

SEC Regulations Committee
March 21, 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
Brad Davidson
Christine Davine
Jackson Day
Tom Elder
Liz Gantnier
Greg Giugliano
Bridgette Hodges
Matthew Kurzweil
Jeff Lenz

Scott Pohlman
Amy Ripepi
Sharon Virag

B. Securities and Exchange Commission

Division of Corporation Finance (Division)

Mark Kronforst, Chief Accountant
Craig Olinger, Deputy Chief Accountant
Nili Shah, Deputy Chief Accountant
Patricia Armelin, Associate Chief Accountant
Jill Davis, Associate Chief Accountant
Todd Hardiman, Associate Chief Accountant (via teleconference)
Lindsay McCord, Staff Accountant (CF-OCA rotator)
Ryan Milne, Associate Chief Accountant
Kyle Moffatt, Associate Director
Leslie Overton, Associate Chief Accountant (via teleconference)
Mark Shannon, Associate Chief Accountant
Mark Green, Senior Special Counsel

Division of Enforcement

Michael Maloney, Chief Accountant (present for part of the meeting)

C. Center for Audit Quality

Annette Schumacher Barr

D. Guests

Keisha Hutchinson, KPMG

II. DIVISION OF CORPORATION FINANCE PERSONNEL AND ORGANIZATIONAL UPDATE

Mark Kronforst, Chief Accountant of the Division, discussed personnel changes in the Division. Specifically, Nili Shah now oversees CF-OCA's consultations with the following four Assistant Director (AD) groups: Consumer Products (AD 2) (assigned to Tricia Armelin), Manufacturing and Construction (AD 6) (assigned to Ryan Milne), Electronics and Machinery (AD 10) (assigned to Tricia Armelin) and Telecommunications (AD 11) (assigned to Jill Davis), in addition to her responsibilities for various policy/training matters. Craig Olinger oversees CF-OCA's consultations with the remaining eight AD groups. Mr. Kronforst also noted that Lindsay McCord is currently participating in the Division's Rotation Program and serves as the liaison for Financial Services I (AD 7).

III. CURRENT FINANCIAL REPORTING MATTERS

A Financial Reporting Manual

On February 6, 2014, the Division staff updated the Financial Reporting Manual (FRM). This edition revised the guidance in section 9520 related to disclosures about critical accounting estimates for share-based compensation in initial public offerings (IPOs), directing registrants to focus disclosures on the methods used to determine the fair value of the company's shares, the nature of the material assumptions involved, and the extent to which the estimates are considered highly complex. Committee members reported that registrants have inquired about the consequences of reducing disclosures, particularly the potential for more SEC staff comments in review. For example, Mr. Kronforst referred to comments he recently made at a conference where he noted that the Division is still very focused on valuation of the share-based compensation awards and may still issue comments requesting additional information. As indicated in the FRM, however, these comments are intended as a means for the SEC staff to better understand the appropriateness of the registrant's accounting for the share-based compensation and not necessarily a request for additional disclosure.

Mr. Kronforst also indicated that, in the future, the FRM will be updated as needed for changes that the staff deems material and not on a set quarterly schedule. The SEC staff understands the value of the FRM to registrants and wants to simplify and streamline the internal updating process. Committee members noted that the FRM provides valuable implementation guidance for registrants and their professional advisors.

B. Definition of a Public Business Entity

On December 23, 2013, the FASB issued ASU 2013-12: *Definition of a Public Business Entity: An Addition to the Master Glossary* which provided a broad new definition of a public business entity (PBE) to be used to determine whether an entity would be included within the scope of the *Private Company Decision-Making Framework: A Guide for Evaluating Financial Accounting and Reporting for Private Companies* and for purposes of other private company relief (e.g., disclosure, transition, effective date differences) that the FASB provides in new standards. At the September 25, 2013 meeting the Committee discussed with the SEC staff several potential practice issues that the definition proposed at that time raised. The SEC staff noted at the September 2013 meeting that it would continue to monitor developments and determine whether any further guidance would be necessary based on the final definition adopted by the FASB.

