Chapter 1

SEC Rulemaking and Other Activity in 2018

Learning objectives

- Identify the SEC's 2018 commission activities.
- Recall the SEC staff guidance.
- Recognize the SEC staff practice issues.

2018 SEC rulemaking and other activity

Overview

One way to understand the focus and activities of the SEC in 2018 would be to quickly peruse the SEC's near-term Regulatory Flexibility Act agenda published in the Fall of 2017. With Chairman Jay Clayton's deliberate intention to streamline the agenda and provide greater transparency about where the SEC's efforts will be concentrated, the SEC advanced 23 out of the 26 rules on the agenda in the past year. Many of the rules and activities that affect financial reporting continued to center on matters related to capital formation, cybersecurity, and the SEC staff's Disclosure Effectiveness Initiative. More specifically, these rules and activities included the following:

- Amendments to the definition of a smaller reporting company that increase the number of registrants eligible to apply scaled disclosures in their filings
- Amendments that eliminate certain redundant and outdated disclosure requirements of Regulations S-X and S-K
- New rules that will require the use of "Inline XBRL" in financial statements, which are intended to improve the accuracy of tagged data and reduce costs over time
- Proposed amendments to Rules 3-10 and 3-16 of Regulation S-X to streamline disclosures associated with registered debt securities
- A Request for Comment on earnings releases and quarterly reports — The request followed a tweet from President Trump, who instructed the SEC to study the frequency of reporting in the United States.
- Interpretive guidance on cybersecurity to further emphasize the importance of cybersecurity policies, procedures, and disclosures — In October 2018, the SEC also released an investigative report about cyber-related frauds perpetrated against public companies and the related internal control requirements.

Although it was not on Chairman Clayton's rulemaking agenda, the SEC and staff also devoted significant time and attention to issues related to initial coin offerings and cryptocurrency-related matters in 2018. Bill Hinman, the director of the Division of Corporation Finance, provided additional insight into whether digital assets are securities and, therefore, subject to securities laws and regulations. Given the prevalence of digital asset transactions, this area will likely continue to require the attention of the SEC and staff.

Although there were changes in commissioners in 2018, Chairman Clayton's agenda was largely carried out by the entire SEC. In January 2018, Hester Peirce (R) and Robert Jackson (D) were sworn in, filling two empty SEC seats. In September 2018, Elad Roisman (R) filled the seat vacated by Michael Piwowar (R) who left the SEC in July 2018. Commissioner Kara Stein's (D) term expired in June 2018, although she stayed through the end of 2018 as permitted by SEC rules on term limits. Another Democratic nominee to fill commissioner Stein's seat is expected in the months to come. At the staff level, Kyle Moffatt replaced Mark Kronforst as chief accountant within the Division of Corporation Finance.

The SEC staff issued other guidance throughout the year to assist registrants and others with interpreting and complying with the SEC's rules and regulations. The staff updated its Compliance and Disclosure Interpretations (C&DIs) and released a web-based version of its Financial Reporting Manual (FRM) that is easier to access and navigate than the traditional PDF format. In 2018, the staff also remained diligent in responding to Rule 3-13 of Regulation S-X waiver requests received from registrants on a timely basis.

2019 SEC rulemaking and other activity

Overview

In March 2019, the SEC proposed amendments to modernize and simplify certain disclosure requirements in Regulation S-K.

In May 2019, the SEC proposed amendments to the accelerated and large accelerated filer definitions, to potentially lower the number of registrants required to obtain an audit of internal control over financial reporting. The SEC also proposed amendments to Rule 3-05 of Regulation S-X, to change the circumstances in which acquired business financial statements are required. The proposal also includes changes to Rule 3-14 (real estate operations to be acquired) and Article 11, Pro Forma Financial Information.

Knowledge check

1. Who is the current chair of the SEC?

    a. Wes Bricker.
    b. Mary Jo White.
    c. William Hinman.
    d. Jay Clayton.

SEC commission activities

Capital formation

Amendments to the definition of a smaller reporting company (Release No. 33-10513)

In June 2018, the SEC adopted amendments to the definition of a smaller reporting company (SRC)[1]. The amendments increase the financial thresholds in the SRC definition, thereby expanding the number of companies eligible for the scaled disclosures permitted by Regulation S-K and Regulation S-X. The SEC's press release stated that its staff estimated that almost 1,000 additional companies would be eligible for SRC status in the first year based on the new definition. The financial thresholds in the definitions of accelerated and large accelerated filer and the related filing requirements (including those related to obtaining audits of internal control over financial reporting) remain unchanged.

Under the amended initial qualification thresholds, a company with less than $250 million of public float qualifies as an SRC. In addition, a company with less than $100 million in annual revenues qualifies if it has either no public float or a public float of less than $700 million.

