Via Electronic Submission to: rule-comments@sec.gov

November 14, 2014

U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Request for Public Comments on the Securities and Exchange Commission's Disclosure Effectiveness Initiative – Recommendations on Regulation S-X and Certain Financial Disclosure Provisions in Regulation S-K

Ladies and Gentlemen:

This letter is submitted on behalf of the Disclosure Effectiveness Working Group (the "Working Group") of the Federal Regulation of Securities Committee and the Law and Accounting Committee (collectively, the "Committees") of the Business Law Section (the "Section") of the American Bar Association (the "ABA") with respect to the "Disclosure Effectiveness" initiative launched earlier this year by the U.S. Securities and Exchange Commission (the "Commission"). In particular, we are responding to the Commission's invitation for public comment on ways to improve both the content and presentation of business and financial information disclosed in registration statements filed under the Securities Act of 1933, as amended (the "Securities Act"), and in periodic and current reports filed under the Securities Exchange Act of 1934, as amended (the "Exchange Act").[1] This is the first of a series of comment letters from the Committees addressing specific aspects of the Commission's Disclosure Effectiveness initiative.

The comments set forth in this letter represent the views of the Committees and have been prepared by members of the Working Group. These comments have not been approved by the ABA's House of Delegates or Board of Governors, and therefore do not represent the official position of the ABA. In addition, these comments do not represent the official position of the Section.

[1] *See, e.g.*, Commission Spotlight on Disclosure Effectiveness, *available at* http://www.sec.gov/spotlight/disclosure-effectiveness.shtml; Speech by Keith F. Higgins, Director, Division of Corporation Finance, U.S. Securities and Exchange Commission, *Shaping Company Disclosure: Remarks before the George A. Leet Business Law Conference* (Oct. 3, 2014), *available at* http://www.sec.gov/News/Speech/Detail/Speech/1370543104412#.VE_3pSxOXvU; Speech by Keith F. Higgins, Director, Division of Corporation Finance, U.S. Securities and Exchange Commission, *Disclosure Effectiveness: Remarks before the American Bar Association's Business Law Section Spring Meeting* (Apr. 11, 2014), *available at* http://www.sec.gov/News/Speech/Detail/Speech/1370541479332.

The Committees thank the Commission for instituting a comprehensive review of the current regulatory regime administered by the Division of Corporation Finance (the "Division" or the "Staff"), and are pleased to submit the following comments and suggestions for improving the quality of disclosure required by certain provisions of Regulation S-X ("S-X") and Regulation S-K ("S-K"), along with two related topics, in ways that we believe will benefit both investors and registrants.

As noted, we expect to submit an additional comment letter (or letters) focusing on other disclosure requirements of S-K, the manner of presentation of such disclosure and various uses of technology that we believe will facilitate and enhance the content and delivery of timely and more relevant information to investors.

Executive Summary

Each of the following recommendations is based on our experience with the referenced provisions and topics in advising registrants responsible for preparing and filing (or submitting) disclosure documents with the Commission. Our recommendations, which are aimed primarily at disclosure requirements applicable to domestic registrants,[2] are intended to: (i) improve the quality and utility to investors of certain financial disclosures; (ii) enhance consistency and reduce redundancy within financial disclosure requirements; (iii) facilitate registrant preparation of required disclosures and promote investor understanding of their significance; and (iv) replace unnecessarily detailed and complex disclosures with more focused and concise disclosures that highlight meaningful information regarding a registrant's business, key risks and financial condition and results of operations.

1. S-X Rule 1-02(w): The Commission should consider replacing the asset, investment and pre-tax income tests in S-X Rule 1-02(w) with tests that use revenue (including, in some cases, pro forma revenue) and fair value to determine the "significance" to the registrant of another entity.

2. S-X Rule 3-05: The Commission should consider:

- increasing to 80% the significance threshold that would trigger the requirement to present audited financial statements for three fiscal years;
- permitting disclosures of audited statements of revenues and direct expenses and assets acquired and liabilities assumed, in lieu of complete financial statements of the acquired business;

[2] Where relevant, we also have suggested changes to similar line-item requirements of Form 20-F, used by foreign private issuers.

- codifying and updating Staff Accounting Bulletin ("SAB") 80[3] by: (i) revising the percentage tests to reflect subsequent changes in S-X Rule 3-05; and (ii) requiring a maximum two years of financial statements for acquired businesses in light of the provisions of Title I of the Jumpstart Our Business Startups Act (the "JOBS Act"); and

- reducing the "black-out" period for filing a registration statement under the Securities Act that is imposed as a result of noncompliance with S-X Rule 3-05, provided that the registrant files certain audited information about the acquired business, completes the measurement period for purchase accounting and includes the acquired business in the scope of the registrant's evaluation of internal control over financial reporting.

3. S-X Rules 3-09 and 4-08(g): The Commission should consider amending S-X Rules 3-09 and 4-08(g) to delete outdated references to non-consolidated, majority-owned subsidiaries.

