

**SEC Regulations Committee**  
**September 23, 2014 - Joint Meeting with SEC Staff**  
**SEC Offices – Washington DC**

**HIGHLIGHTS**

**NOTICE:** The Center for Audit Quality (CAQ) SEC Regulations Committee meets periodically with the staff of the SEC to discuss emerging financial reporting issues relating to SEC rules and regulations. The purpose of the following highlights is to summarize the issues discussed at the meetings. These highlights have not been considered or acted on by senior technical committees of the AICPA and do not represent an official position of the AICPA or the CAQ. As with all other documents issued by the CAQ, these highlights are not authoritative and users are urged to refer directly to applicable authoritative pronouncements for the text of the technical literature. These highlights do not purport to be applicable or sufficient to the circumstances of any work performed by practitioners. They are not intended to be a substitute for professional judgment applied by practitioners.

In addition, these highlights are not authoritative positions or interpretations issued by the SEC or its staff. The highlights were not transcribed by the SEC and have not been considered or acted upon by the SEC or its staff. Accordingly, these highlights do not constitute an official statement of the views of the Commission or of the staff of the Commission.

As available on this website, Highlights of Joint Meetings of the SEC Regulations Committee and its International Practices Task Force (IPTF) and the SEC staff are not updated for the subsequent issuance of technical pronouncements or positions taken by the SEC staff, nor are they deleted when they are superseded by the issuance of subsequent highlights or authoritative accounting or auditing literature. As a result, the information, commentary or guidance contained herein may not be current or accurate and the CAQ is under no obligation to update such information. Readers are therefore urged to refer to current authoritative or source material.

**I. ATTENDANCE**

**A. SEC Regulations Committee**

Melanie Dolan, Chair  
John May, Vice-Chair  
Scott Bourgeois  
Christine Davine  
Tom Elder  
Liz Gantnier  
Greg Giugliano  
Bridgette Hodges  
Matthew Kurzweil  
Steven Jacobs  
Jeff Lenz

Steve Mezzio  
Scott Pohlman  
Amy Ripepi  
Sharon Virag

**B. Securities and Exchange Commission**

*Division of Corporation Finance (Division)*

Craig Olinger, Deputy Chief Accountant  
Nili Shah, Deputy Chief Accountant  
Patricia Armelin, Associate Chief Accountant  
Jessica Barberich, Senior Staff Accountant  
Jill Davis, Associate Chief Accountant  
Louise Dorsey, Associate Chief Accountant  
Todd Hardiman, Associate Chief Accountant  
Jamie Kessel, Senior Staff Accountant  
Lindsay McCord, Associate Chief Accountant  
Ryan Milne, Associate Chief Accountant  
Kyle Moffatt, Associate Director  
Mark Green, Senior Special Counsel

**C. Center for Audit Quality**

Annette Schumacher Barr  
Luba Dinits

**D. Guests**

Keisha Hutchinson, KPMG  
Todd Kosel, PwC  
Matthew Schell, Crowe Horwath

**II. DIVISION OF CORPORATION FINANCE PERSONNEL AND ORGANIZATIONAL UPDATE**

Ms. Shah provided the following personnel update for the Division:

- Associate Director Paul Belvin has retired after more than 15 years of service to the Commission;
- Associate Chief Accountant Mark Shannon left the Commission earlier this month after 7 years of service;
- Anne Parker has been named Assistant Director of AD Group 5 (Transportation and Leisure);

- Dan Gordon has been named Senior Assistant Chief Accountant of AD Group 8 (Real Estate and Commodities);
- Jamie Kessel and Jessica Barberich have joined CF-OCA on rotation from AD Group 9 (Beverages, Apparel and Mining); and AD Group 8, respectively.

### III. DISCLOSURE EFFECTIVENESS

At the [June 25, 2014 meeting](#), Mr. Higgins discussed the current project underway at the SEC to review the effectiveness of existing disclosure requirements. At the September 23, 2014 meeting the staff indicated that the staff is gathering input from a wide array of stakeholders. Comments may also be provided on <http://www.sec.gov/spotlight/disclosure-effectiveness.shtml>.

