CAQ SEC Regulations Committee Highlights

March 20, 2019 – Joint Meeting with SEC Staff

SEC Offices – Washington, DC

I. ATTENDANCE

SEC Regulations Committee	Securities and Exchange Commission	Observers and Guests
Steven Jacobs, Chair Jonathan Guthart, Vice-Chair Jason Cuomo Brad Davidson Rich Davisson Kendra Decker Liz Gantnier Paula Hamric John May Lisa Mitrovich Dan Morrill Terry Spidell Mary Stone Greg Wright	***Division of Corporation Finance (Division)*** Kyle Moffatt, Chief Accountant Patrick Gilmore, Deputy Chief Accountant Lindsay McCord, Deputy Chief Accountant Craig Olinger, Senior Advisor to the Chief Accountant Shelly Luisi, Associate Director - Chief Risk Officer Jessica Barberich, Associate Chief Accountant Tricia Armelin, Associate Chief Accountant Jill Davis, Associate Chief Accountant Todd Hardiman, Associate Chief Accountant Jaime John, Associate Chief Accountant Ryan Milne, Associate Chief Accountant Stephanie Sullivan, Associate Chief Accountant Catherine Brown, Deputy Chief Risk Officer Mark Green, Senior Special Counsel Jarrett Torno, Assistant Chief Accountant Wei Lu, Staff Accountant Shannon Sobotka, Staff Accountant Bob Telewicz, Staff Accountant ***Office of Chief Accountant*** Andrew Pidgeon, Professional Accounting Fellow	Azhar Qureshi, EY Annette Schumacher Barr, CAQ Observer

II. UPDATE ON THE DIVISION'S RECOVERY FROM THE SHUTDOWN

CF-OCA staff shared that it has responded to all S-X Rule 3-13 waiver requests that were delayed due to the shutdown.

III. CURRENT FINANCIAL REPORTING MATTERS

A. Non-GAAP Financial Measures

Committee members and the staff discussed company disclosures of non-GAAP financial measures, including recent examples of comments on measures considered by the staff to be based upon individually tailored accounting principles.

The staff shared some examples of non-GAAP financial measures disclosed by registrants where the staff believes the measures would not be appropriate (primarily because they utilize individually tailored accounting principles).

The staff encourages registrants who are considering the appropriateness of a non-GAAP financial measures to reach out to the staff in CF-OCA or to the respective AD Office with questions regarding existing or proposed disclosures.

B. EGC Transition Issues

Committee members and the staff discussed the following transition issues for registrants with emerging growth company (EGC) status (or changes in EGC status):

- *Is an existing EGC registrant that elected private company transition for ASC 606 and therefore will adopt the standard for the year ended 12/31/19 (but not the quarters during 2019) required to reflect ASC 606 in the 2019 quarters provided for comparative purposes in its 2020 10-Qs?*
    - The staff encourages EGCs that elect the private company transition date for adopting ASC 606 to present comparative 2019 quarterly financial statements under ASC 606. The staff also emphasized the importance of ensuring there is clear and transparent disclosure of the basis on which the financial statements are presented.

- *If an EGC loses status after it submits a draft registration statement or publicly files a registration statement, then it will continue to be treated as an EGC until the earlier of the date on which the issuer consummates its initial public offering (IPO) or the end of the one-year period beginning on the date the company ceased to be an EGC. If the EGC had elected private company transition for new accounting standards in the IPO, , how and when is it required to transition to the new accounting standards for filings subsequent to its consummation of the IPO assuming that was the earliest date?*
    - FRM 10230.1 states if an EGC loses its status after it would have had to adopt a standard absent the extended transition; generally, the issuer should adopt the standard in its next filing after losing status. EGCs that take advantage of an extended transition period provision are encouraged to review their plans to adopt accounting standards upon losing EGC status and to discuss with the staff any issues they foresee in being able to timely comply with new accounting standards already effective for public business entities in the next filing.
- *When is quarterly information under Item 302 of Regulation S-K required to be revised under ASC 606 for a registrant that loses its EGC status?*
    - FRM 10230.1 states if an EGC loses its status after it would have had to adopt a standard absent the extended transition; generally, the issuer should adopt the standard in its next filing after losing status. For example, a registrant that has elected the private company transition and loses its EGC status on December 31, 2019 would be required to reflect the adoption of ASC 606 in its December 31, 2019 annual report on Form 10-K. Since the issuer is not an EGC as of December 31, 2019 it is not provided the accommodation for Item 302 quarterly information, in FRM 11110.2, in that Form 10-K. That is, for the example provided, the issuer would reflect the adoption of ASC 606 in its 2019 quarterly financial information in its December 31, 2019 annual report on Form 10-K.
- *While it is understood that non-EGCs submitting an initial registration statement may need to re-adopt a standard as of the public company adoption date, what is the adoption date of new standards for EGCs in periods following adoption under the private company adoption dates (IPO in 2020 or later)?*
    - The staff indicated it is considering the issue.

C. Contractual obligations table upon adoption of ASC 842, *Leases*

Committee members and the staff discussed whether the lease obligations to be included in the contractual obligations table could or should be determined on a basis consistent with the lease maturity table disclosure required under ASC 842. Committee members observed that the current contractual obligations table presentation is generally consistent with the future minimum lease payments table in ASC 840. However, existing diversity in practice in preparing the ASC 840 footnote disclosure and the requirements in presenting the lease maturity table in ASC 842 could result in a difference for new or modified leases accounted for under ASC 842.

The staff indicated it is considering the issue and affected issuers may contact CF-OCA to discuss if they have specific challenges in applying the Regulation S-K guidance for contractual obligations table in light of ASC 842 adoption.