4. S-X Rule 4-08(g): The Commission should consider amending S-X Rule 4-08(g) to: (i) increase to 20% the threshold for aggregated disclosure of individually insignificant entities; and (ii) require, for an entity that is individually significant at the 10% level, separate summarized financial information, rather than summarized financial information that is aggregated with that provided for other individually significant entities.

5. S-X Rule 3-09: The Commission should consider:

- increasing to 80% the significance threshold that would trigger the requirement to present separate audited financial statements for equity investees;

- eliminating the requirement for separate audited financial statements of a significant equity investee following the registrant's disposition of the investment; and

- permitting registrants to provide audited financial statements for the full year in which an investment is made, together with other disclosures regarding the investment, without the need to submit a pre-filing request to the Staff.

6. S-X Article 10 and Rule 8-03: The Commission should eliminate the requirement for summarized interim financial information for equity method investees unless such information is material.

7. S-X Rule 3-10: The Commission should consider:

- replacing the requirement that a subsidiary be 100% owned by the parent with the requirement that the subsidiary be "wholly owned," as defined in S-X Rule 1-

[3] SAB 80 has been modified slightly by SAB 103, without changing the relevant interpretation for pre-IPO acquisitions.

02(aa), and eliminating the requirement that the parent not have separate assets and operations to qualify for the sole presentation of narrative disclosure;

- eliminating the requirement for the presentation of condensed consolidating financial information, and instead requiring relevant, audited quantitative information about either the issuer/guarantor group or the non-guarantor group, in the registrant's discretion;

- revising the requirement for separate financial statements of recently acquired guarantors to require separate financial statements only when the recently acquired guarantor is significant to the obligated group;

- revising S-X Rule 3-10 to terminate its applicability upon the filing of a Form 15 to suspend the subsidiary issuer's or guarantor's reporting obligations under the Exchange Act with respect to the indebtedness covered by the Rule; and

- codifying in S-X Rule 3-10 customary circumstances for the release of a subsidiary's guarantee that permit continued reliance on S-X Rule 3-10.

8. S-X Rule 3-14: The Commission should consider eliminating S-X Rule 3-14 and integrating the financial statement requirements for real estate operations and triple net lease arrangements into S-X Rule 3-05.

9. S-X Rule 3-16: The Commission should consider eliminating the requirement for separate financial statements for entities providing security, and instead permit summarized financial information about such entities in annual financial statement footnotes.

10. S-X Article 11/Form 8-K Item 2.01: The Commission should consider:

- permitting pro forma financial information for two years, and for acquisitions that are not significant;

- permitting adjustments in more circumstances; and

- conforming the significance test for dispositions to the significance test for acquisitions for purposes of triggering the requirements for pro forma information for, and Form 8-K Item 2.01 disclosures about, dispositions.

11. Critical Accounting Estimates Disclosure in Management's Discussion and Analysis of Financial Condition and Results of Operations (the "MD&A"): The Commission should consider amending S-K Item 303 to require disclosure about management's significant judgments and assumptions underlying such estimates.

12. S-K Item 303(a)(4) Off-Balance Sheet Arrangements; S-K Item 305 Market Risk Disclosures: The Commission should consider eliminating the detailed, prescriptive disclosure requirements in S-K Item 303(a)(4) and S-K Item 305 in light of changes in U.S. Generally

Accepted Accounting Principles ("GAAP") requirements and evolving disclosure principles underpinning both the MD&A and the risk factor disclosures required by S-K Item 503(c).

13. Codification of Commonly Granted Staff Waivers and Other Forms of Financial Reporting Relief: The Commission should codify in Regulation S-X, or disclose publicly until such relief is codified, waivers and other forms of financial reporting relief regularly granted by the Staff.

14. Statutory Safe Harbors for Forward-Looking Information: The Commission should consider, including with respect to its work with the Financial Accounting Standards Board ("FASB"), the placement in registration statements and Exchange Act reports of any future requirements for forward-looking disclosures to ensure that such disclosures qualify for the safe harbors added to each of the Securities Act and the Exchange Act by the Private Securities Litigation Reform Act of 1995 (the "PSLRA").

Background

As noted in the Division's December 2013 Report on Review of Disclosure Requirements in Regulation S-K,[4] the Commission has undertaken several initiatives over the years to reevaluate and update its disclosure and registration requirements. In this context, "certain disclosure items have been updated and reviewed relatively frequently, while others have changed little since they were first put in place after the enactment of the Securities Act."[5] Since 2002, Congress itself has imposed new and different disclosure obligations, most (but not all) implemented through Commission and self-regulatory organization rulemaking. Corporate disclosure documents filed with (or submitted to) the Commission, in the meantime, have become significantly more lengthy, complex and internally redundant, and even, in some cases, include information that has become irrelevant to investors for wide-ranging reasons – from changes in the global economy affecting the way companies generally do business, to developments in communications technology that change the way investors access information. Concerns regarding the risk of "information overload" have been expressed by registrants and investors alike, as exemplified by Commission Chair Mary Jo White's observation last year that:

> When disclosure gets to be "too much" or strays from its core purpose, it could lead to what some have called "information overload"—a phenomenon in which ever-increasing amounts of disclosure make it difficult for an investor to wade through the volume of information she receives to ferret out the information that is most relevant.[6]

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[4] *See* Division of Corporation Finance, U.S. Securities and Exchange Commission, *Report on Review of Disclosure Requirements in Regulation S-K, As Required by Section 108 of the Jumpstart Our Business Startups Act* (Dec. 2013), *available at* http://www.sec.gov/news/studies/2013/reg-sk-disclosure-requirements-review.pdf.

