

# 2020 SEC Reporting Insights

## Introduction

2020 was another busy year for SEC rulemaking and activities that affect financial reporting. The Commission's response to the novel coronavirus (COVID-19) resulted in conditional filing relief for registrants that found themselves unable to file on a timely basis in the earlier days of the pandemic and staff guidance to help registrants think through their disclosures in light of unprecedented uncertainty. Outside of COVID-19 related matters, the SEC continued its focus on capital formation and the Disclosure Effectiveness Initiative, with several rulemaking activities that resulted in significant changes to longstanding SEC rules and regulations. These rulemaking activities, among others, include final rules to amend:

- The accelerated and large accelerated filer definitions (which exclude certain smaller companies from the definition of an accelerated filer);
- The financial disclosure requirements of Regulation S-X for registered debt offerings and periodic reports thereafter;
- The financial disclosure requirements of Regulation S-X for acquired and disposed businesses;
- The Regulation S-K disclosure requirements for the description of business, legal proceedings and risk factors;
- Other aspects of Regulation S-K, including the elimination of selected financial data and other changes to modernize and simplify management's discussion and analysis (MD&A) disclosure requirements; and
- The exempt offering framework used by companies to raise capital in the private capital markets.

The staff also remains focused on the implementation and disclosure issues related to significant new accounting standards, the COVID-19 pandemic, non-GAAP financial measures and the anticipated LIBOR transition, among others.

This publication is intended to provide some key disclosure and reporting reminders for SEC registrants and summarizes the 2020 Commission rulemaking and activities, staff activities and other guidance that affect financial reporting.

## 2020 Reporting Reminders

In the sections that follow, we have summarized some key reporting topics to be mindful of, particularly as the annual reporting season approaches for calendar year-end SEC registrants.

### GOODWILL AND INDEFINITE-LIVED INTANGIBLE ASSETS IMPAIRMENT CONSIDERATIONS

The COVID-19 pandemic has caused significant declines in many registrants' share prices, market volatility and disruptions to operations. Depending on registrants' facts and circumstances, some considered these events to be a trigger for an interim impairment analysis for indefinite-lived intangible assets and/or goodwill under ASC 350, Intangibles – Goodwill and Other. The duration and extent of the adverse economic conditions associated with the COVID-19 pandemic remain uncertain. The potential for prolonged or further adverse economic conditions may result in the need for additional impairment analyses for the remainder of 2020 and beyond. The disclosures regarding impairment assumptions and estimates will likely evolve as conditions change.

All companies are required to disclose the following in the financial statements when an impairment loss is recognized:

- A description of the facts and circumstances that led to the impairment.
- The amount of the impairment loss and the method used to determine fair value of the impaired intangible asset or reporting unit.
- Description of the intangible asset and the income statement caption or line item in which the impairment loss is recorded.

Registrants should also consider providing the following disclosures for each reporting unit that is at risk of failing the impairment test as provided by [Section 9510 .3 of the Division of Corporation Finance's Financial Reporting Manual](#):

- The percentage by which fair value exceeded carrying value as of the date of the most recent test;
- The amount of goodwill allocated to the reporting unit;
- A description of the methods and key assumptions used and how the key assumptions were determined;
- A discussion of the degree of uncertainty associated with the key assumptions. The discussion regarding uncertainty should provide specifics to the extent possible (e.g., the valuation model assumes recovery from a business downturn within a defined period of time); and
- A description of potential events and/or changes in circumstances that could reasonably be expected to negatively affect the key assumptions.

Historically, the staff has issued comment letters to registrants requesting additional information regarding their impairment analysis. In light of current economic factors, we expect a heightened focus by the staff on disclosures related to impairment. The staff often requests additional information regarding the reasons why impairment charges were not taken in an earlier interim period. Therefore, registrants should provide transparent disclosures regarding the discrete events or circumstances that

occurred during the quarter and lead to the impairment charge. Furthermore, registrants should be prepared to respond to potential staff comment letters requesting additional information regarding reporting units with significant declines in operating results that are not identified as “at risk” of failing the impairment test.

### **PAYCHECK PROTECTION PROGRAM LOANS**

On March 27, 2020, President Trump signed into law the Paycheck Protection Program (“PPP”) which authorized two rounds of up to \$660 billion in federally guaranteed forgivable loans to qualifying businesses to pay their employees during the COVID-19 crisis. There are no specific US GAAP standards on accounting by business entities for government assistance. As PPP loans are considered legal-form debt, it is considered appropriate and a common practice to account for them as such under Accounting Standards Codification (ASC) 470, Debt. Under this model, the liability would only be derecognized upon repayment to the creditor or upon legal release under ASC 405-20, Extinguishments of Liabilities. The following are some key reporting reminders for those registrants that were granted PPP loans:

- The receipt and repayment of a PPP loan accounted for as debt under ASC 470 should be presented gross within financing activities on the statement of cash flows, if material.
- Entities that intend to apply for debt forgiveness may elect to account for PPP loan as debt pursuant to the guidance in ASC 470. However, legal release would only occur upon confirmation of forgiveness from the SBA under ASC 405- 20-40-1(b).
- Forgiveness of a PPP loan should be presented as a non- cash financing activity on the statement of cash flows.
- Risk factor disclosure may be appropriate to address eligibility considerations for the PPP loans as well as uncertainties about forgiveness.
- MD&A liquidity disclosures should discuss the borrower’s intent and ability to repay the loan. When a registrant’s operations are only viable due to the receipt of the PPP loan, that fact should also be disclosed.

We expect that the staff’s focus on disclosures surrounding PPP loans and other forms of governmental assistance may continue to increase due to its impact on the financial statements and perceived importance to investors.

