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THE NEWSLETTER FROM BDO'S NATIONAL ASSURANCE PRACTICE

BDO KNOWS: SEC

CONTENTS

SEC YEAR IN REVIEW

SIGNIFICANT 2010 DEVELOPMENTS

In 2010, the Securities and Exchange Commission (SEC) continued to address the causes of the 2008-2009 financial crisis and devoted much of its attention to:

- Providing support to the Obama Administration and Congress as they enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act);
- Enhancing corporate governance, market structure, and corporate disclosure;
- Upgrading the regulation of credit rating agencies;
- Improving the performance of the Division of Enforcement; and
- Responding to the extensive rulemaking and other activities required by the Dodd-Frank Act.

A Commission priority following the financial crisis has been to improve corporate governance. In early 2010, the SEC adopted shareholder advisory voting on executive compensation for recipients of Troubled Asset Relief Program (TARP) funds that have not repaid those funds. It also enhanced the electronic (or "e") proxy rules in an effort to increase the percentage of retail shareholders who vote when proxy statements are made available only via the Internet. In August, the SEC adopted changes to its proxy rules to facilitate the rights of shareholders to nominate directors to a company's board. The Commission adopted these rules in a 3-2 vote, and they have generated controversy both before and after adoption. The Business Roundtable and the U.S. Chamber of Commerce have petitioned the U.S. Court of Appeals to review the new proxy access rule, and the Commission has ordered a stay that has stopped the rules from taking effect until the Court renders its decision. As a result, the rules will not be in effect for the 2011 proxy season.

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The Commission issued a concept release on the U.S. proxy system as part of the SEC's most comprehensive effort to modernize the procedural aspects of shareholder voting in thirty years. The concept release is referred to as "proxy plumbing," and all aspects of proxy voting and transparency are on the table for reconsideration. The concept release asks issuers and shareholders what proxy rules do and don't work. The questions address the accuracy, transparency, and efficiency of the proxy voting process; communication and shareholder participation in the proxy process; and the alignment of voting power and economic interest. Comments were due October 20 and the Commission is evaluating the more than 250 comment letters it received.

The Commission and its staff continued to work on deciding whether, and if so, how and when, to incorporate International Financial Reporting Standards (IFRS) into financial reporting by domestic issuers. In February, the Commission issued a statement communicating its continued support for a single set of high-quality global accounting standards and for the convergence of U.S. GAAP and IFRS. This statement was accompanied by a work plan that the staff will complete to support the Commission's decision-making. In June, the FASB and IASB modified their convergence strategy by prioritizing their major projects and limiting the number of significant exposure drafts to four per quarter. Following the announcement, SEC Chairman Mary Schapiro issued a statement of support for the modified plan, acknowledging that it should increase the quality of standards and expressing confidence that the project timing changes will not negatively affect the SEC's timeline. In October, the staff presented a progress report but noted that it was too early in the process to offer conclusions. The Commission continues to believe that it will be able to make a decision in 2011, although not necessarily by June, the date the FASB and the IASB have set for completing their major convergence projects.

The Dodd-Frank Act requires the Commission to adopt over 100 rules and conduct more than 20 studies. The Commission estimates that it will need to add approximately 800 additional staff to meet its new or expanded regulatory responsibilities. Because of the enormity of this effort and the short time during which it must be completed, the Commission is using new approaches to elicit input and communicate its plans. To encourage public comment early in the rulemaking process, the Commission created email boxes for each topic so individuals and organizations can provide input to the SEC even before rules are proposed (at: *http://www.sec.gov/spotlight/regreformcomments.shtml*). To help communicate the SEC's plans for implementing the Act, the Commission created a section on its website that provides its rulemaking schedule (at: *http://www.sec.gov./spotlight/dodd-frank.shtml*). This section also contains links to completed actions.

The Act exempted non-accelerated filers from the requirement under Section 404(b) of the Sarbanes-Oxley Act to have their auditors attest to their internal control over financial reporting (ICFR). In September, the Commission conformed its rules to the Act. The SEC now deems management reports on ICFR to be filed, not furnished, and these filers no longer need to provide a statement that an auditors' report on ICFR was not provided.

Liquidity shortages that developed during the financial crisis prompted the Commission to consider the adequacy of registrants' short-term borrowings disclosures. To enhance these disclosures, the SEC proposed rules that would require registrants to disclose information about short-term funding needs and how they're financed. At the same time, the Commission issued an interpretive release that provides detailed guidance on identifying internal and external sources of liquidity, describing leverage ratios, and providing narrative information to provide insight into the obligations reflected on the table of contractual obligations. The proposed rules are subject to final rulemaking, but the interpretive guidance became effective upon issuance and should be considered as part of preparing fiscal 2010 filings.

The staff updated its guidance on complying with various Commission's rules and regulations. XBRL interactive data submissions began for the second phase-in group, and the first group started detail tagging their XBRL submissions. The staff updated guidance regarding compliance with the XBRL rules in its Compliance and Disclosure Interpretations (C&DIs). In order to identify and communicate common implementation problems, the staff reviewed several XBRL submissions and published its observations. The staff also updated its C&DIs covering other topics and updated its *Financial Reporting Manual* four times during the year. In addition, the staff added small business compliance guides on oil and gas reporting and updated its guides on the internet availability of proxy materials and Form D.

"Hot" topics for staff comments on filings continued to be areas affected by the financial crisis, such as impairments and valuations. The staff has also focused on accounting and disclosures related to loss contingencies and registrants' use of non-GAAP financial measures.

The SEC staff experienced leadership and structural changes during the year. Brian Croteau was appointed Deputy Chief Accountant for the Professional Practice Group and J.W. Mike Starr was named to a new Deputy Chief Accountant position, Policy Support and Market Monitoring. In this role, Mr. Starr will address potential financial reporting weaknesses and risks in an effort to identify and address issues before they cause problems. In July, the Division of Corporation Finance announced that it was adding three specialized offices to enhance its disclosure review and policy operations. The new offices will focus on large financial institutions, asset backed securities and other structured products, and securities products and capital markets trends. The group focusing on large financial institutions performs continuous reviews of the periodic reports filed by some of the largest bank holding companies, and the Division of Corporation Finance intends to begin continuous reviews of companies in other industries.

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Looking forward to 2011, rulemaking to implement the Dodd-Frank Act is expected to dominate the Commission's agenda since the law requires many of the rules to be issued by July 2011. The Commission will also continue to work toward a decision on transitioning to IFRS.

This publication summarizes many of the 2010 Commission and staff activities described above. We discuss rulemaking initiatives finalized in 2010 first, followed by those still in process as of December 31, 2010. We then discuss guidance the Commission and staff have provided during 2010, including informal guidance regarding matters that frequently generate comments during filing reviews. Although not the focus of this letter, we also briefly discuss the 2010 standards setting and related activities of the Public Company Accounting Oversight Board (PCAOB).

▶NEW COMMISSION RULES

AUDITOR REPORTING ON INTERNAL CONTROL OVER FINANCIAL REPORTING

(Release 33-9142)

The Dodd-Frank Act, which was signed into law on July 21, 2010, exempted non-accelerated filers from the requirement to have their auditors opine on the effectiveness of their ICFR. In September, the Commission adopted rule changes to conform its rules to the Act. The SEC had temporarily exempted non-accelerated filers from the requirement to have their auditors opine on ICFR, but that exemption had expired.

The SEC's rulemaking also made the following changes:

- Non-accelerated filers' management reports on ICFR are now considered filed, not furnished, under the Securities Exchange Act of 1934. This subjects the reports to a higher level of liability; and
- Non-accelerated filers are no longer required to provide a statement within management's report that an auditors' report on ICFR has not been provided.

▶BDO OBSERVATIONS:

Relief from the ICFR audit requirement is available to non-accelerated filers – not to filers whose public float is less than $75 million. Under Exchange Act Rule 12b-2, an accelerated filer retains its accelerated status until its worldwide public float decreases below $50 million as of the end of its second fiscal quarter. Consequently, an accelerated filer with public float between $50 million and $75 million as of the end of its second fiscal quarter continues to be required to file on an accelerated timetable and have its auditors opine on its ICFR.

Newly public issuers continue to be the only filers that are not required to provide management reports on the effectiveness of ICFR. Item 308 of Regulation S-K provides relief to these registrants in their first annual report, but they must provide management's report on ICFR (and an auditors' attestation report if they are accelerated filers) beginning with their second annual report. If newly public companies take advantage of this relief in their first annual report, they must state that management's and the auditors' reports were not provided due to the first-year exemption allowed by the rules.

The release is available on the SEC's website at: *http://www.sec.gov/rules/final/2010/33-9142.pdf*.

CORPORATE GOVERNANCE

This year the Commission finalized rules that were proposed in 2009 and began proposing the corporate governance rules mandated by the Dodd-Frank Act. While rule changes affecting corporate governance are primarily a legal matter, we have provided an overview to help issuers prepare for the new requirements.

Shareholder Voting on Executive Compensation to be Paid by TARP Recipients and e-Proxy Enhancements

(Releases 34-61335 and 33-9108)

In early 2010, the Commission adopted two corporate governance rule changes substantially as proposed. These rules are further discussed in our *2009 SEC Year in Review* publication.

