

SEC in Focus

Quarterly summary of current SEC activities

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Recent SEC amendments to Regulation S-K

SEC eliminates certain MD&A requirements and revises others

The Securities and Exchange Commission (SEC or Commission) adopted **amendments** to Regulation S-K to eliminate certain disclosure requirements and to revise others to make the disclosures provided in management’s discussion and analysis (MD&A) more useful for investors. The amendments, which some calendar-year registrants may be able to apply in annual reports on Form 10-K for 2020, are intended to focus financial disclosures on material information while simplifying compliance for registrants. They change disclosure requirements for registrants in the following areas:

Selected quarterly financial data – The amendments allow registrants to omit the table of selected quarterly financial data they previously provided for each quarter of the two most recent fiscal years and any subsequent interim period, unless there has been a material retrospective change (or changes that are material in the aggregate) affecting comprehensive income.

If the comprehensive income for a quarter has been affected by a material change, a registrant must provide the summarized financial information required by Rule 1-02(bb) for each affected quarter and the fourth quarter of the same year along with earnings per share and the reasons for the change. Rule 1-02(bb) was also amended to add flexibility for registrants to use the same line items that appear in their financial statements.

The disclosure must be reviewed by the independent auditor and is required in annual reports on Form 10-K and in registration statements of registrants (other than smaller reporting companies) that have securities registered under Section 12 of the Securities Exchange Act of 1934.



EY resources

- ▶ To the Point, [SEC eliminates certain MD&A requirements and revises others to make disclosures more useful](#)
- ▶ To the Point, [SEC streamlines some Regulation S-K disclosures and requires human capital disclosures](#)
- ▶ [How to approach the SEC's new human capital disclosures](#)

How we see it

Registrants may voluntarily disclose fourth-quarter data because separate financial statements for that quarter are not presented in any filings, and investors would otherwise have to calculate the amounts using the third-quarter and annual results. Voluntary disclosures don't have to be reviewed by an independent auditor, but they must be read and considered by the auditor for any material inconsistencies with the audited financial statements. In any case, investors may find it beneficial for registrants to continue having this information reviewed by their independent auditor.

Selected financial data – The amendments eliminate the requirement in Item 301 of Regulation S-K for a registrant to present a table of selected financial data for each of its last five years in its registration statements and annual reports.¹

Management's discussion and analysis

The amendments also include a number of changes to Item 303 of Regulation S-K to modernize and simplify the MD&A requirements, which are summarized below.

Objectives of MD&A disclosure – The amendments add objectives that focus the disclosure on material information relevant to assessing a registrant's financial condition, results of operations and cash flows. They address both historical and forward-looking information and refer to material financial and other statistical data that will enhance a reader's understanding of the registrant's financial condition, cash flows and other changes in financial condition, and results of operations.

Material changes – The amendments clarify and emphasize that registrants must provide a narrative discussion of the underlying reasons for material changes in financial statement line items from period to period in both quantitative and qualitative terms. Quantitative disclosure appears to be the focus of this change, which is consistent with the 2003 interpretive guidance and the longstanding practice of the SEC staff to issue comment letters to registrants requesting more quantitative disclosure.

Prospective information – The amendments require the disclosure of prospective information that is "reasonably likely" to have a material impact throughout MD&A. In doing so, the SEC set a consistent threshold to replace the different thresholds that apply to various items under the legacy rules.

Liquidity and capital resources – The amendments combine the requirements for liquidity and capital resources. A registrant must discuss its ability to generate and obtain adequate amounts of cash to meet its requirements and plans for cash in the short term and long term. A registrant must also describe its material cash requirements, their general purpose and the anticipated source of the funds needed to satisfy them.

Contractual obligations table – Registrants are no longer required to include a contractual obligations table in MD&A. However, the amendments related to liquidity and capital resources, including the requirement for registrants to discuss known contractual and other obligations (e.g., purchase obligations) on both a short-term and long-term basis, are intended to make sure that eliminating the table does not result in a material loss of information for investors.

Off-balance sheet arrangements – The SEC replaced the prescriptive legacy requirement to disclose off-balance sheet arrangements in a separate section with a principles-based instruction to provide the disclosure regarding off-balance sheet arrangements throughout MD&A whenever material.