The following table summarizes the new initial qualification thresholds, as compared to the prior thresholds:

SRC criteria	Prior definition	New definition
Public float	Less than $75 million of public float at end of second fiscal quarter	Less than $250 million of public float at end of second fiscal quarter
Revenues	Less than $50 million of revenues in most recent fiscal year and no public float at the end of the second fiscal quarter	Less than $100 million of revenues in most recent fiscal year and no public float or less than $700 million in public float at the end of the second fiscal quarter

The amendments also increase the financial thresholds for a company that is not an SRC to enter SRC status, which are set at 80% of the initial qualification thresholds outlined previously. For example, a company may enter SRC status when its public float falls below $200 million at the measurement date. In addition, a company that is not an SRC because it exceeded either or both of the $100 million annual

[1] The smaller reporting company definition excludes investment companies, asset-backed issuers and majority-owned subsidiaries of a parent that is not a smaller reporting company.

revenue and $700 million public float thresholds may enter SRC status when it meets 80% of the criteria on which it previously failed to qualify ($80 million of annual revenue and $560 million of public float) and continues to meet any threshold it previously satisfied ($100 million of annual revenue and $700 million of public float).

The following table summarizes the subsequent qualification thresholds.

SRC criteria	Prior definition	New definition
Subsequent qualification based on public float	Less than $50 million of public float at end of second fiscal quarter	Less than $200 million of public float at end of second fiscal quarter
Subsequent qualification based on revenues	Less than $40 million of revenues in most recent fiscal year and no public float at the end of the second fiscal quarter	Less than $80 million of revenues in most recent fiscal year, if it previously had $100 million or more of annual revenues Less than $560 million of public float, if it previously had $700 million or more of public float

The prior definitions of accelerated and large accelerated filer contained a provision that automatically excluded registrants that qualified as SRCs. The final rule eliminates that provision, while maintaining the financial thresholds in the definitions of accelerated filer (that is, $75 million of public float) and large accelerated filer (that is, $700 million of public float). Therefore, companies with public float of $75 million or more, but less than $250 million,[2] that qualify as SRCs under the amended definition, would still be subject to the accelerated filing requirements, including the accelerated timing of filing periodic reports and the requirement to provide the auditor's attestation on management's assessment of internal control over reporting required by Section 404(b) of the Sarbanes-Oxley Act of 2002.

The SEC also made conforming changes to Rule 3-05. Rule 3-05 requires financial statements of businesses acquired or to be acquired. Rule 3-05(b)(2)(iv) previously allowed registrants to omit such financial statements for the earliest of three fiscal years required if the net revenues of the business acquired or to be acquired were less than $50 million. The SEC increased this revenue threshold in Rule 3-05 to $100 million in line with the amendments to the SRC definition.

The amendments became effective on September 10, 2018. Further information on the amendments, transition guidance, and a list of scaled disclosures available to SRCs can be found in the staff's Small Entity Compliance Guide available on the SEC's website.

[2] Or less than $700 million of public float if the company has less than $100 million in annual revenues.

Disclosure effectiveness initiatives

Rulemaking and other activities related to the initiative during 2018 and early 2019 are discussed further as follows.

Disclosure update and simplification (Release No. 33-10532)

The SEC adopted rule amendments to eliminate redundant and outdated disclosure requirements of Regulations S-X and S-K in August 2018. Certain disclosure requirements in Regulations S-K and S-X have become outdated, redundant, overlapping, or superseded in light of developments in U.S. GAAP, International Financial Reporting Standard (IFRS), other SEC disclosure requirements and changes in the information environment. The changes made are intended to simplify the overall compliance process but not change the mix of information provided to investors.

Although the changes are voluminous, many of them are not substantive. Some changes merely update the terminology used in the rules. For example, Rule 3-02 of Regulation S-X was modified to refer to the statements of comprehensive income instead of the statements of income. Other changes remove requirements that are duplicative with other SEC or GAAP disclosure requirements. For example, Item 101(b) of Regulation S-K was deleted because it required disclosure of segment financial information, restatement of prior periods when reportable segments change, and discussion of segment performance that may not be indicative of current or future operations. Such disclosures are similar to those required by FASB Accounting Standards Codification® (ASC) 280, *Segment Reporting*, and Item 303(b) of Regulation S-K. The requirement to provide a computation of earnings per share in Item 601(b)(11) of Regulation S-K was also deleted because such disclosure is already required by ASC 260, *Earnings per Share*. Other amendments remove requirements that are simply outdated. For example, the requirement in Item 503(d) of Regulation S-K and related forms to provide a ratio of earnings to fixed charges when an offering of debt securities is registered was eliminated. The SEC believes this requirement is no longer relevant or useful. Additionally, the requirement in Item 201 of Regulation S-K to disclose the high and low stock prices for each quarter over the last two fiscal years was eliminated because such information is widely available.

The amendments contain a notable new requirement to present changes in shareholders' equity in interim financial statements within Form 10-Q filings. The disclosure of changes in shareholders' equity within a registrant's Form 10-Q filing is required on a quarter-to-date and year-to-date basis for both the current year and prior year comparative periods. We understand that a registrant may disclose the changes in one of two ways:

1. Reconcile the changes in two separate schedules detailing the quarter-to-date changes and the year-to-date changes.
2. Reconcile the changes in one schedule, detailing the changes in each quarter within the fiscal year.

In light of the effective date of the amendments, some questioned when a registrant would be first required to disclose the changes in shareholders' equity in its Form 10-Q filing. The staff issued Compliance and Disclosure Interpretation 105.09, which communicates that the staff would not object if

a registrant first discloses the changes in shareholders' equity in its Form 10-Q for the quarter that begins after November 5, 2018, the effective date of the amendments.

