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Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
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24 March 2014

Proposed Rule Amendments for Small and Additional Issues Exemptions Under Section 3(b) of the Securities Act
(Release No. 33-9497)
Commission File No. S7-11-13

Dear Ms. Murphy:

Ernst & Young LLP (EY) is pleased to comment on the *Proposed Rule Amendments for Small and Additional Issues Exemptions Under Section 3(b) of the Securities Act* (the proposal) issued by the Securities and Exchange Commission (SEC or the Commission). The proposal would implement Title IV of the Jumpstart Our Business Startups Act (JOBS Act) by amending Regulation A, an exemption for small offerings under Section 3(b) of the Securities Act of 1933, to establish two tiers of unregistered public offerings: Tier 1 offerings of up to $5 million of securities within a 12-month period and Tier 2 offerings of up to $50 million of securities within a 12-month period.

The objective of the proposal is to make the Regulation A exemption more useful to small companies by modernizing the requirements and expanding the offering size while building in necessary investor safeguards. Small companies have, or will have, several ways to raise capital through exempt offerings under Regulation A, Regulation D and the proposed crowdfunding rules.[1] The proposing release states that future use of the amended Regulation A exemption will depend on how companies weigh the benefits against the costs of compliance and the ongoing reporting requirements.[2]

We believe that the proposal provides adequate investor protection and will increase the attractiveness of Regulation A offerings. However, we recommend that the Commission consider additional opportunities to leverage disclosure requirements in existing SEC rules and regulations applicable to registered offerings and scale those disclosure requirements for purposes of unregistered offerings conducted under Regulation A. We also encourage the Commission to clarify certain terminology and disclosure requirements in the proposal that could be difficult to interpret or apply.

1 Commission File No. S7-09-13, *Crowdfunding Release No. 33-9470; 34-70741*

2 Refer to Section IV.B.1 of the Proposal

This letter discusses our general comments on the proposal. In Appendix A, we summarize our recommendations in a table.

We also have identified a number of areas in the proposal where we believe additional guidance or clarity could be provided that would reduce the need for subsequent FAQs or other interpretive guidance. In Appendix B, we identify specific aspects of the proposal that the Commission should consider clarifying and that are not otherwise discussed in the body of our comment letter.

Financial statement requirements

The proposal would require all issuers to file with the Commission a complete set of financial statements prepared in accordance with US GAAP (or, for Canadian issuers, IFRS as issued by the International Accounting Standards Board) covering the shorter of the two most recently completed fiscal years or the period since inception of the business through the most recent fiscal year-end. In addition, the proposal would require the financial statements to be dated no more than nine months from the filing and qualification date[3] of the offering, and interim financial statements for a period of at least six months if more than 270 days have passed since the end of the fiscal year. We recommend that the final rule make clear that an issuer could voluntarily provide interim financial statements covering a period of less than six months since the end of the fiscal year.

For newly formed companies, the proposal would require financial statements as of a date within nine months of the filing and qualification date of the offering statement covering the period since inception. We believe that newly formed companies should receive additional relief. We note that Regulation S-X requires newly formed registrants to provide an audited balance sheet dated within 135 days of the filing date and that, in most cases, the balance sheet provided is a "seed" balance sheet that communicates little meaningful information to investors. We therefore recommend that Regulation A issuers formed within nine months of the offering date not be required to provide any financial statements. Instead, we recommend that these companies be allowed to provide a narrative discussion of their financial condition and operations since inception.

In an offering statement, Regulation A issuers would be required to update their annual financial statements for the most recently completed fiscal year if more than 90 days have passed since the end of the fiscal year. In our view, Regulation A issuers should have more time to update the annual financial statements than smaller reporting companies in registered offerings.[4] We recommend requiring updating 120 days after fiscal year-end, which would be consistent with the annual reporting deadline for Tier 2 issuers filing Form 1-K.

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[3] In Section II.C.3.b(2) of the Proposal, the Commission said it would add a limitation on the age of financial statements at the qualification date. However, Part F/S (a)(3)(i) and Part F/S (b)(2) of Form 1-A, as proposed, do not include this requirement and would only require financial statements as of a date within nine months of the filing date.

[4] Rule 8-08(b) of Regulation S-X states that a smaller reporting company is not required to provide updated annual financial statements if the effective date of the registration statement falls within 90 days after fiscal year-end and the registrant expects to report income from continuing operations before taxes in the most recent year and has reported income from continuing operations before taxes in at least one of the two years before the year just completed.

Private company accounting standards

We encourage the SEC to consider whether Regulation A issuers and other entities whose financial statements are required in Regulation A offerings should be able to follow US GAAP for private companies. The FASB recently issued Accounting Standards Update (ASU) No. 2013-12, Definition of a Public Business Entity, that would include Regulation A issuers in criterion (a)5 of the definition of a public business entity (PBE). Furthermore, acquired businesses for which a Regulation A issuer would be required to file financial statements with the SEC also would meet the definition of a PBE under criterion (a).

US GAAP now permits entities that do not meet the definition of a PBE to apply private company alternatives aimed at reducing the complexity and cost of complying with certain accounting and reporting requirements. Recent examples of private company alternatives include those affecting the accounting for goodwill and certain derivatives and hedging transactions. The FASB is also using the definition of a PBE to consider whether an entity can use other types of private company relief (e.g., disclosure, transition and effective date differences) that it provides in new standards. The new definition does not change whether an entity is considered public or nonpublic for other existing US GAAP requirements, but the FASB has asked the Private Company Council to research whether to change or consolidate the various definitions of public or nonpublic entities that exist in US GAAP.[6]

We expect that many nonpublic entities will use private company alternatives or elect to follow other types of private company relief in new standards issued by the FASB. Companies that use this relief subsequently may seek to use Regulation A to offer their securities. However, Regulation A issuers and other entities whose financial statements are required to be included in Regulation A offerings would not be able to use private company relief.[7] The FASB has not provided specific guidance to address how private companies would transition to US GAAP for public companies. In the absence of specific transition guidance, we understand that companies that become PBEs after using private company relief may need to retrospectively apply the PBE accounting and reporting requirements to all periods presented. This requirement could increase costs for Regulation A issuers by requiring them and other entities to apply more complex accounting and disclosure standards under US GAAP and by requiring them to revise previously issued financial statements.