Critical accounting estimates – The amendments codify the requirement in the 2003 SEC interpretive guidance to disclose information about critical accounting estimates. Specifically, the amendments require disclosure of quantitative and qualitative information to help investors understand the impact of estimation uncertainty on a registrant’s financial condition or operating results. This disclosure must address how much any critical accounting estimate has changed over a relevant period and a sensitivity analysis, if that information is material and reasonably available.

Discussion and analysis of interim-period results – The amendments provide a registrant with the option to discuss its interim results by comparing its most recent quarter to the immediately preceding quarter rather than to the same quarter of the prior year. A registrant that chooses this option must provide summary financial information for the immediately preceding quarter or identify the EDGAR filing that includes the information. Registrants must continue to include a comparison of year-to-date results as well.

The rules can be applied 30 days after publication in the Federal Register, which is expected in early 2021, and compliance is mandatory 210 days after publication.

Transition guidance for Regulation S-K amendments effective in November 2020

The SEC staff in the Division of Corporation Finance (DCF) issued a frequently asked questions (FAQ) document to provide transition guidance for amended Regulation S-K Items 101, 103 and 105. The amendments are effective for periodic reports and registration statements filed on or after 9 November 2020.

Among other things, the FAQ clarifies that if a registrant files a prospectus supplement to an effective registration statement on Form S-3 on or after 9 November 2020 prior to the filing of its Form 10-K, the prospectus supplement does not need to comply with amended Items 101 and 103. In addition, while Form S-3 requires Item 105 disclosure, the SEC staff said it will not object if the prospectus supplement complies with the legacy Item 105 until the next update to the registration statement on Form S-3 for Section 10(a)(3) purposes.

How we see it

While the SEC staff did not address this in the FAQ, it appears that a registrant could also file a new Form S-3 after the effective date but before it files its Form 10-K and incorporate the previously filed Form 10-K without any revisions to Items 101 and 103. However, the Form S-3 would need to comply with amended Item 105. Registrants should consult with legal counsel before adopting such an approach.

Other SEC rulemaking and current practice matters

SEC adopts amendments to auditor independence rules

The SEC adopted changes to the auditor independence rules that are intended to focus the independence analysis on relationships and services that are more likely to pose threats to an auditor’s objectivity and impartiality. Among other things, the **amendments**:

- Change the definition of a common control affiliate to include a sister entity (i.e., an entity that is under common control with the entity under audit) only if both the sister entity and the entity under audit are material to the controlling entity
- Revise the business relationships rule to replace the term “substantial stockholder” with “beneficial owners (known through reasonable inquiry) of the audit client’s equity securities where such beneficial owner has significant influence over the entity under audit”

“Modest and tailored amendments reduce or eliminate those adverse effects on auditor choice without detracting from the independence obligations of auditors and issuers.

– Former SEC Chairman
Jay Clayton

- ▶ Reduce the look-back period for compliance with the SEC auditor independence rules to include only the fiscal year before the first filing by a domestic entity of an initial public offering (IPO) registration statement or special purpose acquisition company (SPAC) proxy statement
- ▶ Establish a framework under which certain independence issues arising from a merger or acquisition by the audit client that are identified before the transaction and resolved as promptly as possible would not generally result in a breach of independence
- ▶ Expand the group of audit clients that use the Investment Company Complex (ICC) definition to determine their affiliates to include unregistered funds and investment advisers, and modify the definition of ICC

The amendments will be effective on 9 June 2021. Early compliance by auditors is permitted, provided the amendments are applied in their entirety. In addition, on 19 November 2020, the Public Company Accounting Oversight Board (PCAOB) adopted conforming **amendments** to its independence rules, which are subject to approval by the SEC.

SEC amends rules for signatures in electronic filings

The SEC adopted **amendments** to the rule under Regulation S-T that governs signatures in authentication documents for electronic filings. The amendments permit the use of electronic signatures in addition to manual signatures, subject to certain conditions.

The change was requested by several Silicon Valley lawyers, who said the COVID-19 pandemic has made it more difficult to collect manual signatures and noted that improvements in electronic signature technology make it possible to confirm who has signed a document and when. Nearly 100 companies supported the petition.

