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Financial Reporting

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SEC Year in Review

Overview of Significant 2008 Developments

This letter summarizes many of the 2008 activities at the Securities and Exchange Commission that affect financial reporting. We begin with an overview and then discuss many of the activities in greater detail. Although not the focus of this letter, we also briefly discuss the 2008 activities of the Public Company Accounting Oversight Board, the SEC's Advisory Committee on Improvements to Financial Reporting, and the Treasury Department's Advisory Committee on the Auditing Profession.

Fair Value – In the current credit crisis, the SEC focused on questions that developed from the difficulties in measuring fair value in inactive markets. The SEC held roundtables on fair value accounting and issued a joint press release with the FASB. The press release addressed fair value measurement issues such as the use of actual transactions versus management models. The SEC staff also issued letters to registrants urging greater transparency regarding fair value measurements in management's discussion and analysis (MD&A). The press release and the registrant letters did not modify FASB Statement 157, *Fair Value Measurements*. The staff guidance stressed that registrants must use significant judgment in determining fair values and should disclose how these determinations were made.

Use of IFRS by U.S. Companies – The SEC proposed a roadmap for transitioning domestic issuers to reporting in International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB). The roadmap includes milestones that must be achieved before the Commission will consider requiring domestic issuers to report in IFRS. To help inform the SEC's thinking, a limited number of large U.S. issuers would be eligible to voluntar-

ily early adopt IFRS beginning in years ending on or after December 15, 2009. In 2011, the Commission would evaluate progress toward achieving the milestones and decide whether IFRS reporting should be mandated for domestic issuers. If the decision is yes, domestic issuers would begin adopting IFRS in years ending on or after December 15, 2014.

XBRL – SEC Chairman Christopher Cox strongly believes in the power of interactive data reporting and analysis that is based on financial statements filed in Extensible Business Reporting Language or XBRL. The Commission adopted rules that will require issuers to furnish financial statement information in XBRL. The rules require phased-in XBRL reporting over three years beginning with the largest issuers, who will begin reporting in fiscal periods ending on or after June 15, 2009.

Chairman Cox established a project called the Twenty-First Century Disclosure Initiative that is designed to determine how to move the SEC from a form-based to a company-based system of data collection. The goal is to devise an XBRL-based system in which a registrant would provide core data that it would supplement with current periodic and transactional information. In August, the SEC announced that its EDGAR database will be succeeded by the IDEA (Interactive Data Electronic Applications) database. Initially, EDGAR and IDEA will run in parallel with the XBRL based IDEA ultimately replacing EDGAR.

Internal Control over Financial Reporting – The Commission deferred the requirement for auditors of smaller public companies to report on internal control over financial reporting (ICFR) to years ending on or after December 15, 2009. While auditor attestation on ICFR has been deferred for one year for non accelerated filers, all public companies have been required to provide a management report on ICFR since the years ending on or after December 15, 2007. For accelerated filers that became non accelerated based on market capitalization as of the end of the second fiscal quarter, auditor attestation on ICFR will not be required in the current fiscal year. The SEC deferred the auditor attestation requirement to provide time to study the costs and benefits of auditing and management reporting on ICFR in smaller public companies.

Foreign Private Issuers – The Commission adopted amendments to enhance reporting by foreign private issuers. Effective for years ending on or after December 15, 2011, annual reports on Form 20-F will be due in four months, accelerated from six months after year end. At that time, foreign private issuers that do not report in U.S. GAAP or IFRS as issued by the IASB will also be required to provide reconciliations to U.S. GAAP in accordance with Item18 in their annual reports on Form 20-F. Similar to domestic issuers, foreign private issuers will be required to disclose information about changes in and disagreements with accountants. This change will occur in years ending on or after December 15, 2009.

Staff Guidance – The SEC's Division of Corporation Finance (Corp Fin) staff published its *Financial Reporting Manual* in December. *The Financial Reporting Manual* updates and replaces the "Staff Training Manual" which was last issued in 2000. The staff has indicated that the new *Financial Reporting Manual* does not change the guidance or policies included in the Staff Training Manual. The Manual is designed to be an internal staff reference and is very useful when evaluating SEC reporting issues.

The staff once again reviewed executive compensation disclosures, but only in the context of its traditional review program. This was a shift from 2007, when the staff performed a targeted review of 350 issuers' executive compensation disclosures. The staff identified the same issues this year that it had identified last year – a need for registrants to provide greater analysis and to explain the *how* and *why* of compensation decisions.

Throughout the year the SEC staff released guides with plain English explanations of rules and regulations that affect smaller public companies. Also, the staff provided guidance on several issues associated with transitioning to FASB Statements 141R, *Business Combinations*, and 160, *Noncontrolling Interests in Consolidated Financial Statements* and FSP APB 14-1, *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)*. The staff also changed its view on computing significance under the income test in Regulation S-X, Rule 3-09, *Separate Financial Statements of Subsidiaries Not Consolidated and 50 Percent or Less Owned Persons*, on financial statement updating requirements in Form S- 8, and on providing consents for the work of experts.

Advisory Committees – The SEC's Advisory Committee on Improvements to Financial Reporting, known as CIFiR, and the Treasury Department's Advisory Committee on the Auditing Profession, known as ACAP, completed their work and issued final reports. CIFiR made recommendations on reducing substantive complexity, improving the standard setting process, clarifying guidance on materiality, restatements and accounting judgments, and improving the delivery of financial information. ACAP considered three broad issues affecting the sustainability of the auditing profession – human capital, firm structure and finances, and

firm concentration and competition –and made recommendations.

On the Horizon – In 2009, the SEC staff plans to recommend rulemaking to the Commission associated with the new standards on business combinations and non controlling interests, Form 8-K reporting of restatements, and amendments to Regulation D. Technical amendments would conform SEC rules to Statements 141R and 160. Also on the list is an amendment to require issuers to report financial statement restatements on Item 4.02 of Form 8-K and prevent “stealth restatements” (reporting restatements in Form 10-Ks and 10-Qs) from occurring. Both CIFiR and the General Accountability Office have recommended that the Commission modify the Form 8-K rules for this item. The staff plans to complete work on the amendments to Regulation D proposed in 2007. The amendments would allow limited advertising in connection with private offerings of securities to a newly defined category of investors. The proposed rules would also adjust the definition of “accredited investors” to account for inflation.

The Commission hopes to readdress shareholder proxy access in 2009. The issue is the degree of access shareholders should have to proxies for director nominations. Investors contend that they should have the right to put forth independent director nominations without incurring the costs of a proxy fight. In 2007, the Commission voted to restrict shareholders’ proxy access. However, SEC Chairman Christopher Cox noted at the time that while the measure was necessary to promote clarity, the issue was not closed and would be revisited. The staff observed that company communications with shareholders and ownership thresholds for shareholder proposals also became swept up in the proxy access debate and it expects these issues to be addressed when shareholder proxy access is reconsidered.

The Commission’s agenda will be shaped by new leadership, and it may also continue to be influenced by developing economic conditions and other events. In connection with the change in administration, Chairman Cox will step down and will be replaced by a new chair. President Obama has nominated Mary Schapiro, former Chief Executive Officer of the Financial Industry Regulatory Authority, to succeed Chairman Cox. The new chair will fill vacant senior-level staff positions, including the Director of the Division of Corporation Finance and the Chief Accountant.

These changes will follow personnel changes that the SEC experienced in 2008. Luis Aguilar and Elisse Walter, both Democrats and securities attorneys, replaced Roel Campos and Annette Nazareth as the Democratic Commissioners. Troy Paredes, a Republican and a Washington University law professor, replaced Commissioner Paul Atkins.

PCAOB – During 2008, the PCAOB finalized Auditing Standard 6 on evaluating and reporting on the consistency of a company’s financial statements. The PCAOB also proposed standards on engagement quality review and the assessment of risk. New PCAOB rules on tax services for persons in financial reporting oversight roles and communications with audit committees on independence were finalized and approved by the SEC. The PCAOB staff issued guidance on auditing in the current economic environment.

Personnel changes at the PCAOB included the resignation of Kayla Gillan, a board member since the inception of the Board. Former Senate Banking Committee staffer (and contributor to the Sarbanes- Oxley Act of 2002) Steven B. Harris joined the PCAOB as a board member in June.

New Commission Rules

Incorporation by Reference in Form S-11

(Release 33-8909)

In April, the SEC adopted an amendment to Form S-11 to allow registration statements filed on that form to incorporate by reference previously filed information. Form S-11 is an S-1-like form used by real estate entities to register securities offerings. The amendment to Form S-11 became effective on April 15, 2008.