We recommend that the Commission address in the final rule how the FASB's definition of a public business entity should apply to Regulation A offerings. We believe that the costs of revising financial statements to apply US GAAP for public companies outweigh the benefits for a Regulation A issuer, or an acquired business, that has no ongoing reporting obligations. Therefore, we believe that Tier 1 issuers and other entities whose financial statements are required in any Regulation A offerings be permitted to apply private company accounting standards.

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5 Criterion (a) of ASU 2013-12, *Definition of a Public Business Entity,* states that a public business entity includes an entity that "is required by the U.S. Securities and Exchange Commission (SEC) to file or furnish financial statements, or does file or furnish financial statements (including voluntary filers), with the SEC (including other entities whose financial statements or financial information are required to be or are included in a filing)."

6 We also observe that the Accounting Standards Codification (ASC) includes multiple definitions of the term public entity, and Regulation A issuers will be required to comply with certain public company disclosure requirements in existing standards. For example, the term public entity in ASC 280, *Segment Reporting*, includes a business entity that "is required to file financial statements with the Securities and Exchange Commission."

7 The term "private company relief" refers to both private company alternatives and any differences in effective dates, transition or disclosure requirements that the FASB provides to private companies.

We also observe that Section 102(b)(1) of the JOBS Act allows an emerging growth company (EGC) to take advantage of the extended transition periods applicable to private companies for complying with new or revised accounting standards. At a minimum, we recommend that the Commission permit any Regulation A issuer (or other entity whose financial statements are required in a filing by a Regulation A issuer) that qualifies as an EGC to follow the extended transition periods applicable to private companies for complying with new or revised accounting standards.

Audit and independence standards

The proposal would require Tier 1 issuers to provide financial statements on an audited basis if an audit was obtained for other purposes and the audit was performed in accordance with either AICPA or Public Company Accounting Oversight Board (PCAOB) standards. The auditor of a Tier 1 issuer would be required to comply with SEC independence standards but would not have to be registered with the PCAOB. The proposal would require Tier 2 issuers to provide financial statements audited in accordance with PCAOB standards, but the auditor would not have to be registered with the PCAOB. The auditor of a Tier 2 issuer also would be required to comply with SEC independence standards.

We agree with the proposal that financial statements for a Tier 1 issuer should be allowed to continue to be provided on an unaudited basis unless an audit was obtained for other purposes. If financial statements of a Tier 1 issuer have not been audited or reviewed by an independent auditor or accountant, the offering circular should clearly disclose that fact. We also encourage the Commission to address transition reporting requirements for Tier 1 issuers that previously conducted a crowdfunding offering and, as proposed, were required to file reviewed annual financial statements. For example, the SEC has proposed requiring financial statements of a crowdfunding issuer to be reviewed under AICPA standards by an independent accountant for offerings between $100,000 and $500,000. The proposal currently does not address whether a Tier 1 issuer should include the review report covering its annual financial statements if such a review report was previously filed with the SEC in a crowdfunding offering.

We also believe that audited financial statements that are already available would benefit investors. For example, if audited financial statements of a Tier 1 issuer are available for other purposes and the audit was performed in accordance with AICPA or PCAOB standards, we believe that an investor would benefit from obtaining those audited financial statements, even if the auditor did not comply with SEC independence rules. Furthermore, requiring compliance with SEC independence rules in Tier 2 offerings, as proposed, would limit the number of accountants that can audit issuers' financial statements and could increase costs for issuers by requiring them to obtain reaudits of financial statements that were used for another purpose and were not audited by auditors that meet SEC independence rules. We also observe that accounting firms that are not registered with the PCAOB may not have controls and processes in place to comply with and monitor certain aspects of SEC independence rules (e.g., affiliate relationships among audit clients and any of their investors). Therefore, we recommend that the Commission permit compliance with AICPA independence standards for audited financial statements included in Tier 1 and Tier 2 offerings. This approach would reduce compliance costs and retain an accepted and recognized independence framework.

If the Commission decides not to permit compliance with AICPA independence standards, we believe the Commission should clarify whether a Tier 1 issuer would be allowed to voluntarily provide financial statements audited in accordance with AICPA standards, including AICPA independence standards, if

the auditor does not comply with SEC independence rules. Further, to facilitate transition by Tier 2 issuers, the SEC should require SEC independence only for the most recent year's audit and allow AICPA independence standards for the audit of the preceding year.

For Tier 1 issuers, we recommend that the Commission allow for audits to be performed in accordance with the "auditing standards of the PCAOB" rather than the "standards of the PCAOB." Auditors of non-issuers might not be registered with the PCAOB and may not have controls and processes in place to comply with and monitor certain aspects of the PCAOB's professional practice standards (i.e., ethics, independence and quality control standards). In practice, auditors may reference only the auditing standards of the PCAOB in an audit report for a non-issuer. We also observe that in the Commission's proposal on crowdfunding, an issuer may be required to obtain an audit of its financial statements, depending on the size of the offering, but is provided the flexibility to obtain an audit using the "auditing standards" of the AICPA or PCAOB. In Section II.C.3.b(2) of the proposal, the Commission said that it would permit audits of Tier 1 issuers to be performed in accordance with either AICPA standards or the auditing standards of the PCAOB. However, the text of the proposed amendments in Part F/S (b)(7) of Form 1-A refers only to "Standards of the PCAOB."