Shareholder voting on executive compensation to be paid by TARP recipients – This rule requires issuers subject to Section 111(e) of the Emergency Economic Stabilization Act of 2008 that received funds under TARP to conduct a non-binding shareholder vote on the

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compensation of executives. The TARP funds recipients are required to have shareholders vote on executive compensation when they solicit proxies for the election of directors at an annual meeting. The vote does not bind the board of directors and does not limit the ability of shareholders to make proposals related to executive compensation for inclusion in proxy materials. The rule changes became effective February 18, 2010.

e-Proxy enhancements – The SEC's proxy rules that were issued in 2007 have a notice and access model that requires all issuers and other soliciting persons to post proxy materials on a website and furnish notice of the availability of the materials to shareholders. Issuers can also deliver full sets of the printed proxy materials to shareholders. The SEC amended the e-proxy rules because surveys showed that issuers using only the notice and access delivery method had a lower percentage of retail shares voted than issuers using the full-set delivery option.[1] The rule changes allow issuers flexibility in the format and wording of the notice, with the intent of making it easier for shareholders to understand how to access proxy materials, what they are voting on, and how to vote. The changes became effective March 29, 2010.

In addition, the SEC published an Investor Alert and added a Spotlight page to its website that provide information about proxy voting. This information is a resource for both issuers and investors.

The Investor Alert and the Spotlight page are available on the SEC's website at: *http://www.sec.gov/investor/alerts/votingrules2010.htm* and *http://www.sec.gov/spotlight/proxymatters.shtml*.

The SEC staff also updated its smaller reporting company guide on making proxy materials available on Internet sites. The guide is available on the SEC's website at: *http://www.sec.gov/rules/final/2010/33-9108-secg.htm*.

The shareholder voting on executive compensation of TARP recipients release is available on the SEC's website at: *http://www.sec.gov/rules/final/2010/34-61335.pdf*.

The e-proxy enhancements release is available on the SEC's website at: *http://www.sec.gov/rules/final/2010/33-9108.pdf*.

Our publication, *SEC Year in Review – Significant 2009 Developments*, is available on our website at: *http://www.bdo.com/download/1235*.

Shareholder Director Nominations
(Release 33-9136)

Since 2003, the Commission has debated taking action to make it easier and less expensive for small but substantive groups of shareholders to nominate director candidates. Certain business organizations object to this action and have questioned the authority of the SEC to make rules affecting this process. The Dodd-Frank Act provided the SEC with explicit authority to address director nominations, and in August, the Commission adopted changes to its proxy and other rules to facilitate the rights of shareholders to nominate directors to a company's board. The SEC's action was controversial. The Commission adopted the rules in a 3-2 vote after receiving 715 comment letters.

In September, the controversy continued when the Business Roundtable and the U.S. Chamber of Commerce petitioned the U.S. Court of Appeals to review the Commission's proxy access rule. In response, the Commission ordered a stay that has stopped the rules from taking effect until the Court renders its decision. As a result, issuers will not be required to comply with the proxy access rules during the 2011 proxy season.

If the proxy access rules do become effective as adopted, eligible shareholders will be able to submit nominations for directors alongside the candidates nominated by the incumbent board. Eligible shareholders or shareholder groups are defined based on ownership, intent, and timing; they must:

- Hold at least three percent of the voting power entitled to vote on the election of directors and have held this percentage continuously for at least three years;
- Hold the company's securities without intending to change control of the company; and
- Submit their candidates or proposals no later than 120 days before the anniversary date of the mailing of the company's proxy statement in the prior year.

A company will be required to include no more than one shareholder nominee or the number of nominees that represents one-quarter of the company's board of directors, whichever is greater.

The proxy access rules apply to all 1934 Act reporting companies, including investment companies, other than companies whose only public securities are debt securities. The rules are scheduled to take effect for smaller reporting companies (SRCs) three years after the effective date for other filers. Foreign private issuers (FPIs) are not subject to the SEC's proxy rules and therefore are not be subject to these new rules.

1 Statistics summarizing the effect of the notice and access model on retail voting by shareholders are available at: *www.broadridge.com/notice-and-access/index.asp*.

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The release is available on the SEC's website at: http://www.sec.gov/rules/final/2010/33-9136.pdf.

The stay is available on the SEC's website at: http://www.sec.gov/rules/other/2010/33-9149.pdf.

RULEMAKING IN PROCESS

BDO OBSERVATION:

The discussion below outlines several Commission rulemaking projects that are in process. In many cases, the deadline for submitting comments has passed. However, the Commission is often willing to consider comments submitted after the deadline, and in some cases the staff has informally indicated that the number of comments submitted has been limited and more input is desired. Therefore, constituents with views on a proposal should consider submitting comments. Comments letters need not be lengthy or cover all aspects of a proposal. The proposed rules page on the Commission's website (http://www.sec.gov/rules/proposed.shtml) contains links to electronic forms that may provide a convenient means for submitting comments.

SHORT-TERM BORROWINGS DISCLOSURES

(Release 33-9143)

Liquidity shortages that developed during the financial crisis prompted the Commission to consider the adequacy of registrants' short-term borrowings disclosures. After the Lehman Brothers bankruptcy examiner's report, which raised concerns about Lehman's use of repurchase transactions and their effect on the firm's reported financial condition, was released,[2] the SEC staff sent letters (known as "Dear CFO" letters) to more than 20 financial institutions requesting them to provide details of repurchase agreement transactions. The staff asked them to provide quarterly balance sheet amounts and quarterly average amounts of repurchase transactions treated as sales for the past three years. The staff also asked them to explain the business reasons for using repurchase transactions.

After evaluating the responses, in September the Commission proposed amendments to the Management's Discussion & Analysis rules in Item 303 of Regulation S-K[3] and issued a companion interpretive release.[4] The proposed rules are designed to provide investors with a better understanding of a company's actual funding needs and financing activities so they can better evaluate the liquidity risks a company faces.[5]

Under the proposal, issuers would be required to present a new separately-captioned section in MD&A that would provide quantitative and qualitative disclosure and analysis of short-term borrowings – both borrowings outstanding at period end and borrowings made during the reporting period. Issuers would provide quantitative disclosures about short-term borrowings similar to those currently required for bank holding companies under Item VII of Guide 3.[6] The SEC had previously required companies other than bank holding companies to provide quantitative disclosures in a financial statement schedule that was eliminated in 1994.

The rules would apply to all issuers and would be applicable to MD&As presented in periodic reports, registration statements, and proxy and information statements that contain financial statements. For issuers that present their financial statements on the basis of U.S. GAAP, the proposed rules require tabular disclosure of short-term borrowings in the following categories:

- Repurchase agreements;
- Commercial paper;
- Borrowings from banks;
- Borrowing from factors or other financial institutions; and

2 The report is available at: http://lehmanreport.jenner.com/VOLUME%203.pdf.

3 The Commission also proposed similar changes to Item 5 of Form 20-F, *Operating and Financial Review and Prospects*, which applies to foreign private issuers. Both MD&A and Operating and Financial Review and Prospects are referred to as MD&A for ease of discussion. The proposed rules would not apply to registrants that file reports and registration statements with the SEC in accordance with the requirements of the U.S.-Canadian Multijurisdictional Disclosure System.

4 Financial Reporting Release (FR) 83, *Commission Guidance on Presentation of Liquidity and Capital Resources Disclosures in Management's Discussion and Analysis*. The interpretive release is discussed under Commission and Staff Guidance below.

5 The FASB has also added a project to amend ASC 860-10 (formerly FAS 140/166) regarding repurchase transactions. See http://www.fasb.org/cs/ContentServer?c=FASBContent_C&pagename=FASB%2FFASBContent_C%2FProjectUpdatePage&cid=1176157180476#fi_derecognition.

6 The proposed rules would require reporting for interim periods and narrative explanations to provide context for the tabular data required. Guide 3 applies only to annual periods, does not require narrative disclosures, and does not require disclosure of specific categories of short-term borrowings.

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- Any other short-term borrowings on the registrant's balance sheet.[7]

The rules would require issuers to disaggregate these categories by risk attributes, such as currency and interest rate, to provide greater transparency and understanding to users. FPIs that do not prepare financial statements in accordance with U.S. GAAP would be permitted to present categories that correspond to the classifications used to prepare their primary financial statements so long as the detail satisfies the objective of the short-term borrowings disclosure requirements.

Issuers would be required to provide the following tabular data for each category of short-term borrowings:

- The amount outstanding at the end of each period and the weighted average interest rate thereon;
- The maximum amount outstanding during each period; and
- The average amount outstanding during the period and the weighted average interest rate thereon.

Issuers that are financial companies would disclose the maximum and average amounts calculated on a daily basis. Non-financial companies would be permitted to disclose the maximum and average amounts calculated on a month-end basis. Financial companies would be defined as those with business activities such as lending, deposit taking, insurance, underwriting, providing investment advice, and/or broker dealer activities. Issuers that have both financial and non-financial operations would be allowed to present the short-term borrowings disclosures for their non-financial operations separately from those for their financial operations and according to the rules (i.e., monthly maximums and averages rather than daily maximums and averages) for non-financial companies.

An issuer would also be required to provide a narrative explanation of the extent and nature of a company's use of and reliance upon short-term borrowings, including fluctuations within a reporting period. The Commission believes that these qualitative disclosures together with the tabular data would provide important information so that "investors can better understand the role of short-term financing and its related risks to the registrant as viewed through the eyes of management." The topics covered in this narrative would be:

- A general description of the short-term borrowing arrangements included in each category and the business purpose of those arrangements;
- The importance to the registrant of its short-term borrowing arrangements to its liquidity, capital resources, market-risk support, or credit-risk support;
- The reasons for the maximum amount of short-term borrowings during the reporting period, including any non-recurring events, use of proceeds or other information that provides context for material changes during the reporting period; and
- The reasons for any material differences between the amounts of average short-term borrowings during the reporting period and period end short-term borrowings.

