SEC Regulations Committee
June 25, 2014 - Joint Meeting with SEC Staff
SEC Offices – Washington DC

HIGHLIGHTS

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I. ATTENDANCE

A. SEC Regulations Committee

Melanie Dolan, Chair
John May, Vice-Chair
Scott Bourgeois
Brad Davidson
Christine Davine
Jackson Day
Tom Elder
Liz Gantnier
Bridgette Hodges (via teleconference)
Matthew Kurzweil
Jeff Lenz

Steve Mezzio
Scott Pohlman
Amy Ripepi
Sharon Virag

B. Securities and Exchange Commission

Division of Corporation Finance (Division)

Keith Higgins, Director (present for part of the meeting)
Mark Kronforst, Chief Accountant
Craig Olinger, Deputy Chief Accountant
Nili Shah, Deputy Chief Accountant
Patricia Armelin, Associate Chief Accountant
Jill Davis, Associate Chief Accountant
Louise Dorsey, Associate Chief Accountant
Todd Hardiman, Associate Chief Accountant
Lindsay McCord, Associate Chief Accountant
Ryan Milne, Associate Chief Accountant
Leslie Overton, Associate Chief Accountant (via teleconference)
Kyle Moffatt, Associate Director

C. Center for Audit Quality

Annette Schumacher Barr

D. Guests

Keisha Hutchinson, KPMG
Steven Jacobs, EY

II. DIVISION OF CORPORATION FINANCE PERSONNEL AND ORGANIZATIONAL UPDATE

Mr. Higgins provided the following personnel update for the Division:

- Cicely LaMothe has been named Associate Director, overseeing Assistant Director (AD) Group 3 (Information Technology and Services) and AD Group 11 (Telecommunications);
- David Fredrickson was named Chief Counsel;
- Elizabeth Murphy has been named Associate Director (Legal);
- Mauri Osheroff has retired after nearly 40 years of SEC service;
- Sonia Barros has been named Assistant Director for AD Group 8 (Real Estate and Commodities);

- Andrew Mew has been named Senior Assistant Chief Accountant - AD Group 5 (Transportation and Leisure); and,
- Lindsay McCord participated in the Division's Rotation Program and has accepted a permanent position as Associate Chief Accountant within the Division's Office of Chief Accountant.

III. CAPITAL FORMATION INITIATIVES

A. Crowdfunding and Regulation A Rule Proposals

Mr. Higgins provided an update on the Commission's capital formation initiatives.

- **Crowdfunding**

  Mr. Higgins noted that the staff is currently reviewing comments received on the Commission's crowdfunding proposal. Comments received were varied, ranging from concerns that the proposed requirements were too stringent and would stifle the ability of companies to raise capital, to concerns that the proposal does not offer enough investor protection. He added that a definite timeframe for finalization has not been set.

- **Regulation A**

  The SEC proposed amendments to Regulation A, which would exempt certain securities offerings of up to $50 million annually from the registration requirements of the Securities Act of 1933 (Securities Act). Mr. Higgins noted that the aspects of the proposal receiving the most comments related to state preemption and whether a prospective investor's maximum investment in any individual Tier 2 offering should be capped at an amount equal to 10% of the greater of the investor's net worth or annual income. He added that no definite timeline has been set for finalization.

B. Investor Advisory Committee

On April 10, 2014, the IAC held a meeting where it put forth six recommendations related to the SEC's crowdfunding rules. The recommendations address: 1) the amounts of money an investor can invest in crowdfunding; 2) strengthening enforcement mechanisms on investment limits; 3) clarifying and strengthening the obligations of crowdfunding intermediaries to ensure compliance by issuers with the crowdfunding title and relevant regulations; 4) ensuring that educational materials clearly convey the required information and are reviewed and, to the degree possible, understood by investors; 5) withdrawal of the proposed definition of electronic delivery; and 6) offering integration.

IV. DISCLOSURE EFFECTIVENESS

Mr. Higgins discussed the current project underway at the SEC to review the effectiveness of existing disclosure requirements in Regulations S-K and S-X. He shared the following observations with respect to this initiative:

- Each of the AD Groups is reviewing specific disclosures in Regulation S-K, including the Industry Guides, focusing on the business and financial disclosures that appear in Form 10-K and Form 10-Q.
- The Division's Office of Chief Counsel is reviewing Form 8-K requirements.
- The Division's Office of Chief Accountant is reviewing Regulation S-X, specifically those rules that require the filing of separate financial statements for entities other than the registrant, such as acquired businesses, equity method investees and guarantors.
- Also included in this effort is an assessment of whether there is overlap between the GAAP requirements in the footnotes to the financial statements and what the Commission's rules require. The Division will coordinate with, among others, OCA and the FASB on these efforts.
- The staff is currently accepting input from stakeholders. He referred to the Disclosure Effectiveness spotlight page on the SEC website.