### IV. CURRENT FINANCIAL REPORTING MATTERS

#### A. Revenue Recognition Standard

On May 28, 2014, the FASB and the IASB issued a new accounting standard, [Revenue from Contracts with Customers](#) (Accounting Standards Update 2014-09 and IFRS 15, respectively), which is 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 time is permitted as set forth in the standard). For all entities applying IFRS as issued by the IASB, the new standard is effective for annual periods beginning on or after January 1, 2017. Early adoption is permitted for those entities. 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.

#### 1. Transition

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 would 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.

At a recent meeting of the Financial Accounting Standards Advisory Council, the staff stated that it will not object if registrants that apply the new revenue recognition standard retrospectively only apply it in their selected financial data tables to the periods covered by the financial statements. Further, the staff indicated that if the earlier years in the selected financial data table are not retrospectively adjusted, registrants must clearly disclose that fact.

## **2. Emerging Growth Companies**

The Committee also asked the staff whether an emerging growth company (EGC) that elects to follow accounting transition applicable to non-issuers (as permitted by the JOBS Act) would be able to adopt the new standard using the transition timing available to nonpublic entities (i.e., annual reporting periods beginning after December 15, 2017 and interim periods within annual periods beginning after December 15, 2018).

The staff noted that an EGC is not required to comply with new or revised financial accounting standards until a company that is not an issuer is required to comply with such standards, if such standards apply to companies that are not issuers. Therefore an EGC that has elected to follow non-issuer transition provisions would have the option to adopt the revenue standards using the transition applicable to a non-issuer.

The staff is considering whether an EGC that has elected to follow non-issuer transition provisions would be required to apply the new standard to the 2018 selected quarterly financial data included in its 2018 Form 10-K or for 2018 interim periods presented comparatively with interim periods in 2019.

## **3. Non-issuers under S-X Rule 3-05, S-X Rule 3-09 or S-X Rule 4-08(g)**

The Committee also inquired of the staff as to whether a non-issuer whose financial statements (e.g., S-X Rule 3-05 or S-X Rule 3-09) or financial information (e.g., S-X Rule 4-08(g)) are included in an SEC filing would be 1) required to adopt the new standard based on the requirements applicable to a public business enterprise (i.e., annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period), or 2) treated like an EGC for purposes of transition to the new standard (assuming they otherwise met the criteria for being considered an EGC).

The staff noted that a non-issuer whose financial statements (e.g., S-X 3-05 or S-X 3-09) or financial information (e.g., S-X 4-08(g)) are included in an SEC filing would not be considered an EGC. The staff noted that any special accommodations for non-issuers adopting the new revenue standard would be considered on a case-by-case basis.

The staff also indicated that it would appreciate receiving input on the types of SEC reporting implementation questions that are arising in practice. The Committee agreed to aggregate and provide that information to the staff. The staff noted that they will focus on issues that are broad based, and will consider whether additional guidance is necessary.

## **B. Presenting Combined Financial Statements For a Merger of Entities Under Common Control in an IPO When The Combination Occurs After Effectiveness**

Section 13410.3 of the SEC’s Financial Reporting Manual states:

“In an initial registration statement, if a change in the reporting entity or a reorganization will occur at or after effectiveness of the registration statement but no later than closing of the IPO, the staff will consider requests to present consolidated or combined financial statements as the primary financial statements of the registrant in lieu of the separate financial statements of the registrant and of the entities to be reorganized based on the particular facts and circumstances.”

The Committee asked the staff whether the staff expects registrants to “preclear” presentation of combined financial statements if the combination does not occur until at or after effectiveness.

The staff observed that a registration statement speaks as of the date of effectiveness, and the composition of the financial statements of the registrant at that date should be carefully considered. The staff noted that conclusions about the appropriateness of combined financial statements may differ depending on specific facts and circumstances. The staff continues to recommend that registrants preclear filings where combined financial statements are presented in lieu of separate financial statements of the registrant and of the entities to be reorganized when the change/reorganization will occur at or after effectiveness.

## **V. CURRENT PRACTICE ISSUES**

### **A. Current SEC Staff Views on Predecessor Financial Statements, Primarily as they Relate to Identifying a Predecessor**

With the recent increase in IPO and spin-off activity, the determination of a predecessor entity when applicable, has been a frequent area of preclearance with the staff. The evaluation of a predecessor can often be complex and subject to significant judgment. There is limited authoritative guidance for determining the predecessor other than the definition in Rule 405 of Regulation C:

The term **predecessor** means a person the major portion of the business and assets of which another person acquired in a single succession, or in a series of related successions in each of which the acquiring person acquired the major portion of the business and assets of the acquired person.

