



Update of Developments at the Securities and Exchange Commission

October 2009

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Agenda

- ▶ Key personnel changes
- ▶ SEC rulemaking
 - ▶ Section 404(b) deferral
 - ▶ Money market fund portfolio holdings
 - ▶ Technical amendments
 - ▶ XBRL
 - ▶ Oil & gas
 - ▶ Proxy disclosure enhancements
 - ▶ Shareholder proxy access proposal
 - ▶ Executive compensation of TARP recipients
 - ▶ Money market fund reform
- ▶ SEC guidance regarding the FASB Codification
- ▶ SEC study of “mark-to-market” accounting
- ▶ SEC hot buttons
 - ▶ Recent developments
 - ▶ Recurring themes

Key personnel changes

- ▶ Mary Schapiro sworn in as new SEC chairman in January
 - ▶ Priorities include investor protection, enforcement, corporate governance and reform of SEC oversight role of financial intermediaries
- ▶ James Kroeker, SEC Chief Accountant
 - ▶ Former Acting Chief Accountant
- ▶ Meredith Cross, Director of the Division of Corporation Finance
 - ▶ Former Deputy Director in Corporation Finance (1998)
- ▶ Robert Khuzami, Director of the Division of Enforcement
 - ▶ Former federal prosecutor

Section 404(b) for non-accelerated filers

- ▶ October 2009 SEC announced six month extension
- ▶ Non-accelerated filers will be required to comply with Section 404(b) in annual reports for fiscal years ending on or after 15 June 2010
 - ▶ Prior to the extension, a non-accelerated filer would have been required to comply for fiscal years ending on or after 15 December 2009
- ▶ Senior SEC officials have stated that there will be no further deferral of the compliance deadline
- ▶ Non-accelerated filers are still required to comply with Section 404(a)

Final rule: Disclosure of certain money market fund portfolio holdings

- ▶ September 2009 interim final temporary rule requiring money market funds to report weekly portfolio holdings and valuation information to the SEC if the fund's market-based net asset value per share (NAV) is below \$.9975
- ▶ Must notify the SEC of its reporting obligation no later than the next business day after which the fund's market-based NAV falls below \$.9975
- ▶ Subsequently report its portfolio schedule as of the last business day of each week

Final rule: Technical amendments to Regulations S-X and S-K

- ▶ April 2009 final rule conforms certain SEC requirements to ASC 805, *Business Combinations*, and ASC 810-10, *Consolidation – Overall*, including:
 - ▶ Conform the income statement and balance sheet presentation requirements of Regulation S-X to those in ASC 810-10
 - ▶ Require the disclosure of net income attributable to the parent in circumstances in which the disclosure of net income also is required
 - ▶ Require the exclusion of income attributable to noncontrolling interests in circumstances in which income measures are used to assess compliance requirements (e.g., in the calculation of a significant subsidiary under Rule 1-02(w) of Regulation S-X)
 - ▶ Require the statement of changes in stockholders' equity to include changes in noncontrolling interests

Final rule: XBRL reporting

- ▶ January 2009 final rule requires the use of eXtensible Business Reporting Language (XBRL) for SEC financial reporting
- ▶ Three-year phase-in as follows beginning with the first Form 10-Q (or for FPIs, their first Form 20-F or 40-F):
 - ▶ Fiscal periods ending on or after 15 June 2009 — Domestic and FPIs that file using US GAAP and have public float over \$5 billion (approx. 500 companies)
 - ▶ Fiscal periods ending on or after 15 June 2010 — All other US GAAP large accelerated filers (approx. 1,300 companies)
 - ▶ Fiscal periods ending on or after 15 June 2011 — All other filers, including those using IFRS (over 10,000 additional companies)
- ▶ For example, its 30 June 2009 Form 10-Q was the first SEC report required to include XBRL data for a calendar year company in the first phase-in group

Final rule: XBRL reporting (cont'd)