### **REFERENCE RATE REFORM— LIBOR TRANSITION**

The staff remains focused on the transition issues associated with the discontinuation of the London Interbank Offered Rate (LIBOR). The rate is expected to be replaced with an alternative reference rate by a significant number of banks in 2021. LIBOR is a commonly used “benchmark” or “reference rate” for various commercial and financial contracts, including corporate and municipal bonds and loans, floating rate mortgages, asset-backed securities, consumer loans, and interest rate swaps and other derivatives. The change could have a significant impact on the financial markets and may present a material risk for certain market participants, including public companies, investment advisers, investment companies, and broker dealers.

In June, the SEC’s Office of Compliance Inspections and Examinations (“OICE”) issued a Risk Alert that identifies registrant preparedness for the transition away from LIBOR as an examination priority for FY 2020. OCIE will review whether and how the registrant has evaluated the potential impact of the LIBOR transition on the following:

- Business activities;
- Operations;
- Services; and
- Customers, clients, and/or investors.

The staff will review plans that registrants have developed and steps they have taken to prepare for the LIBOR discontinuation, including the following (if applicable):

- The firm’s and investors’ exposure to LIBOR-linked contracts that extend past the current expected discontinuation date, including any fallback language incorporated into these contracts;
- The firm’s operational readiness, including any enhancements or modifications to systems, controls, processes, and risk or valuation models associated with the transition to a new reference rate or benchmark;
- The firm’s disclosures, representations, and/or reporting to investors regarding its efforts to address LIBOR discontinuation and the adoption of alternative reference rates;
- Identifying and addressing any potential conflicts of interest associated with the LIBOR discontinuation and the adoption of alternative reference rates; and
- Clients’ efforts to replace LIBOR with an appropriate alternative reference rate.

The staff continues to express the importance of keeping investors informed about the progress towards risk identification and mitigation, and the anticipated impact that LIBOR transition may have on the company, if material. We would expect that a discussion of the impact will be included within MD&A or Risk Factors in many registrant filings.

## **INTERNAL CONTROL OVER FINANCIAL REPORTING CONSIDERATIONS**

The staff continues to emphasize the importance of high- quality disclosure controls and procedures (DCP) and internal control over financial reporting (ICFR). The COVID-19 pandemic has resulted in a change from physical to remote working environments for many companies, which has increased their reliance on automation and technology. In June, the staff communicated that these types of changes to the business and additional uncertainties may result in additional risks of material misstatement to the financial statements where new or enhanced controls may be needed to mitigate such risks<sup>1</sup>. The staff also reminded registrants that material changes in ICFR that have occurred or are likely to occur must be disclosed in quarterly filings in the fiscal quarter in which they occurred<sup>2</sup>. These changes may be the result of revisions to key judgements, valuations and assumptions requiring disclosure in the financial statements. The challenging and evolving nature of the pandemic has increased the importance of thorough evaluations of ICFR to ensure new and/or existing risks of material misstatement have been identified and addressed.

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<sup>1</sup> Additional information can be found in the SEC staff’s [public statement](#) on the “Continued Importance of High-Quality Financial Reporting for Investors”.

<sup>2</sup> Material changes in the Company’s ICFR should be disclosed in Item 4 of the quarterly report on Form 10-Q and Item 9A of the annual report on Form 10-K

## **FORM 10-K DISCLOSURE AND PROCESS REMINDERS**

### **Modernization of Regulation S-K – Items 101, 103 and 105**

In August, the SEC adopted amendments to the description of business, legal proceedings, and risk factor disclosure requirements of Regulation S-K, many of which have not been updated in over thirty years. The amendments include an increased emphasis on human capital resource disclosures, which can be an important driver of long-term value for many companies and industries. The new rules emphasize a more principles-based, registrant-specific approach to disclosures. The new requirements are effective for filings on or after November 9, 2020.

Some of the key amendments are as follows:

#### **Item 101 (Description of Business):**

- Require principles-based disclosure of the description of a registrant’s business, and information considered material to understanding the general developments of its business;
- Introduce a materiality framework in lieu of the previously prescribed five-year timeframe approach to business disclosures;
- Permit registrants to provide only an update of the general development of the business that focuses on material developments in the reporting period with a hyperlink to a previously filed document that, together with the update, provides a full discussion of the general development of the business;
- Provide a non-exclusive list of disclosure topics that may need to be disclosed which are, in part, based on the existing disclosure topics, but:
- Add a disclosure topic for human capital resources, including human capital measures or objectives that management focuses on in managing the business (to the extent they are material to understanding of the business as a whole); and
- Expand the regulatory compliance disclosure requirement to cover all material government regulations, rather than solely environmental regulations.

#### **Item 103 (Legal Proceedings):**

- Permit the use of hyperlinks or cross-references to legal proceedings disclosure included elsewhere in the filing to avoid duplication (e.g., in the financial statement footnotes); and
- Revise the \$100,000 threshold for disclosure of certain governmental environmental proceedings to \$300,000. However, registrants are permitted to select a different threshold that results in the disclosure of material environmental proceedings if the threshold does not exceed the lesser of \$1 million or one percent of current assets.

#### **Item 105 (Risk Factors):**

- Require a summary risk factor disclosure of no more than 2 pages if the risk factor disclosures exceed 15 pages (a change intended to address the lengthy and generic nature of risk factor disclosures);
- Change the disclosure standard from the “most significant” factors to the “material” factors required to be disclosed; and

- Require risk factors to be organized under relevant headings with any risk factors that apply to an investment in securities to be disclosed at the end of the risk factor section under a separate caption

In summary, these amendments seek to reduce the burden of certain disclosure requirements by permitting greater flexibility in disclosing information about a registrant’s business that is considered material to investors. Registrants should continue to actively engage in an evaluation of their disclosures to enhance the communication of their “story” and the material factors affecting the business to stakeholders.

