2019 SEC Reporting Insights

OVERVIEW

For matters that affect financial reporting in 2019, the Securities and Exchange Commission's focus and activities were consistent with trends observed in the prior year. Rulemaking related to capital formation and the SEC staff's Disclosure Effectiveness Initiative has dominated the Commission's agenda. This rulemaking includes:

- Final rules to modernize and simplify certain disclosure requirements in Regulation S-K, and related rules & forms
- Final rules to permit all issuers to "test-the-waters" prior to a registered public offering;
- Proposed amendments to financial disclosures about acquired and disposed businesses;
- Proposed amendments to the accelerated filer and large accelerated filer definitions;
- Proposed amendments to other Regulation S-K disclosure requirements for the description of business, legal proceedings and risk factors

Outside of the Commission's rulemaking efforts, the staff remains focused on the implementation and disclosure issues related to significant new accounting and PCAOB standards, 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 2019 Commission rulemaking and activities, staff activities and other guidance that affect financial reporting.

2019 SEC 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.

SAB 74 DISCLOSURES

Staff Accounting Bulletin No. 74, Disclosure of The Impact That Recently Issued Accounting Standards Will Have on The Financial Statements of The Registrant. Codified in Topic 11-M.

Over the past several years, reporting and disclosure issues related to the adoption of new, significant accounting standards (e.g., ASC 606, Revenue Recognition and ASC 842, Leases) have been a significant staff focus area. One of these reporting and disclosure issues relates to SAB 74 disclosures, which provide investors with information about the impact that recently issued accounting standards will have on the financial statements of the registrant when adopted in a future period.

A registrant's SAB 74 disclosures are expected to address the following (if applicable):

- Status of implementation;
- A comparison of accounting policies (before and after adoption);
- Disclosure of the quantitative impact of the new accounting standard if it can be reasonably estimated;
- Disclosure that the expected financial statement impact of the new standard cannot be reasonably estimated;
- Consideration of the effect of new footnote disclosure requirements in addition to the effect on the balance sheet and income statement; and
- Qualitative disclosures.

As the public company adoption dates for ASC 606 and ASC 842 have passed for many registrants, we expect the staff to focus on registrants' SAB 74 disclosures related to the new CECL standard.

CURRENT AND EXPECTED CREDIT LOSSES ("CECL") ASU 2016-13*, Financial Instruments – Credit Losses (ASC 326)*, currently effective for public companies for fiscal years (including interim periods within those years) beginning after December 15, 2019, changes the methodology for recognizing and measuring credit losses. The FASB recently affirmed its prior decisions to defer the effective date of ASC 326 for SEC filers that qualify as smaller reporting companies. The new standard revises the accounting requirements related to the measurement of credit losses and will require organizations to measure all expected credit losses for financial assets based on historical experience, current conditions and reasonable and supportable forecasts about collectability. Assets must be presented in the financial statements at the net amount expected to be collected.

As this standard has a far-reaching impact on both financial institutions and non-financial institutions, we would expect that a discussion of the standard's anticipated impact will be included in many registrant filings.

MANAGEMENT DISCUSSION AND ANALYSIS ("MD&A") CHANGES

In March, the SEC adopted amendments to modernize and simplify certain disclosure requirements in Regulation S-K. Among other changes described below under Rulemaking - Disclosure Effectiveness, the amendments include an option to omit MD&A discussion of the earliest of the three years presented in the financial statements if the discussion is included in any of a registrant's prior filings (the location in the prior filing where the discussion can be found must be disclosed) and is not material to an understanding of the registrant. The ability to omit discussion of the earliest period presented in the financial statements is limited to registrants providing three years of financial statements. Registrants that present only two years of financial statements may not omit discussion of either year from MD&A. Furthermore, the instructions to MD&A were revised to omit reference to year-to-year comparisons and allow registrants to use any presentation that enhances an investor's understanding of the registrant's financial condition and results. These changes, which may be considered in upcoming Form 10-K filings, invite registrants to revisit their MD&A disclosures and provide flexibility to tailor the presentation for their facts and circumstances.

Registrants should consider the effect of retrospective changes to the financial statements (e.g., discontinued operations, error corrections, etc.) when determining whether to omit discussion of the earliest period presented in the financial statements from MD&A. Judgment may be applied and accordingly, a registrant should consider whether the previously filed disclosure that it is considering omitting and referring to continues to provide the information necessary to understand the registrant's financial condition, changes in financial condition and results of operations.

