SEC Regulations Committee
March 19, 2013 - Joint Meeting with SEC Staff
SEC Offices – Washington DC

HIGHLIGHTS

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I. ATTENDANCE

A. SEC Regulations Committee

Melanie Dolan, Chair
Steve Meisel, Vice Chair
Jim Brendel
Brad Davidson
Christine Davine
Jack Day
Tom Elder
Greg Giugliano
Bridgette Hodges
Jeff Lenz
Kevin McBride
Sandra Peters
Scott Pohlman
Amy Ripepi

B. Securities and Exchange Commission

Division of Corporation Finance (Division)

Craig Olinger, Acting Chief Accountant
Nili Shah, Deputy Chief Accountant
Angela Crane, Office Chief, Accounting – Disclosure Standards Office
Tamara Brightwell, Senior Special Counsel
Jill Davis, Associate Chief Accountant
Louise Dorsey, Associate Chief Accountant
Todd Hardiman, Associate Chief Accountant
Joel Levine, Associate Chief Accountant
Leslie Overton, Associate Chief Accountant
Ryan Milne, Associate Chief Accountant
Mark Shannon, Associate Chief Accountant
Patricia Armelin, Associate Chief Accountant
Michael Stehlik, Assistant Chief Accountant
Mark Green, Senior Special Counsel

C. Center for Audit Quality

Annette Schumacher Barr

D. Guests

Rob Skubic, KPMG
John May, PwC

II. DIVISION OF CORPORATION FINANCE PERSONNEL AND ORGANIZATIONAL UPDATE

Craig Olinger noted that Kyle Moffatt was promoted to Associate Director in charge of the newly created Office of Disclosure Standards and Patricia Armelin has been promoted to fill the Associate Chief Accountant position vacated by Mr. Moffatt. Additionally, Angela Crane was promoted to Office Chief, Accounting – Disclosure Standards Office, and an active internal search is underway to identify a replacement for Ms. Crane as an Associate Chief Accountant in the Division's Chief Accountant's Office Policy Group.

Melanie Dolan introduced Greg Giugliano and Amy Ripepi, two new members of the Committee.

The Committee thanked the SEC staff for their participation in the December 2012 AICPA National Conference on Current SEC and PCAOB Developments (the 2012 Conference). The SEC staff's input and presentations were very positively received by the audience.

III. CURRENT FINANCIAL REPORTING MATTERS

A. Pro Forma Adjustments

S-X Rule 11-02(b)(6) requires that a pro forma income statement include only adjustments that give effect to events that are (i) directly attributable to the transaction, (ii) expected to have a "continuing impact" on the company, and (iii) factually supportable. The Committee noted that at the 2012 Conference, the Division's staff noted that there appeared to be a handful of items where the twelve month rule of thumb used to evaluate the continuing impact criterion may not work very well and that for those items, the staff was considering whether the use of a more than one time view of continuing impact may better reflect the outcomes of transactions to which pro forma effect is being given.

Todd Hardiman confirmed that the Division's staff has not issued additional guidance. He reiterated the encouragement provided at the 2012 Conference for registrants to contact the Division of Corporation Finance's Office of Chief Accountant if they have a live fact pattern where the different views of what constitutes continuing impact would have a material impact to their pro forma financial statements.

IV. CAPITAL FORMATION INITIATIVES

A. JOBS Act

In April 2012, the Jumpstart Our Business Startups Act (JOBS Act) was signed into law. Among other things, the JOBS Act created a new category of public issuers called Emerging Growth Companies (EGC). Readers should refer to the JOBS Act for the definition of an EGC.

During 2012, the Division's staff published several Frequently Asked Questions (FAQs) designed to provide further guidance about how to implement certain provisions of the JOBS Act. The FAQs are posted on the JOBS Act section of the SEC's web site.

The Committee was interested to learn whether the Division's staff continues to receive questions about the JOBs Act. Nili Shah indicated that the Division's staff does receive questions about how to apply the provisions of the JOBS Act under specific fact patterns from time to time.