Similarly, we recommend that the Commission permit audits of Tier 2 issuers to be performed in accordance with either AICPA standards or the auditing standards of the PCAOB. Tier 2 issuers do not meet the definition of "issuers" under the Sarbanes-Oxley Act of 2002, and therefore, audits performed under standards of the PCAOB otherwise would not be required. We do not believe that the benefits to investors of performing audits of Tier 2 issuers under PCAOB standards would outweigh the costs, which could be significant if audited financial statements are otherwise available and the audits were performed under AICPA standards. Of course, issuers still could decide to obtain an audit that complies with standards of the PCAOB to ease an anticipated transition to Exchange Act reporting. If the Commission decides to require audits of Tier 2 issuers to comply with PCAOB auditing standards (or PCAOB standards), the SEC should facilitate transition by requiring audits to be performed under such PCAOB standards only for the most recent year's audit in the initial Regulation A offering statement and allowing performance under AICPA standards for the audit of the preceding year.

Ongoing reporting

We agree with the Commission that only Tier 2 issuers should be required to file annual reports until their reporting obligation is terminated or suspended. Consistent with appropriate scaling, we believe that the ongoing reporting requirements for Tier 2 issuers should not be more onerous than those required for smaller reporting companies.

Section 401(b)(4) of the JOBS Act permits the Commission to use its discretion in determining the required periodic disclosures for Regulation A issuers. However, the proposal does not offer an analysis supporting the requirement for semiannual reporting.[8] While we agree that the interim reporting obligation of Tier 2 issuers should be appropriately scaled in relation to smaller reporting companies and not be more frequent than semiannual, we recommend that the Commission consider the compliance costs associated with semiannual reporting in evaluating whether interim reporting

[8] Section II.E.1.b of the Proposal states that semiannual interim reporting for Regulation A issuers strikes "an appropriate balance between the need to provide information to the market and the cost of compliance for smaller issuers."

appropriately balances the costs and benefits across the entire spectrum of Tier 2 issuers. For example, the SEC could require semiannual reporting only once the aggregate amount sold in exempt offerings by a Tier 2 issuer exceeds $50 million.

We recommend that the final rule state explicitly that Regulation FD does not apply to Regulation A issuers.[9] However, all Regulation A issuers, including Tier 1 issuers, should be encouraged to broadly report material information on a timely basis using Form 1-U (i.e., selective disclosure by Regulation A issuers should be discouraged). Although this is not addressed in the proposal, we understand that Regulation A issuers would not be subject to Regulation G.[10] We encourage the Commission to seek further comment on whether additional guidance on the use of non-GAAP financial measures by Regulation A issuers is necessary.

We recommend that the deadlines for Tier 2 issuers to report current events on Form 1-U be extended beyond those required by Form 8-K (i.e., four business days after the occurrence of the event). The deadlines to report events on Form 8-K are designed to allow investors that participate in active secondary markets to factor information about important corporate events into the value of a company's securities. While timely reporting of material events is important for Regulation A issuers and investors, we believe that Regulation A issuers should have more time (e.g., 15 business days) to report these events because they have more limited reporting resources than registrants and their securities are less liquid. In addition, we encourage the Commission to consider whether certain events could be reported in the next annual or semiannual report rather than a mandatory Form 1-U report. For example, a change in the issuer's accountant that does not involve a disagreement with management or a reportable event, or sales of equity securities at prices above previous primary offerings, would not appear to be material intervening events that would necessitate a current report on Form 1-U.

Item 1 of proposed Form 1-U is titled "Fundamental Changes." However, the instructions to the Item are limited to the execution and termination of contracts. Section II.E.1.a(2) of the proposal states that the intent is to consolidate the reporting of Items 1.01, 1.02 and 2.01 of Form 8-K but "change the threshold for reporting from a materiality to a fundamental change standard." Item 1 of Form 1-U would be limited to reporting contractual actions representing a "fundamental change to the nature of [an issuer's] business or plan of operations." Nevertheless, Instruction 2 to Item 1 identifies contracts involving specific matters that would be required to be reported (e.g., a material definitive agreement to acquire a business that would exceed the [20%] significance thresholds in Rule 8-04 of Regulation S-X).

We are concerned about whether Tier 2 issuers will consistently interpret and apply the subjective disclosure threshold proposed in Item 1 of Form 1-U. Accordingly, we recommend that the final rule change the title of Item 1 from "Fundamental Changes" to "Major Contracts" and replace the term "fundamental change" with "major change" in describing the threshold for disclosure. Use of the term "fundamental change" could be difficult for issuers to apply and may also result in confusion,

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9 Section IV.B.5.b of the Proposal indicates that Item 7.01 of Form 8-K, *Regulation FD Disclosure*, is not required for Tier 2 issuers but does not otherwise clarify the applicability of Regulation FD (or Regulation G).

10 Rule 102(c) of Regulation G, *General rules regarding Disclosure of Non-GAAP Financial Measures,* defines companies subject to the regulation as those registered under Section 12 of the Exchange Act or required to file periodic reports under Section 15(d) of the Exchange Act.

particularly in light of the proposed Instruction 2, compared to how that term is considered when evaluating the need for a post-effective amendment under Item 512 of Regulation S-K.[11] Further, with respect to contracts involving business acquisitions, we recommend that the measurement of significance be limited to the investment test and the numerical threshold increase to at least 50% to be more consistent with the stated disclosure objective. Moreover, we encourage the SEC to develop a clearer objective standard for reporting contractual developments on Form 1-U in the final rule.