The Securities Offering Reform rulemaking that became effective in 2005 introduced incorporation by reference to Forms S-1 and F-1 for reporting issuers that are current in filing their Exchange Act reports and have filed at least one annual report (e.g., Form 10-K). The same requirements now apply to S-11 filers, and like the S-1 and F-1 issuers, the S-11 issuers:

- Cannot be, or have been (including predecessors) for the past three years, blank check issuers, shell companies, or penny stock issuers; and
- Are required to make their incorporated Exchange Act reports and other materials readily accessible on the web.

Form S-11 does not permit incorporation by reference of Exchange Act reports and materials filed after the registration statement is effective. That is, it does not allow what is known as “forward incorporation by reference.”

Also, Form S-11 filers, like Form S-1 filers, are required to complete a checkbox on the facing page of the form indicating whether they are relying on Securities Act Rule 415 to offer securities "off the shelf" on a delayed or continuous basis. The release is available on the SEC's website at: *http://www.sec.gov/rules/final/2008/33-8909.pdf.*

Auditor Reporting on Internal Control Over Financial Reporting

(Release 33-8934)

In June, the Commission approved a one-year delay in the requirement for auditors of smaller public companies to report on internal control over financial reporting (ICFR). This deferral means that smaller companies will not be required to provide the auditor attestation reports in their annual reports until fiscal years ending on or after December 15, 2009. The deferral does not affect management reporting on ICFR, which has been required for all public companies since fiscal years ended on or after December 15, 2007.

The public float test that public companies must perform to determine filing status and reporting company status occurs as of the end of a company's second fiscal quarter. With the recent stock market slump, many public companies may experience a change in reporting company status, from larger reporting company to smaller reporting company. The filing status for these companies may also change from accelerated to non accelerated filer. A company that moves from accelerated to non accelerated filer status could decide to forego an audit of its ICFR in the year of its filing status change, if the change occurs before the new compliance date. If an audit report is not included in the company's Form 10-K, the company will be required to provide management's evaluation of ICFR in its Form 10-K and disclose the fact that ICFR has not been audited.

The SEC deferred auditor reporting on ICFR one year for non accelerated filers to allow time for a study of the costs and benefits of internal control reporting and auditing, with an emphasis on smaller companies. The study will consider the improvements afforded by SEC staff guidance on evaluating ICFR and PCAOB Auditing Standard 5 on auditing ICFR. The study included a survey of registrants and their experience in assessing ICFR and in having ICFR audited. The results of the study are expected to become available during 2009. In addition to assessing the costs, the findings also will be used to support Commission decisions on improving the efficiency and effectiveness of management evaluation of and auditor reporting on ICFR.

The release is available on the SEC's website at: *http://www.sec.gov/rules/final/2008/33-8934.pdf.*

XBRL

During his tenure, Chairman Cox has promoted the power and ease of analyzing financial statements filed in interactive data format. In December, the Commission adopted rules that will require issuers to provide to the SEC financial statements in interactive data format using XBRL. According to the adopted phase-in schedule, the largest companies will commence XBRL reporting in fiscal periods ending on or after June 15, 2009. The phase-in schedule is as follows:

- Year 1 – the rules apply only to domestic and foreign large accelerated filers that use U.S. GAAP and have a worldwide public float above $5 billion. The SEC estimates that this group includes approximately 500 companies;
- Year 2 – all other domestic and foreign large accelerated filers (i.e., those with over $700 million in public float) using U.S. GAAP will be subject to interactive data reporting; and
- Year 3 – all remaining domestic and foreign 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 are subject to the interactive data reporting requirements.

Domestic filers will commence XBRL reporting in 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 will commence XBRL reporting in their Form 20-F or 40-F for the applicable year ending on or after June 15.

The data provided in XBRL format will be furnished rather than filed for the first two years. In the third year, the data will be filed and subject to the correspondingly increased liability. The XBRL data will not be subject to auditor reporting.

Under the rules, issuers will be required to provide interactive data with their annual and quarterly reports, transition reports, Form 8-K and 6-K reports containing updated or revised versions of financial statements that appeared in a periodic report, registration statements, and on their corporate websites if they maintain one. Issuers will be required to tag their financial statements, footnotes, and schedules. For the first year, footnotes and schedules may be tagged in block text format (i.e., given one tag that describes the overall nature of the disclosure, rather than tagging each piece of information presented in the disclosure). Thereafter, they must be tagged in

detail. The first time an issuer provides XBRL data and the first time it provides data that is tagged in detail, the data may be provided 30 days after the corresponding filing is made. Thereafter, it must be provided with the filing.

Filers that do not provide or post required XBRL data will be deemed not current with their Exchange Act reports. As a result, they will not be eligible to use short form registration statements (e.g., Form S-3) and will not be deemed to have available adequate current public information for purposes of the resale exemption safe harbor provided by Rule 144 for restricted securities until the data is provided.

When the SEC publishes its rulemaking release, it will be available on the SEC's website at: *http://www.sec.gov/rules/final.shtml*

Foreign Private Issuer Reporting

The SEC took significant actions during 2008 to expand and enhance reporting by foreign private issuers. These amendments:

- Accelerate and expand reporting by foreign private issuers;
- Enhance reporting by foreign private issuers that are not SEC registrants whose securities trade over the counter; and
- Change rules covering cross-border business combination transactions and rights offerings to facilitate participation by U.S. security holders in foreign companies' transactions on the same terms as other security holders.

Foreign Issuer Reporting Enhancements
(Release 34-8959)

The Commission adopted a number of amendments to enhance reporting by foreign registrants. The most significant are:

- The due date for annual reports filed on Form 20-F was accelerated from six months to four months after year-end. The accelerated filing requirement must be met beginning in fiscal years ending on or after December 15, 2011.

  – This due date is generally consistent with home country reporting deadlines and aligns the transition date with the date when many registrants will be required by home country rules to adopt IFRS. (Foreign private issuers that report in accordance with IFRS as issued by the IASB are not required to reconcile their financial statements to U.S. GAAP. This will streamline their reporting processes and facilitate meeting this new deadline.)

  – After this change takes effect, domestic registrants that acquire significant foreign targets will need to provide updated target year end financial statements in the Form 8-K two months sooner than under the current rules.

- Foreign private issuers filing annual reports on Form 20-F that do not report in U.S. GAAP or IFRS as issued by the IASB will be required to provide disclosures required by U.S. GAAP in accordance with Item 18 of Form 20-F rather than the more limited disclosures called for by Item17. The financial statements of other foreign companies (e.g., foreign targets and investees) may continue to comply with Item 17. This requirement will also be effective for annual reports for fiscal years ending on or after December 15, 2011, for the same reason as discussed above.

- Foreign private issuers will be required to disclose information about changes in and disagreements with accountants that occur on or after December 5, 2008 beginning in Form 20-Fs for, and registration statements including, fiscal years ending on or after December 15, 2009. The information required will be similar to the disclosure domestic registrants must provide under Item 304 of Regulation S-K.

- An instruction to Item 17 of Form 20-F that permits issuers to omit segment data from financial statements will be eliminated beginning with fiscal years ending on or after December 15, 2009.

- Annual fees and other charges paid by holders of American Depositary Receipts (ADRs) to depositaries, as well as any payments made by depositaries to the foreign private issuers whose securities underlie the ADRs, must be disclosed beginning in fiscal years ending on or after December 15, 2009.

- Significant differences in the corporate governance practices of listed foreign private issuers compared to the corporate governance practices applicable to domestic companies under the relevant exchange's listing standards must be disclosed beginning in fiscal years ending on or after December 15, 2008.

The amended rules also allow foreign private issuers to assess their eligibility to use forms and rules available to foreign private issuers (e.g., Forms 20-F, F-1 and F-3) once a year at the end of the second fiscal quarter, rather than on a continuous basis as previously required. Under the amendments, a foreign issuer that does not quality as a foreign private issuer as of the end of its second fiscal quarter in 2009 would file a Form 10-Q for its

second fiscal quarter and a Form 10-K for the fiscal year. These “former” foreign private issuers would be required to use the domestic rules and forms and would lose the reporting relief offered to foreign private issuers.

The release is available on the SEC’s website at: *http://www.sec.gov/rules/final/2008/33-8959.pdf.*

Reporting by Foreign Private Issuers that are not SEC Registrants Exchange Act Rule 12g3-2b

(Release 34-58465)

Exchange Act Rule 12g3-2(b) exempts foreign private issuers whose securities trade over the counter from registration with the SEC if they submit to the SEC certain information that they publish outside the U.S. The SEC amended its rules to streamline compliance and enhance the amount of information that is presented in English and made available via the Internet. The amendments became effective October 10, 2008.