The following table summarizes the effective dates for various fiscal year-ends:

Fiscal year-end	Disclosure required in the Form 10-Q for the quarter ending:
December 31	March 31, 2019
March 31	June 30, 2019
June 30	March 31, 2019
September 30	March 31, 2019

In connection with this rulemaking, the SEC also referred certain disclosure requirements that overlap with U.S. GAAP but provide incremental information to FASB for potential incorporation into U.S. GAAP. Examples include the following:

- Incremental income tax disclosures required by Rule 4-08(h) of Regulation S-X (for example, disclosing the amount of domestic and foreign pre-tax income and income tax expense).
- Information about major customers required by Item 101 of Regulation S-K (for example, disclosing a customer's name in certain instances and removing the bright-line threshold (10%) for disclosure).

FASB has 18 months from the date the amendments were published in the Federal Register (until June 2020) to complete its consideration of whether the referred items will be added to its agenda for potential standard setting.

The adopting release and the demonstration version of the amendments are available on the SEC's website. Although the rulemaking is part of the SEC's Disclosure Effectiveness Initiative, the amendments also aim to fulfill the SEC's responsibility under the Fixing America's Surface Transportation (FAST) Act to eliminate provisions of Regulation S-K that are duplicative, outdated, or unnecessary for all filers. The amendments became effective on November 5, 2018.

Fast act modernization and simplification of regulation S-K (Release No. 33-10618)

On March 20, 2019, the SEC adopted amendments to modernize and simplify certain disclosure requirements in Regulation S-K. The final rules, which respond to the SEC's mandate under the FAST Act, are primarily based on the staff's November 2016 Report on Modernization and Simplification of Regulation S-K and implement many of the proposed amendments from October 2017. Although the amendments do not make major changes to Regulation S-K, they improve the readability of disclosures, and they discourage repetition and disclosure of immaterial information.

Significant amendments include changes to the following:

- *Management Discussion and Analysis (MD&A)* — A discussion of the earliest of three years presented in the financial statements may be omitted from MD&A if the discussion is included in any of the registrants' prior filings.[3] If discussion of the earliest three years is not presented, the registrant should disclose the location in the prior filing where this discussion can be found. Additionally, the instructions to MD&A were revised to omit reference to year-to-year comparisons and allow registrants to use any presentation that enhances a reader's understanding of the registrant's financial condition and results. These changes provide registrants with additional flexibility to tailor their MD&A presentation for their particular facts and circumstances.
- *Confidential treatment requests* — Registrants may redact confidential information in material contracts and certain other exhibits without first submitting a confidential treatment request to the SEC staff. This approach is permissible as long as the redacted information is both not material and would likely cause competitive harm to the registrant if publicly disclosed.
- *Cross-referencing* — Information outside of the financial statements is prohibited from being cross-referenced within the financial statements unless otherwise permitted or required by the SEC's rules, U.S. GAAP, or IFRS as issued by the International Accounting Standards Board (IASB) (whichever is applicable). Registrants may cross-reference to information included in the financial statements within other sections of an SEC filing.
- *Property disclosures* — Item 102 of Regulation S-K was revised to require a description of a property only if it is material to understanding the business of the registrant. The amendments do not apply to registrants in the real estate, mining, and oil and gas industries.
- *Risk factors* — The instructions for risk factor disclosures were streamlined to remove specific risk factor examples (for example, a registrant's lack of an operating history or a registrant's lack of profitable operations in recent periods, among others). Registrants are encouraged to focus on their own risk identification processes and provide risk disclosure that more precisely applies to their circumstances.
- *XBRL and the use of hyperlinks* — All information that appears on the cover page of certain SEC forms will need to be tagged using Inline XBRL. Additionally, the final rule requires the use of hyperlinks for information that is incorporated by reference and available on the Electronic Data Gathering, Analysis, and Retrieval (EDGAR) system.

The amendments to confidential treatment requests became effective on April 2, 2019. Most of the remaining amendments became effective on May 2, 2019.

Amendments to Regulation A (Release No. 33-10591)

In response to a mandate of the Economic Growth, Regulatory Relief, and Consumer Protection Act, the SEC approved amendments to Regulation A in December 2018 that permit Exchange Act reporting companies to rely on the Regulation A exemption for their securities offerings. Prior to the amendments, Regulation A was not available to public companies. Regulation A provides an exemption from registration for companies that raise up to $50 million in a 12-month period. Larger Regulation A offerings require an offering process and ongoing reporting requirements that are essentially scaled down versions of the offering and ongoing reporting processes used during and after registered

[3] As highlighted in the Adopting Release, the amendments do not otherwise alleviate registrants of their responsibility to provide investors with and focus their MD&A on material information.

offerings. Based on the amendments, companies that meet their Exchange Act reporting obligations are considered to have met their ongoing Regulation A reporting requirements.

The SEC's press release and adopting release contain further information about the amendments. The amendments become effective upon publication in the Federal Register.

Modernization of property disclosures for mining registrants (Release No. 33-10570)

In October 2018, the SEC adopted amendments to modernize property disclosures for mining registrants. The amendments aim to improve the quality and reliability of information provided to the investors by closely aligning the disclosure requirements and policies for mining properties with current industry and global regulatory practices and standards.

