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Moody, Famiglietti & Andronico, LLP
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If you would like to discuss the content of this Financial Reporting and the impact it may have on your business, please call:

William S. Andronico, CPA, MBA, MST
Partner
MFA - Moody, Famiglietti & Andronico, LLP

793 Turnpike Street. North Andover, MA 01845
Tel: (978) 557-5302
Email: wandronico@mfa-cpa.com

SAB 108 Implementation

On September 13, 2006, the SEC staff outlined the approach it believes registrants should use to quantify the misstatement of current year financial statements that results from misstatements of prior year financial statements. The staff communicated its view in Staff Accounting Bulletin (SAB) No. 108. Implementing the approach outlined in SAB 108 may require a registrant to make significant adjustments in its 2006 financial statements. A registrant may also need to disclose the expected effect of applying SAB 108 in the interim financial statements it files before it implements the SAB 108 approach.

This letter addresses SAB 108 implementation issues in a question and answer format by topic. It assumes that the reader is familiar with the basic requirements of SAB 108. The SAB is available at **http://www.sec.gov/interps/account/sab108.pdf**.

Disclosure Prior to and at Adoption

What should registrants disclose in financial statements issued prior to the adoption of SAB 108?

Answer:
The SEC staff has informally stated that SAB 74 (Topic 11M) disclosures are required prior to the adoption of SAB 108 if the effect of adopting the SAB is expected to be material. The staff has informally indicated that the effect should be considered to be material if a cumulative effect adjustment or restatement is expected. SAB 74 is written in the context of a new accounting standard and requires registrants to disclose the following:

- A brief description of the new standard, the date that adoption is required and the date that the registrant plans to adopt, if earlier.
- A discussion of the methods of adoption allowed by the standard and the method expected to be utilized by the registrant, if determined.
- A discussion of the impact that adoption of the standard is expected to have on the financial statements of the registrant, unless not known or reasonably estimable. In that case, a statement to that effect may be made. (The staff has informally indicated that it would ordinarily expect a registrant to be able to quantify the expected impact of adoption.)

In addition, SAB 74 encourages disclosure of the potential impact of other significant matters that the registrant believes might result from the adoption of the standard (such as technical violations of debt covenant agreements, planned or intended changes in business practices, etc.).

Which reports should disclose the adoption of SAB 108?

Answer:
The SEC staff has informally stated that if SAB 108 is adopted in an interim period, a registrant should make all of the disclosures that would be required if it had initially applied the SAB in its annual financial statements. These disclosures should be included in each quarterly report and in the annual financial statements for the year in which SAB 108 was adopted.

In subsequent annual financial statements, the disclosure requirements depend on the method of adoption. If SAB 108 was adopted via restatement, we believe that financial statements for subsequent years need not repeat the disclosures. If SAB 108 was adopted via a cumulative effect adjustment, we believe the disclosures made in the financial statements in the year of adoption should be repeated until the year reflecting the cumulative effect adjustment is no longer presented.

What should a registrant disclose if it implements SAB 108 via a cumulative effect adjustment?

Answer:
SAB 108, Question 3 states that a registrant that reflects the effect of initially applying the guidance in SAB 108 by recording a cumulative effect adjustment "should disclose the nature and amount of each individual error being corrected in the cumulative adjustment. The disclosure should also include when and how each error being corrected arose and the fact that the errors had previously been considered immaterial."

The SEC staff has informally said that registrants should describe every item included in the cumulative effect adjustment. In other words, registrants should not include an "other" item in this disclosure.

Generally, the disclosure does not need to be sufficiently detailed to allow a reader to determine the adjustments that would have been necessary to restate the financial statements for each year. However, there could be fact patterns where discussing the year in which an error originated might be warranted in order to make the disclosure meaningful (e.g., when the cumulative effect adjustment results primarily from a single error made in a single year). Registrants are also not required to disclose when the errors were identified.

What should a registrant disclose if it implements SAB 108 via restatement?

