MOODY, FAMIGLIETTI & ANDRONICO

March 2010

Financial Reporting

Overview 1

International Financial Reporting Standards 2

Accounting Standard-Setters 2

Accounting Estimates and Judgments 3
- Assumptions in the current environment 3
- Reasonableness of accounting judgments 3

Accounting for Financial Instruments...... 3
- Transfer Accounting 3
- Settlement of financial instruments in cash 4
- Hedge accounting 4

Revenue Recognition........ 4
- Bill and hold arrangements 4
- Multiple element arrangements........ 4

Fair Value Versus Carryover Basis........ 5
- Joint venture formations........ 5
- NEWCO in a business combination..... 5

Goodwill Impairment 6

Fair Value Measurements........ 6
- Market participant assumptions........ 6
- Common problems 7

Variable Interest Entities 7

Financial Statements of Acquired Companies 8

Assessing and reporting on internal control over Financial Reporting........ 8
- Material weaknesses........ 8
- Implications of new accounting standards 8
- Variable interest entities 9
- Changes in internal control........ 9

Disclosures Including Non-GAAP Measures 9

SEC Communications and Transparency 10

International........ 10
- Conversion to IFRS 10
- Acceptable bases of accounting........ 11
- Venezuela........ 11

Glossary of Standards........ 12

Report on the AICPA SEC and PCAOB Conference

The annual AICPA National Conference on Current SEC and PCAOB Developments held on December 7-9, in Washington, DC, provided insights into the Securities and Exchange Commission (SEC) staff's views on various accounting and reporting issues. The remarks made by SEC Commissioner Elisse Walter and members of the Office of the Chief Accountant and slides presented by the Division of Corporation Finance may be accessed at the SEC's website, www.sec.gov, under Speeches & Public Statements.

Overview

Although the financial crisis continues to dominate the headlines, market prices are steadily recovering and the jobless rate – although still high – appears to be stabilizing. While further actions are necessary to address the crisis, attention is shifting to identifying the underlying causes and implementing regulatory changes to prevent a similar crisis from occurring in the future. Opinions as to the changes necessary are numerous and varied. Some continue to believe that fair value accounting was one of the primary causes of the market collapse and are urging the creation of a regulatory body or mechanism that would oversee – and overrule, as necessary – decisions made by the FASB. Others are worried about undue political influence currently exerted over standard-setters and the impact on the quality of the standards, the usefulness of information to investors, and ultimately the capital markets.

The SEC staff stressed that investor protection is paramount. Any changes contemplated in structure, standard-setting, rules, and the like should be evaluated from the perspective of the investor and only those changes beneficial to investors should be considered. With this as the backdrop, the SEC staff reaffirmed its belief that fair value accounting increases transparency, which in turn protects investors, enables informed decision-making, and results in efficient markets and capital allocation. In their view, attempts to override fair value accounting would be ill-conceived attempts to disguise the underlying economics.

The recent tension between legislators, regulators, and standard-setters has reinforced the importance of an independent body of standard-setters and a transparent accounting standard-setting process that appropriately considers input from all stakeholders. The SEC staff believes that standard-setters must be free of undue influence – both political and commercial – and independent of those who do not share the same objectives or purpose.

Lastly, the breadth of the financial crisis – worldwide in scope – has reinforced the importance of a global set of accounting standards. The SEC staff continues to support the goal of one set of high-quality global accounting standards that are developed, implemented and consistently enforced worldwide. However, the SEC staff cautioned that significant issues, including those that arose through the comment process on the proposed roadmap, must first be addressed before any decision will be made regarding the use of International Financial Reporting Standards (IFRS) by US issuers. Ultimately, IFRS will be adopted if, and only if, it is in the best interests of US investors.

The comments following elaborate on these topics and provide additional insight into the SEC positions on these and other accounting and reporting issues.

International Financial Reporting Standards

In late 2008 the SEC proposed a roadmap for the potential use of IFRS, as issued by the IASB, by US issuers preparing financial statements for submission to the SEC. Over 200 comment letters were received from a wide variety of market participants including investors, regulators, issuers, accounting firms, standard-setters, and academics. Although there was almost universal support for a single set of high quality accounting standards, there was considerable disagreement as to how to achieve that goal.

The letters highlighted significant issues – operational, transitional, and structural in nature -- that needed to be addressed before IFRS could be accepted universally in the US capital markets. The issues included: (a) completing the convergence projects outlined in the FASB/IASB Memorandum of Understanding currently slated for completion in 2011, (b) ensuring consistent interpretation and enforcement of IFRS across countries, (c) clarifying the on-going role of the FASB, and (d) assessing the impact of accounting changes under IFRS on existing regulatory bodies (e.g., taxes, utilities).

The SEC staff acknowledged the significance of these issues but emphasized that the evaluation and ultimate acceptance of IFRS, if appropriate, must be focused on protecting the investor and be done in a manner that benefits the US capital markets. In this regard, as the SEC staff studies the issues it will focus on: (a) the US investor knowledge of, and perspective on, IFRS, (b) the on-going development and application of IFRS, (c) the impact on the US regulatory environment, (d) the impact on preparers in terms of changes to accounting systems, contracts, and corporate governance, (e) the availability and readiness of IFRS-trained individuals capable of implementing the standards, and (f) the role of the FASB.