[5] *Id.*

[6] Speech by Mary Jo White, Chair of the U.S. Securities and Exchange Commission, *The Path Forward on Disclosure: Remarks before the National Association of Corporate Directors – Leadership Conference 2013* (Oct. 15, 2013), *available at* http://www.sec.gov/News/Speech/Detail/Speech/1370539878806.

Against this background, and informed by our experience in advising registrants on compliance with financial and business disclosure requirements, the comments below identify issues with existing disclosure requirements and recommend solutions in the form of targeted revisions to certain provisions in S-X and S-K, along with two related topics. In formulating our comments, we have kept in mind that a key objective of the Commission's Disclosure Effectiveness initiative is obtaining better – not necessarily less – disclosure.

Discussion

S-X Rule 1-02(w)

Issues

- The pre-tax income, asset and investment "significance" tests in S-X Rule 1-02(w) do not effectively or consistently identify the significance of the tested entity to a registrant. To illustrate:
  - The pre-tax income test can give anomalous results for significance depending upon unusual gains and/or losses.
  - Given that the investment and asset tests are based on book values, these tests do not necessarily measure the economic significance of the tested entity (except when the purchase price is used in the numerator only in the investment test).
  - Registrants regularly receive Staff relief as a result of these tests.
- S-X Rule 1-02(w) affects other provisions of S-X (S-X Rule 3-05, S-X Rule 3-09, S-X Rule 4-08(g), S-X Rule 11-01), so it is important to think about the significance test in the various contexts in which it triggers separate financial statements.

Recommendations

- Revise the significance tests in S-X Rule 1-02(w) by replacing the existing pre-tax income, investment and asset tests with: (i) a revenue test; and (ii) a fair value test, which would permit the use of the investee's or the registrant's book value if fair value is not readily available.
  - RATIONALE: Compared to the existing tests, revenue and fair value–based tests are: (i) more reliable indicators of the significance of a tested entity to the registrant; (ii) easier to calculate; and (iii) calculated using more consistently measured amounts that are not affected by different bases of accounting.

- Revenue Test. The revenue test would compare the registrant's proportionate share of net revenue of the tested entity to the registrant's consolidated net revenue.

  - RATIONALE: A revenue test would be objective and easy to calculate, and would not involve the complication of averaging to address unusual fluctuations. In addition, data regarding the revenue of the tested entity are often more reliable and readily available (and subject to due diligence verification in the case of an acquisition) as compared to an entity's GAAP pre-tax income (if available).

  - RATIONALE: A significance test based on revenue would be more effective than the pre-tax income test in determining the significance of a tested entity to the registrant.

- Fair Value Test. The fair value test would compare the fair value of the registrant's investment in the subsidiary or investee (or, in the case of a business combination, the amount of the consideration transferred or the registrant's proportionate share of such transferred consideration) to the registrant's fair value.

  - RATIONALE: A significance test based on fair value would be more effective in determining the significance of a tested entity to the registrant than the current investment and asset tests, which use the book value of the registrant's total assets (and in the case of the asset test, the book value of the assets of the entity being tested).

  - RATIONALE: The fair value amounts should be available or readily determinable for registrants or equity investees with public equity outstanding. For example, such an entity's fair value could be calculated based on the number of outstanding shares and the market closing price. With respect to acquired businesses (for purposes of S-X Rule 3-05), the fair value of the purchase consideration generally should be readily available and would not require additional valuation efforts. To the extent that an equity investee (for purposes of Rule S-X 3-09) or a registrant (for purposes of S-X Rule 3-05) does not have public equity outstanding and its fair value is not readily available, the test could substitute book value for both the numerator, as applicable, and the denominator.

- Permit guidance consistent with S-X Rule 3-05(b)(3) to apply more broadly for significance testing based on revenue in Rule 1-02(w) (revised per our recommendation).

  - RATIONALE: If pro forma financial information, supported by audited financial information, has been filed for the most recent fiscal year-end

under S-X Rule 11-01, registrants should be permitted to test significance based upon pro forma revenue rather than historical revenue for any transaction in which Rule 1-02(w) is being applied.

S-X Rule 3-05

Issues

- Compliance with the requirement to provide three years of audited financials can be problematic where: (i) the financial statements of an acquired business have not previously been audited; (ii) the acquired business's prior auditor is unwilling to assume liability under the federal securities laws by providing its consent; or (iii) the acquired business's financial statements do not comply with Regulation S-X or are prepared using private company accounting standards.

- Uncertainty about the application of S-X Rule 3-05 can delay transactions or deter a registrant from pursuing a possible transaction.

- Registrants regularly seek Staff relief – this process, despite the best efforts of the Staff, often injects additional delay and uncertainty into an already complex acquisition process.