Answer:
Statement 154 specifies the disclosure requirements when financial statements are restated to correct errors. As with all FASB statements, the provisions of Statement 154 do not need to be applied to immaterial items. Therefore, the SEC staff has informally acknowledged that if a registrant revises its prior year financial statements to implement SAB 108 and correct errors that were considered immaterial under its prior approach, it is not required to provide all of the disclosures Statement 154 requires when financial statements are restated to correct a material error. However, such registrants should clearly disclose that they have corrected errors in prior period financial statements. The disclosures should be as robust as those that a registrant making a cumulative effect adjustment would provide.

Early Adoption

Can a registrant implement SAB 108 in annual financial statements for a year ending on or before November 15, 2006?

Answer:
Yes. The SEC staff has informally indicated that it is acceptable to early adopt SAB 108 in annual financial statements for years ending on or before November 15, 2006.

Implementation Via Cumulative Effect Adjustment

Can errors that are immaterial be corrected in the cumulative effect adjustment?

Answer:
We understand that the SEC staff believes that the cumulative effect accommodation is to be used for a material adjustment. If the cumulative effect of adopting SAB 108 is not material, misstatements should instead be corrected through adjustments to income in the current year. Thus, by correcting an error or errors via a cumulative effect adjustment, a registrant is implicitly asserting that the current year financial statements would be materially misstated if the error or errors were not corrected. Therefore, the staff believes it would be inappropriate for a registrant to assert that the cumulative effect adjustment is immaterial.

While the cumulative effect adjustment must be material, this does not mean that each item that comprises it must be individually material. For example, a registrant that has errors that are each individually immaterial but aggregate to a material amount would need to correct individually immaterial errors via a cumulative effect adjustment. Thus, once a registrant concludes that a cumulative effect adjustment is necessary, we understand that it may correct both individually material and individually immaterial adjustments through that adjustment, and we expect that most registrants in this position will correct all significant uncorrected errors.

We generally do not expect the staff to challenge a registrant's implicit assertion that a cumulative effect adjustment is material. However, we expect that the need to disclose every item reflected in a cumulative effect adjustment, as discussed above, will deter registrants from making inappropriate over-use of the cumulative effect accommodation.

The staff also believes that if a registrant corrects an error via a cumulative effect adjustment, implying that the portion of the error that arose in prior years is material under the dual approach, it would be inappropriate to allow the portion of the error that arose in the current year to remain uncorrected. Consider, for example, a $120 error, $110 of which arose in prior years and was corrected via a cumulative effect adjustment upon adoption of SAB 108. The staff believes that the remaining $10 error should be corrected in the current year financial statements and not left uncorrected.

Can a registrant that has already recorded one or more out-of-period items for error corrections during an interim period in the year of adopting SAB 108 adjust the interim period financial statements to remove the out-of-period items and record them in the cumulative effect adjustment?

Answer:
It depends.

If the out-of-period adjustments for error corrections recorded during the current year would comprise all or substantially all of the cumulative effect adjustment, this approach would probably not be appropriate. Presumably, the registrant in this fact pattern has already concluded that the out-of-period adjustments are not material to the current year. Therefore, it would probably also reach a conclusion that the contemplated cumulative effect adjustment is not material. If that is the case, a cumulative effect adjustment should not be made.

If instead the out-of-period adjustments recorded during the current year would comprise a relatively small portion of the cumulative effect adjustment, then it is more likely that the cumulative effect adjustment would be material, even though the out-of-period adjustments are not. If so, we expect that adjusting the current year financial statements to include the out-of-period adjustments in the cumulative effect adjustment would be the typical result of following the approach discussed in the answer to the preceding question.

If a registrant identifies an out-of-period adjustment that is *material* to the current year but, based on the registrant's previous methodology, is not material to prior years, it will face the question of whether to restate prior financial statements or record the adjustment as part of the cumulative effect adjustment. We understand that, consistent with the view discussed in the following question, the staff would not object if the adjustment is reflected in the cumulative effect adjustment. This treatment in the year of adoption contrasts with the general treatment of material out-of-period adjustments, where the SEC staff has historically concluded, based on the guidance in SAB Topic 5F, that prior year financial statements must be restated, even though they were not materially misstated.