We also have the following recommendations for semiannual reporting on Form 1-SA:

- Item 3 of Form 1-SA does not specify the form and content of the semiannual financial statements, but we believe Regulation A issuers should receive relief similar to smaller reporting companies in quarterly reports on Form 10-Q to provide financial information on a condensed basis consistent with Rule 8-03(a) of Regulation S-X. The final rule also should clarify whether the disclosures required by Rule 8-03(b) of Regulation S-X are required.

- Item 3(d) of Form 1-SA includes a requirement to provide a statement of changes in financial position. We recommend that this requirement be deleted because there is no requirement to include a statement of changes in financial position (or stockholders' equity) in quarterly reports on Form 10-Q.

- Item 3(f) of Form 1-SA would require financial statements of affiliates whose securities constitute a substantial portion of the collateral for an issuance pursuant to Rule 3-16 of Regulation S-X. We recommend that this requirement be deleted because there is no requirement to include such financial statements in quarterly reports on Form 10-Q.

Disclosure framework

We believe the disclosure regime in Regulation S-K for registrants should serve as a baseline to consider and scale requirements for Regulation A offerings. At a minimum, the disclosure requirements of Regulation A should not be more onerous than those for smaller reporting companies in registered offerings. The proposal maintains and augments the existing disclosure framework of Regulation A with detailed disclosure requirements embedded in the various forms (e.g., Form 1-A) rather than leveraging the existing integrated disclosure framework by referencing the well-understood disclosure requirements in Regulation S-K. We encourage the Commission to scale the requirements in Regulation S-K for Regulation A issuers, rather than perpetuate a separate framework within the Form instructions that in many cases is inconsistent with Regulation S-K. For example, the disclosure framework for management's discussion and analysis (MD&A) should be based on the requirements in Item 303 of Regulation S-K for smaller reporting companies, with scaling as appropriate for Regulation A issuers (e.g., an exception from 303(a)(4), *Off-balance sheet arrangements*).

[11] Item 512 of Regulation S-K does not define a "fundamental change," and therefore, management and its legal counsel are responsible for determining what constitutes a fundamental change.

We believe issuers and investors would benefit from a clear and consistently applied framework as follows:

- *Conform the terminology to reduce confusion* — For example, Part II, Item 9(d) of the proposed Form 1-A would require the issuer to "identify the most significant recent trends in production, sales and inventory, the state of the order book and costs and selling prices since the latest financial year." This requirement could result in confusion because it deviates from the requirements of Item 303(a)(3)(ii) of Regulation S-K to discuss known trends or uncertainties that have had or will have a material effect on net sales, revenues or income from continuing operations, and uses terminology specific to the manufacturing industry. In addition, Part II Item 9 of the proposed Form 1-A also would require discussion of "all separate segments of the issuer" rather than the requirement of Regulation S-K Item 303 to discuss segment information when appropriate to an understanding of the business. The use of similar, but different, disclosure requirements will likely result in additional questions about whether the disclosure requirements in Regulation A offerings are intended to be different from existing requirements in Regulation S-K.

- *Eliminate disclosure requirements that are more onerous than those in Regulation S-K or could result in disclosure overload* — The proposal would require disclosure in MD&A of the level of borrowings at the end of the period and the types of financial instruments used by the issuer. These are examples of disclosures that are different from and in some cases more burdensome than disclosures currently required in Item 303 of Regulation S-K. Furthermore, these disclosures would likely duplicate financial statement disclosures. Consistent with recent remarks by SEC commissioners and staff, we encourage the Commission to consider ways to address disclosure overload by making disclosures more efficient and effective. Accordingly, we do not believe that disclosures included in the financial statements should be duplicated in other sections of the offering statement or ongoing reports.

- *Leverage existing implementation guidance* — For example, Part II Item 11 of the proposed Form 1-A would require disclosure of the annual compensation of directors and officers in a tabular format that is less extensive than Item 402 of Regulation S-K as it applies to smaller reporting companies. However, we encourage the Commission to provide additional guidance in the final rule about how amounts should be computed and reported in the table. For example, Instruction 1 to Item 11 of Form 1-A provides that for compensation paid in other than cash (e.g., stock awards, pensions, other non-cash compensation), the compensation amount should be based on the "cash value," unless determining that value is impracticable. By providing additional guidance or integrating the Regulation A issuer requirements into Item 402 of Regulation S-K, implementation questions could be addressed up front, and the need for FAQs or interpretive guidance could be limited. By comparison, there are instructions to Item 402 for each column of the Summary Compensation Table, and the SEC staff released Compliance & Disclosure Interpretations to address numerous implementation questions.[12]

[12] Divisions of Corporation Finance Compliance & Disclosure Interpretations, Regulation S-K, Item 402(c) — Executive Compensation; Summary Compensation Table

Other entity financial statements

The proposal would require Regulation A issuers to provide financial statements of other entities, including completed or probable acquisitions in accordance with Rule 8-04 of Regulation S-X, guarantors and issuers of guaranteed securities in accordance with Rule 3-10 of Regulation S-X, and affiliates that collateralize an issuance in accordance with Rule 3-16 of Regulation S-X. Tier 1 issuers would not be required to obtain audited financial statements of other entities unless an audit was performed for other purposes. A Tier 2 issuer would be required to provide audited financial statements of other entities required by Regulation S-X in the offering document and in its periodic reporting. We recommend that the Commission consider additional scaling for Regulation A offerings as discussed below.