The release is available on the SEC’s website at: *http://www.sec.gov/rules/final/2008/34-58465.pdf.*

Cross-Border Transactions

(Release 33-8957)

The Commission expanded the exemptions from U.S. tender offer rules and registration requirements for cross-border business combination transactions and rights offerings involving foreign companies. The SEC designed these changes to facilitate participation in these transactions by U.S. security holders on the same terms as all other security holders. In addition to the amended rules, the Commission release also provides interpretive guidance on issues related to cross-border transactions. The rules became effective December 8, 2008.

The release is available on the SEC’s website at: *http://www.sec.gov/rules/final/2008/33-8957.pdf*

Oil and Gas Reserve Information

(Release 33-8995)

In December, the Commission adopted revisions to modernize its oil and gas reporting requirements. The changes are intended to provide investors with a more meaningful and comprehensive understanding of a company’s oil and gas reserves.

Updated disclosure requirements are designed to align with current practices and changes in technology that have taken place in the oil and gas industry since the adoption of the original reporting requirements more than 25 years ago.

The new reporting requirements include:

- Permitting the use of new technologies to determine proved reserves if those technologies have been demonstrated empirically to lead to reliable conclusions about reserves volumes.
- Enabling companies to additionally disclose their probable and possible reserves to investors. Prior to the amendments, disclosure was limited to only proved reserves.
- Allowing previously excluded resources, such as oil sands, to be classified as oil and gas reserves. Before these amendments, oil sands were considered to be mining reserves.
- Requiring companies to report the independence and qualifications of a preparer or auditor and requiring companies to file reports when a third party is relied upon to prepare reserve estimates or conduct a reserve audit.
- Requiring companies to report oil and gas reserves using an average price based upon the prior 12-month period – rather than yearend prices – to maximize the comparability of reserve estimates among companies and mitigate the distortion of the estimates that arises when using a single pricing date.

The new requirements are effective for registration statements filed on or after January 1, 2010, and for annual reports on Forms 10-K and 20-F for fiscal years ending on or after December 31, 2009. Early adoption is not permitted. A company may not apply the new rules to disclosures in quarterly reports prior to the first annual report in which the revised disclosures are required.

The release is available on the SEC’s website at: *http://www.sec.gov/rules/final/2008/33-8995.pdf.*

Proposed Rules

Roadmap for Domestic Issuers to File IFRS Financial Statements

(Release No. 33-8982)

The SEC has long believed that having all issuers world-wide prepare financial statements using a single set of high-quality accounting standards is a desirable goal because it enables investors to better compare and evaluate investment opportunities in companies around the globe. The SEC has concluded that the rest of the world will not adopt U.S. GAAP for this purpose and so has been studying the possibility of U.S. issuers filing financial statements prepared in accordance with IFRS. The Commission

staff published an initial "roadmap" for migrating toward the eventual conversion to IFRS in 2005.

The SEC's study of this issue has included, among other activities, obtaining comments on a concept release in 2007 and hosting three roundtable discussions with thought leaders in 2007 and 2008. This led to allowing foreign private issuers that prepare financial statements in accordance with IFRS to do so without reconciling their financial statements to U.S. GAAP beginning with fiscal years ended after November 15, 2007. In 2008, the SEC took the next step on the path to acceptance of IFRS financial statements from all issuers when it issued an updated proposed roadmap that includes the following key elements:

1. Milestones – A list of milestones that must be met before the SEC will consider requiring U.S. issuers to report in accordance with IFRS.

2. Early adoption – Voluntary early adoption of IFRS by a limited number of large U.S. registrants beginning with years ending on or after December 15, 2009.

3. 2011 Decision – A Commission decision in 2011 as to whether the milestones have been met and reporting in IFRS by U.S. issuers should be mandated.

4. 2014 Adoption – If the decision in step 3 is yes, adoption of IFRS by U.S. issuers beginning with years ending on or after December 15, 2014.

The milestones are discussed below. Milestones 1 to 4 should be achieved, and the results of Milestone 5 must be assessed, before the SEC will consider requiring U.S. filers to report in accordance with IFRS.

1. IFRS Improvement – Continued improvement in IFRS so that they become a set of standards that is high quality, sufficiently comprehensive, and established under a robust independent process. The SEC advised the FASB and IASB to finish their joint work on projects they plan to complete by 2011. Also, the Commission would like to see the IASB address topics not currently covered in IFRS.

2. Governance – Independent governance and funding of the International Accounting Standards Committee (IASC) Foundation, the body that oversees the standards setter for IFRS, the IASB. The Trustees of the Foundation proposed to establish a connection between the IASC Foundation and a new Monitoring Group to be composed of securities authorities charged with the adoption or recognition of accounting standards in their respective jurisdictions. The SEC is working with other national securities authorities to establish the Monitoring Group. The SEC will also carefully consider the degree to which the IASC Foundation has a secure, stable funding mechanism that permits it to function independently and that enhances the IASB's standard setting process.

3. XBRL – Satisfactory progress on developing the ability to effectively provide IFRS financial statements in XBRL format. In December 2008, the Commission finalized rules that require domestic and foreign private issuers to provide their financial statements to the SEC and on their corporate websites in interactive data format using XBRL. The IFRS list of tags for interactive data reporting would need to be appropriately developed before it will proceed with requiring IFRS financial statements from all U.S. filers.

4. IFRS Accounting Education – Satisfactory progress in the education and training of U.S. accountants. Before U.S. issuers can begin reporting in IFRS, there is a need for IFRS education for accountants, auditors, investors, and analysts. Also, accounting courses in IFRS would need to be established in the accounting curricula of universities and colleges.

5. Limited Number of Large U.S. Issuers Voluntarily Adopt IFRS – For fiscal years ending on or after December 15, 2009, a limited number of large U.S. registrants would be eligible to voluntarily "test drive" IFRS. The Commission believes that IFRS can be better evaluated if test driven by large U.S. issuers. These issuers would be permitted to voluntarily early adopt IFRS if it would enhance the comparability of their financial statements with those of their peers and if:

- A company is one of the largest 20 companies in the world (measured by market capitalization) in its industry; and
- IFRS is the set of accounting standards used most often by those 20 companies.

Companies meeting these conditions would be able to obtain a "no action" letter from the SEC staff permitting them to report in IFRS instead of U.S. GAAP. The SEC estimates that 110 U.S. companies in 34 industries representing approximately 12% of the aggregate U.S. market capitalization would be eligible to early adopt IFRS.

In the first year of early IFRS adoption, domestic issuers would be required to present three years of financial statements prepared in accordance with IFRS. The Commission is considering two alternatives for disclosing the effect of converting to IFRS:

- Provide a one-time audited reconciliation of the IFRS amounts to U.S. GAAP amounts, the approach reflected in IFRS 1, *First-Time Adoption of International Financial Reporting Standards*; or

• Provide ongoing unaudited reconciliations of the IFRS amounts to U.S. GAAP amounts for all periods presented.

In Milestone 6, based on the progress achieved in Milestones 1 – 4 and the reporting observed from the voluntary adopters in Milestone 5, the Commission would decide in 2011 whether reporting in IFRS should be required for all U.S. issuers.

In Milestone 7, if the Commission decides to require the use of IFRS, adoption would be required beginning in fiscal years ending on or after December 15, 2014. Three years of financial statements prepared in accordance with IFRS would be required at the time of adoption. The Commission would need to decide on the appropriate transition. Two approaches are being considered:

• Require all U.S. registrants to adopt in years ending on or after December 15, 2014; or

• Permit sequential adoption, requiring large accelerated filers to adopt in years ending on or after December 15, 2014, accelerated filers to adopt in years ending on or after December 15, 2015, and all other filers to adopt in years ending on or after December 15, 2016.

Certain financial statement inconsistency could develop during the transition to IFRS reporting. If the Commission were to accept financial statements prepared in accordance with IFRS as published by the IASB from U.S. issuers, then investors and market participants would have to be able to understand and work with both IFRS and U.S. GAAP. Until all registrants are required to report in IFRS, some U.S. issuers would be reporting in U.S. GAAP and others would be reporting in IFRS.

During the transition, U.S. issuers will likely continue to have contracts and regulatory filings based on U.S. GAAP. These contracts might include loan agreements that include covenants or leases that require payments based upon U.S. GAAP financial measures. Similarly, U.S. issuers may use their financial statements as the basis for filings with other regulators and authorities (e.g., local and federal tax authorities, supervisory regulators) that may require U.S. GAAP financial information. For a period of time, issuers will likely file in IFRS and prepare U.S. GAAP financial statements for other purposes until contracts and regulatory filings transition to an IFRS basis.