In order for a registrant to make a cumulative effect adjustment upon adoption of SAB 108, must the misstatement have been listed on the auditor's prior year summary of unadjusted differences?

Answer:
No. The SEC staff has informally said that while SAB 108 was issued to address known errors that were previously evaluated (whether they were listed on the prior year's summary of unadjusted differences or not), it would not object if registrants use the cumulative effect accommodation to correct prior year errors that were not identified until the current year. Of course, to use the cumulative effect accommodation, the effects of both the previously known and newly discovered prior year errors must first be evaluated using the registrant's previous methodology, and the registrant and its auditor must conclude that they are immaterial, considering all relevant quantitative and qualitative factors. For example, newly discovered stock option accounting errors resulting from backdating may not be material quantitatively, but if they are qualitatively material they would require restatement.

A registrant and its auditor would also need to consider the effects of the newly discovered error on previous conclusions regarding the effectiveness of the registrant's internal control over financial reporting and disclosure controls and procedures.

If a registrant adopts SAB 108 by recording a cumulative effect adjustment, can interim income statements be adjusted the next time those financial statements are filed?

Answer:
Yes. Question 3 of the SAB states:

"In the event that the cumulative effect of application of the guidance in Topic 1N is first reported in an interim period other than the first interim period of the first fiscal year ending after November 15, 2006, previously filed interim reports need not be amended. However, comparative information presented in reports for interim periods for the first year subsequent to initial application should be adjusted to reflect the cumulative effect adjustment as of the beginning of the year of initial application. In addition, the disclosures of selected quarterly information required by Item 302 of Regulation S-K should reflect the adjusted results."

This is illustrated in the following example.

Company A, a calendar year company, records management fee revenues on a cash basis as opposed to in the periods they are earned. Company A previously determined that the resulting error was immaterial using the rollover method as revenues were relatively consistent from month to month. Upon adoption of SAB 108 in the third quarter of 2006, Company A quantifies the error using the dual method and determines that the omission of management fees receivable is material and corrects the error in the cumulative effect adjustment. In doing so, the revenue that was earned in December 2005 but recorded in January 2006 was recorded in the cumulative effect adjustment. Company A's first quarter 2006 Form 10-Q, however, also included the revenue that was earned in December but collected in January. As a result, the interim period income statements for 2006 will need to be corrected. In correcting these financial statements, Company A will also correct the errors in recording the management fee revenues earned in March and June 2006 (which were recorded in April and July).

A registrant can correct its interim period financial statements in the year-to-date results in the current year interim reports, in the Item 302 quarterly data presented in the next Form 10-K, and in prior interim period financial statements as those periods are presented as comparative information in the following year.

For Company A this means that:

1. In the third quarter 2006 Form 10-Q, when Company A adopts SAB 108, it discloses the effect on revenue for the current and prior 2006 interim periods, which are adjusted as a result of adopting SAB 108.
2. Company A is not required to amend its previously filed interim reports, i.e., its first and second quarter 2006 Form 10-Qs.
3. Company A corrects the 2006 quarterly revenue, gross profit, net income and earnings per share amounts in the Item 302 quarterly data presented in the 2006 Form 10-K. Also, Company A reconciles its pre and post adjustment quarterly amounts for 2006 as required by Regulation S-K, Item 302(a)(2).
4. Company A corrects the comparative 2006 interim results in the prior year columns in the financial statements it presents in its first and second quarter 2007 Form 10-Qs. In those Form 10-Qs, it also reconciles the prior year amounts to the amounts previously reported.

Implementation Via Restatement

When a registrant decides to adopt SAB 108 by restating prior period financial statements, can it use its previous quantification method to determine whether the prior financial statements are materially misstated?

Answer:
Yes. The SEC staff has informally stated that registrants can evaluate whether their prior period financial statements are materially misstated when they adopt SAB 108 by using their previous quantification method, rather than the dual method. By using the previous quantification method, a registrant should be more likely to conclude that it is restating to correct immaterial (rather than material) errors. If so, we understand that the registrant would not be required to amend prior filings or notify users that the prior financial statements should not be relied upon (by filing an Item 4.02 Form 8-K), as discussed further in the following question.

