of whether an implicit variable interest exists should be based on whether the reporting enterprise may absorb variability of the VIE or potential VIE.

The FSP includes an example of a manufacturing company that has a relationship with a leasing entity. The manufacturing company's related party has a variable interest in the entity. The FSP concludes that in the example fact pattern, under certain circumstances, the manufacturing company would hold an implicit variable interest in the leasing entity. The FSP also indicates that implicit variable interests may exist in other types of arrangements and may arise from transactions with related parties as well as from transactions with unrelated parties.

A reporting enterprise that holds an implicit variable interest in a VIE and is a related party to other variable interest holders should apply the guidance in paragraph 17 of Interpretation 46(R) to determine whether it is the primary beneficiary of the VIE.

DISCLOSURES: A reporting enterprise that is not the primary beneficiary but holds a significant implicit variable interest in a VIE should disclose the information in paragraph 24 of Interpretation 46(R).

EFFECTIVE: In the first reporting period beginning after March 3, 2005, for entities that have adopted Interpretation 46(R). For all other entities, effective in accordance with the effective dates of Interpretation 46(R).

TRANSITION: The FSP should be applied in accordance with the transition provisions of Interpretation 46(R). For entities that have already applied Interpretation 46(R), restatement to the date of the initial application of Interpretation 46(R) is permitted but not required.

OTHER RESOURCES: Deloitte & Touche's *Roadmap* on Interpretation 46(R); AICPA Practice Alert on Auditing VIEs.

Leases

Lease accounting was a hot topic in 2005. Early in the year, the SEC staff issued a letter to the AICPA's Center for Public Company Audit Firms clarifying certain issues relating to lessee accounting for operating leases. This resulted in many companies restating their previously issued financial statements. The SEC staff's guidance focused on the amortization period for leasehold improvements, the accounting for rent holidays, and landlord/tenant incentives. The FASB issued FSP FAS 13-1, "Accounting for Rental Costs Incurred During a Construction Period," in response to a specific question raised as a result of the SEC staff's guidance. Additionally, the EITF reached a final consensus on Issue 05-6, "Determining the Amortization Period for Leasehold Improvements," which provides guidance on leasehold improvements acquired in a business combination. Finally, in November the AICPA issued a series of TPAs that incorporated and expanded upon much of the aforementioned guidance. We have summarized the SEC staff letter, FSP FAS 13-1, Issue 05-6, and the TPAs below.

SEC Staff Letter to Center for Public Company Audit Firms

AFFECTS: Companies (lessees) that have operating leases.

SUMMARY: The SEC staff issued a letter to the Center for Public Company Audit Firms to clarify its views on the following leasing issues:

Amortization of Leasehold Improvements — A lessee under an operating lease should amortize leasehold improvements over the shorter of their economic lives or the lease term. Amortizing leasehold improvements over a term that includes assumption of lease renewals is appropriate only when the renewals have been determined to be reasonably assured as that term is used in FASB Statement No. 13, *Accounting for Leases*.

Rent Holidays — The SEC staff, pointing to Technical Bulletin 85-3,[14] indicated that it is inappropriate for a lessee to suspend recognition of rental expense during a rent holiday. Rather, rent expense in an operating lease should be recognized straight-line over the lease term, including any rent holiday period, unless another systematic and rational allocation is more representative of the leased property's anticipated use.

Landlord/Tenant Incentives — If a landlord makes payments to the lessee under an operating lease intending to reimburse the lessee for the cost, or a portion of the cost, of the leasehold improvements, the SEC staff has the following views on the accounting for such transactions:

- Improvements made by a lessee that are funded by the lessor should be recorded by the lessee as leasehold improvement assets, and amortized over the shorter of their economic life or the lease term;
- The incentives received should be recorded as deferred rent and amortized as reductions to lease expense over the lease term in accordance with paragraph 15 of Statement 13 (the deferred rent should not be netted against leasehold improvements); and
- The incentive payment receipt should be presented as an operating activity in the lessee's statement of cash flows. The acquisition of leasehold improvements for cash should be classified as an investing activity.

DISCLOSURES: The letter highlights the importance of providing clear and concise operating and capital lease disclosures in the notes to the financial statements and, when appropriate, in the critical accounting policies section of MD&A.

TRANSITION: To the extent companies have deviated from the lease accounting standards and related interpretations set forth by the FASB, those companies, in consultation with their auditors, should assess the impact of the resulting errors on their financial statements to determine whether restatement is required. If restatement is deemed unnecessary, companies should disclose that the errors were immaterial to the prior periods presented.

OTHER RESOURCES: Deloitte & Touche's *Heads Up* on the SEC's clarification of lease accounting.

[14] FASB Technical Bulletin No. 85-3, *Accounting for Operating Leases With Scheduled Rent Increases*.

FSP FAS 13-1, "Accounting for Rental Costs Incurred During a Construction Period"

AFFECTS: Companies that enter into building or ground operating leases. The FSP does not apply to lessees that account for the sale or rental of real estate projects under Statement 67.

SUMMARY: Under the provisions of FSP FAS 13-1, lessees may not capitalize rental costs incurred on building or ground operating leases during a construction period. In accordance with Technical Bulletin 88-1,[15] rental costs should be expensed on a straight-line basis starting at the beginning of the lease term (i.e., when the lessee takes possession of or is given control of the leased property), which may be different than the lease inception date (i.e., the date of the lease agreement).

EFFECTIVE: For the first reporting period beginning after December 15, 2005.

TRANSITION: Lessees should cease capitalizing rental costs as of the effective date of the FSP for operating lease arrangements entered into prior to that date. Retrospective application is permitted but not required.

EITF Issue 05-6, "Determining the Amortization Period for Leasehold Improvements Purchased After Lease Inception or Acquired in a Business Combination"

AFFECTS: Companies that acquire leasehold improvements in a business combination and all other companies that purchase leasehold improvements whose useful life extends beyond the term of the lease.

SUMMARY: In June 2005, the EITF reached a consensus on Issue 05-6 requiring that leasehold improvements acquired in a business combination or purchased significantly after, and not contemplated at, the beginning of the lease term be amortized over the lesser of the useful life of the assets or a term that includes renewals that are reasonably assured at the date of acquisition or purchase.

In September 2005, the EITF modified the consensus to clarify that the Issue does not apply to preexisting leasehold improvements. That is, the consensus reached in Issue 05-6 cannot be used to justify the reevaluation of preexisting leasehold improvements for additional renewal periods when new leasehold improvements are placed into service significantly after, and are not contemplated at or near, the beginning of the lease term.

EFFECTIVE: For leasehold improvements purchased or acquired in periods beginning after June 29, 2005.

AICPA TPAs, TIS Sections 5600.07–.17, "Leases"

AFFECTS: Lessees and lessors.

SUMMARY: *Lease Term* — The lease term for accounting purposes may differ from the fixed and noncancelable term stated in the lease. For example, the lease term begins before the date stated in the lease if the lease allows the tenant to make improvements to the leased space before that date. The lease term extends beyond the fixed and noncancelable term to include renewal periods if failure to exercise the renewals would impose a penalty on the lessee.

Recognition of Rent Expense and Rent Revenue on Operating Leases — Rent should be recognized on a straight-line basis over the lease term unless another systematic and rational basis is more representative of the use of the property. The TPAs illustrate the application of this guidance using three examples: scheduled increases in rental space, rent holidays, and scheduled rent increases.

Depreciation of Leasehold Improvements in an Operating Lease — Leasehold improvements contemplated at or near the beginning of the initial lease term should be depreciated over the shorter of (a) the useful life of the improvements or (b) the remaining lease term. If leasehold improvements are placed in service significantly after lease inception, depreciate the assets over the shorter of (a) the useful life of the improvements or (b) the required lease periods and any renewals that are reasonably assured as of the date the assets are acquired.

Effect of Leasehold Improvements on Lease Term — If a lessee acquires leasehold improvements that are expected to have significant value at the end of the initial term of the lease such that the lessee would not be willing to abandon them, the chances that the lessee will exercise renewal options may be reasonably assured. Renewal options that are reasonably assured of being exercised must be added to the term of the lease for accounting purposes.

[15] FASB Technical Bulletin No. 88-1, "Issues Relating to Accounting for Leases."

Landlord Incentive Allowances Toward the Cost of the Lessee's Leasehold Improvements — The lessee should report the allowances as a liability and amortize them on a straight-line basis over the lease term as a reduction of rent expense. In the cash flow statement, lessees should classify expenditures for leasehold improvements as an investing activity. Lessees should classify cash allowances received from the landlord as an operating activity.

Redeemable and Convertible Instruments

Over the last several years, many companies have issued either convertible or redeemable securities. As these types of securities have increased in popularity, we have also seen an increase in the complexity of conversion or redemption features, which in turn makes the accounting more complex. In 2005, the FASB and EITF issued several pieces of guidance related to convertible and redeemable securities. The new guidance is summarized below.

FSP FAS 150-5, "Issuer's Accounting Under Statement 150 for Freestanding Warrants and Other Similar Instruments on Shares That Are Redeemable"

AFFECTS: Companies that have issued freestanding warrants and other similar instruments on shares that are redeemable (either puttable or mandatorily redeemable).

SUMMARY: The FSP clarifies that freestanding warrants and other similar instruments on shares that are redeemable are liabilities under Statement 150[16] regardless of the timing of the redemption feature or price, even though the underlying shares may be classified as equity or temporary equity.

EFFECTIVE: For the first reporting period beginning after June 30, 2005.

TRANSITION: If the guidance in the FSP results in changes to previously reported information, the cumulative effect should be reported according to the transition provisions in Statement 150 in the first reporting period beginning after June 30, 2005.

Revision to EITF Topic D-98, "Classification and Measurement of Redeemable Securities"

AFFECTS: Companies that have issued securities subject to mandatory redemption requirements or whose redemption is outside the issuer's control.