No timetable for further SEC actions or a "date certain" were provided but rather the promise that further communication will be made in the near-term. Regardless of the ultimate decision regarding IFRS for US issuers, the SEC staff stressed that the FASB's continuing commitment to work closely with the IASB is critical to enhancing the quality of accounting standards both in the US and worldwide. The SEC also reiterated its support for the FASB and IASB's renewed commitment to convergence and their increased efforts to complete several major joint projects.

Accounting Standard-Setters

As a result of the financial crisis, some have questioned decisions made by the FASB and, in particular, suggested that fair value accounting was to blame for the market collapse. Others have questioned whether the standard-setting process itself, and the unfettered independence of the standard-setters, is appropriate during such extraordinary times. Regulatory reform to provide additional FASB oversight and/or the ability to overrule FASB decisions is currently being debated.

Accounting standards, if well-designed, provide investors with relevant, reliable, comparable, and unbiased financial information regarding economic performance that, in turn, fosters public trust and assists in the efficient allocation of capital. The SEC staff stressed that the quality of the standards and the usefulness of the information should not be compromised by standards whose sole purpose is to compensate for the current banking crisis. Specifically, accounting standards should not be designed to: (a) portray an artificial stability, (b) disguise the impacts of real business cycles, (c) mask a lack of adequate risk management or supervision, or (d) favor one industry or business practice over another.

Accounting standards should be developed through an independent and trans-

parent process that seeks and considers input from all constituents. The SEC staff believes that additional oversight is inappropriate. Further, the SEC staff cautioned that any attempt to impose additional regulatory oversight would not only impair the independence of the private-sector standard-setting process but the credibility of the standard setting process itself. The ultimate price could be the loss of investor confidence and instability in the capital markets.

Accounting Estimates and Judgments

Assumptions in the current environment

The application of accounting standards in the preparation of financial statements relies heavily on assumptions about the future. In a perfect world, historical trend rates could be relied upon as an indication of future performance. However, in the current economic environment many long-held assumptions regarding market behavior have changed and predicting the future has become increasingly complex.

When developing assumptions consistent with the objectives of the accounting standards, the SEC staff encouraged registrants to:

- Base assumptions on a reasoned analysis that considers current market data, forecasts by industry experts, and actions taken by others in the industry.
- Avoid manipulating assumptions or making changes to a model to achieve a specified outcome (e.g., overly optimistic forecasts, annual resetting of health care cost trend rates).
- Consider disclosing assumptions that were particularly difficult to develop (whether required or not) or, at a minimum, how the determinations were made.

Reasonableness of accounting judgments

The reasonableness of accounting judgments has been a recurring theme over the past few years. In 2008 the Committee on Improvements to Financial Reporting recommended that the SEC staff develop and publish a policy on evaluating the reasonableness of accounting judgments and the factors to be considered. Although a policy has not been published, registrants were encouraged to avoid a "checklist" mentality when analyzing an accounting issue and to carefully, and in good faith, consider the individual facts and circumstances in reaching a conclusion.

Regardless of how well-reasoned or thorough the process, the SEC staff warned that registrants should be prepared to discuss the basis for the conclusion, and the specific facts considered, with the staff. The assertion that accounting judgment has been exercised does not limit the staff's evaluation of the judgment, or shield the registrant from staff questions designed to understand the thought process used in arriving at the conclusion. In all cases, the accounting should be accompanied by transparent disclosure that enables investors to understand the factors considered, and judgments made, by management in arriving at their conclusion.

Accounting for Financial Instruments

Transfer Accounting

Under ASC 860 (formerly FAS 140), a transfer of financial assets is reflected as either a sale, if control has been surrendered, or a collateralized borrowing, if it has not. Over the years significant effort has been expended in designing structures and transactions in order to satisfy the sale criteria and qualify for de-recognition. But recent changes in accounting standards – in particular FAS 166 and 167 – have reduced the likelihood of de-recognition. With the elimination of qualifying special-purpose entities and the FIN 46R scope exception previously afforded them and other asset-backed financing structures, such structures may likely become consolidated variable interest entities (VIEs).

The SEC staff shared its concerns that this change in accounting may have provided the impetus for the design of new structures or transactions in an attempt to achieve more favorable accounting. As an example, the SEC staff described a typical transaction in which the registrant sells perpetual preferred interests in a subsidiary that holds only financial assets and whose activities are limited to servicing those assets. Since the preferred interests are equity, both in description and legal form, some believe that the proceeds received should be classified as noncontrolling interests within equity under ASC 810 (formerly FAS 160), rather than collateralized debt, in the financial statements of the parent.

The SEC staff disagreed with this assessment. Since the subsidiary is created solely to issue beneficial interests backed by financial assets and does not engage in any substantive business activities, interests sold in that subsidiary should be viewed as transfers in the financial assets themselves. The interests should be accounted for under ASC 860 as either a sale or a collateralized borrowing, as

appropriate. Presentation as an equity interest in the reporting entity is not an option.