When a registrant concludes that it will revise prior financial statements to correct a misstatement that is immaterial to those prior period financial statements, must it file an Item 4.02 Form 8-K to "withdraw reliance" on those prior period financial statements and amend the prior filings?

Answer:
Although this is a legal question that a registrant should discuss with counsel, we understand that the answer is no. We understand that a registrant is not required to withdraw reliance on previously filed financial statements that are not materially misstated. We believe this conclusion is consistent with SAB 108, Questions 1 and 2, which state that no amendment of prior filings is required. Questions 1 and 2 state, "Correcting prior year financial statements for immaterial errors would not require previously filed reports to be amended. Such correction may be made the next time the registrant files the prior year financial statements."

Implementation Questions – Both Adoption Methods

What actions, if any, should a registrant take if (a) it expects to make adjustments to implement SAB 108 and (b) it intends to file a registration statement before those adjustments are fully reflected in its financial statements?

Answer:
Our views regarding the actions registrants should take vary depending on the situation. The following examples illustrate fact patterns in which this question could arise:

Example 1
A registrant plans to adopt SAB 108 via a cumulative effect adjustment, but its financial statements do not yet reflect that adjustment. Adoption may or may not require restatement of the current year's interim income statements. SAB 74 disclosure of the expected adjustment may or may not have been made.

Example 2
A registrant plans to adopt SAB 108 via restatement of its financial statements to correct errors that are deemed immaterial under its previous evaluation method, but no restated financial statements have been filed yet. SAB 74 disclosure of the expected restatement may or may not have been made.

Example 3
A registrant plans to adopt SAB 108 via restatement of its financial statements to correct errors that are deemed immaterial under its previous evaluation method. The registrant early-adopted SAB 108, and the interim financial statements filed in the latest Form 10-Q reflect the restatement. However, prior years' annual financial statements have not yet been restated. Thus, the latest comparative interim financial statements on file have been prepared on a basis that is inconsistent with the latest annual financial statements on file.

The actions we believe registrants should take in these fact patterns are outlined below. In each fact pattern, they are the same regardless of whether the registrant intends to present its financial statements in the registration statement or incorporate them by reference.

Example 1
Before filing the registration statement, the registrant should consult with legal counsel and evaluate whether it should present or incorporate by reference in the registration statement restated financial statements reflecting the cumulative effect adjustment and the subsequent effects on the current year interim financial statements.

If the registrant decides to file such financial statements, previous 1934 Act flings should not be amended. Such financial statements should either be presented in the registration statement or filed on an Item 8.01 Form 8-K and incorporated by reference into the registration statement.

Example 2
Before filing the registration statement, the registrant should consult with legal counsel and evaluate whether it should present or incorporate by reference restated financial statements in the registration statement.

If the registrant decides to file such financial statements, previous 1934 Act flings should not be amended. Such financial statements should either be presented in the registration statement or filed on an Item 8.01 Form 8-K and incorporated by reference into the registration statement.

Example 3
The registrant should not include or incorporate by reference in a registration statement annual and subsequent interim financial statements that have been prepared on an inconsistent basis. This would be analogous to reflecting a discontinued operation in the interim financial statements but not the prior annual financial statements, which is not in accordance with GAAP. The registrant should prepare restated annual financial statements and include or incorporate them by reference in the registration statement.

It should be noted that the fact patterns in examples 2 and 3 above (i.e., the need to make an *immaterial* restatement of prior financial statements in order to avoid the need for a material out-of-period adjustment to correct an error in the current period) could arise subsequent to the adoption of SAB 108, although we would expect this to be less frequent after a company adopts SAB 108's dual method of quantifying errors. After adopting SAB 108, we would usually expect a company in the situation in example 2 to restate.

All of the discussion in the preceding paragraphs addresses fact patterns where the restatement of the prior financial statements is deemed *immaterial*, either because the restatement is occurring in connection with the adoption of SAB 108 and the adjustments are immaterial to the prior financial statements under the company's previous evaluation method, or because the restatement is occurring after the adoption of SAB 108 and the adjustments are immaterial to the prior financial statements under the dual evaluation method. If the adjustments to the prior financial statements are material, the company should, of course, file an Item 4.02 Form 8-K to inform investors that they should not rely on the prior financial statements and restate those prior financial statements before filing a registration statement.