The final definition designates "other entities whose financial statements or financial information are required to be or are included in a filing [with the SEC]" as public business entities, and the accompanying basis for conclusions

specifically references financial statements included in a filing with the SEC under Rule 3-09 of Regulation S-X. The definition also encompasses financial statements or financial information provided, for example, under S-X Rules 3-05, 3-10(g), 3-14 (including lessees of triple-net-leased properties), 3-16, 4-08(g), 8-04, 8-06, 8-07 and 10-01(b)(1) as well as Article 11 and various SEC registration statement and proxy statement requirements. In addition, entities that issue securities under the SEC's recently proposed rules for crowdfunding and amendments to Regulation A would meet the definition of a PBE.

The Committee noted that many of the reporting requirements cited above rely on the performance of significance calculations to determine if a specific rule applies. The Committee asked the staff whether a registrant could use the financial statements of an "other entity" (e.g., acquiree or investee) that were prepared using private company alternatives when calculating significance or if the registrant would be required to use financial data based on using public company requirements (even if they needed to be prepared solely for the purpose of performing the significance test).

The SEC staff indicated that if registrants are required to perform the tests using U.S. GAAP information, then the tests could not be performed using information of the "other entity" that applies the accounting alternatives developed by the PCC. The SEC staff indicated that the development of private company GAAP has not changed any existing SEC compliance practices.

The SEC staff added that they are interested in hearing about implementation and application issues related to these matters as they arise.

C. Sustainability Disclosures

The Committee asked the staff to share its views regarding sustainability disclosures which are being advocated by third parties (e.g., the Sustainability Accounting Standards Board (SASB)).

Mr. Kronforst noted that form requirements and the existing rules and regulations as well as the U.S. Supreme Court's views on materiality continue to be the sources of the SEC's disclosure requirements.

IV. CAPITAL FORMATION INITIATIVES

A. Crowdfunding and Regulation A Rule Proposals

- **Crowdfunding**

The SEC recently [proposed rules](#) that would allow startups and other small businesses to raise small amounts of equity capital from potentially large

pools of investors through the internet in a process known as “crowdfunding.” The rules were mandated by the Jumpstart Our Business Startups Act (JOBS Act). The SEC has received numerous comments on the proposed crowdfunding rules, particularly about the proposed thresholds that would require varying forms of financial reporting and assurance. The SEC staff noted no definite timeframe for finalization has been set.

- **Regulation A**

The SEC proposed amendments to Regulation A, as required by the JOBS Act, which would exempt certain offerings of up to \$50 million of securities annually from the registration requirements of the Securities Act. The SEC staff noted that they are in the process of reviewing the comment letters and no definite timeline has been set for finalization.

The SEC staff noted that Chair White has indicated that both proposed rules are a priority for 2014.

[Note: Subsequent to the meeting, the CAQ submitted its comment letter on the Regulation A proposal. It can be found at <http://www.sec.gov/comments/s7-11-13/s71113-60.pdf>.]

B. Disclosure Effectiveness

The SEC staff completed its study of the disclosure requirements in Regulation S-K as mandated by the Jumpstart Our Business Startups Act (JOBS Act). The JOBS Act required the SEC to (1) comprehensively analyze the current requirements of Regulation S-K and (2) determine how those requirements could be modernized to simplify the SEC’s registration process and reduce the cost of compliance for EGCs. The SEC expanded the study to cover all public companies, not just emerging growth companies.

In a recent speech, Chair Mary Jo White said that in the current year, the SEC staff will be focused on making specific recommendations for updating the rules that govern public company disclosure, and as a part of this effort, the Division will be broadly seeking input from companies and investors about how it can make the disclosure rules work better. Specifically, investors will be asked what type of information they want, when they want it and how companies can most meaningfully present that information.

The Committee asked the SEC staff about next steps and timing. The SEC staff indicated additional information will be announced in relatively soon.

[Note: Subsequent to the meeting, Keith F. Higgins, Director of the Division of Corporation Finance, addressed disclosure effectiveness in his remarks before the American Bar Association Business Law Section Spring Meeting on

April 11, 2014. These remarks can be found at:
<http://www.sec.gov/News/Speech/Detail/Speech/1370541479332>]

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 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 requires resource extraction issuers to disclose certain payments made to the U.S. government or foreign governments in certain cases. This rule has been vacated by a Federal Court.

The SEC staff stated that they have no new information to provide about these rules.

[Note: Subsequent to the meeting, the SEC issued a partial stay of 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 of Appeals held would violate the First Amendment. The SEC also issued a statement on the effect of the Court of Appeals decision.]