The future of convergence of the two GAAPs and the role of the FASB is unclear. If U.S. issuers were required to prepare IFRS financial statements, then there is a possibility that the convergence process would simply come to a halt. If convergence does not occur, the future work of the IASB and the FASB may result in standards that are significantly different. The FASB may continue to establish standards, but only for private U.S. companies. Alternatively, the FASB may continue to be the designated accounting standard setter for registrants, and accordingly adopt IFRS as U.S. GAAP.

Comments on the proposal are due February 19, 2009.

Commission and Staff Guidance

Financial Reporting Manual

In December the Corp Fin staff published its *Financial Reporting Manual*. The *Financial Reporting Manual* updates and replaces the "Staff Training Manual," which was last issued in 2000. The staff has indicated that the new *Financial Reporting Manual* does not change the guidance or policies included in the Staff Training Manual. Rather, the *Financial Reporting Manual* updates the Staff Training Manual by covering rules issued since 2000 and providing guidance on additional topics.

The *Financial Reporting Manual* is designed to be an internal staff reference document that provides general non-authoritative guidance. The Manual contains over 250 pages of helpful guidance covering many important SEC reporting topics, and is very useful when evaluating SEC reporting issues. The staff plans to add sections covering additional topics in future updates. Each topic within the Manual will be dated to identify the last update with all topics initially dated September 30, 2008. The new Manual covers the following topics:

• Registrant's Financial Statements
• Other Financial Statements Required
• Pro Forma Financial Information
• Smaller Reporting Companies
• Foreign Private Issuers and Foreign Businesses
• Related Party Matters
• Non-GAAP Measures of Financial Performance, Liquidity and Net Worth
• MD&A
• Reverse Acquisitions and Reverse Recapitalizations
• Effects of Subsequent Events on Financial Statements Required in Filings
• Tender Offers
• Employee Stock Benefit Plans
• Multijurisdictional Disclosure System

The *Financial Reporting Manual* is available on the SEC's website at: *http://www.sec.gov/divisions/corpfin/cffinancialreportingmanual.shtml.*

Fair Value Accounting

Amidst the continuing market turmoil and credit crisis, the SEC and FASB staffs provided guidance to clarify the applica-

tion of Statement 157 to financial assets in inactive markets. The Emergency Economic Stabilization Act (EESA) enacted in October included a provision giving the SEC a deadline of 90 days from passage to study the effect that Statement 157 and fair value accounting have had on the marketplace. See the SEC Staff Projects section below for a link to the study, which concluded that fair value accounting and Statement 157 should be retained, and a summary of the results.

The SEC and FASB staffs issued a joint press release on September 30 discussing how fair value accounting should be applied in inactive markets. Shortly thereafter, the FASB issued FSP FAS 157-3, *Determining the Fair Value of A Financial Asset when the Market for that Asset Is Not Active*, which also addressed fair value measurement in inactive markets. In addition, in March and September, the Corp Fin staff issued letters to registrants encouraging them to enhance MD&A by increasing the transparency of their fair value measurements and the effects of those measurements on their financial statements. None of these materials changed the requirements of Statement 157. They provided guidance and stressed that significant judgment is required in applying Statement 157.

SEC and FASB Joint Press Release

The SEC and FASB joint press release addressed the following five fair value questions:

1. Can management's internal assumptions (e.g., expected cash flows) be used to measure fair value when relevant market evidence does not exist?

2. How should the use of "market" quotes (e.g., broker quotes or information from a pricing service) be considered when assessing the mix of information available to measure fair value?

3. Are transactions that are determined to be disorderly representative of fair value? When is a distressed (disorderly) sale indicative of fair value?

4. Can transactions in an inactive market affect fair value measurements?

5. What factors should be considered in determining whether an investment is other-than-temporarily impaired?

Because fair value measurements and the assessment of impairment may require significant judgments, clear and transparent disclosures are critical to providing investors with an understanding of the judgments made by management.

The press release is available on the SEC's website at: *http://www.sec.gov/news/press/2008/2008-234.htm.*

Staff Letters on MD&A Disclosures

In March and September, the SEC staff sent letters to certain large financial institutions that highlight matters the issuers should consider in their MD&A disclosures. The letters encourage the issuers to clearly communicate the effects of fair value measurements on their financial statements and suggest specific disclosures to help accomplish this objective. The letters highlight matters that all registrants – not just large financial institutions – should consider in preparing their MD&As. They illustrate a trend in Corp Fin staff practice toward enhancing the quality of disclosure by communicating before the filings are made the staff's expectations and the types of comments it is likely to write about disclosure covering particular issues.

Key points the letters recommend that companies transparently disclose follow:

1. Gains resulting from changes in the registrant's creditworthiness – A registrant might recognize gains on derivative or other liabilities carried at fair value that resulted from downgrades in the registrant's creditworthiness. Given the counterintuitive nature of recording a gain when a bad thing happens (i.e., a downgrade in a company's credit rating), the staff believes that transparent disclosure of the amounts of such gains and how they were determined is often critical.

2. Losses resulting from changes in counterparties' creditworthiness – If there have been downgrades in the creditworthiness of counterparties with which the registrant has entered into derivative transactions, the registrant should explain how those downgrades affected the valuation of derivative assets and the effects on the financial statements and the registrant's liquidity.

3. Effects of deterioration in market liquidity – Deterioration in the market liquidity of financial instruments may lead to transfers into Level 3 or changes in the assumptions or techniques used to value Level 3 instruments. Registrants should explain how they factored illiquidity into their fair value determinations and the effect of this consideration.

4. How brokers or pricing services are used when determining fair values – Registrants that use brokers or pricing services to assist them in determining fair values should help investors understand their accounting by disclosing the extent to which and how information obtained by brokers or pricing services was used to develop the fair value measurements reflected in the financial statements.

The SEC's MD&A rules (Regulation S-K, Item 303) require registrants to discuss known trends, demands, commitments, events or uncertainties that are reasonably likely to have a material favorable or unfavorable impact on results of operations, liquidity, and capital resources. Given these requirements, the letters

encourage registrants to consider discussing the judgments and assumptions underlying fair value measurements, the sensitivity of the measurements to those assumptions, and the methodology and inputs used. A summary of the disclosures the staff encouraged in the March and September letters follows:

General Information such as valuation techniques or models used; how and which market indices were used in applying the valuation technique or model; the sensitivity of fair value amounts to inputs the valuation technique or model uses; how increases and decreases in the aggregate fair value of assets and liabilities may affect liquidity and capital resources; and significant judgments made in classifying a particular financial instrument in the fair value hierarchy.

Registrant and Counterparty Credit Risk information such as an explanation of how credit risk is incorporated and considered in the valuation of financial assets or liabilities; gains or losses on financial instruments carried at fair value (e.g., derivatives), if material to results of operations; and an explanation of how the registrant's credit risk, the counterparty credit risk, and the deterioration in a counterparty's credit affect the valuation of its derivative assets and liabilities.

Inactive Markets and Illiquidity information such as the criteria used to determine whether the market for a financial instrument is active or inactive, and which financial instruments are affected by the lack of market liquidity.

Brokers and Pricing Services information such as the nature and amount of assets valued using broker quotes or prices obtained from pricing services, along with the classification in the fair value hierarchy; the number of quotes or prices generally obtained per instrument; whether (and if so, how and why) quotes or prices obtained from brokers and pricing services were adjusted; the extent to which the brokers or pricing services are gathering observable market information as opposed to using unobservable inputs; whether the broker quotes are binding or non-binding; and the procedures performed to validate the prices obtained to ensure the fair value determination is consistent with Statement 157.

Level 3 Assets and Liabilities information such as the amount of Level 3 assets and liabilities in the aggregate and as a percentage of the total assets and liabilities measured at fair value; the amount and reason for transfers of assets and liabilities into Level 3 from Levels 1 and 2; the effect of Level 3 realized and unrealized losses (gains) on results of operations, liquidity and capital resources; and the nature and type of assets underlying any asset-backed securities.