How is the auditors' report affected when a registrant implements SAB 108?

Answer:
It depends on whether a registrant adopts SAB 108 via a cumulative effect adjustment or restatement.

Cumulative Effect Adjustment
When a registrant implements SAB 108 via a cumulative effect adjustment we believe an auditor should add an explanatory paragraph (following the opinion paragraph) to his report.

Suggested language for an explanatory paragraph is as follows:

> As discussed in Note X to the financial statements, effective January 1, 2006, the Company changed its method of quantifying misstatements of prior year financial statements. The Company adopted the dual method, as required by SEC Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements."

Reports on the financial statements for subsequent years should continue to include the explanatory paragraph until the year in which the cumulative effect adjustment is made is the earliest year presented. In that year, the comparability between the earliest year and subsequent years is not affected, so an auditor can remove the explanatory paragraph.

Restatement
When a client implements SAB 108 via restatement and the effect is material, in the year of the change we believe an auditor should add an explanatory paragraph (following the opinion paragraph) to his report.

Suggested language for an explanatory paragraph is as follows:

> As discussed in Note X to the financial statements, the Company has given retroactive effect to the change to the dual method of quantifying misstatements of prior year financial statements. The dual method is required by SEC Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements."

We believe an explanatory paragraph is required only in the year of the change, since in subsequent years all periods presented will be comparable.

Errors Found after SAB 108 has been Adopted

If a registrant identifies new errors relating to pre-SAB 108 years after the SAB has been adopted via a cumulative effect adjustment, what should it do?

Answer:
The SEC staff has informally said that the cumulative effect accommodation is a one-time accommodation. The cumulative effect adjustment cannot be restated to correct additional errors that are found after SAB 108 is adopted. Therefore, the question is whether the prior financial statements were materially misstated because of the additional error and need to be restated, or whether the correction should be reflected as an out-of-period adjustment in the current year's financial statements. The answer to the question requires a two-step analysis.

Step one is to analyze the impact of the additional error on prior years' financial statements. We understand that although a registrant may make this assessment of the prior years' financial statements using the dual method, it is not required to do so. If a registrant chooses to, it may make this assessment using the quantification method that was used in those years. If the error is determined to be material to prior years using that method, then the financial statements must be restated. Once the decision is made to restate a prior year's financial statements, the staff expects that all known errors in that year would be corrected, including those already corrected via the cumulative effect adjustment made when SAB 108 was adopted. Therefore, a registrant would need to change the cumulative effect adjustment to remove any amounts that relate to the errors that are now being corrected through the restatement. This is illustrated through the example shown on the following page.

If the error is determined to be immaterial to prior years using the prior quantification method, after considering all relevant quantitative and qualitative factors and aggregating the error with other errors in those years (including those subsequently corrected via a cumulative effect adjustment), a registrant would go to step two of the analysis.

Step two is to analyze the effect of the out-of-period adjustment that would be made to correct the error in the current year using the dual method. If the adjustment is immaterial to the current year under the dual method, then the error can be corrected in the current year. If the adjustment is material to the current year, then the error cannot be corrected in the current year and the prior year financial statements would need to be corrected. This would be the case even though the error was determined to be immaterial to the prior year financial statements. The correction of the prior year financial statements would affect the cumulative effect adjustment in the manner discussed above.

As noted above, the cumulative effect accommodation is a one-time accommodation, and the cumulative effect adjustment cannot be restated to correct additional errors that are found after SAB 108 is adopted. Given the consequences of failing to correct all material misstatements via the cumulative effect adjustment, registrants considering early adoption may wish to consider taking more time to ensure that they have identified all necessary adjustments.

If a registrant identifies new errors relating to pre-SAB 108 years after the SAB has been adopted via revising previous financial statements, what should it do?

Answer:
The SEC staff has informally said that if a registrant adopted SAB 108 by revising prior financial statements and subsequently finds new errors relating to pre-SAB 108 years, it must use the dual approach to determine whether the prior financial statements were materially misstated and need to be restated. In other words, the approach discussed in the first Implementation Via Restatement question on page 5 (use the previous quantification method) is no longer available after SAB 108 has been adopted.