The amendments were effective 4 December 2020.

SEC changes rules to harmonize the exempt offering framework

The SEC adopted **amendments** to its rules for securities offerings that are exempt from registration. The amendments are aimed at promoting capital formation and expanding investment opportunities, while preserving or enhancing investor protections.

The changes harmonize many of the rules governing the 10 different exemptions from SEC registration requirements. The amendments:

- ▶ Establish a general principle of integration to help an issuer determine whether multiple securities transactions should be considered part of the same offering and establish four safe harbors under which multiple transactions would not be integrated
- ▶ Increase the offering limits for Regulation A, Regulation Crowdfunding and Rule 504 offerings, and revise certain individual investment limits
- ▶ Expand the availability of certain “test-the-waters” communications for exempt securities offerings and permit certain “demo day” communications at events where issuers discuss their business with potential investors
- ▶ Harmonize certain disclosure and eligibility requirements and disqualification provisions for the various exemptions

The rules also provide an 18-month extension to the temporary relief from Regulation Crowdfunding financial statement review requirements that the SEC provided earlier this year to certain issuers impacted by the COVID-19 pandemic.

The amendments generally are effective 60 days after publication in the Federal Register. The extension of the temporary relief from Regulation Crowdfunding provisions will be effective upon publication in the Federal Register and will last until 1 March 2023.

DCF issues disclosure guidance for Chinese companies, new law is enacted

On several occasions over the past year, the SEC has highlighted the potential risks to US investors of investing in emerging markets, including China, and the need for investors to be aware of those risks. In November, the DCF issued Disclosure Guidance **Topic No. 10** to provide the SEC staff's views on disclosure considerations for issuers based in China or with the majority of their operations in China. The Disclosure Guidance summarizes various possible risks related to such issuers and the differences in shareholder rights and recourse, governance and reporting associated with them. It also poses questions for consideration highlighting a wide range of risks related to an issuer's operations that China-based issuers must fully disclose if material.

The staff guidance preceded the enactment of the Holding Foreign Companies Accountable Act, which President Donald Trump signed into law in December 2020. Among other things, the law requires that if the PCAOB is unable to inspect an issuer's public accounting firm for three consecutive years, the issuer's securities will be banned from trading on a national exchange or through other methods in the US. The law potentially impacts a large number of companies based in or with the majority of their operations in China. Before stepping down in December, former SEC Chairman Jay Clayton issued a statement that he has instructed the SEC staff to make recommendations on proposed rules that would implement the legislation and further address exchange listing standards and PCAOB access to audit workpapers consistent with the recommendations made by the President's Working Group on Financial Markets in July 2020.

EY resources

- ▶ To the Point, [SEC adopts rule to modernize fund valuation practices](#)

SEC adopts rule to modernize fund valuation practices

The SEC **adopted** a new rule under the Investment Company Act of 1940 that modernizes valuation practices for registered investment companies and business development companies (collectively, funds). The new rule, among other things:

- ▶ Sets requirements for how fund boards may determine in good faith the fair value of portfolio holdings without readily available market quotations and codifies the common practice of designating a fund's adviser or an officer of an internally managed fund to perform fair value determinations, subject to certain conditions
- ▶ Requires a fund board or the party it designates to perform fair value determinations to periodically assess and manage material valuation risks

The SEC also rescinded certain guidance on the recognition, measurement, disclosure and auditing of fund investments.

The rule is effective 60 days after publication in the Federal Register. The compliance date is 18 months after the effective date, with earlier compliance permitted.

SEC adopts rules for resource extraction issuers

The SEC adopted **rules** for the disclosure of payments by resource extraction issuers to increase the transparency of payments to governments.

Among other things, the rules require a registrant to disclose payments, at the project level, made to the US federal government or foreign governments for the commercial development of oil, natural gas or minerals. The requirement applies to payments made by a registrant and any subsidiaries or entities it controls.

The rules were mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act, but the Commission's attempts to adopt rules in 2012 and 2016 were nullified by court and Congressional actions.

The rules are effective 60 days after publication in the Federal Register, and registrants have a two-year transition period following the effective date.