The September and March letters are available on the SEC's website at:

- September – *http://www.sec.gov/divisions/corpfin/guidance/fairvalueltr0908.htm.*
- March – *http://www.sec.gov/divisions/corpfin/guidance/fairvalueltr0308.htm.*

OCA Letter on Perpetual Preferred Securities

The SEC's Office of the Chief Accountant (OCA) advised the FASB on fair valuing perpetual preferred securities in an October letter. Perpetual preferred securities are equity in form but have debt like characteristics. The SEC staff observed that companies that hold perpetual preferred securities can apply an other-than-temporary impairment model, including an anticipated recovery period, similar to that applied to a debt security. OCA believes that this model can be used only if there is no evidence of deterioration in the credit of the issuer (for example, a decline in the cash flows from holding the investment or a downgrade of the rating of the security below investment grade).

The letter is available on the SEC's website at: *http://www.sec.gov/info/accountants/staffletters/fasb101408.pdf*

Proxy Statements Filed in Connection with Troubled Asset Relief Program

In October, the EESA established the Troubled Asset Relief Program (TARP), and the Treasury Department established the Capital Purchase Program (CPP) to provide capital to eligible financial institutions. Financial institutions that receive approval for participation in the CPP enter into an agreement to issue preferred stock and warrants to the Treasury Department. In many cases, financial institutions participating in the CPP will require approval from their shareholders before the securities or shares issuable upon exercise of the warrants can be issued.

The SEC staff issued guidance, including sample staff comments, on information that should be included in proxy statements filed to solicit shareholder approval for securities issued under the CPP.

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

The SEC and FASB staffs jointly issued a letter advising that they would not object to permanent equity accounting for the warrants issued to the Treasury Department under the CPP. This accounting depends on the issuer having sufficient authorized but unissued shares

of the class of stock that may be required upon settlement and having obtained any other necessary shareholder approvals by the end of the quarter in which are warrants are issued.

The letter is available on the SEC's website at: *http://www.treas.gov/press/releases/reports/secfasbletter.pdf.*

Effects of New Accounting Standards on SEC Rules and Regulations

Business Combinations and Noncontrolling Interests

FASB Statements 141R and 160 are effective for periods beginning after December 15, 2008 and early adoption of the new standards is prohibited. For calendar year end companies, this means that business combinations that closed in 2008 were subject to Statement 141 while those closing in 2009 will be subject to Statement 141R.

At Center for Audit Quality (CAQ) SEC Regulations Committee meetings held this year, the SEC staff acknowledged that certain SEC rules and regulations are in conflict with Statements 141R and 160. The staff stated that registrants should resolve this conflict by following GAAP. The staff plans to recommend that the Commission update the Regulation S-X rules and the Staff Accounting Bulletins that conflict with the new standards. The staff has also provided informal guidance on several other implementation issues. The table above summarizes several issues and the staff's recommendations for resolution. The staff is still considering certain additional issues.

The CAQ SEC Regulations Committee minutes are available on the CAQ's website at: *http://thecaq.aicpa.org/Resources/SEC+Regulations+Committee*

Convertible Debt Instruments That May Be Settled in Cash upon Conversion

FSP APB 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement), is effective for financial statements issued for fiscal years beginning after December 15, 2008 and interim periods within those fiscal years. This FSP affects convertible debt instruments that permit the issuer to settle in cash upon conversion and requires the value of the conversion option to be reflected in equity, resulting in a debt discount. The FSP is to be applied retrospectively but only to instruments that were outstanding during the periods presented in the annual financial statements for the period of adoption. Early application is not permitted.

At the CAQ SEC Regulations Committee meeting held in October, the SEC staff discussed the application of the transition provisions of FSP APB 14-1 in preparing financial data tables for the years prior to those covered by the financial statements. The staff informally advised that the new accounting for instruments that were outstanding during the periods presented in the annual financial statements should also be retrospectively applied for those instruments during earlier years presented in financial data tables. A registrant may have instruments that would be accounted for differently under the FSP that were (1) extinguished or converted before the earliest year presented in the financial statements, but (2) outstanding during earlier periods presented in its financial data table. If so, it may either:

- Apply the FSP only to instruments outstanding during the periods presented in the annual financial statements for the period of adoption; or

- Apply the FSP to all instruments outstanding during the periods included in the financial data table.

In either case, registrants should explain the method of adoption. If the new accounting is not applied to the instruments that were extinguished or converted in the earlier years, the registrant should highlight the lack of comparability between periods in a note to the table.

The CAQ SEC Regulations Committee minutes are available on the CAQ's website at: *http://thecaq.aicpa.org/Resources/SEC+Regulations+Committee*

Computing Significance Under Rule 3-09

At the CAQ SEC Regulations Committee meeting held in October, the SEC staff changed its view on computing significance under the income test in Rule 3-09. This rule defines when issuers are required to provide audited financial statements of significant equity method investees. Previously, the staff believed that the gain or loss on the disposal of an investment accounted for using the equity method should be included in the numerator in the income test of significance to see if separate financial statements of the former investee are required. Now the staff believes that this gain or loss is not required to be included in the numerator of the income test when an investment is disposed of or reduced to a cost method investment.

The CAQ SEC Regulations Committee minutes are available on the CAQ's website at: *http://thecaq.aicpa.org/Resources/SEC+Regulations+Committee/*

Effects of New Accounting Standards on SEC Rules and Regulations
Business Combinations and Noncontrolling Interests

Issue	Recommendation
Direct Acquisition Costs	
Treatment of transaction costs for business combinations that are pending in the Statement 141R transition period	If the transaction closes prior to the effectiveness of Statement 141R, the costs should be capitalized. If the transaction costs are incurred after the effectiveness of 141R, the costs should be expensed. If the transaction costs are incurred before 141R effectiveness but the transaction closes after 141R effectiveness, the expenses incurred in 2008 can be expensed in 2008 or capitalized in 2008 and written off in 2009. As long as a registrant's approach to accounting for acquisition-related costs for the duration of 2008 is reasoned, consistently applied, and appropriately disclosed, the staff will not challenge the accounting.
Significance	
Treatment of transaction costs in the Regulation S-X significance test for an acquired business	Under Statement 141R, the numerator for the investment test should exclude transaction costs.
Treatment of contingent consideration in the Regulation S-X significance tests for an acquired business	Under Statement 141R, the numerator for the investment test should include the fair value of contingent consideration. Significance does not need to be remeasured when the preliminary estimate of the fair value of contingent consideration changes as long as a good faith estimate was made at the time of acquisition.
Performing the income significance test under Regulation S-X when a registrant obtains control over an investee that was previously eligible to be accounted for under the equity method	The holding gain recognized under Statement 160 should be excluded from the numerator for the income test.
Presentation	
Presentation of minority interest in consolidated financial statements under Article 5 of regulation S-X	Follow the presentation requirements of Statement 160 even if they conflict with Article 5 of Regulation S-X.
Definition of "Acquisition"	
Acquired business and pro forma financial statement requirements when control is obtained through events other than transactions	Acquisitions that occur as a result of events such as lapse of contractual rights, rather than transactions, are subject to the reporting requirements under Item 2.01 of Form 8-K and Rule 3-05 and Article 11 of Regulation S-X. Also, the determination of whether an acquisition that will occur as a result of an event, rather than a transaction, is probable should be made based on facts and circumstances and the relevance of the target's financial statements.
Pro Forma Information	
Research and development (R&D) and transactions costs in pro forma income statements after the adoption of Statement 141R	No adjustments should be made to the amounts of R&D expense historically incurred by the target. Transaction costs incurred by the acquirer and the target should be excluded from pro forma income from continuing operations.
Pro forma information in the Statement 141R transition period	Pro forma effects of business combinations should be computed in a manner that is consistent with the way they will be accounted for. Pro formas reflecting business combinations that will be accounted for under Statement 141R should eflect the application of Statement 141R for periods prior to the effective date of 141R, even though 141R was not in effect in those periods.
Retrospective Adjustments	
Information required in registration statements when there are retrospective adjustments to provisional amounts after the adoption of Statement 141R	When retrospective adjustments to provisional amounts are known but not reflected in all financial statements, a registrant must provide or incorporate by reference revised financial statements reflecting the retrospective adjustments if they are material.
Restricted Net Assets	
Restricted net asset computations after Statement 160 is implemented.	Registrants should compute restricted net assets percentages in the same manner as before Statement 160 was implemented.

Form S-8 and Updating Requirements

For the past few years, the SEC staff's view regarding the steps a registrant should take to communicate material subsequent changes that have occurred at the time it files a Form S-8 registration statement have been unclear. The uncertainty has existed in situations where a registrant's previously filed financial statements need to be revised (e.g., due to a material discontinued operation, change in reportable segment, or accounting change that requires retrospective application), but revised financial statements have not yet been filed. Practice has generally been to incorporate disclosure of the change by reference in the Form S-8, but not to revise the registrant's financial statements before incorporating them by reference in the Form S-8. The staff had expressed concerns as to whether a registrant should instead revise its financial statements before filing a Form S-8.