SUMMARY: The revision to Topic D-98 includes a set of changes to provide guidance on the application of Topic D-98 to share-based payment arrangements with employees and is consistent with the guidance in SAB 107. It also includes a second set of changes, related to redeemable common shares, that introduces a new method, akin to the two-class method, to calculate EPS when a class of common stock is redeemable at other than fair value.

EFFECTIVE: The guidance regarding share-based payments should be applied concurrently with the adoption of Statement 123(R). The changes related to redeemable common shares are effective for the first fiscal period beginning after September 15, 2005.

TRANSITION: Share-based payment awards previously classified as permanent equity that are now required to be classified outside of permanent equity should be reclassified at the amount required to be presented outside of permanent equity.

Prior period earnings-per-share amounts presented for comparative purposes should be retroactively adjusted to conform to the guidance on redeemable common shares.

EITF Issue 05-8, "Income Tax Consequence of Issuing Convertible Debt With a Beneficial Conversion Feature"

AFFECTS: Companies that issue convertible debt with a beneficial conversion feature accounted for under Issue 98-5[17] and Issue 00-27.[18]

SUMMARY: The guidance in Issue 05-8 states that the issuance of convertible debt with a beneficial conversion feature results in a basis difference that should be accounted for as a temporary difference for purposes

[16] FASB Statement No. 150, *Accounting for Certain Financial Instruments With Characteristics of Both Liabilities and Equity*.

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

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

of applying Statement 109. The recognition of deferred taxes for the temporary difference should be recorded as an adjustment to additional paid-in capital.

EFFECTIVE: For the first interim or annual reporting period beginning after December 15, 2005.

TRANSITION: Issue 05-8 should be retrospectively applied to all instruments with a beneficial conversion feature accounted for under Issue 00-27. Therefore, the issue would also be applicable to debt instruments that were converted or extinguished but are still presented in the financial statements.

EITF Issue 05-7, "Accounting for Modifications to Conversion Options Embedded in Debt Instruments and Related Issues"

AFFECTS: Companies that modify the conversion terms of convertible debt securities.

SUMMARY: Issuers of convertible debt may modify the terms of the embedded conversion options, for example by changing the conversion price, the number of underlying shares, or the conversion period. Issue 05-7 requires debt issuers to include the change in the fair value of a modified conversion option as a cash flow in their Issue 96-19[19] analysis to determine whether the modification resulted in an extinguishment of the debt and the issuance of new debt. When modifications result in an extinguishment of the debt, the new debt initially should be recorded at fair value and that amount should be used to determine the debt extinguishment gain or loss. If the modification does not result in an extinguishment of the debt, the change in the fair value of the conversion option should be recorded as a discount (or premium) associated with the debt, with a corresponding offset to equity. The EITF also concluded that upon a modification of a conversion option, debt issuers should not recognize a new beneficial conversion feature or reassess an existing beneficial conversion feature. Issue 96-19 was amended to reflect this consensus.

DISCLOSURES: The disclosures required by Statement 154 should be made excluding those disclosures that require the effects of retroactive application.

EFFECTIVE: For future modifications of debt instruments that occur in all interim and annual reporting periods beginning after December 15, 2005. Public companies should also consider the remarks of the SEC Staff at the December 2004 AICPA Conference on Current SEC and PCAOB Developments stating that public companies should include the change in fair value of a modified conversion option in their Issue 96-19 cash flow analysis.

EITF Issue 05-2, "The Meaning of 'Conventional Convertible Debt Instrument' in EITF Issue No. 00-19, 'Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock'"

AFFECTS: Companies that issue non-vanilla convertible debt or convertible preferred stock with a mandatory redemption date.

SUMMARY: Issue 00-19 is used (among other purposes) to evaluate whether an issuer is required to bifurcate a conversion option, under Statement 133, that is embedded in convertible debt. Bifurcation of a conversion option is not required for the issuer if the conversion option would meet the requirements to be classified as equity under Issue 00-19.

Paragraph 4 of Issue 00-19 provides an exception to applying some of its specific requirements for equity classification if the "contract is a **conventional convertible debt instrument** in which only the holder may only realize the value of the conversion option by exercising the option and receiving the entire proceeds in a fixed number of shares or the equivalent amount of cash (at the discretion of the issuer)." [Emphasis added]

Issue 05-2 clarifies that exception. Instruments that provide the holder with an option to convert into a fixed number of shares, and the ability to exercise that option is based on the passage of time or a contingent event, should be considered "conventional." A contingency is not relevant in determining whether the instrument is "conventional." Rather, the ultimate form of settlement should be considered. That is, if upon resolution of the contingency, the instrument is convertible into a fixed

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

number of shares, the instrument is no different than a non-contingent convertible instrument with respect to form of settlement. Convertible preferred stock with a mandatory redemption date may qualify for the exception depending on whether the instrument is more akin to debt or equity.

EFFECTIVE: For new instruments and modifications to existing instruments entered into after June 29, 2005.

Asset Retirement Obligations

The FASB issued Interpretation 47[20] in 2005 to address the diverse accounting practices related to the timing of liability recognition for conditional obligations associated with the retirement of a tangible long-lived asset. The FASB also issued an FSP related to electronic waste obligations resulting from a European Union Directive. Both are summarized below.

FASB Interpretation 47, *Accounting for Conditional Asset Retirement Obligations* — an interpretation of FASB Statement No. 143

AFFECTS: Companies with a legal obligation associated with the retirement of a tangible long-lived asset that results from the acquisition, construction, or development and/or normal operation of a long-lived asset.

SUMMARY: Interpretation 47 clarifies that the term "conditional asset retirement obligation" as used in Statement 143[21] refers to a legal obligation to perform an asset retirement activity in which the timing and/or method of settlement are conditional on a future event that may or may not be within the control of the entity. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and/or method of settlement.

A liability should be recognized for the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated. Uncertainty about the timing and/or method of settlement of a conditional asset retirement obligation should be factored into the measurement of the liability when sufficient information exists to make a reasonable estimate of the fair value of the obligation. The Interpretation provides that an entity has sufficient information to make a reasonable estimate of the fair value of the obligation if (a) it is evident that the acquisition price of the asset embodies the fair value of the obligation, (b) an active market exists for the transfer of the obligation, or (c) sufficient information exists to apply an expected present value technique.

DISCLOSURES: Upon transition, an entity should compute on a pro-forma basis, and disclose in the footnotes to the financial statements for the beginning of the earliest year presented and at the end of all years presented, the amount of the liability for asset retirement obligations as if the Interpretation had been applied during all periods affected. Additionally, the disclosures required by paragraphs 19(c), 19(d), and 21 of APB Opinion No. 20, *Accounting Changes*, should be provided.

EFFECTIVE: The end of fiscal years ending after December 15, 2005.

TRANSITION: The cumulative effect of applying the Interpretation should be recognized as a change in accounting principle under Opinion 20. Retrospective application of interim financial information is permitted, but not required.

OTHER RESOURCES: Deloitte & Touche's *Heads Up* on Interpretation 47.

FSP FAS 143-1, "Accounting for Electronic Equipment Waste Obligations"

AFFECTS: Companies with historical waste obligations (i.e., from products put on the market on or before August 13, 2005) under the European Union's Directive 2002/96/EC on Waste Electrical and Electronic Equipment (the "Directive").

SUMMARY: *Commercial Users* — Under the Directive, the waste management obligation remains with the commercial user until the historical waste equipment is replaced or disposed of. The FSP indicates that the commercial user should apply the provisions of FASB Statement No. 143, *Accounting for Asset Retirement Obligations*, to the obligation associated with the historical waste. That is, commercial users should recognize a liability for the fair value of the asset retirement obligation and capitalize an asset retirement cost by increasing the carrying amount of the related asset by the same amount.

[20] FASB Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations* — an interpretation of FASB Statement No. 143.

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

The waste management obligation for the equipment may be transferred to the producer of the replacement equipment (i.e., when the original equipment is turned in to the replacement producer for disposal) depending on the law adopted by each EU-member country. The commercial user should measure the replacement asset as a residual amount (the excess of the price paid over the fair value of the asset retirement obligation transferred). The commercial user should derecognize the liability and a gain or loss should be recorded based on the difference between the carrying amount of the liability and the portion of the sales price that relates to the obligation. The producer of a replacement asset should recognize revenue for the total amount received, reduced by the fair value of the obligation received at the date of the transfer (that is, on a net basis).

Private Households — Under the Directive, the obligation associated with historical waste held by private households is to be borne collectively by producers selling in the market during each measurement period (which is to be determined by each EU-member community). An individual company's obligation will be based on and triggered by its market share during the period; therefore, the FSP indicates that an obligation should not be recognized prior to the beginning of that period. Instead, a liability should be recognized over the measurement period based on an entity's estimated market share. The liability should then be adjusted as actual information is received.

EFFECTIVE: The later of the first reporting period ending after June 8, 2005, or the date of the adoption of the Waste Electrical and Electronic Equipment Directive by the applicable EU-member country.

TRANSITION: The cumulative effect of applying the FSP should be recognized as a change in accounting principle under Opinion 20.

Sarbanes-Oxley Compliance

In 2005, the SEC and PCAOB focused their efforts on assessing the first year implementation of Section 404 of the Sarbanes-Oxley Act by accelerated filers and their auditors. To gather feedback on the first year implementation of internal control reporting provisions, the PCAOB met with its Standing Advisory Group, and the SEC held a roundtable. The feedback received indicated that compliance with Section 404 was producing benefits, but at too high a cost. In response, on May 16, 2005, the SEC and PCAOB issued coordinated statements and Q&As to companies and their auditors. In November 2005, the SEC issued a Report on the Implementation of Section 404 that includes recommendations to auditors for future internal control audits. The overarching theme of these publications is that companies and auditors should take steps to make the implementation of the SEC's rules and the PCAOB's Auditing Standard more effective and cost-efficient. In addition, the SEC deferred the effective date of Section 404 for nonaccelerated filers. The following is a summary of the significant guidance issued during the year:

SEC and PCAOB Issue Guidance on Internal Control Audits for Issuers and Auditors

AFFECTS: Companies subject to Section 404 of the Sarbanes-Oxley Act and auditors engaged to issue a report on management's assessment of the effectiveness of internal controls over financial reporting.

