

VI. Finance, Mergers, and Acquisitions

*Melissa K. Caen, Emmett N. Ellis IV, and Steven C. Friend**

A. Introduction	123
B. SEC Modernization and Simplification Under the FAST Act.....	124
1. Exhibits—Item 601	124
2. Description of Property—Item 102	125
3. Compliance with Section 16(a) of the Exchange Act—Item 405	125
4. Changes to SEC Forms—Cover Page	126
5. Hyperlinks	126
6. Description of Business—Item 101.....	127
7. Legal Proceedings—Item 103	128
8. Risk Factors—Item 105.....	129
9. Selected Financial Data—Item 301	130
10. Supplementary Financial Information—Item 302.....	130
11. Management’s Discussion and Analysis of Financial Condition and Results of Operations—Item 303	130
12. Parallel Amendments to Financial Disclosures Provided by Foreign Private Issuers.....	134
C. LIBOR and SOFR	134
D. Critical Audit Matters.....	136
E. Auditor Independence	138
F. AICPA Materiality.....	138
G. Green Bonds	139

A. INTRODUCTION

In the second half of 2019 and early 2020, the Securities and Exchange Commission (SEC) continued to pursue disclosure reform and simplification initiatives under the Fixing America’s Surface Transportation Act (FAST Act). The financial community continued to adapt to the planned phasing out of the London Interbank Offered Rate (LIBOR). Pursuant to new standards of the Public Company Accounting Oversight Board (PCAOB), the auditors of certain companies began including “critical audit matters” in the audit report. Finally, the popularity of green bonds in the capital markets showed no signs of abating.

*Melissa K. Caen is Vice President and Associate General Counsel at The Southern Company; Emmett N. Ellis IV is a Partner at Hunton Andrews Kurth LLP in its New York, New York, office; and Steven C. Friend is a Partner at Hunton Andrews Kurth LLP in its New York, New York, office.

B. SEC MODERNIZATION AND SIMPLIFICATION UNDER THE FAST ACT

On March 20, 2019, the SEC issued a final rule adopting proposed rule changes to modernize and simplify certain disclosure requirements in Regulation S-K and related rules and forms.¹ The rule changes were intended to reduce reporting costs and burdens on registrants, improve the readability and navigability of disclosure documents, and discourage repetitive disclosure and disclosure of immaterial information.² The amendments are consistent with the SEC's Congressional mandate under the FAST Act³ to require the SEC to eliminate provisions of Regulation S-K⁴ that are duplicative, overlapping with other disclosure regimes, or unnecessary. The FAST Act was enacted in December 2015 and directs that the SEC review the disclosure requirements of Regulation S-K and modernize and simplify its requirements.⁵ The amendments, among other things, increase flexibility in the discussion of historical periods in Management's Discussion and Analysis, allow companies to redact confidential information from most exhibits without filing a confidential treatment request, and incorporate technology on the cover page of certain filings to improve access to information.⁶

Below is a summary of key disclosure requirements under Regulation S-K that have been modified or eliminated by the amendments:

1. Exhibits—Item 601

- ***Omission of Information from Material Contracts Without Confidential Treatment Request.*** The amendments related to Item 601 permit registrants to omit confidential information from material contract exhibits filed pursuant to Item 601(b)(10) without submitting a confidential treatment request if such information is (1) not material, and (2) would likely cause competitive harm.⁷ This is a change to the current process that requires a registrant to give the SEC an unredacted copy of each exhibit and request confidentiality. The SEC staff will continue to assess the appropriateness of redactions that will be subject to review and comment at the staff's discretion.⁸ Registrants will still need to mark the exhibit index specifying which sections of the exhibit

1. Securities and Exchange Commission (SEC), FAST Act Modernization and Simplification of Regulation S-K, Release No. 33-10618 (Mar. 20, 2019) [84 Fed. Reg. 12,674 (Apr. 2, 2019)], <https://www.sec.gov/rules/final/2019/33-10618.pdf> [hereinafter FAST Act Modernization].

2. *Id.*

3. Fixing America's Surface Transportation Act of 2015. Pub. L. No. 114-94, 129 Stat. 1312, § 72002(2) (2015). The SEC first adopted rule changes to simplify and reduce disclosure requirements under both Regulation S-K and Regulation S-X for public companies, investment advisers, and investment companies on August 17, 2018. Those rules were designed to reduce compliance burdens for public companies without reducing the total mix of information available to investors. *See* Securities and Exchange Commission, Disclosure Update and Simplification, Release No. 10532 (Aug. 17, 2018) [83 Fed. Reg. 50,148 (Oct. 4, 2018)], <https://www.sec.gov/rules/final/2018/33-10532.pdf>.

4. Regulation S-K, 17 C.F.R. pt. 229.

5. Fixing America's Surface Transportation Act of 2015 § 72002(2).

6. *See* FAST Act Modernization, *supra* note 1, at 9.

7. *Id.* at 21, 25.