- ▶ XBRL-tagged financial information is submitted via EDGAR in addition to, but not as a replacement of, the plain text financial statements
- ▶ Must be filed as an additional exhibit to:
 - ▶ Annual and quarterly reports
 - ▶ Transition reports related to a change in fiscal year-end
 - ▶ Reports on Form 8-K and 6-K that contain the registrant's updated financial statements that were tagged when originally filed
 - ▶ Non-IPO Securities Act registration statements that contain the registrant's financial statements (i.e., not required when financial statements are only incorporated by reference)
- ▶ First year of compliance – a company must at least tag entire notes and schedules in XBRL as blocks of text
- ▶ Second year of compliance – a company must provide XBRL tags for the numerical details within its notes and schedules
- ▶ MD&A and executive compensation disclosures cannot be tagged
- ▶ XBRL exhibits will be due at the same time as the related EDGAR filing
 - ▶ Two 30-day grace periods
- ▶ A company also must post its XBRL exhibit on its website for at least twelve months

Final rule: XBRL reporting (cont'd)

- ▶ Consequences of non-compliance
 - ▶ Registrant will be considered not to be current in its reporting obligations (e.g., could not use short-form registration statements)
 - ▶ A delinquent company will be considered current immediately upon filing or posting XBRL exhibit
- ▶ Liability considerations
 - ▶ Limited liability for initial 24-months of XBRL reporting (or until 31 October 2014, whichever is earlier)
 - ▶ After two years, XBRL exhibit will be subject to the same liability as the traditional financial statements
 - ▶ Excluded from officer certification requirements, but included in scope of quarterly disclosure about disclosure controls and procedures
- ▶ Independent auditor involvement not required
- ▶ Mutual funds also will be required to provide the risk/return summary section of a prospectus in XBRL format
 - ▶ Initial registration statements, and post-effective amendments that are annual updates to an effective registration statement, that become effective on or after 1 January 2011
 - ▶ XBRL exhibit can be provided when registration statement becomes effective, or within 15 business days thereafter
- ▶ The SEC staff recently published its observations following a limited review of initial XBRL exhibits in second quarter Form 10-Q's

Final rule: Modernization of the oil and gas reporting requirements

- ▶ December 2008 SEC final rule revises oil and gas reserves estimation and disclosures requirements
 - ▶ Objectives are to increase transparency and maximize comparability among companies (including between domestic and foreign companies)
- ▶ Effective for registration statements filed after 1 January 2010 and annual reports on Form 10-K and 20-F for fiscal years ending on or after 31 December 2009
- ▶ Early adoption is prohibited

Final rule: Modernization of the oil and gas reporting requirements (cont'd)

- ▶ The final rule, among other things:
 - ▶ Expands the definition of oil and gas producing activities to include reserves from non-traditional sources such as oil sands, shale and coalbeds
 - ▶ Allows the use of new technologies to estimate reserves
 - ▶ Permits the optional disclosure of probable and possible reserves
 - ▶ Modifies the prices used to estimate reserves for SEC disclosure purposes to a 12-month average price instead of a period-end price
 - ▶ Requires disclosure of internal controls used to assure objectivity in the reserves estimation process, including disclosure of the qualifications of the technical person (whether an employee or third party) who is primarily responsible

Proposed rule: Proxy disclosure & solicitation enhancements

- ▶ July 2009 proposal would require enhanced disclosure about executive compensation and corporate governance in public company proxy statements
- ▶ Among other things, the proposal would amend the disclosures a company is required to make regarding:
 - ▶ Overall compensation policies and their effect on risk taking
 - ▶ Valuation of stock and option awards of executives and directors
 - ▶ Director and nominee qualifications
 - ▶ Company leadership structure
 - ▶ The board's role in the risk management process
 - ▶ Fees paid to compensation consultants

Proposed rule: Shareholder nomination of directors

- ▶ June 2009 proposal would allow shareholders access to a company's proxy for the nomination of directors, provided that certain other conditions are met
- ▶ As proposed, a shareholder (or group of shareholders) could nominate directors if they owned, for at least one year
 - ▶ For large accelerated filers, at least 1% of the voting shares
 - ▶ For accelerated filers, at least 3%
 - ▶ For non-accelerated filers, at least 5%
- ▶ Limit of no more than one nominee, or up to 25% of the company's board of directors, whichever is greater
- ▶ Nominating shareholder also would be required to make certain disclosures to the company and the SEC (new Schedule 14N)

Proposed rule: Shareholder approval of executive compensation of TARP recipients

- ▶ July 2009 proposal applies to TARP recipients during the period in which any TARP obligation remains outstanding
- ▶ As proposed, a separate shareholder vote on executive pay in annual meeting proxy solicitations
- ▶ A registrant would be required to disclose in the proxy statement the effects of the separate shareholder vote on executive compensation