SUMMARY: The SEC and PCAOB issued the following:

- *May 16, 2005, SEC Commission Statement on Implementation of Internal Control Reporting Requirements* — The statement provides a high level overview of the SEC's observation of issues arising during the first year of implementation of Section 404.
- *May 16, 2005, SEC Staff Statement on Management's Report on Internal Control Over Financial Reporting* — The statement expands upon the SEC Commission Statement by addressing several topics that the SEC identified as companies' concerns regarding their first year of implementation of Section 404.
- *May 16, 2005, PCAOB Policy Statement Regarding Implementation of Auditing Standard No. 2* — The policy statement addresses considerations for properly planning and effectively performing an audit of internal controls over financial reporting, including using the work of others.
- *PCAOB Staff Questions and Answers* — The Q&As, which are the fourth (January 21, 2005) and fifth (May 16, 2005) in a series, provide guidance for auditors on a variety of topics relating to their auditing of internal controls over financial reporting.
- *November 30, 2005, PCAOB Report on the Initial Implementation of Auditing Standard No. 2* — The report includes recommendations for improving audit efficiency and effectiveness in the future. The report also explains certain aspects of Auditing Standard 2[22] and amplifies the policy statement

issued by the PCAOB on May 16, 2005, on effective and efficient implementation of the standard. The PCAOB also acknowledged that auditors have already modified their audit methodologies and training materials in a number of the areas highlighted by this report.

The above body of guidance does not change existing standards. Rather, it provides additional clarification of key components of Auditing Standard 2 and the related SEC rules. The common themes in these documents are that:

- It is management's responsibility to determine the form and level of controls appropriate for each company and to scope their assessment and testing accordingly;
- Both management and auditors must exercise reasoned judgment and employ a top-down, risk-based approach;
- Communications between issuers and their auditors are key to improving internal control and performance of quality audits; and
- Better integration of the internal control and financial statement audits should lead to increased efficiency and effectiveness.

OTHER RESOURCES: SEC Spotlight on Sarbanes-Oxley Rulemaking and Reports.

SEC Rule Extends Section 404 Compliance Date for Nonaccelerated Filers and Establishes Compliance Date for Foreign Private Issuers

AFFECTS: Public companies that are nonaccelerated filers or foreign private issuers.

SUMMARY: In response to recommendations by the SEC Advisory Committee on Smaller Public Companies, in September 2005 the SEC extended the compliance date for internal control reporting requirements for an additional year for nonaccelerated filers. This extension is in addition to the one-year extension granted in March 2005. Nonaccelerated filers, including foreign private issuers that are not accelerated filers, must begin to comply with the Sarbanes-Oxley Section 404 requirements in the first fiscal year ending on or after July 15, 2007. Foreign private issuers that are accelerated filers and file annual reports on Form 20-F or 40-F must begin to comply in the first fiscal year ending on or after July 15, 2006.

Report and Recommendations Pursuant to Section 401(c) of the Sarbanes-Oxley Act of 2002 on Arrangements With Off-Balance-Sheet Implications, Special Purpose Entities, and Transparency of Filings by Issuers

AFFECTS: Financial statement preparers, auditors, and accounting standard setters.

SUMMARY: As mandated by the Sarbanes-Oxley Act, the SEC conducted a study of filings by issuers and published a report that addresses two primary issues: (1) the extent of the use of off-balance-sheet arrangements, including the use of special purpose entities ("SPEs") and (2) whether current financial statements of issuers transparently reflect the economics of off-balance-sheet arrangements.

The report identifies the following goals for those involved in the financial reporting community to improve the transparency of financial reporting:

- Discourage transactions and transaction structures motivated primarily and largely by accounting and reporting considerations, rather than economics;
- Expand the use of objectives-oriented standards;
- Improve the consistency and relevance of disclosures; and
- Focus financial reporting on communication with investors, rather than just compliance with rules.

The report also makes the following recommendations to standard setters related to specific accounting and reporting requirements:

- Reconsider the accounting for leases, defined-benefit pension plans, and other post-retirement benefit plans;

[22] PCAOB Auditing Standard No. 2, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction With an Audit of Financial Statements*.

- Continue to explore the feasibility of reporting all financial instruments at fair value;
- Continue work on consolidation guidance for all entities (including SPEs); and
- Improve guidance on disclosures.

OTHER RESOURCES: Deloitte & Touche's *Heads Up* on the SEC's Report to President and Congress.

Cash Flows

SEC Staff Letter on Cash Flow Statement Classification of Cash Receipts From Inventory Sales

AFFECTS: Companies that sell inventory.

SUMMARY: The staff of the Division of Corporation Finance released a sample letter that was sent to registrants to address presentation of cash receipts from inventory sales in the statement of cash flows. The SEC reminded registrants that Statement 95 requires cash receipts from the sale of inventory to be classified as operating cash flows, regardless of whether the cash flows (1) stem from the collection of a receivable from the customer or the sale of the customer receivable to others, (2) are collected on account or from the issuance of a note, or (3) are collected in the short term or long term.

Additionally, the staff stated that it is not appropriate to present an operating cash inflow and an investing cash outflow between a company and its subsidiary when there has been no cash inflow to the company on a consolidated basis from the sale of inventory.

The contents of this letter have subsequently been incorporated into the "Current Accounting and Disclosure Issues in the Division of Corporation Finance" document posted on the SEC's Web site.

DISCLOSURES: Footnote disclosures should identify where the cash flows related to the sale of inventory are classified in the cash flow statement and explain the nature of the receivables/notes/loans. The line item descriptors on the cash flow statement should be consistent with those on the balance sheet and in the footnotes detailing the components of finance receivables.

Accounting Changes

FASB Statement 154, *Accounting Changes and Error Corrections* — a replacement of APB Opinion No. 20 and FASB Statement No. 3

AFFECTS: Companies that report a change in accounting principle, change in accounting estimate, change in reporting entity, or correction of an error.

SUMMARY: Statement 154 eliminates the requirement in Opinion 20 to include the cumulative effect of a change in accounting principle in the income statement in the period of change. Changes in accounting principle should be retrospectively applied by applying the new accounting principle as of the beginning of the first period presented as if that principle had always been used (unless it is not practical to do so). The cumulative effect of the change is reflected in the carrying value of assets and liabilities as of the first period presented and the offsetting adjustments are recorded to opening retained earnings. Although retrospective application is similar to a restatement of prior periods, Statement 154 gives the treatment a new name to differentiate it from a correction of an error. Only direct effects of the change should be included in the retrospective application; all indirect effects should be recognized in the period of change.

The Statement does not significantly modify the accounting or disclosure requirements for changes in accounting estimate, changes in reporting entity, or corrections of errors. A change in accounting estimate that is effected by a change in accounting principle (e.g., a change in method of depreciation) should be accounted for as a change in estimate.

DISCLOSURES: When a change in accounting principle occurs, companies should disclose the nature of the change, the impact of the adjustments on prior-period information (e.g., earnings per share, retained earnings, and specific affected line items), and information about the recognized indirect effects. If retrospective application to all prior periods is impracticable, companies should disclose the reasons why and the alternative method used.

EFFECTIVE: For accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005.

Investments

FSP FAS 115-1 and 124-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments"

AFFECTS: Companies that hold investments in:

- Debt and equity securities within the scope of Statement 115[23] (including all equity securities held by insurance companies);
- Debt and equity securities within the scope of Statement 124[24] when the holder reports a "performance indicator" as defined in the AICPA Accounting and Audit Guide, Health Care Organizations; and
- Cost-method investments.

SUMMARY: The FSP outlines the following three-step model for identifying investment impairments:

Step 1: Determine Whether the Investment Is Impaired — An investment is impaired if its fair value is less than its cost, as assessed at the individual security level. For cost-method investments, investors should use the fair value calculated for disclosure under Statement 107,[25] if applicable. If the cost-method investment's fair value wasn't calculated, the FSP requires an investor to consider whether any impairment indicators are present, and gives examples of such indicators.

Step 2: Evaluate Whether the Impairment Is Other Than Temporary — Investors should look to existing applicable guidance (e.g., SEC Staff Accounting Bulletin Topic 5.M[26]) to determine whether an impairment is other than temporary. If an investor has decided to sell an impaired available-for-sale security and does not expect the fair value to fully recover prior to the time of sale, the security should be deemed other-than-temporarily impaired in the period the decision to sell is made. Notwithstanding the above, an investor must recognize an impairment loss when the impairment is deemed other than temporary, even if a decision to sell has not been made.

Step 3: If the Impairment Is Other Than Temporary, Recognize an Impairment Loss — If the impairment is other than temporary, the investor should recognize an impairment loss in earnings equal to the difference between the investment's cost and its fair value at the balance sheet date. Recoveries subsequent to the balance sheet date cannot be factored into the impairment measurement. The fair value of the investment becomes the new cost basis and should not be adjusted for subsequent recoveries in fair value.

In periods after recognition of an impairment loss on a debt security, the security should be accounted for as if it had been purchased on the impairment measurement date. The discount (or reduced premium), based on the new cost basis, should be amortized over the remaining life of the security.

DISCLOSURES: The FSP carries forward the disclosure requirements of Issue 03-1.[27]

EFFECTIVE: For reporting periods beginning after December 15, 2005.

OTHER RESOURCES: Deloitte & Touche's *Heads Up* on FSP FAS 115-1 and 124-1.

FSP APB 18-1, "Accounting by an Investor for Its Proportionate Share of Accumulated Other Comprehensive Income of an Investee Accounted for Under the Equity Method in Accordance With APB Opinion No. 18 Upon a Loss of Significant Influence"

AFFECTS: Investors who lose significant influence over an equity method investment.

SUMMARY: The FSP requires that when equity method accounting ceases upon the loss of significant influence of an investee, the investor's proportionate share of the investee's OCI should be offset against the carrying

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

[24] FASB Statement No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations*.