Recommendations

- Revise the significance tests in S-X Rule 1-02(w), as discussed above.

- Require a third year of audited financial statements of an acquired business only when the significance of the acquired business (as calculated under the revised significance tests) exceeds 80% (rather than 50%).

    - RATIONALE: In most cases, two years of financial statements of an acquired business should be sufficient for an investor to evaluate the implications of the transaction (consistent with what has been accepted for emerging growth companies ("EGCs")), particularly in conjunction with pro forma information.

    - RATIONALE: The 80% significance test is already used for purposes of S-X Rule 3-05(b)(4)(iii) as an indicator of "major significance."

- If the acquired business is significant but audited financial statements are not obtainable without unreasonable effort and expense, the registrant should be permitted to provide only an audited statement of revenue and direct expenses (for the required fiscal years and subsequent interim period) and an audited statement of assets acquired and liabilities assumed, as long as the registrant represents in its disclosure document that the audited financial statements are not available without unreasonable effort and expense.

- RATIONALE: GAAP financial statements of the acquired business have limited utility in assessing the future contribution of the acquired business because they do not reflect the effects of purchase accounting adjustments. For that purpose, pro forma financial information is more effective.

- RATIONALE: When the acquired business will not be a separate reporting entity in the future, but instead will become part of the consolidated registrant, certain of the disclosures required by GAAP have limited utility from the perspective of investors in the acquiring business.

- RATIONALE: The ability of a registrant to file the abbreviated financial information for an acquisition rather than full audited financial statements will permit more timely disclosure to investors of historical and pro forma financial information about the acquisition.

- With respect to individually insignificant acquisitions, separate audited financial information should not be required in registration statements filed under the Securities Act, even when significance on an aggregate basis exceeds the 50% level. Instead, a registrant should provide pro forma information (in filings under both the Securities Act and the Exchange Act) when the aggregate effect of individually insignificant acquisitions in a fiscal year becomes significant to the registrant (i.e., exceeds 20%). For individually insignificant acquisitions, a registrant could elect to supplement such pro forma financial information with audited financial information about some or all of the acquired entities, to the extent available.

  - RATIONALE: There is no corresponding disclosure requirement under the Exchange Act reporting regime, and we see no compelling reason to include these additional financial statements in a Securities Act registration statement.

  - RATIONALE: Pro forma information in both Exchange Act and Securities Act filings would benefit investors regardless of whether the significance of acquisition activities is due to one or more business combinations.

- Codify and update the tests in SAB 80 to reflect subsequent changes to S-X Rule 3-05 and limit the reporting requirement to two years of financial statements in light of the JOBS Act's relief for initial public offerings by EGCs. Rather than using the pro forma thresholds of 90%, 80% and 60% in existing SAB 80, use 80% and 60% to determine the need for financial statements for the two fiscal years.

  - RATIONALE: SAB 80 significance levels were not revised at the time the significance thresholds were changed for S-X Rule 3-05. Revisions to align the significance thresholds for application of S-X Rule 3-05 in an

initial registration statement (whether under the Securities Act or the Exchange Act) will reduce complexity and enhance investor understanding.

- RATIONALE: Companies are eligible to use SAB 80 only if they are built from the aggregation of separate businesses that remain substantially intact after acquisition and are filing their first registration statement. Such businesses generally would qualify as EGCs based on having less than $1 billion in total annual gross revenues and, as such, would be required to provide only two years of financial statements in an initial equity offering registration statement.

- Noncompliance with S-X Rule 3-05 requirements should be deemed "cured" upon the registrant's filing of financial statements that: (i) include the post-acquisition results of operations of the acquired business for at least nine consecutive months and the registrant's audited balance sheet that reflects the acquired business; (ii) reflect the completion of the purchase accounting measurement period; and (iii) include the acquired business in the scope of the registrant's evaluation of internal control over financial reporting.

  - RATIONALE: The consequences of the inability to comply with S-X Rule 3-05 are unnecessarily costly compared to the limited informational benefits of the required disclosure, in particular due to the significant disadvantages resulting from the registrant's inability to access the public markets for an unnecessarily long-term period.

  - RATIONALE: This proposal would reduce burdens on registrants while protecting investors as a result of the requirements for an audited balance sheet that reflects the acquired business, completion of the measurement period for purchase accounting and inclusion of the acquired business in the scope of the registrant's evaluation of internal control over financial reporting.

  - RATIONALE: When a registrant can provide some but not all of the periods of audited financial statements that are required under S-X Rule 3-05, the Staff currently considers the combination of pre-acquisition audited financial statements of the acquired business and post-acquisition audited financial statements of the registrant spanning multiple periods (for which nine months is the equivalent of a year under S-X Rule 3-06) as sufficient to satisfy S-X Rule 3-05 requirements.

S-X Rules 3-09 and 4-08(g)

Issues

- References in S-X Rules 3-09 and 4-08(g) to "majority-owned subsidiaries not consolidated" are outdated, because such subsidiaries are now required to be consolidated under GAAP.