8. *Id.* at 25–26.

have been omitted and include a statement that indicates that information from the marked exhibit has been omitted.⁹

- ***Omission of Schedules and Attachments to Exhibits.*** The amendments added new Item 601(a)(5) to permit registrants to omit entire schedules and similar attachments to required exhibits, provided such information (1) does not contain material information, and (2) is not otherwise disclosed in the exhibit or the SEC filing.¹⁰ In addition, each filed exhibit must contain a list briefly identifying the contents of any omitted schedules and attachments.¹¹
- ***Elimination of Two-Year Lookback Period for Material Contracts.*** Previously, Item 601(b)(10)(i) required registrants to file every material contract not made in the ordinary course of business, provided that one of two tests was met: (1) the contract must be performed in whole or in part at or after the filing of the registration statement or report, or (2) the contract was entered into not more than two years before that filing.¹² The amendments limit the two-year lookback test to “newly reporting registrants.”¹³ Registrants with established reporting histories will no longer be subject to the two-year lookback requirement because investors will continue to have access to any material agreements previously filed on EDGAR.¹⁴
- ***New Requirement for Description of Securities.*** The amendments require registrants to provide Item 202 information with respect to their securities registered under the Securities Exchange Act of 1934, as amended (the 1934 Act), as an exhibit to their Form 10-K, rather than limiting such disclosure to registration statements.¹⁵

2. Description of Property—Item 102

Previously, Item 102 required a company to disclose “the location and general character of [its] principal plants, mines and other materially important physical properties.”¹⁶ In response to concerns of immaterial disclosures, the SEC amended Item 102 to require a company’s description of its physical property only if the properties are considered material to the company.¹⁷

3. Compliance with Section 16(a) of the Exchange Act—Item 405

The SEC eliminated the requirement for directors, officers, and ten percent shareholders to furnish copies of reports mandated by Section 16(a) of the 1934 Act to their companies.¹⁸ Previously under this section, directors, officers, and ten

9. *Id.* at 26–27.

10. *Id.* at 62–65.

11. *Id.*

12. *Id.* at 65–68.

13. *Id.*

14. *Id.*

15. *Id.* at 118.

16. *Id.* at 33.

17. *Id.* at 37.

18. *Id.* at 41–42.

percent shareholders were required to provide copies to the registrant of beneficial ownership reports filed under Section 16.¹⁹ Given the availability of these reports on EDGAR, the SEC believed physical delivery is no longer necessary.²⁰ Currently, many companies include a heading and disclosure in their annual report on Form 10-K and their proxy statements regarding any timely reporting failure by their reporting persons. The SEC eliminated both the heading and accompanying disclosure if the company has no delinquencies to report.²¹ In addition, the amendments changed the heading to “Delinquent Section 16(a) Reports” and deleted the checkbox on the cover of the Form 10-K that relates to Item 405 disclosures.²²

4. Changes to SEC Forms—Cover Page

- **Determination of Offering Price—Item 501(b)(3).** Item 501(b)(3) requires disclosure on the front cover of a prospectus of the price for securities, the underwriter’s discounts and commissions, and the net proceeds that the registrant and any selling security holders will receive.²³ In situations where it is impracticable to provide a price for the securities, Instruction 2 to Item 501(b)(1)(3) allowed registrants to explain the method by which the price is to be determined.²⁴ The amendments revised Instruction 2 to explicitly allow registrants to include a clear statement on the cover page, when applicable, that the offering price will be determined by a particular method or formula that is more fully explained in the prospectus.²⁵
- **Market for Securities—Item 501(b)(4).** Previously, Item 501(b)(4) only required disclosure of the “national securities exchanges” that list the securities being offered.²⁶ The amendments expanded the required disclosure on the cover page of the prospectus to include the principal United States market or markets for the securities being offered and the corresponding trading symbols.²⁷ This change provides important information to investors, even as to markets that are not “national securities exchanges.”²⁸

5. Hyperlinks

The amendments require an active hyperlink to information on EDGAR if it has been incorporated by reference into a registration statement or prospectus.²⁹ According to the SEC, “[T]hese amendments will improve the readability and navigability of disclosure documents and discourage repetition, consistent with

19. *Id.* at 40.

20. *Id.* at 42.

21. *Id.* at 43.

22. *Id.*

23. *Id.* at 48.

24. *Id.* at 48–49.

25. *Id.*

26. *Id.* at 49–51.

27. *Id.*

28. *Id.*

29. *Id.* at 76.

[the] FAST Act mandate.”³⁰ Registrants are not required to file an amendment to a document solely to correct an inaccurate hyperlink, unless that hyperlink was included in a pre-effective registration statement, which is similar to the existing requirements for exhibit hyperlinking.³¹

With limited exceptions described in the final release, the amendments became effective on May 2, 2019.³²

On August 8, 2019, the SEC proposed amendments to modernize the description of business, legal proceedings, and risk factor disclosure requirements under Regulation S-K.³³ The proposal is part of the SEC’s ongoing disclosure effectiveness initiative and is consistent with and further promotes the objectives of the FAST Act.³⁴ Specifically, the proposed amendments “reflect a thoughtful mix of perspective and principles-based requirements that should result in improved disclosures and the elimination of unnecessary costs and burdens.”³⁵

Below is a summary of the proposed amendments:

6. Description of Business—Item 101

Item 101(a) requires a description of the general development of the business of the registrant, its subsidiaries, and any predecessor(s) during the past five years, and may include information for earlier periods to the extent material to an investor’s understanding of the business, in their registration statements and annual reports.³⁶ The proposed amendments would eliminate the five-year disclosure timeframe and require registrants to focus on the information material to an understanding of the general development of their business.³⁷ In addition, the proposed amendments would retain the requirement for registrants to describe the general development of the business in initial registration statements.³⁸ For subsequent filings, the proposed amendments would revise Item 101(a)(1) to require an update of such disclosure, focusing on material developments, if any, during the reporting period, including if the business strategy has changed, along with a hyperlink to the registrant’s most recently filed disclosure.³⁹ The hyperlink, together with the update, would provide investors with a full description of the general development of its business.⁴⁰ The proposed amendments would also include a non-exclusive list of topics that a registrant may need to disclose, requiring disclosure of a topic

30. *Id.*

31. *Id.* at 79.