CONTRACTUAL OBLIGATIONS TABLE REPORTING

For many public companies, the annual financial statements included in upcoming Form 10-K filings will reflect the adoption of ASC 842 with operating lease obligations reported on the balance sheet for the first time. Disclosure of the future maturities of operating lease obligations (which are reconciled to total lease liabilities reported on the balance sheet) is required in the financial statement footnotes. While legacy GAAP (ASC 840) did not define the amounts that should be included within the future minimum rental payments' disclosure, ASC 842 defines such amounts. Accordingly, what companies may have historically included in the future maturities' analysis may differ between ASC 840 and ASC 842. For example, ASC 842 requires lessees to include renewal options that are reasonably certain of being exercised, while under ASC 840, many lessees would exclude payments associated with renewal options. This difference, among others, may cause questions about the amounts that should be reflected for lease obligations in the contractual obligations table included within MD&A.

The Division of Corporation Finance's Financial Reporting Manual (FRM) states that "the contractual obligations tabular disclosure should be prepared with the goal of presenting a meaningful snapshot of cash requirements arising from contractual payment obligations." We believe that the payment obligations included with the contractual obligations table should generally be consistent with the future lease payments included within the ASC 842 maturities analysis disclosure in the financial statement footnotes. To the extent it is considered necessary to an understanding of the timing and amount of a registrant's specified contractual obligations, registrants may add footnote disclosure to the table to describe provisions that would increase, accelerate or otherwise change the obligations reflected therein.

INTERNAL CONTROL OVER FINANCIAL REPORTING ("ICFR") CONSIDERATIONS

In January, the Commission settled charges against four public companies for failing to maintain ICFR for seven to ten consecutive annual reporting periods. Two of the charged companies also failed to complete the required evaluation of the effectiveness of ICFR for two consecutive annual reporting periods. This action indicates that the SEC's Enforcement Division is monitoring companies that disclose material weaknesses in ICFR year after year and signals that disclosure of material weaknesses is not enough without meaningful remediation. The Commission continues to express the importance of internal controls in detecting and preventing material errors or fraud in financial reporting. Registrants are reminded that in the event a material weakness is identified, it is critical that a remediation plan is implemented, disclosed, and executed timely. To demonstrate its continued commitment, a registrant's remediation efforts should be updated in its quarterly and annual filings.

FORM 10-K - DISCLOSURE AND PROCESS REMINDERS

IMPROVING DISCLOSURE EFFECTIVENESS IN FORM 10-K

Over the past several years, the SEC has been actively engaged in rulemaking and other activities to encourage and promote disclosure effectiveness in filings. However, disclosure effectiveness does not solely rely on the activities of regulators and standard-setters. Registrants should also actively engage in an evaluation of their disclosures to enhance the communication of their "story" and the material factors affecting the business. Accordingly, registrants may wish to consider the following suggestions to enhance the readability of their Form 10-K, and as a result, enhance their communication with all stakeholders:

Overall

- Eliminate duplication – if a disclosure needs to be repeated, consider cross-referencing instead.
  - However, registrants are prohibited from cross-referencing from within the financial statements to information that is presented outside of the financial statements (e.g., a cross-reference to the MD&A within the financial statement footnotes is explicitly prohibited).
- Use graphs and charts, rather than explaining information in text format (when it makes sense).
- Use headers, sub-headers and bullet point lists.
- Eliminate unnecessary words (e.g., in lieu of disclosing "In accordance with ASC 815, Derivatives and Hedging Activities, we account for derivatives at fair value with changes in fair value recognized in current period earnings," simply state "We account for derivatives at fair value with changes in fair value recognized in current period earnings.")

MD&A and Financial Statement Footnotes

- Simplify the presentation and explanations within MD&A – e.g.,
  - Use tables that include current and prior period amounts as well as the related dollar and percentage changes;
  - Include descriptions of the drivers for significant changes below the table in a bullet point format (do not repeat the dollar, change, or percentage amounts in the bullet as they already appear in the table immediately above); and

    - Reference the periods being compared in a header, rather than including the dates in each explanation.
- Do not duplicate accounting policies within the *Critical Accounting Policies* disclosure of MD&A. Instead, focus on the significant judgments and estimates inherent in the policies, how accurate these estimates have been historically, and the potential impact on the financial statements if the estimates were different.
- Insert a cross-reference within MD&A to the SAB 74 disclosures appearing in the financial statement footnotes in lieu of repeating them within MD&A. Additionally, consider reflecting the SAB 74 disclosures within a table that includes the accounting standard's number and name, a description of the key provisions, the effective dates and the estimated impact of adoption to enhance the readability of the disclosures.
- Consider combining the accounting policy for a financial statement topic with the related footnote to enhance the readability of the information and reduce the likelihood of duplication. If this approach is followed, add a cross reference within the footnote of Significant Accounting Policies to the footnote where the accounting policy can be found.

