

## **SECURITIES AND EXCHANGE COMMISSION**

**[Release Nos. 33-8918; 34-57819; File No. 265-24]**

### **Subcommittee Reports of the SEC Advisory Committee on Improvements to Financial Reporting**

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Request for comments.

**SUMMARY:** The Advisory Committee is publishing four subcommittee reports that were presented to the Advisory Committee at its May 2, 2008 open meeting and is soliciting public comment on those subcommittee reports. The subcommittee reports contain the subcommittees' updates of their work through the May 2, 2008 open meeting and contain preliminary hypotheses and other material that will be considered by the full Committee in developing recommendations for the Committee's final report.

**DATES:** Comments should be received on or before **[insert date 30 days after publication in the Federal Register]**.

**ADDRESSES:** Comments may be submitted by any of the following methods:

#### Electronic Comments

- Use the Commission's Internet comment form

(<http://www.sec.gov/rules/other.shtml>); or

- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number 265-

24 on the subject line.

#### Paper Comments

- Send paper comments in triplicate to Nancy M. Morris, Federal Advisory Committee Management Officer, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549–1090.

All submissions should refer to File No. 265-24. This file number should be included on the subject line if e-mail is used. To help us process and review your comment more efficiently, please use only one method. The Commission will post all comments on its Web site (<http://www.sec.gov/about/offices/oca/acifr.shtml>). Comments also will be available for public inspection and copying in the Commission’s Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

**FOR FURTHER INFORMATION CONTACT:** Questions about this release should be referred to James L. Kroeker, Deputy Chief Accountant, or Shelly C. Luisi, Senior Associate Chief Accountant, at (202) 551-5300, Office of the Chief Accountant, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-6561.

**SUPPLEMENTARY INFORMATION:** At the request of the SEC Advisory Committee on Improvements to Financial Reporting, the Commission is publishing this release soliciting public comment on the subcommittees’ reports. The full text of these subcommittee reports are attached as Exhibits A-D and also may be found on the Committee’s web page at <http://www.sec.gov/about/offices/oca/acifr.shtml>. The subcommittee reports contain the subcommittees’ updates of their work through the May 2, 2008 open meeting of the full Committee and contain preliminary hypotheses and

other material that may be deliberated by the full Committee in considering recommendations for the Committee's final report. As such, the Committee would like to request public input on the material in these subcommittee reports. The subcommittee reports have been prepared by the individual subcommittees and do not necessarily reflect either the views of the Committee or other members of the Committee, or the views or regulatory agenda of the Commission or its staff.

All interested parties are invited to comment on the enclosed subcommittee reports. Comments on the reports are most helpful if they (1) indicate the specific exhibit and paragraph to which the comments relate, (2) contain a clear rationale, and (3) include any alternative(s) the Committee should consider.

**AUTHORITY:** In accordance with Section 10(a) of the Federal Advisory Committee Act, 5 U.S.C. App. 1, § 10(a), James L. Kroeker, Designated Federal Officer of the Committee, has approved publication of this release at the request of the Committee. The solicitation of comments is being made solely by the Committee and not by the Commission. The Commission is merely providing its facilities to assist the Committee in soliciting public comment from the widest possible audience.

Nancy M. Morris  
Committee Management Officer

Dated: May 15, 2008

**SEC Advisory Committee on Improvements to Financial Reporting  
Substantive Complexity Subcommittee Update  
May 2, 2008 Full Committee Meeting**

**I. Introduction**

The SEC's Advisory Committee on Improvements to Financial Reporting (Committee) issued a progress report (Progress Report) on February 14, 2008.<sup>1</sup> In chapter 1 of the Progress Report, the Committee discussed its work-to-date in the area of substantive complexity, namely, its developed proposals related to industry-specific guidance and alternative accounting policies; its conceptual approaches regarding the use of bright lines and the mixed attribute model; and its future considerations related to scope exceptions<sup>2</sup> and competing models.

Since the issuance of the Progress Report, the substantive complexity subcommittee (Subcommittee I) has deliberated each of these areas further, particularly its conceptual approaches and future considerations, and refined them accordingly. This report represents Subcommittee I's latest thinking. The Subcommittee's consideration of comment letters received thus far by the Committee is ongoing and may result in additional changes. The purpose of this report is to update the full Committee, and also to serve as a basis for the substantive complexity panel discussions scheduled for May 2, 2008 in Chicago. Subject to further public comment, Subcommittee I intends to deliberate whether to recommend these preliminary hypotheses to the full Committee for its consideration in developing the final report, which it expects to issue in July 2008.

**II. Exceptions to General Principles**

**II.A. Industry-Specific Guidance**

In the Progress Report, the Committee issued a developed proposal related to industry-specific guidance (developed proposal 1.1). Refer to the Progress Report for additional discussion of this developed proposal. Subcommittee I will consider the panel discussions on May 2, 2008, as well as the public comment letters received, before submitting a final recommendation to the Committee, but at this time, is not intending to propose any significant revisions.

**II.B. Alternative Accounting Policies**

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<sup>1</sup> Refer to Progress Report at <http://www.sec.gov/rules/other/2008/33-8896.pdf>.

<sup>2</sup> Throughout this report, the term "scope exceptions" refers to scope exceptions other than industry-specific guidance.

**This report has been prepared by the individual subcommittee and does not necessarily reflect either the views of the Committee or other members of the Committee, or the views or regulatory agenda of the Commission or its staff.**

In the Progress Report, the Committee issued a developed proposal related to alternative accounting policies (developed proposal 1.2). Refer to the Progress Report for additional discussion of this developed proposal. Subcommittee I will consider the panel discussions on May 2, 2008, as well as the public comment letters received, before submitting a final recommendation to the Committee, but at this time, is not intending to propose any significant revisions.

## **II.C. Scope Exceptions**

**Preliminary Hypothesis 1: GAAP should be based on a presumption that scope exceptions should not exist. As such, the SEC should recommend that any new projects undertaken jointly or separately by the FASB should not provide additional scope exceptions, except in rare circumstances. Any new projects should also include the elimination of existing scope exceptions in relevant areas as a specific objective of these projects, except in rare circumstances.**

### **Background**

Scope exceptions represent departures from the application of a principle to certain transactions. For example:<sup>3</sup>

- SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, excludes certain financial guarantee contracts, employee share-based payments, and contingent consideration from a business combination, among others.
- SFAS No. 157, Fair Value Measurements, excludes employee share-based payments and lease classification and measurement, among others.
- FIN 46R, Consolidation of Variable Interest Entities, excludes employee benefit plans, qualifying special-purpose entities,<sup>4</sup> certain entities for which the company is unable to obtain the information necessary to apply FIN 46R, and certain businesses, among others.

Similar to other exceptions to general principles, scope exceptions arise for a number of reasons. These reasons include: (1) cost-benefit considerations, (2) the need for temporary measures to quickly minimize the effect of unacceptable practices, rather than waiting for a final “perfect” standard to be developed, (3) avoidance of conflicts with standards that would otherwise overlap, and (4) political pressure.

Scope exceptions contribute to avoidable complexity in several ways. First, where accounting standards specify the treatment of transactions that would otherwise be within scope, exceptions may result in different accounting for similar activities (refer to competing models section below for further discussion). Second, scope exceptions

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<sup>3</sup> Refer to appendix A for additional examples.

<sup>4</sup> Subcommittee I notes that the FASB has tentatively decided to remove the qualifying special-purpose entity concept from U.S. GAAP and its exception from consolidation.

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