The staff communicated informally to the CAQ SEC Regulations Committee that it is up to a company and its counsel to determine whether it has a material change that requires updating the financial statements to be incorporated by reference in the Form S-8. Similarly, the staff stated that it is the responsibility of the auditor to determine if it will issue a consent to use its report if there has been a change but the financial statements have not been revised.

Experts and Consents

The SEC staff changed its view on the need to provide consents for the work of experts. Although there is no requirement to refer to the work of valuation specialists and others whose work is used by registrants in preparing their filings, with the expanded use of fair values in financial statements, there has been an increase in such references. If management takes responsibility for a valuation, a consent is not required. For example, if a registrant states that management prepared purchase price allocations and in doing so considered or relied in part upon a report of a third party expert, then there would be no requirement to provide a consent. However, if management attributes a valuation to an expert, a consent is required. For example, if a registrant discloses purchase price allocation figures in the notes to its financial statements and discloses that these figures were prepared based on the report of a third party expert, then the registrant is required to provide a consent.

The guidance is available on the SEC's website:
http://www.sec.gov/divisions/corpfin/guidance/sasinterp.htm, question 141.02.

Smaller Reporting Companies

During 2008, the Commission released nine guides that summarize and explain rules adopted by the SEC as they apply to smaller public companies:

1. Changeover to the SEC's New Smaller Reporting Company System by Small Business Issuers and Non-Accelerated Filer Companies – This guide outlines the criteria to be eligible to take advantage of the scaled reporting available to smaller reporting companies. *http://www.sec.gov/info/smallbus/secg/smrepcosysguid.pdf.*

2. Small Entity Compliance – Guide Exchange Act Rule 14a-8(i)(8) – This guide provides information on excluding certain shareholder proposals from a company's proxy materials. *http://www.sec.gov/info/smallbus/secg/rule14a-8i8-secg.htm*.

3. Shareholder Choice Regarding Internet Availability of Proxy Materials – This guide provides information on making proxy materials available on Internet sites. Internet availability of proxy materials is required for proxy solicitations beginning on or after January 1, 2009. *http://www.sec.gov/info/smallbus/secg/shareholderchoice-secg.htm*.

4. Electronic Shareholder Forums: Amendment to Exchange Act Rule 14a-2 and New Exchange Act rule 14a-17 – This guide provides the guidelines for when communications in electronic shareholder forums qualify for exemptions from the proxy rules. *http://www.sec.gov/info/smallbus/secg/rules14a-2-17-secg.htm.*

5. Filing and Amending a Form D Notice – This guide provides information on filing a Form D, a form required to be filed with the SEC after securities have been sold without registration based on a Regulation D exemption. Until March 16, 2009, a registrant may file a Form D notice or an amendment with the SEC either on paper or online. After that date, issuers must file online. *http://www.sec.gov/info/smallbus/secg/formdguide.htm.*

6. Eligibility of Smaller Companies to use FormS-3 or F-3 for Primary Securities Offerings – This guide provides information on eligibility and capital raising limits for smaller companies filing shelf registrations on Form S-3 or F-3. *http://www.sec.gov/info/smallbus/secg/s3f3-secg.htm.*

7. Revisions to Rules 144 and 145 – This guide provides information on the sale of restricted securities under Rules 144 and 145.
http://www.sec.gov/info/smallbus/secg/rules144-145-secg.htm.

8. Revisions to Form S-11 to Permit Historical Incorporation by Reference – This guide provides information on filing a Form S-11, an S-1-like form for real estate entities that allows incorporation

by reference. *http://www.sec.gov/info/smallbus/secg/s11-secg.htm.*

9. Revisions to Cross-Border Tender Offer, Exchange Offer, Rights Offerings, and Business Combination Rules and Beneficial Ownership Reporting Rules for Certain Foreign Institutions – This guide provides information on the 2008 revisions to the cross border rules and staff interpretations. *http://www.sec.gov/info/smallbus/secg/cross-border-secg.htm.*

These guides, plus the guide on complying with ICFR for smaller public companies that was issued in December 2007, are available on the Small Business Compliance Guides page at: *http://www.sec.gov/info/smallbus/secg.shtml.*

The staff also provided access to its presentation on common financial reporting issues facing smaller reporting companies that had been presented at the Forums on Auditing in the Small Business Environment hosted by the PCAOB. This presentation is available at *http://www.pcaobus.org/About_the_PCAOB/Small_Business/Forum/2008/Philadelphia_Slides_Firms.pdf (see slides 147-191).*

Executive Compensation Disclosure

The SEC staff has advised registrants to address compensation changes made as a result of the current economic environment and to make improvements to executive compensation disclosures in their Compensation Disclosure and Analysis (CD&A).

Under the EESA requirements, registrants participating in TARP have a $500,000 limit on the tax deductibility of their senior executive officers' compensation. The staff observed that registrants participating in this program should address the resulting changes made to their executive compensation programs in their CD&As. The EESA also requires compensation committees to certify in their CD&As that they have performed specified procedures to ensure that compensation arrangements do not encourage excess risk taking. Registrants not participating in the program should also address how recent economic events have affected their compensation programs.

In 2007, Corp Fin performed a targeted review of executive compensation disclosures of approximately 350 issuers, and in 2008 Corp Fin analyzed executive compensation disclosures in connection with its traditional review program. The primary comment in 2008 was the same as in 2007, that registrants should provide more analysis, such as:

- Explain the factors considered when approving each piece of the named executive officers' compensation package;

- Analyze why amounts paid are appropriate in light of the factors considered in approving each piece of compensation; and

- Describe why or how decisions with respect to one element of pay impacted other elements.

The staff has observed that a company must disclose performance targets if they are a material element of its compensation policies and decisions unless the registrant can support that the disclosures cause competitive harm. When performance target information was not disclosed, the staff has asked companies to either disclose the information or explain to the staff why the disclosure would cause competitive harm. If the registrants were able to support that the disclosure would cause competitive harm, the staff has asked the companies to disclose how likely they would be to achieve the target.

The staff has advised registrants that use benchmarking to determine material elements of compensation to identify the companies that comprise the peer group used for benchmarking purposes and the basis for selecting the peer group. Registrants should also explain how compensation they pay compares to that paid by the peer group. The staff observed that this information is essential disclosure and critical for companies when describing how their compensation programs work and how they arrived at specific compensation decisions.

Staff guidance on this topic can be found in a speech by John White, which is on the SEC's website at: *http://www.sec.gov/news/speech/2008/spch102108jww.htm.*

Corp Fin Filing Review Process and Focus

The Corp Fin staff issued an overview of its filing review process in June. While the overview did not provide any new information, it does provide a straightforward explanation of Corp Fin's review process. It also discusses the process for registrants to request that the staff reconsider either issued comments or staff views (referred to as the reconsideration process). The overview also includes a listing of the eleven industry- based Assistant Director Offices and the names of the individuals responsible for the reviews within each office.

The overview is available on the SEC's website at: *http://www.sec.gov/divisions/corpfin/cffilingreview.htm.*

This year the staff added two ways to contact Corp Fin Office of the Chief Accountant electronically. See *http://www.sec.gov/divisions/corpfin/cflegalregpolicy.htm.*

1. Email address: *dcaoletters@sec.gov*. Issuers can direct requests for waivers or accommodations relating to certain financial reporting requirements to this email address.

2.New form on the SEC's website: *https://tts.sec.gov/cgi-bin/corp_fin_interpretive*. Issuers can direct questions to Corp Fin's Office of the Chief Accountant on financial reporting and related issues, including the requirements relating to the form and content of financial statements to be included in Commission filings by using this form. The form is an alternative to calling 202-551-3400.

SEC Staff Projects

Mark-to-Market Accounting Study

Under the EESA legislation, the SEC staff conducted a study of "mark-to-market" accounting and issued the results of the study on December 30, 2008. The information the staff used to make its conclusions included publicly available data and views expressed at the three public roundtables that the SEC hosted related to fair value issues. The study was not limited exclusively to Statement 157, but rather included a broader view of fair value accounting including both mark-to-market accounting and the measurement approach prescribed by Statement 157. The overall conclusion is that neither fair value accounting in the broader context nor Statement 157 should be suspended.