In evaluating the definition, companies and auditors have historically looked to one or more pieces of staff interpretive guidance including, to varying degrees, staff speeches, Section 2065 of the Financial Reporting Manual and analogies to SAB Topic 5.Z.7. To reduce uncertainty in these transactions and enhance consistency, the Committee presented the following scenarios for discussion with the staff:

### Scenario 1

Private Equity Firm controls Subsidiary A and Subsidiary B. As part of its exit strategy, it intends to contribute its equity in both subsidiaries to a Newco for the purposes of an initial public offering of Newco. The financial statements will consist of combined financial statements for the periods in which Subsidiary A and Subsidiary B were under common control. However, they have only been under common control for the most recent annual period. As a result, one of the Subsidiaries will be deemed the predecessor with the other entity deemed to be an acquired business (for which separate financial statements may be required under Rule 3-05).

Questions under this scenario include:

- How should the predecessor be determined in this situation?
- Should the issuer primarily consider the order in which the entities were acquired by the Private Equity Firm?
- Are there considerations such as the relative size of the entities, ongoing management and governance, or other factors that should be given greater weight?
- Is the conclusion impacted if one of the Subsidiaries is a public company?

### Scenario 2

Company A plans to spin off or split off (through an IPO) a portion of its business within Division Blue. Division Blue operates in three geographical markets and the spun off or split off business will be effected through a contribution of two of the three markets into a Newco. The contributed markets consist of net assets held by various legal entities controlled by Company A.

Questions under this scenario include:

- If the two markets comprise substantially all of Division Blue, would carve out financial statements of Division Blue be appropriate to reflect as the predecessor?
- Would carve out financial statements for the two contributed markets within Division Blue be appropriate to reflect as the predecessor?
- Are there any factors that might indicate the financial statements should reflect something other than Division Blue or the two contributed markets?

- If the two markets comprise less than substantially all of Division Blue, would carve out financial statements limited to the two markets being contributed be the appropriate predecessor presentation?
- Are there any circumstances that might indicate the predecessor financial statements should consist of Division Blue in its entirety?
- Would the views be any different if the Division constituted a reportable segment or operating segment with discrete financial information?

### Scenario 3

Company A intends to facilitate a transaction similar to Scenario 2 except that the entity issuing equity in the IPO will be an existing subsidiary (“PubCo”) rather than a Newco. To facilitate the transaction, the company intends to undertake a series of reorganization transactions prior to effectiveness such that PubCo will distribute a significant portion of its business (“Excluded Businesses”) back to Company A.

Questions under this scenario include:

- Must the predecessor financial statements be limited to PubCo’s historical financial statements (as the legal registrant) for all required periods or is there any basis beyond SAB Topic 5.Z.7. to omit the Excluded Businesses for the periods to be presented?
- If the only guidance to consider for an IPO of PubCo is SAB Topic 5.Z.7, do the same limitations apply to reorganizations that occur among legal subsidiaries to be contributed to a Newco that have previously been consolidated by the Parent (Company A) or other affiliates of Company A? In other words, can a registrant, look to the businesses being contributed to Newco or must it respect the legal entities to be consolidated by PubCo post-transaction?

The staff observed that identifying the predecessor entity in many transactions requires careful analysis of all relevant facts and circumstances. The staff noted that current guidance in the FRM, GAAP and various SABs did not contemplate the level of complexity encountered in recent transactions and encourages companies to pre-clear these transactions.

## **B. Direct Auditor Reporting of Cessation of Client-Auditor Relationship**

In May 2014, the SEC approved changes adopted by the PCAOB which amended its rules that require certain registered firms to notify the SEC directly when the client-auditor relationship has ceased.<sup>1</sup> (see Release 34-72087) The changes affect the communication that is commonly referred to as the “SECPS letter” or the “5 day letter.” The changes do not affect the letter required to be filed by the

---

<sup>1</sup> This requirement only applies to registered public accounting firms that were members of the AICPA SEC Practice Section on April 16, 2003 and only relates to issuers that meet the definition of an SEC registrant (as defined in Appendix D of SECPS 1000.38 as adopted by the PCAOB in Rule 3400T).

