

# SEC in Focus

Quarterly summary of current SEC activities

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## SEC reporting implications of new accounting standards

Securities and Exchange Commission (SEC or the Commission) Chief Accountant Wesley Bricker and other SEC staff members shared their views on the SEC reporting implications of the new accounting standards on revenue, leases and financial instruments, among other issues, during the annual AICPA National Conference on Current SEC and PCAOB Developments (AICPA Conference) in December 2016. They discussed the accounting transition disclosures required by Staff Accounting Bulletin (SAB) Topic 11.M, the effects of the adoption of new accounting standards on registration statements and the status of existing staff revenue guidance in SAB Topic 13.

### *Transition disclosures*

SEC staff members emphasized the importance of providing accounting transition disclosures required under SAB Topic 11.M and discussed the SEC staff’s expectations about the extent of these disclosures. Mr. Bricker said that investors and his staff will be looking for increased disclosures in 2016 filings and during 2017 about the significance of the effect (quantitative or qualitative) that the adoption of the new revenue and other major new standards will have on registrants’ financial statements.

Sylvia Alicea, a professional accounting fellow in the Office of Chief Accountant (OCA), said that if a registrant does not know or cannot reasonably estimate how the adoption of a new standard will affect its financial statements, it should make a statement to that effect and consider providing qualitative disclosures to help the reader assess the potential significance of the effect on the registrant’s financial statements.



**EY resources**

- ▶ Compendium of significant accounting and reporting issues, *2016 AICPA National Conference on Current SEC and PCAOB Developments* (SCORE No. 04331-161US)

The SEC staff would not object if companies conclude that the adoption of the new revenue and leases standards is not considered a “fundamental change.”

Separately, Assistant Deputy Chief Accountant Jenifer Minke-Girard said that companies should consider including as part of their qualitative disclosures a description of their processes to assess the effect of a new accounting standard on their financial statements, where they stand in the implementation process, what matters still need to be addressed and what additional steps they plan to take.

### How we see it

As the adoption date of the new revenue standard approaches, registrants should assess the adequacy of their accounting transition disclosures under SAB Topic 11.M in their upcoming annual reports. We expect the SEC staff to closely monitor through its comment letter process whether registrants have appropriately provided quantitative or qualitative information to explain the effect of the new revenue standard. Accordingly, companies should also consider the strength of their internal controls in complying with this disclosure requirement.

#### *Effect of new accounting standards on registration statements*

Nili Shah, a Deputy Chief Accountant in the SEC’s Division of Corporation Finance (DCF), said that in new or amended registration statements filed after the first interim period report reflecting the adoption of the new standard, companies that use the full retrospective transition method to adopt Accounting Standards Codification (ASC) 606 must provide retrospectively recasted financial statements for the most recent annual periods required to be included (or incorporated by reference). For example, a calendar-year registrant filing a Form S-3 registration statement in 2018 after it adopts ASC 606 using the full retrospective method in a Form 10-Q filing, but before it files the annual financial statements for the year of adoption, would be required to recast its prior-period annual financial statements (i.e., for 2015, 2016 and 2017) prior to the Form S-3 going effective. The SEC staff also noted that the guidance in ASC 250-10-45-5 on accounting changes provides an exception if retrospective revision is impracticable. While preclearance would not be required to rely on the exception, the SEC staff is available to discuss fact patterns with companies.

Keith Higgins, Director of DCF, noted that the SEC staff would not object if companies and their securities counsel conclude that the adoption of new accounting standards such as those on revenue recognition and leases is not a “fundamental change” for purposes of drawing on an effective shelf registration statement. A fundamental change would require a post-effective amendment to the shelf registration statement, which would trigger the need to recast as discussed above.

### How we see it

Companies should closely monitor the planned timing of any registration statements if they plan to use the full retrospective method of adoption and consider accelerating the timing of those registration statements, if possible, to avoid needing to recast an earlier period than would otherwise be required.

#### *Application of SAB Topic 13*

Ms. Alicea said SAB Topic 13, *Revenue Recognition*, will continue to apply to registrants until the adoption of the new revenue standard. However, registrants should apply ASC 606 instead of SAB Topic 13 when evaluating the post-adoption accounting for their revenue arrangements.

