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November 15, 2018

By email: rule-comments@sec.gov

U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: File Number S7-19-18: Financial Disclosures About Guarantors and Issuers of Guaranteed Securities and Affiliates Whose Securities Collateralize a Registrant's Securities; Release No. 33-10526; 34-83701

Dear Office of the Secretary:

The Center for Audit Quality ("CAQ") is an autonomous public policy organization dedicated to enhancing investor confidence and public trust in the global capital markets. The CAQ fosters high quality performance by public company auditors; convenes and collaborates with other stakeholders to advance the discussion of critical issues requiring action and intervention; and advocates policies and standards that promote public company auditors' objectivity, effectiveness, and responsiveness to dynamic market conditions. Based in Washington, D.C., the CAQ is affiliated with the American Institute of CPAs. This letter represents the observations of the CAQ but not necessarily the views of any specific firm, individual, or CAQ Governing Board member.

The CAQ appreciates the opportunity to share our views and provide input on the Securities and Exchange Commission's ("Commission" or "SEC") Proposed Rule, *Financial Disclosures About Guarantors and Issuers of Guaranteed Securities and Affiliates Whose Securities Collateralize a Registrant's Securities* (the "proposal" or the "Proposed Rule").

The comments included in this letter focus on the overall objective of the proposal as well as aspects of the proposal that are expected to affect the public company auditing profession.

Overall objective of the Proposed Rule

The CAQ supports the Commission's Disclosure Effectiveness Initiative, including its efforts in the Proposed Rule to amend Rules 3-10¹ and 3-16,² and we

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¹ Regulation S-X, Rule 3-10, *Financial Statements of Guarantors and Issuers of Guaranteed Securities Registered or Being Registered.*

² Regulation S-X, Rule 3-16, *Financial Statements of Affiliates Whose Securities Collateralize an Issue Registered or Being Registered.*

appreciate the Commission's thoughtful consideration of the input provided in our [November 25, 2015 comment letter responding to the Commission's Request for Comment on the Effectiveness of Financial Disclosures about Entities Other than the Registrant](#) as it formulated the proposal. We believe that the proposal has the potential to achieve the Commission's intention to better align the disclosure requirements with the needs of investors by providing them with material information based on specific facts and circumstances in a more understandable manner. In addition, we believe the proposed amendments could reduce the compliance burden by streamlining the requirements for preparers.

Parent company's method of excluding non-obligated subsidiary financial information

The proposal indicates that financial information of non-obligated subsidiaries should be excluded from the Summarized Financial Information³ of the issuers and guarantors (together, "Obligor Group") using any method which "best meets the objective" and "is reasonable in the circumstances." Rather than allowing the parent company to apply any method, we believe that the Commission should limit the appropriate methods for presenting financial information of non-obligated subsidiaries to those that incorporate concepts that are consistent with U.S. Generally Accepted Accounting Principles (GAAP) or, if applicable, International Financial Reporting Standards (IFRS).

We support the provision in the Proposed Rule that would require the method selected be disclosed and applied consistently for all non-obligated subsidiaries for all classes of securities for which disclosure is required. Additionally, we believe that disclosure should separately quantify amounts related to non-obligated subsidiaries that are included in the Summarized Financial Information of the Obligor Group (e.g., the portion of Obligor Group's total assets attributable to its investment in the non-obligor group). This incremental disclosure should apply to both balance sheet and income statement information.

Proposed addition of Rule 13-01(a)(5) and Rule 13-02(a)(5)

Existing Rule 3-10(i)(11) indicates that a registrant's disclosures may not omit any financial or narrative information about each guarantor if that information would be material to investors to *evaluate the sufficiency of the guarantee(s)*. Proposed Rules 13-01(a)(5) and 13-02(a)(5) appear to provide a broader requirement; they would require the disclosure of *any quantitative or qualitative information that would be material to making an investment decision* with respect to the guaranteed or collateralized security.

The CAQ believes that the additional disclosures contemplated by proposed Rule 13-01(a)(5) and Rule 13-02(a)(5) may go beyond the requirements in Exchange Act Rule 12b-20 and S-X Rule 4-01(a) as well as existing S-X Rule 3-10(i)(11). We believe the proposed disclosure requirements in Rule 13-01(a)(5) and Rule 13-02(a)(5) may be too broad to be operational and would be particularly challenging to audit given they would require an evaluation of materiality that is inconsistent with how management and auditors consider the materiality of disclosures in the context of the financial statements taken as whole.

Location of the proposed disclosures

Generally, disclosures included *inside* the consolidated financial statements and related Article 12 schedules are required to be audited or reviewed as specified in Regulation S-X. Alternatively, if disclosures are included *outside* of the consolidated financial statements and related schedules, the auditor's responsibility with respect to such information does not extend beyond the financial information identified in its report, and the auditor has no obligation to perform any procedures to corroborate other information contained in a

³ As defined in Rule 1-02(bb)(1) of Regulation S-X.

document. As such, the auditor is only required to read the other information and consider whether such information, or the manner of its presentation, is materially inconsistent with information, or the manner of its presentation, appearing in the financial statements.⁴

In the proposal, the Commission asks whether it should permit supplemental financial and non-financial disclosure about the subsidiary issuers and/or guarantors and the guarantees (“Proposed Alternative Disclosures”) to be placed outside of the parent’s financial statements. Investors and other financial statement users (stakeholders) may benefit if such disclosures are included inside the financial statements because they would be subject to audit/review requirements. However, we believe the location of the Proposed Alternative Disclosures (and whether the information is audited/reviewed) should be decided considering the needs of stakeholders. We encourage the Commission to consider input received from stakeholders, including input obtained in the comment process, to determine the location of such information. Stakeholders are best positioned to determine the level of assurance they desire on this information, and the public company auditing profession stands ready to provide such services.

If, based on input from stakeholders, the Commission concludes that this information should be audited, we recommend this information be included in an audited supplemental schedule, such as those required by Article 12 of Regulation S-X, rather than the general-purpose financial statements, because the disclosure may only be of interest to holders of the guaranteed securities. While Article 12 schedules are currently only required annually, the Commission could require this schedule on an interim basis if it concludes such information is necessary on an interim basis in all or certain circumstances.


Transition guidance

We encourage the SEC to consider including detailed transition guidance in the final rule that addresses how the effective date should be contemplated by registrants currently providing separate financial statements or condensed consolidating information in their Exchange Act reports as well as for new registration statements filed after the effective date.

* * *

We appreciate the opportunity to comment on the questions raised in the proposal. As the Staff and Commission gather feedback from preparers, users and other interested parties, we would be pleased to discuss our comments or answer any questions that the Staff or Commissioners may have regarding the views expressed in this letter.

Sincerely,



Cynthia M. Fornelli
Executive Director
Center for Audit Quality

⁴ PCAOB Auditing Standard (AS) 2710, *Other Information in Documents Containing Audited Financial Statements*.

cc:

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