Settlement of financial instruments in cash

Accounting for share-based derivatives (e.g., contracts on a company's stock such as options or warrants) and redeemable shares is based on whether or not a company could be required to settle or redeem the security in cash, without regard to likelihood or probability. If a company could be forced to pay cash, the securities would generally be reflected outside of permanent equity and accounted for as either liabilities, if share-based derivatives, or mezzanine equity, if redeemable shares.

The key issue, therefore, is whether the method of settlement is within the control of the company. The SEC staff provided guidance for registrants making such determinations. First, "company" should be interpreted as those parties responsible for managing and governing, as determined by the owners of the entity (i.e, the governance structure). The specific individuals/roles would vary based on the actual structure but would typically be the Board of Directors or executive management in a corporate structure or the general partner in a limited partnership. If these individuals have the power to decide how a security will be settled, settlement would be considered within the control of the company.

Second, when evaluating cash settlement features registrants should consider the possible interaction between rights – in particular, any rights that, in combination, could create a security that is puttable at the option of the holder. As an example, the SEC staff described a preferred share that included two rights – (a) an embedded call option and (b) a contingent control right that allowed the preferred shareholder to assume control of the board if the company failed to pay dividends. In tandem, these rights create a security that is contingently puttable at the option of the holder and would preclude a registrant from concluding that settlement was within the company's control.

Hedge accounting

The SEC staff reminded registrants that hedging methods that do not require a full evaluation of effectiveness (e.g., short cut or critical terms match methods) are intended for straight-forward hedging relationships involving conventional instruments. If unusual terms raise questions about the level of effectiveness, a more complete analysis would be necessary.

Revenue Recognition

Bill and hold arrangements

Staff Accounting Bulletin (SAB) 104 reflects the staff's views on revenue recognition for transactions not specifically addressed in the accounting literature. The views are based on the FASB's conceptual framework and a general notion that revenue should not be recognized until realized or realizable and earned. Four specific criteria – evidence of an arrangement, delivery and performance, fixed or determinable price, and collectability -- should be satisfied prior to recognition. Although "delivery and performance" is one of the criteria that must be met, an exception is provided for bill and hold arrangements if additional criteria are met.

In practice, to reduce or defer costs, some vendors hold product under bill and hold arrangements in an unfinished state and perform the additional processing just prior to delivery. Such an approach would appear to preclude revenue recognition since SAB 104 specifically requires that: (a) the seller must not have retained any specific performance obligations that cause the earnings process to be incomplete and (b) the equipment or product must be complete and ready for shipment.

Nevertheless, some have maintained that revenue recognition is appropriate since the arrangement meets all of the other criteria. As a result, the SEC staff considered the possible interaction of these criteria with other revenue guidance on inconsequential or perfunctory performance obligations and multiple-element arrangements and shared its views. Specifically:

- The inconsequential or perfunctory assertion is appropriate for post-delivery performance obligations but not for product that has not yet been delivered and will require additional processing.
- The assertion that an incomplete product is a separate deliverable is questionable since revenue recognition under a bill and hold arrangement requires that the product held be in the form the customer will ultimately receive. Furthermore, delivery is not generally considered a separate deliverable.

Since bill and hold arrangements are an exception to the general revenue recognition principles, the SEC staff urged registrants to exercise due care when evaluating such arrangements.

Multiple element arrangements

Under ASC 605 (formerly EITF 00-21), segregation of deliverables in a multiple-element arrangement into separate

units of accounting was predicated on satisfying three criteria: (a) stand-alone value for the delivered item, (b) verifiable specific objective evidence or third-party evidence of fair value for undelivered elements, and (c) ability to deliver the undelivered items, if general rights of return exist. In practice, objective and reliable evidence of fair value of the undelivered item was generally assessed first as it was viewed by many as the highest hurdle. If none existed, the arrangement was accounted for as a single unit of accounting and further analysis of the other criteria was unnecessary.

With the adoption of EITF 08-1 and its elimination of the second criterion, more arrangements are expected to be eligible for separation. For these arrangements, more – or new -- attention is expected to be devoted to assessing whether the remaining criteria are met and, in particular, whether there is stand-alone value. As defined, a delivered item has value to a customer on a stand-alone basis if: (a) it is sold separately by any vendor or (b) the customer could resell the delivered item on a stand-alone basis.

With this in mind, the SEC staff focused on how one might assess whether a delivered item has value to a customer on a stand-alone basis through a hypothetical arrangement involving a bio-tech firm and two deliverables – a license for technology and proprietary research and development services. The technology was unique (i.e., not sold by another vendor); used in the development of a new drug; always sold in tandem with the research and development services which are essential to deriving the value from the technology; and not available for sub-licensing or resale under contractual restrictions.

Since the customer was unable to resell the technology and separate technology sales did not exist, the SEC staff concluded that the license did not have stand-alone value and should be combined with the research and development services as a single unit of accounting. However, the SEC staff stressed that a change in one fact (e.g., if other vendors could provide the research and development services) could potentially alter the conclusion. As a result, any assessment must be based on the individual facts and circumstances in the arrangement.