## **SELECT STAFF COMMENT LETTER TOPICS**

As required by the Sarbanes-Oxley Act, the staff reviews registrant filings at least once every three years. The staff reviews may vary from a cover-to-cover review for compliance with the applicable rules and regulations to a targeted review focused on specific disclosures within the footnotes and MD&A for compliance with the relevant accounting standards and related disclosure requirements. Events such as a material restatement, significant volatility in the registrant’s stock price as compared to its peers, or significant business combinations (among other events) may trigger more frequent reviews.

Staff comments in 2020 have continued to focus primarily on the following areas:

- Non-GAAP Financial Measures;
- Management Discussion and Analysis (“MD&A”);
- Revenue Recognition (Topic 606); and
- Segment Reporting.

### **Non-GAAP Financial Measures**

The staff remains focused on registrants’ use of non-GAAP financial measures in their earnings releases and filings (the staff may also comment on measures appearing on company websites and investor presentations). Registrants are reminded to adhere to the [non-GAAP Compliance and Disclosure Interpretations](#) issued in May 2016 when they elect to present such measures.

The staff continues to focus on measures that are perceived to be misleading to investors, particularly those that include “individually tailored accounting principles.” Identifying these measures and adjustments can be very subjective. Some questions to consider when evaluating whether a measure might be considered an individually tailored accounting principle include:

- Does the adjustment shift the measure from an accrual basis of accounting to a cash or modified basis of accounting, such as presenting revenues on a cash receipts or billings basis?
- Does the adjustment change the presentation of revenue from a gross to net basis (or vice versa)?
- Does the adjustment consolidate the results of an entity that does not qualify for consolidation?
- Is an adjustment limited to only select parts, but not all, of an accounting concept?
- Is an adjustment inconsistent with the economics of a transaction or an agreement?

The staff encourages registrants who are considering the appropriateness of an existing or proposed non-GAAP financial measure to consult with the staff in the Chief Accountant's Office of the Division of Corporation Finance, or the respective Assistant Director (AD) Office.

### **Non-GAAP Financial Measure Adjustments for COVID-19**

The pandemic and the related government restrictions have had varying effects on registrants during the year. Registrants may wish to adjust for the effects of COVID-19 within their non-GAAP measures in order to better tell their story to investors. Registrants are reminded that Item 10(e) of Regulation S-K, Regulation G and the staff's guidance on non-GAAP measures continues to apply to adjustments related to the effects of COVID-19. The adjustments should include only those that clearly relate to COVID-19 and are incremental to, and separable from, normal operations.

### **Management Discussion and Analysis ("MD&A")**

The staff continues to comment on MD&A disclosures and encourages registrants to focus on communicating material information to investors. The nature of these comments include:

- Focus on the discussion of the results of operations and the need for more specificity in describing "why" changes have occurred period over period.
- Seek more information about the underlying causes and effects of known trends, events, uncertainties. For example, the staff may ask whether there are any known trends that have had or that the company reasonably expects will have a material favorable or unfavorable impact on revenues or results and whether those changes are expected to continue.
- Request that registrants focus their discussion of critical accounting estimates on the significant judgments and estimates that, if changed or varied, will significantly impact their results (which generally is accomplished by supplementing, not repeating, critical accounting policy disclosure).

The staff also continues to issue comments on performance indicators, financial or nonfinancial, that are used to manage the business and disclosed in MD&A (also refer to the Commission guidance on key performance indicators and metrics within MD&A in the sections that follow). Specifically, the staff reminds registrants to:

- Define the metrics used;
- Discuss how the metric is calculated;
- Discuss any limits on the usefulness of the metric;
- Disaggregate the metric (where applicable); and
- Explain how the metric or period-to-period change in the metric links to the operating results to reveal trends.

### **Revenue Recognition ("Topic 606")**

Year after year, accounting and disclosures related to revenue recognition are one of the key focus areas of staff comments. The staff continues to issue comment letters that seek clarity on:

- The identification of performance obligations – i.e., understanding the analysis of whether certain promised goods or services are or are not separately identifiable.

- The type and nature of variable consideration, including whether any variable consideration is constrained.
- Information regarding the method used to recognize revenue for performance obligations (over time or point-in-time) and why the method is appropriate.
- The analysis for presenting revenues on a gross vs. net basis (i.e., principal/agent considerations).
- Disaggregation of revenue into categories that reflect how economic factors affect the nature, amount, timing, and uncertainty of revenue and cash flows.

We recommend that registrants take a fresh look at Topic 606 disclosures to ensure the required disclosures are included and described in a clear and transparent manner.

### **Segment Reporting**

The staff's comments on segment reporting seek clarity on:

- How registrants identified operating segments;
- How registrants aggregate operating segments into reportable segments;
- Whether registrants have inappropriately included non-GAAP measures in their segment disclosures; and
- Whether registrants provide appropriate entity-wide disclosures related to products and services, revenues attributable to individual foreign countries and revenues from major customers.

The staff often identifies inconsistencies in how the business is described in earnings calls, websites, and industry or analyst presentations and how it is described in their segment reporting footnotes. We recommend registrants review their segment reporting disclosures to ensure the information is consistent with other sources of internal and external information. We recognize that registrants may have made significant changes to their business due to COVID-19 or other factors. These changes may have resulted in a change to the structure of the company and the information regularly reviewed by the Chief Operating Decision Maker ("CODM"). Registrants should consider these factors when evaluating the adequacy of their segment reporting disclosures.

