

AN ALERT FROM THE BDO NATIONAL ASSURANCE PRACTICE

BDO FLASH REPORT

SEC MATTERS



► SUBJECT

SEC STAFF PUBLISHES NEW EDITION OF FINANCIAL REPORTING MANUAL

► SUMMARY

On October 30, 2013, the staff of the Securities and Exchange Commission's Division of Corporation Finance published a new edition of the Division's *Financial Reporting Manual* (FRM).¹ The inside cover lists a summary of the paragraphs that were updated. Some of the updates only provide clarification or housekeeping changes to the existing guidance. However, certain other updates are noteworthy and are summarized below.

Topic 10 - Emerging Growth Companies

Topic 10 was added to the FRM and includes guidance for emerging growth companies. The guidance set forth in Topic 10 is intended to be consistent with the previous guidance provided in the series of frequently asked questions about the general applicability of Title I of the JOBS Act available on the SEC's website.² Conforming changes were also made to other sections of the FRM to address the applicability of such guidance to emerging growth companies.

Section 2065 - Acquisitions of Producing Oil and Gas Properties

Rule 3-05 applies to the acquisition of a business as defined in Rule 11-01(d), which includes the acquisition of a business that represents "less than substantially all of an entity." Section 2065 of the FRM provides reporting guidance for registrants that

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>.

² See the FAQs at <http://www.sec.gov/divisions/corpfin/guidance/cfjjobsactfaq-title-i-general.htm>.

CONTACT:

WENDY HAMBLETON

National Director of SEC Practice
312-616-4657 / whambleton@bdo.com

JEFF LENZ

National Assurance Partner
312-616-3944 / jlenz@bdo.com

PAULA HAMRIC

National Assurance Senior Manager
312-616-3947 / phamric@bdo.com

acquire only selected parts of an entity, which may result in the need to present less than a full set of financial statements under Rule 3-05. When it is impracticable to prepare a full set of financial statements (either legal entity or carve-out financial statements) as required by Regulation S-X, the staff may allow audited statements of assets acquired and liabilities assumed and statements of revenues and direct expenses (i.e., abbreviated financial statements) in satisfaction of a Rule 3-05 requirement.

Previously, the FRM stated that all requests to substitute abbreviated financial statements for full financial statements should be directed to the Office of the Chief Accountant in the Division of Corporation Finance (CF-OCA) prior to filing (typically via a pre-clearance letter). The amendments to the FRM added paragraph 2065.11 which now provides relief from this pre-clearance process for acquisitions of certain producing oil and gas properties. When an oil and gas property acquired represents less than substantially all of the selling entity's key operating assets and liabilities, the staff will accept abbreviated financial statements in satisfaction of the Rule 3-05 requirements if the following criteria are met:

- The acquired interest represents only a portion of the seller's assets and is not a segment or division of an entity, or contained in a separate legal entity;
- Separate financial statements of the acquired property have not been previously prepared and the seller has not maintained the distinct and separate accounts to present full carve-out financial statements of the property; and
- It is impracticable to prepare the full financial statements required by S-X.

It should be noted that the accommodation to present abbreviated financial statements for certain acquired oil and gas properties did not change the guidance for calculating the significance of such acquisitions. Accordingly, written requests to CF-OCA must be made if a registrant wishes to adjust its pre-tax earnings used as the denominator for the income test to exclude costs not directly associated with the registrant's revenue producing activity (which may be desired when the numerator excludes such costs).

Paragraph 2065.12 was also added to the FRM and provides additional guidance to those registrants that plan to present abbreviated financial statements based on the circumstances described in Paragraph 2065.11. This additional guidance specifies that:

- The statement of assets acquired and liabilities assumed may be omitted if the business acquired consists solely of interest(s) in one or more oil or natural gas properties (e.g. working interests and net profit interests).
- The statement of revenues and direct expenses should include the income statement effects of all derivative contracts related to the property that existed during the historical financial statement periods if the derivative contracts were assumed or acquired by the registrant.
- The supplementary disclosures required by ASC 932-235-50-3 through 50-11 (proved oil and gas reserve quantities) and ASC 932-235-50-29 through 50-36 (standardized measure of discounted future cash flows and changes in the standardized measure) should be provided for each full year of operations presented. Additional guidance is provided for circumstances where prior year reserve studies were not made.

Paragraph 2065.10 provides expanded guidance with respect to the pro forma financial information to be provided when only selected parts of an entity are acquired.

All of the guidance discussed above is consistent with approach the staff has historically communicated in responses to pre-clearance letters.

Paragraph 2410.8 - Significance of Equity Method Investees - Effect of Retrospectively Applied Change in Accounting Principle

Section 2410 provides guidance to registrants measuring significance of their equity method investees under Rule 3-09. Under Rule 3-09, financial statements of a majority-owned subsidiary not consolidated by the registrant or an equity method investee are required if such a subsidiary or investee is significant at the 20% level.

Paragraph 2410.8 was updated to clarify that the effect of a retrospectively applied change in accounting principle should be treated in a similar manner to the effect of a discontinued operation for purposes of calculating significance. If a registrant

discontinues an operation or retrospectively applies a change in accounting principle subsequent to the filing of its Form 10-K, the significance of an equity method investee in a subsequently filed registration statement should be measured based on the historical financial statements included in Form 10-K (not the financial statements that reflect the retrospective presentation of the discontinued operation or application of the change in accounting principle). However, an investee's significance in prior years will need to be remeasured using the revised prior year financial statements when the next Form 10-K is filed. This could cause a registrant to need to provide audited investee financial statements that it did not previously need to provide and vice versa.

Additionally, the guidance clarifies that Rule 3-09 financial statements are not required in the Form 10-K for the year that an equity method investment is disposed of if the equity method investment is not significant for any of the registrant's fiscal years presented in Form 10-K (including the year of disposal), measured using the financial statements that have not been retrospectively adjusted to give effect to the discontinued operation or change in accounting principle.

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