The same level of disclosure would be required in annual and interim MD&As, and it would be required for the following periods:

- Each quarterly reporting period without a comparison to prior periods; and
- Each annual reporting period on a comparative basis for all periods presented. Also, the annual report would disclose information for the fourth quarter.

Companies other than bank holding companies would be allowed to phase in the annual reporting over three years.

The Commission would allow SRCs and FPIs to provide less disclosure. SRCs would be permitted to disclose two fiscal years of information rather than three and would not be required to provide quarterly disclosures unless material changes have occurred during the interim reporting period. FPIs would not need to provide interim disclosures in annual reports. They would provide interim information only for interim periods included in registration statements.

Comments on the proposal were due November 29.

7 The proposed rules would also amend Items 2.03 and 2.04 of Form 8-K to refer to the definition of short-term borrowings included in amended Item 303 of Regulation S-K.

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▶BDO OBSERVATIONS:

The SEC also issued a companion interpretive release that provides guidance on transparently disclosing liquidity and funding risks in MD&A. The interpretive release observes that if a registrant's borrowings during a reporting period are materially different than the period-end amounts reported in the financial statements, current rules already require registrants to discuss the intra-period variations. Accordingly, issuers that have such swings in their short-term borrowings should provide such disclosures in their MD&A. We discuss the interpretive release further in the Commission and Staff Guidance section below.

The proposed rules discussed above are not expected to be in effect for 2010 annual reports. The staff has informally indicated that it hopes to have rules in place that would apply to quarterly reports covering the first quarter of 2011.

The Dear CFO letter is available on the SEC's website at: *http://www.sec.gov/divisions/corpfin/guidance/cforepurchase0310.htm*.

The release is available on the SEC's website at: *http://www.sec.gov/rules/proposed/2010/33-9143.pdf*.

DECIDING WHETHER TO INCORPORATE IFRS INTO U.S. FINANCIAL REPORTING

Statement and Work Plan
(Release 33-9109)

During 2010, the Commission continued work on deciding whether, and if so, how and when, to incorporate IFRS into financial reporting by domestic issuers. In 2008, the SEC had proposed a *Roadmap for the Potential Use of Financial Statements Prepared in Accordance with International Financial Reporting Standards by U.S. Issuers*.[8] The SEC staff analyzed the 200-plus comment letters received on the proposed roadmap and in February 2010 the Commission voted to issue the *Commission Statement in Support of Convergence and Global Accounting Standards*. This statement included a detailed work plan for the SEC staff to gather information to address comments received on the proposed roadmap. The staff continues to make progress on the work plan and has issued its first status report, which affirms the project is progressing according to schedule.

In June, the FASB and IASB issued a joint statement modifying their original memorandum of understanding. They announced that certain projects would be delayed and that they would limit the rate at which they issue exposure drafts.[9] Following the joint announcement, Chairman Schapiro issued a statement of support for the modified plan and expressed confidence that the SEC's timeline will not be negatively affected.

At the 2010 AICPA National Conference on Current SEC and PCAOB Developments, Chairman Schapiro affirmed that 2011 (the year cited in the February statement) is still the year the Commission believes it will be in a position to determine whether to incorporate IFRS into the domestic reporting system. She commented that the SEC's ability to make a decision in 2011 depends on the FASB's and IASB's progress on the convergence projects and the results of the SEC staff's work on the detailed work plan. She also affirmed that the first date U.S. domestic issuers would report under IFRS would be no earlier than 2015 (also cited in the February statement).

If the Commission decides to incorporate IFRS into U.S. financial reporting, it will use the output of the work plan to devise an approach for doing so. While the staff's work is not complete and no conclusions have been reached, at the Conference, Deputy Chief Accountant Paul Beswick discussed a possible approach that would entail a combination of converging certain U.S. and international standards and endorsing other international standards, an approach he termed "condorsement." Under the condorsement approach:

- U.S. GAAP would continue to exist;
- The IASB and the FASB would complete the major projects in their Memorandum of Understanding;[10]
- The FASB would not work on any new major projects. The FASB's priority would be to converge existing U.S. GAAP to IFRS for standards that are not on the IASB's agenda and ensure that existing IFRS standards are suitable for U.S. capital markets;

8 The proposed roadmap is available on the SEC's website at: *http://www.sec.gov/rules/proposed/2008/33-8982.pdf*. For an overview of the proposed roadmap, see our publication, *SEC Year in Review – Overview of Significant 2008 Developments*, which is available on our website at: *http://www.bdo.com/download/957*.

9 The FASB and IASB have committed to completing their projects on financial instruments, revenue recognition, leases, the presentation of other comprehensive income, fair value measurement, balance sheet netting of derivative and other financial instruments, and the consolidation of investment companies by June 2011. Delayed projects include financial instruments with characteristics of equity, financial statement presentation, and presentation of discontinued operations. The timing of projects related to the consolidation of voting interest entities and derecognition is yet to be determined. Collectively these projects are referred to as Memorandum of Understanding projects.

10 See footnote 9.

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- The FASB would establish a process to consider whether new standards issued by the IASB are in the interests of U.S. investors/capital markets. Once the FASB has endorsed the standard, ideally without modification, the FASB would integrate the standard into the U.S. codification; and
- The FASB would participate in the IFRS standard setting process like other jurisdictions do.

The detailed work plan focuses on the following six key issues. In October, the staff presented its first scheduled progress report on its work. The staff's work is still in progress and it has not yet reached conclusions on any of the issues.

1. **Is IFRS sufficiently developed and consistent in application for use as the single set of accounting standards in the U.S. reporting system?**
   The staff is considering the sufficiency of IFRS development and consistency of application by analyzing: (1) IFRS as issued by the IASB, (2) IFRS as applied in practice, and (3) IFRS as compared to U.S. GAAP. As part of this analysis, the staff is reviewing and analyzing the financial statements of some of the largest companies in the world that use IFRS, both SEC registrants and companies that do not file financial statements in the U.S. One of the objectives of this project is to evaluate the consistency of IFRS in practice to determine whether there are significant jurisdictional or other differences in the application of IFRS.

2. **Are the accounting standards set by an independent standard-setter and for the benefit of investors?**
   After the work plan was published, the Monitoring Board, which oversees the IFRS Foundation, committed to a review of its governance framework and that of the IFRS Foundation. In the process, the Monitoring Board established a working group to conduct a review of the Monitoring Board's and the IFRS Foundation's governance frameworks and determine whether the current governance structure adequately protects the IASB's independent standard setting process. The staff expects to perform its work in early 2011 after the Monitoring Board's working group has completed its review.

3. **Do investors understand IFRS and how it differs from U.S. GAAP?**
   The staff is assessing U.S. investors' familiarity with IFRS and how investors become educated about changes to accounting standards. The staff plans to assess the scope of, timing of, and approach to changes that would be necessary for effective incorporation of IFRS into the financial reporting system for U.S. issuers. The Commission issued a request for comments in this area,[11] and the staff reported that initial feedback indicates that U.S. investor understanding and education has begun to develop, at least in certain instances.

4. **How would U.S. laws or regulations, outside of the securities laws, for example tax laws and regulatory reporting, be affected by a change in accounting standards?**
   The staff has identified this as a significant issue due to the prominence of U.S. GAAP references in U.S. laws, contractual documents, regulatory requirements and guidelines, and similar documents. If IFRS were adopted without being defined as U.S. GAAP, issuers would likely be in default on contracts and in violation of U.S. laws and regulations that require compliance with U.S. GAAP. If the SEC decides to incorporate IFRS into financial reporting for U.S. domestic issuers by defining IFRS as U.S. GAAP, this major contractual/regulatory issue would likely be significantly mitigated.

5. **What is the impact of adopting IFRS on issuers, both large and small, including changes to accounting systems, contractual arrangements, corporate governance and litigation contingencies?**
   The staff is in the process of comparing IFRS to U.S. GAAP for accounting standards that are not being addressed in the convergence project, as these standards will affect issuers the most in the year of IFRS adoption. The staff is assessing the extent of, logistics for, and estimated time necessary to undertake changes to issuer accounting systems, controls, and procedures for both small and large issuers. The staff solicited public comment in this area[12] and is analyzing the input. The staff plans to continue to review the effects of IFRS on accounting and disclosure requirements for litigation contingencies in the context of the U.S. legal environment.

6. **Are the people who prepare and audit financial statements and other interested parties sufficiently prepared, through education and experience, to make the conversion to IFRS?**
   The staff initially determined that the assessment of whether financial statement preparers, auditors, investors, attorneys, regulators, and educators are IFRS ready will be conducted after the staff has progressed further on the work plan.

The staff plans to provide periodic progress reports on the work plan to the Commission. A more detailed BDO analysis of the progress report is available at: *http://www.bdo.com/ifrs/*.

The Commission's statement, including the work plan, is available on the SEC's website at: *http://www.sec.gov/rules/other/2010/33-9109.pdf*.

11 See release 33-9133, available at: *http://www.sec.gov/rules/other/2010/33-9133.pdf*.
12 See release 33-9134, available at: *http://www.sec.gov/rules/other/2010/33-9134.pdf*.

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Additional information about the work plan is available on the SEC's website at: http://www.sec.gov/spotlight/globalaccountingstandards.shtml.

The staff's progress report is available on the SEC's website at: http://www.sec.gov/spotlight/globalaccountingstandards/workplanprogress102910.pdf.