We expect all four of these topics to remain focus areas of the staff in comment letters on upcoming and next year's filings. We otherwise anticipate an increase in focus on the adoption of ASC 326, Credit Losses, and COVID-19 related accounting and disclosure areas, including goodwill and intangibles as discussed above.

## Commission and Staff Activities

### RULEMAKING – CAPITAL FORMATION

#### Accelerated Filer and Large Accelerated Filer Definitions (Final Rules) (Release No. 34-88365)

In March, the SEC adopted new [rules](#) that revise the accelerated and large accelerated filer definitions. As a result, an issuer that is eligible to be a smaller reporting company (SRC) with less than \$100 million in annual revenue is no longer required to obtain an audit of its internal control over financial reporting (ICFR) and has more time to file its periodic reports on Forms 10-K and 10-Q. A summary of the revised initial qualification thresholds for determination of filer status compared to the previous thresholds is as follows.

	Previous Thresholds	Revised Thresholds
Non-accelerated filer	Public float less than \$75 million	Public float is less than \$75 million -OR- Public float is between \$75 million and \$700 million and annual revenue is less than \$100 million
Accelerated filer	Public float is at least \$74 million, but less than \$700 million	Public float is at least \$75 million, but less than \$700 million and annual revenue is \$100 million or more
Large Accelerated filer	Public float is \$700 million or more	Public float is \$700 million or more

Accordingly, registrants with annual revenue of less than \$100 million and public float between \$75 million and \$700 million no longer qualify as accelerated filers. In addition to amendments that added a conforming revenue rest for exiting accelerated filer and large accelerated filer status, the SEC also increased the public float transition thresholds for exiting accelerated and large accelerated filer status to 80% of the initial qualification thresholds as follows:

	Previous public float threshold for exiting status	Revised public float threshold for exiting status
Accelerated filer	Public float is less than \$50 million	Public float is less than \$60 million
Large Accelerated filer	Public float is less than \$500 million	Public float is less than \$560 million

A Business Development Company (BDC) is also excluded from the definition of an accelerated filer if the BDC has (1) public float of at least \$75 million, but less than \$700 million and (2) investment income<sup>3</sup> of less than \$100 million. BDCs should apply the same transition provisions for accelerated and large accelerated filer status that apply to other issuers (as outlined above, using investment income instead of revenue).

<sup>3</sup> Investment income as defined in Rule 6-07.1 of Regulation S-X

The amendments do not change other key protections from the Sarbanes-Oxley Act of 2002, such as CEO and CFO certifications of financial reports, or the requirement that companies continue to establish, maintain, assess, and report on the effectiveness of their ICFR and disclosure controls and procedures. Further, auditors are still required to obtain an understanding of a company’s ICFR in order to plan their audits, are required to consider control defects that come to their attention and may test controls in order to place reliance on internal controls and reduce substantive audit testing. The amendments became effective on April 27, 2020 and apply to annual reports due on or after such date.

**Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets (Release No. 33-10884)**

In November, the SEC adopted amendments to the exempt offering framework (framework) used by entities to raise capital in the private capital markets. The current exempt framework is considered complex and difficult to understand and apply by many companies. The changes are intended to promote capital formation, simplify the framework, and expand investment opportunities while retaining or improving important investor protections. The amendments follow the SEC’s [concept release](#) issued in June 2019 that solicited public comment on possible ways to simplify, harmonize, and improve the framework, we well as [proposed amendments](#) to the framework issued in March 2020. The final amendments generally become effective 60 days following their publication in the Federal Register.

All offers and sales of securities in the U.S. are required to be registered with the SEC unless one of several exemptions applies. Many of the exemptions are based on the characteristics of the securities being offered. Some of the more common types of exemptions are offerings under Regulations A, D and Crowdfunding under the Securities Act. The amendments:

- Establish a general integration principle to help determine whether multiple transactions are considered part of the same offering for compliance purposes;
- Increase the offering limits and revise certain individual investment limits as follows:

Amendments	Regulation A	Rule 504 of Regulation D	Regulation Crowdfunding
<b>Offering and Investment Limits</b>	Raise maximum offering amount under Tier 2 from \$50 million to \$75 million and for secondary sales under Tier 2 from \$15 million to \$22.5 million	Raise the maximum offering amount from \$5 million to \$10 million	<ul style="list-style-type: none"> <li>• Raise offering limit from \$1.07 million to \$5 million</li> <li>• Investment limits will not apply to accredited investors and changes calculation for non-accredited investors</li> </ul>

- Set clear and consistent rules on offering communications between investors and issuers, including permitting certain “demo day” activities that are not deemed general solicitation or advertising; and
- Synchronize certain disclosure and eligibility requirements and bad actor disqualification provisions to reduce differences between exemptions.

## Amending the “Accredited Investor” Definition (Final Rules) (Release No. 33-10824)

In August, the SEC adopted [amendments](#) to the definition of an “accredited investor” under SEC rules. Accredited investors have greater access to private capital market transactions. Previously, the qualifications of an accredited investor were focused solely on the investor’s income and net worth, whereas the amended definition is intended to allow other institutional and individual investors to qualify if they have the requisite financial knowledge, sophistication, and expertise. The SEC also amended the definition of a “qualified institutional buyer” under Rule 144A, expanding the list of eligible entities that meet the definition. The amendments will become effective on December 8, 2020.

## RULEMAKING – DISCLOSURE EFFECTIVENESS

The Commission continues to propose and adopt amendments that are intended to better align disclosure requirements with the needs of investors, provide them with information that is material and easier to understand and reduce the costs and burdens to registrants.

