SEC Regulations Committee
June 18, 2013 - Joint Meeting with SEC Staff
SEC Offices – Washington DC

HIGHLIGHTS

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I. ATTENDANCE

A. SEC Regulations Committee

Melanie Dolan, Chair
Jim Brendel
Brad Davidson
Christine Davine
Jack Day
Greg Giugliano
Bridgette Hodges
Wayne Landsman
Jeff Lenz
Kevin McBride
Sandra Peters
Scott Pohlman
Amy Ripepi
Michelle Stillman

B. Securities and Exchange Commission

Division of Corporation Finance (Division)

Craig Olinger, Acting Chief Accountant
Nili Shah, Deputy Chief Accountant
Patricia Armelin, Associate Chief Accountant
Jill Davis, Associate Chief Accountant
Joel Levine, Associate Chief Accountant
Ryan Milne, Associate Chief Accountant
Mark Shannon, Associate Chief Accountant
Michael Stehlik, Assistant Chief Accountant
Barry Summer, Associate Director
Mark Kronforst, Associate Director
Jonathan Ingram, Deputy Chief Counsel
Roger Schwall, Assistant Director
Brad Skinner, Senior Assistant Chief Accountant
Mark Green, Senior Special Counsel
Ted Yu, Senior Special Counsel and Counsel to the Director
John Fieldsend, Special Counsel
Eduardo Aleman, Special Counsel
John Hodgin, Petroleum Engineer

C. Center for Audit Quality

Annette Schumacher Barr

D. Guests

Keisha Hutchinson, KPMG
John May, PwC
Rob Skubic, KPMG

II. DIVISION OF CORPORATION FINANCE PERSONNEL AND ORGANIZATIONAL UPDATE

Nili Shah noted that Michael Stehlik has accepted a position as Financial Analyst in the Office of Disclosure Standards. The Committee thanked Mr. Stehlik for his contributions to the SEC Regulations Committee meetings over the past six years.

III. CURRENT FINANCIAL REPORTING MATTERS

A. Cybersecurity Disclosure Reviews

In October 2011, the SEC's Division of Corporation Finance issued written guidance for registrants about disclosure obligations relating to cybersecurity risks and cyber incidents. During the December 2012 AICPA National Conference on Current SEC and PCAOB Developments (the Conference), the SEC staff remarked that information identified outside of a registrant's filings may prompt the staff to issue comments about the registrant's cybersecurity disclosures. The staff noted instances in which a registrant's risk factor disclosures included the possibility of a cyber attack, even though other information suggested that such an attack had already occurred. The SEC staff indicated at the Conference that, while it is not necessary to report all incidents, a registrant that has been subject to an attack should disclose that fact and provide enough information for investors to understand the cybersecurity risks faced by the registrant. To the extent material, a registrant should disclose in MD&A its costs related to responding to the attack, such as cost of claims associated with the attack or increased protection costs. Additionally, registrants should consider cyber incidents when evaluating their disclosure controls and procedures.

In a letter to Chairman White from Senator John D. Rockefeller IV dated April 9, 2013, the Senator urged the Commission to take steps to expand public company disclosure about cybersecurity practices and risks. The letter asserted that while the measures taken to date by the SEC staff were an important first step in this area, additional disclosure obligations should be issued at the Commission level because "the disclosures are generally still insufficient for investors to discern the true costs and benefits of companies' cybersecurity practices."

At the June 18, 2013 meeting, Nili Shah indicated that the SEC staff's expectations expressed in the October 2011 guidance and at the Conference about cybersecurity disclosures have not changed. Consistent with Chairman White's May 1, 2013 response to the Senator's letter, the SEC staff continues to evaluate and comment on registrant disclosures about the potential ramifications and risks from cyber events when such events are, or could be, material.

B. New Compliance and Disclosure Interpretations

On May 16, 2013, the staff of the SEC's Division of Corporation Finance issued several new Compliance and Disclosure Interpretations (C&DIs). The Committee discussed two of those new C&DI's with the staff:

1. An Item 2.06 Form 8-K for a material impairment is not required to be filed if the impairment conclusion is made at a time that coincides with, but is not in connection with, the preparation, review, or audit of financial statements to be filed in the next periodic report under the Exchange Act (see C&DIs for Exchange Act Form 8-K, Item 2.06 Material Impairments, Question 110.01).

   Mr. Jonathan Ingram noted that the SEC staff issued the interpretation in response to questions received from registrants seeking clarification of the Form 8-K requirements. The interpretation does not change existing guidance nor does the SEC staff expect the C&DI to change current practice.

2. A registrant may classify oil and gas reserves as proved developed reserves if it has expended all of the money required to install and implement an improved recovery technique but has not yet achieved a production response from the

technique (see C&DIs for Oil and Gas Rules, Rule 4-10(a)(6) Definitions – Developed Oil and Gas Reserves, Question 106.01).