BDO OBSERVATIONS:

BDO has resources that provide information and training on IFRS. They include:

IFRS Resource Center:
The Ac'sense℠ webinar self-study courses:

- December 2010 *IFRS Project Update*
- August 2010 *IFRS Share-Based Payments*
- May 2010 *IFRS Taxation*
- January 2010 *IFRS vs. IFRS for SMEs*
- August 2009 *IFRS Business Combinations*
- June 2009 *IFRS Adoption and IFRS Standard No. 1*
- May 2009 *IFRS Implementation and Process Considerations*

Additional IFRS publications are available at *IFRS Accounting Publications*.

IMPLEMENTING THE DODD-FRANK ACT

This section summarizes the Commission rulemaking and studies mandated by the Dodd-Frank Act that most directly affect corporate governance and financial reporting.

U.S.Whistleblower Program
(Release 34-63237)

In November, the Commission proposed the whistleblower rules required by Section 922 of the Act. The proposed rules implement the Act's requirement that the Commission pay an award to whistleblowers who voluntarily provide original information to the SEC that leads to a successful enforcement action with sanctions of over $1 million. Under the proposed rules, individuals who gain the information by auditing the financial statements or through acting as the company's lawyers/compliance personnel are not allowed to receive a whistleblower award. Comments on the proposal were due December 17. The final rules must be adopted by April 15, 2011.

BDO OBSERVATION:

A controversial aspect of the proposed rules is the possibility that they might encourage whistleblowers to report potential violations to the SEC but not through internal company reporting processes, thereby undermining the ability of a company and its auditors to consider the impact of the potential violation on the company financial statements on a timely basis.

The whistleblower program proposed rules are available on the SEC's website at: http://www.sec.gov./rules/proposed/2010/34-63237.pdf.

Say-on-Pay and Proxy Vote Reporting
(Releases 33-9153 and 34-63123)

The initiative to allow shareholders advisory (i.e., non-binding) votes on executive compensation, termed "say on pay," began developing in 2007. In that year, groups of institutional investors promoted the say-on-pay vote, and approximately 50 registrants included shareholder resolutions in their proxy statements. The number of such shareholder resolutions grew to over 400 in 2009. The Commission first formalized the initiative in early 2010, when it finalized rules that require TARP funds recipients to hold shareholder advisory votes on executive compensation as discussed above.

Read more

Under Section 951 of the Dodd-Frank Act, the SEC must issue rules that require shareholder advisory votes on (1) executive compensation when registrants solicit proxies for the election of directors, and (2) executive compensation arrangements in merger transactions (known as golden parachute arrangements) when shareholders vote on such transactions. In October, the Commission proposed rules that would require advisory votes on these matters. The proposed rules also would require certain institutional investment managers to disclose how they voted on executive compensation and golden parachute arrangements.

The say-on-pay rules were proposed in Release 33-9153 and would require public companies subject to the Commission's proxy rules:

- To provide their shareholders with an advisory vote on executive compensation. The vote would occur every year, every other year, or once every three years;
- To provide their shareholders, at least once every six years, with an advisory vote on the desired frequency of the votes on executive compensation. A company would then disclose its decision regarding how frequently it will conduct advisory votes in the periodic report covering the period during which the advisory vote on voting frequency occurs;
- To disclose in the Compensation Discussion and Analysis how the company has considered the results of previous say-on-pay votes; and
- To provide their shareholders with an advisory vote on golden parachute arrangements in connection with mergers and similar transactions. The advisory vote would be provided at the meeting at which shareholders are asked to approve the transaction.

Institutional investment managers would be required to report their votes on executive compensation and golden parachute arrangements at least annually under rules proposed in Release 34-63123.

Comments on both proposals were due November 18.

▶BDO OBSERVATIONS:

The Commission plans to adopt rules covering advisory votes on say-on-pay and golden parachute arrangements in the first quarter of 2011. The Act requires shareholder advisory votes on separate resolutions to approve executive compensation and the frequency of say-on-pay votes at the first annual or other meeting of the shareholders occurring on or after January 21, 2011, whether the SEC has finalized its rules by that time or not.

In preparation for the say-on-pay votes, some companies are considering modifying their executive compensation plans and are reaching out to seek investors' views. These companies are proactively working to obtain a positive response to the first say-on-pay vote.

The releases are available on the SEC's website at: *http://www.sec.gov/rules/proposed/2010/33-9153.pdf* and *http://www.sec.gov/rules/proposed/2010/34-63123.pdf*.

Internal Control Over Financial Reporting Study
(Release 34-63108)

As discussed above, the Dodd-Frank Act exempted non-accelerated filers from the requirement to have their auditors opine on the effectiveness of their ICFR. The Act also requires the Commission to study how it can reduce the burden of the ICFR auditor attestation requirement on small accelerated filers with public floats between $75 million and $250 million and whether reducing the compliance burden or completely exempting such companies from the requirement would encourage companies undertaking initial public offerings to list on exchanges in the U.S.

The Commission solicited public comments regarding these matters, which were due December 6. The Act requires the Commission to complete the study by April 21, 2011.

The Commission's request for public comment is available on the SEC's website at: *http://www.sec.gov./rules/other/2010/34-63108.pdf*.

Corporate Governance
The Dodd-Frank Act also requires the SEC to adopt rules regarding executive compensation and the manner in which a corporation is governed:

- *Say-on-pay* – Section 951 requires shareholder advisory votes on executive compensation and golden parachutes and certain institutional investment managers to report how they voted on executive compensation and golden parachutes. These rules were proposed by the SEC in October and are discussed above.

▶ Read more

- *Compensation committee oversight disclosures* – Section 952 requires the compensation committee of an issuer to consider conflict of interest standards to be established by the Commission before selecting a compensation consultant, legal counsel, or other adviser. The Act requires the SEC to adopt rules by July 21, 2011, requiring issuers to disclose in proxy materials whether they have done this. The Act also requires the SEC to adopt rules by July 16, 2011, directing the exchanges to adopt listing standards that require compensation committee members to be independent.

- *Pay-for-performance and pay ratio disclosures* – Section 953 requires issuers to disclose compensation information such as executive compensation compared to stock performance charted over a five year period (termed pay-for-performance) and the ratio of the CEO's total compensation to the median total compensation of all other company employees. The SEC plans to propose rules requiring this disclosure by July 21, 2011.

- *Compensation clawback policies* – Section 954 requires the SEC to direct the exchanges to adopt listing standards that require issuers to develop and implement compensation clawback policies under which they must recover incentive-based executive compensation paid over a three-year look-back period if the issuer has a material accounting restatement. The SEC plans to propose rules requiring such listing standards by July 21, 2011.

- *Director and employee hedging policies* – Section 955 requires issuers to disclose whether directors and employees are permitted to hedge against a decrease in value of equity securities granted as compensation. The SEC plans to propose the rules requiring this disclosure by July 21, 2011.

- *Board leadership structure disclosure* – Section 972 requires issuers to disclose why they chose the same person, or different people, to serve as the chairman and chief executive officer. Item 407(h) of Regulation S-K already requires this information to be disclosed.

Other Disclosures

The Dodd-Frank Act requires issuers to disclose the following if they use conflict minerals, have mine safety issues, or make payments to governments for resource extraction:

- *Conflict minerals* – Section 1502 requires issuers to determine and disclose annually whether any conflict minerals necessary to their production originated in the Democratic Republic of the Congo or an adjoining country.[13] If so, an issuer is required to provide an audited report certified by the issuer describing the measures taken to exercise due diligence on the source and chain of custody of the minerals.

- *Mine health and safety* – Section 1503 requires issuers that are mine operators to disclose in each periodic report filed with the SEC information related to health and safety violations, including the number of certain violations, orders, and citations received from the Mine Safety and Health Administration (MSHA). Form 8-K filings are also required for certain MSHA communications.

- *Resource extraction issuer payments to governments* – Section 1504 requires issuers to disclose annually payments made to the United States or a foreign government for oil, natural gas, or minerals when the issuer develops such resources commercially.

The Commission proposed rules covering these disclosures in December, and comments are due by January 31, 2011. The Act requires the SEC to adopt rules requiring the conflict minerals and payments to governments disclosures by April 15, 2011. SEC rulemaking is not required to implement the mine health and safety disclosure requirements. These disclosures have been required since August 20, 2010. The releases are available on the SEC's website at: *http://www.sec.gov/rules/proposed/2010/34-63547.pdf*; *http://www.sec.gov/rules/proposed/2010/33-9164.pdf*; and *http://www.sec.gov/rules/proposed/2010/34-63549.pdf*.

The Dodd-Frank Act is available at: *http://www.sec.gov./about/laws/wallstreetreform-cpa.pdf*.

13 Conflict minerals are minerals mined in conditions of armed conflict and human rights abuses.

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▶COMMISSION AND STAFF GUIDANCE

INTERPRETIVE RELEASES

Liquidity and Capital Resources in MD&A
(Release 33-9144, FR 83)

As noted above, in September the Commission issued an interpretive release designed to improve liquidity disclosures in MD&A. The release focuses on liquidity, leverage ratios, and the contractual obligations table and provides guidance on identifying and separately describing internal and external sources of liquidity.

Liquidity
The Commission's MD&A rules require issuers to disclose known trends and uncertainties that have impacted historical results or are reasonably likely to shape future periods. The interpretive guidance advises a registrant to disclose information about liquidity trends and uncertainties such as:

- Difficulties accessing the debt markets;
- Reliance on commercial paper or other short-term financing arrangements;
- Maturity mismatches between borrowing sources and the assets funded by those sources;
- Changes in terms requested by counterparties;
- Changes in the valuation of collateral; and
- Counterparty risk.

