

Mr. Brent J. Fields  
Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549 1090

26 October 2018

**Re: Concept Release on Compensatory Securities Offerings and Sales (Release No. 33-10521; File No. S7-18-18)**

Dear Mr. Fields:

Ernst & Young LLP is pleased to respond to the Securities and Exchange Commission (SEC or Commission) on its concept release, *Compensatory Securities Offerings and Sales*.

Our comments address the financial statement disclosures required under Rule 701. We have observed situations in which the application of Rule 701 is unnecessarily complex or inconsistent with other disclosure frameworks within the securities laws and regulations.

In our comment letter, we suggest potential amendments for the Commission to consider to address these concerns without reducing investor protection. Specifically, we recommend that the Commission consider amending the Rule's disclosure requirements by:

- ▶ Simplifying and limiting the provisions of Part F/S of Form 1-A that apply to companies issuing securities under Rule 701
- ▶ Aligning the requirements for updating financial statements issued under Rule 701 with those in Regulation A
- ▶ Allowing the provision of audit reports performed in accordance with the International Standards on Auditing (ISAs) if such audited financial statements of a foreign company are available

**Application of Regulation A to Rule 701(e) disclosures**

We believe Regulation A continues to represent the appropriate framework for private companies to satisfy the disclosure requirements of Rule 701, but we believe the recent amendments to Regulation A implementing Section 401 of the Jumpstart Our Business Startups (JOBS) Act have introduced unnecessary complexity that the Commission should address. We also believe the Commission should further align Rule 701 with Regulation A by conforming the financial statement updating requirements.

### ***Simplifying Regulation A applicability***

The Concept Release notes that issuers relying on Rule 701 may choose to provide financial statements that comply with the requirements of either Tier 1 or Tier 2 Regulation A. We recommend that Rule 701 clarify that a private company only needs to comply with Tier 1 of Regulation A, which allows the financial statements provided to be unaudited unless audited financial statements are otherwise available. Unless the private company already is complying with Tier 2 reporting requirements due to another exempt offering, it would not logically choose to comply with those more onerous financial statement requirements only for purposes of Rule 701.

Tier 1 of Regulation A also requires financial statements of various other entities (i.e., Rules 3-10, 3-16 and 8-04 of Regulation S-X<sup>1</sup> apply). We question whether any financial statements other than those of the issuer are necessary for purposes of the issuance of compensatory securities under Rule 701. Accordingly, we recommend the Commission revise Rule 701(e) to limit the references to Regulation A to Rules (a) and (b) (1-6) of Part F/S of Form 1-A.

### ***Age of financial statements***

Rule 701 currently requires financial statements to be as of a date no more than 180 days before the sale of securities in reliance on the exemption.<sup>2</sup> The Concept Release notes that this could require Rule 701 issuers to update their financial statements more frequently than other issuers, such as foreign private issuers and those issuing exempt securities under Regulation A whose financial statements may be up to 270 days old. Rule 701 essentially requires issuers to update their financial statements quarterly while foreign private issuers and Regulation A issuers need only update their financial statements semiannually. We believe the requirements under Rule 701 should be no more burdensome than those for other issuers, so we recommend aligning the updating requirements with Regulation A. This would allow Rule 701 issuers to update their financial statements no more frequently than semiannually and allow the annual financial statements to be up to nine months old.

### ***Foreign private issuers***

In connection with adopting amendments to Rule 701 in 1999,<sup>3</sup> the Commission evaluated the Rule's effect on foreign private issuers (FPIs), noting commenters' observations "that FPIs typically undertake broad-based offerings to their U.S. employees for legitimate compensatory reasons and in order to treat all of their employees alike regardless of their location." In 2007,<sup>4</sup> the SEC made conforming amendments to Rule 701(e)(4) to allow non-reporting FPIs to provide financial statements in accordance with IFRS as issued by the International Accounting Standards Board without reconciling to US GAAP.

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<sup>1</sup> Rule (b)(7) of Part F/S of Form 1-A.

<sup>2</sup> 17 CFR 230.701(e)(4).

<sup>3</sup> 17 CFR Part 230; Release No. 33-7645; File No. S7-5-98; II.C.

<sup>4</sup> Release Nos 33-8879; 34-57026; International Series Release No. 1306; File No. SJ-13-07.

Similarly, we believe Rule 701 should explicitly allow FPIs to provide financial statements audited under ISAs. While financial statements provided to comply with Rule 701(e) may be unaudited,<sup>5</sup> the Rule only recognizes audits performed in accordance with US generally accepted auditing standards (US GAAS) or Public Company Accounting Oversight Board (PCAOB) auditing standards. Yet many FPIs obtain audits performed in accordance with ISA for home country financial reporting obligations.

Consequently, under the current rules, FPIs face two options under Rule 701: (1) incur the cost of a re-audit in accordance with US GAAS or PCAOB auditing standards, or (2) omit the ISA opinion and label the financial statements “unaudited.” We believe that investors would benefit from the receipt of the ISA audit report if such audited financial statements are available.

### **Timing of disclosure**

Rule 701 currently requires the delivery of disclosures within “a reasonable period of time before the date of sale.” While offerings under other exemptions such as Regulation A specify when these disclosures must be provided to potential investors, we believe Rule 701 issuers should have the discretion to determine when delivery of the disclosures is reasonably in advance, due to their relationship with the recipient and the fact that they are issuing the securities as compensation. Accordingly, we believe the existing timing of delivery is appropriate for the investors in Rule 701 transactions.

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We would be pleased to discuss our comments with the Commission or its staff at your convenience.

Yours sincerely,



Copy to: Wesley Bricker, Chief Accountant, Office of Chief Accountant  
Kyle Moffatt, Chief Accountant, Division of Corporation Finance

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<sup>5</sup> Part F/S (b)(2) of Form 1-A.