If the error is determined to be immaterial to prior years using the dual method, after considering all relevant quantitative and qualitative factors and aggregating the error with other errors in those years, the registrant would tentatively conclude that the prior year financial statements would not need to be adjusted. The registrant would then need to evaluate the effect of the error on the current year using the dual method, as discussed in the answer to the preceding question

The staff is approaching registrants that adopt SAB 108 via restatement as though the registrant has changed its error quantification method to the dual approach for all periods. The staff is approaching registrants that adopt SAB 108 via a cumulative effect adjustment as having changed their method from the date of adoption forward. Consequently, the staff allows registrants that adopt by cumulative effect to use their prior method to quantify subsequently identified errors that occurred in periods prior to adoption. As discussed in the answer to the preceding question, if a prior error is corrected through an out-of-period adjustment, the materiality of the adjustment to the year in which it is recognized must be evaluated using the dual method. We expect that this would often negate the "benefit" of using the prior quantification method to quantify the misstatement of the earlier years. Nevertheless, a registrant may wish to consider this difference in approach when selecting an approach for adopting SAB 108.

SAB 108 and IPOs

If a company has been filing Exchange Act reports with the SEC on a voluntary basis and is filing a registration statement, is it considered to be filing an initial registration statement?

Answer:
Footnote 6 to SAB 108 states that if a registrant's initial registration statement is not effective on or before November 15, 2006 and prior year financial statements are materially misstated based on the dual approach, then prior year financial statement should be restated in accordance with Statement 154. It is not clear whether a company that is not required to file reports but has done so voluntarily must comply with footnote 6 or can use the transition approach available to issuers with Exchange Act reporting obligations. Although we do not expect footnote 6 to apply, a com-

Example –
New Error Identified After SAB 108 Adoption

Company A previously identified the following errors, and after an appropriate materiality evaluation adopted SAB 108 via a cumulative effect adjustment to beginning retained earnings in 2006 (this example ignores cost of sales and tax effects):

	2004	2005	2006
Contingency reserve overstated	$(100)		
Sales cutoff error, sales understated		$(150)	
Cumulative effect adjustment to correct errors and implement SAB 108			$250

After Company A adopted SAB 108 and made the cumulative effect adjustment, it identifies another sales cutoff problem. A 2005 sale of $200 was recorded in 2006. Company A:

1. Analyzes the impact of the additional error on the 2005 financial statements using the quantification method it used in 2005, the rollover method.
2. Determines the error is material, and concludes it must restate the 2005 and 2006 financial statements.
3. Makes the following adjustments:

	2005	2006
To correct sales for previously identified understatement	$150	
To correct sales for newly discovered understatement	$200	$(200)
To remove previously identified sales understatement from the cumulative effect adjustment		$(150)

After the restatement, the cumulative effect adjustment would consist solely of the reversal of the $100 excess contingency reserve.

pany in this situation should consider contacting the SEC staff to confirm this.

SAB 108 and SAB 99

How does SAB 108 interact with SAB 99 and other materiality guidance?

Answer:
The SEC staff notes in the SAB that SAB 108 does not alter the analysis required by SAB 99 (Topic 1M). SAB 108 addresses how to quantify misstatements. SAB 99, on the other hand, provides guidance on how to consider quantitative and qualitative factors in evaluating whether misstatements are material.

SAB 108 and Interim Periods

Does SAB 108 apply to interim periods?

Answer:
We understand that SAB 108 applies to quantifying misstatements of interim period financial statements as well as annual period financial statements. However, SAB 108 does not address the thought process to be used in evaluating whether those misstatements are material to interim period financial statements. The SEC staff has informally acknowledged that there is diversity in practice in evaluating materiality with respect to interim period financial statements and stated that it hopes to address this issue. Pending further guidance, the staff believes, and we agree, that careful judgment must be exercised in evaluating misstatements in interim periods. Further, the lack of clear guidance for applying SAB 108 in interim periods should not lead one to conclude that a misstatement that will be material at year end does not need to be addressed until that time. Nor is this a basis for ignoring errors in interim periods that are expected to be corrected by year end.