Separate from possible rule-making, the staff is also seeking to make current disclosures more effective by highlighting actions that registrants can take proactively. Among a number of options available to registrants are: 1) eliminating redundancies by, for example, using cross references; and 2) ensuring that MD&A focuses on material matters rather than mechanically discussing each financial statement line item regardless of the materiality. The staff clarified that improving disclosure does not need to begin with a "blank page." The staff appreciates the difficulty and timing involved and recognizes that an iterative process may be more feasible. The staff also clarified that any thoughtful attempts to improve disclosure would not trigger a review or result in any additional comments.

V. 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 companies with conflict minerals (tantalum, tin, gold and tungsten) in their products to disclose by May 31, 2014 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 would have required resource extraction issuers to disclose certain payments made to the U.S. government or foreign governments in certain cases. The extractive industries payments rule has been vacated by a Federal Court.

On April 14, 2014, the US Circuit Court of Appeals for the District of Columbia (the Court) issued an opinion in the appeal addressing the SEC's Conflict Minerals Rule (the Rule). Although the Court upheld most aspects of the Rule, it found that the rule and the Dodd Frank Act violated the First Amendment to the extent that they require issuers to report to the SEC and to state on their Web sites when their products have not been found to be free of conflict minerals from the Democratic Republic of the Congo and adjoining countries that benefited armed groups.

On April 29, the Division released a statement that provides guidance about the staff's expectations for companies that must comply with the Rule noting that the SEC expects companies to file Form SD and the disclosures required by the Rule on or before the June 2, 2014, due date for 2013 reporting (May 31, 2014 fell on Saturday). On May 2, the Commission issued an order staying the effective date for compliance with the portions of Exchange Act Rule 13p-1 and Form SD that would require statements by issuers that the Court held would violate the First Amendment.

Mr. Higgins noted that approximately 1,300 companies filed Form SD, and the staff will determine whether additional implementation guidance is necessary. He also noted that registrants should not expect staff reviewers to automatically ask registrants why they have not filed a Form SD.

VI. CYBERSECURITY ROUNDTABLE

On March 26, 2014, the SEC held a roundtable to discuss cybersecurity and the issues and challenges it raises for market participants. The roundtable panelists discussed various topics, including the current cybersecurity landscape, issues faced by market systems, including stock exchanges, public company disclosures, and issues faced by broker-dealers, investment advisers and transfer agents.

Mr. Higgins noted that one of the key take-aways from the roundtable is the difficulties registrants face in providing disclosures about the adequacy of preventive actions taken to reduce cybersecurity risks without making the company vulnerable to cyber threats. He referenced the October 2011 *CF Disclosure Guidance: Topic 2, Cybersecurity*, which lays out Division's views regarding disclosure obligations relating to cybersecurity risks and cyber incidents. The staff will continue to review registrant disclosures.

VII. CURRENT FINANCIAL REPORTING MATTERS

Mr. Kronforst and Ms. Shah provided the following update.

A. Earnings Per Unit Within MLP's (Master Limited Partnership)

An MLP is a type of limited partnership in which the entity's partnership units are available to investors and traded on public exchanges similar to corporate

stock. The equity of an MLP usually consists of (1) a general partner (GP) interest, who typically holds a small percentage of the outstanding partnership units and manages the operations of the partnership and (2) limited partner (LP) interests, who provide capital and hold most of the ownership but have limited influence over the operations. The MLP as a business structure is often used by energy-related companies.

Typically, in connection with the initial public offering of an MLP, a parent company (also the GP) contributes certain businesses and/or assets to the MLP at formation. Subsequent to the IPO, the parent/GP may contribute additional businesses to the MLP. Because those subsequent contributions are accounted for under ASC 805, *Business Combinations*, as reorganizations of entities under common control, the MLP's financial statements are retrospectively revised to include the assets, liabilities, revenues and expenses of the contributed businesses for all periods for which they were under common control with the parent/GP. In recent reviews of MLP filings, the staff has raised questions about MLP calculations of earnings per unit (EPU) in the retrospectively revised historical financial statements subsequent to the contribution of an additional business.

In practice, following the contribution of a business, an MLP typically does not retrospectively revise earnings used in calculating EPU (the numerator) to reflect the revised earnings presented in the income statement. This presentation of an MLP's EPU stems from an analogy to the two-class method of calculating EPS under GAAP on the basis that the historical earnings generated by the newly contributed business were not available to holders of LP interests prior to the date of contribution. An alternative computation of an MLP's EPU is retrospectively adjusted to include historical earnings related to the newly contributed business consistent with requirements to retroactively adjust financial statement information. Given the differing views on the computation, the EITF has been asked to address this accounting issue.

At the meeting, the staff indicated that it would not object to additional supplemental disclosure of retroactively adjusted EPU outside of the financial statements.

VIII. CURRENT PRACTICE ISSUES

A. Income Statement Presentation for REITs upon adoption of ASU 2014-08, Reporting Discontinued Operations

Rule 3-15 of Regulation S-X identifies certain income statement presentation requirements for a REIT. Specifically, under S-X Rule 3-15, a "gain or loss on sale of properties" should be presented after income or loss before extraordinary items and cumulative effects of changes in accounting principles. In other words, income from continuing operations is presented exclusive of any gain or loss on

sale. In addition Section 2355 of the Division's Financial Reporting Manual (FRM) notes that REITs should follow S-X Rule 3-15 when sales of properties do not qualify as discontinued operations.