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

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

[27] EITF Issue No. 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments."

value of the investment. To the extent that this results in a negative carrying value, the investor should adjust the carrying value to zero and record the residual balance through earnings.

EFFECTIVE: As of the first reporting period beginning after July 12, 2005.

TRANSITION: Upon adoption, equity adjustments for an investee's OCI that are recorded in shareholders' equity of the investor and relate to an investment for which the investor no longer has an ability to exercise significant influence should be offset against the carrying value of the investment. This adjustment should exclude any OCI arising from the investor's available-for-sale treatment of the investment under Statement 115. If comparative financial statements are provided for earlier periods, those financial statements should be retrospectively adjusted to reflect application of the FSP.

Employee Benefits

Final Rules on Medicare Prescription Drug Benefits

AFFECTS: Employers that sponsor postretirement heath care plans that provide prescription drug benefits.

SUMMARY: The final rule implements the provisions of the Social Security Act establishing and regulating the Medicare Prescription Drug Benefit. The rule provides employers with the information necessary to determine whether benefits provided by their plans are actuarially equivalent to Medicare Part D (as that term is contemplated in FSP FAS 106-2[28]) and therefore qualify for a subsidy under the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (the Act). Employers and sponsors are reminded that FSP FAS 106-2 provides important guidance on accounting considerations related to the Act.

EFFECTIVE: March 22, 2005.

AICPA TPAs on Federal Subsidies From the Medicare Prescription Drug Act

AFFECTS: Companies sponsoring health care benefit plans that receive federal subsidies from the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (Act).

SUMMARY: TIS Section 6930.09, "Accounting and Disclosure Requirements for Single-Employer Employee Benefit Plans Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003," indicates that a single-employer health and welfare benefit plan should not consider the effects of the subsidy when calculating the plan's accumulated postretirement benefit obligation (APBO). The APBO recorded in the plan's financial statements is not reduced by any potential subsidy and should differ from that recorded in the plan sponsor's financial statements.

TIS Section 6930.10, "Accounting and Disclosure Requirements for Multiemployer Employee Benefit Plans Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003," indicates that a multiemployer plan's financial statements should consider the effects of the subsidy when calculating the plan's APBO.

The difference occurs because for a single-employer plan, the subsidy is a benefit paid directly to the plan sponsor, and not to the plan (i.e., the plan sponsor is not obligated to contribute the subsidy to the plan). For a multiemployer plan, however, the trust and not the plan sponsor (i.e., the contributing employers) receives the subsidy directly.

DISCLOSURES: Benefit plan financial statements should reference the Act and include disclosure of the subsidy's impact on the APBO. If employers have not determined whether the benefits provided by its plan are actuarially equivalent to Medicare Part D, that fact should be disclosed. The TPAs identify separate disclosures for single-employer and multiemployer plans.

TRANSITION: If a plan has previously accounted for the effects of the subsidy differently than as provided for in the TPAs, the resultant change should be recognized as a change in accounting principle.

[28] FASB Staff Position No. FAS 106-2, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003."

EITF Issue 05-5, "Accounting for the Altersteilzeit Early Retirement Programs"

AFFECTS: U.S. companies with German subsidiaries or non-U.S. companies that provide benefit arrangements for employees under an Altersteilzeit (ATZ) Early Retirement Program or an arrangement with the same terms.

SUMMARY: The Altersteilzeit arrangement is an early retirement program in Germany designed, in part, as an incentive toward early retirement. Typically, ATZ arrangements offer the following two alternatives to employees:

- Type I — Participants work 50 percent of the time for each year of the entire ATZ period, and receive 50 percent of their normal salary each period.
- Type II — Participants work full-time for half of the ATZ period and do not work for the remaining half of the ATZ period. Salary for each year of the entire ATZ period is 50 percent of the normal salary.

In addition to salary payments, participants also receive termination benefits consisting of a bonus and additional employer contributions to the German government pension scheme on behalf of the ATZ participants. Most employees participating in ATZ arrangements select the Type II arrangement.

Issue 05-5 provides that employers with ATZ programs should recognize salary payments ratably over the portion of the ATZ period when the employee is providing active services (the "active service period"). Accruals for the termination benefit under Type II arrangements should be accrued ratably from the date the employee signs the ATZ contract to the end of the active service period and discounted if payment is expected to be deferred for longer than one year. The bonus feature and additional contributions into the German government pension scheme under a Type II ATZ arrangement should be accounted for as a postemployment benefit under FASB Statement 112, *Employers' Accounting for Postemployment Benefits*. Companies should recognize subsidies from the German government when the criteria to receive them have been met and the employer is entitled to them.

DISCLOSURES: Upon transition, provide the disclosures required by paragraph 22 of Statement 154 regarding a change in estimate, and paragraphs 17–18 regarding a change in accounting principle.

EFFECTIVE: For fiscal years beginning after December 15, 2005.

TRANSITION: The consensus should be reported as a change in estimate effected by a change in accounting principle under Statement 154.

Derivatives

Statement 133 Implementation Issue B38, "Embedded Derivatives: Evaluation of Net Settlement With Respect to the Settlement of a Debt Instrument Through Exercise of an Embedded Put Option or Call Option"

AFFECTS: Companies that issue debt instruments with embedded put or call options (including prepayment options), hold freestanding call options on their own debt instruments, or issue freestanding put options on their own debt instruments. Implementation B38 also applies to the counterparties to such instruments.

SUMMARY: The guidance indicates that the potential settlement of a debtor's obligation to a creditor that would occur upon exercise of an embedded put option or call option meets the net settlement criterion in paragraph 9(a) of Statement 133. Thus, if all the criteria in paragraph 12 are met, the embedded put or call option should be bifurcated from the debt host contract and accounted for separately under the provisions of Statement 133.

EFFECTIVE: The first day of the first fiscal quarter beginning after December 15, 2005.

TRANSITION: If a company had not bifurcated an embedded derivative but is now required to do so, the company should account for the effects of initially complying with the guidance prospectively for all existing instruments, except for the existing contracts that qualify for the grandfathering provisions of paragraph 50 of Statement 133, which exempts certain hybrid instruments from the embedded derivative provisions of that Statement on an all-or-none basis. The effects of initially complying with the guidance as of the effective date should be reported as a cumulative-effect-type adjustment directly to retained earnings in accordance with Statement 154. The cumulative-effect adjustment should be calculated in accordance with the transition provisions in paragraph 51 of Statement 133.

Statement 133 Implementation Issue B39, "Embedded Derivatives: Application of Paragraph 13(b) to Call Options That Are Exercisable Only by the Debtor"

AFFECTS: Companies that issue or invest in debt instruments with embedded call options (including a prepayment option) that can accelerate settlement.

SUMMARY: The guidance indicates that the conditions in paragraph 13(b) of Statement 133 do not apply to an embedded call option in a hybrid instrument containing a debt host contract if the right to accelerate the settlement of the debt can be exercised only by the debtor (issuer/borrower). This is because the borrower, not the investor, has the unilateral ability to obtain the right to receive the high rate of return specified in paragraph 13(b) of Statement 133. Thus, the embedded call option is considered clearly and closely related to the host contract and is not required to be separated from the host contract and accounted for as a derivative.

EFFECTIVE: The first day of the first fiscal quarter beginning after December 15, 2005.

TRANSITION: If a company had bifurcated an embedded derivative but is no longer required to do so, the company should account for the effects of initially complying with the implementation guidance prospectively for all existing financial instruments.

Technical Revision to Statement 133 Implementation Issue B16, "Embedded Derivatives: Calls and Puts in Debt Instruments"

AFFECTS: Companies that issue or invest in debt with embedded calls and puts that can accelerate settlement.

SUMMARY: As a result of the issuance of Implementation Issues B38 and B39, technical revisions were made to Implementation Issue B16 to conform the guidance in the three Implementation Issues.

Natural Disasters

AICPA TPAs Resulting From Recent Natural Disasters

AFFECTS: Companies and auditors impacted by natural disasters.

SUMMARY: TIS Section 5400.05, "Accounting and Disclosures Guidance for Losses From Natural Disasters — Nongovernmental Entities," addresses issues that may arise in accounting for losses from natural disasters and identifies relevant accounting literature. Topics include income statement classification of losses (i.e., ordinary vs. extraordinary), recognition of impairment losses, recognition of non-impairment losses and costs, accounting for insurance recoveries, and required disclosures.

TIS Section 8345.01, "Audit Considerations When Client Evidence and Corroborating Evidence in Support of the Financial Statements Has Been Destroyed by Fire, Flood, or Natural Disaster," addresses the impact that the destruction of a client's evidence or corroborating evidence has on the auditor's procedures and report.

TIS Section 8345.02, "Considerations When Audit Documentation Has Been Destroyed by Fire, Flood, or Natural Disaster," addresses the extent to which an auditor must re-perform audit procedures or recreate destroyed audit documentation in order to express an opinion on the financial statements.

TIS Section 9070.05, "Consideration of Impact of Losses From Natural Disasters Occurring After Completion of Audit Field Work and Signing of the Auditor's Report but Before Issuance of the Auditor's Report and Related Financial Statements," identifies such a loss as a Type II subsequent event that would not result in an adjustment to the financial statements, but may require disclosure therein. Additionally, management and the auditor should consider whether the event affects the entity's ability to continue as a going concern.

SEC Limited Relief for QSPEs Affected by Hurricane Katrina

AFFECTS: Qualifying special-purpose entities (QSPEs) in the FEMA-designated disaster areas associated with Hurricane Katrina.

SUMMARY: The SEC staff has indicated that efforts by lending/loan servicing institutions to aid customers in areas devastated by Hurricane Katrina will not jeopardize the qualifying status of certain QSPEs, provided that those efforts fall within certain parameters. The exception will be allowed even though the process for granting such relief may not have been entirely specified or permitted in the legal documents that established the QSPEs. The parameters include the following: (1) the forbearances or other types of relief are offered only for a short period of time, (2) relief is granted only to FEMA-designated disaster areas associated with Hurricane Katrina, and (3) if granting such relief is an action that requires approval under the legal documents that established the QSPE, or if the legal documents of the QSPE need to be amended to allow this relief to be offered, those amendments or approvals must be obtained as quickly as possible.