Financial statements of acquired or to-be-acquired businesses

For registered offerings, registrants must strictly apply the requirements of Regulation S-X in measuring the significance of acquired businesses. In some situations, the SEC staff provides interpretive relief (e.g., Staff Accounting Bulletin Topic No. 1J, *Application of Rule 3-05 in Initial Public Offerings*), while in others, it permits registrants to request relief when strict application of the rules and guidelines results in an unreasonable conclusion.[13]

We agree with the Commission that it makes sense to leverage the existing framework of Rule 8-04 of Regulation S-X to evaluate the need to consider providing financial statements of acquired businesses or probable acquisitions for purposes of offerings under Regulation A. However, we believe the Commission should consider providing additional relief to Tier 1 and Tier 2 issuers by consolidating the significance thresholds (e.g., at 25% or 30%) and only requiring financial statements of the acquiree for the latest pre-acquisition annual and interim period. Furthermore, if financial statements of acquired businesses or probable acquisitions are not available or have not been audited (for Tier 2 offerings), we do not believe an issuer should be precluded from issuing securities using the Regulation A exemption if it reasonably believes the acquiree's financial statements would not be material to investors. Instead, if the acquiree is quantitatively significant under Rule 8-04 but financial statements are not available, the issuer should provide a narrative disclosure about the acquired business, the purpose of the acquisition and plan of integration with the issuer's operations along with summarized financial data of the acquired business to the extent available. The issuer also should clearly disclose why the financial statements of the significant acquiree are not available or not audited (for Tier 2 offerings). Even if full financial statements of the acquired business or probable acquisition are not available, Tier 1 and Tier 2 issuers should provide pro forma financial information about significant acquisitions to the extent possible, with disclosure about any limitations of such pro forma information.

If audited financial statements are available, we recommend that the Commission permit the audit to be performed in accordance with either AICPA auditing standards or the auditing standards of the PCAOB by an auditor that is independent under AICPA standards (consistent with existing requirements for financial statements pursuant to Rules 3-05 and 8-04).

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[13] Section 2015 of the Division of Corporation Finance's Financial Reporting Manual states, "Registrants may request CF-OCA interpretation in unusual situations or relief where strict application of the rules and guidelines results in a requirement that is unreasonable under the circumstances."

As proposed, Item 7(b) of Form 1-K would require a Tier 2 issuer to include "annual financial statements of the issuer that would meet the requirements of Part F/S of Form 1-A if included in an offering statement being qualified on the due date" of the Form 1-K. We recommend that the Commission clarify whether a Tier 2 issuer is required to comply with Rule 8-04 in its Form 1-K, particularly with respect to probable acquisitions.[14] If financial statements of completed significant acquisitions under Rule 8-04 are required in Form 1-K, we recommend that the issuer be permitted, and encouraged, to report financial statements in a Form 1-U or Form 1-SA, rather than wait until its next annual report on Form 1-K. We also recommend that once filed, the financial statements of completed acquisitions under Rule 8-04 should not be required to be repeated in subsequent periodic filings, consistent with current requirements in Form 8-K for registered issuers.

Financial statements of guarantors or issuers of guaranteed securities

In our experience, the costs and challenges of complying with Rule 3-10 of Regulation S-X continue to increase. In the 2000 adopting release, *Financial Statements and Periodic Reports for Related Issuers and Guarantors*,[15] the Commission estimated that preparing condensed consolidating financial information would cost only $1,000 more than preparing summarized financial information. In practice, companies face challenges and incur significant costs to comply with Rule 3-10. We encourage the Commission to consider alternatives to the existing disclosures required by Rule 3-10. For example, the Commission should consider providing the following additional relief to Tier 1 and Tier 2 issuers:

- Permit narrative-only disclosure if the parent and all of its consolidated subsidiaries provide guarantees (or if non-guarantor subsidiaries are minor) of securities issued by either the parent or a subsidiary (regardless of whether the parent has independent assets or operations[16]), or if the aggregate net assets of the issuer and guarantors (exclusive of interests held in non-guarantor subsidiaries) exceed the proposed or outstanding amount of the guaranteed securities

- Require condensed consolidating financial information for guarantors and subsidiary issuers within the footnotes of the issuer's financial statements for only the most recent annual period (no interim disclosures would be required in either the offering circular or on an ongoing basis)

- Not require separate audited financial statements of subsidiary issuers or guarantors that are not 100% owned or whose guarantee is not full and unconditional, but as required by Rule 3-10(i), each subsidiary issuer or guarantor that is not 100% owned, or whose guarantee is not full and unconditional or joint and several, would continue to be presented in a separate column in the condensed consolidating financial information

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14 We also recommend that the Commission clarify whether a Tier 2 issuer is required to comply with Rules 3-10 and 3-16 of Regulation S-X in its annual financial statements on Form 1-K.

15 Release Nos. 33-7878; 34-43124; FR-55, 24 August 2000

16 Rule 3-10 permits narrative-only disclosure in lieu of condensed consolidating financial information if certain conditions are met and the parent company has no independent assets or operations.

- For recently acquired subsidiary issuers or guarantors subject to Rule 3-10(g), provide summarized financial information (consistent with Rule 1-02(bb) of Regulation S-X) in lieu of separate financial statements if separate financial statements of the acquired entity are not otherwise provided (e.g., under Rule 8-04 of Regulation S-X)

Financial statements of affiliates that collateralize an issuance

Rule 3-16 of Regulation S-X requires separate financial statements of affiliates that collateralize an issuance if their securities constitute a substantial portion of collateral.[17] Regulation A issuers would be required to perform the "substantial portion of collateral" test on the offering date, and Tier 2 issuers would be required to reassess as of the end of each fiscal year for which a Form 1-K is required.

We recommend that Regulation A issuers be permitted to provide summarized financial information (consistent with Rule 1-02(bb) of Regulation S-X) of affiliates that substantially collateralize the issuance in lieu of full financial statements. We believe that summarized financial information would give holders of securities in Regulation A issuers a sufficient understanding of the collateral provisions and financial condition of the affiliate.

