



SEC Regulations Committee Highlights

Joint Meeting with SEC Staff

Held Virtually on October 21, 2020

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.

These highlights were prepared by a representative of CAQ who attended the meeting and do not purport to be a transcript of the matters discussed. The views attributed to the SEC staff are informal views of one or more of the staff members present, do not constitute an official statement of the views of the Commission or of the staff of the Commission and should not be relied upon as authoritative. Users are urged to refer directly to applicable authoritative pronouncements for the text of the technical literature.

As available on this website, highlights of Joint Meetings of the SEC Regulations Committee 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subsequent issuance of technical pronouncements or positions taken by the SEC staff, nor are they deleted when they are superseded by the issuance of subsequent highlights or authoritative accounting or auditing literature.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

SEC Regulations Committee	Securities and Exchange Commission	Observers and Guests
Steven Jacobs, Chair Jonathan Guthart, Vice-Chair Todd Castagno Kendra Decker Fred Frank Marie Gallagher Paula Hamric John May Lisa Mitrovich Dan Morrill Steve Neiheisel Mark Shannon Chris Spahr Terry Spidell Mary Stone Scott Wilgenbusch Greg Wright	<i>Staff from the Division of Corporation Finance (Division) and Office of the Chief Accountant</i>	Adam Dufour, EY Rohit Elhance, Grant Thornton Mark Kronforst, EY Brandon Landas, BDO Kathleen Malone, Deloitte Polia Nair, EY Annette Schumacher Barr, CAQ Observer Carolyn Hall, CAQ Observer

II. ORGANIZATIONAL, PERSONNEL AND PROJECT UPDATES

A. Staff Update

The staff provided the following update of recent changes in the Division of Corporation Finance:

- [Jessica Kane](#) was named Director of the Division's Disclosure Review Program.
- [Tamara M. Brightwell](#) was named Deputy Director of the Division's Disclosure Review Program.
- [Lindsay McCord](#) was named Chief Accountant.
- Pat Gilmore will return to the Division's Office of Chief Accountant as Deputy Chief Accountant, from the Disclosure Review Program where he recently served as Acting Director.

B. Financial Reporting Manual (FRM) Update

The staff expect to issue an updated FRM that reflects some recent rulemaking, including the updated definitions of a smaller reporting company (SRC) and large accelerated filer/accelerated filer, the disclosure update and simplification amendments, as well as a few other items. However, the update will not reflect recent amendments to Regulation S-X, including Rules 3-05, 3-10, 3-16, 3-14 and Article 11.

Regarding the amendments to Rules 3-10 and 3-16, the staff noted that the [Small Entity Compliance Guide for Financial Disclosures about Guarantors and Issuers of Guaranteed Securities and Affiliates Whose Securities Collateralize a Registrant's Securities](#) has been posted on the SEC's website.

The staff also indicated they are planning a holistic review of the FRM and welcome any feedback or ideas.

III. CURRENT FINANCIAL REPORTING MATTERS

A. Modernization of Regulation S-K Items 101, 103, and 105

The Committee asked the staff about transition related to the [Final Rule](#) on modernizing Items 101, 103, and 105 of Regulation S-K. Specifically, the Committee asked whether the final rule applies to all filings on or after the effective date or to filings that include a balance sheet date after the effective date. The staff stated that the rules will become effective on November 9, 2020 and as such, the form and content of any filing made on or after that date needs to reflect the

provisions of the Final Rule. In other words, if a registrant files a Form 10-K or Form 10-Q on or after November 9, it is required to include all the disclosures mandated in the Final Rule applicable to the form. The Committee also asked whether a registration statement that is first filed before the effective date, but amended after the effective date, would need to comply with the final rule and whether any revised disclosure would be necessary if a new registration statement is filed that incorporates by reference Exchange Act reports filed prior to the effective date. The staff indicated that the new rules apply to first-time public filings of registration statements and as such, any amendments associated with previously filed registration statements first filed before November 9, 2020 (not draft registration statements) would be grandfathered under the old rules.

Note: Subsequent to the meeting, the staff issued [Transitional FAQs Regarding Amended Regulation S-K Items 101, 103 and 105](#).

B. Implementation Questions Regarding Final Rule 3-10 Amendments

Committee members and staff discussed implementation questions regarding the final [amendments to Rule 3-10 contained in SEC Release No. 33-10762, - “Financial Disclosures about Guarantors and Issuers of Guaranteed Securities and Affiliates Whose Securities Collateralize a Registrant’s Securities”](#). The staff are considering what responsive guidance may be necessary for these questions in the near future.

The Committee also asked the staff whether the modified reporting framework set forth in new S-X 3-10/13-01 would be available to an issuer of trust preferred securities that is not consolidated by the parent company guarantor (as was previously permitted and discussed at the 2003 AICPA SEC Conference). The staff indicated they are considering this issue.