The staff is not taking a similar position for relief provided by lending/loan servicing institutions in the aftermath of other hurricanes, even if those storms prompted FEMA to designate additional disaster areas. If the legal documents of the QSPE are going to be amended to allow for the possibility of providing similar relief in the future, the wording needs to be extremely restrictive. The SEC staff believes that Hurricane Katrina was an extremely rare event. The SEC does not believe it would be acceptable for a QSPE's governing documents to allow blanket relief for any natural disaster or act of God that could occur every year or every couple of years.

Buy/Sell Arrangements

EITF Issue 04-13, "Accounting for Purchases and Sales of Inventory With the Same Counterparty"

AFFECTS: Companies that buy and sell (or exchange) inventories with the same counterparty.

SUMMARY: The EITF concluded that entities that enter into inventory purchase and sales transactions with the same counterparty, in contemplation of one another, should combine the transactions and treat them as nonmonetary exchanges involving inventory. The EITF abstract also includes indicators that should be considered in making the determination as to whether transactions were entered into in contemplation of one another. Nonmonetary exchanges of finished goods for raw material and finished goods for work-in-process in the same line of business should be recorded at fair value. All other inventory-for-inventory exchange transactions within the same line of business do not culminate the earnings process and therefore should be recognized at carrying value.

DISCLOSURES: The amount of revenue and costs (or gains and losses) associated with inventory exchanges at fair value should be disclosed.

EFFECTIVE: For new inventory arrangements entered into, or modifications or renewals of existing inventory arrangements occurring, in interim or annual reporting periods beginning after March 15, 2006.

TRANSITION: The carrying amount of inventory acquired under arrangements prior to initial application of Issue 04-13 that still remains in the statement of financial position at the date of initial application should not be adjusted.

SEC Staff Letter on Buy/Sell Arrangements

AFFECTS: Companies engaging in buy/sell or comparable transactions.

SUMMARY: The staff of the Division of Corporation Finance released a sample letter sent to registrants engaged in oil and gas operations regarding buy/sell arrangements. The letter requires disclosures and indicates that the guidance may have application to non-petroleum products and other industries.

DISCLOSURES: The letter requires that the proceeds and costs associated with buy/sell arrangements reported on a gross basis be separately identified on the face of the income statement for all periods presented (as separate line items or parenthetically). Companies should fully disclose in the accounting policy notes the characteristics of material arrangements of this type, the circumstances under which they are used, and the accounting literature relied upon in determining whether gross or net reporting would apply. If material, companies should quantify the effects and address any related material trends and uncertainties in MD&A. If proceeds and related costs from buy/sell or comparable arrangements are reported on a gross basis and a registration statement is filed under the Securities Act of 1933 prior to including disclosure in an annual report, the issue should be disclosed as a recent development in the registration statement.

EFFECTIVE: For filings that include financial reports covering periods ending on or after December 15, 2004.

Insurance

AICPA SOP 05-1, *Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection With Modifications or Exchanges of Insurance Contracts*

AFFECTS: Insurance enterprises that incur deferred acquisition costs on internal replacements of insurance and investment contracts other than those specifically described in FASB Statement No. 97, *Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses From the Sale of Investments*.

SUMMARY: The SOP defines internal replacements as modifications in product benefits, features, rights, or coverages that occur by the exchange of a contract for a new contract, or by amendment, endorsement, or rider to a contract, or by the election of a feature or coverage within a contract. The accounting treatment for such replacements depends on whether the replacement contract is considered substantially changed from the replaced contract. A substantial change is treated as the extinguishment of the replaced contract, and all unamortized deferred acquisition costs, unearned revenue liabilities, and deferred sales inducement assets from the replaced contract should no longer be deferred in connection with the replacement contract. A replacement contract that is substantially unchanged should be accounted for as a continuation of the replaced contract.

DISCLOSURES: Companies should disclose the accounting policy applied to internal replacements, including whether the company has availed itself of the alternative application guidance in the SOP and, if so, for which types of internal replacement transactions. The effect of the change on retained earnings as of the date of adoption should also be disclosed.

EFFECTIVE: For internal replacements occurring in fiscal years beginning after December 15, 2006. Initial application should be as of the beginning of an entity's fiscal year (i.e., if the SOP is adopted prior to the effective date, all prior interim periods of the year of adoption should be restated).

TRANSITION: SOP 05-1 should be applied prospectively; retrospective application is not permitted. For internal replacements occurring prior to the year of adoption, the previous accounting should not be changed. For internal replacements occurring after adoption, the effect on unamortized deferred acquisition costs, unearned revenue liabilities, and deferred sales inducement assets should be reported in a manner similar to the cumulative effect of a change in accounting principle with offsetting adjustments to opening retained earnings as of the date of adoption.

AICPA TPAs on Noninsurance Enterprises With Property and Casualty Insurance Arrangements That Limit Insurance Risk

AFFECTS: Noninsurance companies that enter into property and casualty insurance arrangements that limit the insurer's risk.

SUMMARY: The ten TPAs[29] focus on certain aspects of finite insurance products utilized by noninsurance enterprises. The guidance identifies relevant literature to consider in addressing specific facts and circumstances. The TPAs address topics such as a description of finite insurance, typical insurance risk limiting features in finite insurance contracts, why risk transfer is important under GAAP, differences between retroactive and prospective insurance, and deposit accounting.

[29] AICPA Technical Practice Aids, TIS Section 1200.07 to 1200.16, "Accounting by Noninsurance Enterprises for Property and Casualty Insurance Arrangements That Limit Insurance Risk."

Other U. S. Accounting Topics

FSP FIN 45-3, "Application of FASB Interpretation No. 45 to Minimum Revenue Guarantees Granted to a Business or Its Owners"

AFFECTS: Companies that issue guarantees to make payments to a business or its owners if the revenue of the business falls below a certain amount during a specified period of time.

SUMMARY: The FSP requires that guarantors apply Interpretation 45[30] to minimum revenue guarantees. That is, a liability should be recognized at inception for the fair value of the obligation to stand ready to perform under the guarantee even if it is not probable that the contingent events that would cause payment will occur.

DISCLOSURES: The FSP indicates that guarantors should apply the disclosure requirements of paragraphs 13–16 of Interpretation 45 to all minimum revenue guarantees, including those issued prior to the initial application of the FSP.

EFFECTIVE: For new minimum revenue guarantees issued or modified on or after the beginning of the first fiscal quarter following November 10, 2005.

TRANSITION: The FSP should be applied prospectively, except that the disclosure provisions of Interpretation 45 apply to all minimum revenue guarantees (including those issued prior to application of the FSP). A guarantor's previous accounting for minimum revenue guarantees issued prior to the FSP's initial application should not be changed to reflect application of Interpretation 45.

FSP FAS 140-2, "Clarification of the Application of Paragraphs 40(b) and 40(c) of FASB Statement No. 140"

AFFECTS: Transferors of financial assets and qualifying special-purpose entities (QSPEs).

SUMMARY: Paragraphs 40(b) and 40(c) of Statement 140[31] include criteria to determine if a derivative pertains to beneficial interests sold to parties other than the transferor, which is one of the requirements that an entity must meet to be considered a QSPE. Paragraph 40(b) of Statement 140 requires that in determining whether a derivative pertains to beneficial interests sold to parties other than the transferor, a consideration must be made as to whether the notional amount of the derivative held by a QSPE initially exceeds the amount of beneficial interests issued to third parties. Further, paragraph 40(c) requires an analysis of the characteristics of the derivative.

The FSP clarifies that the requirements of paragraphs 40(b) and 40(c) must only be met at the date a QSPE issues beneficial interests or when a derivative financial instrument needs to be replaced upon the occurrence of a specified event outside the control of the transferor. The analysis of these requirements should include the expected assets of the QSPE and the expected amount of beneficial interests held by outside parties over the expected life of the QSPE.

Unexpected subsequent events outside the control of the transferor that were not contemplated when the beneficial interests of the QSPE were issued do not impair an entity's qualified status. A transferor that purchases previously issued beneficial interests from an outside party, holds them temporarily, and classifies them as trading securities, should not consider them when determining if the requirements of paragraphs 40(b) and 40(c) have been met.

EFFECTIVE: As of November 9, 2005.

TRANSITION: The guidance regarding unexpected events should be applied prospectively. The guidance regarding a transferor's purchases of beneficial interests from outside parties is effective as of November 9, 2005, for such purchases and for transferors' previous purchases that were consistent with the guidance in the FSP.

[30] FASB Interpretation 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others."

[31] FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*.

FSP FAS 19-1, "Accounting for Suspended Well Costs"

AFFECTS: Companies that use the successful efforts method of accounting for oil and gas producing activities.

SUMMARY: Statement 19[32] generally requires capitalized exploratory well costs to be expensed if the reserves cannot be classified as "proved" within one year following the completion of drilling. The FSP states that exploratory well costs should continue to be capitalized when the well has found a sufficient quantity of reserves to justify its completion as a producing well and the enterprise is making sufficient progress assessing the reserves and the economic and operating viability of the project. The FSP provides indicators of whether an enterprise is making sufficient progress assessing the reserves and viability of the project.

DISCLOSURES: The FSP includes disclosure requirements that provide users with information about management's evaluation of capitalized exploratory well costs, such as the amount of capitalized exploratory well costs pending the determination of proved reserves, changes in capitalized exploratory well costs, and specific disclosures regarding exploratory well costs that have been capitalized for a period of greater than one year after the completion of drilling (including the number of projects for which those costs relate, an aging of those amounts, a description of the projects and the activities undertaken to date to evaluate the reserves and the projects, and the remaining activities required to classify the associated reserves as proved).

EFFECTIVE: The first reporting period beginning after April 4, 2005.

TRANSITION: The guidance should be applied prospectively to existing and newly capitalized exploratory well costs. Any capitalized exploratory well costs that are expensed upon application of this guidance should be recognized in income from continuing operations and either be presented as a separate component of operations or disclosed in the notes to the financial statements. Companies should quantify and describe the projects to which those costs relate. Capitalization of exploratory well costs that were previously expensed is not permitted.