Proposed rule: Money market fund reform

- ▶ June 2009 proposal would strengthen the regulatory framework for money market funds
- ▶ The proposed amendments would:
 - ▶ Require that money market funds hold sufficiently liquid securities
 - ▶ Limit money market funds to investing in only the highest quality securities
 - ▶ Require funds to periodically stress test fund portfolios
 - ▶ Require money market funds to report their portfolio holdings monthly
 - ▶ Require funds to be able to process purchases and redemptions at a price other than \$1.00
 - ▶ Expand the ability of affiliates of money market funds to purchase distressed assets from the funds

SEC guidance on FASB Codification

- ▶ SEC guidance addresses three key issues:
 - ▶ References in the SEC's rules and staff guidance to specific standards under US GAAP should be understood to mean the corresponding reference in the Codification
 - ▶ The SEC and its staff intend to embark on a longer term rulemaking and updating initiative to revise references to US GAAP in the SEC's rules and staff guidance comprehensively
 - ▶ The Codification does not supersede any SEC rules or regulations
- ▶ SEC staff guidance on Codification references
 - ▶ Encourage use of "plain English" accounting references
 - ▶ In financial statements for periods ending after 15 September 2009, specific GAAP references should be to Codification
 - ▶ References should be on a consistent basis for all periods
 - ▶ Codification should not change practice with respect to any references to specific SEC rules and interpretive releases in financial statements

SEC study of “mark-to-market” accounting

- ▶ The Emergency Economic Stabilization Act required that the SEC report to Congress on the effect of “mark-to-market” accounting – delivered on 30 December 2008
- ▶ Study recommends that the use of the fair value accounting standards not be suspended
- ▶ Does recommend improvements to existing practice, including:
 - ▶ Reconsideration of the accounting for impairments
 - ▶ Development of additional guidance for determining fair value of investments in inactive markets, including situations where market prices are not readily available
 - ▶ Simplification of the accounting for investments in financial instruments, including the continued exploration of the feasibility of reporting all financial instruments at fair value

SEC hot buttons: recent developments

- ▶ MD&A
 - ▶ Loan loss allowances
 - ▶ Liquidity & capital resources
 - ▶ Debt covenants
- ▶ Goodwill impairment risks
- ▶ Internal control reporting
- ▶ Naming and obtaining the consent of an expert
- ▶ Non-GAAP measures
- ▶ Materiality

MD&A – Loan loss allowances

- ▶ August 2009 “Dear CFO” letter identifies a number of disclosures regarding provisions and allowances for loan losses that registrants may wish to consider in preparing MD&A
- ▶ The letter primarily focuses on MD&A disclosures related to:
 - ▶ Higher-risk loans
 - ▶ Changes in practices in establishing loan loss allowance
 - ▶ Declines in collateral value

MD&A – Liquidity & capital resources

- ▶ Provide an overview of how the registrant's business has been affected by economic developments and how the registrant intends to maintain sufficient liquidity
- ▶ Analyze all internal and external sources of liquidity
- ▶ Discuss the sufficiency of the unused availability under existing short-term credit arrangements
- ▶ Discuss any uncertainty surrounding the ability to access funds when needed and any implications of not being able to access funds
- ▶ Discuss any uncertainties regarding future compliance with financial covenants and the material implications of a breach
- ▶ Discuss any plans to remedy any identified material deficiency in liquidity

MD&A – Debt covenants

- ▶ For material covenants, compare the required ratios or amounts to the calculated ratios or amounts, for each reporting period
 - ▶ Also consider showing specific computations (with corresponding US GAAP reconciliation, if necessary)
- ▶ Discuss potential risks and consequences of non-compliance with debt covenants and any potential trends in such compliance that may lead to non-compliance
- ▶ Discuss any default provisions in debt agreements which could cause an event of default on one debt instrument to trigger default under another debt agreement (cross-default provisions)
- ▶ Discuss if any debt covenant limits the ability to obtain additional financing
- ▶ If waivers received for covenant breaches, the specific covenants should be disclosed
 - ▶ Discuss the nature of the waiver, including how long the waiver applies
- ▶ Discuss the effect of credit downgrades and late payments on covenants