The Committee asked whether an EGC that voluntarily presents three years of its financial statements in an initial registration statement (rather than two years as permitted under the JOBS Act) may, nonetheless, provide two years of acquiree financial statements pursuant to Rule 3-05 of Regulation S-X even if the acquiree is greater than 50% significant (and has revenues of $50 million or more). Ms. Shah noted that this scenario has similarities to FAQ 16, which address both Rule 3-05 and

Rule 3-09 financial statements. Ms. Shah noted that the EGC may include only two years of financial statements of the Rule 3-05 acquiree or Rule 3-09 investee, as applicable, even in situations where an EGC voluntarily provides a third year of financial statements.

B. Recommendations by the SEC Advisory Committee on Small and Emerging Businesses

Ms. Shah indicated that at its February 1, 2013 meeting, the SEC Advisory Committee on Small and Emerging Businesses approved the following recommendations to the SEC:

- Increase tick size to improve liquidity for smaller exchange-listed companies (this recommendation included allowing companies to set their own tick size within a certain range designated by the Commission);
- Encourage the creation of a U.S. equity market for small and emerging companies that is limited to accredited investors. The regulatory regime for companies whose securities trade in this market would be appropriately scaled (i.e., considering the nature and needs of the investors);
- Increase the public float threshold for smaller reporting companies from $75 million to $250 million, extend to those companies many of the same benefits granted to emerging growth companies under the JOBS Act, provide those companies with relief with respect to Item 601 of Regulation S-K, and provide smaller reporting companies with an exemption from XBRL requirements; and
- Relay the Committee's disapproval of the Conflict Minerals and Resource Extraction provisions of the Dodd-Frank Act to Congress, as appropriate.

Ms. Shah indicated that the SEC staff is currently considering the various recommendations by the Advisory Committee.

The Advisory Committee's recommendations may be found at http://sec.gov/info/smallbus/acsec.shtml

V. SEC STAFF AND OTHER INITIATIVES

A. Financial Reporting Manual

Mike Stehlik noted that the next update to the Division's Financial Reporting Manual (FRM) is expected to be issued soon in the ordinary course, with updates dated as of December 31, 2012.

[Note: On April 4, 2013, the Division's staff issued its quarterly update of the FRM with updates dated as of December 31, 2012.]

B. Rulemaking for Conflict Minerals and Extractive Industry Payments

On August 22, 2012, the SEC adopted two rules mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act. One rule requires certain companies to disclose their use of conflict minerals (tantalum, tin, gold and tungsten) that originated in the Democratic Republic of the Congo or an adjoining country. The other rule requires domestic and foreign resource extraction issuers to disclose certain payments made to the U.S. government or foreign governments in certain cases.

Tamara Brightwell indicated that the SEC staff has received many questions and requests for guidance about implementation of, and compliance with, the rules. The Committee also highlighted an additional question about the rules' transition requirements for entities that complete their initial public offerings in 2013 or beyond.

Ms. Brightwell noted that the SEC staff is currently developing responses to the questions it has received and that the staff hopes to provide guidance soon. The SEC staff also continues to encourage stakeholders to send additional questions about implementation of, and compliance with, the rules.

C. Rule 3-14 of Regulation S-X

Rule 3-14 of Regulation S-X provides specialized reporting instructions for acquired real estate operations.

Mr. Olinger indicated that members of the Real Estate and Commodities Office within the Division (AD Group 8) are considering ways in which application of Rule 3-14 may be clarified and/or simplified in areas such as: (i) calculating significance of acquired properties; (ii) aggregation of insignificant properties; (iii) the treatment of triple-net-lease structures; and (iv) blind pools. AD Group 8 has also seen recent instances in which real estate investment trusts have acquired single family residential properties and is considering how to apply Rule 3-14 to such transactions.

Mr. Olinger encouraged registrants with questions about the application of Rule 3-14 to contact the Division's Office of Chief Accountant.

D. Changes in Guarantor Structure and Impacts on Rule 3-10 Reporting

The Committee noted that at the 2012 Conference, the Division's staff discussed application of Rule 3-10 of Regulation S-X, which allows a registrant with guaranteed public debt to present condensed consolidating financial information (or other reduced disclosure) in the footnotes of the parent company's financial statements in lieu of filing separate financial statements for each subsidiary issuer or subsidiary guarantor of the debt, if certain conditions are met. At the 2012 Conference, the Division's staff observed that the framework for preparing condensed consolidating financial information should use GAAP and Article 10 of Regulation S-X as a frame of reference.

