

SEC Regulations Committee
March 31, 2015 - Joint Meeting with SEC Staff
SEC Offices – Washington DC

HIGHLIGHTS

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I. ATTENDANCE

SEC Regulations Committee	Securities and Exchange Commission	Observers and Guests
John May, Chair	<i>Division of Corporation Finance (Division)</i>	Annette Schumacher
Christine Davine, Vice-Chair	Mark Kronforst, Chief Accountant	Barr, CAQ Observer
Janie Copeland	Craig Olinger, Deputy Chief Accountant	Todd Kosel, PwC
Brad Davidson	Nili Shah, Deputy Chief Accountant	
Melanie Dolan	Patricia Armelin, Associate Chief Accountant	
Fred Frank	Jessica Barberich, Senior Staff Accountant – OCA	
Liz Gantnier	Rotator	
Greg Giugliano	Louise Dorsey, Associate Chief Accountant	
Bridgette Hodges	Jamie Kessel, Senior Staff Accountant – OCA Rotator	
Steven Jacobs	Cicely LaMothe, Associate Director	
Jeff Lenz	Austin Lee, Valuation Fellow	
Scott Pohlman	Lindsay McCord, Associate Chief Accountant	
Amy Ripepi	Ryan Milne, Associate Chief Accountant	
	Mark Green, Senior Special Counsel	
	Angela Crane, Office Chief, Disclosure Standards	
	<i>Office of the Chief Accountant</i>	
	Shelly Luisi, Senior Associate Chief Accountant	

II. DIVISION OF CORPORATION FINANCE PERSONNEL AND ORGANIZATIONAL UPDATE

Subsequent to the meeting, the Division of Corporation Finance's Office of Chief Accountant hired the following individuals as Associate Chief Accountants:

- Jessica Barberich, previously on rotation in CF-OCA.
- Pat Gilmore, previously an Accounting Branch Chief in AD 3, Information Technologies and Services
- Kevin Vaughn, previously an Accounting Branch Chief in AD 10, Electronics and Machinery.

III. CURRENT FINANCIAL REPORTING MATTERS

A. Revenue Recognition Standard

On May 28, 2014, the FASB and the IASB each issued a new accounting standard, Revenue from Contracts with Customers (Accounting Standards Update (ASU) 2014-09 and IFRS 15, respectively), intended to improve and converge the financial reporting requirements for revenue from contracts with customers. For public business enterprises that follow U.S. GAAP, the new standard is effective for annual periods beginning after December 15, 2016 and interim periods within those years (i.e., fiscal year 2017). Early application for those entities is not permitted. For all other entities (nonpublic entities) that follow U.S. GAAP the new standard is effective for annual periods beginning after December 15, 2017, and interim periods within annual periods beginning after December 15, 2018 (although adoption at an earlier date is permitted as set forth in the standard). For all entities applying IFRS as issued by the IASB, the new standard is required for annual periods beginning on or after January 1, 2017 and early adoption is permitted. Under both the FASB and IASB standards, 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.

[Note: On April 1, 2015, the FASB proposed to delay the effective date of ASU 2014-09 by one year but to permit entities to adopt on the original effective date if they choose. The proposed delay is not final, pending an exposure draft and public comment.]

At the Committee's September 23, 2014 Joint Meeting with the staff, the staff indicated that it would appreciate receiving input on the types of SEC reporting implementation questions that are arising. Subsequent to the meeting, the Committee provided a list of SEC reporting transition questions to the staff. This list included questions related to:

- Impact of adopting the standard via the full retrospective approach on areas such as:
 - significance testing for acquired businesses and equity method investees; and

- financial statement presentation requirements in connection with new or amended registration statements/proxy statements;
- MD&A presentation; and
- Specific impacts on “emerging growth companies” as that term is defined in securities laws.

The staff thanked the Committee for its efforts in identifying transition related issues. The staff noted that they are in the process of considering the questions raised and determining whether and, if so, how to communicate any views related to transition issues.

B. Reporting Implications of FASB’s New Consolidation Standard

On February 18, 2015, the FASB issued Accounting Standards Update No. 2015-02, Consolidation (Topic 810): Amendments to the Consolidation Analysis, which focuses on the consolidation evaluation for reporting organizations that are required to evaluate whether they should consolidate certain legal entities. The new standard is effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted. Additionally, the new standard may be applied retrospectively (in previously issued financial statements for one or more years) or by recording a cumulative-effect adjustment to equity as of the beginning of the fiscal year of adoption. In response to questions raised by the committee, the staff noted the following observations:

- Registrants who apply the new requirements retrospectively will need to assess the need to revise the historical financial statements in connection with a new or amended registration statement/proxy statement (e.g., pursuant to Item 11 of Form S-3).
- Registrants who adopt the standard retrospectively are not required to revise any periods not covered by their audited financial statements. For example, if the registrant has revised the most recent three years in its audited financial statements as a result of adopting the new standard, the registrant is not required to also revise the earliest two years in the selected financial data table.
- Item 2.01 of Form 8-K, Completion of Acquisition or Disposition of Assets, would not be triggered if the adoption of the standard requires the registrant to newly consolidate or deconsolidate an entity. However, if consolidation or deconsolidation occurs as the result of a reconsideration event *subsequent* to the initial adoption of the standard, registrants would need to consider the requirements of Item 2.01 of Form 8-K. See the Highlights from the June 2009 and June 2011 Joint Meetings and CAQ Alert 2010-20.
- If a registrant newly consolidates an entity as a result of the new standard, questions may arise about whether the registrant may exclude that entity from management’s assessment of internal control over financial reporting in the

initial year of consolidation. Although FAQ #3 from the SEC staff's "Management's Report on Internal Control Over Financial Reporting (ICFR) and Certification of Disclosure in Exchange Act Periodic Reports (Frequently Asked Questions)" was not drafted to specifically address consolidation of VIEs, registrants may analogize to this FAQ under appropriate facts and circumstances. One factor to consider when making this determination is the period of time between the adoption date of ASU 2015-02 and the date of management's assessment. The determination depends on a registrant's specific facts and circumstances and the staff encouraged discussion with the staff prior to filing.