SAB 108 and Other Entities' Financial Statements

Does SAB 108 apply to other entities' financial statements filed to comply with rules such as Rules 3-05, 3-09, 3-14 and 3-16 and Item 9.01 of Form 8-K?

Answer:
Staff Accounting Bulletins represent the SEC staff's views regarding the application of GAAP. Therefore, SAB 108 applies to the financial statements of all entities that are filed with the SEC, including the financial statements of entities that are not registrants, such as those filed to comply with rules such as Rules 3-05, 3-09, 3-14 and 3-16 of Regulation S-X and Item 9.01 of Form 8-K.

The SAB also applies to the financial statements of other entities that are used for purposes of ongoing accounting by a registrant (i.e., equity method investees), whether those financial statements need to be filed or not.

When is SAB 108 effective for the financial statements of other entities?

Answer:
Although SAB 108 does not address the effective date for such entities, we understand that if the other entity is itself an Exchange Act registrant, the SAB's effective date guidance applicable to those registrants applies to the other entity.

The SEC staff has not communicated its view regarding the effective date for financial statements of other entities that are not SEC registrants. Until the staff does so, we suggest registrants consider following the approach outlined below. A registrant should also consider confirming with the staff that it will not object to its planned approach.

- For other entities whose financial statements are filed to provide information regarding a discrete transaction (i.e., those filed to comply with Rules 3-05 and 3-14 and Item 9.01 of Form 8-K), we suggest that a registrant analogize to the SAB's effective date provisions for IPOs, which are in footnote 6. If the other entity financial statements were first filed in a filing other than a registration statement covering an IPO on or before November 15, 2006, they need not reflect the application of the dual method, even if they are re-filed after November 15, 2006. If these financial statements were first filed on or before November 15, 2006 in a registration statement covering an IPO and that registration statement was not effective until after November 15, 2006, then those financial statements must be restated to reflect the application of the dual method for all periods.

- For other entities whose financial statements are used for purposes of ongoing accounting by a registrant (i.e., financial statements of equity method investees, whether they need to be filed or not) or are filed to update supplemental information regarding a registrant (i.e., those filed to comply with Rules 3-09 and 3-16), we suggest that a registrant analogize to the SAB's effective date provisions for registrants and ensure that the investee or affiliate has complied with the SAB by the time it would be required to comply if it were a registrant. However, the approach outlined in the preceding sentence should not be used if the investee or affiliate financial statements are being used or filed in connection with a registration statement covering an IPO. In such a filing, the investee or affiliate financial statements should be restated to reflect the application of the dual method for all periods if the registration statement was not effective until after November 15, 2006.

Is the cumulative effect adjustment transition approach available for other entities?

Answer:
Although SAB 108 does not address transition for such entities, we understand that if the other entity is itself an SEC registrant, whatever transition approach the other entity used in its SEC filings is appropriate.

The SEC staff has not communicated its view regarding transition in financial statements of other entities that are not SEC registrants. Until the staff does so, we suggest registrants consider following the approach outlined below after the effective date (discussed in the preceding question). A registrant should also consider confirming with the staff that it will not object to its planned approach.

- For other entities whose financial statements are filed to provide information regarding a discrete transaction (i.e., those filed to comply with Rules 3-05 and 3-14 and Item 9.01 of Form 8-K), we suggest that a registrant analogize to the SAB's transition provisions for IPOs, which are in footnote 6, and if necessary, restate those financial statements to apply the dual method.

- For other entities whose financial statements are used for purposes of ongoing accounting by a registrant (i.e., financial statements of equity method investees, whether they need to be filed or not) or are filed to update supplemental information regarding a registrant (i.e., those filed to comply with Rules 3-09 and 3-16), we suggest that a registrant use one of two approaches:

  – Analogize to the SAB's transition provisions for IPOs, which are in footnote 6, and if necessary, restate the other entity's financial statements to apply the dual method. If a restatement is made, the other entity is an equity method investee, and the effect on the equity income recorded by the investor is material, the investor would need to make a corresponding restatement of its financial statements to correct the equity income it has recorded.