At this meeting, the Committee asked:

What is the appropriate way to reflect the following events in condensed consolidating financial information?
(a) Transfer of a business between issuers, guarantors and nonguarantors
(b) Transfer of assets between issuers, guarantors and nonguarantors
(c) Change in composition of issuers, guarantors and nonguarantors

Mr. Olinger noted that the application of Rule 3-10 necessarily depends on the unique facts and circumstances, but shared two general observations:

- Registrants should make the condensed consolidating financial information as comparable as practicable.
- It is important for an entity to provide clear and transparent disclosure with respect to how these transfers of assets and businesses or other changes have been reflected in the condensed consolidating financial information and to be consistent with GAAP.

He also observed the following:

Transfers of businesses within a consolidated group - These transfers are ordinarily accounted for by the receiving entities as common control mergers and are accounted for **retrospectively under US GAAP**. Likewise, transfers of businesses amongst a consolidated group should be reflected retrospectively in the accounts of both the transferee and transferor in the condensed consolidating financial information. A registrant need not apply the prohibition on "de-pooling" to a transferor of a business as might apply in full standalone registrant financial statements (see SAB Topic 5.Z.7).

For example, assume a business within a guarantor subsidiary is transferred to a non-guarantor subsidiary in a particular accounting period. In this case, the entity should reflect that transferred business in only the non-guarantor column on a retrospective basis for all periods presented (and make the corresponding adjustments to retrospectively remove the transferred business from the guarantor column).

Transfers of assets (i.e., not a business) among issuers, guarantors and nonguarantors - These are generally accounted for **prospectively** under U.S. GAAP. Accordingly, such transfers of assets should generally be reflected on a prospective basis in the condensed consolidating financial information as well.

Changes in the composition of guarantors and nonguarantors in condensed consolidating financial information (i.e., changes in individual subsidiaries designated as guarantors or nonguarantors) – These should generally be reflected **retrospectively** based on the guarantee structure that existed as of the most recent balance sheet date included in the report. However, changes to the group of subsidiary guarantors resulting from disposition of one or more guarantor subsidiaries (i.e., the subsidiary is no longer a part of the consolidated group and was released from its guarantee) create two presentation alternatives:

- One alternative is that the condensed consolidating financial information should reflect the guarantor designations as of the most recent balance sheet date included in the filing. Under this alternative, any subsidiary already disposed of and no longer designated as a guarantor at the most recent balance sheet date should be retrospectively reflected in the nonguarantor columns of the condensed consolidating financial information (similar to the treatment that occurs when a subsidiary guarantor is released from a guarantee under select circumstances but remains a part of the consolidated group). A guarantor subsidiary not disposed of but that qualifies for discontinued operations treatment and that is still designated as a guarantor at the balance sheet date should remain in the guarantor columns (as a discontinued operation) until the date of disposal (at which point the subsidiary would be retrospectively reflected in the nonguarantor columns). Under this alternative, if a registrant has not previously been required to present condensed consolidating financial information (e.g., as provided in Note 1 to Rule 3-10(c) or Note 5 to Rule 3-10(d)), the change in guarantor status could potentially create the need to add condensed consolidating financial information to depict a "more than minor" non-guarantor subsidiary which is no longer a part of the consolidated group.

- Another alternative is that a disposed subsidiary should remain in the guarantor columns through the date of disposal with no retrospective application of loss of guarantor status in order to portray the operational history of the guarantor(s).

The staff will accept either approach. Registrants should carefully consider which presentation is most appropriate in their facts and circumstances.

E. Use of Data Analytics by the SEC Staff

The Committee noted that in a speech by Craig Lewis, Chief Economist and Director, Division of Risk, Strategy and Financial Innovation, at the FEI Conference on Financial and Information Technology on December 13, 2012 and also in a speech given by Chairman Walter on February 19, 2013, comments were made about the anticipated future use of data analytics by the SEC staff to inform monitoring programs across the SEC, including the filing review process of the Division of Corporation Finance. Certain programs developed by the SEC intend to use quantitative analytics to assess the degree to which registrants' financial statements appear anomalous compared to others in the industry or peer group. The Committee asked about the use of such analytics by Division Staff.

Ms. Shah indicated that the SEC staff currently has no additional information to share with respect to the data analytics or models discussed in the speeches referenced above.