Fair Value Versus Carryover Basis

Joint venture formations

The transfer of a consolidated business in exchange for an interest in a joint venture has generally been reflected at carryover basis in the financial statements of both the investor and the joint venture. Absent the receipt of cash or near-cash consideration, the investor would simply attribute the carrying amount of the contributed business to the new investment with no recognition of gain/loss. Similarly, based on strong views historically held by the SEC staff, the joint venture would generally reflect the business at carryover basis in its financial statements. The only exception, which was limited in practice, would be if a business were contributed to a new entity and its fair value supported by an equal amount of monetary assets.

This approach had been based, in part, on concerns over the recognition of gains at the investor level, the ability to reliably value the business at the investee level, and the SEC staff's interpretation of GAAP as it existed at the time. However, over time companies have become more familiar with fair value concepts and models and regulators, investors and the like more comfortable with the underlying valuations. Additionally, with the adoption of FAS 160, an investor is now required to recognize a gain or loss upon de-recognition of the consolidated business to the extent the fair value of the consideration received differs from the carrying amount of the net assets contributed.

The SEC staff stressed that changes in GAAP may result in changes in their views and acknowledged that there may now be more circumstances in which recognition at fair value by the joint venture may be appropriate but offered no new model or definitive guidance. Registrants were urged to carefully evaluate the facts and circumstances to determine whether a new basis of accounting will result in decision-useful information for investors.

NEWCO in a business combination

As a result of new accounting standards on business combinations (FAS 141R) and non-controlling interests (FAS 160), the SEC staff is reconsidering whether, and under what circumstances, a newly-formed entity (NEWCO) should be considered the accounting acquirer in a business combination. The SEC staff is concerned that transactions designed to achieve the same economic outcome, although structured differently to satisfy legal or regulatory requirements, may result in significantly different accounting.

As an example, the SEC staff described two scenarios. In the first, Company C, a 100% wholly-owned subsidiary of Company B, simultaneously repurchases 60% of its shares from Company B and sells a like number of shares to Company A for cash. In the second, Company A purchases the shares by creating and funding a temporary NEWCO that merges with and into Company C. In both cases the economic outcome is the same – Company A acquires a 60% ownership

interest -- but then the similarities end. While the first transaction would typically be accounted for as a business combination by Company A and an equity transaction (i.e., issuance and repurchase of shares) by Company C, the accounting for the second transaction is less clear.

ASC 805 (formerly FAS 141R) states "a new entity that transfers cash or other assets … as consideration may be the acquirer." Some have interpreted this phrase to mean that any NEWCO that issues other than equity interests may qualify as the accounting acquirer while others believe the NEWCO must have substance. Since there is no current guidance on how to assess substance, the following factors, derived from superseded standards and perceived SEC staff views, are generally considered: (a) whether NEWCO survives the transaction, (b) its level of pre-combination activities, (c) how long NEWCO has existed, and (d) whether the elements of the transaction are integrated and interdependent.

The SEC staff acknowledged that the most recent bias among preparers has been to avoid new basis (and its accompanying revaluations and higher charges) but cautioned that the current environment of declining asset values may make new basis accounting more attractive to some. When considering the appropriate accounting, the SEC staff encouraged registrants to consider the specific facts and circumstances, apply reasonable judgment, and avoid any "bright-lines" or preconceptions (e.g., if a NEWCO survives it will always be the accounting acquirer).

Goodwill Impairment

In the current economic environment, goodwill impairment assessments are performed on a fairly regular basis. Registrants are oftentimes required to perform interim assessments as triggering events indicating potential impairment continue to occur (e.g., book value greater than market capitalization). As a result, the SEC staff shared its latest views on how to best perform such assessments.

The first step in a goodwill impairment assessment is to determine whether there is the potential for impairment (i.e., whether the fair value of the reporting unit is less than the carrying amount of the net assets including goodwill). Although ASC 350 (formerly FAS 142) provides a conceptual definition of fair value as "the price that would be received to sell the unit as a whole in an orderly transaction between market participants," it does not specify the methods to be used in deriving fair value.

In practice, there are two approaches to determining fair value – the equity value or the enterprise value, which is commonly defined as the sum of the fair value of debt and equity. Although the approach selected would not have any bearing on the test results in many circumstances, it would have a significant impact on a reporting unit whose equity is negative (i.e., stockholders' deficiency). Since fair value under the equity method cannot be less than zero, such a reporting unit would always pass the first test – an outcome that may run counter to the economic realities (e.g., deteriorating operations). In these situations, the SEC staff believes that a step one test performed on an enterprise value basis would likely be a better indicator of potential goodwill impairment.

Overall, registrants were encouraged to exercise reasonable judgment when determining whether a step two test is warranted and to not rely solely on whether step one passed or failed. When there is evidence that the approach selected for step one testing would significantly affect the results, registrants should consider performing a complete impairment assessment.

The SEC staff also suggested that registrants provide expanded disclosures for each reporting unit that has material goodwill and is at risk of failing the step one test. In assessing "at risk," registrants should consider reporting units whose fair value was not substantially in excess of carrying value and apply judgment to the specific facts and circumstances (e.g., the narrower the margin the greater the risk). For these reporting units, registrants should disclose: (a) the percentage by which fair value exceeded the carrying amount, (b) the amount of goodwill allocated to the reporting unit, (c) key assumptions that drive fair value (e.g., cost of capital or growth rates), and (d) any uncertainty or potential events that could have a negative effect.. Due to the interplay between assumptions, the SEC staff now believes that a sensitivity analysis focused on the impact of a change in only one assumption does not provide the most meaningful information.