If a company's borrowings during a reporting period are materially different than the period-end amounts reported in the financial statements, the interpretive release notes that the company is already required to discuss the intra-period variations under current MD&A rules. Also, companies should consider describing cash management and risk management policies that are relevant to an assessment of their financial condition. A company that maintains a portfolio of cash and other investments that is a material source of liquidity should consider providing information about the nature and composition of that portfolio, including a description of the assets held and any related market risk, settlement risk or other risk exposures.

Leverage Ratio Disclosures
The guidance recommends that when a registrant discloses leverage ratios and other capital measures, it should disclose how it calculated the ratios. A registrant should provide clear explanations of the context for the measure and may need to include:

- An explanation of any inputs to the measure that are unusual, infrequent, or non-recurring;
- A discussion of why a financial measure used is different from other measures commonly used in the registrant's industry; and
- A presentation of the reasons for including a particular financial measure and why it is useful.

When a registrant provides capital or leverage ratio disclosures, it may be required to disclose additional information if the measure is non-financial or non-GAAP. If the measure is non-financial, and there is no commonly accepted method of calculating the capital or leverage ratio, the registrant should provide an explanation of its calculation.[14] If the leverage or capital measure is a non-GAAP financial measure, an issuer should provide disclosures required by Item 10(e) of Regulation S-K.

Contractual Obligations Table
The contractual obligations table provides information about a registrant's future payment obligations. The interpretive guidance highlights that the purpose of the table is to provide insight into a registrant's short-term and long-term liquidity and capital resources needs by:

- Aggregating information about contractual obligations and contingent liabilities and commitments in one location; and
- Establishing a context for investors to assess the relative role of off-balance sheet arrangements.

The guidance recommends that a registrant consider using footnotes to provide the information necessary for an understanding of the timing and amount of the specified contractual obligations and additional narrative discussion outside of the table.

14 See *http://www.sec.gov/rules/interp/33-8350.htm*, footnote 28.

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The interpretive release is available on the SEC's website at: *http://www.sec.gov/rules/interp/2010/33-9144.pdf*.

Climate Change
(Release 33-9106, FR 82)

In February, the SEC issued an interpretive release that explains how climate change matters should be addressed in the context of its disclosure requirements. The release does not add new disclosures, but discusses the application of the SEC's rules and provides examples. The release directs issuers to address the following questions in their business, legal proceedings, risk factors, and MD&A disclosures if the effect is reasonably likely to be material:

- What is the effect of enacted or pending climate change legislation or regulations?
- What is the effect of treaties or international accords related to climate change?
- What are the potential indirect consequences of climate change regulation (e.g., decreased demand for goods that produce significant greenhouse gas emissions)?
- What is the actual or potential physical effect of climate change (e.g., the severity of weather, sea levels, the arability of farmland, and water availability) on results of operations?

The release was effective upon issuance, so issuers should consider the above questions in their year end disclosures. The release states that the SEC staff will monitor the impact of the interpretive release on issuer filings as part of its ongoing disclosure review program.

The interpretive release is available on the SEC's website at: *http://www.sec.gov./rules/interp/2010/33-9106.pdf*.

STAFF GUIDANCE

Non-GAAP Measures
In January, the SEC staff revised its guidance on disclosing non-GAAP financial measures to remove impediments to disclosing non-GAAP measures that companies believe provide meaningful information to investors. The revisions are designed to make the staff's interpretive guidance consistent with the related rules (Regulation G and Item 10(e) of Regulation S-K). The staff issued the guidance in the form of C&DIs on the use of non-GAAP financial measures. These C&DIs replaced the staff's FAQ on non-GAAP financial measures. The staff encourages registrants to use their SEC filings as a means of communicating with investors and made the changes in an effort to enhance communication and the usefulness of SEC filings.

The non-GAAP C&DIs are available on the SEC's website at: *http://www.sec.gov./divisions/corpfin/guidance/nongaapinterp.htm*.

XBRL
In 2008, the Commission determined that all companies should file information in an interactive data format using eXtensible Business Reporting Language, as XBRL enhances the ability of users to analyze and compare financial information. The Commission divided registrants into three groups and began phasing in XBRL reporting in 2009:

- Group 1 – Consists of domestic and foreign large accelerated filers that use U.S. GAAP and have a worldwide public float above $5 billion. XBRL submissions generally began for fiscal periods ended on or after June 15, 2009;

- Group 2 – Consists of all other domestic and foreign large accelerated filers (generally filers with over $700 million in public float) using U.S. GAAP. XBRL submissions generally began for fiscal periods ended on or after June 15, 2010; and

- Group 3 – Consists of all remaining filers using U.S. GAAP, including smaller reporting companies, and all foreign private issuers that prepare their financial statements in accordance with IFRS as issued by the IASB. XBRL submissions generally will begin with fiscal periods ending on or after June 15, 2011.

Domestic filers begin XBRL reporting by submitting an exhibit to their Form 10-Q for the first quarter ending on or after June 15 of the year that the rules become applicable. Foreign private issuers begin their XBRL reporting by submitting an exhibit to their Form 20-F or 40-F for the applicable year ending on or after June 15. Issuers are also required to provide XBRL exhibits with each current report (i.e., Form 8-K or 6-K) containing updated or revised versions of their financial statements and with registration statements that include financial statements. However, issuers are not required to provide XBRL exhibits with their initial public offerings.

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To allow filers time to become familiar with tagging footnotes and schedules, the rules phase in the level of detail in which this information must be tagged. In a group's initial year, each footnote to the financial statements and each financial statement schedule generally needs only to be tagged individually as a single block of text. Beginning in the second year, a group is required to tag the footnotes and schedules in detail. In 2010, the largest companies began to provide XBRL submissions with detailed tagging.

The rules also provide issuers with two grace periods to ease the transition. Generally, interactive data exhibits are required at the same time as the rest of the related report. However, a filer's initial interactive data exhibit is not required until 30 days after the earlier of the due date or filing date of the related report. In the second year of XBRL reporting, a filer also has an additional 30 days to provide the first interactive data exhibit that includes the detailed tagging of its footnotes and schedules.

This year, the SEC staff addressed how changes in an issuer's public float can affect its XBRL phase-in group. The staff stressed that an issuer's phase-in group must be redetermined annually at year end based on its second quarter public float. This approach is consistent with how a registrant determines whether it is an accelerated filer.

The following examples illustrate some of the nuances of the transition to XBRL reporting:

- A large accelerated filer with a December 31 year end had less than $5 billion of public float on June 30, 2008, and 2009, putting it in Group 2. The company provided block tagged XBRL data in its Form 10-Qs for the quarters ended June 30 and September 30, 2010. At June 30, 2010, the company's public float exceeded $5 billion, so when it redetermines its phase-in group at December 31, 2010, it finds that it has moved into Group 1. The XBRL data in the December 31, 2010, Form 10-K and subsequent filings must be detail tagged, even though the filer is in its first year of interactive data reporting.
- A filer with a December 31 year end was not a large accelerated filer based on its public float on June 30, 2009, putting it in Group 3. At June 30, 2010, the company's public float exceeded $700 million, so when it redetermines its phase-in group at December 31, 2010, it finds that it has become a large accelerated filer and moved into Group 2. The company does not need to provide XBRL data in its December 31, 2010, Form 10-K because XBRL data is first required to be provided in a Form 10-Q. However, the company is required to provide block tagged data in its Form 10-Q for the quarter ended March 31, 2011, and to provide detail tagged data beginning with its June 30, 2011, Form 10-Q.
- A large accelerated filer with a December 31 year end had less than $5 billion of public float on June 30, 2008, and 2009, putting it in Group 2. The company provided block tagged XBRL data in its Form 10-Qs for the quarters ended June 30 and September 30, 2010. The company's public float dropped below $500 million at June 30, 2010, so when it redetermines its phase-in group at December 31, 2010, it finds that it is no longer a large accelerated filer and has moved into Group 3. Although it may do so, the company is not required to submit XBRL data in its December 31, 2010, Form 10-K or March 31, 2011, Form 10-Q. The company must resume submitting XBRL data in its Form 10-Q for the quarter ending June 30, 2011. If it remains in Group 3, the company would not be required to detail tag the financial statement footnotes and schedules until it files its June 30, 2012, Form 10-Q.
- A large accelerated filer with a June 30 year end had less than $5 billion of public float on December 31, 2008, and 2009, putting it in Group 2. Because XBRL data is first required to be provided in a Form 10-Q, the company is first required to provide block tagged data in its Form 10-Q for the quarter ended September 30, 2010. The company is also required to provide block tagged XBRL data in its Form 10-Qs for the quarters ended December 31, 2010, and March 31, 2011. The company's public float continued to exceed $500 million at December 31, 2010, so it remains a large accelerated filer in Group 2. Therefore, the company is required to provide detail tagged data in its June 30, 2011, Form 10-K. Most filers are able to provide block tagged data four times before they are required to provide detail tagged data and are able to first provide detail tagged data in a Form 10-Q. However, filers with June, July and August year ends are only able to provide block tagged data three times before they are required to begin providing detail tagged data, and they must first provide detail tagged data in a Form 10-K.

During the year the staff updated its C&DIs on XBRL implementation issues, reviewed XBRL submissions and provided its observations. The staff also updated the resource page on the SEC's website that provides interpretations, FAQs, and a public education webcast. We have provided links to these resources below.