- The significance thresholds result in the need for registrants to file financial statements for investees when summarized disclosures of the investee's financial condition and results of operations would likely be just as useful to investors.

- S-X Rule 3-09 can require the filing of audited financial statements after an equity investment has been sold.

Recommendations

- Revise the significance tests in S-X Rule 1-02(w), as discussed above.

- Given that GAAP now requires the consolidation by a parent of all subsidiaries,[7] S-X Rules 3-09 and 4-08(g) should be amended to delete references to "majority-owned subsidiaries not consolidated."

- S-X Rule 4-08(g) disclosures for individually insignificant equity investees (a level of 10% or less) should be required only if they are significant on an aggregate basis at a level greater than 20%.

    - RATIONALE: The 20% level for individually insignificant equity investees is more likely to provide material information to investors. In this regard, we note that S-X Rule 8-03 requires smaller reporting companies to disclose summarized income statement information for equity investees only at a 20% level.

- Amend S-X Rule 4-08(g) to require separate summarized financial information for individual equity investees that are significant at the greater than 10% significance level (except when separate financial statements of the investee are filed as provided below) instead of permitting aggregation of financial information with other individually significant entities' financial information.

    - RATIONALE: Enhancing the disclosure requirement for individually significant entities will provide investors with better information than the Rule currently provides.

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[7] *See* FASB Accounting Standards Codification Topic ("ASC") 810 *Consolidation.*

- RATIONALE: It is not uncommon for the Staff to accept separate summarized financial information regarding significant investees in the registrant's footnotes in response to waiver requests when separate financial statements are not available.

- Separate audited financial statements of equity method investees should not be required unless the equity investee is significant at the 80% significance level. Separate financial statements should be required for that year and thereafter, except that: (i) separate financial statements should not be required to be audited when significance is below the 80% significance level; and (ii) no separate financial statements should be required for any year when the equity investee is not significant at a greater than 10% level.

  - RATIONALE: The 80% significance level most reasonably represents the level at which a registrant's financial statements alone would not provide financial information sufficient to make an investment decision, such that separate financial statements of the investee should be required.

  - RATIONALE: The Commission should not require financial statements of an equity investee for any year before the equity investee is significant at the 80% level because the potential costs in obtaining the audited financial statements of an equity investee that does not already have audited financial statements for a year prior to when the equity investee became significant would outweigh the benefit to investors of such information.

  - RATIONALE: With respect to the three immediately preceding recommendations above concerning S-X Rules 4-08(g) and 3-09, we further note that ASC 323-10-50-3c[8] provides that disclosures about "material" equity investees can be provided via either summarized information or separate statements. The use of greater than 10% for individual significance, greater than 20% for the aggregate of individually insignificant equity investees, and greater than 80% for audited financial statements in each of those recommendations is consistent with ASC 323-10-50-3c.

- Separate audited financial statements and summarized balance sheet information should not be required for an equity investee following the registrant's disposition of the investment.

  - RATIONALE: Currently, S-X Rules 4-08(g) and 3-09 apply to equity investees that meet the significance test, even if the registrant disposes of the equity investment before year end. Once such disposition has

[8] *See* ASC 323 *Investments – Equity Method and Joint Ventures.*

occurred, the audited financial statements and summarized balance sheet information for the investment are no longer useful to investors and should not be required.

- Currently, S-X Rule 3-09 applies to equity investees in the year of their acquisition and requires financial statements covering the period of ownership. If necessary, a registrant should be allowed to file audited annual financial statements for an 80% significant investee that include periods prior to the registrant's ownership (supplemented by summarized financial information in the footnotes for only the periods in which the investment is held) without making a pre-filing request of the Staff.

    - RATIONALE: This change will facilitate compliance and eliminate the need for registrants to submit and clear pre-filing requests with the Staff, which requests are generally granted today.

- S-X Article 10 and S-X Rule 8-03 should not require summarized interim financial information for equity investees unless there has been a material adverse change in the investee's financial condition or operations since the most recently reported annual information, or unless audited financial statements were required for the most recent fiscal year under Rule 3-09 as revised (i.e., the investee is significant at the 80% level).

    - RATIONALE: GAAP does not explicitly require any disclosures about equity method investees in interim financial statements.

S-X Rule 3-10

Issues

- The requirement in the exceptions set forth in S-X Rule 3-10(b) through (f) that the subsidiary be 100% owned by the parent registrant, and the requirement in the exceptions in S-X Rule 3-10(c) through (f) that, to present solely narrative disclosure, the parent have no independent assets or operations, are both unnecessarily restrictive.

- The preparation of condensed consolidating financial information is very difficult and complex.

- Many companies have had to restate their financial statements because of errors in preparing the condensed consolidating financial information since, but for S-X Rule 3-10, the financial data required in the condensed consolidating financial information is not prepared.

Recommendations

- Expand the instances when no separate financial information for a subsidiary guarantor or subsidiary issuer is required to include cases in which a "wholly owned subsidiary" (as defined in S-X Rule 1-02(aa)) is the issuer or provides a full and unconditional and joint and several guarantee.