## Recent updates to SEC staff guidance

### *Financial Reporting Manual*

The SEC staff updated its *Financial Reporting Manual* to incorporate its views on certain SEC reporting issues related to the adoption of new accounting standards, including the following:

- ▶ Registrants filing pro forma financial information in the year they adopt the new revenue standard are not required to reflect the effect of the standard in the pro forma income statement for the previous year.
- ▶ The date of initial application for purposes of the new leases standard would not change if a registrant is required to provide financial statements for earlier periods when issuing retrospectively revised financial statements for a registration statement filed in the year of adoption.
- ▶ Registrants do not need to disclose a consolidated 10-year loss reserve development table as specified in Industry Guide 6 once they begin disclosing the claims development tables required by Accounting Standards Update 2015-09, *Disclosures about Short-Duration Contracts*, after adoption.

### *Compliance and Disclosure Interpretations*

The SEC staff issued *Compliance and Disclosure Interpretations* (C&DIs) on the following topics:

- ▶ Pay ratio disclosures – New guidance on the disclosure of the ratio of the median employee's annual total compensation to that of the principal executive officer addresses how a registrant should select a "consistently applied compensation measure" to identify the median employee if annual total compensation is not calculated in accordance with Item 402(c)(2)(x) of Regulation S-K. It also addresses how furloughed employees and workers whose compensation is determined by an unaffiliated third party should be considered in the employee population used to determine the median employee. The rule is effective for fiscal years beginning on or after 1 January 2017.
- ▶ Annual report delivery obligation – In lieu of submitting the annual report to shareholders on EDGAR or mailing paper copies, registrants may satisfy their obligation to furnish the report to the SEC by posting it on their corporate website. If a registrant chooses this option, it must keep the annual report accessible for one year after it is posted.
- ▶ Foreign private issuers – Certain provisions of Securities Act Rule 405 and Exchange Act Rule 3b-4 were clarified, including the following:
  - ▶ When a registrant has two boards of directors, it must assess whether the majority of the board that performs the functions closest to those undertaken by a US-style board is made up of US citizens or residents. If those functions are divided between both boards, the registrant may aggregate the members of both boards to calculate the majority.
  - ▶ A registrant must assess on a consolidated basis the location from which its officers, partners or managers primarily direct, control and coordinate its operations to determine whether its business is administered principally in the US.
  - ▶ A registrant may use geographic segment information to determine whether more than 50% of the assets are located in the US or may apply another reasonable methodology on a consistent basis.

## SEC rulemaking and implementation

### EY resources

- ▶ To the Point, [SEC adopts rules to enhance investment company reporting](#) (SCORE No. 03582-161US)

### Final rules on registered investment company reporting

The SEC [adopted](#) new rules and forms and amended other rules to modernize and enhance the reporting and disclosure of information by registered investment companies (RICs). The SEC said these changes, which require RICs to report certain information in a structured XML format, will allow it to more effectively analyze data reported by funds. The SEC also amended Regulation S-X to standardize and enhance disclosures about derivatives and other items in investment company financial statements. Certain RICs will be required to report information about their monthly portfolio holdings on new Form N-PORT within 30 days of the end of each month. In addition, RICs, except face-amount certificate companies, will be required to file census-type information annually on new Form N-CEN within 75 days of the end of their fiscal year (or calendar year for unit investment trusts).

The compliance date for Form N-PORT is 1 June 2018, for fund complexes with \$1 billion or more in net assets, or 1 June 2019 for smaller fund complexes. The compliance date for Form N-CEN is 1 June 2018, and the amendments to Regulation S-X are effective 1 August 2017.

### Final rules on fund liquidity risk management and swing pricing

The SEC [adopted](#) final rules designed to reduce the risk that investors in exchange-traded funds (ETFs) and open-end mutual funds (except money market funds) will be unable to redeem their shares and receive their assets in a timely manner during periods of financial stress. The rules require these funds to establish a liquidity risk management program and expand their disclosures about fund liquidity and redemption practices.

The SEC also [adopted](#) final rules permitting open-end funds (except for money market funds and ETFs) to use swing pricing, which is designed to protect existing shareholders from dilution associated with shareholder purchases and redemptions. When the level of net purchases or net redemptions exceeds a specified percentage of net asset value (i.e., the swing threshold), the fund would reflect in its net asset value the costs associated with satisfying requests for shareholder purchases or redemptions. The use of swing pricing would be an additional tool to help funds manage liquidity risks.

Fund complexes with net assets of \$1 billion or more will be required to comply with the liquidity risk management program requirements starting 1 December 2018, while those with less than \$1 billion in net assets will have to do so starting 1 June 2019. The effective date for the swing pricing rule is 19 November 2018.

### New rules on exemptions for intrastate and regional securities offerings

The SEC [adopted](#) a new Rule 147A to overcome the limitations of current rules governing intrastate offerings. The SEC decided to retain and amend current Rule 147 as a safe harbor under Section 3(a)(11) to preserve the continued availability of existing state law exemptions for in-state offers, including crowdfunding.