D. EBITDA measure after the adoption of new leasing standards

Committee members observed that it is common for both domestic registrants applying US GAAP and foreign private issuers applying IFRS as issued by the IASB (IFRS Filers) to include earnings before interest, tax, depreciation and amortization (EBITDA) as a non-GAAP performance measure in earnings releases and periodic reports. Because of the differences between ASC 842 and IFRS 16, *Leases*, an EBITDA measure presented by a domestic registrant after the adoption of ASC 842 may no longer be comparable to the same measure presented by an IFRS Filer after the adoption of IFRS 16.

While both ASC 842 and IFRS 16 require lessees to capitalize all leases on the balance sheet, IFRS 16 requires a single lessee accounting model (i.e., single classification) while ASC 842 requires a dual classification approach (i.e. operating lease or finance lease). Under IFRS 16, the reduction in the right of use asset is recorded as “depreciation” by lessees (similar to a finance lease under ASC 842). In comparison, under ASC 842 the reduction in the right of use asset relating to operating leases is recorded as part of lease expense rather than depreciation.

The staff acknowledged the differences between ASC 842 and IFRS 16 and that it could impact the EBITDA measures. The staff noted that there are other areas in which IFRS and US GAAP differ. The staff would continue to object to a non-GAAP measure presented by a U.S. GAAP registrant that adjusts EBITDA to add back any operating lease expense since it is not recorded as “depreciation” or interest under ASC 842. Likewise, the SEC staff would view a measure presented by an IFRS registrant that adjusts EBITDA to deduct interest and depreciation solely related to leases as an individually tailored accounting principle. The staff would not object to both U.S. GAAP and IFRS registrants separately identifying the differences (e.g., a U.S. GAAP registrant may separately disclose lease expense recognized during a period attributable to operating leases consistent with its ASC 842 disclosures or an IFRS registrant may separately disclose the amount of interest and depreciation expenses under IFRS 16) in their filings.

E. S-X Rule 3-05 Requirements for EGCs in an IPO

Committee members and the staff discussed a scenario where an EGC filing a registration statement for an IPO requires financial statements of an acquired entity pursuant to S-X Rule 3-05. Under the significance tests, the registrant will have to provide one-year financial statements for the acquired entity at the time of the contemplated offering and intends to do so through a combination of pre-acquisition audited financial statements of the acquired entity together with post-acquisition audited financial statements of the issuer (i.e., following the guidance in FRM 2030.4). Committee members and the staff discussed whether the EGC in the above scenario can delay providing the pre-acquisition audited financial statements of the acquired entity in any draft or publicly filed registration statement prior to the contemplated offering until it is required to provide the post-acquisition audited financial statements of the registrant.

The staff reiterated its position that the acquired entity's financial statements could not be omitted from any publicly filed registration statements.[1] However, for the purposes of a draft registration statement, the staff indicated that a registrant with this fact pattern should consult, before making such submission, with its respective Assistant Director (AD) office assigned to the filing or CF-OCA. An AD office may agree to review the draft registration statement without the pre-acquisition financial statements of the acquired entity in it, but the registrant should clearly disclose in the transmittal letter to the draft registration statement what information is omitted. The registrant should discuss with the AD office or CF-OCA timing for providing the pre-acquisition financial statements of the acquired entity.

F. S-X Rule 3-05 Significance Tests

Committee members observed that the adoption of the new leasing standard (ASC 842) could have a significant effect on a registrant's balance sheet. Consequently, the investment and asset tests for determining significance under S-X Rule 3-05 could be materially affected due to the adoption of ASC 842. Committee members and the staff discussed the following specific questions on this topic:

- *Will registrants that elected to adopt the standard by recasting prior comparative periods, be able to use the prior year-end balance sheet recasted for the adoption of ASC 842 included in the first quarter 10-Q (rather than having filed recasted annual audited financial statements as discussed in FRM 2025.1) to perform the investment and asset significance tests required under S-X Rule 3-05?*
    - The staff will continue to consider this issue.

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[1] For CF's policy on omission of financial information from draft registration statements and publicly filed registration statements see the following links: *Compliance and Disclosure Interpretations - FAST Act* and *Voluntary Submission of Draft Registration Statements - FAQs*.

- *Will registrants that utilized the practical expedient under ASC 842 that allows companies to not recast prior comparative periods be allowed to use the first quarter balance sheet to perform the significance tests?*
    - Regulation S-X does not permit the use of interim balance sheets for purposes of calculating significance under S-X Rule 3-05. Therefore, the staff indicated that it would *not* be appropriate for these registrants to use the first quarter balance sheet to perform the significance tests under S-X Rule 3-05.

G. Financial Statement Schedules for an Investee under S-X Rule 3-09

Committee members and the staff discussed whether financial statement schedules (specified by Article 12 of Regulation S-X) are required for the investee under S-X Rule 3-09.

The staff indicated that Article 12 schedules are considered part of the financial statements and registrants are required to include such schedules, as applicable, with the financial statements of its significant equity method investees under S-X Rule 3-09. The staff further clarified that the guidance in FRM section 2005.2 that allows registrants to omit such schedules for S-X Rule 3-05 financial statements does not extend to S-X Rule 3-09 financial statements. However, if a required Article 12 schedule is burdensome to prepare and not material for investors, a registrant may request relief from providing the schedule from the staff under S-X Rule 3-13.

H. Form 8-K under Item 2.01 requirement in relation to Rule 3-05 waivers

The staff clarified that registrants receiving an accommodation under S-X Rule 3-13 to omit financial statements of an acquired entity that trips significance under any of the tests in S-X Rule 3-05 are still required to file an Item 2.01 Form 8-K related to the acquisition. The staff explained that while S-X Rule 3-13 allows the staff to waive the financial statement requirements under Regulation S-X, the staff does not have the delegated authority to waive the Form 8-K requirement.