F. Upcoming Financial Disclosure Roundtable

The Committee noted that in his speech at the 2012 Conference, Chief Accountant Paul Beswick discussed plans for an upcoming Financial Disclosure Roundtable. Mr. Beswick observed that feedback provided in response to the FASB disclosure projects has highlighted that there are different perspectives about what information should be included in a company's basic financial statements versus its broader financial reporting package (e.g., in MD&A). He indicated that SEC staff intends to hold a roundtable to solicit information on this issue. The Committee inquired about the status of the roundtable.

Ms. Shah indicated that the SEC staff is drafting a paper that is expected to be published in advance of the roundtable. The purpose of the paper is to provide background with respect to the issues to be discussed at the roundtable, for example, to distinguish between disclosure provided in the notes to financial statements versus the MD&A. The roundtable meeting is expected to be held in late spring or early summer.

VI. CURRENT PRACTICE ISSUES

A. Complying with Rule 3-09 of Regulation S-X When the Registrant's and Investee's Fiscal Year ends Differ by Six Months

The Committee and the staff discussed diversity in practice they have seen in domestic registrants' Form 10-Ks related to the application of Rule 3-09 of Regulation S-X when a domestic registrant must file for the first time in its Form 10-K (or an amendment thereto) financial statements of a significant equity method investee that has a different fiscal year end than the domestic registrant. The diversity relates to determining which fiscal year of the investee is its most recent fiscal year for purposes of complying with Rule 3-09.

Companies generally file financial statements for the investee's fiscal year end that is closest to the registrant's fiscal year end regardless of whether such investee's fiscal year end is before or after the registrant's fiscal year end. However, a question arises in the application of this practice when the investee's fiscal year differs from the registrant's by 6 months (e.g., registrant has a 12/31 year end but investee has a 6/30 year end). Specifically, should the registrant file the investee's financial statements for the fiscal year ending prior to the registrant's year end (e.g. investee's fiscal year end for 6/30/2012 when registrant has a 12/31/2012 year end) or the investee's fiscal year end that ends after the registrant's fiscal year end (e.g. investee's fiscal year ended 6/30/2013)?

Mr. Hardiman noted that either approach is acceptable under Rule 3-09, provided that the selected approach is applied consistently on an investee by investee basis. He indicated that registrants should consider their specific facts and circumstances and the information needs of users of their financial statements when deciding which approach to apply.

The Committee observed that some registrants recognize their equity in the earnings of an investee on a lag basis. Mr. Hardiman indicated that the acceptability of the two approaches would not be dependent on whether the registrant recorded its equity in the investee's earnings on a lag basis.

B. Applying the Annual Report "Grace Period" in Rule 3-09 of Regulation S-X in Connection with a Registration Statement

The Committee noted that Rule 3-09 of Regulation S-X specifies the date by which financial statements of an equity method investee must be filed for purposes of a registrant's Form 10-K. Rule 3-09 requires that for purposes of filing on Form 10-K, the financial statements of a private equity method investee that does not meet the definition of a foreign business must be filed within 90 days after the investee's year end, but in no event earlier than the due date of the registrant's Form 10-K. If the investee's financial statements are due after the registrant's annual report is required to be filed, the financial statements required by Rule 3-09 may be filed in an amendment to the registrant's annual report. The option to include the investee's financial statements as an amendment to the registrant's annual report in these circumstances is commonly referred to as the annual report "grace period."

The Committee noted that questions arise in practice as to whether a registrant may file a registration statement (or have a registration statement become effective) after a registrant files its Form 10-K but before it amends the Form 10-K to file the financial statements of a significant equity method investee (i.e., during the annual report "grace period").

Mr. Hardiman indicated that the annual report "grace period" set forth in Rule 3-09 relates to the Form 10-K; it does not relate to registration statements. This is true even if the disclosure in the registration statement relies on the incorporation by reference of the Form 10-K. CF-OCA is still considering the appropriate application of this guidance to automatic shelf registration statements and Form S-8.