Unlike the current or amended Rule 147 for intrastate offering, under the new Rule 147A:

- ▶ An issuer in an intrastate offering will be able to engage in general solicitation and advertising of its offering, using any form of mass media, including publicly available internet websites, even if the offering materials are accessible to out-of-state residents, as long as all of the offering materials prominently disclose that sales will be made only to the residents of the same state as the issuer.
- ▶ An issuer will be able to make an intrastate offering within the state of its principal place of business even if its business is incorporated or organized in a different state.

The amended Rule 147 and new Rule 147A will be effective 20 April 2017.

For regional securities offerings, the SEC also raised the offering limit under Rule 504 of Regulation D to \$5 million from \$1 million in any 12-month period and disqualified certain “bad actors” from participating in Rule 504 offerings. Rule 504 continues to impose no limits on the number of purchasers or their qualifications (i.e., all may be unaccredited and not necessarily sophisticated), but it does prohibit general solicitation and advertising. The amendments are effective 20 January 2017. The SEC also repealed Rule 505 effective 22 May 2017.

### **Proposal would require universal proxy ballot**

The SEC [proposed](#) requiring the use of a universal proxy ballot that lists the names of all board nominees, regardless of whether they are nominated by the company or a dissident shareholder. The proposed rule would allow shareholders voting by proxy to use a single ballot to vote for any combination of candidates nominated by either the company or dissident shareholders.

### **Update on disclosure effectiveness initiative**

#### ***Report on Modernization and Simplification of Regulation S-K***

The SEC staff issued its [Report on Modernization and Simplification of Regulation S-K](#) in November 2016 to Congress, as required by the Fixing America's Surface Transportation Act (FAST Act). The report highlighted recent changes proposed by the Commission in its disclosure effectiveness initiative. The SEC staff also made certain recommendations for the Commission to consider for future rulemaking, including:

- ▶ Revise Item 303 for management's discussion and analysis to require only a period-to-period comparison for the two most recent fiscal years presented in the financial statements and permit registrants to include a hyperlink to the prior year's annual report for the additional period-to-period comparison
- ▶ Eliminate the requirement to provide a table of contractual obligations and instead require registrants to include a hyperlink to the relevant financial statement notes, along with a discussion of liquidity that describes material changes to contractual obligations and the ability to pay such obligations over time
- ▶ Allow registrants to omit attachments and schedules filed with exhibits, unless they contain information that has not been disclosed and would be material to an investment decision
- ▶ Revise Item 102 to clarify that physical properties should be disclosed only to the extent they are material to the registrant's business

The FAST Act requires the Commission to issue proposed rules to implement the recommendations in the report within 360 days.

### **Other SEC activities**

#### **CAQ SEC Regulations committee meeting**

The Center for Audit Quality (CAQ) SEC Regulations Committee issued [highlights](#) from its 27 September 2016 meeting with the SEC staff that included:

- ▶ A discussion of the SEC staff's views on non-GAAP financial measures and the implementation of the C&DIs issued in May 2016

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#### **EY resources**

- ▶ To the Point, [SEC explores possible changes to Regulation S-K requirements for business and financial disclosures](#) (SCORE No. 00544-161US)
- ▶ EY Comment Letter – [Regulation S-K concept release requirements for business and financial disclosures](#) (SCORE No. 02125-161US)
- ▶ EY Comment Letter – [Amendments to Smaller Reporting Company Definition](#) (SCORE No. CL02785-161US)
- ▶ EY Comment Letter – [Disclosure Update and Simplification](#) (SCORE No. CL03620-161US)
- ▶ EY Comment Letter – [Exhibit Hyperlinks and HTML Format](#) (SCORE No. CL03612-161US)
- ▶ EY Comment Letter – [Subpart 400 of Regulation S-K Disclosure Requirements](#) (SCORE No. CL04154-161US)

- ▶ A confirmation that, absent relief based on its specific rules and a registrant's circumstances, the registrant must provide condensed consolidating information to comply with Regulation S-X Rule 3-10 if the guaranteed securities were outstanding at period end even if the securities were subsequently extinguished before the filing date
- ▶ The SEC staff's view that it would not take exception to periods used to prepare pro forma financial information differing by slightly more than 93 days when that difference is solely a result of one of the companies having a 52-53 week year when combined with a calendar-year company

### **IAC discusses 2017 priorities**

The Investor Advisory Committee (IAC) discussed investor protection priorities for 2017, including suggestions from members to continue working on its initiatives from 2016, such as the universal proxy proposal. At the December 2016 meeting, SEC Chair Mary Jo White emphasized the importance of rulemaking done to protect investors following the 2008 financial crisis and urged both the Commission and the IAC to continue working together to address the issues facing investors in areas under the Commission's jurisdiction.