Fair Value Measurements

Market participant assumptions

Under ASC 820 (formerly FAS 157), fair value must be determined from the perspective of market participants. Although simple in concept, the standard has proven challenging in practice for assets and liabilities with no available observable prices. In these situations, market participant assumptions may not be readily available without undue cost or effort, or they may vary substantially based on the facts and circumstances of each category of market participants.

Understanding the challenge, the SEC staff suggested that registrants use a three step approach when developing market participant assumptions. As a starting point, registrants should look to their own assumptions (e.g., expected use, asset life, cash flows from use or sale). Second, the potential exit markets should be identified and the defining characteristics of each considered including:

- Level of activity within the markets (i.e., active, inactive, or recently inactive)
- Distinct groups of market participants (e.g., strategic versus financial buyers, small versus large, profitable versus unprofitable, regional versus national, etc.)
- Differing levels of competitiveness (i.e., perfect competition, monopoly, oligopoly, fragmented)

Lastly, the significant distinguishing characteristics of the identified market participants should be reconciled to those of the registrant and the registrant's initial assumptions should be adjusted, as necessary. Although there may be circumstances where the assumptions are not significantly different, the SEC staff would expect registrants to exercise reasonable judgment in arriving at such a conclusion and to document how the market participant assumptions were developed.

Common problems

The SEC staff also shared some common problems involving valuations:

- Using a Black Scholes model for other than plain vanilla options
- Relying on third party valuations without understanding, validating, or "owning" the valuation
- Using inconsistent assumptions in multiple valuations involving similar instruments
- Assuming, rather than actively determining, that a market is distressed, and that its information can be ignored or underweighted

Variable Interest Entities

Under FAS 167, a reporting enterprise must consolidate a VIE in which it has a controlling financial interest. Specifically, consolidation is required if an enterprise has both: (a) power over the activities that most significantly impact an entity's economic performance and (b) exposure to losses and benefits that could be potentially significant to the entity.

Determining if a reporting enterprise has a controlling interest requires significant judgment and a clear understanding of the arrangement.

As such, the SEC staff provided the following qualitative factors to consider:

- The purpose and design of the entity (i.e., the risks that were to be created and passed on to the variable interest holders)
- The terms and characteristics of the financial interest, including the level of seniority
- The enterprise's business purpose for holding the financial interest

The party with power may also change over the life of a VIE. For example, a collaborative effort may involve two parties – one responsible for research and development and one responsible for the manufacturing/distribution of any developed product. In this fact pattern, the "significant" activities – and the party controlling them – may change over the life cycle of the entity as it progresses from a development stage company focused on research and development to a commercial operation focused on production and sales.

Registrants should also consider the economic substance of a structure and whether the terms are substantive. For example, if the party responsible for managing a collection of transferred assets could be removed by the transferor for poor performance, the manager is more likely to be an agent of the transferor. Similarly, if a manager doesn't have the financial wherewithal necessary to exercise a buy-sell clause, the agreement would in substance appear to be a call option on the part of the transferor. In both cases, the SEC staff believes that the reporting enterprise has not relinquished control and continues to be subject to all the risks of ownership.

The SEC staff stressed that the issue of substance is particularly relevant in the current environment and that "creative" off-balance sheet structures are being designed and marketed to remove underperforming assets (e.g., past due loans, securities, or real estate with declining values) with little apparent transfer of risk. Auditors and registrants were encouraged to remain vigilant when evaluating the substance of an arrangement. The SEC staff reiterated its long-standing view that transactions structured to achieve specific accounting or reporting goals rather than reflect the economic substance of the arrangements reduce the transparency in financial reporting.

Financial Statements of Acquired Companies

Questions are frequently raised regarding the financial statement requirements for acquired or target companies under Rule 3-05 of Regulation S-X. They arise in connection with filing reviews, prefiling conferences, and informal inquiries and focus on how many years of financial statements, if any, are required. As a result, the SEC staff provided the following guidance:

- A determination as to whether the acquiree represents a business should be based on Article 11 of Regulation S-X and not on ASC 805.
- If the acquiree is a predecessor to the registrant, financial statements of the acquiree that are S-X compliant must be provided for all periods required of the registrant, regardless of the level of significance, and the forepart of the filing must address its operations (e.g., business, MD&A, selected financial data).
- The significance tests should be applied as written with no adjustments. If the results are anomalous, registrants should analyze the facts and circumstances, including the usefulness to an investor, and consult with the SEC staff to see if a reduction in the number of financial statement periods is warranted.
- The significance tests for acquisitions accounted for under FAS 141R should be based on its underlying principles (e.g., the investment test should include contingent consideration at fair value and exclude transaction costs).
- A registrant unable to obtain pre-acquisition financial statements in connection with an IPO should consider whether the pre and postacquisition periods, in the aggregate, satisfy the requirements (i.e., cover the required number of months).

