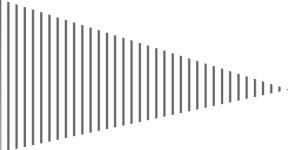
Compendium of significant accounting and reporting issues



# 2012 AICPA National Conference on Current SEC and PCAOB Developments

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#### **Summary**

Representatives of the Securities and Exchange Commission (SEC or Commission), the Public Company Accounting Oversight Board (PCAOB), the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) shared their views on various accounting, auditing and reporting issues at the three-day AICPA National Conference on Current SEC and PCAOB Developments (Conference) last week in Washington, DC.

Highlights included:

*IFRS update* – The SEC is continuing to evaluate whether further analysis is necessary relative to whether and, if so, when and how to incorporate IFRS into the US financial reporting system. SEC officials at the Conference advised stakeholders to "stay tuned," but didn't indicate a decision would be made any time soon. Speakers from both the SEC and the FASB discussed the importance of the US setting its own accounting standards while continuing to work with the IASB to improve comparability and narrow differences in the standards.

Joint projects – Speakers throughout the conference commended the outreach performed by the FASB and IASB (collectively, the Boards) and their progress on the convergence projects. Several speakers focused on the need for the FASB and the IASB to coordinate their efforts when developing implementation guidance (e.g., on revenue recognition) to help maintain convergence when the new standards go into effect. Speakers from the FASB stressed the need for timely interpretive guidance once the standards are issued, as well as when practice questions arise during implementation and post-implementation.

**Audit quality** – SEC and PCAOB officials stressed the importance of audit quality to the capital markets and the relevance of inspection findings, particularly findings pertaining to internal control over financial reporting (ICFR). Some findings in this area could have implications to preparers in their own evaluations of ICFR. PCAOB



officials also said that based on comments received to date, they are considering feedback on mandatory audit firm rotation while they take other steps to improve auditor independence, objectivity and professional skepticism.

Accounting, disclosure and reporting matters – The SEC staff discussed year-end financial statement considerations and the SEC staff's areas of focus in its filing reviews, including revenue recognition disclosures, the valuation of deferred tax assets and observations related to the new fair value disclosures. Various panelists commented on the need to evaluate disclosure requirements, particularly the dividing line between the footnotes to the financial statements and the rest of the financial reporting package (e.g., Management's Discussion and Analysis or MD&A). SEC Acting Chief Accountant Paul Beswick said the SEC staff plans to host a roundtable in 2013 to better understand whether disclosure gaps exist and the assessments made in determining what type of information should appear in the financial statements versus the broader financial reporting package.

#### Remarks of SEC officials

#### Investor protection facilitates capital formation

SEC Commissioner Luis Aguilar highlighted the importance of investor protection in fostering capital formation. To make investment decisions, he said investors must have sufficient, reliable and useful information in which they have confidence. He also reminded accountants of their critical role in the capital formation process as "gatekeepers" who protect the integrity of the capital markets by helping investors get the reliable financial statements they need to make sound investment decisions.

When the foreign operations of US issuers are audited by foreign auditors, Commissioner Aguilar said that it should be transparent to investors what role foreign accounting firms played in the audit. He believes this transparency is necessary because US investors rely on the work of foreign auditors when making investment decisions.

Further, Commissioner Aguilar remains "seriously concerned" about what he believes is a lack of effective oversight of foreign auditors that audit or participate in the audits of SEC registrants. Although foreign auditors registered with the PCAOB are required to have periodic inspections, audit regulators in certain European countries and China have resisted PCAOB inspections. Similarly, in investigating accounting irregularities and possible fraud, the SEC staff has had difficulty obtaining access to audit workpapers and other documentation in foreign countries such as China. Commissioner Aguilar said that to protect investors and promote capital formation, the SEC must question whether issuers audited by foreign firms should be allowed to trade in the US markets if their auditors are unable to comply with US law.

Commissioner Aguilar also commented on the results of the PCAOB's inspections over the last 10 years since the enactment of the Sarbanes-Oxley Act of 2002. He noted that the inspection results raise "serious issues" about the quality of many audits, and, in his view, audit failures identified by the PCAOB "damage investor confidence, discourage investment and impede the efficient allocation of capital required for true capital formation." He also noted that in light of those results, the PCAOB is working on potential approaches to improve audit quality.

"There is no substitute for an environment where investors can rely on the integrity of published financial information."

SEC Commissioner
 Luis Aguilar

Commissioner Aguilar discussed the importance of effective internal control over financial reporting in protecting investors and fostering capital formation. Internal controls are "fundamental" to reliable financial reporting, he said. He also expressed concerns about repeated efforts to roll back the auditor attestation requirement in Section 404(b) of the Sarbanes-Oxley Act. These efforts have continued despite evidence indicating that Section 404(b) benefits investors by promoting good financial reporting and that the related costs of compliance are declining. He is concerned that rolling back Section 404(b) requirements would harm both investors and capital markets and ultimately would damage investor confidence. Commissioner Aguilar encouraged the SEC and the PCAOB to monitor the financial reporting and internal controls of issuers that have been exempted from the auditor attestation requirement, such as non-accelerated filers exempted by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) and emerging growth companies (EGCs) exempted by the Jumpstart Our Business Startups Act (JOBS Act). Commissioner Aguilar said that "we should not hesitate to call for the reinstatement of that obligation if necessary to promote capital formation and protect investors."

"If the goal of all
these efforts is a
single set of high-quality
global standards,
keeping implementation
consistent is of
paramount importance."

– SEC Acting Chief Accountant

Paul Beswick

#### Remarks by Acting Chief Accountant

The dividing line between the financial statements and other public disclosures

What type of information should be included in a set of financial statements versus the broader financial reporting package (e.g., MD&A)? This is a common question that has emerged as a result of feedback on the FASB's three separate disclosure projects (i.e., liquidity and interest rate disclosures, going concern and the disclosure framework).

Mr. Beswick said he intends for the Office of the Chief Accountant (OCA) and staff from other offices and divisions to organize a public roundtable to discuss this issue. The initial focus will include whether constituents believe there are disclosure gaps and the critical assessments for determining what type of information should appear in the financial statements versus the broader financial reporting package. Mr. Beswick said that the PCAOB and the FASB should be involved in the roundtable, along with representatives of the accounting profession, preparers, investors, the legal community and other regulators.

Mr. Beswick said looking at the history of how interpretive guidance on MD&A has developed over time also could be helpful in assessing this issue.

#### Convergence projects

Mr. Beswick said he is encouraged by the level of convergence the FASB and the IASB have achieved in their joint leasing and revenue recognition projects. While the Boards remain diverged on the impairment aspect of the financial instruments project, he noted that the Boards are a lot closer to converging on classification and measurement than many would have predicted. He recommended the Boards seek public comment on their impairment models at the same time to see whether they can reconcile the two views.

Mr. Beswick also emphasized the importance of the SEC and other global securities regulators working together to keep implementation of the standards consistent. He cautioned everyone to be thoughtful and deliberative in their approaches to non-authoritative implementation guides rather than trying to be the "first to press." He noted that both the SEC and the FASB are considering whether there might be a "more holistic approach" to implementation guidance and welcomed suggestions.

#### Auditor independence and audit quality

Mr. Beswick observed that some accounting firms are actively growing their consultancy practices or expanding into other non-audit services that are far removed from an accountant's professional mandate to perform quality audits. He expressed concern about the potential effect of this expansion, not only on auditor independence, but also on the allocation of the appropriate firm resources to improve audit quality.

Mr. Beswick encouraged accounting firms to reflect when faced with decisions about growing non-audit services, because these decisions will shape the public's long-term views of the firms and potentially the profession.

#### SEC staff views on PCAOB initiatives

#### The PCAOB's near-term priorities

SEC Deputy Chief Accountant Brian Croteau highlighted his belief that investors have benefited from the rules implemented in the decade after the passage of the Sarbanes-Oxley Act in 2002. However, he said that now is an opportune time to consider how audit quality can continue to be improved. He highlighted the six near-term priorities in the PCAOB's strategic plan and expressed support for those initiatives. In particular, he said the focus on the content and readability of inspection reports, the timeliness of remediation determinations, deeper analysis of inspection findings and updating PCAOB auditing standards to respond to common inspection findings had the potential to significantly improve audit quality.

Mr. Croteau also noted that, while only a small percentage of inspection findings have led to the identification of material misstatements, there still should be significant focus on improvements to audit quality, especially in key areas. He encouraged auditors to consider whether there were any sources of audit evidence that they may not have considered – particularly sources that may provide contradictory evidence – as well as whether auditors have merely looked at evidence provided by management or instead performed an independent search for other relevant and reliable sources of evidence.

#### Updating the standard auditor's report

Mr. Croteau said he expects the PCAOB's project to improve the auditor's report to gain momentum in 2013. One change that has been suggested is a requirement that the auditor's report include an emphasis of certain matters. While acknowledging that emphasis-of-matter paragraphs in the auditor's report could result in improvements to management's disclosures in those areas, he also noted that such a model would require the development of:

- Appropriate criteria for determining what to emphasize
- Sufficient direction on what should be said about the matters being emphasized
- Sufficient information for investors to allow them to understand the reasons for including the information in the auditor's report

He and Mr. Beswick encouraged stakeholders to actively participate in the PCAOB standard-setting process and provide their views on improvements to the auditor's report.

#### COSO framework

Mr. Croteau discussed the Committee of Sponsoring Organizations' (COSO) project to update its internal control framework and provide more comprehensive and relevant conceptual and practical guidance. He noted that the SEC staff has received a number of questions about the potential transition to an updated framework, including how the release of the updated framework would affect issuers' obligations to evaluate the effectiveness of their internal control over financial reporting. While he said the SEC staff would be reluctant to address transition until COSO's work is completed, because COSO has stated that its original framework continues to be suitable and would remain available for use, he noted that it may be acceptable for issuers to elect to use either of the frameworks for a period of time.

#### Broker-dealers

Mr. Croteau noted that the SEC is actively working on finalizing rules for broker-dealers. He noted that the SEC is continuing to coordinate with the PCAOB on its related rulemaking efforts. Until then, he noted that AICPA standards should continue to be used for audits of registered broker-dealers, with the important exception that auditors of broker-dealers must follow SEC independence rules.