Mr. John Hodgin stated that the interpretation about classifying oil and gas reserves was issued because registrants had asked the SEC staff to confirm their understanding about changes in the definitions of proved and developed reserves included in the 2008 final rule, *Modernization of Oil and Gas Reporting*, noting that certain caveat language in the old definitions was not carried forward under the new rule. The C&DI provides the staff's view that registrants that participate in oil and gas producing activities using enhanced recovery techniques can classify reserves as proved and developed before receiving a production response if the registrant has made all of the required expenditures and the reserves meet the proved and developed criteria in Rules 4-10(a)(22) and 4-10(a)(6) of Regulation S-X, respectively (see Section 210.4-10 of Regulation S-X). The interpretation does not contain new guidance nor is it expected to change current practice.

C. 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 March 31, 2013.

[Note: On July 16, 2013, the Division's staff issued its quarterly update of the FRM with updates dated as of March 31, 2013.]

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 and 2013, 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.

Nili Shah indicated that, at this point, the Division's staff has answered all questions that have general applicability. Ms. Shah stated that the SEC staff has not yet answered some questions that relate to specific fact sets and narrow application of the rules of the JOBS Act, nor does it expect to publish FAQs on these types of questions. If additional questions are received in the future that have general applicability, the SEC staff may consider issuing further FAQs.

The Committee also inquired as to the status of the study on Regulation S-K called for by the JOBS Act. The staff indicated they are continuing to work on the study and hope to complete it as soon as reasonably possible.

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

Ted Yu indicated that at its May 1, 2013 meeting, the SEC Advisory Committee on Small and Emerging Companies invited Bill Hambrecht, Chairman and CEO of WR Hambrecht and Co., Duncan Niederauer, CEO of NYSE Euronext, and Robert Greifeld, CEO of NASDAQ OMX Group, to discuss ways to improve trading activity for smaller companies and facilitate capital formation by smaller companies. The following topics were discussed at the meeting:

- Identification of ways to increase interest in trading activity of smaller companies by analysts and market makers, including tick size reform and the creation of certain incentive programs for market makers;
- The introduction of a liquidity concentration program within the NASDAQ. This program would be similar to the program in the European Union, which allows trading activity subsequent to an IPO to only occur on a certain exchange for a specific period of time; and
- Identification of alternative ways to raise capital (e.g., Regulation A+, internet-based auctions) other than through Title I of the JOBS Act for IPOs attempting to raise up to $50 million.

Mr. Yu indicated that the SEC staff and the Advisory Committee members are currently considering the various recommendations made by the Advisory Committee. The current charter for the Advisory Committee expires in October 2013 at which time the SEC will decide whether to extend it.

The materials from the Advisory Committee's May 1, 2013 meeting may be found at http://sec.gov/info/smallbus/acsec.shtml

V. SEC STAFF AND OTHER INITIATIVES

A. 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 with conflict minerals (tantalum, tin, gold and tungsten) in their products to disclose whether those minerals originated in the Democratic Republic of the Congo or an adjoining country and, if so, exercise due diligence and file a Conflict Minerals Report. The other rule requires resource extraction issuers to disclose certain payments made to the U.S. government or foreign governments in certain cases.

In May 2013, the SEC staff issued frequently asked questions (FAQs) and responses about complying with both the conflict minerals and resource extraction rules. The

FAQs focused on areas such as applicability and scope of the rules, disclosure and reporting under the rules, how the rules apply in initial public offerings and the impact of noncompliance on Form S-3 eligibility.

John Fieldsend indicated that the SEC staff is still evaluating a number of additional questions about implementation of, and compliance with, the conflict minerals rules and that the staff is considering how to respond to those specific inquiries (e.g., directly with the party who raised the question or more generally through publication of written interpretive responses). Mr. Fieldsend noted that the staff is currently developing these responses with the goal of providing additional guidance soon.

The SEC staff also noted that it has responded to all questions received to date about the rules for payments by resource extraction issuers. Should additional questions be received, the staff will consider the best way to disseminate any further guidance.

B. COSO Revised Framework

In May, 2013 the Committee of Sponsoring Organizations of the Treadway Commission (COSO) released its updated *Internal Control – Integrated Framework* (2013 Framework). The changes made to update COSO's 1992 Framework are meant to be evolutionary, and take into account changes in the business environment and operations over the last 20 years. The 2013 Framework retains the definition of internal control and the COSO cube, including the five components of internal control: Control Environment, Risk Assessment, Control Activities, Information and Communication, and Monitoring Activities.

The Committee noted that SEC Chief Accountant Paul Beswick said during a recent speech that he is expecting questions about whether the SEC will provide management with any guidance on transition or implementation related to the 2013 Framework. He also stated that the SEC staff plans to monitor the transition for issuers using the 1992 Framework to evaluate whether any staff or Commission actions become necessary or appropriate at some point in the future. Ms. Shah reiterated Mr. Beswick's comments and stated that the staff is currently referring users of the COSO 1992 framework to the statements made on the COSO web site about the 2013 Framework. The staff will consider the nature of any disclosures about use of the 2013 Framework that may be expected.