EITF Issue 04-6, "Accounting for Stripping Costs in the Mining Industry"

AFFECTS: Mining enterprises that capitalize post-production stripping costs or expense these costs as incurred.

SUMMARY: The EITF concluded that costs to remove overburden and other mine waste material to access mineral deposits (referred to as stripping costs) incurred during production are variable production costs that should be included in the cost of inventory extracted during the period the stripping costs are incurred. That is, production stripping costs incurred in a given period should be associated with the activities of that period, without consideration of future potential benefits.

EFFECTIVE: For fiscal years beginning after December 15, 2005.

TRANSITION: The effect of initially applying the consensus should be accounted for in a manner similar to a cumulative-effect adjustment as described in paragraphs 19(a)–(c) of Opinion 20, with any adjustment recognized in the opening balance of retained earnings in the year of adoption. Alternatively, the change in accounting may be recognized by restating prior-period financial statements through retrospective application.

Modification to EITF Issue 01-9, "Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products)"

AFFECTS: Vendors that offer consideration to customers (e.g., discounts, coupons, rebates, free products or services, slotting fees, cooperative advertising, and buydowns).

SUMMARY: The decision tree in Issue 01-9 was updated to reflect that if the consideration given by a vendor is cash and it is receivable by the customer as a result of a single exchange transaction, then Issue 01-9 applies, regardless of when the customer receives the cash. In contrast, if a sales incentive is offered in the form of product or services, and the delivery is after the point of sale, Issue 01-9 does not apply.

[32] FASB Statement No. 19, *Financial Accounting and Reporting by Oil and Gas Producing Companies*.

Additionally, a footnote was added to Issue 4 to clarify that Issue 01-9 does not address the accounting for an offer to a customer, in connection with a current revenue transaction, for free or discounted products or services from the vendor that is redeemable by the customer at a future date without a further exchange transaction with the vendor.

FSP EITF 85-24-1, "Application of EITF Issue No. 85-24, 'Distribution Fees by Distributors of Mutual Funds That Do Not Have a Front-End Sales Charge,' When Cash for the Right to Future Distribution Fees for Shares Previously Sold Is Received From Third Parties"

AFFECTS: Distributors of mutual funds.

SUMMARY: The FSP addresses how a distributor should account for cash received from a third party for its right to future cash flows relating to distribution fees for shares previously sold. Revenue recognition is appropriate when cash is received from a third party for the rights[33] if the distributor has neither continuing involvement with the rights nor recourse. These conditions are met when neither the distributor nor any member of the consolidated group that includes the distributor (1) retains any disproportionate risks or rewards in the cash flows of the rights that are sold, (2) guarantees or assures in any way the purchaser's rate of return on the investment in the related rights, or (3) contractually restricts the ability of the consolidated group or the mutual fund independent board to remove, replace, or subcontract any of the service providers of the fund. Deferred costs for the shares sold to which the rights pertain should be expensed concurrent with the recognition of revenue consistent with the requirements of Issue 85-24.

DISCLOSURES: Distributors should disclose the amount of revenue recognized and the related amount of deferred costs that have been expensed in each period in which they receive cash from a third party for the rights.

EFFECTIVE: For reporting periods beginning after March 11, 2005.

TRANSITION: The effect of initially applying the FSP should be recognized as the cumulative effect of a change in accounting principle pursuant to the guidance in Statement 3[34] and Opinion 20. The guidance should be applied based on the terms of the arrangements that exist at the end of the reporting period for which the guidance is first effective.

Modification to Effective Date of EITF Issue 04-10, "Determining Whether to Aggregate Operating Segments That Do Not Meet the Quantitative Thresholds"

AFFECTS: Public companies with more than one operating segment that does not meet one of the quantitative thresholds in FASB Statement No. 131, *Disclosures About Segments of an Enterprise and Related Information*.

SUMMARY: The EITF previously decided that the effective date of Issue 04-10 should coincide with the effective date of FSP FAS 131-a[35] since the two issues were interrelated. However, the Board decided not to issue the proposed FSP. Therefore, the Task Force agreed that the consensus in Issue 04-10 should be effective for fiscal years ending after September 15, 2005.

TRANSITION: Upon initial application of Issue 04-10, the corresponding information for earlier periods, including interim periods, should be restated, unless it is impractical to do so.

PCAOB Rules on Ethics and Independence

AFFECTS: Registered public accounting firms.

SUMMARY: *Rule 3502, Responsibility Not to Knowingly or Recklessly Contribute to Violations* — Persons associated with a registered public accounting firm should not take or omit to take an action knowing, or recklessly not knowing, that the act or omission would directly and substantially contribute to a violation by that firm of relevant laws, rules, and professional standards.

[33] This FSP refers to 12b-1 fees and contingent deferred sales charges for shares previously sold collectively as "rights."

[34] FASB Statement No. 3, *Reporting Accounting Changes in Interim Financial Statements*.

[35] Proposed FASB Staff Position No. FAS 131-a, "Determining Whether Operating Segments Have 'Similar Economic Characteristics' Under Paragraph 17 of FASB Statement No. 131, *Disclosures About Segments of an Enterprise and Related Information*."

Rule 3520, Auditor Independence — The rule codifies in an ethics rule that a registered public accounting firm and its associated persons must be independent of the firm's audit client throughout the audit and professional engagement period.

Rule 3521, Contingent Fees — Firms are not independent of their audit clients if they enter into contingent fee arrangements with those clients.

Rule 3522, Tax Transactions — A firm is not independent of an audit client if it provides services related to marketing, planning, or opining in favor of the tax treatment of a transaction (1) with tax-advisor imposed conditions of confidentiality or (2) that is based on an aggressive interpretation of applicable tax laws and regulations. The scope of this rule includes listed transactions as defined by U.S. Treasury Department regulations.

Rule 3523, Tax Services for Persons in Financial Reporting Oversight Roles — A firm is not independent if it provides tax services to certain members of management who serve in financial reporting oversight roles at an audit client or to immediate family members of such persons.

Rule 3524, Audit Committee Pre-approval of Certain Tax Services — The rule increases the audit committee pre-approval requirements for tax services by requiring a firm to (1) describe the proposed tax services engagements in writing, (2) discuss with the audit committee the potential effects of the services on the firm's independence, and (3) document the substance of that discussion.

EFFECTIVE: The effective date of the rules will be established upon SEC approval, which, as of this publication date, has not occurred.

*Rules 3502 and 352*0 — 10 days after approval by the SEC.

Rule 3521 — For contingent fee arrangements that were not paid in their entirety, converted to fixed fee arrangements, or otherwise unwound before 60 days after approval by the SEC.

Rule 3522 — For tax services completed later than 60 days after approval by the SEC.

Rule 3523 — Will not apply to tax services being provided pursuant to an engagement in process at the time the SEC approves the rules, provided that such services are completed on or before the later of June 30, 2006, or 10 days after approval by the SEC.

Rule 3524 — Will not apply to any tax service pre-approved before 60 days after approval by the SEC, or, in the case of an issuer that pre-approves non-audit services by policies and procedures, the rule will not apply to any tax service provided by March 31, 2006.

International Financial Reporting Standards

SEC Rule, *First-Time Application of International Financial Reporting Standards*

AFFECTS: Foreign private issuers registered with the SEC.

SUMMARY: The SEC's rule amends Form 20-F to provide a one-time accommodation for foreign private issuers that adopt IFRS prior to or for the first financial year starting on or after January 1, 2007. For their first year of reporting under IFRS, eligible foreign private issuers will be allowed to file two years rather than three years of statements of income, changes in shareholders' equity, and cash flows prepared in accordance with IFRS, with appropriate related disclosure. The accommodation retains current requirements regarding the reconciliation of financial statement items to U.S. GAAP.

DISCLOSURES: An issuer that includes Previous GAAP financial information must include certain narrative disclosure regarding its operating and financial review and prospects for the reporting periods covered by Previous GAAP financial information, and include appropriate cautionary language with respect to that data to avoid inappropriate comparison with information presented under IFRS.

In addition the rule outlines disclosures related to operating and financial review and prospects, information on the company, derivatives and market risk, interim periods during the transition year, issuers using IFRS as adopted by the European Union, and the first-time adoption of IFRS (regardless of the year in which the change in basis of accounting occurs), including exceptions to IFRS and reconciliations from Previous GAAP.

EFFECTIVE: May 20, 2005.

IFRS 7, *Financial Instruments: Disclosures* and Amendments to IAS 1, *Presentation of Financial Statements — Capital Disclosures*

AFFECTS: Companies that prepare and present general purpose financial statements in accordance with IFRSs.

SUMMARY: *IFRS 7* — The Standard requires disclosure of (1) the significance of financial instruments to an entity's financial position and performance and (2) qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk. The Standard further details specific disclosures pertaining to each of the two broad categories above (e.g., information on financial assets and financial liabilities measured at fair value through profit and loss). IFRS 7 supersedes IAS 30[36] and the disclosure requirements of IAS 32.[37]

Amendments to IAS 1 — The amendments add requirements to disclose (1) the entity's objectives, policies, and processes for managing capital, (2) quantitative data about what the entity regards as capital, (3) whether the entity has complied with its capital requirements, and (4) the consequences of noncompliance if it has not complied.

EFFECTIVE: For annual periods beginning on or after January 1, 2007.

IFRIC 7, *Applying the Restatement Approach Under IAS 29,* Financial Reporting in Hyperinflationary Economies

AFFECTS: Companies whose functional currency becomes hyperinflationary.

SUMMARY: IFRIC 7 clarifies IAS 29 with respect to the following:

Restatement of Comparative Amounts When Hyperinflation Is Identified — In the period in which the economy of the functional currency becomes hyperinflationary, the requirements of IAS 29 should be applied as though the economy had always been hyperinflationary. Restatements of nonmonetary items carried at historical cost are made to reflect inflation from the dates when those items were first recognized to the closing balance sheet date of the reporting period. Restatements of other nonmonetary items are made to reflect inflation from the dates at which the current values for those items were established to the closing balance sheet date of the reporting period.