DCF issues guidance for SPACs

The DCF issued [Disclosure Guidance Topic No. 11, Special Purpose Acquisition Companies](#), to provide the SEC staff's views on disclosure and other securities law obligations that SPACs should consider in connection with their IPOs and subsequent business combinations with operating companies. The guidance addresses disclosures that SPACs should consider, including disclosures about the nature of the economic interests of the SPAC's sponsors, directors, officers and affiliates so that public investors understand their financial incentives and any potential conflicts of interest.

SEC approves new NYSE direct listing rules

The SEC [approved](#) direct listing rules proposed by the New York Stock Exchange (NYSE) that allow companies to raise capital by selling new shares to the public without an IPO and the costs associated with it, such as traditional underwriting fees. Previously, NYSE rules allowed companies to list only existing shares for resale by existing shareholders in a direct listing and required them to conduct an IPO to raise capital.

Separately, Nasdaq also has filed a [proposal](#) with the SEC that would allow companies that qualify for its highest tier to raise capital by selling new shares in direct listings, among other things. The proposal requires SEC approval.

SEC staff updates Financial Reporting Manual

The SEC staff in the DCF updated the [Financial Reporting Manual](#). Among other changes, the SEC staff conformed the manual to the SEC's new definitions of the terms smaller reporting company, accelerated filer and large accelerated filer. Some changes were also made to address outdated guidance in the manual, but the update did not address the SEC's recent amendments to the disclosure requirements for significant acquired businesses and disposals or guaranteed debt securities.

SEC proposes changes to rules for exempt compensatory offerings

The SEC [proposed](#) changes to its framework for compensatory securities offerings by non-issuers that are exempt from registration with the SEC. The amendments to Securities Act Rule 701 are intended to modernize the framework for exempt compensatory securities in light of the significant evolution in compensatory offerings and the composition of the workforce since the Commission last substantively amended these regulations. Key changes to Rule 701 would include:

- ▶ Revising the disclosure requirements for Rule 701 exempt transactions that exceed \$10 million, including the type of financial disclosure required and the frequency with which it must be updated
- ▶ Raising two of the three alternative regulatory ceilings that limit the amount of securities a non-reporting issuer may sell pursuant to the Rule 701 exemption during any consecutive 12-month period
- ▶ Allowing the exemption for offers and sales of securities under a written compensatory benefit plan established by the issuer's subsidiaries

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We view [the] proposal as a way to improve benefits for these important workers and to introduce them to the powerful role that our capital markets can play in building a nest egg for retirement and for passing along to the next generation.

— SEC Commissioners
Hester Peirce and
Elad Roisman

Separately, the SEC **proposed** a temporary provision that would, on a trial basis, allow an issuer to use the Rule 701 exemption to compensate certain workers who provide services through the issuer's technology-based marketplace platform but are not statutory employees of the issuer (i.e., platform workers) with equity awards at a level up to 15% of their compensation but not to exceed \$75,000 in a three-year period. This proposed provision would expire in five years, unless the SEC takes further action.

Comments on both proposals are due on 9 February 2021.

Nasdaq proposes board diversity requirements for listed companies

Nasdaq filed a **proposal** with the SEC that would require the boards of all companies listed on the exchange to meet certain minimum diversity requirements or publicly disclose why they aren't doing so.

Under the proposal, most Nasdaq-listed companies would be expected to have, or explain why they do not have, at least one director who self-identifies as female and one director who self-identifies as either an underrepresented minority or as lesbian, gay, bisexual, transgender, queer or other (LGBTQ+). The proposal defines an underrepresented minority as an individual who self-identifies in one or more of the following groups: Black or African American, Hispanic or Latinx, Asian, Native American or Alaska Native, Native Hawaiian or Pacific Islander, or two or more races or ethnicities.

Nasdaq-listed companies would be required to disclose statistical information about their directors' self-identified gender, race and self-identification as LGBTQ+ in a uniform manner within one year of the SEC's approval of the proposed listing rules. However, companies would have two to five years to meet the minimum board composition expectations, depending on their listing tier.

Companies that do not meet the board composition objectives within the required timeframe would not be subject to delisting if they provide a public explanation of their reasons for not meeting the objectives.