registrant with the SEC commonly referred to as the "Exhibit 16 letter" (e.g., the letter required by S-K 304(a)(3)). These changes are designed to make the auditors' notices more meaningful by generally requiring direct auditor reporting to the SEC only when the registrant has not timely reported the auditor change on Form 8-K. The revised rules read as follows:

- " (1) When the member firm has been the auditor for an SEC registrant (as defined in Appendix D, SECPS §1000.38) that is **required** to file current reports on Form 8-K and has resigned, declined to stand for re-election or been dismissed, report the fact that the client-auditor relationship has ceased directly in writing to the former SEC client, with a simultaneous copy to the Office of the Chief Accountant of the Securities and Exchange Commission, unless the former client reports the change in auditors in a timely filed Form 8-K.<sup>fn.4</sup> Such report shall be sent to the former SEC client and to the Office of the Chief Accountant by the end of the fifth business day following the member firm's determination that the client-auditor relationship has ended, **if the issuer has not reported the change in auditors to the SEC in a timely filed Form 8-K.**
- (2) When the member firm has been the auditor for an SEC registrant (as defined in Appendix D, SECPS § 1000.38) that is **not required** to file current reports on Form 8-K and has resigned, declined to stand for re-election or been dismissed, report the fact that the client-auditor relationship has ceased directly in writing to the former SEC client, with a simultaneous copy to the Office of the Chief Accountant of the Securities and Exchange Commission.<sup>fn.5</sup> Such report shall be sent to the former SEC client and to the Office of the Chief Accountant by the end of the fifth business day following the member firm's determination that the client-auditor relationship has ended, **irrespective of whether or not the registrant has reported the change in auditors in a timely filed report.**" **[emphasis added]** [footnotes omitted].

The staff indicated that questions relating to the new rules should be addressed either to the Office of the Chief Accountant or the staff of the PCAOB.

### C. Using IFRS as Issued by the IASB When Preparing Financial Statements Pursuant to S-X 3-14 or Lessee/Tenant Financial Statements Related to a Significant Triple Net Lease

In Release 33-8879 the SEC amended its disclosure requirements to, among other things, permit financial statements of a foreign business prepared in accordance with IFRS as issued by the IASB to be filed pursuant to S-X Rule 3-05 or S-X Rule 3-09 without reconciliation to U.S GAAP. That release did not address financial statements prepared pursuant to S-X 3-14 or financial statements of a lessee/tenant related to a significant triple net lease.<sup>2</sup>

---

<sup>2</sup> FRM 2340 states that "When a registrant has triple net leased one or more real estate properties to a single lessee/tenant, and such properties represent a "significant" portion of the registrant's assets, an investor may need to consider the lessee's financial statements or other financial information in order to evaluate the risk to the registrant from this asset concentration. In circumstances where a registrant acquires a property resulting in a significant asset concentration, the registrant should generally provide full audited financial statements of the lessee or guarantor for the periods required by S-X 3-01 and 3-02 / S-X 8-02 and 8-03."



Unlike S-X Rule 3-05 and S-X Rule 3-09 (which specifically reference the use of Item 17 of Form 20-F for foreign businesses), S-X Rule 3-14 is silent with respect to the use of bases of accounting other than U.S. GAAP. Although FRM Section 6410e indicates that "[t]he staff also permits Item 17 for acquired real estate operations under S-X Rule 3-14 and S-X Rule 8-04 for smaller reporting companies," there is no reference to the omission of a U.S. GAAP reconciliation if financial statements of an acquired foreign real estate entity are prepared in accordance with IFRS as issued by the IASB and there is no reference to financial statements of a significant lessee/tenant related to a triple net lease.

The Committee asked the staff whether the staff would permit registrants to file financial statements of a foreign business prepared pursuant to S-X Rule 3-14 or of a foreign business-lessee/tenant related to a significant triple net lease prepared in accordance with IFRS as issued by the IASB without reconciliation to U.S. GAAP (consistent with the principle articulated in section III.D.1.b of Release 33-8879<sup>3</sup>).

The staff noted that the rules do not specifically scope in S-X Rule 3-14; therefore, registrants should pre-clear this presentation with the staff.

---

<sup>3</sup> The Release indicates that "Generally, the historical financial statement requirements for a foreign acquired business or investee under Rule 3-05 or 3-09 are governed by the status of that entity, and do not impose a higher presentation burden on a non-issuer entity than on an issuer."