B. Enforcement

Mr. Kronforst introduced Michael Maloney, Chief Accountant of the Enforcement Division. Mr. Maloney recently joined the SEC and has experience in public accounting, litigation support and forensic accounting. Mr. Maloney indicated that due to his recent arrival his particular areas of focus were still developing. However, he noted that in his past experience certain areas (e.g., revenue recognition, acquisition accounting, related party disclosures, variable interest entities, and off balance sheet transactions) demonstrate recurring instances of accounting and reporting problems. He also noted that new focus areas are driven in part by trends, based on what is going on in the economy. For example, as a result of the ongoing state of the banking industry, the allowance for loan losses has been a focus area.

VI. CURRENT PRACTICE ISSUES

A. Dividends per Share on the Face of the Annual Income Statement

The Committee discussed with the SEC staff potential confusion regarding the presentation of dividends per share on the face of a registrant's annual income statement. The SEC staff has issued comments asking registrants to disclose this information in the notes to the financial statements citing ASC 260-10-45-5, which states:

“Per-share amounts not required to be presented by this Subtopic that an entity chooses to disclose shall be computed in accordance with this Subtopic and disclosed only in the notes to financial statements; it shall be noted whether the per-share amounts are pretax or net of tax.”

However, dividends per common share are required to be presented on the face of interim income statements under Rule 10-01(b)(2) of Regulation S-X. In addition, there is an annual requirement to disclose dividends per share on the shareholders' equity statement under Rule 3-04 of Regulation S-X.

The SEC staff noted that it will not object to registrants presenting dividends per share on the face of the annual income statement.

B. Due dates for lessee/tenant financial statements to be included in Form 10-K when the registrant has triple net leased one or more properties to a single lessee/tenant and such properties represent a significant portion of the registrant's assets

FRM 2340 states that a registrant should generally provide audited financial statements of a lessee/tenant (in the registrant's Form 10-K) if the registrant has a significant asset concentration due to one or more properties being triple net leased to a single lessee/tenant. The FRM does not specifically address the timing of when the lessee/tenant's financial statements would be required to be filed. The Committee discussed with the SEC staff whether the SEC staff will permit registrants to provide the financial statements of the lessee/tenant by analogizing to the filing schedule of a significant equity method investee under Rule 3-09 of Regulation S-X. The SEC staff indicated that this approach would be acceptable. For example, if the lessee/tenant is a private company with a calendar year end (i.e., a non-accelerated filer), and the registrant is a calendar year-end large accelerated filer, the registrant may file its Form 10-K within 60 days after year-end without the audited financial statements or any other financial information of the lessee/tenant but the registrant would be required to file the lessee/tenant's audited financial statements as an amendment to the Form 10-K within 90 days after year-end.

C. Pro Forma Condensed Income Statement Presentation of the Comparative Interim Period

The SEC staff addressed a question from the Committee about guidance in FRM 3230.2 about pro forma presentations for discontinued operations that are not yet reflected in a registrant's annual historical financial statements or for a reorganization of entities under common control.

The SEC staff confirmed that when pro forma income statements are provided in a filing for all periods presented by the registrant, pro forma income statements would only be required for the annual periods and subsequent interim period. A registrant may, but is not required to, provide a pro forma income statement for the comparative interim period.

D. Retrospective revision of previously issued annual financial statements in connection with an abbreviated registration statement filed pursuant to Securities Act Rule 462(b)

Rule 462(b) of the Securities Act is sometimes used to upsize a securities offering, if certain conditions are met, by filing an abbreviated registration statement that becomes effective immediately upon filing. For example, in a delayed primary offering using Form S-3, Securities Act Rules CDI 244.03 indicates that Rule 462(b) can be used in connection with a final take-down of all of the securities from a shelf registration statement and that upsizing via the Rule 462(b) registration statement is only available once per delayed shelf registration statement.

As indicated in Securities Act Rules CDI 244.02, other than price-related information, an abbreviated registration statement filed pursuant to Rule 462(b) may not contain any information other than the cover page, the page incorporating the earlier registration statement by reference, the required signatures and any additional opinions and consents required as exhibits.

Securities Act Rules CDI 244.06 states that financial statements incorporated by reference in a Rule 462(b) registration statement are not subject to the age of financial statements updating requirements in Rule 3-12 of Regulation S-X, as long as the financial statements complied with Rule 3-12 in the original effective registration statement for the offering. However, a registrant should consider whether more current information would be required to be disclosed to make the information in the registration statement not misleading.