- Permit the sole presentation of narrative disclosures when the parent has independent assets and operations, provided that any non-guarantors are minor.

- Substitute the current requirements for the presentation of condensed consolidating financial information with the requirement to present, on an audited basis, the revenues, operating income, assets and liabilities of either the guarantors and issuers as a single obligated group, or of the non-guarantors as a single group, in the discretion of the registrant, provided that the registrant consistently discloses such information in the future.

    - RATIONALE: This recommendation is based on the type of information typically included, on an unaudited basis, with respect to the non-guarantor group in offering memoranda for Rule 144A debt offerings. In this regard, we note that such memoranda typically include unaudited EBITDA (together with the other unaudited financial information cited above), which investors apparently believe is important and which the Commission therefore might also consider requiring or permitting. If institutional investors do not believe that condensed consolidating financial information is necessary to informed investment decisionmaking, it seems likely that such information would not be useful to other types of investors or public market participants.

- S-X Rule 3-10(g) should require separate financial statements for recently acquired guarantors for the most recent fiscal year only where the newly acquired guarantor is significant (based on the significance tests revised as previously suggested) to the obligated group in the aggregate (i.e., the issuer(s) and all guarantors).

    - RATIONALE: The current test based upon the principal amount of the debt being registered does not yield an "apples-to-apples" comparison. Revising the approach consistent with the above would be more likely to require separate statements only when they are relevant to enabling investors to understand the financial capacity of the obligated group (i.e., omitting pre-acquisition financial statements for a recently acquired guarantor when they would not be necessary to provide investors with a sufficient understanding of the obligated group).

- The references to S-X Rules 3-10(i)(9) and (10) in other provisions of S-X Rule 3-10 (to the extent such provisions are retained) should be reviewed to eliminate the references when they seem unnecessary or irrelevant, such as the reference in S-X Rule 3-10(b) to S-X Rules 3-10(i)(9) and (10).

    - RATIONALE: Clarification of the rule will facilitate compliance.

- Revise S-X Rule 3-10 and any other related rules (e.g., Exchange Act Rule 12h-5) to permit a registrant (whether a co-issuer with its subsidiary or a guarantor of its subsidiary's securities) to cease complying with S-X Rule 3-10 once the relevant debt securities are held by fewer than 300 record holders and the registrant files a Form 15 to suspend its reporting obligations under the Exchange Act.

    - RATIONALE: Based on the Commission's release adopting S-X 3-10,[9] the Staff has taken the position that, when the S-X Rule 3-10 has been relied upon to omit separate financial statements of an issuer or guarantor, S-X Rule 3-10 will continue to apply "for so long as the subject securities are outstanding."[10] However, when the subject securities are held by fewer than 300 persons, those securities are eligible for the automatic suspension of the reporting obligation pursuant to Section 15(d) of the Exchange Act. Therefore, S-X Rule 3-10 should cease to apply, provided the registrant has filed a Form 15 to suspend its reporting obligations under the Exchange Act. That is, the reporting provisions of S-X Rule 3-10 should not exist for as long as the guaranteed security is outstanding, but instead should end coincident with when the Exchange Act reporting obligation would have ceased if Rule 12h-5 had not been available.

- Codify in S-X Rule 3-10 the customary circumstances for the release of a subsidiary's guarantee that permit continued reliance on S-X Rule 3-10.

    - RATIONALE: The Division's Financial Reporting Manual ("FRM") includes examples of customary circumstances in which S-X Rule 3-10 may be available. Codifying these and other examples in the Rule will facilitate registrants' understanding of and compliance with the Rule.

S-X Rule 3-14

Issues

- S-X Rule 3-14 appears to have the same objective and principle for acquired real estate operations as S-X Rule 3-05 does for other acquired businesses; however,

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[9] *See* Securities Act Release No. 7878, "Financial Statements and Periodic Reports For Related Issuers and Guarantors" (Aug. 4, 2000), *available at* http://www.sec.gov/rules/final/33-7878.htm.

[10] *Id.*

there are several aspects of the two that are inconsistent, leading to unnecessary complexity and requiring disclosure of information about acquired real estate operations under circumstances that would not trigger financial statements for another acquired business.

- The absence from S-X 3-14 of several of the provisions that exist in S-X Rule 3-05 has resulted in the requirements being directed by Staff guidance rather than Commission rules. Although the Staff is very responsive to registrant requests for guidance, substantial time and costs could be avoided if this guidance were codified and added to S-X Rule 3-05.

Recommendations

- Eliminate S-X Rule 3-14 and require the acquisition of real estate operations to be addressed in, and to comply with, the requirements of S-X Rule 3-05 (as modified consistent with our suggestions above) as it relates to significance, number of periods, and age of financial statements, etc.
    - RATIONALE: The acquisition of real estate operations is generally accounted for as a business combination under GAAP, so the significance requirements for real estate operations should be the same as those for other business combinations.
    - RATIONALE: In the Commission's 1996 release that revised certain requirements of S-X Rule 3-05, commenters requested that the Commission also clarify S-X Rule 3-14. The Commission deferred making the requested clarifications, but indicated that it would consider changes "in the context of its evaluation of a more comprehensive disclosure scheme."[11]
- Permit the financial statements required by S-X Rule 3-05 (as modified consistent with our suggestions above) for acquired real estate operations to continue to be a statement of revenues and certain direct expenses (exclusive of mortgage interest, depreciation and amortization, taxes, and overhead) similar to the recommendation in S-X Rule 3-05 above to permit the use of abbreviated financial statements.
    - RATIONALE: The nature of the presentation used today for S-X Rule 3-14 seems to operate well and provide sufficient information for investors and for the development of pro forma financial information and should be incorporated into S-X Rule 3-05, revised as previously suggested.