    We believe the approach outlined in the preceding paragraph should be used if the investee or affiliate financial statements are being used or filed in connection with a registration statement covering an IPO if it was not effective until after November 15, 2006. We believe this approach should also be used for an equity method investment that was made after November 15, 2006 or an affiliate that became a collateral entity after November 15, 2006.

  – Take the view that since the registrant does not have to restate any of its other prior year accounts to reflect the dual method, there is no need to restate the equity method accounts to reflect the dual method. Accordingly, a registrant can permit the other entity to use the transition approach of its choice. If the other entity is an equity method investee, it chooses to implement the dual method via a cumulative effect adjustment, and the effect on the equity income recorded by the investor is material, the investor would need to make a corresponding cumulative effect adjustment in its financial statements. If the investee chooses to implement via restatement and the effect on the equity income recorded by the investor is material, the investor would need to make a corresponding restatement of its financial statements as discussed above.

If an other entity adopts SAB 108 and it is not an SEC registrant, what is the effect on the auditors' report?

Answer:
The FASB has not issued guidance on quantifying misstatements in private company financial statements, and Statement 154 does not provide for restating financial statements through a cumulative effect adjustment to current year opening retained earnings, as permitted by SAB 108. Nevertheless, if the financial statements of a company that is not a registrant reflect a cumulative effect adjustment to comply with SAB 108 in the manner described in the answers to the two preceding questions and they are filed with the SEC, we believe that they comply with GAAP as interpreted by the SEC. Therefore we believe that the auditors' report on such financial statements does not need to be modified to call attention to the fact that the presentation is different than that called for by Statement 154.

We believe the report should, however, address the lack of consistency in the manner discussed on pages 6-7.

Does SAB 108 apply to private companies whose financial statements are not filed with the SEC? If not, what approach should these companies use for quantifying misstatements?

Answer:
SAB 108 does not apply to private companies whose financial statements are not filed with the SEC, and these companies are not required to use the dual method.

- As indicated in the answer to the preceding question, the FASB has not issued guidance on quantifying misstatements in private company financial statements. We understand that the FASB will consider providing guidance, but the Board has not decided whether it will do so or when.
- SAS 107 (paragraph 53) does not require auditors of private companies to use the dual method.

In addition, Statement 154 does not allow private companies to implement a change in approach to quantifying misstatements by restating financial statements through a cumulative effect adjustment.

Consequently, we expect most private companies to continue to use their current approach for quantifying misstatements until FASB guidance is issued.

SAB 108 and Foreign Private Issuers

If a foreign private issuer prepares its primary financial statements on a basis other than U.S. GAAP, is it required to follow SAB 108's dual approach in its primary financial statements?

Answer:
We understand that the SEC staff's current expectation is that a foreign private issuer will follow SAB 108's dual approach in preparing its primary financial statements unless the accounting standards covering its primary financial statements explicitly call for some other approach. The staff strongly encourages foreign private issuers that contemplate not applying SAB 108 in their primary financial statements to discuss their approach, including the contemplated disclosures, prior to filing.

If a foreign private issuer prepares its primary financial statements on a basis other than U.S. GAAP, and the GAAP applied in their primary financial statements does not allow for a cumulative effect adjustment, how should the foreign private issuer reflect the adoption of SAB 108?

Answer:
A registrant should reflect the adoption of SAB 108 in accordance with the accounting standards covering its primary financial statements. We understand that the SEC staff would not object if a registrant accounts for the adoption of the dual method as a change in accounting principle.

Accounting Conventions

Should the dual approach be applied in evaluating accounting conventions?

Answer:
We understand that registrants that use accounting conventions (e.g., expensing rather than capitalizing capital expenditures under a certain dollar amount, amortizing deferred debt issuance costs

using the straight line method, rather than the effective interest rate method, etc.) must evaluate whether they result in material errors using the dual method. The amount of effort required to perform this evaluation will depend on the facts and circumstances. However, a registrant must be able to reasonably conclude that the use of an accounting convention does not result in a material misstatement.

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