Topic 13 of the FRM includes guidance regarding the effects of material subsequent events (e.g., discontinued operation, change in reportable segment, change in or the adoption of a new accounting principle) on financial statements required to be included or incorporated by reference in registration statements.

Under Item 11 of Form S-3 (or otherwise pursuant to SEC rules and regulations) a registrant must revise its “pre-event” annual financial statements that are incorporated by reference into a new registration statement or post-effective amendment after it files post-event financial statements that reflect a material change in accounting principle requiring retrospective application of GAAP (or, consistent with staff practice, a material discontinued operation or material change in reportable segments). The Committee asked the SEC staff if the same requirement applies to an abbreviated registration statement filed pursuant to Rule 462(b). The Committee observed that, based on reading the FRM, Form S-8 appears to be the only new registration statement that is permitted to go effective without revised financial statements for a material retrospective application of GAAP provided that the registrant determines that there has not been a material change and the auditor issues a consent to the use of its report in the Form S-8 on the financial statements in the Form 10-K that have not been retroactively restated.

The SEC staff noted that the guidance in Topic 13 is not intended to suggest that a registration statement filed pursuant to Rule 462(b) is subject to the same requirements as other registration statements, including Forms S-3 or even S-8. Registrants should refer to the contents of Rule 462(b) and the related interpretive guidance provided in the CDI when determining whether financial statements need to be revised.

E. Application of Rule 4-08(g) of Regulation S-X when separate financial statements of a significant investee are provided and remaining investees, in the aggregate, are less than 10% significant

Rule 4-08(g) of Regulation S-X requires a registrant to present summarized financial information in its annual financial statement footnotes for all of its equity method investees when significance, individually or in the aggregate, exceeds 10% (20% for smaller reporting companies). When separate financial statements of a significant equity method investee are provided to satisfy Rule 3-09 of Regulation S-X (or are otherwise provided, if considered material for investors) at the same time the financial statements are filed, SAB Topic 6K.4.b states that the summarized financial information for such investee may be excluded from the 4-08(g) disclosure. In that circumstance, the 4-08(g) disclosure would generally be included for all remaining investees.

The SAB Topic referred to above provides that a registrant cannot arbitrarily exclude summarized information for individual entities solely because the aggregate information for the omitted entities does not exceed a 10% level. However, the SAB acknowledges that the exclusion of summarized information for certain entities is appropriate where it is impracticable to accumulate the information and the omitted information is de minimis.

In some circumstances, financial statements of a significant equity method investee under Rule 3-09 are filed at the same time as the registrant's Form 10-K and the summarized financial information for the 3-09 entity is excluded from the 4-08(g) disclosure. For example:

Entity	Highest Significance	Rule 3-09 FS Provided	Rule 4-08(g) Disclosure
Investee A	35%	Yes	N/A
Investee B	2%	N/A	Yes
Investee C	3%	N/A	Yes
Investee D	1%	N/A	Yes
Total	41%	35%	6%

The Committee asked the SEC staff if the separate financial statements of Investee A are provided at the same time as the registrant's Form 10-K, may the registrant exclude the Rule 4-08(g) disclosure in its entirety if the registrant believes that such disclosure is not material and significance of the remaining investees does not exceed 10% (in the aggregate) or may it only exclude those entities where it is impracticable to accumulate the information and the omitted information is de minimis.

The SEC staff noted that it would not object to the exclusion of the Rule 4-08(g) disclosure in the fact pattern above.

F. Individually Insignificant Real Estate Acquisitions Acquired During the Year

The SEC staff revised Section 2320.2 of the FRM to eliminate a registrant's need to consider individually insignificant real estate properties acquired during the most recently completed fiscal year when aggregating properties for significance under Rule 3-14 of Regulation S-X.

In response to a question from the Committee, the SEC staff indicated that while Rule 3-06 of Regulation S-X does not apply to acquired real estate operations, the second sentence of Section 2330.5 in the current version of the FRM is no longer applicable because there is no need to provide accommodation for individually insignificant acquisitions that are included in the registrant's audited financial statements for at least nine months (as it is no longer required to be evaluated for significance for a registration statement after the registrant's financial statements for that year have been filed).