It is becoming more common for acquisitions to be conducted through a special purpose acquisition company (SPAC), an entity structured solely for the purpose of raising capital and acquiring an operating company. In a typical arrangement a shell company (SPAC) raises funds through an IPO in order to pursue the acquisition of an existing company. A proxy is ultimately circulated for the proposed acquisition and shareholders either vote to approve the merger or to distribute the capital. Since a SPAC, by design, has no operations, the SEC staff presumes that the collection of assets to be acquired by the SPAC represents a business under Article 11 of Regulation S-X. Additionally, the pre-acquisition historical financial statements of the operating company provide important information for SPAC shareholders voting on the transaction and an historical benchmark for future investors analyzing trends. As a result, it would be rare for the SEC staff to waive the requirement for operating company financial statements. Further, since the costs of the transaction are only reflected in the financial statements of the SPAC, the pre-acquisition financial statements of the SPAC should also be provided in the proxy.

Assessing and Reporting on Internal Control Over Financial Reporting

Material weaknesses

Since 2004 management of accelerated filers has been assessing, and auditors attesting to, the effectiveness of internal control over financial reporting. Over this 5 year period the SEC staff noted what it viewed as two potentially disturbing trends. First, despite the recent economic crisis and the challenging financial reporting issues it created, the percentage of registrants reporting material weaknesses continues to decline (from 15% to 4%). Second, the percentage of material weaknesses that resulted in a material adjustment to the financial statements continues to increase (from 55% to 75%).

The SEC staff acknowledged that these trends could be due to registrants vigilantly addressing previously reported material weaknesses, while also controlling the unique financial reporting risks introduced by the recent economic conditions. But a more skeptical view would be that all material weaknesses are not being identified and/or reported (e.g., inappropriately concluding that only control deficiencies that result in material adjustments rise to the level of material weaknesses). When testing the design and operating effectiveness of controls, the SEC staff urged registrants and their auditors to focus on what could go wrong and not simply on what did go wrong.

Implications of new accounting standards

Internal control over financial reporting is not static; as accounting standards

change so must the controls. With this in mind, the SEC staff suggested that changes in the accounting for business combinations and in revenue recognition for multiple-deliverable arrangements may warrant special attention, on the part of registrants and auditors alike, to determine if internal control over financial reporting adequately addresses these new standards.

In addition to significantly changing the accounting for business combinations, FAS 141R has expanded the definition of a business and included, in its scope, transactions that do not involve the exchange of consideration. As such, a critical assessment of controls in this area may include determining whether controls exist to identify: (a) all transactions that qualify as business combinations (e.g., development stage companies, transactions where control is obtained through contractual rights or lapse of veto rights) and (b) other accounting implications beyond ASC 805 (e.g., new reporting units for goodwill impairment assessment as a result of expanded definition of a business).

Likewise, EITF 08-1 has introduced estimated selling price as a new "default" measure of value and significantly expanded revenue recognition disclosures. As such, an assessment in this area may involve determining whether controls exist to: (a) ensure that the estimated selling price is only used when vendor specific objective evidence or third-party evidence is unavailable, (b) identify circumstances requiring an updating of estimates of value, and (c) identify and accumulate disclosure information not typically captured in the accounting system (e.g., general terms of delivery/performance of services, refund and cancellation provisions, etc.).

Variable interest entities

The SEC advised registrants that VIEs consolidated upon adoption of FAS 167 must be included in management's assessment of internal control over financial reporting. In 2007 the SEC staff published frequently asked questions (FAQ) on internal control over financial reporting that provided exceptions for certain VIEs and business combinations. However, since consolidation is now based on control and a VIE consolidated upon adoption does not constitute a business combination transaction under the transition guidance, the SEC staff does not believe the exceptions discussed in the FAQ apply.

Since adoption is as of the beginning of the fiscal year, the SEC staff believes that registrants will not only have the right and authority to assess the controls of the consolidated entity, but sufficient time within which to perform and complete such an assessment. The only exception, which is considered rare, would be where the VIE existed before December 15, 2003 and the registrant lacks both the authority and ability to perform an assessment.

Changes in internal control

Under Item 308 of Regulation S-K registrants are required to describe any material changes in internal control that occurred during a period. Nevertheless, an increasing number of filings that identify changes in reported material weaknesses and/or assessments of effectiveness during the period contain no disclosure regarding any changes in internal control. If changes in internal control, as a result of remediation, are not described, the SEC staff may question the validity of the remediation efforts and assume that the previously reported deficiencies in internal control over financial reporting still exist. Additionally, disclosures regarding changes in internal control provide important and useful information to investors.

Disclosures Including Non-GAAP Measures

The SEC staff highlighted a number of projects that it has undertaken in an effort to improve the usefulness of information provided to investors and focused, in particular, on non-GAAP measures. In 2003 the SEC staff published interpretive guidance on non-GAAP measures in the form of frequently asked questions. There is now concern that the interpretations may be more restrictive than originally intended by the rules and inappropriately prohibiting disclosure of information that would be useful to investors. As a result, the SEC staff is in the process of clarifying its guidance – in particular its views involving the exclusion of recurring and non-recurring items and the inclusion of items that are not "expressly permitted" by home country regulators. Revisions are to be issued in sufficient time to allow registrants to consider changes in their disclosures in connection with the 2009 annual filings.