C. Upcoming Financial Disclosure Roundtable

In his speech at the 2012 Conference, 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 the SEC staff intends to hold a Financial Disclosure Roundtable to solicit information on this issue. At the meeting, the Committee inquired about the status of this roundtable. The staff indicated that the timing of the roundtable has not been determined.

VI. CURRENT PRACTICE ISSUES

A. Smaller Reporting Companies and Disposition Pro Forma Information

The rules governing pro forma information regarding a significant disposition of a business for a smaller reporting company are contained in Article 8 of Regulation S-X. Those requirements differ from the requirements for a larger reporting company. Specifically, Article 8 provides that smaller reporting companies "may wish to consider" the guidelines in Article 11 of Regulation S-X.

The Committee asked the staff if there are any specific factors that a smaller reporting company (SRC) should consider in deciding whether to provide pro forma information reflecting a significant disposition of a business. Joel Levine indicated that the requirements in Article 8 are a carryforward from Item 310 of Regulation S-B.[1] He observed that the nature and extent of pro forma information to be provided by an SRC to reflect a significant disposition of a business requires judgment based on all relevant facts and circumstances. Mr. Levine noted that an acceptable approach would be for SRCs to look at guidance in S-X Rule 11-01 for larger reporting companies and exercise judgment as to whether the significance thresholds applicable for the larger companies are appropriate to the SRC. This is consistent with guidance in Section 5320 of the FRM. However, Mr. Levine acknowledged that significance prescribed by S-X Rule 11-01 applicable to larger companies may not necessarily be relevant for every SRC and judgment should be exercised in determining what would be considered material to investors.

B. Effect of New Revenue Recognition Standard on Disclosures Outside of the Financial Statements

The FASB and IASB (the Boards) are expected to release a final, generally converged standard on revenue recognition later in 2013. Although the final standard is not expected to be adopted until 2017 by US companies, the Committee observed several SEC reporting matters outside of the financial statements that may be affected by the new standard. The final U.S. standard is expected to provide two transition options: (i) cumulative effect at the beginning of the year of adoption (e.g., January 1, 2017 for calendar year-end registrants) referred to as the modified retrospective method or (ii) retrospective for all periods presented (including the use of certain practical expedients) with a cumulative effect at the beginning of the earliest period presented.

The staff indicated they would expect registrants to disclose the transition method to be employed once it has been selected.

Areas in which adoption of the new revenue recognition standard may affect disclosures outside of the financial statements that were discussed by the Committee and the SEC Staff include: (a) disclosures about the effect of a new accounting standard on a registrant's financial position and results of operations, as required by

[1] To streamline and simplify regulation, Regulation S-B was consolidated into Regulation S-K in 2008. The scaled financial statement requirements in Item 10 of Regulation S-B were moved into new Article 8 of Regulation S-X. (Release 33-8876).

SAB 74 (SAB Topic 11-M), (b) disclosure in MD&A about the effect on comparative periods if a registrant uses the modified retrospective transition method and (c) presentation of historical information in the five-year selected financial data table if a registrant uses the retrospective transition method. The staff indicated that it has begun thinking about potential questions registrants may have. The staff asked the Committee members about the factors that registrants may be considering in selecting a transition method. Committee members indicated that, at this stage, they believe many companies are still in the very early stages of understanding the new standard and the extent to which systems and other changes will be required in order to implement the new standard. Those changes, and the amount of analysis and effort required to apply the new standard to transactions that precede adoption, will likely influence transition decisions.

C. Adoption of a New Accounting Standard that Requires Retrospective Application During an Interim Period and Application of Rule 3-09 of Regulation S-X in a Registration Statement During that Period

The Committee and the SEC staff discussed whether the adoption of a new accounting standard via retrospective application to previously issued financial statements would require the registrant to reassess the significance of equity method investees under Rule 3-09 of Regulation S-X with respect to those historical periods. The FRM contains guidance addressing the reassessment of significance under Rule 3-09 when historical financial statements are revised to reflect a discontinued operation. That guidance does not address a change in accounting principle.

The Committee asked the SEC staff if the guidance in FRM Section 2410.8 about determining significance of equity method investees after a discontinued operation has been reflected in a registrant's financial statements (for purposes of complying with Rule 3-09 of Regulation S-X) would also be applicable when calculating significance after historical financial statements have been revised to reflect adoption of a new accounting standard through retrospective application.

Committee members noted that re-performing the significance calculation can cause an equity method investee that was not significant to a registrant in an historical period to become significant, and vice versa. It can be difficult for registrants to obtain audited financial statements of an equity method investee when there was no expectation that the investee would be significant. Furthermore, retrospective application of an accounting principle can change the numerator and the denominator in the calculation.

Committee members also observed that some registrants might consider the effect of retroactive measurements of significance for equity method investees when deciding between alternative transition methods.

The SEC staff will consider whether any further guidance should be provided.