EY resources

- ▶ [2020 AICPA Conference on Current SEC and PCAOB Developments](#)

AICPA Conference on Current SEC and PCAOB Developments

Regulators and standard setters discussed a broad range of financial reporting, auditing and regulatory topics in December at the annual AICPA Conference on Current SEC and PCAOB Developments (Conference), which was held virtually for the first time.

The speakers and panelists included representatives of the SEC, the Financial Accounting Standards Board (FASB or Board), the International Accounting Standards Board (IASB) and the PCAOB.

A number of the topics addressed at the Conference related to the COVID-19 pandemic, including how companies, auditors, regulators and standard setters have been responding to its many challenges.

Highlights included:

Accounting standard setting – The FASB paused its ongoing standard-setting activities at the beginning of the pandemic to prioritize emerging issues related to COVID-19. However, the FASB continued its post-implementation review activities related to the new standards on credit losses, leases and revenue recognition, including outreach to stakeholders to obtain feedback on how to improve these standards. FASB staff members highlighted a recent proposal to amend the new leases standard to address issues identified in feedback from stakeholders.

Reference rate reform – The FASB continues to monitor global developments associated with the transition away from the London Interbank Offered Rate (LIBOR) and other rates that are due to be phased out as a result of reference rate reform. FASB staff members discussed the FASB's recent proposal on reference rate reform. SEC staff members also stated their expectations for clear and transparent disclosures about registrants' plans for the transition and discussed the accounting implications of reference rate reform for affected financial instruments.

SEC rulemaking – SEC staff discussed new rules the SEC has adopted related to capital formation and disclosure effectiveness, including amendments to disclosure requirements for significant business acquisitions, subsidiary guarantors and issuers of registered debt, as well as MD&A and other areas outside the financial statements.

Non-GAAP measures – SEC staff members provided guidance on the use of non-GAAP measures by companies to discuss the effects of the pandemic. They also said that presenting certain types of other non-GAAP financial measures may be inappropriate, including non-GAAP revenue measures.

Audit matters – Members of the PCAOB discussed its response to COVID-19 and emphasized that auditors may need to perform additional procedures or perform procedures differently to respond to changes in a company's business and internal controls. The SEC staff commended the PCAOB for performing outreach and implementing inspection strategies to understand changes to audit firms' policies, procedures and methodologies in response to COVID-19. They also discussed the post-implementation efforts related to critical audit matters (CAMs) and highlighted the recent amendments to Rule 2-01 of Regulation S-X that are intended to modernize the SEC's auditor independence rules.

Personnel changes

SEC Chairman Jay Clayton left the SEC

Jay Clayton, Chairman of the SEC, left the Commission at the end of last year. Mr. Clayton had served as Chairman since May 2017.

Under his leadership, the Commission has adopted more than 65 final rules, many of which were intended to modernize rules that had not been reviewed or updated in decades. During his tenure, Mr. Clayton also promoted diversity and inclusion at the Commission and guided it through the challenges caused by the COVID-19 pandemic.

Commissioner Elad L. Roisman has been designated Acting Chair until a new Chair is appointed.

Other personnel changes following the election

Bill Hinman concluded his tenure with the SEC as Director of the SEC's DCF. Shelley Parratt, Deputy Director of the Division, is serving as Acting Director.

Stephanie Avakian concluded her tenure with the SEC as Director of the SEC's Division of Enforcement. Marc P. Berger, Deputy Director of the Division, is serving as Acting Director.

Dalia Blass will conclude her tenure with the SEC as Director of the SEC's Division of Investment Management in January 2021. Sarah ten Siethoff, Associate Director of the Division, will serve as Acting Director upon Ms. Blass's departure.

SEC appoints new PCAOB board member

The SEC **announced** the appointment of Megan Zietsman as a member of the PCAOB for a five-year term through October 2025. Ms. Zietsman, the Chief Auditor and Director of Professional Standards of the PCAOB since February 2019, filled the PCAOB seat that was **vacated** by James G. Kaiser at the end of his term.