#### **Ernst & Young resources**

 Compendium of significant accounting and reporting issues,
 2011 AICPA National Conference on Current SEC and PCAOB Developments (SCORE No. CC0341)

#### Internal control over financial reporting

Following up on a topic of significant discussion at last year's conference, Mr. Croteau noted that he was encouraged by signs of significant improvements in issuer understanding of valuation information provided by third-party pricing services. He noted that third-party pricing services appear to be providing more transparent information and users of the services appear to be making use of "price challenges" and "deep dives" to assist them in evaluating the valuation information received. However, he encouraged issuers to focus on their internal controls in this area, particularly whether the controls are adequate to identify when securities become thinly traded, such that necessary changes to the valuation approach as well as the related disclosures can be made on a timely basis.

Similarly, Mr. Croteau mentioned that PCAOB inspection findings could provide useful information to issuers about their evaluation of the effectiveness of their internal control over financial reporting in other areas.

#### International financial reporting standards

Julie Erhardt shared her perspective, as the International Deputy in OCA, about how other jurisdictions have approached the decision to move to the use of IFRS as their national accounting standards and the factors those jurisdictions considered from a policy perspective. She said that considerations in whether to adopt IFRS in other jurisdictions generally fall into three categories: (1) the domestic upgrade (or the "make versus buy") decision, (2) the foreign investment factor and (3) the foreign access factor.

#### Domestic upgrade or "make versus buy"

Ms. Erhardt said that "buy" wins out when policymakers decide that they can improve national accounting standards by adopting IFRS instead of creating or upgrading their own standards. She said that policymakers also may consider tangible and intangible aspects including (1) the relative quality of financial statement information expected to be produced, (2) the relative cost of producing and maintaining accounting

standards, (3) whether the use of IFRS can help overcome negative perceptions about national accounting standards and (4) whether the use of IFRS gives a particular country more of a "seat at the international table."

#### Foreign investment

The foreign investment factor considers the degree to which businesses in a country raise capital from outside their jurisdiction. Ms. Erhardt suggested that if the capital needs of businesses in a country exceed the resources of that company's investors, the shortfall prompts the need to import capital (obtain foreign investments). The pricing of inbound capital is where accounting standards come into play. For example, the cost of capital may be lower if IFRS-based reporting is more familiar to foreign providers of capital.

#### Foreign access

The foreign access factor considers the natural friction between processes for cross-border importing of capital by a country's businesses and the processes for cross-border exporting of capital by savers making investments. One way to reduce international capital movement friction between countries is aligning their public capital market policy profiles (e.g., accounting standards).

Ms. Erhardt said that a country's decision to incorporate IFRS into its national accounting standards is not just about the accounting standards themselves. While all three factors can affect a country's policy considerations, a country may face a more difficult policy scenario if the factors provide mixed signals. In weighing the policy decision, "countries have also focused on the role that those accounting standards serve in their public capital markets, and then in turn how those capital markets serve their function in society, and ultimately under which approach their society would be better off."

#### IFRS ... stay tuned

The SEC staff highlighted the Final Report it issued In July 2012 on its IFRS Work Plan. In the Final Report, the SEC staff said that a wholesale adoption of IFRS by looking directly to the IASB would present challenges, and the vast majority of participants in the US capital markets did not support that approach. However, the Final Report noted that there was significant support for exploring other methods of incorporating IFRS, such as an endorsement mechanism. Such an approach would retain the ability for the US to influence accounting standard setting, reduce the burden of conversion for US issuers and retain references to US GAAP that are embedded throughout US laws and regulations.

The SEC staff described the areas of the Work Plan and summarized the SEC staff's findings. The SEC staff emphasized that the intent of the Work Plan was not to make a recommendation to the Commission about whether or how to incorporate IFRS into the US financial reporting system. Instead, it was designed to inform the Commissioners about various factors to consider in their determination. The SEC staff also reiterated that the completion of the Work Plan does not imply and should not be construed to imply that any policy decisions regarding IFRS have been made. Additional analysis is necessary, and the SEC staff is currently awaiting further instructions from the Commission.

"The consideration of incorporating IFRS may be the single most important accounting determination for the Commission since the determination to look to the private sector to establish accounting standards in the 1930s."

SEC Acting Chief Accountant
 Paul Beswick

#### Ernst & Young resources

► To the Point, SEC staff releases Final Report on IFRS (SCORE No. BB2377)

#### How we see it

With the scheduled departure of current SEC Chairman Mary Schapiro on 14 December 2012, the White House announced that President Obama intends to designate current SEC Commissioner Elisse Walter as the new chair. The change in SEC chair, along with other delayed rulemaking projects required by the Dodd-Frank Act and JOBS Act, adds to the uncertainty about whether the Commission will make a decision about IFRS in 2013.

#### Division of Corporation Finance initiatives

Meredith Cross, Director of the SEC's Division of Corporation Finance (Division), said the Division had a busy year, and she highlighted various rulemaking and other developments.

#### Rulemaking

Dodd-Frank Act

During the past year, the SEC adopted final rules mandated by the Dodd-Frank Act, including:

- Net worth standard for accredited investors
- Exemptions for securities-based swaps
- Listing standards for compensation committees
- Specialized disclosure rules on mine safety, payments by resource extraction issuers and conflict minerals

Ms. Cross noted that the conflict minerals and resource extraction final rules adopted in August 2012 involved "extremely complex" issues. She noted that the SEC tried to make the rules workable within the context of the statutes. For example, the final conflict minerals rule allows the independent private sector audit of a conflict minerals report to be performed by either CPA or non-CPA auditors following the Government Auditing Standards (Yellow Book) of the Government Accountability Office (GAO). Audits by non-CPAs would need to follow the performance audit standards of the GAO. The SEC's intention was to expand the population of eligible professional services firms in an effort to lower compliance costs.

Ms. Cross said that the SEC staff is gathering implementation questions about the conflict minerals and resource extraction final rules and may provide interpretive guidance. She also said that both rules are facing legal challenges in federal court to either modify or set aside the final rules.

#### How we see it

Despite the pending legal challenges to the conflict minerals rule, we recommend that companies continue their scoping assessments and preparations to comply with the disclosure, due diligence and audit requirements. Although the first conflict mineral disclosures are not due until 2 June 2014, that report will cover calendar year 2013, so companies should prepare to begin tracking the necessary information while monitoring the progress of the lawsuits.

#### **Ernst & Young resources**

- ► To the Point, SEC requires listing standards for compensation committees (SCORE No. CC0351)
- ► To the Point, Final conflict minerals rule addresses many stakeholder concerns (SCORE No. CC0353)
- ► To the Point, Oil, gas and minerals issuers must disclose payments to governments (SCORE No. CC0354)
- ► Third Quarter 2012 Standard Setter Update (SCORE No. BB2422)
- ► Technical Line, Implementing the JOBS Act (SCORE No. CC0363)
- ► To the Point, SEC proposes allowing solicitation and advertising in certain exempt offerings (SCORE No. CC0355)

Ms. Cross noted the following pending Dodd-Frank Act rulemaking:

- Final rules related to the disqualification of felons and other "bad actors" from exempt offerings conducted under Rule 506 of Regulation D
- Final rules on risk retention by sponsors of asset-backed securities
- Proposed enhanced compensation disclosure rules for pay for performance, pay disparity and hedging by employees and directors
- Proposed rules on the "clawback" of executive incentive-based compensation

Ms. Cross noted the SEC staff is working to recommend a final rule on bad actors before the Commission considers a final rule on general solicitation (See discussion in the *Jumpstart Our Business Startups Act* section below). Ms. Cross noted that the Dodd-Frank Act imposes no deadlines on the compensation rule proposals; however, the SEC staff is working to draft these proposals and expects the Commission to issue them in the near term.

#### How we see it

The day after her remarks, Ms. Cross announced that she will leave the SEC at the end of 2012 and return to the private sector. Her departure, as well as that of Chairman Mary Schapiro, may affect the timing of the pending rulemaking activity.

Jumpstart Our Business Startups Act

The JOBS Act, enacted on 5 April 2012, was designed to give private companies greater access to capital and make it easier for certain companies to go public.

Ms. Cross provided a brief update on certain aspects of the Division's implementation efforts for the JOBS Act, noting:

- Frequently Asked Questions<sup>1</sup> (FAQs) on the implementation of the JOBS Act, particularly related to EGCs, a new category of issuer that qualifies for regulatory relief for up to five years after going public. She said that companies should contact the SEC staff if they have additional questions about Title I.
- In August 2012 the SEC proposed a rule required by Title II of the JOBS Act on general solicitation that would allow companies to solicit investors and advertise offerings of restricted securities that are exempt from registration because all purchasers are accredited investors. Ms. Cross said the SEC staff hopes that the Commission will adopt a final rule on general solicitation in the near term but prefers that the SEC adopt a final rule on "bad actors" first.
- Rule proposals are still required for the crowdfunding exemption and the new \$50 million exemption threshold for public offerings (also known as Regulation A Plus).
- The SEC staff has completed a few studies required by the JOBS Act (e.g., report on decimalization) and is working on the required Regulation S-K study about how to simplify nonfinancial disclosures for EGCs.

Ms. Cross noted that the SEC Advisory Committee on Small and Emerging Companies has been providing the Commission with thoughts on areas that may help small businesses, including scaling disclosure requirements and corporate governance rules for smaller public companies and market structure issues, particularly decimalization ("tick" size) and its effect on the initial public offering market.

#### New Disclosure Standards Office

Ms. Cross noted that the SEC has established an Office of Disclosure Standards that will help her make the certification to Congress about the effectiveness of the Division's filing review program and its controls, as mandated by the Dodd-Frank Act. The SEC staff in this office will focus on the effectiveness of the review program as well as the quality and consistency of comment letters.

#### Filing reviews

Ms. Cross said the Division has performed more than 5,000 company reviews over the past year, exceeding requirements mandated under the Sarbanes-Oxley Act. Ms. Cross noted that the SEC staff has been issuing more timely comment letters and more targeted comments. She noted that during the past year the SEC staff started publicly releasing review correspondence sooner (i.e., no earlier than 20 business days following the completion of a filing review, rather than 45 calendar days as in the past).

Ms. Cross noted that the SEC staff's public comment letters and issuer responses are attracting more attention from the media and investors. As a result, company responses should be considered as part of the total mix of company information (along with a company's website and press releases). Ms. Cross noted that it is important for a company to carefully consider how it drafts its responses and what information it includes about the company because that information becomes part of the company's disclosure record and could expose the company to liability for making material false or misleading statements.

In a subsequent panel, the SEC staff discussed its most frequent areas of comments in filings. Refer to the *Accounting*, *disclosure* and *reporting* section of this publication for further discussion.