[11] *See* Securities Act Release No. 7355, "Streamlining Disclosure Requirements Relating to Significant Business Acquisitions" (Oct. 10, 1996), *available at* https://www.sec.gov/rules/final/33-7355.txt.

- Require summarized financial information of significant tenants under triple-net lease arrangements at a significance level consistent with S-X Rule 3-05 (i.e., 20%) and separate financial statements when the property's fair value or revenues represent more than 80% (i.e., S-X Rule 3-09, revised as previously suggested) of the registrant's fair value or revenues.

    - RATIONALE: Tenant financial statements are required under Staff guidance because of investment concentration and related credit risk. As a result, the requirement to present separate financial statements, rather than summarized financial information, of tenants should be consistent with the investment concentration considerations in S-X Rule 3-09.

    - RATIONALE: Using an 80% significance test is consistent with our prior recommendations regarding S-X Rule 3-09, and 80% is already a threshold for "major significance" in current S-X Rule 3-05.

S-X Rule 3-16

Issue

- To avoid the significant burden of preparing and disclosing the separate audited annual financial statements triggered by S-X Rule 3-16, registrants typically structure agreements specifically to avoid the application of the Rule, with the result that pledges of subsidiary's stock are avoided despite their possible usefulness as a capital-raising option for registrants.

Recommendation

- Permit registrants to provide, in audited annual financial statement footnotes, summarized financial information about entities providing security, rather than the separate financial statements required by S-X Rule 3-16.

    - RATIONALE: Market practice has developed in the Rule 144A secured transaction market to prohibit or eliminate a pledge of capital stock and other securities of a subsidiary if the pledge would trigger the requirement to provide separate financial statements under S-X Rule 3-16 in connection with a registered A/B exchange offer. If institutional investors do not believe that separate financial statements are necessary for their understanding of the financial condition of the entities providing security when making an investment decision, it seems likely that such information would not be useful to other types of investors or market participants.

S-X Article 11 – Pro Formas
Form 8-K, Items 2.01 and 9.01

Issues

- It is not clear under current rules whether pro forma information would be permitted when separate financial statements of an acquired business are not also provided.

- S-X Rule 11-02(b)(6) and Staff interpretations in the FRM significantly limit the adjustments that a registrant can reflect in pro forma financial information.

- S-X Rule 11-02(c)(2)(i) precludes the presentation of pro forma condensed statements of income for more than the most recent fiscal year, which therefore prevents presentation of comparable periods.

Recommendations

- Permit registrants to present additional pro forma information that they believe is material to an understanding of their financial condition and results of operations, regardless of whether historical financial statements for an acquired business are required – after all, these disclosures will be subject to the liability provisions of the federal securities laws.

- Permit additional adjustments to reflect management's plans if such adjustments have a reasonable basis and are made in good faith and for items that the combined company would not have incurred if the acquisition had taken place at the beginning of the period presented, provided they are clearly segregated and include appropriate disclosure.

- Permit pro formas for two fiscal years.

    - RATIONALE: These changes will provide registrants with greater flexibility to present pro forma information that they believe will be useful to investors.

- Revise S-X Rule 11-01(b)(2) (with respect to dispositions of a business) and Item 2.01 of Form 8-K (with respect to dispositions of assets as well as a business) to conform the significance test for dispositions (currently greater than 10%) to the significance test for acquisitions (currently greater than 20%).

    - RATIONALE: The disparity in the tests for acquisitions and dispositions seems unnecessary in determining the trigger for pro forma disclosure of information that may be material to an investor, and unnecessarily complicates registrants' interpretation and application of the requirements of Items 2.01 and 9.01 of Form 8-K.

S-K Item 303: Critical Accounting Estimates Disclosure

Issues

- Interpretations and guidance issued by the Commission and the Division with respect to the disclosures expected in the MD&A indicate that disclosure about management's critical accounting estimates should be included in this section, but no rule expressly requires this disclosure or defines its parameters, particularly with respect to the significant accounting policies footnote to the financial statements.

- Registrants often copy the text from the significant accounting policies footnote into the MD&A, rather than explaining in the MD&A the impact of significant accounting estimates and the underlying management judgments and assumptions.

Recommendation

- Amend S-K Item 303 to: (i) require a discussion about the most significant assumptions and judgments that management makes in connection with the preparation of the financial statements; and (ii) explain that the disclosure included in the MD&A is meant to supplement, not duplicate, the referenced footnote. The Commission may want to consider whether requiring independent auditor negative assurance would enhance the quality of the recommended disclosures.