The XBRL C&DIs are available on the SEC's website at: *http://www.sec.gov./divisions/corpfin/guidance/interactivedatainterp.htm*.

The staff updated its observations from its review of interactive data submissions in November, and they are available on the SEC's website at: *http://www.sec.gov/spotlight/xbrl/staff-review-observations.shtml*.

The staff's updated interpretations and FAQs related to interactive data submissions are available on the SEC's website at *http://www.sec.gov/spotlight/xbrl/staff-interps.shtml*.

A public education seminar presented on March 23 is available on the SEC's website at: *http://www.sec.gov/spotlight/xbrl/xbrl-webcasts.shtml*.

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The XBRL resource page is available on the SEC's website at http://xbrl.sec.gov.

Subsequent Events

In February, the FASB amended Accounting Standards Codification Topic 855, *Subsequent Events*, to address concerns about conflicts with SEC guidance and other practice issues. The amendments:

- Defined a new type of entity, termed an "SEC filer." An SEC filer is an entity required to file or furnish its financial statements with the SEC.[15]
- Continue to require an SEC filer to evaluate subsequent events through the date its financial statements are issued. However, an SEC filer is no longer required to disclose in the financial statements that it has done so or the date through which subsequent events have been evaluated.
- Require entities that are not SEC filers to evaluate subsequent events through the date the financial statements are available to be issued and to disclose the date through which subsequent events were evaluated. Entities other than SEC filers whose financial statements are included in SEC filings continue to be required to disclose the evaluation date.
- Clarified that conduit bond obligors are public entities that must evaluate subsequent events through the date the financial statements are issued. However, conduit bond obligors are not SEC filers and must disclose the date through which subsequent events have been evaluated.

The CAQ SEC Regulations Committee discussed the practical application of the definition of an SEC filer with the SEC staff in April. The staff informally indicated that the determination of whether a registrant is an SEC filer is made at the time the financial statements are first issued, and a company does not have to "re-open" its subsequent events recognition if its financial statements are subsequently filed with the SEC. This means the following entities are and are not SEC filers:

Entities that ARE SEC filers	Entities that are NOT SEC filers
Entity with a 1934 Act or 1940 Act reporting obligation	Entity filing an initial registration statement under the 1933, 1934 or 1940 Act (including all pre-effective amendments)
Voluntary filer of Forms 10-Q and 10-K – Entities that voluntarily file should follow the SEC's rules as if they are 1934 Act registrants.	Acquired business/real estate property (Item 9.01 of Form 8-K, Rules 3-05 and 3-14 of S-X)
Guarantor of public debt (Rule 3-10 of S-X) – Following the effective date of the registration statement for the guarantee, the guarantor has a reporting obligation with the SEC.	Target business in Form S-4 or F-4
Employee benefit plan filing a Form 11-K – Following the effective date of the Form S-8 registration statement, the employee benefit plan must file financial statements with the SEC.	Entity acquired by a public operating or shell company and either (a) the legal target/accounting acquiree will be the registrant's predecessor, so its financial statements will be required in future filings pursuant to Rules 3-01 and 3-02 of S-X or (b) the transaction will be accounted for as a reverse acquisition
Issuer or non-issuer registered broker dealer	Equity method investee (Rule 3-09 of S-X)
	Entity whose securities collateralize public debt (Rule 3-16 of S-X)

The CAQ SEC Regulations Committee minutes are available on the CAQ's website at: http://thecaq.org/resources/secregs/highlights.htm.

15 This definition also includes entities subject to Section 12(i) of the Securities Exchange Act of 1934, primarily banks and savings associations whose deposits are insured under the Federal Deposit Insurance Act.

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General Partner Balance Sheets

As further discussed in our *2009 SEC Year in Review* publication, Staff Accounting Bulletin 113 removed the requirement for oil and gas limited partnerships to include the balance sheet of the general partner in a registration statement.[16] However, this change conflicts with Rule 8-07 of Regulation S-X, which requires a smaller reporting company to present a general partner balance sheet in a registration statement of a limited partnership .

During 2010 the SEC staff revised the *Financial Reporting Manual* to clarify the requirements for a general partner balance sheet as follows:

- Oil and gas companies that are not smaller reporting companies – These companies can rely on SAB 113 and do not need to request permission to exclude the general partner's balance sheet.

- Other companies that are not smaller reporting companies – Likewise, these companies do not need to request the staff's permission to exclude the balance sheet of the general partner. However, the *Financial Reporting Manual* describes situations in which the relationship between the limited partnership and the general partner can be relevant to an investor and the disclosures that should be made to make the relationship clear.

- Smaller reporting companies – Rule 8-07 of Regulation S-X requires a smaller reporting company to provide the balance sheet of the general partner in certain circumstances. If a smaller reporting company believes that relief is appropriate, it should request relief in writing from the Division of Corporation Finance's Chief Accountant's Office.

The staff has indicated that the following general partner attributes, if present, weigh heavily in deciding to waive the requirement for the general partner's balance sheet:

- Minimal assets;
- No obligation to fund the losses of the limited partnership; and
- No obligation to provide capital to the limited partnership.

The staff discussed general partner balance sheet requirements at the April CAQ SEC Regulations Committee meeting. The minutes are available on the CAQ's website at: *http://thecaq.org/resources/secregs/highlights.htm*.

SAB 113 is available on the SEC's website at: *http://www.sec.gov/interps/account/sab113.htm*.

Section 2805 of the *Financial Reporting Manual* addresses general partner balance sheet requirements and is available on the SEC's website at: *http://www.sec.gov./divisions/corpfin/cffinancialreportingmanual.shtml*.

Significance Tests

The SEC staff has revised its guidance for computing the significance of other entities, such as businesses acquired and equity method investees, to determine whether separate financial statements or financial data are required. The significance tests are located in Rule 1-02(w) of Regulation S-X, and are generally referred to as the investment, asset, and income tests. The staff's updated guidance concerns three applications of the income test:

- Income averaging – Generally, a registrant uses its pretax income from continuing operations for the most recently completed audited fiscal year as the denominator in the income test. However, Rule 1-02(w) allows a registrant to use its average income as the denominator if the income for the most recently completed year is at least 10 percent lower than the average of the income for the last five fiscal years. Any loss year is treated as a zero when computing the average, and the total is always divided by five. Previously, the staff interpreted Rule 1-02(w) to prohibit income averaging if the registrant had a pre-tax loss in the most recent fiscal year. Under the revised guidance, a registrant is now allowed to income average if it had a pre-tax loss in the most recent fiscal year.

- Income tests for equity method investees – Under Rule 1-02(w), the numerator for the income test is based on the registrant's equity in the income from continuing operations before income taxes, extraordinary items and cumulative effect of a change in accounting principle of the investee (referred to as pre-tax income). The staff now believes that the numerator should be calculated based on the registrant's proportionate share of the investee's pre-tax income as reflected in its separate financial statements, adjusted for any basis differences. This is a change from the staff's old practice in which the numerator was computed using amounts in the registrant's financial statements.

- Income tests for disposed businesses – Registrants are required to file an Item 2.01 Form 8-K and to file pro forma information in registration statements if a business disposition exceeds 10 percent using the Rule 1-02(w) tests. Under the revised guidance, if the

16 In SAB Topic 12.A.3.d.

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disposed business is not a discontinued operation, the denominator includes pre-tax income of the disposed business. If the disposed business is a discontinued operation, the denominator excludes the pre-tax income of the disposed business.

Sections 2015.8, 2410.2, and 2130.3 of the *Financial Reporting Manual* address income averaging, income tests for equity method investees, and income tests for disposed businesses, respectively. The Manual is available on the SEC's website at: *http://www.sec.gov./divisions/corpfin/cffinancialreportingmanual.shtml*.

Foreign Targets

This year the SEC staff addressed an issue that registrants that acquire foreign businesses may encounter. The financial statements of significant acquired foreign businesses must be prepared using a comprehensive basis of accounting, and the staff has taken the view that IFRS for Small and Medium-sized Entities (SMEs)[17] meets this requirement. Accordingly, registrants that acquire a foreign business may present the financial statements of the foreign target in accordance with IFRS for SMEs. Financial statements prepared in accordance with IFRS for SMEs are not appropriate for issuers, predecessors of issuers, or domestic acquired businesses. Financial statements prepared in accordance with IFRS for SMEs must be reconciled to U.S. GAAP (not IFRS) when the significance of the target exceeds 30 percent.

The staff views outlined in the preceding paragraph also apply to financial statements of equity method investees that are foreign businesses.

Section 6410 of the *Financial Reporting Manual* addresses targets that are foreign businesses and is available on the SEC's website at: *http://www.sec.gov./divisions/corpfin/cffinancialreportingmanual.shtml*.

Stock-Based Compensation in IPOs

Companies going public often do not have objective indicators of the pre-IPO value of their stock. When significant amounts of stock or stock-based instruments have been issued, the estimates used to determine stock-based compensation expense are often a critical accounting policy. The SEC staff's practice is to request companies in this situation to consider providing the following disclosures in MD&A:

1. A description of the methods and assumptions used in estimating the fair value of the underlying stock and the instruments granted;

2. A table disclosing the number of instruments granted, exercise price, fair value of the underlying stock, and fair value of the instruments granted for the twelve-month period preceding the most recent balance sheet date;

3. Narrative disclosures that describe the factors contributing to significant changes in the fair values of the underlying stock during the period referred to above. In addition to describing the factors, these disclosures should relate those factors to changes in assumptions. The nature and extent of disclosure should be commensurate with the level of changes in the valuations; and

4. If considered meaningful to investors, the disclosures outlined in 1 and 2 should also include analysis before and/or after the period indicated. Circumstances warranting expanded disclosure may include (a) significant grants and changes in fair value occurring after the most recent interim period and prior to the initial public offering or (b) an estimated IPO price that differs significantly from the most recently determined fair value.