# Remarks of FASB and IASB chairs and accounting standard setter update

## The US markets require clear accounting standards and interpretations

FASB Chairman Leslie Seidman discussed how the FASB has changed during her 10-year term as a board member and chairman and how those changes have shaped recent discussions about global accounting standards.

One of the key principles underlying the establishment of the FASB is that it be independent of industry, public accountants and politicians so that it can develop standards that promote neutral and complete financial reporting for the investing public. Ms. Seidman explained that the FASB must continuously earn the right to be the independent, standard-setting organization for the US. She explained that the Board works toward this goal by "demonstrating our competence, our willingness to listen and learn, and our ability to modify our thinking, if necessary, to produce standards that will fairly reflect economic activity and produce useful information in a cost-efficient manner."

"In the United States, we need clear and unambiguous standards for those who must apply the standard, enforce it and use the resulting information."

FASB Chairman
 Leslie Seidman

Ms. Seidman cited the recent establishment of the Private Company Council, the post-implementation review process and recent workshops on the revenue recognition project as examples of initiatives that have placed the FASB in a unique position to best understand the needs of US stakeholders.

The input received through its outreach efforts has helped shape the FASB's views on the convergence projects. For example, Ms. Seidman said that because the US is a heavily regulated marketplace, US preparers and auditors want accounting standards that are sufficiently clear. Ms. Seidman stated that she does not believe the US marketplace can function with standards that are based only on broad principles. Ms. Seidman also said that an accounting standard must be capable of rigorous interpretation and application so that "similar events and transactions are accounted for similarly across time periods and among companies."

US preparers and auditors repeatedly request clarity in the way standards are written to help mitigate uncertainty in how they should be applied. Ms. Seidman cited the FASB's project on classification and measurement of financial instruments as one in which it responded to the demands of stakeholders by including application guidance in the exposure draft to help stakeholders better understand the FASB's intent.

In addition, when questions arise about the application of a standard, US stakeholders expect the FASB or the Emerging Issues Task Force (EITF) to address them in a timely manner. It will be important for the FASB and the IASB to develop a process to answer interpretive questions on converged standards.

Ms. Seidman said it is important to understand how IFRS is interpreted, applied and enforced in various jurisdictions that have already adopted these standards. She said that the findings in the SEC staff's Final Report on its IFRS Work Plan regarding diversity in application of IFRS across jurisdictions, or jurisdictional modifications to particular standards, suggest that a goal of 100% comparability is not achievable in the short term.

Ms. Seidman said that while the SEC will make a decision on its own timetable about whether and, if so, how and when to incorporate IFRS into the US financial reporting system, she believes the FASB and the IASB should continue to complete the major convergence projects outlined in their Memorandum of Understanding. She said that even though the relationship between the FASB and the IASB will likely change, it does not mean the FASB thinks that attempts at convergence have ended or that divergence will occur. Rather, Ms. Seidman said that the FASB looks forward to new ways of working with the IASB toward the goal of comparable financial reporting for investors around the world.

#### Is the US committed to IFRS?

IASB Chairman Hans Hoogervorst shared his views on the role of the US in the development of IFRS and the pursuit of a single set of high-quality global accounting standards. He said that while he understands that the decision in the US is not an easy one and that a wholesale adoption of IFRS for all companies on day one may not be a reasonable expectation, he believes that the US is well prepared for a successful transition to IFRS.<sup>2</sup>

Mr. Hoogervorst noted that more than 100 countries, including three-quarters of the G20, have adopted IFRS. The US has had enormous influence over the IASB's standard setting over the past decade through the convergence efforts of the FASB and the IASB. Mr. Hoogervorst said the expectation had been that the US would become a permanent participant in the development, application and enforcement of IFRS as the single set of global accounting standards. But given that the SEC still hasn't made a decision on whether to further incorporate IFRS into the US financial reporting system, concerns exist about the continued role of the US in the IFRS standard-setting process. He said that the role of the US and its continued influence in the IASB's standard setting must be commensurate with its commitment to IFRS.

Mr. Hoogervorst expressed disappointment that the US hasn't decided to fully endorse IFRS. He also expressed concerns that the status quo increases the risk that converged standards could diverge post-implementation. He said that merely striving for greater comparability between standards will not be sufficient, and that the lack of tangible next steps by the US could make other countries skeptical of its commitment to IFRS.

Mr. Hoogervorst believes that IFRS has become the global accounting language for the greater part of the world. He concluded his remarks by saying, "I find it hard to imagine IFRS without a leadership role for the United States. But leadership requires vision, mettle and tough decisions. All of these qualities should be in ample supply in the United States, and therefore, I remain optimistic about the future."

#### **Ernst & Young resources**

- Joint Project Watch, FASB/IASB joint projects from a US GAAP perspective - September 2012 (SCORE No. BB2415)
- Third Quarter 2012 Standard Setter Update (SCORE No. BB2422)
- Comment Letter, More implementation guidance needed in final revenue standard (SCORE No. BB2441)
- To the Point, Boards explore a new direction on license arrangements (SCORE No. BB2442)
- ► To the Point, Licenses constrain progress on revenue redeliberations (SCORE No. BB2440)

#### Accounting standard-setting update

Staff members from the FASB and the IASB provided an update on the Boards' joint projects of revenue recognition, leases, financial instruments and insurance contracts, along with other projects and initiatives on the Boards' separate agendas.

#### Revenue recognition

The FASB and the IASB staff members provided an overview of the status and key decisions in the revenue recognition joint project. This standard is expected to be finalized in the first half of 2013. Remaining redeliberation topics that are broadly applicable include disclosure and transition.

Sue Cosper, FASB Technical Director, acknowledged the concerns of constituents regarding the need for implementation guidance and noted that the FASB will be discussing potential ways to address these concerns in the coming weeks. Ms. Cosper observed that it is important to address implementation concerns jointly with the IASB to prevent future diversity in the application of the converged revenue standard.

#### How we see it

In a recent comment letter, we applauded the FASB and the IASB for their commitments to facilitate implementation of a final revenue standard. We also recommended that the Boards provide additional implementation guidance to avoid diversity in practice.

In a separate panel discussion on the joint revenue recognition project, representatives from the user, preparer and auditor constituencies discussed key areas of the proposed model. A financial statement user expressed concerns about transition and emphasized the importance of comparability in financial statements. This user noted that if comparability is not achieved through required retrospective application, more discussion should be provided in MD&A so users can fully understand a company's operations and changes in operations over the periods presented. The panel discussed challenges of implementing the new standard, including changing internal control processes, educating financial statement users and determining the effect of the new standard on business activities. The panel also reiterated the need for implementation guidance.

A preparer expressed concern that many of the new disclosures, particularly forward-looking information, would be difficult to prepare and to audit, and certain of the new disclosures might not be useful to investors. The user said that having key revenue data points and an analysis of revenue trends to make projections is important. However, many of the details, particularly the forward-looking disclosures, could be included in MD&A rather than in the audited footnotes.

#### Leases

The Boards have completed their redeliberations on leases, which have resulted in significant changes from the prior exposure draft, and the Boards expect to expose the revised proposal for comment in the first quarter of 2013. The FASB and the IASB staffs provided an overview of the proposed model, which would generally end off-balance sheet accounting for leases by lessees. The proposed model also would significantly change the timing of lease revenue and expense recognition for certain leases.

#### Financial instruments

#### Classification and measurement

The FASB staff indicated that the FASB expects to issue its exposure draft on classification and measurement in the first quarter of 2013. The IASB staff said that the two Boards had different starting points on the projects, but amendments to the IASB's classification and measurement model were proposed in November 2012 to bring its model closer to the FASB's. The FASB and the IASB staff members agreed that although some differences still exist between the two models, many changes have been made in an attempt to converge.

#### *Impairment*

While acknowledging divergence in impairment approaches, members of both the FASB and the IASB staffs said that once both exposure drafts are issued and additional feedback is received, there will be an opportunity for the Boards to resolve differences in the models. The FASB's exposure draft is expected in the next two weeks, while the IASB's exposure draft is expected in the first quarter of 2013.

#### Hedging

The FASB staff said redeliberations over the FASB's hedging model will not begin until decisions are finalized on the classification and measurement project, which is expected to occur in 2013. The IASB staff member indicated that the IASB's review draft has been available for public comment for about 90 days, and the review process likely will be completed in January 2013.

#### Insurance

The IASB staff said that the IASB started at a different point than the FASB on the insurance project because the IASB does not currently have a standard for insurance contract accounting. The FASB and the IASB expect to issue an exposure draft and a targeted re-exposure draft, respectively, during the first half of 2013.

#### **Ernst & Young resources**

- To the Point, FASB proposes limiting scope of new offsetting disclosure requirements (SCORE No. BB2443)
- ► To the Point, Management would have to assess going concern (SCORE No. BB2437)

# Mr. Doty emphasized the importance of high-quality audits and said inaccurate financial reporting has far-reaching adverse economic effects.

#### Selected projects and initiatives

The FASB staff also discussed the FASB's projects on the disclosure framework, accounting for repurchase agreements, liquidity and interest rate disclosures, balance sheet offsetting and going concern. The initiatives that the IASB staff highlighted included the IASB's implementation and maintenance program and its project on accounting for common control transactions.

#### Remarks of PCAOB officials

#### Chairman Doty says audit quality is critical

PCAOB Chairman James Doty said that high-quality, independent auditing is critical to the nation's economic success and that audit firm culture should support auditors' high-quality work. He also discussed the PCAOB's agenda to enhance the relevance, credibility and transparency of audits.

#### High-quality, independent auditing is critical to our economic success

Mr. Doty said that an integral component to the nation's economic success is the confidence of the "users of capital and the providers of capital alike." Investor losses aren't the only result of inaccurate reporting. It also results in inefficient allocations of capital by market participants that rely on this information to make business and investing decisions. High-quality auditing facilitates reliable reporting which, in turn, facilitates efficient capital allocation. Given the importance of the audit, Mr. Doty said stakeholders should not only focus on whether the financial statements were prepared in accordance with generally accepted accounting principles, but also whether the audits that support such conclusions are being conducted in accordance with professional auditing standards.

#### Audit firm culture must support auditors' work

Mr. Doty observed that in recent years, audit fees have generally changed in line with inflation while fees generated by audit practices have shrunk as a percentage of accounting firms' total revenues. He said this trend threatens to weaken the audit profession overall. While inspection findings over the past 10 years have increased, Mr. Doty noted that he has seen dramatic improvement in audit quality as a result of auditors' responses to inspection findings. He stressed that these improvements were particularly noteworthy for firms that have invested significant resources to understand the root cause of inspection findings, implemented actions to address those causes and monitored and tested the effectiveness of those actions. Importantly, he noted that those efforts need to be supported by "meaningful, believable and consistent messages internally that quality is not one of many goals, but the firm's number one priority."