### **SEC Advisory Committee defers recommendation for board diversity disclosures**

The SEC's Advisory Committee on Small & Emerging Companies (ACSEC) deferred making a recommendation on board diversity disclosures until it considers certain concerns. ACSEC plans to discuss the recommendation in its upcoming meeting.

## **Current practice matters**

### **Recent updates on non-GAAP financial measures**

The SEC staff acknowledged at the AICPA Conference that companies have been changing their disclosures of non-GAAP financial measures in response to the updated C&DIs issued in May 2016. However, Mr. Bricker said companies can make more progress in evaluating the appropriateness of a non-GAAP measure and its prominence, as well as the effectiveness of disclosure controls and procedures, among other things.

Mark Kronforst, Chief Accountant of DCF, also expressed the following staff views on some specific non-GAAP measures and adjustments:

- ▶ *Prominence* – The SEC staff is now issuing comments requesting that companies present the GAAP measure first in the required non-GAAP reconciliation (i.e., reconciling from GAAP to the non-GAAP measure) because it believes presenting the non-GAAP measure first would give it undue prominence.
- ▶ *Stock compensation* – The SEC staff would not object to non-GAAP performance measures that include adjustments adding back stock compensation.
- ▶ *Restructuring charges* – In most cases, the SEC staff is unlikely to object to non-GAAP measures that remove restructuring charges unless a company's fact pattern suggests that it has restructuring initiatives on a recurring basis.
- ▶ *Business combinations* – Following a business combination, the staff will not object to non-GAAP adjustments that eliminate the effects of recording inventory or deferred revenue at fair value.
- ▶ *Individually tailored accounting principles* – The staff has objected to a few types of non-GAAP measures that use individually tailored accounting principles. For example, the SEC staff has objected to non-GAAP measures that accelerate revenue recognition, change the number of shares used in calculating earnings per share or alter consolidation principles by presenting financial statement measures using proportionate consolidation.

In most cases, the SEC staff is unlikely to object to non-GAAP measures that remove restructuring charges.



Mr. Kronforst also cautioned companies that, as it relates to non-GAAP measures and ASC 280 segment disclosures, companies cannot circumvent the non-GAAP rules by presenting multiple segment measures of profit in their financial statements.

### **MD&A disclosure considerations for income taxes**

During the AICPA Conference, Ms. Shah observed that the SEC staff continues to issue comments on income tax disclosures included in management's discussion and analysis (MD&A). She further expressed concerns that registrants' income tax disclosures in MD&A often aren't cohesive and don't tell a complete story about the company's tax positions and related trends and uncertainties.

Ms. Shah said that when the staff reviews a registrant's income tax disclosures in MD&A, it primarily looks for robust MD&A disclosures related to:

- ▶ Reasons for historical changes in the effective tax rate
- ▶ Discussion about changes in reconciling items between the effective and statutory tax rates
- ▶ Insight into the extent to which past income tax rates are indicative of future tax rates
- ▶ Trends and uncertainties related to changes in unrecognized tax benefits
- ▶ Differences between trends in income tax expenses and cash taxes paid

### **How we see it**

While both the Financial Accounting Standards Board (FASB) and the SEC consider ways to enhance income tax disclosures as part of specific projects, it's no surprise that the SEC staff is seeking expanded disclosures from registrants based on the existing principles-based MD&A requirements. In preparing MD&A this year, registrants should revisit whether they adequately discuss trends and uncertainties related to their income tax provision, including the effect of uncertain tax positions and the underlying drivers of changes in effective tax rates.

### **Auditor's involvement in interpretive and waiver process**

During the AICPA Conference, the SEC staff recommended that registrants seek the input and feedback of their auditors on interpretive and waiver letters prior to their submission to DCF to make the SEC staff's review more efficient.

### **SEC staff no longer requires 'Tandy' language**

The SEC staff said it no longer requires registrants to acknowledge in their responses to comment letters that their disclosures are their responsibility and that they will not raise the SEC review process as a defense in any legal proceeding. These representations are known as "Tandy" language, after the first company to receive such a request.

### **2017 US GAAP Taxonomy released**

The 2017 US GAAP Financial Reporting Taxonomy is available on the FASB website, along with materials that describe changes from the 2016 version. The 2017 Taxonomy may be used for SEC XBRL submissions only after it is adopted by the SEC, which is expected in early 2017.