The following are key aspects of the amendments:

- Require a registrant with material mining operations to disclose certain information concerning its mineral resources in addition to its mineral reserves.
- Require a registrant's disclosure of exploration results, mineral resources, or mineral reserves in SEC filings to be based on, and accurately reflect, information and supporting documentation prepared by a "qualified person" (in other words, a mining expert).
- Require a registrant to obtain a dated and signed technical report summary from the qualified person. This technical report summary will also be filed as an exhibit to the relevant SEC filings in certain circumstances.
- Require certain registrants with material mining operations to provide investors with an overview of its properties and mining operations, including summary and individual property disclosure provisions in either a narrative or tabular format.
- Provide updated definitions of mineral reserves and mineral resources.

The final rules reflect numerous changes to the proposed rules issued in June 2016 based on feedback received by the SEC on the proposal. The SEC's press release on the amendments contains further details about these changes.

Registrants are required to comply with the new rules in their first fiscal year beginning on or after January 1, 2021. Registrants may voluntarily apply the new disclosure requirements at an earlier date. The existing disclosure requirements contained in Guide 7 remain effective until all registrants are required to comply with the final rules, at which time they will be rescinded.

Proposed Rules

Financial disclosures required by Rules 3-10 and 3-16 of Regulation S-X (Release No. 33-10526)

The SEC proposed rule amendments to simplify and streamline the financial disclosures required in and subsequent to registered debt offerings in late July 2018. The proposal would amend Rule 3-10 applicable to guarantors and issuers of guaranteed securities and Rule 3-16 applicable to affiliates whose securities collateralize a registrant's securities. The proposal follows the SEC's Request for Comment on the Effectiveness of Financial Disclosures about Entities Other Than the Registrant published in September 2015. The proposed changes are intended to better align the financial reporting

requirements with the needs of investors by providing them with information that is material and easier to understand. They are also intended to reduce the costs and burdens to registrants, thereby encouraging them to conduct more offerings on a registered basis.

Background

Rules 3-10 and 3-16 affect disclosures made in connection with registered debt offerings and subsequent periodic reporting. Rule 3-10(a) states the general rule that every issuer of a registered security that is guaranteed[4] and every guarantor of a registered security must file the financial statements required for a registrant by Regulation S-X. The rule also sets forth five exceptions to this general rule. Each exception specifies conditions that must be met. If the conditions are met, separate financial statements of each qualifying subsidiary issuer and guarantor may be omitted, but the parent company must provide certain "alternative disclosures."

The form and content of the alternative disclosures are determined based on the facts and circumstances and can range from a brief narrative to highly detailed condensed consolidating financial information.

Subsidiary issuers and guarantors that are permitted to omit their separate financial statements under Rule 3-10 are also automatically exempt from Exchange Act reporting under Exchange Act Rule 12h-5. The parent company, however, must continue to provide the alternative disclosures for as long as the guaranteed securities are outstanding.

Rule 3-16 requires a registrant to provide separate financial statements for each affiliate whose securities constitute a substantial portion of the collateral, based on a numerical threshold, for any class of registered securities as if the affiliate were a separate registrant. Although affiliates whose securities are pledged as collateral are not registrants with respect to the collateralized security and are not generally subject to the related reporting requirements, existing Rule 3-16 requires financial statements as if the affiliates were registrants.

Summary of Proposed Amendments

The following is a summary of the significant proposed changes.

[4] A guarantee of a debt or debt-like security ("debt security") is a separate security under the Securities Act and, as a result, offers and sales of these guarantees must be either registered or exempt from registration. If the offer and sale is registered, the issuer of the debt security and the guarantor must each file its own audited annual and unaudited interim financial statements required by Regulation S-X. Additionally, the offer and sale of the securities pursuant to a Securities Act registration statement causes the issuer and guarantor to become subject to reporting under Section 15(d) of the Exchange Act. Reporting under Section 15(d) requires filing periodic reports that include audited annual and unaudited interim financial statements for at least the fiscal year in which the related Securities Act registration statement became effective.

Rule 3-10

The proposed amendments would continue to follow the approach of permitting issuers to omit separate financial statements of subsidiary issuers and guarantors when certain conditions are met. However, the conditions and the required alternative disclosures would change. The proposed amendments would do the following:

- Require disclosure of any quantitative or qualitative information that would be material to making an investment decision with respect to the guaranteed security.
- Amend the condition that each subsidiary issuer or guarantor must be 100% owned by the parent company to omit its separate financial statements. The proposed rule would require that the subsidiary issuer or guarantor be a consolidated subsidiary of the parent company pursuant to the relevant accounting standards.
- Require summarized financial information for the issuers and guarantors, which may be presented on a combined basis. The summarized financial information would be required for only the latest year and subsequent interim period. This would replace the current requirement to provide condensed consolidating financial information for all periods presented in the consolidated financial statements.
- Require expanded qualitative disclosures about the guarantees and the issuers and guarantors.
- Permit the alternative disclosures to be provided outside the footnotes to the financial statements (such as in MD&A) in the registration statement covering the offer and sale of the subject securities and any related prospectus as well as in Exchange Act reports required to be filed shortly thereafter. Subsequently, the alternative disclosures would need to be provided in footnotes to the parent company's audited annual and unaudited interim consolidated financial statements.
- Permit a registrant to stop providing the alternative disclosures when the issuers and guarantors no longer have an Exchange Act reporting obligation with respect to the guaranteed securities, rather than requiring them for as long as the guaranteed securities are outstanding.