32. *Id.* at 1–2.

33. Securities and Exchange Commission, Modernization of Regulation S-K Items 101, 103, and 105, Release Nos. 33-10668; 34-86614 (Aug. 18, 2019) [84 Fed. Reg. 44,358 (Aug. 23, 2019)], <https://www.sec.gov/rules/proposed/2019/33-10668.pdf>.

34. See *supra* note 3.

35. Press Release, Securities and Exchange Commission, SEC Proposed to Modernize Disclosures of Business, Legal Proceedings, and Risk Factors Under Regulation S-K (Aug. 8, 2019), <https://www.sec.gov/news/press-release/2019-148>.

36. Regulation S-K, tit. 17, ch. II, § 229.101(a).

37. See *supra* note 33, at 12.

38. *Id.* at 16.

39. *Id.*

40. *Id.* at 16–17.

only to the extent that such information is material to an understanding of the general development of the registrant's business.⁴¹

Item 101(c) requires a narrative description of the business done and intended to be done by the registrant and its subsidiaries, focusing on the registrant's dominant segment or each reportable segment about which financial information is presented in the financial statements.⁴² Item 101(c) also specifies twelve enumerated items that must be disclosed with respect to the registrant's business in general, to the extent material to an understanding of the registrant's business taken as a whole.⁴³ The proposed amendments would include a non-exclusive list of topics that would require disclosure to the extent material to an understanding of the registrant's business.⁴⁴ Under the SEC's proposal, the revised rule would not explicitly reference some of the disclosure items currently contained in Item 101(c), such as working capital practices, disclosure about new segments, and dollar amount of backlog orders believed to be firm.⁴⁵ Nevertheless, disclosure about such topics, as well as any other topics regarding the registrants' business, would still be required to the extent that they are material to an understanding of their business.⁴⁶ This list would also modify the regulatory compliance disclosure requirement to cover not only environmental regulations, but also other material government regulations.⁴⁷

7. Legal Proceedings—Item 103

Item 103 requires disclosure of any material pending legal proceedings, other than ordinary routine litigation incidental to the business, to which the registrant or any of its subsidiaries is a party or of which any of their property is the subject.⁴⁸ Such disclosure includes environmental proceedings to which a governmental authority is a party unless the registrant reasonably believes that it will not result in sanctions of \$100,000 or more.⁴⁹ Item 103 also requires disclosure for proceedings known to be contemplated by government authorities.⁵⁰ The proposed amendments to Item 103 would (1) expressly permit disclosure regarding material legal proceedings to be provided by including hyperlinks or cross-references to legal proceedings information located elsewhere in the document; and (2) increase the threshold for disclosure of environmental proceedings to which the government is a party from \$100,000 to \$300,000 to adjust for inflation.⁵¹

41. *Id.* at 18.

42. Regulation S-K, tit. 17, ch. II, item § 229.101(c).

43. *Id.*

44. *See supra* note 33, at 26–28.

45. *Id.* at 27.

46. *Id.*

47. *Id.*

48. Regulation S-K, tit. 17, ch. II, item § 229.103.

49. *Id.*

50. *Id.*

51. *See supra* note 33, at 54–64.

8. Risk Factors—Item 105

Item 105 requires disclosure of the most significant factors that make an investment in the registrant or offering speculative or risky, and provides that such discussion be concise and organized logically.⁵² Item 105 further instructs that the disclosure should not include risks that could apply generically to any registrant or any offering.⁵³ The proposed amendments to Item 105 would mandate the following:⁵⁴

- summary risk factor disclosure under an appropriately captioned heading if the risk factor section exceeds fifteen pages, consisting of a series of short bulleted or numbered statements summarizing the principal factors that make an investment in the registrant or offering speculative or risky;
- refinement of the principles-based approach of Item 105 by replacing the requirement to discuss the “most significant” risks with “material” risks; and
- registrants to organize their risk factor disclosure under relevant headings, with any risk factors that may generally apply to an investment in securities disclosed at the end of the risk factor section under the caption “General Risk Factors.”

The proposals were subject to a sixty-day comment period, with comments due on or before October 22, 2019.⁵⁵

On January 30, 2020, the SEC proposed additional changes to Regulation S-K.⁵⁶ The proposed amendments are part of the SEC’s comprehensive evaluation of disclosure requirements pursuant to the SEC’s Report on Review of Disclosure Requirements in Regulation S-K (S-K Study) mandated under Section 108 of the Jumpstart Our Business Startups Act.⁵⁷ The SEC considered public input in determining how the S-K Study might improve disclosures.⁵⁸ Similar to the modernization and simplification to Regulation S-K disclosure requirements made in March 2019, these proposed amendments are consistent with the SEC’s congressional mandate under the FAST Act⁵⁹ and the 1982 reorganization of Regulation S-K

52. Regulation S-K, tit. 17, ch. II, item § 229.105.

53. *Id.*

54. *See supra* note 33, at 92–93.

55. *Id.* at 1.

56. Regulation S-K, 17 C.F.R. § 229.

57. *Id.* at 6-7.

58. *Id.* at 7.