## Personnel changes

### SEC Chair White to step down in January 2017

Mary Jo White said she will step down as SEC chair at the end of the current administration in January 2017. She has led the agency since April 2013, and her term was set to expire in 2019. Chair White's departure will leave three of the five commissioner seats vacant, assuming there are no confirmations prior to the end of her tenure.

In a recent [letter](#) to the US Senate Committee on Banking, Housing, and Urban Affairs and Subcommittee on Securities, Insurance, and Investment, Ms. White listed a number of rulemaking initiatives that are on her agenda before her departure, including:

- ▶ Proposal for requiring the use of the inline XBRL format in the submission of certain Commission filings
- ▶ Request for comment on statistical and other disclosures by bank holding companies and other financial institutions

President-elect Donald Trump plans to nominate Jay Clayton, a partner at Sullivan & Cromwell LLP, to head the SEC. Mr. Clayton has dealt with legal matters involving merger and acquisition transactions, capital market offerings, regulatory and enforcement proceedings, among others. His appointment requires approval from the Senate Banking Committee and confirmation by the Senate.



Mary Jo White



Jay Clayton

### DCF Director Higgins to leave in early January 2017

Keith Higgins, Director of the SEC's Division of Corporation Finance, plans to leave the Commission in early January 2017. He has been with the SEC since 2013. Shelley Parratt, the current Deputy Director for the Division of Corporation Finance, will become the Acting Director.

### SEC names Bricker Chief Accountant, Panucci Deputy Chief Accountant

Wesley Bricker was named Chief Accountant in the SEC's Office of the Chief Accountant (OCA), succeeding James Schnurr, who is retiring. Mr. Bricker has served as Interim Chief Accountant since July 2016 and was previously Deputy Chief Accountant in OCA's Accounting group.

Additionally, Marc Panucci was named Deputy Chief Accountant in OCA. He will oversee OCA's Professional Practice group, which is responsible for matters related to internal control over financial reporting, auditor independence and auditing standards. He succeeds Brian Croteau.



Wesley Bricker

### Other changes

The following members of the SEC staff also announced they will leave the SEC by early January or before:

- ▶ Andrew Ceresney, Director of SEC's Division of Enforcement
- ▶ Mark Flannery, Director of SEC's Division of Economic and Risk Analysis
- ▶ Stephen Luparello, Director of SEC's Division of Trading and Markets

Chair White's departure will leave three of the five commissioner seats vacant.



## Enforcement activities

The SEC [charged](#) an energy services provider and four former executives for prematurely recognizing revenue on service contracts to meet internal targets. The company restated its financial statements in 2013 for annual periods 2008 through 2011 and the first quarter of 2012 to correct its accounting. The SEC found that company's controller recklessly participated in the improper revenue recognition because the company's internal controls did not require adequate documents from one of its divisions to support journal entries recorded at the corporate level. The company agreed to pay \$1 million to settle the charges, and the four executives also agreed to settlements.

Separately, a technology company and two former executives agreed to [settle](#) the SEC's charges that they understated the company's paid-time-off liability by \$800,000 to meet a performance target in the first quarter of 2013, among other things. The technology company agreed to pay \$2.5 million to settle the charges, and the two executives agreed to pay fines and penalties.

The SEC [charged](#) a chemical company and its general counsel for failing to make timely material loss contingency disclosures. The SEC alleged that the company's general counsel did not inform the company's chief executive officer, chief financial officer, audit committee and external auditors about material facts related to a Department of Justice (DOJ) investigation of the company. This resulted in, among other things, the company's failure to timely disclose or accrue in several SEC filings the loss contingencies related to the DOJ investigation. The company restated its results for the three quarters during which the DOJ investigation occurred. However, the company is contesting the SEC's allegations.

Separately, the SEC [charged](#) the top executives and the founder of a hedge fund for allegedly inflating asset values and improperly using investor funds to cover losses.

The SEC, along with other US and foreign regulatory authorities, continued to pursue enforcement actions involving violations under the Foreign Corrupt Practices Act (FCPA). In the recent quarter ended 31 December 2016, five companies agreed to pay more than \$2 billion in fines to settle FCPA charges with the SEC and other regulatory authorities.

The SEC recently [awarded](#) \$20 million to a whistleblower, the third largest award it has made since its whistleblower program began in 2011. The program has paid more than \$136 million to 37 whistleblowers since its inception.

### What's next at the SEC?

After Chair White leaves the Commission in January 2017, a deadlock between the two remaining commissioners could stall rulemaking and other actions until the Chair or other vacancies are filled and confirmed by the Senate.

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