The SEC staff has undertaken a "core disclosure" project to eliminate duplicative disclosures and enhance the quality and usefulness of disclosures provided to investors. Future changes being considered, or recently adopted, include focusing risk factors on specific company risks as gleaned from other sections of the forepart (e.g., MD&A, market risks) and including some discussion of mitigating activities, eliminating a listing of properties, and reflecting full grant date fair value for stock and option awards in summary compensation tables.

In the meantime, the SEC staff suggested the following:

- SAB 74 – MD&A should address the financial and non-financial impact of a change in accounting on future operations (e.g., material known trends, impact on contracts), rather than the impact of adoption on the financial statements which should be the focus in the notes to the financial statements. Additionally only disclosures for new accounting standards that could have a material impact on a registrant (e.g., industry, nature of transaction) are necessary.

- Codification – registrants should focus on describing accounting principles and underlying concepts rather than citing the codification references which are generally meaningless to investors.

- Income taxes – MD&A should focus on the factors affecting income taxes and consider the items identified in the tax rate reconciliation in the notes to the financial statements. Additionally, registrants should consider providing settlement information for deferred taxes since balance sheet classification is based on current/non-current classification of the associated assets/liabilities and not anticipated settlement date.

SEC Communications and Transparency

The SEC staff publishes interpretive guidance on its website to assist registrants and auditors in understanding and complying with SEC rules and regulations. Two primary publications – the Financial Reporting Manual (FRM) and the Compliance and Disclosure Interpretations (C&DI) – are supplemented as necessary with more time-sensitive or targeted guidance (e.g., industry specific, type of issuer).

The FRM is an internal training tool and reference document that addresses topics of specific interest to accountants (e.g., financial statement requirements, disclosures) and is currently being expanded to include positions reached in joint meetings with the CAQ SEC Regulations Committee and the International Practices Task Force. It is updated periodically to provide new or revised interpretations (most recently on December 7, 2009).

The C&DIs are interpretations of Regulation S-K and, although primarily legal in nature, include information relevant to accountants. In late 2009 the SEC staff published the following: (a) a letter sent to CFOs in the banking industry addressing MD&A disclosures for provisions and allowances for loan losses, (b) a presentation at the PCAOB forum for smaller reporting companies, and (c) areas of frequent staff comments directed at financial institutions.

International

Conversion to IFRS

Since 2008 foreign private issuers who file financial statements under IFRS, as issued by the IASB, are no longer required to reconcile their financial statements to US GAAP. As more countries adopt IFRS, some foreign private issuers that have previously filed US GAAP financial statements with the SEC, in lieu of local GAAP financial statements, are considering converting to IFRS for SEC reporting purposes. US investors accustomed to US GAAP financial statements would then be provided with financial statements retrospectively restated in accordance with IFRS. This change in accounting raises the question as to whether registrants should identify the changes in the financial statements or disclose the material differences between US GAAP and IFRS.

Under IFRS 1, first-time adopters are required to provide a reconciliation of financial statements presented under "previous GAAP" (as originally filed) to those prepared under IFRS (as restated). However, this requirement generally would not apply in a situation in which a registrant converts from US GAAP to IFRS since most foreign private issuers identify local GAAP – not US GAAP – as previous GAAP. Additionally, many registrants considering this change have already adopted IFRS in prior years and no longer qualify as first-time adopters.

Although there are no existing SEC rules addressing this situation, the SEC staff believes that foreign private issuers that convert from US GAAP to IFRS should provide a "bridge" for investors between the financial statements previously presented under US GAAP and those restated under IFRS. For a foreign private issuer that elects to adopt IFRS simultaneously for local and SEC reporting purposes, the staff believes that in addition to the IFRS 1 reconciliation, registrants should provide information to enable users to understand the material reconciling items between US GAAP and IFRS. This could be accomplished through either:

- An analysis of the differences between US GAAP and IFRS consistent in form and content with the requirements under Item 17 of Form 20-F and for the same periods that would be required in an IFRS 1 reconciliation (i.e., impact on beginning equity, ending equity, and profit/loss for the year immediately preceding the year of adoption of IFRS).

- A two-step reconciliation that would include an analysis of the differences

between US GAAP and local GAAP (i.e., previous GAAP) as described above coupled with an IFRS 1 reconciliation of local GAAP to IFRS.

A foreign private issuer that has adopted IFRS in a prior year should provide a reconciliation of US GAAP to IFRS under an Item 17 approach, as described above, showing the impact on ending equity in the year immediately preceding, and on profit and loss for the two years immediately preceding, the year of adoption of IFRS.

In all cases, the disclosures should be audited and included in the audited financial statements or, if impracticable, in an audited supplemental financial statement schedule.

Acceptable bases of accounting

If a foreign business does not qualify as foreign private issuer, it is generally required to use domestic forms (e.g., 10-Ks and 10-Qs) and prepare its financial statements in accordance with US GAAP. However, an exception was afforded Canadian companies if their local regulators required that the financial statements be prepared in accordance with Canadian GAAP. In these situations, the SEC accepted the Canadian GAAP financial statements and simply required that they be accompanied by a reconciliation to US GAAP in accordance with Item 18 of Form 20-F.