Rule 3-09(b) of Regulation S-X states (in part) that "[i]nsofar as practicable, the separate financial statements required by this section shall be as of the same dates and for the same periods as the audited consolidated financial statements required by Rules 3-01 and 3-02." Mr. Hardiman stated that when a registrant is preparing a registration statement during the annual report "grace period," it should apply the Rule 3-12 age of financial statement requirements based on whether the registrant satisfies the conditions of Rule 3-01(c) of Regulation S-X to determine whether the investee's financial statements for its most recently completed year-end are required to be included/incorporated by reference in the registration statement (interim financial statements, however, would not be required under Rule 3-09).

The Committee and the staff discussed how this guidance should be applied. Applying this guidance to a registrant with a December 31, 2012 year end with a significant investee with the same year end where the registrant incurred a loss in its most recent fiscal year (2012) and the registration statement is filed March 15, 2013

would require filing the audited financial statements of the investee for the year ended December 31, 2012 (together with financial statements for the other relevant prior years, which may be unaudited if the investee was not significant in those prior years). The Committee also believes that if the investee's financial statements do not have to be updated based on the conditions in Rule 3-01(c) but the registration statement includes or incorporates by reference the registrant's 2012 audited financial statements, audited December 31, 2011 investee financial statements (together with financial statements for the other relevant prior years, which may be unaudited if the investee was not significant in those prior years) would satisfy the requirement (even though the investee was determined not to be significant in 2011).

If the investee in the above example were a foreign business, the age of financial statement requirements would allow a domestic registrant's registration statement to be filed on March 15, 2013 without including investee financial statements updated to December 31, 2012 notwithstanding the registrant's non-satisfaction of the conditions in Rule 3-01(c) because Rules 3-01(h), 3-02(d) and 3-12(f) refer to the updating requirements of Item 8.A of Form 20-F which indicates that the most recent annual financial statements of a foreign business can, in this case, be as old as 15 months at the time the registration statement is filed. In other words, December 31, 2011 audited financial statements of an equity method investee that is a foreign business (together with financial statements for the other relevant prior years, which may be unaudited if the investee was not significant in those prior years) could be provided in a new or amended registration statement until April 1, 2013 without regard to the registrant's eligibility under Rule 3-01(c).

C. Measuring the Significance of a Recently Acquired Subsidiary or Issuer Guarantor Under Rule 3-10(g) of Regulation S-X

The Committee noted that Rule 3-10(g)(1)(ii) of Regulation S-X requires that a registrant include in a registration statement for guaranteed debt the financial statements of a recently acquired subsidiary issuer or subsidiary guarantor if "the net book value or purchase price, whichever is greater, of the subsidiary is 20% or more of the principal amount of the securities being registered." [emphasis added].

The Committee noted diversity in practice as to how the phrase "principal amount of the securities being registered" should be interpreted when more than one class of guaranteed securities is being registered on a single registration statement. The Committee noted that a single registration statement may be used to register multiple series of securities that fall under the same indenture but have different debtholders, maturity dates and/or interest rates.

Patricia Armelin indicated that a registrant should evaluate significance under S-X 3-10(g) based on the principal amount of each series of notes separately. She stated that the form of the registration statement (i.e., a single registration statement versus multiple registration statements) does not impact how significance is evaluated.

D. Application of the Updating Requirements for Rule 3-05 Financial Statements When Rule 3-06 of Regulation S-X Has Previously Been Used to Satisfy the Audited Financial Statements Requirement in the Most Recent Year

The Committee noted that under certain circumstances, including the acquisition of a business, a registrant may rely on Rule 3-06 of Regulation S-X to present audited financial statements for a nine-month period to satisfy the requirement to provide audited financial statements for a fiscal year.

The Committee asked how the financial statement updating rules apply to audited financial statements for a nine month period in connection with a subsequent filing (e.g., a subsequent registration statement or proxy statement or for the purposes of the Form 8-K reporting the consummation of the acquisition).

Joel Levine stated presenting audited financial statements for a nine month period in reliance on S-X Rule 3-06 does not affect the annual updating provisions of S-X Rule 3-12. So, if a calendar year entity presents audited financial statements for the nine-month period ended September 30, audited financial statements would need to be updated for the year ending December 31 when the September 30 financial statements become stale pursuant to S-X Rule 3-12. It is not acceptable to provide unaudited interim financial statements for the three-month period ending December 31 to satisfy the updating requirement. Mr. Levine noted that various sections of the FRM provide guidance on updating nine-month interim financial statements in various contexts, including a subsequent registration statement or proxy statement.