59. Fixing America’s Surface Transportation Act of 2015. Pub. L. No. 114 P.L. 94, 129 Stat. 1312 § 72002(2) (2015). The SEC first adopted rule changes to simplify and reduce disclosure requirements under both Regulation S-K and Regulation S-X for public companies, investment advisers and investment companies on August 17, 2018. Those rules were designed to reduce compliance burdens for public companies without reducing the total mix of information available to investors. *See* Securities and Exchange Commission, Disclosure Update and Simplification, Release No. 10532 (Aug. 17, 2018) [83 Fed. Reg. 50,148 (Oct. 4, 2018)], <https://www.sec.gov/rules/final/2018/33-10532.pdf>.

as the central repository for non-financial statement disclosure requirements.⁶⁰ ⁶¹ These proposed amendments are designed to, in addition to the aforementioned benefits, reduce costs and reporting burdens on registrants.⁶² The SEC also considered technology advancements and changes in U.S. Generally Accepted Accounting Principles (U.S. GAAP) requirements in proposing the amendments.⁶³

Below is a summary of key disclosure requirements under Regulation S-K that have been modified or enhanced by the proposed amendments:

9. Selected Financial Data—Item 301

Item 301 mandates registrants to provide five years of selected financial data in a tabular form, along with any additional fiscal years that may be required to prevent misleading the reader.⁶⁴ The SEC proposes to eliminate disclosure of Selected Financial Data.⁶⁵ Under the SEC's proposed amendment, registrants will no longer be required to provide five years of selected financial data in light of technological developments that make the information available on both EDGAR and data-tagged financial statements.⁶⁶

10. Supplementary Financial Information—Item 302

Item 302(a) mandates registrants to provide two years of selected quarterly financial data, including specified operating results and variances in results from previously reported amounts on Form 10-Q.⁶⁷ Item 302(b) requires registrants engaged in oil and gas producing activities to disclose information related to those activities for each period presented.⁶⁸ The SEC determined the requirements of Item 302(b) are duplicative of Financial Accounting and Standards Board (FASB) proposed amendments to U.S. GAAP.⁶⁹ The SEC proposes to eliminate supplementary financial information.⁷⁰ The elimination of Item 302(b) is subject to the FASB finalizing its related amendments to U.S. GAAP.

11. Management's Discussion and Analysis of Financial Condition and Results of Operations—Item 303

Item 303 mandates registrants to provide information related to the registrant's financial condition and results of operations.⁷¹

60. SEC, Adoption of Integrated Disclosure System, Release No. 33-6383 (Mar. 3, 1982) [47 Fed. Reg. 11,380 (Mar. 16, 1982)].

61. MD&A Release No. 33-10750, at 8–9.

62. *Id.* at 8.

63. *Id.* at 9.

64. *Id.* at 14.

65. *Id.* at 10.

66. *Id.* at 15–16.

67. Regulation S-K, 17 C.F.R. § 229.302(a); MD&A Release No. 33-10750, at 22.

68. Regulation S-K, 17 C.F.R. § 229.302(b); MD&A Release No. 33-10750, at 29.

69. MD&A Release No. 33-10750, at 30; FASB, File Reference No. 2019-600, https://www.fasb.org/jsp/FASB/Document_C/DocumentPage&cid=1176172611572.

70. MD&A Release No. 33-10750, at 10.

71. Regulation S-K, 17 C.F.R. § 229.303.

- **Objective—(New) Item 303(a).** The SEC proposes to add a new Item 303(a) that requires the registrant to state the principal objectives of Management’s Discussion and Analysis (MD&A) and streamline the information that follows.⁷² This modification would incorporate the substance of current instructions 1, 2, and 3 to Item 303(a) and emphasize the overall purpose of the disclosure.⁷³
- **Full fiscal years—Item 303(a).** The SEC proposes to recaption the “full fiscal years” disclosure from current Item 303(a) to Item 303(b), as Item 303(a) is proposed to provide the objectives of MD&A.⁷⁴ Registrants must discuss their financial condition, changes to their financial condition and results of operations, including matters of liquidity, capital resources, unusual events, or economic changes, trends, or uncertainties, off-balance sheet arrangements, and tabular disclosure of contractual obligations.⁷⁵
 - **Capital resources—Item 303(a)(2).** Item 303(a)(2) currently requires registrants to disclose material commitments for capital expenditures for the latest fiscal period and to indicate their purpose and anticipated sources of funds.⁷⁶ The SEC proposes that registrants be required to disclose material cash requirements, including capital expenditure commitments as of the most recent fiscal period, anticipated sources of funds to satisfy their cash requirements, and the general purpose of the requirements.⁷⁷ The SEC believes that capital resources are a strong indicator of a registrant’s chances of survival⁷⁸ and, accordingly, seeks a more meaningful analysis of capital resources than is currently required.⁷⁹ While the SEC has declined to define “capital resources,” this term may include funds needed to maintain current operations, to complete projects already underway, to achieve previously stated objectives or plans, or to meet commitments for capital or other expenditures.⁸⁰
 - **Results of operations—Item 303(a)(3)(ii).** Item 303(a)(3)(ii) currently requires registrants to disclose any known trends or uncertainties that have had or that the registrant reasonably expects to have a material impact on net sales or revenues or income from continuing operations.⁸¹ However, the SEC proposes that, in the future, registrants be required to disclose known events *reasonably likely* to materially change the relationship between their costs and revenues, as opposed to those that simply *will* cause

72. MD&A Release No. 33-10750, at 32.

73. *Id.*

74. *Id.* at 39.