    - RATIONALE: Clarity within the rule will elicit valuable information that may be helpful to investors in understanding the results reflected in the financial statements and discussed in the MD&A, and reduce redundant "boilerplate" disclosures. Auditor association with the disclosure may impose more rigor on its preparation, although any additional costs and burdens of such association would also need to be considered.

S-K Item 303(a)(4)
Item 5.E. of Form 20-F

Issue

- The off-balance sheet disclosures required by S-K Item 303(a)(4) have been largely supplanted by developments in GAAP,[12] and the current disclosures provided are generally boilerplate and/or redundant.

[12] *See supra* note 7.

Recommendations

- Revise (with appropriate cross-references to the financial statement footnotes) or eliminate this requirement in light of current GAAP, and consider in this regard the benefits of shifting to a more "principles-based" approach to the MD&A disclosure in this area (e.g., the potential impact on the registrant of the acceleration or increase of material off-balance sheet arrangements).

- Revise the corresponding requirement in Item 5.E. of Form 20-F to permit a registrant to omit the required disclosure to the extent that off-balance sheet transactions are disclosed in the footnotes to the audited financial statements.

S-K Item 305
Item 11 of Form 20-F

Issue

- The market risk disclosures required by S-K Item 305 were initially envisioned as a potentially temporary provision pending the development of corresponding standards under GAAP, which since have been developed.

Recommendations

- Eliminate S-K Item 305 in light of current GAAP requirements,[13] or consider refocusing the Item to permit principles-based disclosures of market risk, perhaps in the MD&A (which some issuers do in any case).

- Revise the corresponding requirement in Item 11 of Form 20-F to the extent that market risk disclosures are included in the section of the filing that corresponds to MD&A or in the footnotes to the audited financial statements.

Codification of Commonly Granted Staff Waivers and Other Forms of Financial Reporting Relief

Currently, as noted in certain of the recommendations above, the Staff issues interpretations, relief and waivers of applicable requirements of Regulation S-X upon request. Although the Staff routinely publicizes some of these positions, codification of these interpretations, relief and waivers, where possible, and prominent, timely and centralized public disclosure of those regularly provided positions that have not yet been codified, with details on the conditions to such registrant reliance on such positions, would facilitate compliance by registrants and reduce, or eliminate, the need for registrants to seek the Staff's views on their particular situations.

[13] *See* ASC 820 *Fair Value Measurements* and ASC 815 *Derivatives and Hedging.*

Forward-Looking Statements – The Importance of Safe Harbor Coverage in Considering the Elimination of Redundant Information

We urge the Commission to continue to consider carefully, as it weighs the costs and benefits of potential disclosure reforms, the liability implications of differences in the type and placement of both forward-looking information (including certain estimates, judgments and projections) on the one hand, and financial statement disclosures that report historical transactions on the other hand (although we recognize that application of GAAP in this context often requires use of estimates, assumptions and judgments regarding future events). The safe harbors for forward-looking statements added to the Securities Act and the Exchange Act by the PSLRA (Section 27A of the Securities Act and Section 21E of the Exchange Act) do not apply (among other instances) to forward-looking information presented in the financial statements (including footnotes) prepared in accordance with GAAP, while such information is protected if disclosed in the MD&A.

We believe that the Commission should continue to encourage registrants to disclose forward-looking information to investors where material – whether pursuant to the mandatory "known trends, events and uncertainties" element of S-K 303 or otherwise – while taking into account the potential liability to registrants of the location of such disclosures. Accordingly, we urge the Commission, in working with the FASB, to coordinate their respective disclosure improvement projects to ensure that any recommendations for streamlining financial disclosure requirements to eliminate redundancy do not have the unintended effect of unnecessarily increasing liability exposure for registrants.

* * *

We appreciate the opportunity to comment on the Commission's Disclosure Effectiveness initiative, and respectfully request that the Commission and the Staff consider our recommendations and suggestions. We are available to meet and discuss these matters with the Commission and/or the Staff and to respond to any questions.

Very truly yours,

/s/ Catherine T. Dixon
Chair, Federal Regulation of Securities Committee
ABA Business Law Section

/s/ Randall D. McClanahan
Chair, Law and Accounting Committee
ABA Business Law Section

/s/ Thomas J. Kim
Chair, the Committees' Disclosure Effectiveness Working Group

Working Group Drafting Committee:

Robert E. Buckholz
Catherine T. Dixon
Rani Doyle
Robert Evans III
Linda L. Griggs
Christopher M. Holmes
Steven C. Jacobs
Matthew E. Kaplan
Stanley Keller
Randall D. McClanahan
Steven J. Slutsky
Thomas W. White

cc:
The Hon. Mary Jo White, Chair
The Hon. Luis A. Aguilar, Commissioner
The Hon. Daniel M. Gallagher, Commissioner
The Hon. Kara M. Stein, Commissioner
The Hon. Michael S. Piwowar, Commissioner
Keith F. Higgins, Director, Division of Corporation Finance
Mark Kronforst, Chief Accountant, Division of Corporation Finance