



# SEC Regulations Committee Highlights

## Joint Meeting with SEC Staff

Held Virtually on March 24, 2021

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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.

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### I. ATTENDANCE

SEC Regulations Committee	Securities and Exchange Commission	Observers and Guests
Jonathan Guthart, Chair John May, Vice-Chair Muneera Carr Kendra Decker Sam Eldessouky Fred Frank Marie Gallagher Paula Hamric Steven Jacobs Lisa Mitrovich Dan Morrill Steve Neiheisel Mark Shannon Chris Spahr Mary Stone Scott Wilgenbusch	<i>Staff from the Division of Corporation Finance (Division) and Office of the Chief Accountant</i>	Erin McCloskey, KPMG Annette Schumacher Barr, CAQ Observer Carolyn Hall, CAQ Observer



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## II. ORGANIZATIONAL, PERSONNEL AND PROJECT UPDATES

### A. Staff Update

Jonathan Guthart introduced Sam Eldessouky and Muneera Carr as new Committee members.

### B. Financial Reporting Manual (FRM) Update

The staff expects to update the FRM to reflect certain aspects of recent rulemaking, including the amendments to Regulation S-X Rules 1-02, 3-05, 3-10, 3-14, 3-16 and Article 11. The staff indicated that they do not have an expected release date of the FRM for these amendments.

## III. CURRENT FINANCIAL REPORTING MATTERS

### A. Committee observations on Environmental, Social and Governance (ESG)-related disclosures

Committee members shared observations regarding preparation, uniformity and timing of ESG-related disclosures, including those related to human capital and climate change.

### B. New Business Acquisitions and Dispositions Rules

#### 1. Staff observations on pro forma financial information prepared under the new rules.

Committee members discussed the presentation of pro forma data and the computation of pro forma Earnings Per Share (EPS) in Initial Public Offering (IPO) registration statements. As noted above, the staff indicated that as part of the broader effort to update the FRM they are currently in the process of revising FRM Section 3400, Special Applications, to incorporate the amended rules. With respect to computations of pro forma EPS, when convertible securities will automatically convert to common stock upon the IPO, the number of shares used to compute pro forma EPS should include the number of common shares into which the securities will convert as if they were outstanding as of the beginning of the most recently completed fiscal year presented in the Article 11 pro forma financial statements, irrespective of when the convertible instrument was issued.



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## 2. Continued discussions on Amendments to Financial Disclosures about Acquired and Disposed Businesses.

Committee members and staff continued a discussion on implementation questions regarding the final amendments in Release 33-10786, Amendments to Financial Disclosures about Acquired and Disposed Businesses.

The SEC staff are considering what responsive guidance may be necessary related to these questions.

## 3. Financial Statements used to Determine Significance Under Rule 3-05

Article 11 states that when determining significance, a registrant should use “the registrant’s most recent annual consolidated financial statements **required** to be filed **at or prior** to the date of acquisition or disposition and the business’s pre-acquisition or pre-disposition financial statements for the same fiscal year as the registrant...” **(emphasis added)** Committee members and staff discussed how registrants should evaluate significance for transactions that closed early in the fiscal year in the circumstances described below:

- a) IPO – Assume a calendar year end company files an IPO registration statement in 2021 and includes its audited financial statements for both 2020 and 2019. If the company had an acquisition on February 5, 2020, is it permitted (or required) to use its financial statements as of and for the year ended December 31, 2018 for purposes of the Rule 3-05 significance test since those would be the “financial statements **required** to be filed at or prior to the date of acquisition”? **(emphasis added)** Alternatively, would the company be permitted (or required) to assess significance on the basis of the issuer’s December 31, 2019 financial statements as such financial statements will be required to be presented when filing the IPO registration statement?

In this scenario, the staff indicated that the registrant would be **required** to assess significance on the basis of the issuer’s December 31, 2019 financial statements.

- b) Existing registrant – For purposes of assessing significance under Item 2.01 of Form 8-K, how should “financial statements **required** to be filed **at or prior** to the date of acquisition” **(emphasis added)** be applied when an existing registrant acquires a company and, prior to the date of acquisition, voluntarily filed its Form 10-K for the most recently completed fiscal year prior to its due date? Assume a registrant acquires a company on February 5, 2021 and voluntarily filed its December 31, 2020 Form 10-K on February 1, 2021, is the registrant permitted (or required) to calculate significance using the registrant’s December 31, 2019 financial statements, which are the most recent annual



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financial statements required to be filed at or prior to the date of acquisition? Alternatively, is the registrant permitted (or required) to use its December 31, 2020 financial statements since those are the most recent preacquisition audited financial statements filed at the time of the acquisition?