#### Initiatives to enhance the relevance, credibility and transparency of audits

Mr. Doty discussed a number of initiatives and near-term priorities that are part of the strategic plan the PCAOB recently reaffirmed. The plan includes continuing to develop the PCAOB's global network firm inspection program and refining the standard-setting process for audits of EGCs. Near-term inspection priorities will focus on increasing the efficiency, timeliness and usefulness of inspection reports. The PCAOB also will consider ways to deepen its analysis of inspection findings, over time and across firms, to provide better perspective on potential issues before they become pervasive. Given how important inspection information is to audit committee oversight of the independent auditor, the PCAOB will study ways to provide timely and effective information about inspection observations. The PCAOB also plans to enhance its interaction with audit committees, Mr. Doty said.

Near-term research and analysis priorities include a new project to identify audit quality measures, with a long-term goal of tracking and evaluating those measures over time. Mr. Doty said the PCAOB's near-term standard-setting priorities include developing a framework to organize and integrate the PCAOB's interim standards with its other auditing standards and enhancing the framework for its standard-setting process to improve its effectiveness and transparency to the investing public.

#### **Ernst & Young resources**

- ➤ Technical Line, Auditor communications with audit committees (SCORE No. EE0907)
- To the Point, PCAOB public meeting on auditor independence and audit firm rotation (SCORE No. EE0900)

#### PCAOB standard setting and professional skepticism

PCAOB board member Jeanette Franzel and Martin Baumann, PCAOB Chief Auditor and Director of Professional Standards, discussed the PCAOB's 2013 standard-setting agenda and its recent Staff Audit Practice Alert No. 10, *Maintaining and Applying Professional Skepticism in Audits* (the Practice Alert).

#### 2013 standard-setting agenda

Ms. Franzel discussed a number of standard-setting projects for 2013. As part of the discussion, she noted that the PCAOB, in response to the JOBS Act, has spent a significant amount of time developing a process to analyze the costs and benefits of its rulemaking on EGCs to help the SEC determine whether new PCAOB standards should apply to such entities. In addition, she noted that the PCAOB planned to further incorporate economic analysis in its rulemaking efforts.

Ms. Franzel said the PCAOB's standard-setting agenda for 2013 includes the following projects:

- board member Jay Hanson said the PCAOB will continue to evaluate feedback on the mandatory audit firm rotation initiative and use that feedback to take other steps to improve auditor independence and objectivity. These efforts include the PCAOB's release on *Information for audit committees about the PCAOB inspection process*, the adoption of Auditing Standard No. 16 (AS 16), *Communications with Audit Committees*, and its release of the Practice Alert on professional skepticism. Mr. Hanson noted that, in his view, substantial impediments exist to any attempts by the PCAOB to implement mandatory firm rotation, including the need to gather empirical data to support the assertion that audit firm rotation would improve audit quality.
- Auditor's reporting model: While the PCAOB has received significant support for making changes to the current auditor's report, it is being deliberate and thoughtful in developing its proposal on this topic. Mr. Baumann said the PCAOB expects to issue a proposal for public comment in the first half of 2013. He anticipates further roundtable discussions and economic analysis before the PCAOB makes a decision about any changes.

- Communications with audit committees: AS 16 has been adopted by the PCAOB and is awaiting SEC approval, which is anticipated by mid-December. Mr. Baumann noted that some audit firms are planning to early-adopt the standard's communication requirements, recognizing the benefits to audit committee oversight of a company's financial reporting and audit processes.
- Going concern: Mr. Baumann noted that the financial crisis demonstrated a need to improve the going concern auditing standard, as well as a need for improved reporting by issuers. The PCAOB is working closely with the FASB on its project and plans to issue a proposal to revise the auditing standard shortly after the FASB releases its exposure draft in early 2013.
- Other projects: Ms. Franzel noted that, in addition to the projects highlighted above, the PCAOB plans to adopt or re-propose a standard on the identification of the engagement partner and other participants in the audit as well as the auditing standard on related parties. The PCAOB also plans to propose changes to its interim standards related to the auditor's responsibilities with respect to other accounting firms, individual accountants and specialists, and it might change the manner in which its audit standards are organized.

#### Applying professional skepticism

Mr. Baumann announced the Practice Alert and described professional skepticism as an attitude that includes a questioning mind and a critical assessment of audit evidence, emphasizing that it represents an essential element of an effective audit. However, he said the PCAOB and other audit regulators around the world continue to note instances when it does not appear that audits were conducted with an appropriate level of professional skepticism.

Mr. Baumann observed that there are many conditions, incentives and pressures inherent in the audit environment that can impede the appropriate application of professional skepticism and allow unconscious biases to prevail. Certain attributes of an audit firm's system of quality controls can help mitigate risks posed by these factors, including:

- Tone-at-the-top that consistently reinforces the importance of maintaining professional skepticism throughout the audit
- Performance appraisal, promotion and compensation processes that encourage and reward the application of professional skepticism
- Workload and scheduling processes that allow auditors to spend an appropriate amount of time gathering and evaluating audit evidence
- Monitoring activities that identify potential issues with professional skepticism and take corrective actions in a timely fashion

Other important aspects of applying professional skepticism include being alert for biases and other circumstances that can affect the manner in which auditors gather and evaluate information, as well as evaluating all available evidence, whether it corroborates or contradicts the assertions of management. Mr. Baumann noted that while the application of professional skepticism is important in all areas of the audit, it is particularly important in the following:

 Areas involving significant management judgment, such as accounts with significant measurement uncertainty, related-party transactions or transactions outside the ordinary course of business

- The evaluation of whether uncorrected misstatements result in a material misstatement of the financial statements
- The evaluation of the presentation of the financial statements, including whether they are fairly presented in accordance with the applicable financial reporting framework

Mr. Baumann said he considers the Practice Alert essential reading for all auditors. He also noted that the Practice Alert would help audit committees and others understand the responsibilities of auditors to maintain an attitude of professional skepticism throughout the audit.

Mr. Baumann noted that the PCAOB continues to explore other actions to enhance professional skepticism.

#### How we see it

The PCAOB continues to maintain a broad standard-setting agenda, with an aggressive timetable for 2013. Some of the projects have significant implications for both auditors and companies subject to audit.

#### Inspections and enforcement update

Helen Munter, Director of the PCAOB's Division of Registration and Inspections, said the Division has completed nearly 250 inspections in the current year, including inspections in foreign countries. To date, those inspections have shown improvement in audit quality because audit firms have made significant investments in internal quality control structures, root cause analyses and internal inspection programs. While those improvements have not reduced the number of inspection findings, she stated that she expected to see improved results in the future.

Echoing remarks made by Mr. Croteau, Ms. Munter said significant progress has been made in the current year related to the auditor's consideration of the information obtained from third-party pricing services. However, Ms. Munter noted that overall inspection findings indicate that improvements are needed in a variety of other areas, including the following:

- Internal control over financial reporting:
  - Failure to identify controls that sufficiently address the risk of material misstatement and to sufficiently test controls identified. Ms. Munter noted that in some instances the PCAOB found audit issues when a company's documentation of its controls did not clearly link its controls to the identified financial reporting risks.
  - Failure to adequately understand, document, test and evaluate entity-level, monitoring and other management review controls, including consideration of the precision of those controls relative to the assessed level of risk.
  - Failure to appropriately evaluate all identified deficiencies, as well as a failure to evaluate whether identified adjustments or exceptions indicate possible control deficiencies.
  - Failure to identify and/or adequately test compensating controls in response to identified deficiencies.

- Management estimates Lack of sufficient analysis, or documentation of such analysis, of critical assumptions underlying management's estimates, including consideration of evidence that may contradict that used by management in making the estimates.
- Fraud risks Failure to appropriately plan and execute testing procedures to address identified fraud risks.
- Journal entry testing Failure to design and perform sufficient procedures on items selected for testing.
- Substantive analytical procedures Failure to appropriately design and execute substantive analytical procedures, including the failure to develop sufficiently precise expectations and perform sufficient procedures or analysis on identified variances.

Ms. Munter and others from the PCAOB also said inspection and enforcement activities indicate a tendency on the part of auditors to compartmentalize evidence as it is obtained during an audit. They reminded auditors that it is important to step back and look collectively at all evidence obtained during the audit when evaluating assertions made by management in the preparation of the financial statements, as well as to make sure audit evidence obtained by the auditor is appropriate and sufficient to support its opinion.

#### Accounting, disclosure and reporting

#### **Emerging growth companies**

The SEC staff discussed the JOBS Act, focusing on Title I related to EGCs. The SEC staff noted that although the JOBS Act was effective on enactment, there have not yet been corresponding updates to existing SEC rules or SEC staff guidance. The SEC staff reminded issuers that the financial reporting relief included in Title I is currently available to qualified EGCs.

The SEC staff gave an overview of the EGC eligibility and disqualification criteria along with the SEC staff's interpretive FAQs.<sup>1</sup>

The SEC staff indicated that it is considering implementation questions for the accounting standards transition relief for EGCs. Those questions include how an EGC will shift to public company transition dates after it loses EGC status or after its irrevocable election to follow public company transition dates.

#### Loss of EGC status

The SEC staff has received a number of questions about the loss of EGC status and the transition to non-EGC status. On the timing of transition and the related reporting requirements, the SEC staff noted that if a calendar-year EGC loses its status on or before 31 December 2012, the registrant would be required to file its 2012 Form 10-K as a non-EGC. In this example, the EGC relief provisions would not apply to the registrant's 2012 Form 10-K. That means the registrant would have to comply with Section 404(b) auditor attestation requirements of the Sarbanes-Oxley Act unless it is a non-accelerated filer.<sup>3</sup>

#### Ernst & Young resources

► Technical Line, Implementing the JOBS Act (SCORE No. CC0363)

A company that loses EGC status must comply with Section 404(b) for the fiscal year that status is lost.

#### **Ernst & Young resources**

- Financial Reporting Developments,
   Business combinations
   (SCORE No. BB1616)
- Financial Reporting Developments, Consolidated and other financial statements: Noncontrolling interests, combined financial statements, and parent company financial statements (SCORE No. BB1577)

#### Current practice issues panel

Partners from several of the large accounting firms discussed current practice issues involving revenue recognition, contingent consideration for the sale of a business, consolidation of LLCs, accounting issues in the Eurozone and restatement trends. An SEC staff member from OCA also provided her perspectives on each issue.

