



# SEC Regulations Committee Highlights

## March 13, 2018 – Joint Meeting with SEC Staff SEC Offices – Washington, DC

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## I. Attendance

SEC Regulations Committee	Securities and Exchange Commission	Observers and Guests
Christine Davine, Chair Steven Jacobs, Vice-Chair Timothy Brown Curt Calaway Jason Cuomo Brad Davidson Rich Davisson Liz Gantnier Jon Guthart John May Terry Spidell Jake Vossen Greg Wright	<b>Division of Corporation Finance (Division)</b> Kyle Moffatt, Chief Accountant Patrick Gilmore, Deputy Chief Accountant Lindsay McCord, Deputy Chief Accountant Craig Olinger, Senior Advisor to the Chief Accountant Shelly Luisi, Associate Director - Chief Risk Officer Christy Adams, Associate Chief Accountant Tricia Armelin, Associate Chief Accountant Jessica Barberich, Associate Chief Accountant Todd Hardiman, Associate Chief Accountant Jaime John, Associate Chief Accountant Ryan Milne, Associate Chief Accountant Eiko Yaoita Pyles, CF-OCA Rotator Stephanie Sullivan, Associate Chief Accountant Jarrett Torno, CF-OCA Rotator Mark Green, Senior Special Counsel <b>Office of Chief Accountant</b> Robert Sledge, Professional Accounting Fellow Ruth Ueijo, Professional Accounting Fellow	Chris Alabi, CAQ Kendra Decker, Grant Thornton Paula Hamric, BDO Phillip Posey, Deloitte Annette Schumacher Barr, CAQ

## II. Personnel and Committee Update

Kyle Moffatt was appointed Chief Accountant and Pat Gilmore and Lindsay McCord were appointed Deputy Chief Accountants in the Division's Office of Chief Accountant (CF-OCA). Stephanie Sullivan has rejoined CF-OCA. Jaime John is now the point of contact for Rule 3-05 prefiling submissions and Jarrett Torno is the point of contact for Rule 3-10 prefiling submissions.

## III. Current Financial Reporting Matters

### A. Financial reporting implications of tax reform legislation

#### 1. Non-GAAP financial measures

Some registrants may adjust for the impact of the Tax Cuts and Jobs Act (Tax Act) in their non-GAAP financial measures. Depending on the registrant's specific facts and circumstances, certain adjustments for tax reform may be appropriate. The staff indicated that such adjustments, however, should be balanced (i.e., both revenue and expense impacts should be disclosed). For example, adjusting for only one impact, such as the adjustment of deferred taxes upon the change in corporate tax rates, but not other impacts, such as the deemed repatriation transition tax, would not be appropriate.

Some registrants may also include adjustments that attempt to depict a "normalized" tax rate (i.e., adjustments that apply the new tax rate to periods prior to enactment). The staff indicated that such adjustments to non-GAAP measures may not be appropriate as they may not reflect performance during the historical periods when the tax laws were different (for example, different tax strategies and changes in certain judgements or tax assertions).

#### 2. Pro forma financial statements

If registrants elect to reflect the impact of the Tax Act in pro forma financial statements as a material event under Rule 11-01(a)(8) of Regulation S-X, they are encouraged to discuss their specific facts and circumstances with the staff on a prefiling basis to determine the appropriateness of any such pro forma adjustments.

### B. Waivers of financial statements required by Rule 3-09 of Regulation S-X

Rule 3-09 of Regulation S-X requires that annual financial statements be filed for each equity method investee for which either the income or the investment test set forth in Regulation S-X 1-02(w) exceeds 20 percent for any of the registrant's fiscal years required to be presented in the filing. If significant, annual financial statements of the equity method

investment must be provided for all periods presented and must be audited for the period(s) in which significance is met.

Registrants commonly seek a waiver for the omission of the annual financial statements of equity method investees when anomalies in operating results result in an otherwise insignificant equity method investment meeting one of the relevant tests of significance. In such Rule 3-09 waiver letters, the staff indicated that it is permissible for registrants to request that the relief be granted for the current filing, as well as all future filings that would require the same Rule 3-09 financial statements assuming significance is not met in those future periods. If the equity method investment is significant in future periods, this relief would no longer apply.