The staff indicated that in this scenario, the registrant would have an option to use either its December 31, 2019 or December 31, 2020 financial statements.

#### 4. Staff Observations Regarding Rule 3-13 Waivers relating to Rule 3-05

The staff relayed the following suggestions regarding Rule 3-13 waiver requests:

- Requests should include information that would help the staff understand what information would be required, absent relief, and why it would not be material to investors; and
- Requests should include the results of both the revenue (if applicable) and income components of the income test, not just lower of the two.

#### C. Modernization of Regulation S-K

1. Application of the Management's Discussion and Analysis (MD&A), Selected Financial Data, and Supplementary Financial Information release (New Rules)

With respect to **Critical Accounting Estimates (CAE) disclosures and interim reporting**, the staff indicated that the new CAE disclosures would be required in a Form 10-Q if a company adopts the New Rules in an interim period. Accordingly, a registrant may consider whether there have been material changes from the critical accounting estimates disclosure presented under the legacy guidance in the most recent annual period. In situations where a registrant adopted the rules for the first time in the first quarter 2021 Form 10-Q and incremental material information would be required to be compliant with the New Rules (as compared to what was previously reported under the old rules in the 2020 Form 10-K), the registrant may provide the incremental information by either (1) supplementing the existing disclosure in the 2020 Form 10-K by including the incremental information in the 2021 Form 10-Q or (2) providing the entire required disclosure in the 2021 Form 10-Q. In either alternative, the information provided should be sufficient for readers to understand the context of the new disclosure.

With respect to **transition and registration statements**, the staff indicated that an initial registration statement filed after the mandatory compliance date of the New Rules should comply with the New Rules. If a registration statement is filed prior to the mandatory



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compliance date and the registrant has not already complied with the New Rules in previous filings, there is no need to comply with the New Rules for amendments to that registration statement that are filed after the mandatory compliance date.

With respect to **interim period MD&A disclosure**, the Committee and staff discussed, and the staff confirmed, that a registrant which elects to revise the quarterly periods being compared upon initial compliance with the New Rules would be required to present the MD&A comparison in both its historic presentation and the new revised presentation. For example and assuming the change in MD&A comparison occurs in the first quarter Form 10-Q, the registrant would disclose both the comparison of the first quarter of the current year with that of the prior year and the comparison of the first quarter of the current year with the fourth quarter of the prior year. It would also disclose the reason for the change.

#### D. Staff Observations on CAMs requirements in EGC Scenarios

The staff recently received questions about application of the Emerging Growth Company (EGC) scope exception for the PCAOB's Critical Audit Matters (CAMs) requirements. The staff shared those questions and its views with the Committee:

**Fact Pattern A:** Pursuant to Securities Act Section 6(e), Company A is submitting a draft registration statement on Form S-1 as an entity that will qualify as an Emerging Growth Company (EGC), that includes December 31, 2020 audited financial statements. As an EGC, the Company qualifies for the CAM exemption in AS 3101.05.b and is not required to include CAMs in its audit report on the December 31, 2020 financial statements included in the draft registration statement.

**Fact Pattern B:** A Special Purpose Acquisition Company (SPAC) which qualifies as an EGC is acquiring a target (non-issuer) that would qualify as an EGC if it were conducting an initial public offering. After the acquisition is consummated, the combined company will remain an EGC. The auditor of the target will be issuing a US GAAS/PCAOB report on the target's December 31, 2020 financial statements to be included in the Form S-4/proxy/Super 8-K. The staff would not object to CAMs being omitted from an auditors' report for the target company's financial statements included in the Form S-4/proxy/Super 8-K.

**Fact Pattern C:** Company A files a Form S-1 publicly in December 2020 as an EGC. In 2021, Company A updates the Form S-1 to include December 31, 2020 audited financial statements and the 2020 revenue will result in Company A losing its EGC status. As discussed in [Jobs Act FAQ #3](#), Company A will continue to be treated as an EGC for purposes of disclosure requirement accommodations, including the scope exception for CAMs for the audit report for its December 31, 2020 financial statements until the earlier of:



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- (a) The date on which the issuer consummates its initial public offering, or
- (b) The end of the one-year period beginning on the date the company ceased to be an EGC.