We also recommend that the Commission limit the substantial portion of collateral test to the qualification date of the offering with no reassessment required by Tier 2 issuers as of the end of each subsequent fiscal year. In connection with their initial investment decisions, we expect that investors would consider the significance of the collateral at the time of the offering, which should drive the need for financial information of the affiliate in the offering statement and in ongoing reports (for Tier 2 issuers). If the Commission retains an annual reassessment of the substantial portion of collateral test, we recommend that the denominator continue to be the amount of collateralized securities originally issued, not the amount outstanding as of the reassessment date. That is, we do not believe an affiliate should meet the substantial portion test just because a portion of the collateralized securities have been repurchased or repaid.

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

Yours sincerely,

Ernst & Young LLP

[17] Securities constitute a substantial portion of collateral under Rule 3-16 of Regulation S-X if the aggregate principal amount, par value, book value or market value of the securities pledged as collateral, whichever is the greatest, equals 20% or more of the principal amount of the collateralized securities.

Appendix A — Comparison of the Regulation A proposal and our recommendations

This table outlines our recommendations on the requirements for Regulation A issuers relative to the SEC's proposal:

Provision	Tier 1 — SEC proposal	Tier 2 — SEC proposal	Tier 1 — EY recommendation	Tier 2 — EY recommendation
Number of periods of annual financial statements	Financial statements would cover the shorter of the two most recently completed fiscal years, or the period since inception. For companies in existence for less than one year, financial statements must be as of a date within nine months of the date of the filing of the offering statement.		Same, except that companies formed within nine months of the filing date of the offering statement should be required to provide only a discussion of their financial condition and operations since inception in the offering statement.	
Age of financial statements in offering statement	If more than 90 days have passed since the end of the issuer's most recently completed fiscal year, the issuer would provide annual financial statements for its most recently completed year. If the offering statement is more than nine months after the issuer's most recently completed fiscal year, the issuer would provide financial statements for at least a six-month interim period (and comparative period).		Financial statement updating requirements should align with the timing of annual reports on Form 1-K (i.e., if more than 120 days have passed since the end of the issuer's most recently completed fiscal year, the issuer would provide annual financial statements for its most recently completed year) and semi-annual reports on Form 1-SA (if applicable). If not otherwise required, interim financial statements could be provided voluntarily.	
Ability to follow accounting standards as a private company	Not specified		Tier 1 issuers and other entities whose financial statements are required in a Regulation A offering should be exempt from the definition of a PBE. These entities with no ongoing reporting requirement should be allowed to follow private company accounting alternatives and other private company relief (e.g., disclosure, transition and effective date differences) provided by the FASB. Regulation A issuers that would qualify as emerging growth companies should be permitted to follow private company effective dates for new or revised accounting standards issued by the FASB.	
Financial statement audit requirements	Tier 1 issuers would not be required to provide audited financial statements unless audited financial statements are prepared for other purposes, the audit was performed in accordance with AICPA or PCAOB standards, and the auditor was independent under Rule 2-01 of Regulation S-X but need not be PCAOB-registered.	Tier 2 issuers would be required to provide financial statements audited in accordance with PCAOB standards by an auditor that is independent under Rule 2-01 of Regulation S-X but need not be PCAOB-registered.	Audited financial statements should be provided if the audit was obtained for other purposes, performed in accordance with either AICPA standards or the auditing standards of the PCAOB, and conducted by an auditor that is independent under AICPA standards. If the financial statements have not been audited or reviewed, the offering circular should clearly disclose that fact. The Commission should address transition reporting considerations for Tier 1 Regulation A issuers that previously conducted a crowdfunding offering and, as proposed, were required to file reviewed annual financial statements.	Same, except that Tier 2 issuers should be permitted to provide financial statements audited in accordance with either AICPA standards or the auditing standards of the PCAOB, and the audit should be conducted by an auditor that is independent under AICPA standards.

Provision	Tier 1 – SEC proposal	Tier 2 – SEC proposal	Tier 1 – EY recommendation	Tier 2 – EY recommendation
Ongoing reporting of current events (Form 1-U)	Not applicable	Tier 2 issuers would be required to report the following events (generally within four business days): ▶ Fundamental changes in the business (defined as major and substantial changes in the business or plan of operations or changes reasonably expected to result in such changes, such as a significant acquisition or disposition or material definitive agreement) ▶ Bankruptcy or receivership ▶ Material modification to rights of securityholders ▶ Changes in accountants ▶ Non-reliance on previous financial statements or a related audit report or completed interim review ▶ Changes in control ▶ Departure of certain officers ▶ Unregistered sales of equity securities	Tier 1 issuers should be permitted and encouraged to broadly report material information on a timely basis using Form 1-U.	Same, except for the following recommendations: (1) provide more time (e.g., 15 business days) to report on Form 1-U after occurrence of the event, (2) permit companies to disclose a change in accountants in the next periodic filing instead of reporting on Form 1-U if the change does not involve a disagreement or reportable event (as defined in S-K Item 304), (3) permit companies to disclose sales of equity securities in the next periodic filing if the price was not below that of previous primary offerings, and (4) replace the term "fundamental changes" and clarify the threshold for reporting events under Item 1 of Form 1-U.
Disclosure requirements, including description of the business, property, MD&A and executive compensation	Express MD&A disclosure requirements about the results of operations, liquidity and capital resources for the two most recently completed fiscal years. Issuers would not be required to include disclosures about off-balance sheet arrangements or a tabular presentation of contractual obligations.		Disclosure framework should be based on integrated disclosure requirements in Regulation S-K with appropriate scaling considering the needs of investors in exempt offerings and costs to comply with the disclosure requirements. At a minimum, the disclosures should not be more extensive than disclosures required of smaller reporting companies.	
	Describe the business during the past three years and the characteristics of the issuer or industry that materially affect future performance.			
	State the location and general character of principal plants and material physical properties and describe any major encumbrances.			
	For the three highest paid officers or directors, disclose, in tabular format, cash compensation, other compensation and total compensation for the latest fiscal year, and describe proposed compensation in the future under any ongoing plan or arrangement. Compensation information should be provided on an accrual basis (unless otherwise noted) and include the "cash value" for amounts paid in other than cash.			