Rule 3-16

The proposed amendments would replace the existing requirement to provide separate financial statements for each affiliate that has securities pledged as collateral with financial and nonfinancial disclosures about the affiliate(s) and the collateral arrangement. The financial disclosures would consist of summarized financial information similar to that to be provided by issuers and guarantors of guaranteed securities discussed previously.

Comments on the proposal were due on December 3, 2018.

Amendments to financial disclosures about acquired and disposed businesses (Release No. 33-10635)

On May 3, 2019, the SEC proposed numerous amendments to the financial disclosure requirements for acquired and disposed businesses. Some of the significant proposed amendments would:

- change the calculations for measuring the significance of acquired and disposed businesses (reducing the circumstances in which historical financial statements of an acquired business will be required under Regulation S-X Rule 3-05);
- change the financial statement requirements for a significant acquired business (reducing the circumstances in which historical financial statements are required and the periods of the financial statements);

- align certain financial statement requirements of Regulation S-X Rule 3-14 for acquired real estate operations with Regulation S-X Rule 3-05 for acquired businesses (increasing the significance threshold to 20% and eliminating the need for three years of financial statements for acquisitions from related parties); and
- amend Article 11, Pro Forma Financial Information, to permit the use of "Management Adjustments" to reflect certain synergies and other transaction effects of the acquired business within the pro forma financial statements).

The proposal is part of the SEC's Disclosure Effectiveness Initiative and follows the SEC's *Request for Comment on the Effectiveness of Financial Disclosures about Entities Other Than the Registrant* published in September 2015. The proposed changes are intended to enhance the financial information about acquired and disposed businesses for investors, facilitate access to capital, and reduce the complexity and cost to prepare the required disclosures.

Some of the significant proposed amendments compared to the current requirements are as follows:

Topic	Proposed amendments	Current guidance
Measuring the significance of an acquired business	▪ Revise the investment test to compare the registrant's investment in and advances to the acquired business to the registrant's "aggregate worldwide market value"[5] ▪ Revise the income test to – add a measure of significance based on revenue (significance would be based on the lower of the income or revenue tests), – use income from continuing operations after income taxes, and – use the absolute values for loss years in the income averaging calculation ▪ Permit the use of certain pro forma financial information to measure significance	▪ The investment test compares the registrant's investment in and advances to the acquired business to the carrying value of the registrant's total assets. ▪ The income test is based on income from continuing operations before income taxes and often produces anomalous results under certain circumstances (for example, when the acquired business has a large loss and the registrant has minimal income). The income averaging calculation uses "zero" for loss years. ▪ The significance tests do not permit the use of pro forma financial information.

[5] The current investment test would continue to apply to registrants with no publicly traded common equity.

Topic	Proposed amendments	Current guidance
Measuring the significance of a disposed business	▪ Conform the significance tests for a disposed business with those of an acquired business (where applicable) and raise the significance threshold to 20% ▪ Permit the use of certain pro forma financial information to measure significance	▪ A disposed business is considered significant using a 10% threshold under Regulation S-X Rule 1-02(w). ▪ The significance tests do not permit the use of pro forma financial information.
Financial statement requirements for a significant acquired business	▪ Limit the required historical annual financial statements for an acquired business to two years even when significance exceeds 50% ▪ Remove the requirement to provide the comparative prior period interim financial statements when significance is less than 40% ▪ Remove the requirement for separate financial statements of a significant acquired business in a registration or proxy statement once the business has been included in the registrant's financial statements for a complete fiscal year ▪ Permit the use of abbreviated financial statements if certain requirements are met	▪ Three years of historical annual financial statements are required for an acquired business if significance exceeds 50%. ▪ The comparative prior period interim financial statements are required when significance thresholds are met. ▪ Financial statements of a significant acquired business are generally required to be provided in a registration statement or proxy statement when they have not been previously filed or the acquired business is of major significance. ▪ Requests to provide abbreviated financial statements in lieu of full or carve-out financial statements must be cleared by the SEC staff prior to filing (except for certain acquisitions that include significant oil and gas producing activities).
Financial statement requirements for individually insignificant businesses	▪ Revise the disclosure requirements for "individually insignificant businesses" that are significant in the aggregate to disclose the impact of all acquired businesses in the pro forma financial information, but require financial statements only for those that are more than 20% significant	▪ Historical financial statements (and the related pro forma financial information) are required for a substantial majority of individually insignificant but significant in the aggregate businesses.

Topic	Proposed amendments	Current guidance
Financial statement requirements for acquired real estate operations	▪ Generally align Regulation S-X Rule 3-14 with Regulation S-X Rule 3-05 (which includes eliminating the requirement for three years of financial statements for acquisitions from related parties and revise Regulation S-X Rule 3-06 to allow a period of 9 to 12 months to satisfy the requirement to provide 1 year of financial statements for an acquired/to be acquired real estate operation)	▪ The significance thresholds and financial statement requirements (including timing) differ under Regulation S-X Rule 3-14 for acquired real estate operations and Regulation S-X Rule 3-05 for acquired businesses.
Pro forma financial statements presented in accordance with Article 11 of Regulation S-X	▪ Permit two categories of pro forma adjustments: – "Transaction Accounting Adjustments" (to reflect the accounting for the transaction) – "Management's Adjustments" (to reflect certain synergies and other transaction effects of the acquired business within the pro forma financial statements)	▪ Pro forma adjustments are limited to those adjustments that are directly attributable to the transaction, factually supportable, and — as it relates the income statement — expected to have a continuing impact. Synergies and other actions taken or to be taken by management to integrate the acquired business after consummation of the transaction may not be reflected, but a discussion of such facts is allowed with transparent disclosure.