Once the registrant ceases to be an EGC, it no longer qualifies for the EGC scope exception in the PCAOB's CAM requirements. As such, a follow-on registration statement after the IPO is effective could require CAMs if the registrant is no longer an EGC. For questions on this fact pattern, a registrant may contact CF-OCA.

**Fact Pattern D:** Company A is an EGC and is not required to communicate CAMs because of the exemption in AS 3101.05.b. Company A's auditor makes reference to the report of another auditor for the audit of Joint Venture (JV) X, a non-issuer that is an equity method investment of Company A. JV X's auditors' report is required to also refer to the PCAOB's standards (i.e., a US GAAS/PCAOB report), since Company A's auditor is making reference to JV X's auditor. In this specific fact pattern, the staff would not object to JV X's auditor omitting CAMs from its audit report relating to JV X since Company A is an EGC. However, if an issuer in this situation is not an EGC, the staff indicated that the company may consult with the staff.

## **E. Financial statement requirements in an S-4 and/or merger proxy for a non-reporting target merging with a public operating company, shell company or SPAC in a reverse merger**

The Committee noted that it has observed an increase in the volume of reverse merger transactions where a non-reporting operating company (non-reporting target) merges with a shell company or SPAC. In many of these transactions, the non-reporting target is deemed to be the accounting acquirer. As stated in FRM 2200.1, the determination of the target company follows the legal form of the transaction irrespective of the accounting for the transaction and that target's financial statement requirements in Form S-4 are based on factors including whether it is a reporting or non-reporting company.

As it relates to the adoption of new accounting standards, ASU 2017-13, Revenue Recognition (Topic 605), Revenue from Contracts with Customers (Topic 606), Leases (Topic 840), and Leases (Topic 842), Amendments to SEC Paragraphs Pursuant to the Staff Announcement at the July 20, 2017 EITF Meeting and Rescission of Prior SEC Staff Announcements and Observer Comments, permits an entity that qualifies as a PBE solely because its financial statements or financial information is included in another entity's filing to adopt Topic 606 and Topic 842 using delayed adoption dates. (See Topic III(C) in the [July 29, 2020 Meeting Highlights](#).)

At the July 29, 2020 Joint Meeting, the staff and Committee members discussed the applicability of ASU 2017-13 to the financial statements of the non-reporting target (accounting acquirer) included in Form S-4 in a reverse merger transaction where a non-reporting operating company **merges with a SPAC**. (See Topic III(B) in the [July 29, 2020 Meeting Highlights](#).)



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At the March 24, 2021 Joint Meeting, the Committee and staff discussed the applicability of ASU 2017-13 to the financial statements of a non-reporting target (accounting acquirer) included in Form S-4 in a reverse merger transaction where a non-reporting operating company **merges with a public operating company**. The staff indicated that if the registrant, target and combined entity after the merger are all EGCs and the legal acquiror elected to defer adoption, the entity could continue with non-PBE adoption dates. The staff also indicated for a non-reporting operating company merger with a public operating company that non-PBE adoption dates would be acceptable in the Form S-4 when the target would *not* qualify as an EGC and/or when the post-merger entity will *not* qualify as an EGC, because the target is eligible to use delayed adoption dates based upon the provisions of ASU 2017-13. In that case, however, upon consummation of the merger, target's financial statements become those of the registrant (predecessor financial statements) and ASU 2017-13 no longer applies. PBE adoption dates must be used in the financial statements included in the Form 8-K reporting the acquisition that are due within approximately 75 days of consummation. The staff encouraged companies to adopt a new accounting standard using PBE adoption dates in the Form S-4 given the Form 8-K reporting the acquisition will need to be prepared using PBE adoption dates.

The staff also offered a reminder about SAB 74 disclosure requirement and that those disclosures in the target's financial statements are expected to be robust, including quantitative information, if non-PBE adoption dates are used in the financial statements included in the Form S-4 because of the short period of time between merger consummation and when target financial statements using PBE adoption dates would be required in the subsequent Form 8-K.

#### F. Staff Observation Regarding Filing Process

The staff provided a reminder that draft or initial registration statements must be complete when they are submitted/filed except for the specified items in the FAST Act or Division's confidential submission policy.