## Financial Disclosures About Guarantors and Issuers of Guaranteed Securities and Affiliates Whose Securities Collateralize A Registrant’s Securities (Final Rules) (Release No. 33-10762)

In March, the SEC adopted new [rules](#) to simplify and streamline the financial disclosures required by Rules 3-10 and 3-16 of Regulation S-X in registered debt offerings and periodic reports thereafter. Overall, the 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; and
- Reduce the costs and burdens to registrants, thereby encouraging them to conduct more offerings on a registered basis.

Some key aspects of the final rules include:

**Rule 3-10 of Regulation S-X:** (applicable to guarantors and issuers of guaranteed securities) is partly relocated to new S-X Rule 13-01. The amendments continue to allow issuers to omit separate financial statements of subsidiary issuers and guarantors when certain conditions are met, and:

- Amend the condition that requires each subsidiary issuer or guarantor to be 100% owned by the parent company in order to omit its separate financial statements. Under S-X Rule 1301, the subsidiary issuer or guarantor is only required to be consolidated in the parent company’s consolidated financial statements.
- Replaces the current requirement to present condensed consolidating financial information for all periods presented in the consolidated financial statements. Under S-X Rule 13-01, summarized financial information<sup>4</sup> will be required for issuers and guarantors (which may be presented on a combined basis) for the most recently completed fiscal year and subsequent year-to-date interim period included in the parent company’s consolidated financial statements.
- Require expanded qualitative disclosures about the issuers and guarantors, the terms and conditions of the guarantees, and how the issuer and guarantor structure and other factors may affect payments to holders of the guaranteed securities.

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<sup>4</sup> The required summarized financial information is defined in S-X Rule 1-02(bb).

- Require disclosure of information about each guarantor that would be material for investors to evaluate the sufficiency of the guarantee (consistent with existing disclosure requirements).
- Permit registrants to provide the amended disclosures outside of the parent company’s annual and interim financial statements (meaning such disclosures would not be subject to audit or review procedures) in management’s discussion and analysis (MD&A). If the disclosures are not made in MD&A or voluntarily within the financial statements, they must be presented in a prospectus immediately following “Risk Factors,” if any, or immediately following pricing information described in Item 105 of Regulation S-K.
- Permit a registrant to stop providing the financial and nonfinancial 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.

**S-X Rule 3-16:** (applicable to affiliates whose securities collateralize a registrant’s securities) is replaced with the requirements in new S-X Rule 13-02. The amendments:

- Replace the existing requirement to provide separate financial statements for each affiliate whose securities are pledged as collateral with financial and non-financial disclosures about the affiliate(s) and the collateral arrangement (disclosures which are permitted to be presented outside the financial statements).
- Replace the requirement to provide disclosure only when the pledged securities meet or exceed a numerical threshold relative to the securities registered or being registered with a requirement to provide the proposed financial and non-financial disclosures in all cases, unless they are immaterial.

The amendments to Rules 3-10, 13-01, 3-16 and 13-02 of Regulation S-X are also applicable to financial statements for a subsidiary of a smaller reporting company (SRC) that issues securities guaranteed by that SRC or if an SRC’s securities that are registered or being registered are collateralized by the securities of the SRC’s affiliates. The amended requirements under Rule 3-10 and new 13-01 of Regulation S-X also apply to asset-backed securities under Regulation S-K. Further, consistent with existing practice under Rule 3-10, the Office of the Chief Counsel [announced](#) that it would not recommend enforcement action if issuers of certain “Trust Preferred Securities” continue to omit their separate financial statements following the effectiveness of the new rules, as long as certain conditions were met (refer to pages 3 and 4 of the [letter](#) sent by a law firm requesting the staff’s views on the matter).

The amendments are effective on January 4, 2021. However, registrants may voluntarily apply the amendments to registration statements and periodic reports before that date.

**Amendments to Financial Disclosures About Acquired and Disposed Businesses (Final Rules) (Release No. 33-88365)**

In May, the SEC adopted new [rules](#) that amend the financial disclosure requirements of Regulation S-X for acquired and disposed businesses. The SEC also amended the significance tests for a “significant subsidiary” in certain SEC rules. The amendments are intended to enhance the financial information about acquired and disposed businesses for investors, facilitate access to capital, and reduce the complexity and cost associated with the related disclosures. When a registrant acquires a significant business, the

registrant is required to provide separate audited annual and unaudited interim preacquisition financial statements of the acquired business based on the significance of the entity acquired to the business of the registrant (see S-X Rules 1-02 (w), 3-05, and 3-14 (real estate operations)) and unaudited pro forma financial information (see Article 11). Some of the significant amendments compared to the current requirements are as follows:

Topic	New Guidance	Current Requirements
Measuring the significance of an acquired business	<ul style="list-style-type: none"> <li>• Revise the investment test to compare the registrant’s investment in and advances to the acquired business to the registrant’s “average aggregate worldwide market value,” as defined</li> <li>• Revise the income test to:               <ul style="list-style-type: none"> <li>- Use the lower of income from continuing operations before taxes or revenue when revenue is applicable</li> <li>- Use the absolute values for loss years in the income averaging calculation</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• 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</li> <li>• The income test is based solely on income from continuing operations before 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.</li> </ul>
Measuring the significance of a disposed business	<ul style="list-style-type: none"> <li>• Conform the significance tests for a disposed business with those of an acquired business (where applicable) and raise the significance threshold to 20%</li> </ul>	<ul style="list-style-type: none"> <li>• A disposed business is considered significant using a 10% threshold under S-X Rule 1-02(w)</li> </ul>
Financial statement requirements for a significant acquired business	<ul style="list-style-type: none"> <li>• Limit the required historical annual financial statements for an acquired business to two years even when significance exceeds 50%</li> <li>• Remove the requirement to provide the comparative prior period interim financial statements when significance is less than 40%</li> <li>• 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 nine months or a complete fiscal year, depending on the significance</li> <li>• Permit the use of abbreviated financial statements if certain requirements are met</li> </ul>	<ul style="list-style-type: none"> <li>• Three years of historical annual financial statements are generally required for an acquired business if significance exceeds 50%</li> <li>• The comparative prior period interim financial statements are required when significance thresholds are met</li> <li>• 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</li> <li>• 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)</li> </ul>