Provision	Tier 1 – SEC proposal	Tier 2 – SEC proposal	Tier 1 – EY recommendation	Tier 2 – EY recommendation
Financial statements of acquired businesses in offering statements	Tier 1 issuers would be required to provide financial statements of significant acquisitions (i.e., those over 20% significant) under S-X 8-04 in the offering statement. Audited financial statements would not be required unless available for other purposes, the audit was performed in accordance with AICPA or PCAOB standards, and the auditor was independent under Rule 2-01 of Regulation S-X.	Tier 2 issuers would be required to provide financial statements of significant acquisitions (i.e., those over 20% significant) under S-X 8-04. Financial statements must be audited in the offering statement; however, it is not clear from the proposal whether the audit would need to be performed in accordance with PCAOB auditing standards	Regulation A issuers should provide audited financial statements, if available, of acquired or to-be-acquired businesses if significant under Rule 8-04 of Regulation S-X, but issuers should be provided additional relief by consolidating the significance thresholds (e.g., at 25% or 30%) and only requiring financial statements of the acquiree for the latest pre-acquisition annual and interim period. Furthermore, if financial statements of acquired businesses or probable acquisitions are not available or have not been audited (for Tier 2 offerings), we do not believe an issuer should be precluded from issuing securities using the Regulation A exemption if it reasonably believes the acquiree's financial statements would not be material to investors . Instead, if the acquiree is quantitatively significant under Rule 8-04 but financial statements are not available, the issuer should provide a narrative disclosure about the acquired business, the purpose of the acquisition and plan of integration with the issuer's operations along with summarized financial data of the acquired business to the extent available. The issuer also should clearly disclose why the financial statements of the significant acquiree are not available or not audited (for Tier 2 offerings). Even if full financial statements of the acquired business or probable acquisition are not available, Tier 1 and Tier 2 issuers should provide pro forma financial information about significant acquisitions to the extent possible, with disclosure about any limitations of such pro forma information. If audited financial statements are available, allow the audit to be performed in accordance with either AICPA auditing standards or the auditing standards of the PCAOB by an auditor that is independent under only AICPA standards (consistent with existing requirements for financial statements pursuant to Rule 3-05 and 8-04).	
Financial statements of acquired businesses in Form 1-K	Not applicable	Form 1-K would appear to require Tier 2 issuers to provide audited financial statements of significant completed and probable acquisitions under S-X 8-04.	If financial statements of significant acquired businesses are available, issuers should be permitted and encouraged to report financial statements in a Form 1-U.	Clarify whether a Tier 2 issuer is required to comply with Rule 8-04 of Regulation S-X in Form 1-K, particularly with respect to probable acquisitions. If financial statements of significant completed acquisitions are required (see recommendations above regarding significance test and required periods), issuers should be permitted, and encouraged, to satisfy their reporting requirements by including the financial statements in a Form 1-U or Form 1-SA, rather than wait until the next annual report on Form 1-K.

Provision	Tier 1 – SEC proposal	Tier 2 – SEC proposal	Tier 1 – EY recommendation	Tier 2 – EY recommendation
Financial statements of guarantors or issuers of guaranteed securities	Tier 1 issuers would have to comply with Rule 3-10 of Regulation S-X, except that only two years are required. Audited financial statements would not be required unless available for other purposes, the audit was performed in accordance with AICPA or PCAOB standards, and the auditor was independent under Rule 2-01 of Regulation S-X.	Tier 2 issuers would have to comply with Rule 3-10 of Regulation S-X, except that only two years are required. Financial statements would have to be audited under PCAOB standards, and the auditor is subject to independence requirements under Rule 2-01 of Regulation S-X.	Permit issuers to follow Rule 3-10 with the following additional relief: ► Permit narrative-only disclosure if the parent and all of its consolidated subsidiaries provide guarantees (or if non-guarantor subsidiaries are minor) of securities issued by either the parent or a subsidiary (regardless of whether the parent has independent assets or operations), or if the aggregate net assets of the issuer and guarantors (exclusive of interests held in non-guarantor subsidiaries) exceed the proposed or outstanding amount of the guaranteed securities ► Require condensed consolidating financial information for guarantors and subsidiary issuers within the footnotes of the issuer's financial statements for only the most recent annual period (no interim disclosures would be required in either the offering circular or on an ongoing basis) ► Not require separate audited financial statements of subsidiary issuers or guarantors that are not 100% owned or whose guarantee is not full and unconditional, which would continue to be depicted under the presentation requirements for condensed consolidating financial information under Rule 3-10(i) ► Provide summarized financial information in lieu of separate financial statements for recently acquired subsidiary issuers or guarantors subject to Rule 3-10(g)	
Financial statements of affiliates that collateralize an issuance	Tier 1 issuers would be required to comply with Rule 3-16 of Regulation S-X except that only two years would be required. Audited financial statements would not be required unless available for other purposes, the audit was performed in accordance with AICPA or PCAOB standards, and the auditor was independent under Rule 2-01 of Regulation S-X.	Tier 2 issuers would be required to comply with Rule 3-16 of Regulation S-X except that only two years are required. Financial statements are required to be audited under PCAOB standards, and the auditor is subject to independence requirements under Rule 2-01 of Regulation S-X. Tier 2 issuers would be required to provide unaudited interim financial statements in accordance with S-X 3-16 in semi-annual reports.	Tier 1 issuers should be required to provide only summarized financial information (consistent with Rule 1-02(bb) of Regulation S-X) of affiliates that collateralize the issuance and meet the conditions under Rule 3-16.	Tier 2 issuers should be required to provide only summarized financial information of affiliates that collateralize the issuance and meet the conditions under Rule 3-16. No requirement to provide S-X 3-16 financial statements nor summarized financial information in semi-annual reports (to align with requirements for existing registrants that are not required to include in Form 10-Q). The substantial portion of the collateral test should be performed only at the qualification of the offering and not reassessed as of the end of each fiscal year for which a Form 1-K is required.