Risk Factors

- Tailor and focus on the significant risks to the business – avoid boilerplate risk disclosures that could apply to any organization.
- Ensure that risk factors are not being used to disclose known trends and uncertainties which should be included within MD&A.
- Avoid risk factors for items that are simply not material (e.g., exclude risk factors that imply a concentration with a customer or supplier exists, when such concentration is not disclosed in the financial statement footnotes because the concentration is not material).

FINALIZING THE FORM 10-K PROCESS

Filing a registrant's Form 10-K requires the coordination of many participants in the financial reporting process– management, the board of directors, outside counsel, auditors, and possibly third-party service providers, among others. Completion of the financial reporting process requires careful attention to detail – for example, ensuring that:

- The EDGARized version of the 10-K is complete and accurate (i.e., no missing paragraphs or columns from tables, no truncation of information in tables, etc.);
- All relevant dates appear within the audit reports, consents, and signatures;
- The form and content of registrants' annual certifications are accurate; and
- All material contracts are included within the exhibits to the filing.

Typographical errors and missing exhibits, signatures, or opinions commonly require amendments to Form 10-K filings. Such errors and omissions may require registrants to evaluate whether they have deficiencies in their internal controls over financial reporting. Such amendments can be minimized by a comprehensive review of these matters prior to filing.

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.

Some of the most prevalent staff comments in 2019 are focused on the following areas:

- Revenue Recognition (ASC 606)
- Non-GAAP Measures
- Management Discussion and Analysis ("MD&A")

REVENUE RECOGNITION ("ASC 606")

As expected, the staff continues to issue comment letters that seek clarity on ASC 606 accounting and disclosures, including:

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

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.

Many of the staff's comments focus on non-GAAP measures that appear to:

- Modify GAAP recognition and measurement principles (i.e., constitute an individually tailored accounting principle);
- Exclude normal cash operating expenses from performance measures; or
- Be applied inconsistently period to period (i.e., changing measures over time).

The staff's focus on individually tailored accounting principles is consistent with prior years and is intended to address measures that may be considered misleading to investors. 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 Division of Corporation Finance, Chief Accountant's Office or the respective Assistant Director (AD) Office.

Non-GAAP Measures following the Adoption of ASC 842

Following the adoption of ASC 842, many registrants were required to recognize a right-of-use asset related to their operating leases. As the expense associated with the reduction of the right-of-use asset for operating leases over time is a component of rent expense, it should not be characterized or reflected as "amortization" in EBITDA or Adjusted EBITDA performance measures. While US GAAP characterizes the reduction of the right-of-use asset as rent expense, IFRS 16, Leases, characterizes the reduction as "amortization." Accordingly, registrants that report under IFRS and disclose EBITDA will include the reduction of the right-of-use asset within amortization expense.

MANAGEMENT DISCUSSION AND ANALYSIS ("MD&A")

Year after year, the staff frequently comments on MD&A disclosures and encourages registrants to focus on communicating material information to investors. The nature of these comments:

- 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. 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.

COMMISSION AND STAFF ACTIVITIES

RULEMAKING – CAPITAL FORMATION

ACCELERATED FILER AND LARGE ACCELERATED FILER DEFINITIONS (PROPOSED RULES) (RELEASE NO. 34-85814)

In May, the SEC proposed amendments to the definitions of an accelerated and large accelerated filer. As proposed, smaller reporting companies (SRCs) 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 ICFR. The proposed changes are intended to reduce compliance costs and promote capital formation for smaller reporting issuers.

Specifically, the proposed amendments would:

- 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. The initial qualification thresholds for accelerated and large accelerated filer status based on public float would remain the same (i.e., $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).
    - Registrants that would 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 $700 million.
    - Conversely, registrants with more than $100 million in annual revenue and between $75 million and $700 million in public float would still qualify as accelerated filers.
- Add a conforming revenue test to the transition thresholds for exiting both accelerated and large accelerated filer status.
- 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 table below:

	Current Threshold for Exiting Status	Proposed Threshold for Exiting Status
Accelerated Filer	Public float is less than $50 million at end of second fiscal quarter	Public float is less than $60 million (80% of $75 million initial qualification threshold), at end of second fiscal quarter
Large Accelerated Filer	Public float is less than $500 million at end of second fiscal quarter	Public float is less than $560 million (80% of $700 million initial qualification threshold), at end of second fiscal quarter.

SOLICITATIONS OF INTEREST PRIOR TO A REGISTERED PUBLIC OFFERING (FINAL RULES)

RULEMAKING – DISCLOSURE EFFECTIVENESS INITIATIVE

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.