Highlights included:

#### Gross versus net revenue recognition

Gross versus net revenue recognition considerations (Accounting Standards Codification (ASC) 605-45) continue to be a hot accounting issue, particularly for service companies and resellers of software and hardware. This discussion focused on the subjectivity of the analysis, including the evaluation of the two "strong" indicators of gross reporting – primary obligor and general inventory risk. Generally speaking, gross reporting is appropriate only when at least one of the two strong indicators is present. The SEC staff indicated it also continues to receive questions on this topic. When evaluating such arrangements, the SEC staff generally evaluates the arrangement and each of the indicators from the customer's perspective.

#### Seller accounting for contingent consideration

In certain circumstances, transfers of controlling interests in a business may involve the seller receiving contingent consideration. This discussion focused on the seller's accounting for contingent consideration that does not qualify as a derivative. Initial and subsequent recognition and measurement for seller's contingent consideration was discussed as part of EITF 09-4, *Seller Accounting for Contingent Consideration*; however, a final consensus was not reached. In that discussion, the EITF expressed views on two models for the initial recognition of the contingent consideration:

- Fair value model based on ASC 810-10-40-5
- A gain contingency model based on ASC 450 that generally results in no initial recognition

During the EITF discussion, the FASB staff observed that reasonable interpretations appear to exist to support both views. At the Conference, the SEC staff noted there are conceptual merits to both alternatives. Nonetheless, the SEC staff recommended preparers consider the needs of their financial statement users when evaluating which alternative is more appropriate in their circumstances. The SEC staff observed that "some evidence" suggests some users prefer fair value.

Similar to the initial recognition discussion, the SEC staff urged preparers to consider the needs of users of their financial statements in their subsequent accounting for contingent consideration.

#### How we see it

We believe the basis for recognition and measurement of contingent consideration by the seller is an accounting policy choice that should be applied on a consistent basis. Given that the EITF considered this matter and did not arrive at a consensus, we believe that significant diversity exists in practice. Companies should carefully consider the accounting for these transactions, particularly when there are both fixed and contingent components. In those instances, entities should consider preclearing the accounting with the Office of the Chief Accountant.

#### **Ernst & Young resources**

- ► SEC Comments and Trends, An analysis of current reporting issues (SCORE No. CC0357)
- ➤ 2012 SEC annual reports Form 10-K (SCORE No. CC0360)
- Compendium of significant accounting and reporting issues,
   2011 AICPA National Conference on Current SEC and PCAOB Developments (SCORE No. CC0341)

#### SEC staff focus areas

The SEC staff from the Division of Corporation Finance discussed the areas it commonly focuses on during the filing review process. The topics discussed included:

#### Guarantor financial information

The SEC staff shared some observations related to the application of Rule 3-10 of Regulation S-X (Rule 3-10). Rule 3-10 allows for condensed consolidating financial information or, in certain instances, disclosure only in the parent company's financial statements in lieu of separate financial statements for each subsidiary issuer and guarantor of registered debt.

#### 100% ownership

The conditions in Rule 3-10 require that an issuer or guarantor subsidiary be 100% owned. The SEC staff reminded registrants that this ownership requirement differs from "wholly owned," which is based on owning substantially all the shares rather than 100%. Specifically, the SEC staff stated that disclosure in the footnotes to the financial statements should assert that subsidiary issuers and guarantors are 100% owned in order to apply the Rule 3-10 relief.

#### Full and unconditional

The SEC staff also noted that guarantees must be full and unconditional to qualify for Rule 3-10 relief. This condition was discussed from both a subsidiary and parent guarantor perspective. At last year's conference, the SEC staff provided its views on customary release provisions pertaining to subsidiary guarantees and updated the Financial Reporting Manual<sup>4</sup> to clarify that the SEC staff would not object if registrants present condensed consolidating financial information when these provisions exist.

In its remarks, the SEC staff said guarantees with customary release provisions should not be described as full and unconditional without also providing disclosures describing the circumstances when the subsidiary guarantor may be released. If subsidiary release provisions are not customary in nature, the subsidiary may not qualify for Rule 3-10 relief. The SEC staff encouraged registrants to consult with the Office of Chief Counsel within the Division of Corporation Finance if they have questions about the nature of guarantee release provisions and their qualification for Rule 3-10 relief.

The SEC staff also reminded registrants that when there are customary release provisions, Rule 3-10 relief applies only to subsidiaries guaranteeing parent debt and doesn't apply when the parent is a guarantor. The SEC staff noted that parent guarantee release provisions would not qualify for relief under Rule 3-10 because the relief for subsidiary issuers is premised on the ability of debt holders to rely on the guarantee of the parent throughout the term of the debt. However, the SEC staff indicated that in limited situations Rule 3-10 relief may be available when parent guarantee release provisions exist, such as a provision releasing the parent when the guaranteed debt is extinguished. The SEC staff again encouraged registrants to consult with the Office of Chief Counsel in the Division of Corporation Finance when parent release provisions exist and the registrant still intends to apply the relief in Rule 3-10.

#### Significant acquired guarantor subsidiaries

The SEC staff also spoke about requirements to present financial information for recently acquired subsidiary guarantors, which require separate pre-acquisition financial statements of the acquired subsidiary guarantor in a 1933 Securities Act registration statement when the acquired subsidiary is significant and has been included in the consolidated annual financial statements for less than nine months.

The SEC staff reminded registrants that the significance test in S-X Rule 3-10(g) may have different reporting implications than S-X Rule 3-05 (and the related tests of significance under S-X Rule 1-02(w)) because Rule 3-10(g) significance is measured relative to the principal of debt issued, not to the acquiring registrant.

Additionally, if a registrant is presenting separate financial statements of an acquired business under Rule 3-05 of Regulation S-X and only certain of the acquired subsidiaries will be guaranteeing the debt being registered, it may be able to satisfy the Rule 3-10(g) requirements by presenting a condensed consolidating schedule for the most recent year in any Rule 3-05 financial statements rather than presenting additional separate or combined financial statements of the acquired guarantors.

#### Form and content reminders

The SEC staff reminded registrants that the form and content of condensed consolidating financial information should follow the general guidance for interim financial statements in Article 10 of Regulation S-X. The level of detail should be consistent with what a registrant might include in its interim financial statements on Form 10-Q (i.e., all major captions on the face of the financial statements).

The SEC staff also reminded registrants that the individual columns in the condensed consolidating financial information need to be in accordance with GAAP. For example, intercompany receivables or liabilities should be classified as current or long-term assets or liabilities, not as liabilities with debit balances or assets with credit balances. Proper classification in the condensed consolidating statements of cash flows also was mentioned as an area where the SEC staff has identified errors.

#### How we see it

Given that condensed consolidating financial information is presented in lieu of separate reporting by the subsidiary guarantors and issuers, the SEC staff may be more likely to insist on amendments to correct errors than it would for errors in other notes to the financial statements.

#### Pro forma adjustments

In accordance with Article 11 of Regulation S-X, adjustments in the pro forma income statement must have a continuing impact on the registrant. At last year's conference, the SEC staff communicated its view that an item would need to affect the results of operations for a period greater than 12 months to be considered to have a continuing impact.

The SEC staff has recently evaluated certain adjustments that may not satisfy the 12-month standard (e.g., interest expense for a bridge loan that may be incurred for a period of less than 12 months). The SEC staff said it is still evaluating these fact patterns and may consider additional guidance in the future. In the meantime, the SEC staff is willing to discuss any fact patterns with registrants struggling with this issue.

Individual columns within S-X Rule 3-10 condensed consolidating financial information should be presented in accordance with GAAP.

#### How we see it

The remarks on the continuing impact aspect of a pro forma adjustment appear to signal a shift in direction from what was communicated to the Center for Audit Quality (CAQ) SEC Regulations Committee in June 2012, namely, that anything more than one-time would be considered to have a continuing impact. Given these remarks, registrants should consider discussing with the SEC staff whether a particular adjustment with a duration of less than 12 months would be appropriate.

Results of operations disclosures in MD&A should explain not only what, but why significant changes occurred.

#### MD&A disclosures

Results of operations

MD&A continues to be the SEC staff's most frequent area of comment, and discussion of the results of operations is the most common area of comment within MD&A. Due to the volume of comments issued, the SEC staff outlined its expectations for the results of operations disclosures in MD&A.

The SEC staff warned registrants not to use boilerplate language or provide a discussion of information that is readily apparent on the face of the financial statements. Disclosures of results of operations should quantify and discuss the underlying factors that led to changes in financial statement line items. Registrants should disclose not only *what*, but *why* significant changes occurred. This enhanced disclosure is achieved by identifying and describing the factors that caused changes in the financial statements as well as quantifying their effects if known.

For example, a registrant's sales may have increased partially due to volume increases, but the registrant also should disclose the reason for the volume increases and the related financial statement effect. Registrants also should consider disclosing whether the debt crisis in Europe has had a material effect on results of operations with respect to (1) segment sales, (2) margins and (3) significant customers and suppliers.

Additional factors that may help explain why changes occurred and therefore may be appropriate to disclose include:

- Acquisitions during the reporting period
- Pricing changes
- Volume changes and the reasons for such changes
- New contracts with customers or suppliers
- Inflation
- Foreign exchange rates

The SEC staff also said that even though changes in certain financial statement line items may not be material due to offsetting factors, if offsetting variances are material, they should be disclosed along with their causes.

Segment-level disclosures of results of operations may be necessary to supplement the consolidated company disclosures and to provide clarity about disaggregated revenues and expenses, as required by Regulation S-K. For example, if a significant portion of the change in consolidated sales or margins is caused by one segment, the registrant should quantify these amounts and provide the reasons why such changes occurred. The SEC staff emphasized disclosures need not be repetitive, so segment information may be integrated into the consolidated analysis in MD&A, if appropriate.

Registrants also should consider discussing key metrics that are used by management in evaluating results of operations. For example, retail companies use metrics such as same-store sales and store openings and closings to assess results of operations. Social networking and online gaming companies typically use average monthly or daily users. A registrant should provide disclosure about how those metrics are calculated because some companies may calculate a commonly cited metric differently from others. Additionally, the discussion of these metrics should explain how they link to the financial statements. For example, average monthly users may be used to illustrate revenue per average user and to help explain a change in sales.

The SEC staff has indicated that obligations with fixed and determinable amounts should be included in the contractual obligations table.

