

CAQ SEC Regulations Committee Releases Highlights of September 27, 2016, Joint Meeting With SEC Staff

Today, the Center for Audit Quality (CAQ) posted to its Web site the [highlights](#) of the September 27, 2016, CAQ SEC Regulations Committee joint meeting with the SEC staff. Topics discussed at the meeting include:

- **Requests for interpretive guidance** — The Committee and the SEC staff discussed registrants' processes related to matters requiring preclearance with the SEC staff and, specifically, auditor involvement in preclearance letters. The staff has observed that "some filing preclearance letters do not reflect the staff's widely-known views on certain reporting matters and this can make resolution of matters less efficient." As a result, the staff "is exploring ways to help registrants improve submission quality," including encouraging involvement of audit firms who might have a more current perspective.
- **Disclosure effectiveness** — The SEC's interest in comments from constituents related to their ongoing [disclosure effectiveness](#) initiative was discussed.
- **Non-GAAP measures** — The SEC staff's continued focus on the application of SEC rules governing non-GAAP measures was discussed. The staff "indicated that comment letters on [the use of] non-GAAP measures may be separate and distinct from a routine comment letter relating to the review of periodic filings." In this regard, registrants that have received comments on their Form 10-K or other filings may separately receive comments on their use of non-GAAP measures or vice versa.

The following non-GAAP measure presentation and disclosure matters were also covered:

- The presentation of a full non-GAAP income statement is not permissible under Regulation S-K, Item 10(e).¹
- The evaluation of certain non-GAAP measure adjustments:
 - Recent comments have focused on "adjustments relating to restructuring charges, acquisitions/purchase accounting items and legal settlements." The SEC staff's comments seek to gather additional information about the nature and circumstances specific to each adjustment, which assists the staff in concluding on the appropriateness of the adjustment.
 - The staff is "continuing to evaluate the appropriateness of certain adjustments related to derivatives and pensions."
 - "Adjustments related to stock-based compensation have not been the focus of efforts to date."
- The use of certain non-GAAP per-share performance measures is permitted, but the SEC staff will object to per-share presentation of measures that are "presented as performance measures but appear to be consistent with liquidity measures." Measures that can be used as liquidity measures are not permitted to be presented on a per share basis. The staff will focus on "the substance of the non-GAAP measure and not management's characterization of the measure" when making this assessment.²

¹ SEC Regulation S-K, Item 10(e), "Use of Non-GAAP Financial Measures in Commission Filings."

² See SEC [Non-GAAP Financial Measures Compliance & Disclosure Interpretations](#), Question 102.05, and Section 4.4 of Deloitte's [A Roadmap to Non-GAAP Financial Measures](#).

- The calculation and presentation of non-GAAP measures that use the pro rata consolidation method (as is common within the real estate industry) is inconsistent with the Commission's rules for reporting non-GAAP financial measures and recent staff interpretive guidance³ related to individually tailored accounting principles.

Editor's Note: The SEC's position related to measures that use pro rata consolidation was further clarified at the National Association of Real Estate Investment Trusts (NAREIT) Senior Financial Officer Workshop on September 27, 2016, at which "a Division staff member communicated this position." An October 18, 2016, NAREIT alert, "Further Guidance on Pro-Rata Reporting of Non-GAAP Financial Measures and Metrics" (available to NAREIT members only), explains the staff's position on pro rata consolidation and discusses certain other alternative presentations that may not violate the non-GAAP measure rules.

- **SAB Topic 13 update** — The SEC staff is considering the impact of the new revenue recognition standard⁴ to existing SEC rules and regulations, including any required updates to SAB Topic 13.⁵
- **Regulation S-X, Rule 3-10, reporting requirements** — The requirement for presenting condensed consolidating financial information in accordance with Regulation S-X, Rule 3-10,⁶ was discussed for instances in which the registered guaranteed debt has been extinguished after a period-end but before the financial statements are filed. The SEC staff advised that, in such instances, the presentation of condensed consolidating financial information would be required since the requirement for such information applies as long as the guaranteed securities are outstanding. The staff further indicated that "registrants seeking relief from this requirement may submit a letter with their specific facts and circumstances to CF-OCA."⁷
- **Pro-forma financial statement requirements** — The Committee discussed the financial reporting requirements under Regulation S-X, Rule 11-02(c)(3),⁸ as they apply to a circumstance in which the registrant's and the acquired company's year-ends differ by more than 93 days *solely* because one or more of the companies uses a 52- or 53-week fiscal year-end. When questioned about whether preparation of Article 11 pro forma financial statements would be permitted in this specific circumstance (i.e., without conforming the periods to be within 93 days), "the staff indicated that they have observed this fact pattern with limited frequency and suggested that they likely would not comment if a company did not adjust the periods."
- **Transition questions related to the new leasing standard, ASU 2016-02**⁹ — The SEC staff continues to deliberate implementation issues related to the date of initial application of the new leasing standard, including how to apply the guidance to previously issued financial statements that are required to be recast for a new or amended registration statement after the registrant has applied the new leasing standard in a set of interim financial statements, but before the annual financial statements for the year of adoption have been issued. The staff indicated "they are considering the question and how to communicate their views."

³ See SEC Non-GAAP Financial Measures Compliance & Disclosure Interpretations, Question 100.04.

⁴ FASB Accounting Standards Codification (ASC) Topic 606, *Revenue From Contracts With Customers*.

⁵ SEC Staff Accounting Bulletin Topic 13, "Revenue Recognition."

⁶ SEC Regulation S-X, Rule 3-10, "Financial Statements of Guarantors and Issuers of Guaranteed Securities Registered or Being Registered."

⁷ SEC Division of Corporation of Finance, Office of Chief Accountant.

⁸ SEC Regulation S-X, Article 11, "Pro Forma Financial Information."

⁹ FASB Accounting Standards Update (ASU) No. 2016-02, *Leases*. When effective, the ASU will supersede ASC 840, *Leases*, and add ASC 842, *Leases*.

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