### C. New Accounting Standards

#### 1. Item 5-03(b) of Regulation S-X:

The Committee and staff discussed the interplay between the requirements of Rule 5-03(b) of Regulation S-X for the presentation on the face of the financial statements of revenue categories (for example, revenue from products, services and income from rentals) and the requirements of the new revenue and leasing standards. Registrants may submit to the staff live fact patterns that show potential inconsistencies between Article 5-03 and GAAP (Accounting Standards Codification (ASC) 606, *Revenue from Contracts with Customers*, and ASC 842, *Leases*).

#### 2. Presenting comparable periods under ASC 606 within MD&A:

The Committee and staff discussed the presentation of comparable prior periods under ASC 606 to facilitate MD&A, even if a company uses the modified retrospective transition method. If a registrant chooses to include supplemental MD&A disclosures for the comparable period(s) using ASC 606, the discussion should not be more prominent than the historical MD&A discussion and registrants should limit the discussion to only those items for which they are able to determine the impacts. For example, a registrant should not present a supplemental measure of gross profit or operating income adjusted for ASC 606 unless it is able to appropriately make adjustments to the impacted costs as well as the revenues. A full income statement, should not be presented. However, net income under ASC 606 for the prior periods may be discussed if a registrant is able to determine the impacts on all affected income statement line items.

In addition, a company adopting ASC 606 using the modified retrospective transition method is also permitted to present the 2018 results as determined pursuant to ASC 605 on a supplemental basis in MD&A. These disclosures should be comparable to those required to be included in the financial statement footnotes under ASC 250 and should

only be included in the period of adoption (e.g. 2018 only). In addition, if a registrant chooses to include these disclosures in MD&A, prominence should be given to the ASC 606 results. Amounts determined using ASC 605 should only be discussed in a way that allows investors to understand changes for comparability purposes.

#### **D. Use of most recent year-end financial statements in assessing Regulation S-X, Rule 1-02(w) significance in an IPO**

In situations where draft registration statements (DRS) are submitted, the staff confirmed that a company conducting an IPO can assess significance under Rule 1-02(w) of Regulation S-X for an acquisition that takes place after year end using the issuer's most recent year-end financial statements, even if such financial statements are not included in the DRS, as long as the issuer's most recent year-end audited financial statements will be included in its first public filing. Registrants calculating significance in this manner are encouraged to inform the Division's Assistant Director office applicable to the registrant prior to submitting the draft registration statement. Contact information is available on the Division's webpage.

#### **E. Audit requirements for pre-transaction periods following a reverse merger involving two operating companies**

A non-public operating company that is an accounting acquirer in a reverse merger with a public operating company is not considered an issuer for purposes of their pre-acquisition financial statements included in any Form S-4, proxy statement, or Form 8-K on Item 2.01 related to the merger. As such, the audit report on the pre-acquisition financial statements of the accounting acquirer included in these filings can be performed in accordance with AICPA standards and the auditor need not be SEC or PCAOB independent.

However, the financial statements of the accounting acquirer are presented as the historical financial statements of the issuer once the reverse merger is reported in a periodic report that includes the period in which the merger is consummated. Thus, any reissuance of the pre-acquisition annual financial statements in a registration statement or Form 10-K after that point would require a PCAOB opinion for all periods presented.

For example, a public operating company ("PubCo") completed a reverse merger with a non-public operating company ("OpCo") in May 2018. OpCo was the accounting acquirer and both companies have a December 31st year-end. The historical financial statements presented for the issuer for 2017 and 2016 in the December 31, 2018 Form 10-K will be those of OpCo. The historical financial statements for those years, in addition to the current year, must comply with the audit requirements of an issuer. Therefore, all years presented must be audited in accordance with PCAOB standards.



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Similar considerations would apply to other disclosures that are unique to issuers such as Item 302 of Regulation S-K, *Supplementary Financial Information*; segment reporting under ASC 280, *Segment Reporting*; and earnings per share under ASC 260, *Earnings per Share*.

## **F. Other Items Discussed**

1. Conforming the adoption of new accounting standards in pro forma financial statements (recently updated section 3250.1(m) of the FRM)
2. Transitioning to a new accounting standard after loss of EGC status (FRM section 10230.1)

Registrants are encouraged to discuss the application of the guidance for each of these items with the SEC staff when there are unique or complex fact patterns.