75. Regulation S-K, 17 C.F.R. § 229.303.

76. *Id.* § 229.303(a)(2).

77. *See* MD&A Release No. 33-10750, *supra* note 72, at 46.

78. *Id.* at 46

79. *Id.* at 45.

80. *Id.* at 47.

81. Regulation S-K, 17 C.F.R. § 229.303(a)(3)(ii).

the relationship to materially change.⁸² This change is consistent with other Item 303 disclosure requirements for known trends.⁸³

- **Results of operations—Item 303(a)(3)(iii).** Item 303(a)(3)(iii) states that where financial statements indicate a material increase in net sales or revenues, registrants must include a narrative around the extent to which the material increase was attributable to increases in prices, the volume or amount of goods or services being sold, or new products or services.⁸⁴ The SEC proposes to clarify that the discussion of reasons underlying material *changes*, not only material *increases*, in net sales or revenues is required.⁸⁵
- **Results of operations—Item 303(a)(3)(iv).** The SEC proposes to eliminate this item, which currently requires registrants to discuss the impact inflation and price changes have had on net sales, revenue, and income from continuing operations for the most recent three fiscal years.⁸⁶ However, registrants will still be required to discuss inflation and price changes if part of a known trend or uncertainty that has had, or which the registrants reasonably expect will have, a materially favorable or unfavorable impact on net sales, revenue, or income from continuing operations.⁸⁷
- **Off-balance sheet arrangements—Item 303(a)(4).** Item 303(a)(4) requires the registrant to discuss off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on its financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures, or capital resources material to investors.⁸⁸ The SEC proposes to replace this requirement with instructions to discuss such obligations in the broader context of MD&A in order to promote the principles-based nature of MD&A.⁸⁹ This includes commitments or obligations, including contingent obligations, from arrangements with unconsolidated entities or persons that are reasonably likely to have or, have had, a material current or future effect on the registrant’s financial condition (e.g., revenues, expenses, liquidity, cash requirements or capital resources), even if the obligation is not required reporting on the registrant’s consolidated balance sheets.⁹⁰ This change will also decrease overlap with U.S. GAAP requirements.⁹¹
- **Tabular disclosure of contractual obligations—Item 303(a)(5).** Item 303(a)(5) requires registrants to disclose a table with contractual obligations, including type of obligation and overall payments due, for four

82. MD&A Release No. 33-10750, at 48.

83. *Id.* at 49.

84. Regulation S-K, 17 C.F.R. § 229.303(a)(3)(iii).

85. MD&A Release No. 33-10750, at 50.

86. Regulation S-K, 17 C.F.R. § 229.303(a)(3)(iv).

87. MD&A Release No. 33-10750, at 52.

88. Regulation S-K, 17 C.F.R. § 229.303(a)(4).

89. MD&A Release No. 33-10750, at 61.

90. *Id.* at 62.

91. *Id.* at 60.

prescribed periods.⁹² The SEC proposes to eliminate tabular disclosure of contractual obligations from MD&A.⁹³ This modification is intended to simplify and reduce repetition, as the requirement overlaps with U.S. GAAP requirements.⁹⁴

- **Interim periods—Item 303(b).** Item 303(b) requires registrants provide disclosure for interim periods to provide insight to financial conditions and results of operations between specified periods.⁹⁵ The SEC proposes to change the “interim periods” disclosure from being Item 303(b) to Item 303(c).⁹⁶ The SEC’s intent is to modernize this requirement to permit registrants to compare their most recently completed quarter to either the corresponding quarter of the prior year or the immediately preceding quarter.⁹⁷ The SEC believes this change will provide flexibility and enhance disclosure for investors.⁹⁸
- **Critical accounting estimates—(New) Item 303(b)(4).** The SEC proposes to require registrants to provide critical accounting estimates.⁹⁹ In 2001, 2002, and 2003, the SEC made various efforts, with mixed success, to encourage and require disclosure of critical accounting policies and judgments that companies made that would affect their disclosures.¹⁰⁰ The 2002 proposed rules requiring disclosure were not adopted, but, in 2003, the SEC’s MD&A Interpretive Release stated that companies should consider accounting estimates or assumptions where their nature is material due to the subjectivity and judgment levels necessary.¹⁰¹ Where disclosed, the SEC stated that registrants should analyze factors including how they arrived at their estimates and assumptions, how accurate previous estimates and assumptions were, how much their estimates and assumptions had changed in prior years, and whether they were likely to change in the future.¹⁰² This proposed amendment takes the prior efforts a step further by requiring what was suggested in the 2003 MD&A Interpretive Release.¹⁰³ This clarity in defining a “critical accounting estimate” is designed to facilitate meaningful analysis of measurement uncertainties without duplicating financial statement discussion of significant policies.¹⁰⁴ Registrants should be less likely to use boilerplate disclosure language, though there will be some duplication with U.S. GAAP requirements.¹⁰⁵

92. Regulation S-K, 17 C.F.R. § 229.303(a)(5).

93. MD&A Release No. 33-10750, at 10.

94. *Id.* at 68.

95. Regulation S-K, 17 C.F.R. § 229.303(b).

96. *See* Item 303(b) above. MD&A Release No. 33-10750, at 86.

97. MD&A Release No. 33-10750, at 86.

98. *Id.* at 87.

99. MD&A Release No. 33-10750, at 77.

100. *Id.* at 72–73.

101. *Id.* at 73.

102. *Id.*

103. *Id.* at 77.