The proposed amendments also include updates to:

- clarify when historical financial statements and pro forma financial information are required;
- make corresponding changes to the requirements for smaller reporting companies;
- permit the use of, or reconciliation to, IFRS as issued by the IASB in the financial statements of an acquired business in certain circumstances;
- define a significant subsidiary tailored to business development companies and other investment companies; and
- address financial reporting for fund acquisitions by business development companies and other investment companies.

The proposal is subject to a 60-day public comment period after its publication in the Federal Register.

Amendments to the accelerated filer and large accelerated filer definitions (Release No. 34-85814)

On May 9, 2019, the SEC proposed to amend the definitions of an accelerated and large accelerated filer. As proposed, smaller reporting companies with less than $100 million in annual revenue would not be required to obtain an audit of their internal control over financial reporting. The proposed amendments would not change other key protections from the Sarbanes-Oxley Act of 2002, such as independent audit committee requirements, CEO and CFO certifications of financial reports, or the requirement that companies continue to establish, maintain, and assess the effectiveness of their Internal Control over Financial Reporting (ICFR). The proposed changes are intended to reduce compliance costs and promote capital formation for smaller reporting issuers.

The initial qualification thresholds for accelerated and large accelerated filer status based on public float would remain the same (that is, $75 million or more but less than $700 million in public float for an accelerated filer and more than $700 million in public float for a large accelerated filer).

Specifically, the proposed amendments would do the following:

- Change the definitions of an accelerated and large accelerated filer to exclude issuers that otherwise qualify as an SRC and have annual revenues of less than $100 million in their most recently completed fiscal year. Examples of registrants that will no longer qualify as accelerated filers under the proposed definitions include
  - registrants with annual revenue of less than $100 million and public float between $75 million and $250 million and
  - registrants with no revenue and public float between $75 million and $700 million.

  Conversely, registrants with more than $100 million in annual revenue and between $75 million and $250 million in public float would still qualify as accelerated filers.
- Increase the public float transition thresholds for exiting accelerated and large accelerated filer status to 80% of the initial qualification thresholds as reflected in the following table.

	Current threshold for exiting status	Proposed threshold for exiting status
Accelerated filer	Public float is less than $50 million at the end of the second fiscal quarter.	Public float is less than $60 million (80% of $75 million initial qualification threshold) at the end of the second fiscal quarter.
Large accelerated filer	Public float is less than $500 million at the end of the second fiscal quarter.	Public float is less than $560 million (80% of $700 million initial qualification threshold) at the end of the second fiscal quarter.

The proposal is subject to a 60-day public comment period after it is published in the Federal Register.

Other commission activities

Inline XBRL filing of tagged data (release no. 33-10514)

In June 2018, the SEC amended its XBRL reporting requirements to require the use of "inline XBRL," which will allow the financial statements to be readable by both humans and machines. Historically, issuers have been required to provide XBRL data in an exhibit to their filings. Consequently, issuers copy their financial statement information into a separate document and tag it in XBRL. The amendments require issuers to embed XBRL tags directly in their financial statements using a format known as inline XBRL in lieu of providing tagged data in a separate exhibit. The intent of the amendments is to reduce the preparation costs over time and improve the quality, timeliness, and usefulness of the data, which benefits investors and other market participants.

The Inline XBRL requirements take effect based on filing status as follows:

- June 15, 2019 — Large accelerated filers that prepare financial statements in accordance with U.S. GAAP
- June 15, 2020 — Accelerated filers that prepare financial statements in accordance with U.S. GAAP
- June 15, 2021 — All other filers

Form 10-Q filers will commence inline XBRL reporting in their Form 10-Q for the first quarter ending on or after these dates.

The requirement for companies to post XBRL data on their websites is eliminated upon the applicable effective date.

Currently, the information in XBRL files is excluded from the officer certification requirements, and issuers are not required to obtain assurance on such information from third parties such as auditors. In the adopting release, the SEC noted that the change in format to inline XBRL does not change this.

Request for comment on earnings releases and quarterly reports (Release No. 33-10588)

In late December 2018, the SEC released a Request for Comment that solicits input on the nature, content, timing, and frequency of earnings releases and quarterly reports. The request follows a tweet made by the president in August, who directed the SEC to study the frequency of reporting and consider a semi-annual system. However, this is not the first time the SEC has considered the issue. The SEC previously requested comment on the frequency of reporting in its Concept Release on the business and financial disclosure requirements of Regulation S-K in April 2016.

Broadly speaking, this latest request seeks input on how the SEC might simplify the process associated with the release of quarterly earnings and reports while maintaining the investor protection benefits of disclosure. The SEC also seeks input on how the periodic reporting process, earnings releases, and earnings guidance affect corporate decision making and strategic decisions In other words, does the process lead to an overemphasis on short-term thinking by registrants and other stakeholders?