C. Predecessor Financial Statements

The Committee and the staff discussed recent trends related to predecessor financial statements in spinoffs and IPOs. The discussion centered on financial reporting differences which can arise depending on the legal form of the transaction (e.g., contributing the capital stock of a legal entity to a Newco Registrant (with certain assets/liabilities/operations of that entity transferred out of the entity at or before the effective date of the related registration statement) versus contributing to a Newco Registrant just the assets/liabilities/operations that will be retained by the entity at the effective date).

The Committee and staff also discussed how registrants should evaluate who the predecessor is in put-together transactions where multiple entities that are roughly the same size are acquired by a Newco in a business combination in which Newco is the accounting acquirer. In this situation, the staff noted that it may not be readily apparent which entity or entities should be treated as the predecessor. The Staff also noted that the fact patterns it has seen have been unique, and in certain circumstances registrants have concluded that there is more than one predecessor.

D. Auditor Change Disclosures for Mandatory Audit Firm Rotation

Recently some foreign jurisdictions have adopted rules that mandate the periodic rotation of a public company's independent audit firm. Certain SEC filings require the disclosure of changes in auditor. However, these SEC requirements were not drafted in contemplation of mandatory auditor rotation. The Committee and staff discussed what the trigger is for purposes of reporting a change in auditor when the registrant is subject to mandatory audit firm rotation. The staff noted that they had not addressed this question previously and would welcome an opportunity to go through a live fact pattern.

IV. CURRENT PRACTICE ISSUES

A. Application of Regulation S-X Rule 3-14 in a Registration Statement

Rule 3-14 of Regulation S-X requires the presentation of financial statements for significant real estate operations acquired or to be acquired. Rule 3-14(a) indicates that Rule 3-14 financial statements are required if, during the period for which the registrant's income statements are required, the registrant has acquired one or more properties which in the aggregate are significant, or if, since the date of the registrant's latest balance sheet, the registrant has acquired or proposes to acquire one or more properties which in the aggregate are significant.

Paragraph 2310.1 of the Financial Reporting Manual (FRM) states "S-X 3-14 financial statements must be provided for each completed purchase of an individually significant property made *during each year presented*..." (emphasis added). Based upon the guidance in the FRM, in a registration statement, currently all acquisitions may be required to be assessed for significance under Rule 3-14, even those occurring during the third or second year back.

Unlike S-X Rule 3-05, S-X Rule 3-14 only requires the financial statements for a significant real estate operation for the most recent year and applicable interim period¹. For acquisitions occurring in the second or third year back, these real estate operations will be included in the registrant's audited financial statements for a full 12 months, which is the maximum period audited financial statements for the property would have been provided. Particularly for acquisitions during the third year back, this could result in pre-acquisition financial statements for the individually significant property that predate the registrant's financial statements.

The Committee asked the staff if it would permit registrants to provide financial statements under S-X Rule 3-14 for only those properties that have not been included in the registrant's audited financial statements for a full 12 months.

The staff noted that based upon the rule, in a registration statement, acquisitions that have occurred during any period presented are required to be assessed for significance under Rule 3-14. This includes evaluating the significance of acquisitions occurring during the third or second year back to determine whether pre-acquisition financial statements are required. This also requires that previously filed financial statements provided under Rule 3-14 continue to be included or incorporated by reference in registration statements until the property has been consolidated for the entire three-year period.

The staff added that if the application of Rule 3-14 results in a requirement to provide information that is not considered material to investors, then registrant should write in to the staff to discuss.

¹Assuming that the property was not acquired from a related party. See S-X, Rule 3-14(a)(1).

B. Applicability of Item 302(a) of Regulation S-K, *Selected Quarterly Financial Data*, in a non-IPO Form S-1 Registration Statement

Item 11 of Form S-1 requires companies to furnish the information required by Item 302 of Regulation S-K. Item 302(a) of Regulation S-K requires registrants (other than foreign private issuers and smaller reporting companies) with securities registered pursuant to Section 12(b) (other than mutual life insurance companies) or Section 12(g) of the Exchange Act to provide selected quarterly financial data for each full quarter within the two most recent fiscal years and any subsequent interim periods for which financial statements are included or are required to be included by Article 3 of Regulation S-X.

Section 1620.1 of the Financial Reporting Manual states that “a company is not required to furnish selected quarterly financial data in its *initial* registration statement under the Securities Act if it does not have any securities registered under Section 12(b) or 12(g) of the Exchange Act.” (emphasis added) Accordingly, companies sometimes do not furnish selected quarterly financial data in their IPO registration statement on Form S-1.

In many IPO situations, the registration statement under Section 12(b) or 12(g) (usually Form 8-A) becomes effective at the time the Form S-1 is declared effective. However, once the Exchange Act registration statement is effective, the question arises as to whether a company is required to provide selected quarterly financial data in connection with a “follow-on” registration statement on Form S-1 filed after the IPO.

The staff noted that if securities are registered under Section 12(b) or 12(g) at the time of the follow-on registration statement (and one of the exemptions referred to in S-K 302 is not applicable), then the instructions to Form S-1 require this information to be provided in that registration statement. Whether the registrant has filed its first Form 10-K is not relevant to the analysis.