104. *Id.*

105. *Id.* at 78.

- **Safe Harbor—Item 303(c).** Item 303(c) provides registrants a safe harbor to apply to all forward-looking information included in responses to Items 303(a)(4) and 303(a)(5).¹⁰⁶ The SEC proposes to eliminate the requirements under the safe harbor provisions in light of the proposed replacement of Item 303(a)(4) and Item 303(a)(5).¹⁰⁷
- **Smaller reporting companies—Item 303(d).** Item 303(d) allows smaller reporting companies to provide information for the two most recent fiscal years if it includes net sales and revenues and income from continuing operations.¹⁰⁸ The SEC proposes to eliminate the requirement for smaller reporting companies in light of the elimination of Items 303(a)(3)(iv) and Item 303(a)(5).¹⁰⁹

12. Parallel Amendments to Financial Disclosures Provided by Foreign Private Issuers

The SEC proposes making parallel amendments on Forms 20-F and 40-F, as these changes affect disclosures on the aforementioned forms.¹¹⁰

The proposal was published in the Federal Register on February 28, 2020. The comment period for the proposal was open for sixty days after publication.¹¹¹

C. LIBOR AND SOFR

Andrew Bailey, the Chief Executive of the United Kingdom’s Financial Conduct Authority (FCA), the regulator currently overseeing LIBOR, publicly stated that the FCA had to exert significant effort in convincing banks to remain on the LIBOR panels and that it would not persuade or compel LIBOR panel banks to make LIBOR submissions beyond the end of the 2021.¹¹² As a consequence, the future of LIBOR beyond 2021 is uncertain.

The Alternative Reference Rate Committee (ARRC)—a committee convened by the Federal Reserve that includes major market participants, and on which the SEC staff and other regulators participate—has proposed an alternative rate to replace U.S. Dollar (USD) LIBOR as the Secured Overnight Financing Rate (SOFR). The ARRC, which first met in December of 2014, was convened in order to identify an alternative reference rate for use primarily in derivatives contracts.¹¹³ On June 22, 2017, the ARRC identified SOFR as its recommended alternative to USD LIBOR.¹¹⁴ The ARRC considered a comprehensive list of potential

106. Regulation S-K, 17 C.F.R. § 229.303(c).

107. MD&A Release No. 33-10750, at 93.

108. Regulation S-K, 17 C.F.R. § 229.303(d).

109. MD&A Release No. 33-10750, at 95.

110. *Id.* at 11.

111. *Id.* at 1.

112. Max Colchester, *Scandal-Hit LIBOR to Be Phased Out*, WALL ST. J. (July 27, 2017).

113. Alternative Reference Rates Committee, Frequently Asked Questions (Jan. 31, 2019), <https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/ARRC-faq.pdf>.

114. *Id.*

alternatives, including (1) other term unsecured rates; (2) overnight unsecured rates, such as the Effective Federal Funds Rate (EFFR) and the Overnight Bank Funding Rate, other secured “repo” rates, Treasury bill and bond rates; and (3) overnight index swap rates linked to EFFR.¹¹⁵ SOFR is a broad measure of the cost of borrowing cash overnight collateralized by U.S. Treasury securities.

On July 12, 2019, the SEC’s Division of Corporation Finance, Division of Investment Management, Division of Trading and Markets, and Office of the Chief Accountant issued a “Staff Statement on LIBOR Transition.”¹¹⁶ According to the statement, “The Commission staff is actively monitoring the extent to which market participants are identifying and addressing these risks. . . . There are rarely quick fixes to these types of issues and the Commission staff encourages market participants to focus on them now to avoid business and market disruptions after 2021.”¹¹⁷

The statement went on to describe the transition from the various SEC divisions responsible for the statement. In particular, the Division of Corporation Finance advised that:

- The evaluation and mitigation of risks related to the expected discontinuation of LIBOR may span several reporting periods. Consider disclosing the status of company efforts to date and the significant matters yet to be addressed.
- When a company has identified a material exposure to LIBOR but does not yet know or cannot yet reasonably estimate the expected impact, consider disclosing that fact.
- Disclosures that allow investors to see this issue through the eyes of management are likely to be the most useful for investors. These disclosures may entail sharing information used by management and the board in assessing and monitoring how transitioning from LIBOR to an alternative reference rate may affect the company. They could include qualitative disclosures and, when material, quantitative disclosures, such as the notional value of contracts referencing LIBOR and extending past 2021.¹¹⁸

In a November 4, 2019, speech to the SEC Fixed Income Market Structure Advisory Committee, Chairman Clayton identified one particular issue that he found in replacing LIBOR with SOFR. Chairman Clayton explained as follows:

- LIBOR-based securities and products generally reflect three components: (1) a risk free rate; (2) a bank funding/base lending spread over this risk free rate; and (3) an additional fixed spread to/from the lender/borrower or customer.

115. *Id.*

116. Press Release, SEC, Staff Statement on LIBOR Transition (July 12, 2019), <https://www.sec.gov/news/public-statement/libor-transition>.