Many of the detailed questions in the release focus on the following categories:

- The information content resulting from the quarterly reporting process, including how companies determine whether to issue an earnings release, what information is included in that release, and how it affects the usefulness of information included in Form 10-Q
- The timing of the quarterly earnings process, including how the release of earnings in a Form 8-K relates to the issuance of the Form 10-Q
- The earnings release as the core quarterly disclosure, including whether registrants should be given the option to follow a "Supplemental Approach" in which they can use their earnings releases (if issued) to satisfy certain core financial requirements of Form 10-Q
- The reporting frequency, including whether the SEC should move to a semi-annual reporting model for all or certain categories of reporting companies

The SEC's press release contains further details about the request. Comments were due on March 21, 2019.

Cybersecurity

Since taking office, Chairman Clayton has highlighted the importance of cybersecurity to the SEC and to all market participants. Explained as follows, the SEC issued an interpretive release in February that provides a framework for registrants to consider when evaluating whether to disclose information about cybersecurity risks and incidents.

SEC Statement and guidance on public company cybersecurity disclosures (Release No. 33-10459)

In response to the increasing significance of cybersecurity incidents, the SEC issued an interpretive release in February 2018 that outlines its views with respect to cybersecurity disclosure requirements under the federal securities laws as they apply to public operating companies. The release reinforces and expands the guidance on reporting and disclosing cybersecurity risks and incidents that the Division of Corporation Finance (the Division) issued in 2011. In addition, the release addresses the importance of cybersecurity policies and procedures and the application of insider trading prohibitions in the cybersecurity context.

The Division's 2011 guidance reminded registrants that although existing disclosure requirements do not explicitly include cybersecurity risks or cyber incidents, registrants may nonetheless be obligated to make such disclosures. The specific disclosure obligations within the Division's 2011 guidance included the following:

- Risk factors
- MD&A of financial condition and results of operations
- Description of business
- Legal proceedings
- Financial statement disclosures
- Disclosure controls and procedures

Each of those specific disclosure obligations was reinforced within the release. Additionally, the release expanded upon the Division's 2011 guidance by including a focus on the following new topics:

- Stressing the importance of cybersecurity policies and procedures — Companies were reminded that establishing and maintaining effective disclosure controls and procedures must include considerations for cybersecurity. The SEC also reminded companies to consider the materiality of cybersecurity risks and incidents when preparing their disclosures and included the relevant obligations companies have related to periodic reports, Securities Act and Exchange Act filings, and current reports.
- Application of insider trading prohibitions in the cybersecurity context — Cybersecurity risks and incidents may create material nonpublic information. The SEC encouraged companies to not only consider federal securities laws related to insider trading, but to also review their own insider trading policies and procedures already in place to prevent trading on the basis of material nonpublic information related to cybersecurity risks and incidents. In addition, the SEC expects companies to have policies and procedures to ensure that any disclosures of material nonpublic information related to cybersecurity risk and incidents are not made selectively, and that they comply with the Regulation F-D disclosure requirements.
- Board risk oversight disclosures — These were expanded to include cybersecurity risks when disclosing how the board of directors administers its risk oversight function.

Shortly after the release, Chairman Clayton issued a statement summarizing the new topics and encouraging companies to "examine their controls and procedures, with not only their securities law disclosure obligations in mind, but also reputational considerations around sales of securities by executives."

Consistent with the Division's 2011 guidance, the SEC's release reinforced the notion that companies are not to provide a "roadmap" on how to compromise their systems. Instead, companies are to provide meaningful disclosures that would be material to an investor and to provide such disclosures in a timely fashion.

Financial Reporting Manual

In 2018, the staff of the SEC's Division of Corporation Finance made its FRM available in a web-based format. Previously, the FRM was accessible only in a PDF format, which is still available on the SEC's website. At the conference, the staff indicated that it is working on an update to the FRM, particularly to reflect changes from rulemaking activity in 2018 (for example, amendments to the SRC rules) and guidance for emerging growth companies' adoption of new accounting standards.

Compliance and Disclosure Interpretations

The SEC staff updated its C&DIs several times during the year. Many of these updates were legal in nature and provide guidance on non-GAAP financial measures, Proxy Rules and Schedules, Regulation S-K, and Securities Act Forms, among others.

Knowledge check

2. What is one of the notable changes included in the SEC's disclosure update and simplification initiatives that was adopted in Release No. 33-10532 in 2018?

    a. Requirement to present changes in shareholders' equity in interim financial statements within Form 10-Q filings.
    b. Changes to definition of smaller reporting companies.
    c. Requirement to embed XBRL tags directly in their financial statements using a format — known as inline XBRL.
    d. Permitting Exchange Act reporting companies to rely on the Regulation A exemption for their securities offerings.

3. When is the effective date of the inline XBRL requirements?

    a. June 15, 2019, for all other filers.
    b. June 15, 2020, for all accelerated filers.
    c. June 15, 2021, for accelerated filers that prepare their financial statements in accordance with U.S. GAAP.
    d. June 15, 2019, large accelerated filers that prepare their financial statements in accordance with U.S. GAAP.

4. The cybersecurity interpretive release issued by the SEC in February 2018 _____ and _____ the guidance on reporting and disclosing cybersecurity risk and incidents.

    a. Updates, replaces.
    b. Reinforces, expands.
    c. Updates, amends.
    d. Reinforces, condenses.