#### Contractual obligations

The SEC staff noted that the contractual obligations table instructions allow for flexibility in presentation. The SEC staff said that if uncertainties exist about the amounts and future timing of certain contractual obligations (e.g., variable interest payments, unrecognized tax benefits, expected payments or contributions to benefit plans), a registrant may include those items within the table and disclose its assumptions about amounts and timing in an explanatory footnote to the table. Alternatively, the SEC staff would not object to a registrant disclosing uncertain items only in a footnote to the table. The footnotes also should be used to disclose which obligations are and are not included in the table. Although the SEC staff didn't discuss this at the Conference, SEC staff members have previously said that contractual obligations with fixed and determinable amounts should be included in the contractual obligations table instead of in a footnote.

#### Non-GAAP financial measures

The SEC staff discussed recent focus areas related to non-GAAP financial measures. The SEC staff reminded registrants that it is not acceptable to present full non-GAAP income statements for the purposes of reconciling non-GAAP measures to the most directly comparable GAAP measure because it gives undue prominence to non-GAAP information. This view applies to earnings releases furnished on Form 8-K (which is where many of the recent SEC comments have been focused) as well as other filings with the SEC.

The SEC staff also expressed concerns over the use of non-GAAP measures that reflect adjustments for pension and other items related to post-employment benefits. The SEC staff is concerned that such measures could confuse investors and reminded registrants to clearly disclose what the adjustments represent (e.g., an adjustment to remove the amortization of actuarial gains and losses). The SEC staff noted measures labeled "non-cash pension expense" might be confusing because typically, pension liabilities are ultimately settled in cash. Further, the SEC staff noted that if a non-GAAP measure adjusts for actuarial gains and losses, registrants should include quantitative disclosures regarding actual and expected asset returns.

#### Cybersecurity

The SEC staff noted that with the increased reliance on digital technologies to conduct business, there has been an increased focus on how cybersecurity risks and their related effects on operations should be disclosed.

The SEC staff said that it may issue comments questioning registrants about their cybersecurity disclosures when it identifies information outside a registrant's filings about a cybersecurity event. The SEC staff said that it will question a registrant's risk factor disclosures when the registrant has implied in its disclosures that it might experience a cyber attack, but other information suggests that a cyber attack has already taken place. In these situations, the SEC staff expects registrants to acknowledge that they have experienced cyber attacks.

The SEC staff reminded registrants that they also should consider the potential effect of cyber incidents on their conclusions about disclosure controls and procedures, particularly if it is reasonably possible that information may not be properly recorded due to a cyber incident.

#### Variable interest entities (VIEs)

The SEC staff has been focusing on disclosures related to consolidated VIEs, particularly when the registrant has substantially all of its operations in foreign jurisdictions that prohibit direct foreign ownership in certain industries. The SEC staff expects registrants to avoid boilerplate disclosures of the facts and circumstances evaluated to determine the primary beneficiary. The SEC staff emphasized that a list of contracts between a VIE and the registrant does not provide sufficient insight into the methodology the registrant used to make determinations using the VIE consolidation model. Instead, registrants should discuss the terms of the contracts, such as duration, mutual consent provisions and revocability clauses, and provide an analysis of how those terms convey power and benefits. In providing the disclosures, registrants should consider any provisions that might limit their ability to exercise power, such as conflicts of interest or other relationships. Those details help the users of the financial statements understand the judgments made by the registrant that lead to consolidation.

The SEC staff indicated that it has issued many comments when MD&A disclosures do not adequately address material VIE operations. The SEC staff said MD&A should include information on the registrant's financial position, performance and cash flows that are separate from the VIE. This disclosure will help investors better understand the effect deconsolidation could have on the registrant. Lastly, the SEC staff said that when material service fees included in contracts with a VIE (that transfer economics) are not being settled, this fact and the amounts should be disclosed in MD&A to provide investors with a better understanding of how economics are "flowing or not flowing" to the registrant.

#### Segment reporting

The SEC staff reiterated its focus on segment disclosures and highlighted two areas of frequent comment: identification of operating segments and aggregation of operating segments into reportable segments.

The SEC staff acknowledged that identifying operating segments and determining their aggregation into reportable segments requires significant judgment. Therefore, the SEC staff indicated that when either of these judgments is

questioned in a comment letter, registrants should tell their "complete story." In explaining the identification of operating segments, registrants should analyze how the chief operating decision maker makes resource allocation decisions and assesses performance. Registrants also should provide sufficient analysis of how they applied the accounting guidance in ASC 280 to determine aggregation of operating segments as well as how any outliers or unusual circumstances in a particular period affected their conclusion.

The SEC staff also indicated that a registrant should continually monitor changes in facts and circumstances that could cause a change in segment reporting conclusions. For example, a change in a registrant's internal reporting due to a significant acquisition could affect the composition of its operating segments. Additionally, if a number of operating segments are aggregated based on the similarity of their economic characteristics and those characteristics change over time, a registrant should consider what effect such change has on its conclusions about segment reporting.

Registrants should disclose the "full story" about why an impairment charge was taken in a

specific period.

#### Goodwill impairment

The SEC staff reminded registrants of its continued focus on goodwill impairment disclosures. The SEC staff may challenge the timing of a goodwill impairment charge, particularly when the reasons for the charge existed in prior periods. The SEC staff emphasized that registrants should disclose the "full story" about why an impairment charge was taken in a specific period.

The SEC staff also said that it may ask for supplemental information about how assets and liabilities are allocated to reporting units in the goodwill impairment test. In particular, the SEC staff recently has seen an allocation methodology used in certain regulated industries in which shareholders' equity is allocated to reporting units and that allocation is used as a proxy for the carrying amount. The SEC staff noted that, when it comments on such an allocation, it wants to understand why it is an appropriate proxy for the carrying amount of the assets and liabilities of a reporting unit. In assessing this approach, the SEC staff said that it would focus on understanding any unallocated balances.

In addition, the SEC staff also reminded registrants that if an interim impairment test is performed, the results of the test should be disclosed, regardless of whether an impairment charge was taken. The registrant also should include details about the facts and circumstances that drove the need to perform the interim goodwill impairment test.

#### Income taxes

The SEC staff noted that registrants should continually assess the negative and positive evidence in determining whether to record, maintain or reverse a valuation allowance. When determining the weight to place on each piece of evidence, registrants should consider how objectively verifiable the evidence is.

The SEC staff outlined the following points that registrants should consider to evaluate and weigh positive and negative evidence when assessing the realizability of deferred tax assets:

What were the magnitude and duration of past losses, and what are the expected magnitude and duration of current profitability?

- What factors caused losses in prior periods, and what is causing current profitability?
- How accurate were forecasts of income (loss) in prior periods relative to actual income (losses)?
- Has the registrant had significant changes in its business that would affect the accuracy of its projections?

In assessing the relative weight of positive evidence, specifically forecasted income, registrants should consider the extent to which actual results have deviated from forecasted results. When significant deviations exist, projections of future income may be less objectively verifiable. As a result, forecasted income may be given a lower weighting in consideration of all evidence.

Registrants also should determine that projections used as positive evidence are consistent with other assumptions used elsewhere in the financial statements, such as for impairment assessments.

When a registrant decides to reverse a valuation allowance, the SEC staff indicated that it would expect disclosures explaining what occurred in the current reporting period that made the reversal appropriate at that point in time. Registrants also should disclose the positive and negative evidence and the weighting given in reaching their conclusions.

The SEC staff reminded registrants that the existence of cumulative losses in recent years is not conclusive evidence with respect to the realizability of deferred tax assets. US GAAP contemplates situations in which a registrant has sufficient objectively verifiable positive evidence to overcome the negative evidence of cumulative losses.

For example, objectively verifiable positive evidence may be that the factors that caused recent losses will not recur in the future. In addition to the absence of these factors in future periods, a registrant must demonstrate a strong earnings history, exclusive of the factors that caused the loss, and that the loss is not a continuing condition. However, the SEC staff stated that overcoming the negative evidence of cumulative losses will likely be challenging because of the need for objectively verifiable positive evidence.

#### Loss contingencies

The SEC staff noted that it has seen improvement in the accounting and disclosure of loss contingencies. However, the SEC staff reminded registrants that it continues to focus on certain areas related to loss contingencies, primarily related to the disclosure of the reasonably possible range of loss, including when there is a reasonable possibility of a loss in excess of the amount accrued.

The SEC staff also acknowledged that the recognition and disclosure of contingencies require judgment; therefore, it is important that registrants "tell their whole story" in their disclosures and in any comment letter responses relating to loss contingencies. This information will help the SEC staff understand the decisions the registrant made when applying ASC 450. Registrants also were reminded that disclosures related to loss contingencies should evolve over time as the contingency progresses. Even if a filling has been cleared in one period, the SEC staff still may comment on loss

The SEC staff is focused on the level of objectively verifiable positive evidence used to support reversing a valuation allowance.

Loss contingency disclosures should evolve over time as the contingency progresses. contingency disclosures in a future period if subsequent changes or developments are noted and the related disclosures do not appear to have been updated in a timely manner.

Further, the SEC staff said the fact that the FASB removed the loss contingency project from its standard-setting agenda has not affected how the SEC staff treats loss contingency disclosures in its reviews. The SEC staff's focus, as always, continues to be enforcing compliance with the existing standard on loss contingencies (ASC 450).

#### Revenue recognition

In light of the current economic environment, the SEC staff noted that it has begun issuing comments to certain registrants related to the collectibility criterion for revenue recognition. The registrants that have received those comments generally share common characteristics, including the fact that they sell products to resellers, have significant days sales outstanding and high gross margins.

The SEC staff noted that determining whether collectibility can be reasonably assured, as required by SAB Topic 13, depends on facts and circumstances. To help determine whether the collectibility criterion has been met, the SEC staff suggested that registrants consider customer creditworthiness and payment terms, as well as additional factors such as historic collection practices, accounts receivable aging trends and collection and write-off history. The SEC staff also reminded registrants that until collectibility can be reasonably assured, revenue must be deferred. In some instances, the deferral may extend until cash is actually collected.