The study addresses six key issues and makes eight recommendations for improvements. The six key areas and a brief synopsis of each area follows:

1. Effects of Fair Value Accounting Standards on Financial Institutions' Balance Sheets – the staff noted that the majority of assets are not measured using fair value and the percentage of the assets that are marked-to market through the income statement is even less. The impact on fair value could, however, be material to the income statement.

2. Impact of Fair Value Accounting on Bank Failures in 2008 – the staff's conclusion was that fair value accounting did not appear to be a significant factor in bank failures.

3. Impact of Fair Value on the Quality of Financial Information Available to Investors – Investors generally supported fair value measurements as useful information for decision making. Investors did note that improvements could be made to the fair value standards, especially in the areas of impairment, application of Statement 157, and disclosure requirements.

4. Process Used by the FASB in Developing Accounting Standards – the staff supports the process of an independent rulemaking body and encourages implementation of the CIFiR Committee recommendations for the creation of a financial reporting forum.

5. Alternatives to Fair Value Accounting Standards – the staff's conclusions in this area support the existing fair value approach and did not identify a preferable alternative. The staff again noted some areas of improvement in the existing accounting including accounting for impairments, fair value measurements in inactive markets, further analysis of the utility of incorporating credit risk in fair value measurements of liabilities, and presentation and disclosures.

6. Advisability and Feasibility of Modifications to Fair Value Accounting Standards – this section includes the key recommendations as follows:

- Statement 157 should be improved but not suspended
- Existing fair value and mark-to-market requirements should not be suspended
- Additional measures should be taken to improve the application for existing fair value standards, especially as it relates to Level 2 and Level 3 estimates
- The accounting for financial asset impairment should be readdressed
- Implement further guidance to foster the use of sound judgment
- Accounting standards should continue to be established to meet the needs of investors
- Additional formal measures to address the operation of existing accounting standards should be established
- Address the need to simplify the accounting for investments in financial assets

The study is available on the SEC's website at: *http://www.sec.gov/news/studies/2008/marktomarket123008.pdf.*

CIFiR Projects

The SEC staff has undertaken the projects listed below in response to the final recommendations of CIFiR (discussed in the Advisory Committees section below):

- Judgment – articulate a policy explaining how the staff evaluates the reasonableness of judgments and the factors it considers in making this assessment;
- Qualitative factors in error evaluation – provide guidance on qualitative factors that may allow for a large error not to be material;

• Interim materiality – issue guidance clarifying how materiality concepts should be applied to errors identified in interim periods;

• Error corrections – consider alternative methods that registrants could use to correct and report errors in order to reduce unnecessary restatements; and

• Dark period disclosure – consider information registrants should provide after a restatement is announced but before the amended financial statements are filed.

Twenty-First Century Disclosure Initiative

In June, Chairman Cox began an effort to change financial disclosure called the Twenty-First Century Disclosure Initiative. The Initiative is based on the idea of moving from a form-based system of collecting data (e.g., Forms 10-K, 10-Q, 8-K, and S-3) to a company file system. Under a company file system, a registrant would supply core information that is always available in an interactive data file and would supplement this with current periodic and transactional information. This idea has a long history at the SEC but has gained momentum with the advent of XBRL. The Initiative is divided into three phases:

• In the first phase, the staff will prepare a report that outlines a high-level plan to make the transition to an interactive company file system.

• In the second phase, the Commission will establish a Federal Advisory Committee in early 2009. The Advisory Committee will review the plan and make recommendations to the Commission for implementing it.

• In the final,multi-year phase, the Commission will consider and begin acting on the Advisory Committee's recommendations, engaging the Commission's normal notice and comment rulemaking process.

The information on the Initiative is available on the SEC's website at: *http://www.sec.gov/spotlight/disclosureinitiative.shtml.*

This year the SEC announced that IDEA (Interactive Data Electronic Applications) will be the successor to the SEC's EDGAR database. IDEA will at first supplement and then eventually replace the EDGAR system, which will become an archive of SEC filings. Like company file systems, IDEA will rely on registrant submitted XBRL data.

Information on IDEA is available on the SEC's web site at: *http://www.sec.gov/news/press/2008/2008-179.htm.*

PCAOB Developments

Final Standards

Auditing Standard 6 and Conforming Amendments

In January, the PCAOB issued Auditing Standard 6, *Evaluating Consistency of Financial Statements*, to outline auditor responsibilities to evaluate and report on the consistency of a company's financial statements and to remind auditors of their responsibility under FASB Statement 154, *Accounting Changes and Error Corrections*. Auditors must evaluate the consistency of presentation between the year(s) in which they are reporting on, and the immediately preceding year (for successor auditors) or earliest year presented (for continuing auditors). Auditors must also clarify in their report whether adjustments to previously issued financial statements resulted from a change in accounting principle or the correction of a misstatement. Explanatory paragraphs relating to the correction of a misstatement must include that the restatement was due to the correction of an error and also reference the company's disclosure of such correction. AS 6 does not require the auditor's report to disclose a change in classification, unless such change is a change in accounting principle or the correction of a misstatement. AS 6 was approved by the SEC in September and became effective November 15, 2008.

The FASB issued Statement 162, *The Hierarchy of Generally Accepted Accounting Principles*, to incorporate the GAAP hierarchy into its own standards and, accordingly, the PCAOB has amended its interim standards to remove reference to the GAAP hierarchy. The amendments do not change the principles for evaluating the fair presentation of the financial statements in conformity with GAAP.

Additionally, in contemplation of other accounting principles on which auditors may report, the PCAOB has made a revision to indicate that the auditor should look to the requirements of the SEC for the company under audit to identify the accounting principles that are applicable to that company. This change allows for the preparation of financial statements in conformity with IFRS on which the auditor reports.

The release can be found on the PCAOB's website: *http://www.pcaob.org/Rules/Docket_023/PCAOB_Release_No._2008-001_--_Evaluating_Consistency.pdf.*

The SEC release approving AS 6 can be found on the SEC's website: *http://www.sec.gov/rules/pcaob/2008/34-58555.pdf*

Final Rules

In August, the SEC approved PCAOB Rule 3526, *Communication with Audit Committees Concerning Independence*, and an amendment to PCAOB Rule 3523, *Tax Services for Persons in Financial Reporting Oversight Roles*. PCAOB Rule 3526 supersedes Independence Standards Board Standard 1 (ISB 1). This rule, similar to ISB 1, requires registered firms to confirm, in writing, that as of the date of the communication, the firm is independent in compliance with Rule 3520, *Auditor Independence*, and document the substance of all discussions with the audit committee of the issuer. Rule 3526 also requires such communications with a potential audit client's audit committee *prior* to accepting an audit engagement. The amendment to Rule 3523 permits tax services to be provided to persons in a financial reporting oversight role for the portion of the audit period that precedes the professional engagement period. These tax services are required to cease when a registered firm either signs an initial engagement letter or begins audit procedures, whichever is earlier.

Rule 3526 became effective as of September 30, 2008. The amendment to Rule 3523 became effective August 22, 2008.

The release is available on the PCAOB's website at: *http://www.pcaobus.org/Rules/Docket_017/2008-04-22_Release_2008-003.pdf.*

Proposed Standards

Engagement Quality Review

In February, the PCAOB proposed for public comment a new auditing standard on engagement quality review and conforming amendments. This proposed standard would supersede the Board's interim quality control standard. In addition to requiring certain specified procedures, the proposed standard would require the engagement quality reviewer to assess whether there are areas within the engagement that pose a higher risk that the engagement team failed (1) to obtain sufficient competent evidence or (2) to reach an appropriate conclusion. In these areas, the engagement quality reviewer should evaluate whether the engagement team responded appropriately to the assessed risks, the judgments made were reasonable, and the results of the procedures performed support the engagement team's overall conclusions.

The proposed standard includes a new requirement that the engagement quality reviewer must satisfy before providing concurring approval of issuance of the auditor's report. Under the existing requirement, the reviewer has to conclude that no matters have come to his or her attention that would cause the reviewer to believe that the financial statements are not in conformity with GAAP or that the audit was not conducted in accordance with the standards of the PCAOB.

The proposed standard would go further by requiring that the reviewer must not provide concurring approval of issuance if he or she knows, or should know based upon the requirements of the standard, that the engagement team failed to obtain sufficient competent evidence, the engagement team's overall conclusion or report is inappropriate, or the firm is not independent of its client. Concurring approval of issuance would be required before the firm could grant the client permission to use the auditor's report.

The proposed standard would apply to all engagements performed in accordance with the standards of the PCAOB. Comments were due on the proposal in May and the standard has not yet been finalized.