5. Which statement is correct regarding the staff's guidance on cybersecurity disclosures?

    a. Disclosure controls do not apply to cyber breaches.
    b. Insider trading policies should not be contemplated when evaluating information about a cyber breach.
    c. The disclosure controls and procedures related to cyber incidents should ensure timely communication of cyber breaches.
    d. Cyber breach disclosures should not be communicated on a timely basis because it will disrupt the trading markets.

Practice issues

In addition to the SEC rulemaking and other activities mentioned previously, the SEC staff discussed various other topics throughout 2018.

Rule 3-13 waivers

As permitted by Rule 3-13, the SEC staff may waive or modify certain financial statement requirements. In this regard, the staff encourages registrants to consult with them when financial statement

requirements are not material to the total mix of information available to investors. The staff may grant relief to a registrant when such requests are consistent with investor protection. Although each Rule 3-13 waiver depends on a registrant's specific facts and circumstances, the staff provided the following insights:

Acquired or to be acquired business meets only one significance test

When an acquired or to be acquired business meets only one of the significance tests under Rule 1-02(w) of Regulation S-X, the staff may consider alternative measures of significance or an alternative financial statement presentation. For instance, when significance is triggered solely based on the income test (such as during a break-even period), the staff may look to other supplemental measures of significance used by the registrant, including revenues, operating income, and/or other nonfinancial measures.

Similarly, the staff may allow a registrant to present abbreviated financial statements (such as an audited statement of assets acquired and liabilities assumed based on an allocation of the purchase price at fair value on the transaction date) in lieu of full financial statements when the acquisition is significant solely based on the investment test. In this scenario, the staff will generally want to understand why the registrant paid an apparent premium for the business.

Omission of required financial statements for an acquired or to be acquired business

A registrant must present financial statements covering all related businesses when the related businesses are significant in the aggregate. However, one of the related businesses may not be significant to the overall acquisition. In that situation, the staff may agree to the omission of the financial statements of the individually insignificant business. Additionally, the acquisition of a significant business during the earliest year presented in a company's initial registration statement may no longer be meaningful to an investor when the company experienced significant growth after the acquisition. As a result, the staff may allow the financial statements of the previously acquired business to be omitted.

In an initial Form 10 filing, an SRC may also request relief when the audited financial statements of a significant business acquired during the earliest year presented are difficult to obtain. Lastly, the staff will consider requests for the omission of a significant acquired business's financial statements in a draft registration statement when the company's publicly filed financial statements will include the operations of the acquired business for at least a full year.

Substitution of financial statements

When an acquired business meets the definition of a foreign private issuer except for the ownership condition, the staff will consider a registrant's request to present financial statements prepared under IFRS — without reconciliation to U.S. GAAP and in lieu of U.S. GAAP financial statements. The staff may also consider similar requests for financial statements required under Rule 3-09 of Regulation S-X.

Furthermore, Rule 3-09 may require partial-year financial statements of an investee during the year of acquisition or disposition. When such partial-year financial statements are difficult to obtain, the staff

may grant requests to present full-year financial statements in lieu of the partial-year financial statements.

The staff also encouraged registrants to propose appropriate alternative disclosures as part of their waiver requests. For example, a registrant may suggest an expanded version of the summarized financial information under Rule 4-08(g) of Regulation S-X in lieu of full investee financial statements.

Finally, the staff continues to look for ways to improve transparency in the Rule 3-13 process. Although the subject of a Rule 3-13 waiver request may contain confidential information, the staff acknowledged that others may benefit from an understanding of the staff's approach to specific requests.

Financial Statement Requirements in a Form S-4 Or merger proxy for an operating company merging with a special purpose acquisition entity

During 2018, at the July and September Center for Audit Quality SEC Regulations Committee meetings, the committee and staff discussed the financial statement requirements for private operating companies in a Form S-4 or merger proxy filed by a public Special Purpose Acquisition Company (SPAC). Public SPACs are like public shell companies except that they raise money from investors for the purpose of acquiring an existing private operating company (sometimes in a specific industry). It is common for a SPAC to file a Form S-4 or merger proxy which solicits shareholder approval for the merger transaction and contains the financial statements of the private company. The staff communicated that it views the acquisition of a private operating company by the SPAC as the private company's initial public offering. (Moreover, the private company is considered to be the predecessor of the registrant.) Accordingly, the private company's financial statements included in the S-4/merger proxy should be audited in accordance with PCAOB standards and include all of the required public company disclosures (for example, Regulation S-X, segments, and earnings per share disclosures, among others). Additionally, the private operating company should evaluate the need to provide financial statements for any probable or consummated business acquisitions in accordance with Rule 3-05. Registrants who are unable to provide an auditor's report reflecting the use of PCAOB auditing standards for the private company in the Form S-4/merger proxy should discuss their facts and circumstances with the staff prior to filing.

Release of serious deficiency letters

In June 2018, the staff announced that it would begin releasing serious deficiency letters through the EDGAR system. A serious deficiency letter (or "bedbug" letter, as it is sometimes referred to) is issued when a registration statement or offering document is so deficient that the staff defers its review until the deficiencies are corrected. Letters associated with publicly filed registration statements or offering documents are made available on EDGAR within 10 calendar days of issuance. Letters associated with confidential submissions would be released only on EDGAR with the rest of the SEC correspondence associated with the filing no sooner than 20 business days after completion of the review.