Enforcement activities

SEC Division of Enforcement publishes 2020 annual report

The SEC's Division of Enforcement said in its annual [report](#) for fiscal year 2020 that, despite the many unprecedented challenges caused by COVID-19, it brought 715 enforcement actions, including 405 standalone actions, and returned \$602 million to harmed investors. In addition, through the Division's efforts, the SEC awarded a record \$175 million to 39 whistleblowers in fiscal year 2020, both the highest dollar amount and the highest number of individuals to receive awards in any fiscal year.

The report noted that 15% of the standalone enforcement actions involved issuers' reporting, accounting or auditing issues, including charges that companies had weaknesses in internal controls, failed to disclose material information, or made other false and misleading statements.

The Division's other cases involved a wide range of issues, including those related to securities offerings, investment advisers, broker-dealer misconduct, insider trading and market manipulation.

Former executives of financial service company charged for misleading investors about key performance metric

The SEC charged the former chief executive officer (CEO) and another former top executive of a financial service company for their roles in allegedly misleading investors about the success of the company's core business for at least two years.

The SEC's order alleged that the former CEO signed and certified statements filed with the Commission that he should have known were misleading, regarding both the success of the company's core business strategy and its "cross sell" metric that was inflated by accounts and services that were unauthorized, unnecessary or unused.

The other top executive allegedly publicly described and endorsed this metric as a means of measuring the company's financial success, despite the fact that it was inflated by those unauthorized or fraudulent accounts and services. The complaint further alleges that the executive signed misleading sub-certifications as to the accuracy of the company's public disclosures when the executive knew or was reckless in not knowing that statements in those disclosures regarding the metric were materially false and misleading.

Without admitting or denying the allegations, the company's former CEO agreed to pay a civil penalty of \$2.5 million and to cease and desist from further violations. The SEC's complaint charges the other executive with violating the antifraud provisions of the federal securities laws and seeks a permanent injunction, civil penalties, disgorgement with prejudgment interest and an officer-and-director bar.

Restaurant charged for providing misleading COVID-19 disclosures

The SEC announced that a publicly traded restaurant company agreed to pay \$125,000 to settle charges of providing misleading disclosures about the effects of COVID-19 on its business operations and financial condition. This is the first time the SEC has charged a public company for misleading investors about the financial effects of the pandemic.

According to the order, the company stated that its restaurants were "operating sustainably" during the COVID-19 pandemic in its March 2020 and April 2020 press releases that were included in SEC filings. Those statements were allegedly materially false and misleading because the company's internal documents at the time showed that it was losing cash and that it projected that it had only 16 weeks of cash remaining.

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The Commission will continue to hold responsible not only the senior executives who make false and misleading statements but also those who certify to the accuracy of misleading statements despite warnings to the contrary.

— SEC Division of Enforcement Director Stephanie Avakian

The order finds that, although the company allegedly did not disclose this internal information in its SEC filings, the company shared this information with potential private equity investors or lenders in connection with an effort to seek additional liquidity. The order also finds that, although the March 2020 filing described actions the company had undertaken to preserve financial flexibility during the pandemic, the company failed to disclose that it had already informed its landlords that it would not pay rent in April due to the adverse effects of the pandemic on its business.

Without admitting the allegations, the company agreed to pay the penalty and to cease and desist from further violations of the charged provisions.

China-based issuer charged for fraud

The SEC charged a China-based issuer with materially misstating the company's operating results. The complaint alleges that the company intentionally fabricated more than \$300 million in retail sales transactions from at least April 2019 to January 2020 in order to falsely (1) achieve rapid growth and increased profitability and (2) meet the company's earnings estimates.

Without admitting or denying the allegations, the company agreed to a settlement of \$180 million.

What's next at the SEC?

As calendar year-end registrants start to file 2020 annual reports in the coming months, we expect the SEC staff to continue to focus on the quality of issuers' COVID-19-related disclosures, especially disclosures in MD&A about their expectations of the long-term effects of the pandemic. We also expect the SEC staff to focus on registrants' compliance to the amended Regulation S-X Rules 3-05, 3-14 and Article 11 on reporting on acquired businesses and real estate operations and the new and amended disclosure requirements of Regulation S-K.

Endnote:

¹ Smaller reporting companies are not subject to Item 301, and emerging growth companies do not need to disclose data for any period prior to the earliest audited financial statements presented in their initial registration statement.