Over the last few years, many of the Canadian regulators have been accepting US GAAP financial statements for companies that are registered in the US. As a result, the SEC staff believes that the accommodation is no longer warranted and has decided to eliminate it, coincident with Canada's adoption of IFRS, in 2011. However, a new exception is being provided for any foreign private issuers who voluntarily choose to file on domestic forms. To encourage the use of domestic forms – which are considered to provide more extensive and useful information – the SEC will accept financial statements prepared under IFRS, as issued by the IASB, or under local GAAP and reconciled to US GAAP under Item 18.

The following issues are currently being debated and, until decisions are made and definitive guidance is published, registrants were advised to contact the SEC staff directly with any questions:

- Whether IFRS for Small and Medium-sized Entities, which is limited to entities with no public accountability, is an acceptable basis of accounting for financial statements required under Rules 3-05 and 3-09 of Regulation S-X.
- Whether IFRS precludes the presentation of certain financial statements for non-issuers (e.g., combined, carve-outs, single year).

Venezuela

An entity is generally considered highly-inflationary when the three year cumulative inflation rate equals or exceeds 100%. Once the threshold is reached, highly inflationary status is applied prospectively under US GAAP (i.e., with the period commencing after the determination) and retrospectively under IFRS (i.e., to the beginning of the year in which the determination is made).

The determination, as it relates to Venezuela, is complicated by the fact that there are two different indices that may be considered – (a) the consumer price index (CPI) which is a city-wide index used since 1984 and (b) the blended rate which is a combination of the CPI and a more representative national consumer price index developed in 2008 that covers the entire country. As of October 31, 2009, the cumulative inflation rates were in excess of 100% using the CPI and 99.6% using the blended rate.

Based on the most recent data, the SEC staff advised registrants to assume the 100% threshold will be reached as of December 31, 2009 (i.e., account for Venezuela as highly inflationary as of January 1, 2010 under US GAAP and as of January 1, 2009 under IFRS). However, if the blended rate does not exceed 100% as of November 30, 2009 and appears to be dropping the staff would be willing to reconsider.

Under US GAAP, financial statements should be translated using the exchange rate that will be available for dividend remittances. However, foreign currency controls implemented in Venezuela over the last few years have resulted in two markets for the sale and purchase of foreign currency and two widely disparate exchange rates. Transactions that are approved by, and conducted with, the government are based on a fixed rate determined by the government (the "official rate"). Transactions that effectively by-pass the government are accomplished through structured transactions involving the purchase and sale of securities and are based on a variable rate (the "parallel rate"). The two rates may vary greatly and the parallel rate is currently three times as costly as the official rate (i.e., number of bolivars exchanged for a US dollar).

Historically registrants have been advised to use the official rate for translation purposes. However, obtaining government approval has become increasingly difficult -- the volume of approved transactions continues to decrease and the length of time between submission and approval continues to increase. As a result, the SEC staff acknowledged that a "one size fits all" approach may not be appropriate.

Registrants were advised to determine which rate is appropriate based on their particular facts and circumstances and to be ready to support the position. If the rate used is material to the registrant (e.g., potential gains/losses) the SEC staff would expect the registrant to disclose this and provide additional disclosures such as: (a) summarized financial information for Venezuelan operations, (b) the exchange rate used, (c) net monetary assets and liabilities by currency, and (d) the potential impact of a change in exchange rates on financial statements in MD&A.

If you would like to discuss the content of this Financial Reporting, please call:

William S. Andronico
CPA, MBA, MST
Partner

Tel: (978) 557-5300
Email: wandronico@mfa-cpa.com

Glossary of Standards

ASC 350
Intangibles – Goodwill and Other

ASC 605
Revenue Recognition

ASC 805
Business Combinations

ASC 810
Consolidation

ASC 820
Fair Value Measurements and Disclosures

ASC 860
Transfers and Servicing

EITF 00-21
Revenue Arrangements with Multiple Deliverables

EITF 08-1
Revenue Arrangements with Multiple Deliverables

FAS 140
Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities – a Replacement of FASB Statement 125

FAS 141R
Business Combinations

FAS 142
Goodwill and Other Intangible Assets

FAS 157
Fair Value Measurements

FAS 160
Noncontrolling Interests in Consolidated Financial Statements - an Amendment of ARB No. 51

FAS 166
Accounting for Transfers of Financial Assets – an Amendment of FASB Statement 140

FAS 167
Amendments to FASB Interpretation 46R

FIN 46R
Consolidation of Variable Interest Entities

IFRS 1
First-Time Adoption of International Financial Reporting Standards

SAB 74
Disclosure of the Impact that Recently Issued Accounting Standards Will Have on the Financial Statements of the Registrant When Adopted in a Future Period

SAB 104
Revenue Recognition

S-K, Item 308
Internal Control over Financial Reporting

S-X, Article 11
Pro-Forma Financial Information

S-X, Rule 3-05
Financial Statements of Businesses Acquired or to be Acquired

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

Material Discussed in this Financial Reporting is meant to provide general information and should not be acted on without obtaining professional advice tailored to your firm's individual needs. The information in this Financial Reporting is for general guidance only and is not a substitute for professional advice.

IRS CIRCULAR 230 DISCLOSURE: To ensure compliance with requirements imposed by the IRS, we inform you that any U.S. tax advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the prupose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.