The proposed standard is available on the PCAOB's web site at: *http://www.pcaobus.org/Rules/Docket_025/2008-02-26_Release_No_2008-002.pdf.*

Auditor's Assessment of and Responses to Risk

In October, the PCAOB proposed for public comment seven new auditing standards related to the auditor's assessment of and responses to risk and related conforming amendments. The proposed standards would supersede the Board's interim auditing standards related to audit risk and materiality, audit planning and supervision, consideration of internal control in an audit of financial statements, audit evidence, and performing tests of accounts and disclosures before year end. Comments are due on the proposals by February 18, 2009.

The proposed standards are available on the PCAOB's web site at: *http://www.pcaob.org/Rules/Docket_026/2008-10-21_Release_No_2008-006.pdf.*

Guidance

In December, the PCAOB issued Staff Audit Practice Alert 3, *Audit Considerations in the Current Economic Environment*. The purpose of the alert is to assist auditors in identifying matters related to the current economic environment that might affect audit risk and require additional audit emphasis. The alert emphasizes that previously identified audit risks may become more significant or new risks may arise as a result of the current economic environment.

The alert is organized into six sections –

1.Overall audit considerations

This section describes the overall considerations related to planning, fraud, internal controls, substantive procedures, and communications with audit committees that may be affected by changes in the economic environment.

2. Auditing fair value measurements. The difficulties surrounding the measurement of fair value and the adequacy of disclosures are highlighted along with matters important for auditors to consider in fair value estimates. FSP FAS 157-3 is specifically mentioned as providing important application guidance, as is the PCAOB Staff Audit Practice Alert 2, *Matters Related to Auditing Fair Value Measurements of Financial Instruments and the Use of Specialists*.

3. Auditing accounting estimates. This section emphasizes that changes in facts, circumstances, or a company's procedures may cause the auditor to consider factors other than those considered in the past to be significant to the accounting estimate.

4. Auditing the adequacy of disclosures. The importance of the adequacy of the disclosures surrounding a company's risks and uncertainties is highlighted with respect to the presentation of financial statements in conformity with GAAP. This section also discusses other information included in documents containing the financial statements (which the auditor should read and consider whether such information, or the manner of its presentation, is materially inconsistent with that appearing in the financial statements).

5. Auditor's consideration of a company's ability to continue as a going concern. This section reminds auditors of their responsibility to evaluate whether there is substantial doubt about the company's ability to continue as a going concern for a year beyond the balance sheet date in light of the current economic environment. For instance, some companies may have difficulty in retaining lines of credit or maintaining debt covenant ratios, among other matters.

6. Additional audit considerations for selected financial reporting areas. Selected financial reporting areas that may be affected by the current economic environment are presented that may require additional audit consideration.

The alert can be found on the PCAOB's website at: *http://www.pcaobus.org/Standards/Staff_Questions_and_Answers/2008/12-05_APA_3.pdf.*

Advisory Committees

SEC Advisory Committee on Improvements to Financial Reporting

The SEC established CIFiR, chaired by Robert Pozen, in 2007. CIFiR's charge was to produce recommendations within one year, and the Committee released its final report in August 2008. CIFiR's goal was to address unnecessary complexity in the U.S. financial reporting system and improve the usefulness of financial information for investors and other users. The SEC staff is responding to these recommendations as discussed under SEC Staff Projects above.

CIFiR provided the following recommendations:

Substantive Complexity

• Reduce exceptions to general accounting principles such as industry specific guidance, alternative accounting policies, scope exceptions and competing models.

• Eliminate bright lines in accounting guidance. Lease accounting provides an excellent example of such a bright line – if the present value of the minimum lease payments is 90% or more of the fair value of the asset, then it is a capital (not an operating) lease.

• Improve financial statement presentation by differentiating between operating, investing, and financing activities.

• Develop a disclosure framework to integrate SEC and FASB disclosures and to require disclosure of significant assumptions and sensitivity analysis similar to those required in critical accounting policies in MD&A.

Standard Setting Process

• Increase investor involvement and perspective in standards-setting by adding investors to the Financial Accounting Foundation that oversees the FASB, the FASB, and the FASB staff.

• Enhance governance of the FASB by amending the FASB mission statement and objectives to emphasize the goal of reducing complexity.

• Improve the FASB's standards setting process by creating a Financial Reporting Forum composed of preparers, auditors, investors, and other user communities to recommend immediate and long-term priorities.

• Reduce the number of parties that interpret GAAP and the volume of interpretive guidance.

Audit Process and Compliance

• Issue guidance that reinforces appropriate materiality concepts based on how an error affects the total mix of information available from the perspective of a reasonable investor. Both qualitative and quantitative factors should be considered and the guidance should promote a consistent application of the concept of materiality.

• Issue guidance on how to correct an error with the goal of reducing unnec-

essary restatements. Prior period financial statements should be restated only for material errors.

– Error corrections should be based on the needs of those making current investment decisions. For example, a material error that is not important to a current investment decision would not require restatement of the financial statements in which the error occurred. In the current period, the error *would* need to be promptly corrected and prominently disclosed.

– The SEC should revise Form 8-K to state clearly that the form needs to be filed for all determinations of non-reliance on prior financial statements.

• Issue guidance on disclosure of financial and other reliable information while a restatement is pending. Improve adequacy of disclosure during the "dark" period when error assessment and restatement preparation are in process.

• Issue guidance on clarifying and consistently applying materiality concepts to errors identified in interim periods.

• Articulate a policy on how the SEC staff evaluates the reasonableness of judgments and the factors it considers when making this assessment. The PCAOB staff should also articulate such a policy.

Delivering Financial Information

• Migrate to mandatory filing of XBRL-tagged financial statements. The SEC adopted rules requiring this migration in December.

• Enhance interpretive guidance regarding disclosures on corporate websites. The SEC issued an interpretive release *(see http://www.sec.gov/rules/interp/2008/34-58288.pdf)* in July that addresses this.

• Encourage private sector development of key performance indicators and other metrics on relevant activity and industry-specific bases.

• Encourage industry groups such as National Investors Relation Institute, Financial Executives International, and CFA Institute to update guidance on best practices for earnings releases.

• Mandate executive summaries in annual and quarterly reports (i.e., Forms 10-K and 10-Q).

CIFiR's reports and certain webcasts are available on the SEC's website at: *http://www.sec.gov/about/offices/oca/acifr.shtml.*

Treasury Department's Advisory Committee on the Auditing Profession

ACAP was established in 2007 to develop recommendations to address the sustainability of a strong and vibrant auditing profession. The chairs of ACAP were Arthur Levitt (former SEC Chairman) and Don Nicolaisen (former SEC Chief Accountant). ACAP considered the adequacy of human capital, financial resources, and audit market competition and concentration and issued its final report in October.

The report included the following recommendations:

• Consider enhancements to the auditor reporting model;

• Strengthen fraud detection skills;

• Explore mandating the engagement partner's signature on the auditor's report;

• Consider requiring larger audit firms to produce a public annual report and file with the PCAOB a confidential report with audited financial statements;

• Explore independent board members for audit firms;

• Expand reporting of auditor changes, including disclosing the reason for changes in Form 8-K and notifying the PCAOB of any premature partner changes;

• Disclose contracts that limit auditor choice in registration statements, annual reports, and proxy statements;

• Adopt annual shareholder ratification of public company auditors by *all* public companies and disclose the name of the engagement partner in proxy statement covering the ratification;

• Develop "indicators of audit quality and effectiveness" and require audit firms to disclose indicators; and

• Monitor potential sources of catastrophic risk faced by audit firms and establish a mechanism to preserve and rehabilitate a troubled firm. Information on the Committee and its reports are available at: *http://www.treas.gov/offices/domesticfinance/acap/index.shtml.*

In April, as a part of the ACAP project, Treasury published a study of public company restatements from 1997 – 2006. The study noted that restatements increased nearly eighteen-fold, from 90 in 1997 to 1,577 in 2006. The increase was largely driven by restatements made by non-exchange traded companies. From 1997 – 2006, restatements attributed to fraud and those affecting revenues declined, while restatements related to accounting for non-operating expenses, nonrecurring events, and reclassifications significantly increased. While the number of restatements grew over the decade, market reactions to the restatements diminished. The study did find that market reactions to restatements differed based on the type of restatement.

Restatements attributed to fraud and those affecting revenue tended to have more negative market reactions, while restatements related to accounting for non-operating expenses, non-recurring events, and reclassifications typically did not have "discernibly negative" market reactions.

The report is available on Department of Treasury's web site at: *http://www.treas.gov/press/releases/reports/FinancialRestatements_1997_2006.pdf.*

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