Section 9520 of the *Financial Reporting Manual* addresses stock valuation disclosures in IPOs and is available on the SEC's website at: *http://www.sec.gov./divisions/corpfin/cffinancialreportingmanual.shtml*.

Rating Agency Consents

The Dodd-Frank Act makes significant changes to the regulation of credit rating agencies and requires the SEC to adopt a number of new rules to implement these changes. The Act itself immediately instituted credit rating agency consent requirements by repealing Securities Act Rule 436(g). Before its repeal, Rule 436(g) had allowed issuers to provide credit rating information in a registration statement or prospectus without providing a credit rating agency's consent.

As a result of the repeal of Rule 436(g), issuers are required to provide a consent from the credit rating agency if information about the security's credit rating is included or incorporated by reference in a 1933 Act registration statement or a prospectus.[18] However, if the issuer discloses a credit rating in a filing with the Commission that is related only to the company's liquidity, cost of funds, the terms of agreements

17 Published by the IASB in July 2009.

18 Regulation AB governs offerings of asset-backed securities and requires issuers of ABS to disclose whether an issuance or sale of any class of such securities is conditioned on the assignment of a rating by a credit rating agency and, if so, the minimum credit rating and identity of each agency. With the rescission of Rule 436(g), this Regulation AB requirement necessitates a consent from a credit rating agency, but credit rating agencies have been unwilling to provide such consents. In order to facilitate transition and permit registered offerings of ABS to continue without interruption, the SEC staff issued a no-action letter on July 22, 2010, allowing issuers to omit the credit rating disclosure from registration statements filed under Regulation AB until January 24, 2011. On November 23, 2010, the SEC staff extended the no action position indefinitely in order to allow adequate time to complete the regulatory actions required by the Dodd-Frank Act.

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that refer to credit ratings, or changes in credit ratings, the SEC considers this to be "issuer disclosure-related ratings information," and a rating agency consent is not required. Examples of issuer disclosure-related ratings information follow:

- An issuer notes its ratings in the context of a risk factor discussing the risk of failing to maintain a certain rating and the potential impact a change in credit rating would have on it;
- An issuer refers to or describes its rating in the context of its liquidity discussion in MD&A; and
- An issuer describes debt covenants, interest rates, or dividend restrictions that are tied to credit ratings.

SEC staff guidance on the consent requirement is available on the SEC's website at: Compliance and Disclosure Interpretations, Securities Act Rules, Sections 233.04-08, *http://www.sec.gov./divisions/corpfin/guidance/securitiesactrules-interps.htm*.

Financial Reporting Manual

The SEC staff updated its *Financial Reporting Manual* four times during 2010. The staff added guidance discussed above applicable to:

- Significance testing;
- Stock valuation disclosures in IPOs; and
- General partner balance sheets.

The staff also made significant progress on its project to update the Manual to reflect topics covered during several years of CAQ SEC Regulations Committee meetings. It plans to complete this project in early 2011 and then begin making similar updates to reflect topics covered during meetings of the Committee's International Practices Task Force.

Each update to the Manual indicates which sections were updated, and the Manual is available on the SEC's website at: *http://www.sec.gov./divisions/corpfin/cffinancialreportingmanual.shtml*.

C&DIs

The SEC staff updated its C&DIs throughout the year. The updates provided guidance on topics such as non-GAAP financial measures and XBRL submissions, as discussed above, and various legal matters.

The C&DIs are available on the SEC's website at: *http://www.sec.gov./divisions/corpfin/cfguidance.shtml*.

Smaller Reporting Companies

During 2010, the Commission released three guides that summarize and explain rules adopted by the SEC as they apply to smaller public companies:

1. **Filing and Amending a Form D Notice**
   The SEC staff updated this guide for smaller companies to explain Form D, a form used to file notice of an exempt offering of securities with the SEC under Rule 504, 505, or 506 of Regulation D or Section 4(6) of the Securities Act of 1933. The guide is available on the SEC's website at: *http://www.sec.gov/info/smallbus/secg/formdguide.htm*.

2. **Internet Availability of Proxy Materials**
   This guide is discussed in the Corporate Governance section of this publication. The guide is available on the SEC's website at: *http://www.sec.gov/rules/final/2010/33-9108-secg.htm*.

3. **Oil and Gas Reporting Modernization**
   The staff prepared this guide for smaller reporting companies to summarize the oil and gas reporting rules that were amended in 2009. The guide is available on the SEC's website at: *http://www.sec.gov/info/smallbus/secg/oilgasreporting-secg.htm*.

The staff provided access to its 2010 presentations covering common financial reporting issues it encounters in reviewing filings made by smaller issuers. One was presented with the CAQ, and the other was presented in PCAOB forums on auditing in a small business environment. The presentations are available at: *http://video.webcasts.com/events/aicp001/35866/browser/slides/20101019123784575000/slidepdf.pdf* and *http://sec.gov/news/speech/2010/spch1210wc.pdf*.

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AREAS OF FREQUENT SEC STAFF COMMENT

Loss Contingency Disclosures

The SEC staff believes that in many instances registrants are not providing investors with the disclosures about loss contingencies required by ASC 450, *Contingencies* (formerly FAS 5). The staff focuses on whether companies are complying with the following GAAP disclosure requirements regarding reasonably possible losses that are not accrued because they are not both probable and reasonably estimable:

- The nature of the contingency; and
- An estimate of the possible loss or range of loss or a statement that such an estimate cannot be made.

The staff has advised that issuers can comply with these disclosure requirements in one of three ways:

- State the amount or range of potential loss;
- State that any loss (or any loss in excess of the amount accrued) would not be material; or
- State that the amount of potential loss can't be estimated.

The staff has cautioned that issuers must try to estimate the amount of the potential loss before taking the last approach.

In addition, when an issuer announces a material legal settlement, the staff may review the issuer's prior period accounting and disclosures to evaluate whether any required accruals were appropriately recognized and appropriate disclosure was made.

The staff has observed that the disclosures required by Item 103 of Regulation S-K, *Legal Proceedings*, and ASC 450 have different objectives, and attempts to satisfy both through an integrated set of disclosure often fail. The staff has noted that integrated disclosure is often lengthy but does not provide the required disclosure of the reasonably possible loss required by ASC 450.

The staff has been particularly concerned about potential risks and costs associated with mortgage and foreclosure-related activities or exposures, and in October, it sent "Dear CFO" letters to a number of companies. The letters discuss a number of points that companies with these exposures should consider in complying with ASC 450 and the MD&A rules.

The FASB is also focused on loss contingency disclosures. The FASB is reconsidering the disclosures proposed in its Exposure Draft, *Disclosure of Certain Loss Contingencies*. The FASB has delayed this project and plans to work with the SEC to determine whether its efforts have resulted in improved loss contingency disclosures. The FASB plans to discuss loss contingency disclosures later in 2011.

The Dear CFO letter is available on the SEC's website at: *http://www.sec.gov/divisions/corpfin/guidance/cfoforeclosure1010.htm*.

The staff discussed loss contingencies at the CAQ SEC Regulations Committee September meeting. The minutes are available on the CAQ's website at: *http://thecaq.org/resources/secregs/highlights.htm*.

Potential Long-Lived Asset and Goodwill Impairment

When a business experiences a downturn, the SEC staff will consider whether the company should have recorded impairment charges on its long-lived assets and goodwill. Examples of situations that could generate a staff comment include significant decreases in revenue and gross margin, business restructurings, sales of assets associated with discontinued operations, and suspensions of development projects.

If a registrant defines goodwill impairment as a critical accounting policy because impairment could materially impact the company's operating results, the staff believes the MD&A requirements to discuss known trends or uncertainties that are reasonably likely to materially affect future operating results require an issuer to disclose the following in MD&A:

- The identity of reporting units with a material amount of goodwill that is at risk of failing step 1 of the impairment test in ASC 350-20-35 (formerly FAS 142);
- For each such reporting unit:
  - The percentage by which the estimated fair value exceeds the carrying value;
  - The amount of goodwill allocated to the reporting unit;
  - The methods and key assumptions that drive the estimated fair value and how the key assumptions were determined;
  - The degree of uncertainty associated with the key assumptions. For example, to the extent that assumptions in a discounted cash flow model materially deviate from historical results, include a discussion of these assumptions;
  - Potential events and/or circumstances that could reasonably be expected to have a negative effect on the estimated fair value; and
- The reporting units with a material amount of goodwill that are *not* at risk of failing step 1.

The staff discussed impairment at the CAQ SEC Regulations Committee meeting in April. The minutes are available on the CAQ's website at: *http://thecaq.org/resources/secregs/highlights.htm*.

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Section 9510 of the *Financial Reporting Manual* addresses goodwill impairment and is available on the SEC's website at: *http://www.sec.gov./divisions/corpfin/cffinancialreportingmanual.shtml*.