Appendix B — Suggestions for clarifications or technical corrections

This table lists examples of items that can be clarified or corrected in the final rule:

Section	Description	EY recommendation
Form 1-A Part I Notification, Item 1	Disclosure of the number of units of outstanding securities that are "publicly traded"	Define the term "publicly traded."
Form 1-A Part I Notification, Item 1	Disclosure of the "Name of Auditor (if any)"	Clarify that the disclosure is required only if the auditor's report is included in the offering document.
Form 1-A Part I Notification, Item 1	Financial statement information	Revise to eliminate or conform with existing disclosures required by S-K Item 301. If current level of information is retained, conform line item descriptions with those in Regulation S-X. For example, it's not clear what is meant by "Total expenses" and how this amount should be computed from amounts presented in the underlying financial statements.
Form 1-A Part F/S (a)(3)(i) and Part F/S (b)(2)	Regulation A issuers must provide financial statements dated within nine months of the filing date.	Clarify the requirement stated in Section II.C.3.b(2) of the Proposal that the financial statements should also be dated within nine months of the qualification date of the offering statement .
Form 1-A Part F/S (a)(3)(vi)	Tier 1 issuers must comply with Rule 3-10 of Regulation S-X, except that 1) only two years are required and 2) audited financial statements are not required unless available for other purposes, audited in accordance with AICPA or PCAOB standards, and auditor is independent under Rule 2-01 of Regulation S-X.	Clarify what is meant by "audit of these financial statements is obtained for other purposes" in the context of Rule 3-10. For example, if audited financial statements are otherwise available without the disclosures required by Rule 3-10, can such audited financial statements be provided with an unaudited footnote covering the Rule 3-10 disclosure, or would the Tier 1 issuer be required to have the auditor opine on that footnote for purposes of the financial statements included in the offering circular or should only unaudited financial statements be presented if the audited financial statements do not comply with Rule 3-10?
Form 1-A Part F/S (b)(1)	Regulation S-X does not apply to a Tier 1 issuer's financial statements, while Part F/S (b)(5) requires Tier 1 issuers to provide financial statements of acquired businesses described in Rule 8-04 of Regulation S-X.	Rule 8-04 of Regulation S-X requires that the financial statements of the significant acquired business comply with other S-X requirements, which would be inconsistent with the financial statement requirements for a Tier I issuer. Clarify whether the financial statements of acquired businesses must comply with only the financial statement periods of Rule 8-04 of Regulation or if all S-X requirements apply.
Form 1-A Part F/S (b)(3)	Tier 1 issuers must provide statements of "other stockholders' equity."	This terminology is not consistent with US GAAP or Regulation S-X and should be replaced with "changes in stockholders' equity (and noncontrolling interests)."

Section	Description	EY recommendation
Form 1-A Part F/S (b)(5)	Tier 1 issuers must provide financial statements of acquired businesses described in Rule 8-04 of Regulation S-X.	Clarify that financial statements of real estate operations acquired or to be acquired (Rule 8-06 of Regulation S-X) are not required.
Form 1-A Part F/S (c)(2)	The section states "Audited financial statements are required for Tier 2 offerings."	Clarify that an audit is required only of financial statements for the annual periods and that interim period financial statements required in the offering statement may be unaudited and are not required to be reviewed by the independent accountant.
Form 1-K Part II, Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations	Item 2 of Form 1-K requires the following MD&A disclosure: "Set forth the information required by Item 9 of Form 1-A for the previous two completed fiscal years." Item 9(c) of Form 1-A requires that issuers "that have not received revenue from operations during each of the three fiscal years immediately before the filing of the offering statement, must describe, if formulated, their plan of operation for the twelve months following the commencement of the proposed offering."	Revise Form 1-K to exclude the disclosure required by Item 9(c) of Form 1-A assuming that was the Commission's intent as stated in FN 397: "As proposed, Form 1-K would not include the additional MD&A disclosure required in Form 1-A for issuers that have not received revenue from operations during each of the three fiscal years."
Form 1-K Part II, Item 7 Financial Statements	Item 7(b) of Form 1-K requires a Tier 2 issuer to include "annual financial statements of the issuer that would meet the requirements of Part F/S of Form 1-A if included in an offering statement being qualified on the due date of the report." Part F/S of Form 1-A requires a Tier 2 issuer to comply with Article 8 of Regulation S-X, including requirements to provide financial statements of other entities.	Clarify whether a Tier 2 issuer is required to comply with Rules 3-10, 3-16 and 8-04 of Regulation S-X in Form 1-K.
Form 1-SA Item 3, Financial Statements	The proposed rule does not provide guidance on the form or content of the interim financial statements.	Clarify whether financial statements can be presented using a condensed format consistent with S-X 8-03(a) and whether additional disclosure requirements of S-X 8-03(b) are applicable.
Form 1-SA Item 3(d)	Interim statements of changes in financial position are required for the period between the end of the preceding fiscal year and the end of the interim period covered by this report, and for the corresponding period of the preceding fiscal year.	Remove Item 3(d) because neither this statement nor a statement of changes in stockholders' equity is an existing requirement on Form 10-Q.