#### Multiple-element considerations

The SEC staff suggested registrants consider improvements to their disclosures for multiple-element arrangements in the following areas:

- Overall disclosure Provide a complete description of rights and obligations,
   separate from the discussion of the accounting for those rights and obligations
- Disclosure of significant deliverables Disclose the judgments made in concluding whether a deliverable is or is not a separate unit of accounting, and, if a deliverable is deemed to be perfunctory, disclose the reasons supporting this conclusion
- Disclosure of relative selling price Provide an analysis of how total arrangement consideration was allocated to each unit of accounting, explaining how the estimated selling price for each unit of accounting was determined and any significant assumptions used in this determination
- Disclosure of recognition Provide a discussion of the timing and pattern of recognition for each unit of accounting

#### How we see it

Although these observations were provided by the SEC staff in the context of the biotechnology and pharmaceutical industries, we expect the SEC staff to be looking for similar disclosures for all multiple-element revenue transactions. The SEC staff also discussed disclosures pertaining to the milestone method of accounting for research and development arrangements. The SEC staff noted that registrants should separately quantify and describe individually significant milestones and may aggregate only insignificant milestones.

#### SEC staff industry considerations

The SEC staff highlighted certain areas of frequent comment for certain industry sectors, including the technology, banking and insurance industries.

#### Technology

With the increasing market for virtual goods most often sold by companies that operate gaming or social network sites, the SEC staff clarified expectations on the accounting and disclosure for these transactions. The SEC staff highlighted the view that the sale of a virtual good represents a service, not the sale of an actual good. In reviewing disclosures for these arrangements, the SEC staff said it is looking for enhanced disclosures that include the time period over which a registrant is recognizing revenue from the sale of a virtual good, the means by which customers are acquiring these goods (e.g., virtual currency) and the methodology for measuring revenue. If the arrangements include processing fees and refund provisions, the SEC staff is looking for greater transparency into the accounting consideration given to those terms.

#### Banking

The SEC staff has observed diversity in how registrants define "indirect exposure" as it relates to European sovereign debt exposures as discussed in CF Disclosure Guidance: Topic No. 4, European Sovereign Debt Exposures. The SEC staff expects a registrant to disclose its definition of "indirect exposure." Also, when the registrant's disclosures indicate possible indirect exposures, the SEC staff said it wants to understand how the registrant evaluated this exposure and how it managed the related risk. The SEC staff also highlighted its release of CF Disclosure Guidance: Topic No. 5, Staff Observations Regarding Disclosures of Smaller Financial Institutions, and reminded registrants that those observations generally apply to all financial institutions, regardless of size.

The SEC staff also provided comments on three other prevalent banking issues: allowance for loan losses, reserve releases and fair value disclosures. The SEC staff said it frequently reminds registrants to expand their disclosures about the context in which management develops its quantitative and qualitative allowance assumptions. If there are any changes to the allowance, they should be disclosed in the financial statement notes and discussed in MD&A, which should explain why those changes are consistent with changes in asset quality. Registrants also should discuss the quantitative effect of significant reserve releases and why those releases are appropriate given trends in their asset-quality metrics. Lastly, the SEC staff discussed fair value disclosures in light of the new requirements in ASU 2011-04. On this topic, the SEC staff identified three areas for improved disclosure:

Wide range of significant inputs – Consider including a weighted average to enhance the reader's ability to understand the context of the range and how it affects the fair value measurement, or qualitative information about the distribution within the range, including which instruments are driving the range and where significant inputs for each instrument are in the range (low versus high end)

The SEC staff highlighted that the sale of a virtual good represents a service, not the sale of an actual good.

- Multiple valuation techniques When a particular asset class is valued using multiple techniques, identify and quantify the portion of the population valued using each valuation method
- Sensitivity analysis Provide more detailed qualitative information about the sensitivity analysis, including identifying the specific inputs changed in the analysis and the specific directional effect on estimated fair value as a result of each change

#### Insurance

Insurance companies must issue financial statements prepared on a statutory basis, and ASC 944-505 and Article 7 of Regulation S-X require disclosure of certain statutory information in the notes to the GAAP financial statements. The SEC staff said it is inappropriate to label the information required by GAAP or Regulation S-X that is taken from the statutory financial statements as "unaudited, preliminary or subject to revision." The SEC staff said GAAP requires disclosures about statutory accounting amounts and completion of GAAP financial statements should not depend on the finalization of statutory financial statements. The SEC staff also discussed that a number of companies were not disclosing statutory capital and surplus as required or saying only that they met regulatory requirements. The SEC staff said registrants should disclose the amounts to allow the reader to quantitatively assess the surplus available relative to the regulatory requirement. The SEC staff also frequently comments on dividend restriction disclosures required under Rule 4-08(e) of Regulation S-X. The nature and amounts of these restrictions should be addressed separately at both the parent and subsidiary level in addition to addressing the related liquidity implications in MD&A.

#### Auditor reporting matters

The SEC staff highlighted certain reporting matters involving a registrant's auditor.

#### Risk factor when auditors are in jurisdictions not subject to PCAOB inspection

Certain foreign jurisdictions do not allow the PCAOB access to inspect the audits and quality control procedures of their registered audit firms. When the principal audit firm is located in a country or jurisdiction in which the PCAOB is not allowed to perform inspections, the SEC staff expects registrants to disclose this fact under a separate risk factor heading. Registrants should explain that the inability to inspect prevents the PCAOB from regularly evaluating the auditor's audits and its quality control procedures. The SEC staff expects registrants to disclose that US investors that rely on the auditors' report are deprived of the benefits of PCAOB inspections of the auditors.

#### How we see it

The SEC staff remarks focused solely on principal auditors. However, given the continued concerns about the PCAOB's inability to inspect in certain jurisdictions, this disclosure eventually could extend to companies with substantial foreign operations and whose principal auditors use the work of their global network firm members in countries that are not yet subject to PCAOB inspection.

#### Referencing the standards of the PCAOB

An auditor, in connection with audit engagements performed for issuers (or any non-issuers whose audit report is relied upon by the principal auditor of an issuer) in accordance with the auditing and related professional practice standards of the PCAOB, is required to refer to the "standards of the Public Company Accounting Oversight Board (United States)" in the auditor's report. The SEC staff noted that it has seen reports inappropriately reference only the auditing standards of the PCAOB, which incorrectly may imply that the auditor did not adhere to the PCAOB's related professional practice standards in conducting the audit (e.g., independence standards). The SEC staff noted that this limiting language would generally be allowable for audits of financial statements of non-issuers (e.g., Rule 3-05 financial statements of a significant acquired business, Rule 3-09 financial statements of a significant investee where the other auditor's report is not being referred to by the principal auditor).

The SEC staff noted that the CAQ issued an alert on this matter on 9 November 2012.<sup>7</sup>

#### Foreign private issuers and IFRS considerations

Craig Olinger, Acting Chief Accountant of the SEC's Division of Corporation Finance, briefly highlighted the increasing number of foreign private issuers (FPIs) that are preparing their financial statements in accordance with IFRS. He noted that approximately 200 FPIs prepared their financial statements in accordance with IFRS in 2011, and he expects this number to increase to approximately 500 by the end of 2012. This increase is primarily due to countries such as Canada and South Korea converting to IFRS and early adopters of IFRS in Argentina and Mexico. As a result of this increase, the SEC staff now is reviewing IFRS financial statements from a broader range of registrants, including from the telecommunications, financial services, health care and natural resources industries.

#### Confidential draft submissions

Under the JOBS Act, an EGC whose common equity securities have not been previously sold pursuant to an effective registration statement under the Securities Act of 1933 may submit to the SEC a draft registration statement for confidential nonpublic review. As a result, there are now two types of confidential draft submission processes available to foreign private issuers – one for dual-listed companies and one for EGCs. Mr. Olinger noted that while the two processes are similar, there are some slight differences, and registrants should refer to the SEC's website or contact the Office of International Corporation Finance in the Division of Corporation Finance for further guidance.

#### Review of IFRS filers

The SEC staff reiterated that the financial statements of all SEC registrants are subject to the same level of review, regardless of whether they are prepared in accordance with US GAAP, IFRS or home-country GAAP. As a result of its review process, the SEC staff identified several common themes in comment letters issued on IFRS financial statements that generally are consistent with the prior year and with the themes in comment letters issued to US GAAP filers. These themes include the following:

Financial instruments – The SEC staff said that this is the most frequently addressed area of comment for IFRS filers, particularly for recognition, measurement and disclosure matters. Comments generally relate to registrants in the financial services industry, including how loan portfolios are evaluated for impairment.

- Financial statement presentation The SEC staff continues to see variations in what is included or excluded from measures on the face of the income statement across all industries. The SEC staff reminded registrants to provide disclosures about the nature of expenses and accounting policies that require significant judgment or involve significant estimation uncertainty. Other comments related to the nature and terms of items classified as cash equivalents.
- Provisions and contingent liabilities The SEC staff said this is an area with an increasing number of comments across all industries. The SEC staff has been asking registrants to provide more granular disclosure about the uncertainties and risks related to their contingencies (e.g., the expected amount and timing of outflows of economic benefits) as well as the composition of provision classes.
- Impairment of assets The SEC staff comments include how cash-generating units are grouped, the use of post-tax discount rates and the level at which management monitors goodwill internally for impairment. The SEC staff also has frequently requested MD&A disclosure about cash-generating units with a high risk of impairment.
- Consolidation, associates and joint ventures The SEC staff continues to request clarification about the facts and circumstances that led a registrant to conclude that it controls an entity and to provide disclosures required by IAS 27, Separate Financial Statements, about the nature and terms of its relationships with subsidiaries including any restrictions.
- Revenue recognition The SEC staff comments have focused on gaining a better understanding of a registrant's types of revenue transactions and how it applied the criteria under IAS 18, Revenue, to each of those transactions. The SEC staff also has asked registrants to clarify or expand disclosure about their revenue recognition policy, particularly when they have revenue transactions with multiple elements.
- Operating segments The SEC staff continues to inquire about how operating segments were determined and how the aggregation tests were applied. The SEC staff also asked registrants to include or expand IFRS 8, Operating Segments, disclosures, particularly the entity-wide disclosures about products and services.
- Income taxes The SEC staff asked registrants to explain the nature of items disclosed within the rate reconciliation. The SEC staff also asked registrants to provide disclosures about deferred tax assets that were not recognized and whether those unrecognized deferred tax assets were evaluated at the end of the year.
- Business combinations The SEC staff requested that registrants provide additional information or clarification about purchase price allocations and to add or expand disclosures about the nature and financial effect of a particular business combination.
- First-time adoption of IFRS The SEC staff asked registrants to disclose whether any mandatory exceptions, or how optional exemptions, were applied under IFRS 1, First-time adoption of IFRS, which is a requirement in Form 20-F. The SEC staff also asked for additional disclosure when the IFRS 1 reconciliation was presented without sufficient detail about the individual reconciling items.

