

AN ALERT FROM THE BDO NATIONAL ASSURANCE PRACTICE

BDO FLASH REPORT

SEC MATTERS



► SUBJECT

SEC PUBLISHES UPDATE TO THE FINANCIAL REPORTING MANUAL

► SUMMARY

On February 6, the staff of the Securities and Exchange Commission's Division of Corporation Finance published an update to the Division's *Financial Reporting Manual* (FRM).¹ The update marks the beginning of a new approach by the staff to maintaining the FRM. Previously, updates to the FRM were published quarterly. Now, the staff plans to publish updates as it considers them necessary. Consistent with previous updates, the inside cover of the FRM lists a summary of the paragraphs that were updated.

The February 6 update amended Section 9520, which provides guidance on stock-based compensation disclosures in the management's discussion and analysis section of IPO registration statements. Stock-based compensation is generally a critical accounting estimate for a private company going public. Since the stock is privately held, the fair value estimates can be complex and highly subjective. Prior to the update, Section 9520 called for tabular disclosures about recent grants and a detailed discussion of the factors contributing to significant changes in fair value. At the 2013 AICPA Conference on SEC and PCAOB Developments, the staff noted that the disclosures appearing in IPO registration statements were voluminous and often exceeded the requirements and intent of FRM Section 9520.

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¹ The FRM is an internal SEC staff reference document that provides general guidance covering several SEC reporting topics. While the FRM is not authoritative, it is often a helpful source of guidance for evaluating SEC reporting issues. The FRM, along with other helpful guidance, can be accessed from the Division of Corporation Finance home page, which is located at: <http://www.sec.gov/divisions/corpfin.shtml>.

In that spirit, the new guidance will allow companies to scale back stock-based compensation disclosures in IPO registration statements. Specifically, the updates request registrants to consider the following disclosures:

- a. The methods that management used to determine the fair value of the company's shares and the nature of the material assumptions involved.
- b. The extent to which the estimates are considered highly complex and subjective.
- c. A statement indicating that the estimates will not be necessary to determine the fair value of new awards once the underlying shares begin trading.

In making these disclosures, companies may cross-reference to information provided elsewhere in the prospectus.

Accordingly, a comprehensive history of awards or details sufficient to allow re-computation of compensation expense is not needed. While the staff may issue comments asking companies to explain the reasons for valuations that appear unusual, paragraph 9520.2 makes it clear the comments should not be interpreted as requests for additional disclosures. Rather, the comments are intended to elicit information for the staff to address whether the accounting for share-based compensation was appropriate.

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