Prior to the issuance of the new accounting standard on discontinued operations (ASU 2014-08) in April 2014, US GAAP financial statements often resulted in the same presentation as S-X Rule 3-15 because the gain or loss on sale of most real estate properties was presented as discontinued operations, i.e. presented below income from continuing operations. That result stemmed from the fact that sales of many real estate properties met the US GAAP definition of a discontinued operation. However, the new standard changes the definition of a discontinued operation (see ASC 205-20-45-1A through 1C, as amended by ASU 2014-08).

Upon adoption of ASU 2014-08, property sales will less often meet the definition of a discontinued operation and REITs will need to consider the classification of gains and losses on sales of property.

The Committee discussed with the staff how registrants should comply with the requirements of S-X Rule 3-15 given its inconsistency with US GAAP. The staff noted that based on current guidance, it will not object to a REIT's presentation as long as the approach is clear to investors and complies with US GAAP or S-X Rule 3-15.

B. Complying with S-X Rule 3-12 in connection with a registration statement on Form 10 which becomes effective automatically

A Form 10 filed pursuant to Section 12(g) of the Exchange Act automatically becomes effective 60 days after the initial filing (or earlier if acceleration is requested and granted). A Form 10 filed pursuant to Section 12(b) of the Exchange Act automatically becomes effective 30 days after certification by the applicable exchange (or earlier if acceleration is requested and granted). Rule 3-12 of Regulation S-X addresses the age of financial statements in a registration statement or proxy and requires that the financial statements in a registration statement be updated at the effective date if certain conditions are met.

FRM 1220.9 states that the "[a]ge of financial statements [for a Form 10] is based on the effective date of the filing." Given that a Form 10 may go effective automatically (and independent of the filing of an amendment), it is not clear whether a registrant is required to file an amendment to the Form 10 to comply with S-X Rule 3-12 at the effective date or whether the registrant may comply with S-X Rule 3-12 by filing the applicable Exchange Act report (e.g., Form 10-Q).

The Committee asked the staff how a registrant should update its financial statements in a Form 10 at the effective date to comply with S-X Rule 3-12. The

staff noted that S-X Rule 3-12 requires that the registrant's Form 10 must be current as of the effective date.

C. Use of a "To-Be-Issued" Audit Report

In certain situations, a registrant's financial statements included in a registration statement may reflect a transaction that has not yet occurred but (a) will occur just prior to or at effectiveness and (b) will be reflected retrospectively in the historical financial statements in accordance with US GAAP. Examples are a stock split or a legal reorganization. In those circumstances, the staff will commence a review of a registration statement that includes a "to-be-issued" audit report on financial statements that have already been revised to reflect the transaction retrospectively (see FRM Section 4710).

The FRM guidance cites specific examples of when such a draft report may be used but indicates that use of a draft report is not limited to these events. The Committee asked the staff whether a registration statement including a to-be-issued audit report and the related retrospectively revised financial statements might be reviewed in a situation where a registrant has a component that qualifies as a discontinued operation before an initial registration statement is filed but after the date of the latest balance sheet included in the initial filing.

In order to qualify, the following must be completed prior to the initial filing: 1) the disposal of the discontinued operation has occurred; 2) the audit of the financial statements, including the retrospective revision; and 3) registrant consultation with the appropriate Assistant Director group.

D. Impact of New Revenue Recognition Standard on Disclosures Outside of the Financial Statements

On May 28, 2014, the FASB and the IASB issued a new accounting standard, Accounting Standards Update 2014-09, *Revenue from Contracts with Customers*, which is intended to improve and converge the financial reporting requirements for revenue from contracts with customers. The new standard is effective for annual and interim periods in fiscal years beginning after December 15, 2016, for public business entities applying U.S. GAAP and for annual periods beginning on or after January 1, 2017, for entities applying IFRS. Early adoption is permitted only under IFRS. An entity may choose to adopt the new standard either retrospectively or through a cumulative effect adjustment as of the start of the first period for which it applies the new standard.

At its June 18, 2013 meeting, the Committee discussed with the staff several areas outside of the financial statements that may be affected by the new revenue recognition standard, including (a) disclosure required by SAB 74 ("Disclosure of the impact that recently issued accounting standards will have on the financial statements of the registrant when adopted in a future period," SAB Topic 11-M),

(b) disclosure in MD&A if a registrant uses the modified retrospective transition method, and (c) disclosure in the five-year selected financial data table. The staff indicated that it will consider each of these areas and evaluate reasonable alternatives for providing disclosure. The staff noted that it would also consider whether to provide guidance about these and other affected disclosures.

As the revenue recognition standard was issued on May 28, 2014, at the June 25, 2014 meeting the Committee revisited these issues with the staff. The staff noted that it is close to finalizing guidance that will address whether the staff will provide relief to the disclosure requirements for the five-year selected financial data table if the new standard is adopted retrospectively.