Valuations

The SEC staff frequently believes investors should receive more information regarding how an issuer estimated the fair value of a reporting unit or an indefinite-lived asset, and may ask an issuer to expand its disclosure to discuss:

- The method used to value the asset or reporting unit (e.g., income, market, or replacement cost);
- If multiple methods are used, how the amounts derived using each method were weighted in arriving at the value used for accounting purposes and why this weighting was used;
- General descriptions of the valuation techniques or models used;
- Key assumptions and the basis for the assumptions;
- How the technique or model was validated;
- How sensitive the fair value estimate was to the significant inputs used; and
- If any of these items have changed since the prior valuation, the reasons why the changes were made.

A method that is commonly used to value FCC licenses and franchise agreements is the multi-period excess earnings method (MPEEM). From time to time the staff has questioned whether the MPEEM is a residual method, which is prohibited by ASC 805-20-S99-3 (formerly Emerging Issues Task Force Topic D-108) when valuing intangible assets other than goodwill, and whether an alternate approach such as the Greenfield method would be more appropriate. At its November meeting, the Valuation Resource Group (VRG)[19] concluded that the MPEEM is not a residual method and is an appropriate method for valuing intangible assets, and the SEC observer concurred. The VRG acknowledged that the Greenfield method may also be appropriate when valuing certain types of intangible assets.

The staff has raised with increasing frequency the issue of whether it is appropriate to use the Black-Scholes formula to value instruments such as options, warrants and embedded derivatives that must be bifurcated. When all of the inputs used in the formula are not fixed, it may be necessary to use a lattice model or Monte Carlo simulation to appropriately consider such features.

Segments

The SEC staff expects strict compliance with segments reporting disclosures required by ASC 280-10 (formerly FAS 131). The staff will question inconsistencies between the segments identified in the audited financial statements and statements about the way management views the business made in the business section, MD&A, and materials that are publicly available on the issuer's website. Also, the staff may request internal operating reports that are reviewed by the chief operating decision maker to support the segments disclosed by the issuer.

Non-GAAP Measures

The SEC staff frequently comments on the following matters related to registrants' non-GAAP financial measures:

Inconsistencies – Sometimes registrants present non-GAAP financial measures in analyst presentations but not in documents they file with the SEC. While the C&DIs related to non-GAAP measures the staff issued in 2010 (discussed above) were issued in part to reduce impediments to including non-GAAP measures in filings, the staff generally will not ask a registrant to include a non-GAAP measure in a filing. Often, the substance of the disclosure is the same in the analyst presentation and the filing (e.g., the company discusses the relevant components of the non-GAAP measure in the analyst presentation and the filing but simply doesn't "do the math" and present the resulting non-GAAP measure in the filing). In this case, there is no cause for concern. However, if management communicates in a public disclosure that certain non-GAAP measures are key performance indicators but does not include them in the company's filing and the filing conveys a different message to investors, the staff may question whether the filing omits material information.

Confusing measures – Issuers occasionally present measures that the staff deems to be confusing or misleading to investors. One example is system-wide sales by franchisors – a measure that includes sales by entities that the registrant does not control.

Full non-GAAP income statements – Some registrants present a full non-GAAP income statement, a presentation that the staff believes is inappropriate. Section 102.10 of the C&DIs states that such presentation attaches undue prominence to the non-GAAP information.

Prominence – When registrants present non-GAAP financial measures with greater prominence than GAAP measures, the staff may question whether the registrant has complied with Item 10(e)(1)(i)(A) of Regulation S-K, which requires the most directly comparable GAAP measure to be presented with equal or greater prominence. The staff may question prominence based on both the order in which the measures are

19 The FASB formed the VRG to assist the Board in matters involving implementation issues surrounding fair value measurements used for financial reporting purposes. The VRG does not make any authoritative decisions.

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presented and the degree of emphasis. For example, the staff may challenge a discussion of non-GAAP financial measures that significantly exceeds the length of the discussion of the corresponding GAAP measures.

Adjustments – The staff has observed adjustments to non-GAAP financial measures that are not clearly described and commented that registrants should not describe an adjusted measure using terminology that would imply it is an unadjusted measure. Section 103.01 of the C&DIs states that a measure that includes adjustments to the standard definition of EBITDA should not be labeled "EBITDA."

Cash flows per share – The staff can be expected to challenge the use, even in oral discussions or website disclosures, of operating cash flows per share or other per share measures that are not in accordance with ASR 142. The ASR states that per share data, other than that relating to net income, net assets and dividends, should be avoided in reporting financial results.

The staff discussed non-GAAP financial measures at the April and September CAQ SEC Regulations Committee meetings. The minutes are available on the CAQ's website at: *http://thecaq.org/resources/secregs/highlights.htm*.

The non-GAAP C&DIs are available on the SEC's website at: *http://www.sec.gov./divisions/corpfin/guidance/nongaapinterp.htm*.

Financial Institutions

The SEC staff has published a presentation on areas of frequent staff comment on filings by financial institutions. The presentation is available on the SEC's website at: *http://www.sec.gov./news/speech/2010/spch1210slh.pdf*.

PCAOB DEVELOPMENTS

APPROVED STANDARDS

In January, the SEC approved Auditing Standard 7, *Engagement Quality Review*, and conforming amendments to the interim quality control standards, which had been adopted by the PCAOB in July 2009. The standard is effective for engagement quality review of audits and interim reviews for fiscal years that began on or after December 15, 2009. The standard is expected to improve the reliability of audited financial statements by increasing the likelihood that engagement quality reviewers will identify significant engagement deficiencies before audit reports are issued.

In approving the standard, the SEC encouraged the PCAOB to issue guidance on the standard's documentation requirement and the PCAOB did so in February. This guidance, in the form of a Q&A document, clarifies that all interactions between the engagement quality reviewer and the engagement team need not be documented.

The standard and Q&A document are available on the PCAOB's website at: *http://pcaobus.org/Standards/Auditing/Pages/Auditing_Standard_7.aspx* and *http://pcaobus.org/Standards/QandA/2010-02-19_EQR_QA%20_2.pdf*.

In December, the SEC approved eight auditing standards related to the auditor's assessment of and response to risk in an audit of financial statements. The standards address audit procedures performed throughout the audit, from initial planning through evaluation of audit results. The PCAOB had adopted the standards in August, and they are effective for audits of fiscal years beginning on or after December 15, 2010.

The PCAOB's and SEC's releases can be found on their websites at: *http://pcaobus.org/Rules/Rulemaking/Pages/Docket026.aspx* and *http://www.sec.gov/rules/pcaob/2010/34-63606.pdf*.

PROPOSED STANDARDS

During the year, the PCAOB exposed two auditing standards for comment; *Communications with Audit Committees*, issued in March, and *Confirmation*, issued in July.

Communications with Audit Committees addresses requirements for auditors to communicate with audit committees, with an emphasis on effective two-way communication. *Confirmation* expands the requirement to use confirmation procedures beyond cash and accounts receivable to cash and other relationships with financial institutions, certain significant risks, and receivables that arise from credit sales, loans, or other transactions. The standard also discusses methods of obtaining and validating confirmations given the movement towards more electronic and less mailed responses.

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Further, in August the PCAOB issued a concept release that addresses the provisions of the Sarbanes-Oxley Act which authorize the PCAOB to sanction registered firms and their supervisory personnel for failing to reasonably supervise associated persons who violate certain laws, rules or standards (Section 105(c)(6) of the Sarbanes Oxley Act). The release discusses the concepts relating to possible rulemaking or standard setting that would require firms to make and document clear assignments of the supervision responsibilities that are already required to be part of an audit practice.

The proposed standards and concept release can be found on the PCAOB website, within the Current Standard-Setting and Related Rulemaking Activities section, at: *http://pcaobus.org/Standards/Pages/CurrentStatus.aspx*.

GUIDANCE

Staff Audit Practice Alerts

During 2010 the PCAOB issued three Staff Audit Practice Alerts: *Auditor Considerations Regarding Significant Unusual Transactions* (Alert No. 5), *Auditor Considerations Regarding Using the Work of Other Auditors and Engaging Assistants from Outside the Firm* (Alert No. 6), and *Auditor Considerations of Litigation and Other Contingencies Arising from Mortgage and Other Loan Activities* (Alert No. 7). As with all other staff audit practice alerts, these alerts do not introduce any new auditing requirements but, rather, highlight new, emerging or otherwise noteworthy circumstances that may affect how auditors conduct audits under existing standards. The Alerts remind auditors and their firms that they have:

- Certain responsibilities with respect to significant unusual transactions (Alert No. 5). The Alert assists auditors in assessing and responding to the risks of material misstatement associated with these transactions;
- Obligations when using the work of other firms or using assistants engaged from outside the firm (Alert No. 6); and
- Responsibilities when auditing loss contingencies, disclosures, and related items (Alert No. 7). The Alert advises auditors regarding the potential risks and costs associated with mortgage- and foreclosure-related activities and their audit implications.

These alerts are available on the PCAOB's website, within the Staff Audit Practice Alerts section, at: *http://pcaobus.org/Standards/Pages/Guidance.aspx*.

PCAOB Report – Observations of PCAOB Inspectors Related to Audit Risk Areas Affected by the Economic Crisis

In September, the PCAOB issued a report on inspection observations related to audit risk areas affected by the economic crisis. The report summarizes inspection observations of audits of financial institutions and other companies obtained in reviews of firms' audits from 2006 through 2008. The report discusses audit risks and challenges identified during the inspection process that resulted, in large part, from the disruption in the credit and financial markets and the broader economic downturn.

This report is available on the PCAOB's website at: *http://pcaobus.org/Inspections/Documents/4010_Report_Economic_Crisis.pdf*.

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