117. *Id.*

118. *Id.*

- The current LIBOR benchmark incorporates both (1) and (2), the risk free rate and the bank funding spread over the risk-free rate. Although each of these components fluctuates with market conditions (e.g., changes in treasury yields and changes in the cost of funding for banks) and such fluctuations are not uniform, they are expressed to the market as a single number. For example, “three-month LIBOR.”
- The SOFR benchmark, on the other hand, incorporates just the first component, the fluctuating risk-free rate, but not the second component, the fluctuating bank funding spread over the risk-free rate.
- As a result, a loan, bond, or product, comprised of (1) the SOFR rate and (2) an additional fixed spread, would not be expected to fully incorporate the floating bank funding spread.
- This difference in approach makes a like-for-like mapping of a LIBOR product to a SOFR product challenging.¹¹⁹

Finally, and consistent with Chairman Clayton’s focus in November 2019, on January 21, 2020, the ARRC published a consultation on spread adjustment methodologies.¹²⁰ The consultation seeks views on the appropriate spread adjustment methodology the ARRC should recommend as part of its fallback recommendations for “cash” products referencing LIBOR. Market participants were encouraged to submit responses to the consultation by March 6, 2020.

D. CRITICAL AUDIT MATTERS

On June 1, 2017, the PCAOB adopted a new auditing standard, AS 3101, *The Auditor’s Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*, to enhance the relevance and usefulness of the auditor’s report by providing additional and important information to investors.¹²¹ The new standard and related amendments require auditors to include in the auditor’s report (1) a discussion of “critical audit matters” (CAMs); (2) disclosure of auditor tenure, specifically the year in which the auditor began serving consecutively as the company’s auditor; and (3) other information primarily intended to clarify the auditor’s role and responsibilities related to the audit of the financial statements and make the auditor’s report easier to read.¹²²

119. Jay Clayton, Remarks to the SEC Fixed Income Market Structure Advisory Committee (Nov. 4, 2019), <https://www.sec.gov/news/public-statement/statement-clayton-fimsac-110419>.

120. Federal Reserve Bank of New York, ARRC Consultation on Spread Adjustment Methodologies for Fallbacks in Cash Products Referencing USD LIBOR (Jan. 21, 2020), https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2020/ARRC_Spread_Adjustment_Consultation.pdf.

121. Press Release, Public Company Accounting Oversight Board, PCAOB Adopts New Standard to Enhance the Relevance and Usefulness of the Auditor’s Report with Additional Information for Investors (June 1, 2017), <https://pcaobus.org/News/Releases/Pages/auditors-report-standard-adoption-6-1-17.aspx>.

122. PCAOB Release No. 2017-001, Public Company Accounting Oversight Board, Auditor’s Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion

The updated standard requires the auditor to communicate in the auditor's report any CAMs arising from the current period's audit of the financial statements or state that the auditor determined that there are no CAMs.¹²³ A CAM is defined as a matter communicated or required to be communicated to the audit committee and that (1) relates to accounts or disclosures that are material to the financial statements and (2) involved especially challenging, subjective or complex auditor judgment.¹²⁴

In determining whether a matter meets the new CAM standard, the auditor must take into account, alone or in combination, certain factors, including, but not limited to (1) the auditor's assessment of the risks of material misstatement, including significant risks; (2) the degree of auditor judgment related to areas in the financial statements that involved the application of significant judgment or estimation by management, including estimates with significant measurement uncertainty; (3) the nature and timing of significant unusual transactions and the extent of audit effort and judgment related to these transactions; (4) the degree of auditor subjectivity in applying audit procedures to address the matter or in evaluating the results of those procedures; (5) the nature and extent of audit effort required to address the matter, including the extent of specialized skill or knowledge needed or the nature of consultations outside the engagement team regarding the matter; and (6) the nature of audit evidence obtained regarding the matter.¹²⁵

The provisions related to CAMs have taken effect for audits of fiscal years ending on or after June 30, 2019, for large accelerated filers, and for fiscal years ending on or after December 15, 2020, for all other companies to which the requirements apply.¹²⁶

According to a survey of recent filings of large accelerated filers with fiscal years ending on June 30, 2019, the top five CAMs companies have been disclosing in recent filings are the following:¹²⁷

1. Goodwill and indefinite-lived intangible asset impairment.
2. Revenue recognition.
3. Accounting for acquisitions.
4. Tax contingencies.
5. Fair value of liabilities or equities.

In the electric utility industry, the most common CAM in Annual Reports on Form 10-K seems to be the effects of accounting for rate regulation.

and Related Amendments to PCAOB Standards (June 1, 2017), <https://pcaobus.org/Rulemaking/Docket034/2017-001-auditors-report-final-rule.pdf>.

123. *Id.* at 11.

124. *Id.*

125. *Id.* at 11–12.

126. PCAOB Release No. 2017-001, *supra* note 122.

127. Ron Kral, *Critical Audit Matters Have Arrived*, ACCT. TODAY (Oct. 25, 2019), <https://www.accountingtoday.com/opinion/critical-audit-matters-have-arrived>.

E. AUDITOR INDEPENDENCE

On December 30, 2019, the SEC proposed amendments¹²⁸ to update certain auditor independence requirements. The proposed amendments are intended to focus the independence analysis on those relationships or services that are more likely to pose threats to an auditor's objectivity.

Under Rule 2-01(b) of Regulation S-X,¹²⁹ the SEC "will not recognize an accountant as independent, with respect to an audit client, if the accountant is not, or a reasonable investor with knowledge of all relevant facts and circumstances would conclude that the accountant is not, capable of exercising objective and impartial judgment on all issues encompassed within the accountant's engagement." In addition, in determining whether an auditor is independent, the SEC "will consider all relevant circumstances, including all relationships between the accountant and the audit client."¹³⁰ Rule 2-01(c) provides a list of financial, employment, business and non-audit service relationships that the SEC views to be inconsistent with the independence standard set forth in the rule.