Goodwill impairment risks

- ▶ Current market conditions have made goodwill impairments more common
- ▶ For each reporting unit with a material amount of goodwill that is “at risk,” the SEC staff expects the registrant’s MD&A to disclose:
 - ▶ The percentage by which the fair value of the reporting unit exceeds its carrying value at the date of the last impairment test
 - ▶ The amount of goodwill allocated to the reporting unit
 - ▶ A qualitative discussion of key assumptions that drive the fair value of the reporting unit (i.e., the SEC staff encourages, but does not require, disclosure of the key numerical assumptions or a quantitative sensitivity analysis)
 - ▶ Any uncertainties surrounding those key valuation assumptions
 - ▶ Events that could have a negative effect on the fair value of the reporting unit

Goodwill impairment risks (cont'd)

- ▶ If an impairment was recorded, disclose:
 - ▶ The fact and circumstances that led to the charge
 - ▶ The timing of the "triggering event"
 - ▶ The effect of the impairment on the business, including future expectations
 - ▶ What went wrong?
- ▶ The SEC staff has aggressively probed the method of estimating the fair value of reporting units
 - ▶ Expects registrants to validate valuations by reconciling the aggregate fair value of goodwill reporting units to the market capitalization of the consolidated entity
 - ▶ Objective evidence must support implied control premiums

Internal control reporting

- ▶ Current economic climate could adversely affect ICFR (e.g., increased fraud risk)
 - ▶ Do appropriate controls exist to address changing risk profile?
- ▶ Common ICFR disclosure deficiencies:
 - ▶ Disclosure of a control deficiency should not be the same as a description of the related financial statement adjustment
 - ▶ No information provided on the underlying cause of a material weakness or its potential effect
 - ▶ Not all material weaknesses appear to be disclosed after consideration of management's reported remediation efforts

Naming and obtaining the consent of an expert

- ▶ November 2008 revised SEC staff interpretation relating to Securities Act filings (e.g., Form S-1, S-3)
- ▶ Requirement to obtain and file the consent of an expert depends on the context of the disclosures about the use of the expert
 - ▶ To the extent that any statement or figure included or incorporated by reference is attributed to a third-party expert, the expert should be named and a consent is required
 - ▶ If disclosures clearly attribute respective statements or amounts to the registrant, a consent is not required, even if the expert is named
- ▶ Prior SEC staff interpretation indicated that the consent requirements would apply to any reference to a third-party expert, regardless of reliance, in a Securities Act filing

Non-GAAP measures

- ▶ The SEC staff recently acknowledged that its administrative practices may be discouraging registrants from providing meaningful information to investors and that it plans to issue clarifying guidance on the use of non-GAAP measures in SEC filings
 - ▶ SEC staff monitors earnings calls, analyst presentations and corporate websites
 - ▶ May challenge why SEC filings do not include non-GAAP measures otherwise disclosed
- ▶ If presented, the non-GAAP measure must be accompanied by the disclosures required by Item 10(e)(1)(i) of Regulation S-K, which are:
 - ▶ Present, with equal or greater prominence, the most directly comparable financial measure calculated and presented in accordance with GAAP
 - ▶ Numerically reconcile the non-GAAP financial measure to the most directly comparable GAAP measure
 - ▶ Disclose the reasons why management believes the non-GAAP financial measure provides useful information to investors
 - ▶ Disclose, to the extent material, any additional purposes for which management uses the non-GAAP financial measure

Materiality

- ▶ SEC staff frequently challenges conclusions regarding materiality
- ▶ Responses to SEC staff inquiries should:
 - ▶ Avoid focusing only on the considerations listed in SAB Topic 1.M
 - ▶ Be as company-specific as possible
 - ▶ Consider the effects of errors on key performance indicators disclosed by the company in its SEC reports and earnings releases

SEC hot buttons: recurring themes

- ▶ Fair value disclosures
- ▶ Off-balance sheet arrangements and VIEs
- ▶ Deferred tax assets
- ▶ Other-than-temporary impairment
- ▶ Share-based payments
- ▶ Disclosure controls and procedures
- ▶ Revenue recognition
- ▶ Segments
- ▶ Warrants and embedded conversion features
- ▶ Executive compensation
- ▶ Contingencies
- ▶ Inventory
- ▶ Intangible assets
- ▶ Impairment and disposal of long-lived assets
- ▶ Critical accounting estimates