Restatement of Deferred Taxes in the Opening Balance Sheet — The opening balance sheet value of deferred taxes should be determined in two stages:

(1) Deferred tax items are remeasured in accordance with IAS 12, *Income Taxes*, after restating the nominal carrying amounts of the nonmonetary items in the opening balance sheet by applying the measuring unit at that date.

(2) Remeasured deferred tax items are restated for the change in the measuring unit from the date of the opening balance sheet to the closing balance sheet date of that period.

EFFECTIVE: For annual periods beginning on or after March 1, 2006.

IFRIC 6, *Liabilities Arising From Participating in a Specific Market — Waste Electrical and Electronic Equipment*

AFFECTS: Companies that sold household equipment before August 13, 2005.

SUMMARY: IFRIC 6 provides guidance on accounting for liabilities for historical household waste management costs in response to questions arising from the European Union's Directive on Waste Electrical and Electronic Equipment.

[36] IAS 30, *Disclosures in the Financial Statements of Banks and Similar Financial Institutions*.

[37] IAS 32, *Financial Instruments: Disclosure and Presentation*.

The IFRIC concluded that the event giving rise to the liability for costs of waste management for equipment sold to private households before August 13, 2005, is participation in the market during a measurement period (i.e., a period in which market shares are determined for the purposes of allocating waste management costs). It is this date, rather than the date of production or sale of the equipment, that is the triggering event for liability recognition.

EFFECTIVE: For annual periods beginning on or after December 1, 2005.

TRANSITION: Changes in accounting principle resulting from application of this Interpretation should be accounted for in accordance with IAS 8[38] (i.e., retrospectively).

Amendment to IAS 39, *Financial Instruments: Recognition and Measurement — The Fair Value Option*

AFFECTS: Companies that elect the fair value option for measuring financial assets and financial liabilities.

SUMMARY: The amendment limits the use of the fair value option to financial instruments that meet any of the following conditions: (1) the instrument is classified as held for trading; (2) the use of the fair value option eliminates or significantly reduces an accounting mismatch; (3) the instrument is part of a group of financial assets, financial liabilities, or both that are managed and evaluated on a fair value basis in accordance with a documented risk-management or investment strategy; or (4) the instrument contains one or more embedded derivatives that meets particular conditions.

DISCLOSURES: The amendment includes a consequential amendment to IAS 32 that expands the disclosure requirements for financial assets and financial liabilities classified as at fair value through profit and loss. These amendments will also be included in IFRS 7, which will replace IAS 32.

The additional disclosure includes, for financial assets or financial liabilities designated as at fair value through profit and loss, (1) the criteria for such designation and how the entity has satisfied those criteria, (2) the carrying amounts, and (3) gains and losses recognized in profit or loss. There are also disclosure requirements primarily related to loans and receivables designated as at fair value through profit and loss.

EFFECTIVE: For annual periods beginning on or after January 1, 2006.

TRANSITION: The Amendment includes transition provisions related to the designation of previously recognized financial assets and liabilities at fair value as well as de-designations from fair value. Generally, companies should restate comparative financial statements using new designations. In the case of designations at fair value, comparative financial statements should be restated provided they meet certain criteria at the beginning of the comparative period or, if acquired after the beginning of the comparative period, would have met the criteria at the date of initial recognition.

Amendment to IAS 39, *Financial Instruments: Recognition and Measurement — Cash Flow Hedge Accounting of Forecast Intragroup Transactions*

AFFECTS: Companies with cash flow hedges of the currency risk on intragroup forecast transactions denominated in a currency other than the functional currency of the entity entering into the transaction.

SUMMARY: The amendment permits the foreign currency risk of an intragroup forecast transaction to be a hedged item in the consolidated financial statements provided that (a) the hedged intragroup transaction is highly probable and meets all other hedge accounting criteria, (b) the hedged intragroup transaction is denominated in a currency other than the functional currency of the entity entering into the transaction, and (c) the foreign currency risk will affect consolidated profit or loss. If a hedge of a forecasted intragroup transaction qualifies for hedge accounting, then any gain or loss recognized directly in equity (in accordance with the hedge accounting rules of IAS 39) must be reclassified into profit or loss in the same period or periods during which the foreign currency risk of the hedged transaction affects the consolidated profit or loss.

EFFECTIVE: For annual periods beginning on or after January 1, 2006.

[38] IAS 8, *Accounting Policies, Changes in Accounting Estimates, and Errors*.

TRANSITION: If a company has designated as the hedged item an external forecast transaction that (a) is denominated in the functional currency of the entity entering into the transaction, (b) gives rise to an exposure that will have an effect on consolidated profit or loss (i.e., is denominated in a currency other than the group's presentation currency), and (c) would have qualified for hedge accounting had it not been denominated in the functional currency of the entity entering into it, the company may apply hedge accounting in the consolidated financial statements in the period(s) before the date the amendments are applied.

The provisions requiring reclassification of gains or losses do not need to be applied to comparative information relating to periods before the date that the company applies the provisions that permit intragroup forecast transactions to qualify as the hedged item.

Amendment to IAS 39, *Financial Instruments: Recognition and Measurement*, and IFRS 4, *Insurance Contracts*

AFFECTS: Issuers of financial guarantee contracts.

SUMMARY: The amendments to IAS 39 define a financial guarantee contract as a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument. The IAS 39 amendments require that issuers of financial guarantee contracts include the resulting liabilities in their balance sheets. The issuer of the contract should initially measure the liability at fair value and subsequently measure it at the higher of (a) the amount determined in accordance with IAS 37, *Provisions, Contingent Liabilities, and Contingent Assets*, or (b) the amount initially recognized less cumulative amortization recognized in accordance with IAS 18, *Revenue*. However, if specific criteria are met, the issuer may use the fair value option in IAS 39.

Issuers that have previously explicitly asserted that such contracts were insurance contracts and used accounting specific to insurance contracts may elect to apply either IFRS 4 or the guidance described above.

The amendments also state that the following loan commitments are within the scope of IAS 39: (a) loan commitments that can be settled net in cash or by delivering or issuing another financial instrument and (b) commitments to provide a loan at below-market interest rates.

EFFECTIVE: For annual periods beginning on or after January 1, 2006.

Amendments to IFRS 1, *First-time Adoption of International Financial Reporting Standards*, and IFRS 6, *Exploration for and Evaluation of Mineral Resources*

AFFECTS: Companies that both adopt IFRSs for the first time before January 1, 2006, and apply IFRS 6 before that date.

SUMMARY: The amendments clarify that an entity that both adopts IFRSs for the first time before January 1, 2006, and applies IFRS 6 before that date, is exempt, in the first year of application, from IFRS 6's requirements relating to comparative disclosures as well as recognition and measurement for the comparative period.

EFFECTIVE: June 30, 2005.

Withdrawal of IFRIC 3, *Emission Rights*

AFFECTS: Companies with emission rights.

SUMMARY: IFRIC 3 was withdrawn with immediate effect due to unsatisfactory mismatches in reporting and measurement when compared to other IFRSs.

OTHER RESOURCES: Deloitte & Touche's IFRS in Your Pocket 2005; Deloitte & Touche's IFRSs and US GAAP — A pocket comparison; www.iasplus.com.

GASB

GASB Concepts Statement 3, *Communication Methods in General Purpose External Reports That Contain Basic Financial Information*

AFFECTS: State and local governments that issue general purpose external financial reports that contain basic financial statements.

SUMMARY: The Concepts Statement provides a conceptual basis for selecting an appropriate communication method (i.e., recognition in basic financial statements, disclosure in notes to the basic financial statements, or required supplementary information, or supplementary information) to present items of information within general purpose external financial reports. It also addresses the necessary elements for the effective communication of relevant and reliable messages within financial reports. The Concepts Statement clarifies the roles and responsibilities of the preparer, the user, and the GASB regarding the effective communication of information.

GASB Statement 47, *Accounting for Termination Benefits*

AFFECTS: State and local governments that offer either voluntary (e.g., early retirement incentives) or involuntary (i.e., severance) termination benefits.

SUMMARY: Statement 47 provides recognition and measurement guidance for termination benefits. The Statement requires that a liability and expense for involuntary termination benefits be recognized in accrual basis financial statements when (1) a termination plan has been approved by those with the authority to commit the government to the plan, (2) the plan has been communicated to the employees, and (3) the amount can be estimated.

A liability and expense for voluntary termination benefits should be recognized in accrual basis financial statements when the offer is accepted and the amount can be estimated.

Liabilities and expenditures should be recognized in modified accrual basis financial statements to the extent the liabilities are expected to be liquidated with expendable available financial resources.

Termination benefits affecting defined benefit postemployment benefits (e.g., pensions or retiree healthcare) should be accounted for in the same manner as defined benefit pensions or other postemployment benefits (OPEB), in accordance with the requirements of GASB Statement 27[39] or Statement 45.[40]

DISCLOSURES: Employers should disclose a description of the termination benefit arrangements, the cost of the termination benefits, the significant methods and assumptions used to determine termination benefit liabilities, changes in an actuarial accrued liability for a pension or OPEB plan associated with a termination benefit, and whether there is any termination benefit that otherwise meets the recognition criteria but is not recognized because the expected benefits are not estimable.

EFFECTIVE: For termination benefits provided through an existing defined benefit OPEB plan, the provisions should be applied simultaneously with the requirements of GASB Statement 45. For all other termination benefits, the provisions are effective for periods beginning after June 15, 2005.

TRANSITION: In the initial year of implementation, the requirements of Statement 47 should be applied to any previous commitments of termination benefits that remain unpaid at the effective date of the Statement. The cumulative effect of applying the guidance should be reported as a restatement of beginning net assets. Financial statements for prior periods are not required to be restated.

[39] GASB Statement No. 27, *Accounting for Pensions by State and Governmental Employers*.

[40] GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postretirement Benefits Other Than Pensions*.