Topic	New Guidance	Current Requirements
Financial statement requirements for individually insignificant businesses	<ul style="list-style-type: none"> <li>Revise the disclosure requirements for “individually insignificant businesses” that are significant in the aggregate to disclose the impact of all acquired businesses in pro forma financial information, but only require historical financial statements for those that are more than 20% significant</li> </ul>	<ul style="list-style-type: none"> <li>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</li> </ul>
Financial statement requirements for acquired real estate operations	<ul style="list-style-type: none"> <li>Generally align S-X Rule 3-14 with S-X Rule 3-05 (which includes eliminating the requirement for three years of financial statements for acquisitions from related parties and revising S-X Rule 3-06 to allow a period of nine to twelve months to satisfy the requirement to provide one year of financial statements for an acquired/to be acquired real estate operation)</li> </ul>	<ul style="list-style-type: none"> <li>The significance thresholds and financial statement requirements (including timing) differ under S-X Rule 3-14 for acquired real estate operations and S-X Rule 3-05 for acquired businesses</li> </ul>
Pro forma financial statements presented in accordance with S-X Article 11	<ul style="list-style-type: none"> <li>Revise to include the following categories of pro forma adjustments: <ul style="list-style-type: none"> <li>Require “Transaction Accounting Adjustments” (to reflect required accounting for the transaction) and “Autonomous Entity Adjustments” (to reflect the operations and financial position of registrant as an autonomous entity, if previously part of another entity), and</li> <li>Permit, but not require, “Management’s Adjustments” in certain circumstances (to reflect certain synergies and other effects of the transaction to acquire the business within the pro forma financial statements)</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>Pro forma adjustments are limited to those adjustments directly attributable to the transaction, factually supportable, and as it relates to 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, although a discussion of such facts is allowed with transparent disclosure</li> </ul>

The amendments also include updates to:

- Expand the use of pro forma financial information to measure significance;
- Clarify when historical financial statements and pro forma financial information are required within S-X Rule 3-05 and Article 11;
- 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 investment companies; and
- Address financial reporting for fund acquisitions by business development companies and investment companies.

The amendments are effective at the beginning of a registrant’s fiscal year beginning after December 31, 2020. However, early application is permitted if the amendments are applied in their entirety.

**Management’s Discussion and Analysis, Selected Financial Data, and Supplementary Financial Information (Final Rules) (Release No. 33-10890)**

In November, the SEC adopted amendments to the disclosure requirements of Regulation S-K. Like other proposed and final amendments to Regulation S-K issued over the past two years, the changes are intended to modernize, simplify, and enhance the SEC’s framework for disclosures outside the financial statements. The amendments:

- Eliminate the requirement to disclose selected financial data (S-K Item 301) and replace the requirement to disclose quarterly supplementary financial data (S-K Item 302(a)) with a principles-based requirement for material retroactive changes;
- Streamline the disclosure instructions to management’s discussion and analysis (MD&A) (S-K Item 303) and clarify the overall objective of MD&A;
- Clarify the disclosure requirements regarding the results of operations by codifying other guidance within Regulation S-K (e.g., the discussion of the reasons underlying material changes is required);
- Amend certain other longstanding prescriptive disclosure requirements within MD&A (e.g., disclosure of contractual obligations in a tabular format would no longer be required); and
- Promote a principles-based approach to certain disclosures within MD&A.

Some of the other significant changes compared to the current requirements are as follows:

Topic	Amendments	Current Requirements
Interim Periods (Item 303(b)(2))	<ul style="list-style-type: none"> <li>• Discuss material changes in the results of operations for the most recently completed quarter as compared to either the corresponding quarter of the prior year OR to the immediately preceding quarter.</li> </ul>	<ul style="list-style-type: none"> <li>• Discuss any material changes in the results of operations for the most recent fiscal year-to-date period presented in the statement of operations and corresponding year-to-date period of the preceding fiscal year</li> </ul>
Off-balance sheet arrangements (Item 303(a)(4))	<ul style="list-style-type: none"> <li>• Within the context of MD&amp;A, discuss commitments or obligations, including contingent obligations, arising from arrangements with unconsolidated entities or persons that have, or are reasonably likely to have, a material current or future effect on such registrant’s financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, cash requirements, or capital resources.</li> </ul>	<ul style="list-style-type: none"> <li>• Discuss, in a separately captioned section, off balance sheet arrangements that have or are reasonably likely to have current or future effect on the registrant’s financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures, or capital resources that is material to investors.</li> </ul>

<p>Contractual Obligations (Item 303(a)(5))</p>	<ul style="list-style-type: none"> <li>Eliminate the requirement to present a contractual obligations table and enhance the discussion of liquidity and capital resources to focus on material short- and long-term cash requirements from known contractual and other obligations.</li> </ul>	<ul style="list-style-type: none"> <li>Disclose in a tabular format the contractual obligations as of the latest fiscal year end balance sheet. The table must disclose contractual obligations by type and payments due by prescribed periods of time.</li> </ul>
<p>Capital Resources (Item 303(a)(2))</p>	<ul style="list-style-type: none"> <li>Describe material cash requirements, including commitments for capital expenditures, as of the latest fiscal period, the anticipated source of funds needed to satisfy such cash requirements, and the general purpose of such requirements. <ul style="list-style-type: none"> <li>Material cash requirements could include items such as funds necessary to maintain current operations, complete projects underway, and achieve stated objectives or plans; or commitments for capital and other expenditures.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>Describe material commitments for capital expenditures as of the end of the latest fiscal period and indicate the general purpose of such commitments and the anticipated sources of funds needed to fulfill such commitments. Any material trends in the registrant’s capital resources should be described.</li> </ul>