Note: On November 10, 2020, the staff issued a [no-action letter regarding certain trust preferred securities in relation to the question above](#).

C. Impact of COVID-19 and observations on disclosures

Committee members and staff shared observations regarding disclosures on the impact of COVID-19. It was observed that some registrants have elected to include a dedicated section in MD&A focusing on COVID while others have disclosed its impact throughout the filing. Regarding Q1 filings, companies appeared to consider the Division’s [Disclosure Guidance Topic No. 9](#) amidst the uncertainties that existed at the time. Regarding Q2 filings, generally registrants provided good disclosures regarding operations, liquidity and capital resources, further considering the views expressed by the staff in [Disclosure Guidance Topic No. 9A](#). As registrants are preparing future periodic reports, the staff suggested that registrants consider their ability to provide more robust disclosure regarding long-term views on the impact of COVID-19 (e.g., how do they plan on paying

back debt taken out to manage recent short-term liquidity challenges?). Regarding disclosures of Non-GAAP financial measures, the staff did not observe many objectionable disclosures of Non-GAAP measures in Q1 or Q2 filings.

Industry representatives on the Committee reported that the staff's guidance provided in Disclosure Guidance Topics 9 and 9A was very helpful to registrants. The preparer community has tried to differentiate and report on the impacts of COVID as best possible but variables are often difficult to isolate. Looking forward, uncertainty continues regarding the duration of the pandemic and its potential impact on financial performance which could challenge the ability to provide disclosures about longer-term expectations.

D. Implementation Questions Regarding Final Rule 3-05 Amendments

Committee members and staff continued a discussion on implementation questions regarding the final amendments to Rule 3-05, *Amendments to Financial Disclosures about Acquired and Disposed Businesses*. The SEC staff are considering what responsive guidance may be necessary related to these questions in the near future.

E. S-X Rule 3-05 financial statements when the acquired entity previously elected to use a risk-free discount rate to account for its leases under ASC Topic 842, *Leases*

ASC Topic 842 provides a policy election to nonpublic business entities to use a risk-free discount rate to account for its leases, including determining lease classification and measuring the lease liability and right-of-use asset (ASC 842-20-30-3). The FASB provided this election as an accommodation for private companies to make the application of the leasing guidance easier.

This election is not available for public business entities (PBE). A PBE lessee is required to use its incremental borrowing rate (IBR) if the rate implicit in the lease is not readily determinable. ASC Topic 842 Glossary's definition of a PBE includes the following:

An entity may meet the definition of a PBE solely because its financial statements or financial information is included in another entity's filing with the SEC. In that case, the entity is only a PBE for purposes of financial statements that are filed or furnished with the SEC.

The Committee asked the staff for its views regarding a Registrant that acquires a non-PBE (lessee) that previously elected to use a risk-free discount rate to account for its leases, specifically whether the Registrant is required to calculate the significance (under S-X) of the acquired entity based on the lessee's IBR or rate implicit in the lease if, readily determinable (PBE rate) for its leases rather than the previously used risk-free rate. The staff observed that the risk-free rate may result in higher calculated significance. Therefore, if a registrant elects to measure

significance using pre-acquisition financial statements of the acquired business and the only difference between those financial statements and a PBE set of financial statements is the risk-free rate, the staff would not object.

The Committee also asked the staff whether the financial statements of an entity (lessee) that is only considered to be a PBE because its financial statements are included in another entity's SEC filing (e.g., S-X Rule 3-05 financial statements) can continue to reflect the lessee's previous accounting policy election to use the risk-free discount rate to account for its leases. The staff indicated that such entities are required to provide financial statements that reflect the recognition and measurement principles applicable to public business entities. Accordingly, the company would have to assess whether an adjustment to use the PBE rate would be material to necessitate revision.

F. Determining the numerator for the income component of the income test in connection with the disposition of a business

The Committee noted that registrants are oftentimes required to assess the significance of a business that has been disposed of or is probable of being disposed of in order to determine whether pro forma financial information depicting the disposition of the business is required to be filed (e.g., under Item 9.01 of Form 8-K or in a registration statement). Rule 1-02(w)(1)(iii)(A) prescribes that the numerator for the income component of the income test of significance is "[t]he absolute value of the registrant's and its other subsidiaries' equity in the tested subsidiary's consolidated income or loss from continuing operations before income taxes (after intercompany eliminations) attributable to the controlling interests..."

The Committee asked the staff for their views regarding how the numerator of the income component of the income test of significance should be calculated in connection with the disposition of a business. The staff noted that the numerator is calculated based on the income statement effects that would be removed from the registrant's income statement during the tested period (similar to the requirements for presenting discontinued operations under ASC 205-20-45) rather than determining pre-tax income on a carve-out basis using the principles of SAB Topic 1.B.1.