CAQ SEC Regulations Committee Highlights

June 25, 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 Fred Frank 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 Christy Adams, Associate Chief Accountant Jessica Barberich, Associate Chief Accountant Tricia Armelin, 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, CF-OCA Rotator Shannon Sobotka, CF-OCA Rotator ***Office of Chief Accountant*** Lauren Alexander, Professional Accounting Fellow	Polia Nair, EY Annette Schumacher Barr, CAQ Observer Andrew Zulauf, CAQ Observer

II. CURRENT FINANCIAL REPORTING MATTERS

A. Use of averaging for purposes of testing significance when registrant has applied the full retrospective method of adopting ASC 606 but has not re-casted the earliest two periods

The second computational note to the income significance test in Rule 1-02(w)(3) of Regulation S-X mandates that if income of the registrant consolidated exclusive of amounts attributable to any noncontrolling interest for the most recent fiscal year is at least 10 percent lower than the average of the income for the last five fiscal years, such registrant average income should be used for purposes of the income significance test. This computational note also applies when the registrant reports a loss for the last completed fiscal year – in that case the absolute value of the registrant loss should be compared to the average income for the last five years. In FRM 11110.1, the SEC staff provided registrants relief from recasting all five years in the selected financial data table when the registrant has utilized the retrospective method of adoption for ASC 606.

The Committee observed that it is unclear how the use of averaging would apply when only the most recent three years have been re-casted for the retrospective adoption of ASC 606 (or any other new accounting standard) in reliance on that guidance. The Committee asked whether a registrant would 1) compute a five-year average notwithstanding a lack of comparability 2) compute an average only based upon those periods that reflect the new accounting standard, or 3) be precluded from using the average income.

The staff acknowledged that there have been accounting standards in the past with retrospective adoption. Registrants may consult with the staff if they have an unusual fact pattern or an anomalous significance test outcome when using income averaging.

B. Emerging Growth Company (EGC) Transition Issues

The SEC staff continues to consider many transition questions involving fact patterns where an EGC has lost its status due to a disqualifying event.

The Committee discussed specific EGC application questions with respect to mergers between shell companies (including Special Purpose Acquisition Corporations) that maintain EGC status and non-public operating companies. Specifically, the questions relate to the impact that the merger transaction may have on the ability of the parties to use EGC accommodations in the filings 1) related to the merger transaction and 2) for the combined entity post-merger consummation. As EGC status is a legal construct, the ability for an entity to qualify to use the accommodations afforded EGCs is dependent on the facts and circumstances of the transaction and the underlying entities. Registrants with questions in this area should consult with the staff.

C. Application of amended MD&A provisions that permit the omission of the earliest period of MD&A in a filing in circumstances where there has been a retrospective change to the financial statements, including error corrections and changes in accounting principle, among others

Recently, the *FAST Act Modernization and Simplification of Regulation S-K* adopting release amended Instruction 1 to Item 303(a) of Regulation S-K to state the following: "For registrants providing financial statements covering three years in a filing, discussion about the earliest of the three years may be omitted if such discussion was already included in the registrant's prior filings on EDGAR that required disclosure in compliance with Item 303 of Regulation S-K."

During the rule proposal process, the SEC asked whether registrants should be allowed to exclude a discussion of the earliest of the three years in a filing if there has been a material change to either of the earliest two years due to a restatement to correct an error or a retrospective adoption of a new accounting principle. Footnote 36 to the adopting release states that the SEC is "not adopting different or additional conditions on the omission of the earliest year discussion." As a result, amended Instruction 1 does not address retrospective changes that can arise due to accounting errors, retrospective adoption of new accounting principles, segment changes, discontinued operations, or changes in the reporting entity.

The Committee asked the staff how registrants should consider the effect of retrospective changes in omitting the earliest year discussion, given that registrants must disclose the location in the prior filing where the disclosure can be found. The staff noted that this amendment does not change the standard that applies to all of MD&A – a registrant shall provide such other information that it believes to be necessary to an understanding of its financial condition, changes in financial condition and results of operations. Accordingly, where there has been a retrospective change, a registrant should assess whether the previously filed disclosure that it is considering omitting and making reference to continues to provide the information necessary to understand the registrant's financial condition, changes in financial condition and results of operations.

D. Interim periods required for changes in stockholders' equity in a registration or proxy statement

Committee members and the staff discussed interim periods required for changes in stockholders' equity and whether the comparative interim period of the prior year is required in a registration or proxy statement. Committee members discussed the requirements in Reg. S-X Rule 3-04 and the guidance in FRM 1120 and observed diversity in practice in this area. The staff acknowledged the observations made by Committee members and will keep them in mind for future updates to the FRM and rulemaking.

E. Non-GAAP measures

Committee members and the staff continued their discussion of 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. Specifically, the group discussed the disclosure of non-GAAP measures of financial performance which exclude the amortization of acquired intangible assets. Registrants who are considering the appropriateness of an existing or proposed non-GAAP financial measure are encouraged to consult with the staff in CF-OCA or the respective AD Office.