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Insights

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SEC

Executive Compensation Disclosure

On October 21, 2008, John W. White, Director of the SEC's Division of Corporation Finance, delivered a speech in which he gave his observations on executive compensation disclosure and related recent developments. Specifically, Mr. White discussed certain of the findings that resulted from the SEC's review of the second year of company disclosures under the new executive compensation disclosure requirements. The primary areas of comment were:

- The need for more analysis - Filers need to concentrate their Compensation Disclosure and Analysis (CD&A) into an informative analytical discussion of the material elements of compensation, how they arrived at the varying levels of compensation, and why they believe their compensation practices and decisions fit within their overall objectives and philosophy. Often, the "how and the why" were missing in explaining the connection between the company's philosophies and processes and the numbers the company presents in its tabular disclosure. Companies are encouraged to eliminate boilerplate and unnecessary narrative disclosure.
- Disclosure of performance targets - In preparing its disclosure, a company must determine whether performance targets are a material element of its compensation policies and decisions and, if they are material, provide disclosure in accordance with Item 402 of Regulation S-K. Where companies omitted from their CD&A the performance objectives that are tied to a named executive officer's incentive compensation, they must justify the omission in light of the appropriate standard set forth in Instruction 4 to Item 402(b). In putting together their disclosure in this area, companies must remember to return to the underlying principles-based standard. Companies are encouraged to look to the SEC's updated and revised Compliance and Disclosure Interpretations for more guidance in this area.
- Disclosure relating to benchmarking – Where a company benchmarks a material element of compensation, the SEC expects it to identify the companies that comprise the peer group used for benchmarking purposes. The SEC also expects meaningful disclosure that provides insight into the basis for selecting the peer group, and the relationship between actual compensation and the data utilized in benchmarking or peer-group studies. In many cases, the benchmarking methodologies that companies are using are not sufficiently clear nor have companies adequately explained how they are utilizing the data collected from their analyses of peer-group pay. The composition of the comparison groups and the extent to which companies are setting their compensation levels to remain competitive with a peer group is essential disclosure and critical for many companies when describing how their compensation programs work or how they arrived at specific compensation decisions.

Mr. White also noted that current market events are affecting many companies' compensation decisions and thus should be affecting the drafting of their upcoming CD&A. Management is encouraged to carefully consider if and how recent economic and financial events affect the company's compensation program.

Mr. White's speech is available in full at http://www.sec.gov/news/speech/2008/spch102108jww.htm.

International

Guidance on the Application of Fair Value Measurement when Markets Are No Longer Active

The International Accounting Standards Board (IASB) recently published the following educational guidance on the application of fair value measurement when markets are no longer active:

- *IASB Expert Advisory Panel - Measuring and Disclosing the Fair Value of Financial Instruments in Markets that are no Longer Active.* This final report is a summary of seven meetings held by an IASB advisory panel consisting of measurement experts who are users, preparers, and auditors of financial statements, as well as regulators and others. In the report, the panel identifies practices that experts use for measuring the fair value of financial instruments when markets become inactive and practices for fair value disclosures in such situations. The report provides information about the processes used and judgments made when measuring and disclosing fair value. The report is available in full at http://www.iasb.org/NR/rdonlyres/0E37D59C-1C74-4D61-A984-8FAC61915010/0/IASB_Expert_Advisory_Panel_October_2008.pdf.
- *Using Judgment to Measure the Fair Value of Financial Instruments when Markets are no Longer Active - An IASB Staff Summary.* This summary document prepared by the IASB staff sets out the context of the expert advisory panel report and highlights important issues associated with measuring the fair value of financial instruments when markets become inactive. It takes into consideration and is consistent with FASB Staff Position No. FAS 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active*, and the clarifications on fair value accounting issued jointly by the SEC's Office of the Chief Accountant and Financial Accounting Standards Board staff on September 30, 2008. The summary document is available in full at http://www.iasb.org/NR/rdonlyres/F3AFDA4D-6605-42CE-858F-23BBB9044355/0/IASB_Staff_Summary_October_2008.pdf.

Common Pitfalls in the IFRS Conversion Process – Real Life Lessons from Europe

This article is the seventh in a series of articles that takes our readers on a journey through International Financial Reporting Standards (IFRS) with a special focus on the standards' quintessential feature: they are principles-based. In this article, we summarize some of the challenges faced by European companies when they converted to IFRS in 2005, and how U.S. preparers and auditors can capitalize on that experience.

The conversion to IFRS is not simply an accounting exercise, but rather a project embracing the company as a whole. Whether a large multinational company or a small single-location company, European experience has shown that underestimating the complexity of an IFRS conversion project can result in unnecessary efforts, unexpected costs, and missed opportunities. Following is a summary of the most common pitfalls Europeans experienced when converting to IFRS in 2005:

- IFRS conversion projects were started too late generally due to preparers not having a proper grasp of IFRS and thinking it would be a "journal entry" exercise focused on differences between their previous accounting framework and IFRS. The conversion process is much more than that.

- Not enough time was dedicated to the preliminary stage. Early identification of difficult issues to be faced and judgment calls to be made is an indispensable preliminary step for proper set up of the conversion project.
- Expecting to find solutions overnight. The solution to a complex issue is the result of a thorough process. Entities need to start researching issues early and share information throughout the process with consultants and auditors.
- Unexpected issues arise. The conversion to IFRS is comparable to a home remodeling project – you always end up spending more time and money than expected. Be prepared for the unexpected by allowing plenty of time, and budgeting accordingly.
- Underestimating the time needed to develop the financial statement footnotes. Companies should not be so absorbed in the preparation of the financial statements that they fail to notice the extensive disclosures required by IFRS.
- Focusing on the short-term impact of IFRS on the financial statements. Management should realize that some accounting choices made at the time of conversion to IFRS will bear consequences for a long time in the future.
- System changes require lots of time. The conversion to IFRS might impact the entire IT system; it is not simply using conversion spreadsheets.
- Lack of knowledge made some companies dependent on external consultants. External consultants can be helpful, but ultimately the company should possess the internal knowledge and resources necessary to convert to IFRS.

With 20/20 hindsight, many European companies likely would have approached the conversion to IFRS differently. Hopefully, their experience will be used by U.S. companies to avoid the common mistakes and pitfalls described above.

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