Among other changes, the proposals would

- include materiality qualifiers in the provisions of Rule 2-01(f)(4) related to operating companies under common control;
- shorten the look-back period under Rule 2-01(f)(5)(iii) for domestic first-time filers in assessing compliance with the independence requirements;
- amend Rule 2-01(c)(3) to replace the reference to "substantial stockholders" in the business relationship rule with the concept of beneficial owners with significant influence; and
- replace Rule 2-01(e) with a new Rule 2-01(e) to introduce a transition framework to address inadvertent independence violations that arise only as a result of merger and acquisition transactions.¹³¹

Comments were due on the proposed amendments on or before March 16, 2020.

F. AICPA MATERIALITY

In January 2020, the American Institute of Certified Public Accountants (AICPA) Auditing Standards Board issued guidance in Statement on Auditing Standards No. 138¹³² and Statement on Standards for Attestation Engagements

128. SEC, SEC Proposed Rules, Release Nos. 33-10738, 34-87864 Dec. 30, 2019), <https://www.sec.gov/rules/proposed.shtml> [hereinafter SEC Proposed Rules Release].

129. 17 C.F.R. pt. 210.

130. *Id.*

131. SEC Proposed Rules Release, *supra* note 128.

132. AM. INST. CERTIFIED PUBLIC ACCTS., STATEMENT ON AUDITING STANDARDS NO. 138 AMENDMENTS TO THE DESCRIPTION OF THE CONCEPT OF MATERIALITY (Dec. 2019).

No. 20.¹³³ Specifically, the guidance revises the materiality standard for audits of financial statements and attestation engagements, such that misstatements, including omissions, that are material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements. Previously, the standard was that misstatements, including omissions, were considered material if they, individually or in the aggregate, “could reasonably be expected to influence the economic decision of users.” The new materiality standard aligns with the definition used by the International Accounting Standards Board and the International Auditing and Assurance Standards Board. The change also aligns with the description of materiality used by the U.S. judicial system, the auditing standards of the PCAOB, the SEC, and the FASB. The standards become effective for audits of financial statements for periods ending on or after December 15, 2020, and for AICPA practitioners’ examination or review reports dated on or after December 15, 2020.¹³⁴

G. GREEN BONDS

The popularity of “green bonds”—bonds issued to raise funds for new and existing projects with environmental benefits—has continued. The Executive Committee for the Green Bond Principles recently published (1) the Green Project Mapping document;¹³⁵ (2) the Guidance Handbook;¹³⁶ and (3) the Impact Reporting Handbook.¹³⁷ The Green Project Mapping document includes a table mapping the categories of projects against the five environmental objectives referenced in the Green Bond Principles. The Guidance Handbook is a seventeen-page guide containing a number of general FAQs regarding green bonds and includes a “Core Components” section exploring the use of proceeds, issuer transparency, project eligibility, management of proceeds, and reporting obligations. Finally, the Impact Reporting Handbook includes reporting recommendations, information regarding the allocation of proceeds and recommended impact report content.

As noted by Moody’s, green bond issuances in 2019 continued at a significant pace. Notable domestic green bond issuances in 2019 include the following:

133. AM. INST. CERTIFIED PUBLIC ACCTS., STATEMENT ON STANDARDS FOR ATTESTATION ENGAGEMENTS NO. 20 AMENDMENTS TO THE DESCRIPTION OF THE CONCEPT OF MATERIALITY (Dec. 2019).

134. Press Release, American Institute of Certified Public Accountants, AICPA’s Auditing Standards Board Issues New Standards to Amend the Description of the Concept of Materiality (Dec. 5, 2019), <https://www.aicpa.org/press/pressreleases/2019/aicpa-asb-issues-new-standards-to-amend-the-description-of-the-concept-of-materiality.html>.

135. INT’L CAPITAL MKT. ASS’N, GREEN PROJECT MAPPING (June 2019), <https://www.icmagroup.org/assets/documents/Regulatory/Green-Bonds/June-2019/Green-Projects-Mapping-Document-100619.pdf>.

136. INT’L CAPITAL MKT. ASS’N, GUIDANCE HANDBOOK (Apr. 2019), <https://www.icmagroup.org/assets/documents/Regulatory/Green-Bonds/Guidance-Handbook-April-2020-200820.pdf>.

137. INT’L CAPITAL MKT. ASS’N, HANDBOOK—HARMONIZED FRAMEWORK FOR IMPACT REPORTING (June 2019), <https://www.icmagroup.org/assets/documents/Regulatory/Green-Bonds/June-2019/Handbook-Harmonized-Framework-for-Impact-Reporting-WEB-100619.pdf>.

- Owens Corning \$450 million principal amount of senior notes (August 2019)
- Public Service Company of Colorado \$550 million principal amount of first mortgage bonds (August 2019)
- Southwestern Public Service Company \$300 million principal amount of first mortgage bonds (June 2019)
- Eversource Energy \$400 million principal amount of debentures (May 2019)
- Avangrid, Inc. \$750 million principal amount of notes (May 2019)
- Duke Energy Progress, LLC \$600 million principal amount of first mortgage bonds (March 2019)
- DTE Electric Company \$650 million principal amount of general and refunding mortgage bonds (February 2019)
- Verizon Communications Inc. \$1 billion principal amount of notes (February 2019)
- MidAmerican Energy Company \$1.5 billion principal amount of first mortgage bonds (January 2019)