Topic	Amendments	Current Requirements
<p>Critical Accounting Estimates</p>	<ul style="list-style-type: none"> <li>Codifies and clarifies guidance about the disclosure of critical accounting estimates within Regulation S-K.</li> <li>Defines a critical accounting estimate as an estimate made in accordance with GAAP that involves a significant level of estimation uncertainty and has had or is reasonably likely to have a material impact on the registrant’s financial condition or results of operations.</li> <li>Clarifies current guidance and requires disclosure, to the extent material, of why the estimate is subject to uncertainty, how much each estimate has changed during the reporting period, the sensitivity of the reported amounts to the material methods, assumptions, and estimates underlying the estimate’s calculation.</li> </ul>	<ul style="list-style-type: none"> <li>Disclosure guidance regarding critical accounting estimates appears within Commission interpretative guidance on MD&amp;A disclosure.</li> <li>Disclose critical accounting estimates and assumptions when: <ul style="list-style-type: none"> <li>The nature of the estimates or assumptions is material due to the levels of subjectivity and judgment necessary to account for highly uncertain matters or the susceptibility of such matters to change; and</li> <li>The impact of the estimates and assumptions on financial condition or operating performance is material.</li> </ul> </li> <li>Disclose specifically why accounting estimates or assumptions bear the risk of change.</li> </ul>

The final rules are effective 30 days after publication in the Federal Register. Registrants will be required to apply the amended rules for their first fiscal year ending on or after 210 days after publication in the Federal Register (referred to as the “mandatory compliance date”). Registrants are required to apply the amendments in a registration statement that on its initial filing date is required to include financial statements for a period on or after the mandatory compliance date. Voluntary early compliance is permitted following the effective date if the disclosures are responsive to the amended item in its entirety.

## **STAFF GUIDANCE**

### **Covid-19 Disclosure Guidance**

In late March, the Division of Corporation Finance issued [Disclosure Guidance Topic No. 9](#) which provides the SEC staff’s views on disclosures and securities law obligations that registrants should consider related to COVID-19, including business and market disruptions. The staff expressed the importance of high-quality financial reporting as the demand for decision-useful information only increases in times of heightened uncertainty. The guidance is focused on assisting registrants in fulfilling their obligation to timely disclose information that clearly depicts the effects that COVID-19 is having and is expected to have on their business.

The staff expect registrants to disclose:

- The impacts COVID-19 has had on the registrant’s business;
- Management’s expectations of its future impact and management’s response; and
- Management’s plans for addressing related uncertainties.

Consideration should be given to whether such disclosures involve forward-looking information to ensure that the information is provided in a manner that maintains the safe harbors under the Securities Act and the Exchange Act. The staff also reminded registrants to consider the requirements of trading activities by the officers and directors and other insiders of the registrant who have access to material nonpublic information that impacts the registrant, before that information is disclosed publicly.

Registrants are also reminded that Regulation G and Item 10 of Regulation S-K requirements on non-GAAP measures continue to be effective. It would not be considered acceptable to adjust for lost revenues or normal expenses (e.g. payroll) due to suspension of operations because of COVID-19. Depending on the facts and circumstances, it may be acceptable to exclude certain costs directly attributable to COVID-19. Such adjustments should be carefully evaluated to ensure compliance with the requirements.

### **Disclosure Guidance Topic No. 9A**

In June, the staff issued [Disclosure Guidance Topic No. 9A](#) to supplement previously issued Disclosure Guidance Topic No. 9. The supplemental guidance provides disclosure considerations regarding the effects and risks of COVID-19 on a registrant’s operations and financial conditions, including liquidity and capital resources within management’s discussion and analysis (“MD&A”). The staff continued to encourage companies to provide disclosures that allow investors to evaluate the current and expected impact of COVID-19 through the eyes of management and to proactively update disclosures as facts and circumstances change.

Many registrants have made operational adjustments in response to the adverse effects of COVID-19 that may be considered material to an investor. These adjustments have often focused on preserving liquidity and complying with new health and safety guidelines. Corp Fin expects registrants to provide robust and transparent disclosure regarding these adjustments within MD&A to the extent they are material. The supplemental guidance provides questions for registrants to consider as they analyze their specific facts and circumstances to determine the appropriate level of disclosure. Questions provided by Corp Fin are generally focused on the following areas:

- Access to revolving lines of credit or capital raised in the public markets;
- Ability to timely service debt or other obligations;
- Ability to maintain compliance with covenants;
- Modifications to contract terms;
- Changes to capital expenditure activities;
- Disposals of material assets or business lines;
- Altered terms with customers, concessions;
- Supplier finance programs;
- Known trends and uncertainties; and
- A registrant’s ability to continue as a going concern.

Registrants have also received federal assistance in the form of loans and tax relief through the Coronavirus Aid, Relief, and Economic Security Act (CARES Act). Corp Fin expects registrants to provide disclosure regarding the short and long-term impact of that assistance on their financial condition, results of operations, liquidity, and capital resources, as well as the related disclosures and critical accounting estimates and assumptions within MD&A

### **Key Performance Indicators and Metrics In MD&A**

In January, the staff issued [guidance](#) on the disclosure of key performance indicators and metrics in MD&A. The guidance provides considerations and disclosures that are expected to accompany non-financial and financial metrics<sup>5</sup> used to describe the performance or status of the business.