#### First-time adoption of IFRS

The SEC staff has been monitoring disclosures and compliance with SEC reporting requirements when registrants adopt IFRS for the first time. The SEC staff said that overall, registrants complied with the required disclosures and reporting requirements but highlighted some common practice issues. For example, under Form 20-F, an FPI is eligible to omit the reconciliation to US GAAP only if it states unreservedly and explicitly in an appropriate note to the financial statements that its financial statements are prepared in accordance with IFRS as issued by the IASB. Also, the independent auditor must opine in its report that the financial statements comply with IFRS as issued by the IASB. The SEC staff noted that in some cases the compliance statement was improperly excluded from the notes or audit report.

The SEC staff also commented that some auditors of foreign private issuers reporting under IFRS improperly included a conditional statement of substantial doubt in the PCAOB audit report when going concern uncertainties existed. Other registrants presented selected financial data tables with side-by-side comparisons of their previous GAAP and IFRS information. Form 20-F instead requires the IFRS information to be disclosed separately from previous GAAP information and not side by side. Similarly, some registrants provided MD&A discussions that compared IFRS financial information to previous GAAP, which is not permitted on Form 20-F.

The SEC staff also observed a practice issue resulting from recent amendments to IFRS 1. As amended, IFRS 1 now permits registrants that may have previously adopted IFRS but did not report under IFRS in the most recent year to qualify as "first-time adopters" and reapply IFRS 1. This change to IFRS creates an inconsistency with the definition used in Form 20-F that provides first-time adopters with certain accommodations. The SEC staff encouraged registrants that are reapplying IFRS 1 to preclear whether the use of the Form 20-F accommodations for first-time adopters would be appropriate in their particular facts and circumstances.

#### Iran Threat Reduction and Syria Human Rights Act of 2012

The SEC staff noted that registrants have been seeking guidance on how to comply with the Iran Threat Reduction and Syria Human Rights Act of 2012 (Act), which was effective on 10 August 2012. The SEC staff clarified that disclosure is required in periodic reports with filing due dates after 6 February 2013, even if the registrant files the report before that date, for any activities specified in the Act during the period covered by the report (e.g., 1 January 2012 through 31 December 2012 for a calendar-year Form 10-K). If neither the registrant nor its affiliates have engaged in any of the specified activities, no disclosure is required. The interpretations discussed by the SEC staff were contained in the Division's Compliance and Disclosure Interpretations (C&DIs)<sup>8</sup> issued later that day.

The disclosure requirement covers specified activities by the registrant and its affiliates. Registrants will be required to disclose (1) the type and extent of activities engaged in by the registrant and its affiliates, (2) gross revenues and net profits generated from the activities and (3) whether the registrant intends to continue the activity. In its C&DIs, the SEC staff clarified that the term "affiliate" includes any person that directly or indirectly controls, is controlled by or is under common control with, the registrant. Accordingly, the scope of the required disclosures can include people and entities that are not consolidated within the registrant's financial statements.

#### Communications with the SEC staff

The SEC staff provided registrants with a brief overview of the process it uses when it sends comment letters via electronic mail. For periodic reports, the SEC staff will call the registrant's principal financial officer or principal executive officer to obtain the appropriate email address. Once the comment letter has been emailed to the registrant, the registrant is responsible for further distribution of the letter (e.g., to legal counsel and auditors).

For publicly filed registration statements, when it is clear that the registrant is being represented by legal counsel, the SEC staff will call legal counsel or the registrant to obtain the appropriate email address and will then email the letter to either counsel or the registrant.

With respect to confidential registration statement submissions under the JOBS Act, the SEC staff will only call legal counsel to obtain the appropriate email address. The SEC staff noted that it contacts legal counsel in these cases to help preserve confidentiality, as the SEC staff may not know who at the registrant is aware of the submission.

In corresponding with the SEC staff during the comment letter process, registrants should file response letters on EDGAR and not email the SEC staff about extension requests or questions, nor should they email anything for which they are requesting confidential treatment.

The SEC staff also noted that its responses to requests for confidential treatment and waivers will not be emailed. Those responses will be sent to registrants via US mail or facsimile, even though waiver requests from registrants should be emailed to the SEC staff at dcaoletters@sec.gov.

Further, the SEC staff provided the following information as a resource to help registrants determine, based on the purpose of their communication, whom they should contact at the SEC and by what means:

Purpose of communication	Contact
Comment process	<ul> <li>Disclosure Operations staff listed in comment letter</li> </ul>
Staff interpretation or informal question	Financial Reporting - CF Office of Chief Accountant at (202) 551-3400
	<ul> <li>Small Business Policy – CF Office of Small Business Policy at (202) 551-3460</li> </ul>
	Submit requests through online form at: https://tts.sec.gov/cgi-bin/corp_fin_interpretive
Formal requests about financial reporting	► dcaoletters@sec.gov
Formal consultations on the application of GAAP	► OCA@sec.gov

#### Center for Audit Quality update

Cindy Fornelli, Director of the CAQ, provided an update on the CAQ's efforts to facilitate the communication of audit-related matters to management, audit committees and other stakeholders through various resources created by the CAQ, including:

- Audit Committee Annual Evaluation of the External Auditor,<sup>9</sup> developed by the CAQ and a number of organizations, is a questionnaire that can be used by audit committees to review auditor performance and assist with audit firm retention decisions.
- Discussion with Audit Committees About Inspection Findings and Quality Control Matters<sup>10</sup> is a practice aid that can promote communication between an audit committee and its independent audit firm about the firm's internal quality control system, including information about the nature and effect of internal and PCAOB inspection results.
- CAQ Guide to PCAOB Inspections<sup>11</sup> provides investors and capital market stakeholders with a straightforward outline of the PCAOB inspections program.

#### **Endnotes:**

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<sup>&</sup>lt;sup>1</sup> The JOBS Act FAQs are available at http://www.sec.gov./spotlight/jobs-act.shtml.

After release of the SEC staff's Final Report on its Work Plan on IFRS in July 2012, the trustees of the IFRS Foundation published a staff analysis of the SEC staff's report. The IFRS Foundation's Report to the Trustees of the IFRS Foundation was cited by Mr. Hoogervorst and is available through the following website: http://www.ifrs.org/Alerts/PressRelease/Pages/IFRS-Foundation-Staff-Analysis-of-SEC-Final-Staff-Report-on-IFRS.aspx.

Non-accelerated filers are not subject to Section 404(b) auditor attestation requirements.

The Division of Corporation Finance's Financial Reporting Manual is available at http://www.sec.gov/divisions/corpfin/cffinancialreportingmanual.shtml.

<sup>&</sup>lt;sup>5</sup> CF Disclosure Guidance: Topic No. 4, *European Sovereign Debt Exposures*, is available at http://www.sec.gov/divisions/corpfin/guidance/cfguidance-topic4.htm.

<sup>6</sup> CF Disclosure Guidance: Topic No. 5, Staff Observations Regarding Disclosures of Smaller Financial Institutions, is available at http://www.sec.gov/divisions/corpfin/quidance/cfquidance-topic5.htm.

The CAQ alert is available at http://www.aicpa.org/InterestAreas/CenterForAuditQuality/ NewsAndPublications/CAQAlerts/2012/DownloadableDocuments/CAQ\_Alert\_2012\_16\_11092012.pdf.

The C&DIs on complying with the Iran Threat Reduction and Syria Human Rights Act of 2012 are available at http://www.sec.gov./divisions/corpfin/guidance/exchangeactsections-interps.htm#147.01.

<sup>&</sup>lt;sup>9</sup> The questionnaire is available at http://www.thecaq.org/resources/pdfs/AuditorAssessment.pdf.

<sup>10</sup> The practice aid is available at http://www.thecag.org/resources/pdfs/AuditCommitteeCommunications.pdf.

<sup>&</sup>lt;sup>11</sup> The guide is available at http://www.thecaq.org/resources/pdfs/GuidetoPCAOBInspections.pdf.

### Appendix - Quoted speeches

	Speech and link to source
SEC Commissioner Luis Aguilar	<ul> <li>Speech by SEC Commissioner: Capital Formation from the Investor's Perspective http://www.sec.gov/news/speech/2012/spch120312laa.htm</li> </ul>
SEC Acting Chief Accountant Paul Beswick	Speech by SEC Acting Chief Accountant: Remarks Before the 2012 AICPA Conference on Current SEC and PCAOB Developments http://www.sec.gov/news/speech/2012/spch120312pab.htm
SEC Deputy Chief Accountant Brian Croteau	<ul> <li>Speech by SEC Deputy Chief Accountant: Remarks Before the 2012 AICPA National Conference on Current SEC and PCAOB Developments – Audit Policy and Current Auditing and Internal Control Matters http://www.sec.gov/news/speech/2012/spch120312btc.htm</li> </ul>
SEC Deputy Chief Accountant Julie Erhardt	Speech by SEC Deputy Chief Accountant: Remarks at the AICPA Conference on Current SEC and PCAOB Developments http://www.sec.gov/news/speech/2012/spch120312jae.htm
SEC Senior Associate Chief Accountant Jenifer Minke-Girard	Speech by SEC staff: Remarks Before the 2012 AICPA Conference on Current SEC and PCAOB Developments http://www.sec.gov/news/speech/2012/spch120312jmg.htm
FASB Chairman Leslie Seidman	➤ Speech by FASB Chairman: Remarks to the American Institute of Certified Public Accountants National Conference on Current SEC and PCAOB Developments http://www.fasb.org/cs/BlobServer?blobkey=id&blobwhere=1175825300928&blobheader=application%2Fpdf&blobcol=urldata&blobtable=MungoBlobs
IASB Chairman Hans Hoogervorst	<ul> <li>Speech by IASB Chairman: AICPA Conference on Current SEC and PCAOB Developments – opening remarks http://www.ifrs.org/Alerts/PressRelease/ Pages/AICPA-Dec-12.aspx</li> </ul>
PCAOB Chairman James Doty	<ul> <li>Speech by PCAOB Chairman: Keynote Address - AICPA National Conference on Current SEC and PCAOB Developments http://pcaobus.org/News/Speech/Pages/12032012_AICPA.aspx</li> </ul>
PCAOB Chief Auditor and Director of Professional Standards Martin Baumann	Speech by PCAOB Chief Auditor and Director of Professional Standards: Remarks 2012 AICPA Conference on Current SEC and PCAOB Developments http://pcaobus.org/News/Speech/Pages/12042012_AICPA.aspx