GASB Guide to Implementation of GASB Statements 43 and 45 on Other Postemployment Benefits

AFFECTS: State and local governments that provide postemployment benefits subject to GASB Statement 43[41] or Statement 45.

SUMMARY: The Guide provides answers to over 250 questions about topics such as:

- Scope and applicability of Statement 43 and Statement 45, including distinguishing between other postemployment benefits (OPEB) and other forms of employee benefits such as compensated absences, termination benefits, and pensions;
- Actuarial issues, including the timing and frequency of actuarial valuations associated with OPEB, and selection of methods and assumptions;
- Treatment of implicit rate subsidies that arise when retirees are insured in a group with current employees; and
- Option for certain employers and plans with small plan memberships to apply an alternative measurement method to estimate liabilities and expenses associated with their OPEB obligations.

GASB Questions and Answers on Postemployment Benefits

AFFECTS: State and local governments with postemployment benefits subject to GASB Statement 45.

SUMMARY: The Q&As address why Statement 45 was necessary, how postretirement benefits were accounted for prior to Statement 45, what Statement 45 accomplishes, and the most common misconceptions about Statement 45.

Other SEC Developments

Securities Offering Reform

AFFECTS: Companies issuing securities under the Securities Act of 1933 ("Securities Act").

SUMMARY: The rule modifies the registration, communications, and offering processes under the Securities Act. The amendment divides issuers into four categories: (1) well-known seasoned issuers, (2) seasoned issuers, (3) unseasoned issuers, and (4) non-reporting issuers. Well-known seasoned issuers are most impacted by the modifications. The more significant changes result in the following:

- Improved communications to investors regarding securities offerings;
- Changes to disclosure liability in registration statements, prospectuses, and oral communications;
- Improved shelf registration procedures, under which well-known seasoned issuers will be permitted to use automatic shelf registrations; and
- Implementation of an "access equals delivery" model that enables participants to conduct securities offerings without actually printing and delivering final prospectuses if they file a final prospectus with the SEC and comply with certain other conditions.

DISCLOSURES: Form 10-K filers must include disclosures of risk factors, where appropriate. Accelerated filers and well-known seasoned issuers must disclose material written SEC staff comments that were issued more than 180 days before the end of the fiscal year to which the annual report relates when those comments remain unresolved at the time of filing the annual report. Voluntary filers must disclose such status on the cover of Form 10-K, Form 10-KSB, and Form 20-F.

EFFECTIVE: December 1, 2005.

[41] GASB Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*.

SEC Staff Securities Offering Reform Transition Questions and Answers, September 2005

AFFECTS: Companies issuing securities under the Securities Act of 1933.

SUMMARY: The SEC's first group of Q&As on Securities Offering Reform addresses issuers' transition to compliance with the new rules and forms, specifically:

- The effective date of the new rules,
- Use of the new communication rules,
- Inclusion of new undertakings,
- Automatic shelf registration statements,
- Other shelf issues, and
- Form 10-K, 10-Q, and 20-F amendments.

SEC Staff Securities Offering Reform Questions and Answers, November 2005

AFFECTS: Companies issuing securities under the Securities Act of 1933.

SUMMARY: The SEC's second group of Q&As address the following topics related to the Reform rule:

- Filing requirements related to free writing prospectuses (a written communication that constitutes an offer to sell or a solicitation of an offer to buy securities that are or will be the subject of a registration statement),
- The definition of well-known seasoned issuers,
- The definition of ineligible issuers,
- Requirements related to automatic shelf registration statements,
- Availability of "Access Equals Delivery" provisions (Rule 172),
- Timing of required notifications to purchasers of registered securities (Rule 173), and
- Determination of the principal amount of securities being registered for the purposes of Rule 3-10 of Regulation S-X (Financial Statements of Guarantors and Issuers of Guaranteed Securities Registered or Being Registered).

Shell Company Regulations and Amendments

AFFECTS: Reporting shell companies (i.e., registrants with no or nominal operations and either no or nominal assets, assets consisting solely of cash and cash equivalents, or assets consisting of any amount of cash and cash equivalents and nominal other assets).

SUMMARY: The rules and amendments, which relate to a shell company's use of Form S-8, Form 8-K, and Form 20-F, deter fraud and abuse committed through the use of shell companies in the securities markets. The changes ensure that investors in shell companies have timely access to the same type of information that is available to investors in public companies with continuing operations. Among other changes, the modifications (1) define a shell company, (2) prohibit the use of Form S-8 by shell companies, and (3) require companies to indicate on the cover page of their Exchange Act periodic reports that they fall within the definition of a shell company.

The Form 8-K guidelines were modified to require that within four business days after a company ceases being a shell company, it must disclose information comparable to the information required to be provided if it were filing an Exchange Act registration statement.

EFFECTIVE: August 22, 2005, except that Form 8-K, Item 5.06 is effective November 7, 2005.

Technical Amendment, Asset-Backed Securities

AFFECTS: Issuers of asset-backed securities.

SUMMARY: The SEC made technical amendments to the rules regarding registration, disclosure, and reporting requirements for asset-backed securities under the Securities Act of 1933 and the Securities Exchange Act of 1934.

EFFECTIVE: For registered offerings of asset-backed securities commencing with an initial bona fide offer after December 31, 2005.

SEC Staff Alert, 2004 Annual Report Reminders

AFFECTS: All public companies.

SUMMARY: The SEC staff issued an alert to remind companies of important points in completing 2004 annual reports on Forms 10-K and 10-KSB. The contents are not new interpretations, but rather highlight the following existing requirements or previously articulated positions of the Commission or the Staff: (1) disclosure of previously unreported Form 8-K events, (2) appropriate versions of Section 404 internal control certifications, (3) location of the internal control reports within the annual report, and (4) auditor consents when the Form 10-K includes the auditor's report on management's assessment of internal controls over financial reporting.

XBRL

SEC XBRL Voluntary Reporting Program

AFFECTS: Registrants choosing to participate in the voluntary XBRL program.

SUMMARY: In February 2005, the SEC adopted a final rule and updated the EDGAR Filer Manual enabling registrants to submit tagged financial information using the eXtensible Business Reporting Language (XBRL) format (taxonomy) as exhibits to specified EDGAR filings. Tagging uses standard definitions to turn text-based information into documents that can be retrieved, searched, and analyzed through automated means. The XBRL exhibits will be publicly available but will be considered furnished rather than filed. XBRL-related documents should be described either as "unaudited" or, for quarterly financial statements, "unreviewed." The XBRL-related documents may be submitted at the same time as or after the official EDGAR filing to which they relate. Registrants choosing to participate in the program must also continue to file their financial information in HTML or ASCII format, as currently required. In August 2005, the SEC extended the XBRL program to investment companies.

EFFECTIVE: The XBRL program was originally effective for companies other than investment companies on March 16, 2005; however, the implementation was delayed until April 4, 2005, because the taxonomies were not ready. The XBRL program was extended to investment companies effective August 8, 2005.

OTHER RESOURCES: SEC Spotlight on Tagged Data and XBRL Initiatives.

SEC FAQs on XBRL

AFFECTS: Registrants choosing to participate in the voluntary XBRL program.

SUMMARY: The frequently asked questions apply primarily to preparers of XBRL-related documents and address topics such as the appropriate level of testing and validation on XBRL documents, external references, and supported taxonomies.

PCAOB Questions & Answers on XBRL Attest Engagements

AFFECTS: Auditors engaged to issue a report on the accuracy of XBRL data.

SUMMARY: The PCAOB staff questions and answers provide guidance for auditors who are engaged to report on whether the XBRL data accurately reflects the corresponding information in the official EDGAR filings. The guidance addresses both performance and reporting matters. The voluntary XBRL program does not require companies to obtain auditor attestations; however, companies may elect to do so.

Appendix A: Summary of SAB Topic 11.M

SEC Staff Accounting Bulletin Topic 11.M[42] indicates that filings that include financial statements should include disclosure of the impact that a recently issued accounting standard will have on the financial position and results of operations of the registrant when such standard is adopted in a future period. This disclosure guidance applies to all accounting standards that have been issued but not yet adopted by the registrant unless the impact on its financial position and results of operations is not expected to be material. MD&A requires disclosure of presently known material changes, trends, and uncertainties that have had or that the registrant reasonably expects will have a material impact on future sales, revenues, or income from continuing operations. With respect to financial statement disclosure, GAAS specifically addresses the need for the auditor to consider the adequacy of the disclosure of impending changes in accounting principles if (a) the financial statements have been prepared on the basis of accounting principles that were acceptable at the financial statement date but that will not be acceptable in the future and (b) the financial statements will be restated in the future as a result of the change. The SEC staff believes that recently issued accounting standards may constitute material matters and, therefore, disclosure in the financial statements should also be considered in situations where the change to the new accounting standard will be accounted for in financial statements of future periods, prospectively or with a cumulative catch-up adjustment.

Disclosures should include the following:

- 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.

[42] 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."

Appendix B: Abbreviations

AcSEC	Accounting Standards Executive Committee
AICPA	American Institute of Certified Public Accountants
APB	Accounting Principles Board
ARB	Accounting Research Bulletin
ASB	Auditing Standards Board
DIG	Derivatives Implementation Group
EITF	Emerging Issues Task Force
FAS	Financial Accounting Standard
FASB	Financial Accounting Standards Board
FIN	FASB Interpretation
FSP	FASB Staff Position
GAAP	Generally Accepted Accounting Principles
GASB	Governmental Accounting Standards Board
IAS	International Accounting Standard
IASB	International Accounting Standards Board
IFAC	International Federation of Accountants
IFRIC	International Financial Reporting Interpretations Committee
IFRS	International Financial Reporting Standard
MD&A	Management's Discussion & Analysis
NCGA	National Council on Governmental Accounting
PCAOB	Public Company Accounting Oversight Board
SAB	Staff Accounting Bulletin
SAS	Statement on Auditing Standards
SEC	Securities and Exchange Commission
SOP	Statement of Position
TPA	Technical Practice Aid

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