- Based on a registrant’s facts and circumstances, the SEC expects the following disclosures to accompany disclosures of key performance indicators and metrics:
- A clear definition of the metric and how it is calculated;
- A statement indicating the reasons why the metric provides useful information to investors; and
- A statement indicating how management uses the metric in managing or monitoring the performance of the business.

The guidance includes additional disclosure considerations for companies that change the method by which they calculate or present a metric from one period to another (e.g., differences in the metrics between periods, reasons for the changes, etc.).

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<sup>5</sup> Examples of such metrics include same store sales, revenue per subscriber, active customers, employee turnover rates, etc.).

Registrants should also consider:

- The extent to which an existing regulatory framework applies, such as GAAP or, for non-GAAP measures, Regulation G or Item 10 of Regulation S-K;<sup>6</sup>
- Whether there are estimates or assumptions underlying the metric or its calculation, and whether disclosure of such items is necessary for the metric not to be misleading; and
- Additional information that may be necessary to provide adequate context for an investor to understand the metric presented. The guidance reminds registrants of the importance to maintain effective disclosure controls and procedures when disclosing material key performance indicators or metrics that are derived from the company's own information.

The guidance reminds registrants of the importance to maintain effective disclosure controls and procedures when disclosing material key performance indicators or metrics that are derived from the company's own information.

### **Financial Reporting Manual**

The staff of the SEC's Division of Corporation Finance published an update to the [Financial Reporting Manual](#) (FRM) in November.<sup>7</sup> The update is not intended to communicate any new interpretive guidance. Many of the changes are considered conforming changes for some of the rule changes over the past few years and staff guidance disseminated through other communications. However, the update does not include changes for the recent rulemaking described herein that will change the financial disclosure requirements about guarantors and issuers of guaranteed securities or acquired and disposed businesses; caution should be exercised in applying the FRM guidance in connection with these new rules. The update includes revisions for:

- The amendments to the definition of a smaller reporting company;
- The amendments to the definition of an accelerated and large accelerated filer;
- The disclosure update and simplification amendments;
- The application of S-X Rule 3-13 waiver requests to Form 8-K;
- The audit requirements for a special purpose acquisition company's non-reporting target in Form S-4/F-4;
- The calculation of the income test under S-X Rule 3-09 when there is more than one equity method investee; X The staff's perspective on qualified audit reports;
- Other examples of legend (or "to-be-issued") audit reports; and
- The removal of outdated Corp Fin guidance and US GAAP references.

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<sup>6</sup> Regulation S-K Item 10(e)(4) states that non-GAAP financial measures exclude operating and other statistical measures; and ratios or statistical measures calculated using (1) financial measures calculated in accordance with GAAP and/or (2) operating and other measures that are not non-GAAP measures.

<sup>7</sup> The FRM is an internal staff reference document that provides general guidance covering several SEC reporting topics. While the FRM is not authoritative, it is a helpful source of guidance for evaluating SEC reporting issues

## Compliance and Disclosure Interpretations (C&DIs)

### Omission of Earliest Year From MD&A

In January, the staff issued [C&DIs 110.02](#), [110.03](#) and [110.04](#) related to a registrant's ability pursuant to Regulation S-K to omit a discussion in MD&A of the earliest of the three years presented in the financial statements and instead cross reference to the discussion that appears in a previous filing. The C&DIs provide the following guidance:

- The registrant must assess its information about the earliest of three years to determine whether such information is required under S-K Item 303(a). The earliest year may not be omitted if the information is necessary to an understanding of its financial condition, changes in financial condition and results of operations. However, such information may be expressly incorporated by reference.
- The omitted discussion of the earliest year is not considered part of the current filing unless that disclosure is explicitly incorporated by reference.
- A registration statement that incorporates Form 10-K by reference will contain only the MD&A that was included or incorporated by reference in the most recently filed Form 10-K.

### Reporting Compensation for Periods Affected by COVID-19

In September, the staff issued [C&DI 219.05](#) to assist public companies in determining whether benefits provided to executive officers because of COVID-19 should be disclosed as perquisites or personal benefits for purposes of S-K executive compensation proxy disclosures. The guidance provides a roadmap for an analysis of whether an item meets the threshold of being "integrally and directly related to the performance of the executive's duties" which depends on the particular facts and circumstances. If this threshold is met, disclosure would not be required. Disclosure will be required if the item confers a direct or indirect benefit and has a personal aspect that is not generally available to all employees. Registrants should carefully analyze such benefits provided to executives during the pandemic and clearly document why such benefits are or are not perquisites for purposes of S-K executive compensation proxy disclosures.

### Special Purpose Acquisition Companies (SPACs) Use of Form S-3

In September, the staff issued [C&DI 115.18](#) to address the question of whether a combined entity arising from a merger between a private operating company and a reporting shell company, such as a special purposes acquisition company (SPAC), is permitted to use the SPAC's pre-combination reporting history for purposes of determining the combined entity's eligibility to use Form S-3 (a short-form registration statement). The guidance clarified that the combined entity will generally need 12 months of Exchange Act reporting history following the completion of the merger to become S-3 eligible.

Centri Business Consulting provides the highest quality finance and accounting consulting services to its clients by being reliable and responsive to their needs. Centri provides companies with the expertise they need to meet their reporting demands. Centri specializes in financial reporting, internal controls, technical accounting research, valuation, and CFO advisory services for companies of various sizes and industries. From complex technical accounting transactions to monthly financial reporting, our professionals can offer any organization the specialized expertise and multilayered skill sets to ensure the project is completed timely and accurately.

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