FAST ACT MODERNIZATION AND SIMPLIFICATION OF REGULATION S-K (FINAL RULES) (RELEASE NO. 33-10618)

In March, 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 Fixing America's Surface Transportation 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. While 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:

- **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. 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 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 if 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 Commission's rules, US GAAP, or IFRS as issued by the 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 9 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. 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 (e.g., 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 EDGAR system.

The amendments to confidential treatment requests became effective on April 2, 2019. Use of XBRL tags on the cover pages of certain filings will be phased in over three years, depending on the nature of the filer. All other amendments became effective on May 2, 2019.

FINANCIAL DISCLOSURES ABOUT ACQUIRED AND DISPOSED BUSINESSES (PROPOSED RULES)

(RELEASE NO. 33-10635)

In May, the SEC proposed amendments to the financial disclosure requirements for acquired and disposed businesses. 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 disclosure.

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" • Revise the income test to: o Add measure of significance based on revenue (significance would be based on the lower of the income or revenue tests) o Use income from continuing operations **after income taxes** o Use the absolute values for loss years in the income averaging calculation o Permit the use of certain pro forma financial information to measure significance in a registration or proxy statement once the business has been included in the registrant's financial statements for a complete fiscal year o 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
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 by 20% • Permit the use of certain pro forma financial information to measure significance	• A disposed business is considered significant using a 10% threshold under S-X Rule 1-0(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	• Three year of historical annual financial statements are required for an acquired business if 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 previously filed or the acquired business is of major significance

	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	• 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 only require financial statements 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
Financial Statement Requirements for Acquired Real Estate Operations	• 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)	• The significance thresholds and financial statement requirements (including timing) differ under S-X Rue 3-14 for acquired real estate operations and S-X Rule 3-05 for acquired businesses
Pro Forma Financial Statements 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), and ○ "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 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.

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.

MODERNIZATION OF REGULATION S-K ITEMS 101, 103, AND 105 (PROPOSED RULES)

(RELEASE NO. 33-10668)

In August, the SEC proposed amendments to the description of business, legal proceedings, and risk factor disclosure requirements of Regulation S-K. Other than the proposed changes to legal proceedings, which continue to reflect a prescriptive-based approach to disclosure, the other amendments would emphasize a more principles-based approach.

Among other things, the proposed amendments would revise:

Item 101 (Description of the Business)

- To make the disclosure topics within the business section more principles-based, generally require disclosure only to the extent such information is material to an understanding of the business, and:
    - Provide a non-exclusive list of the types of information that may need to be disclosed;
    - Include disclosure topics related to:
        - Transactions and events affecting the registrant's operations (including changes in a previously disclosed business strategy);
        - Human capital resources, including any human capital measures or objectives that management focuses on in managing the business; and
        - Material government regulations (in addition to environmental provisions);
    - 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 the previous filing that, together with the update, provides a full discussion of the general development of the business; and
    - Eliminate the prescribed timeframe for this disclosure

Item 103 (Legal Proceedings)

- To state that the required information about material legal proceedings may be provided using hyperlinks or cross-references to legal proceedings disclosure included elsewhere in the filing to avoid duplication; and
- To revise the $100,000 threshold for disclosure of environmental proceedings where the government is a party to $300,000 to adjust for inflation.

Item 105 (Risk Factors)

- To address the lengthy and generic nature of risk factor disclosure by:
    - Requiring a summary risk factor disclosure if the section exceeds 15 pages;

- Changing the disclosure standard from the "most significant" factors to the "material" factors required to be disclosed; and
- Requiring 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.

STAFF GUIDANCE

FINANCIAL REPORTING MANUAL

In July, the staff of the SEC's Division of Corporation Finance made revisions to its Financial Reporting Manual (FRM) which primarily reflect the changes from rulemaking activity in 2018 and other changes. Other key revisions made to the manual:

- Removed guidance which stated the staff's expectations for the basis of presentation for financial information presented within the selected financial data table. Previously, FRM 1610 stated that the staff generally expected all periods presented in selected financial data to be presented on a basis consistent with the annual financial statements. For example, if a company adopted a new accounting standard that required retrospective presentation or disposed of a business that qualified as a discontinued operation, the staff would generally expect the years prior to the annual financial statements (years 4 – 5) to also reflect the retroactive change. While such guidance has been removed, registrants are reminded to review the guidance in Item 301 of Regulation S-K and apply judgement when making a determination about the basis of presentation reflected in years 4 and 5 (i.e., whether the periods should be recast or whether additional disclosures in a footnote to the table could sufficiently describe the factors materially affecting comparability of the periods presented).
- Removed guidance related to acquired business financial statement requirements in a Form 10 by a smaller reporting company (smaller reporting companies filing a Form 10 that wish to provide anything than what is otherwise required by S-X Rule 8-05 should request a waiver under S-X Rule 3-13).