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**SEC Comment Letters — Including
Industry Insights**

November 2017

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Foreword

To our clients, colleagues, and other friends:

We are frequently asked to provide our perspective on the topics the SEC staff focuses on in its comment letters to registrants. The 2017 edition of *SEC Comment Letters — Including Industry Insights* offers such perspective. In addition to extracts of letters and links to relevant related resources, it contains analysis of staff comments to help registrants understand trends and improve their financial statements and disclosures. You will also find an update on some of the SEC's strategic priorities as well as a summary of comment letter trends related to the top 10 topics of frequent comment and other various comment letter statistics. The 2017 edition also includes the following appendices: (1) [Appendix A](#), which gives a glimpse into the SEC staff's review and comment letter process; (2) [Appendix B](#), which discusses best practices for working with the SEC staff; (3) [Appendix C](#), which provides helpful tips on searching the SEC's EDGAR database for comment letters; (4) [Appendix D](#), which lists the titles of standards and other literature referred to in this publication; and (5) [Appendix E](#), which defines the abbreviations we used.

The 2017 edition captures developments on relevant financial reporting topics through the date of publication. The SEC and its staff will continue to provide registrants with information that is pertinent to their filings by means of rulemaking and written interpretive guidance as well as speeches delivered at various forums, of which the AICPA Conference is a prime example. Deloitte's [US GAAP Plus](#) Web site is a resource you can use to keep current on the SEC's latest activities related to financial reporting matters — including the SEC staff's participation at the next AICPA Conference, which is scheduled for December 4–6, 2017, and will be discussed in an upcoming issue of our [Heads Up](#) newsletter.

We hope you find the 2017 edition — and other publications on US GAAP Plus and the [Deloitte Accounting Research Tool](#) — useful resources as you prepare your annual reports and plan for the upcoming year.

In line with the SEC's disclosure effectiveness initiative, we encourage you to consider materiality, relevance, and redundancy as you assess whether to provide additional disclosures or enhance existing ones.

As always, we encourage you to contact us for additional information and assistance, and we welcome your feedback.

Sincerely,

Deloitte & Touche LLP

Acknowledgments

Lisa Mitrovich and Courtney Sachtleben oversaw the development of this publication. The 2017 edition of *SEC Comment Letters — Including Industry Insights* would not have been possible without the significant contributions of the Accounting Services, Audit & Assurance Services, and SEC Services departments and the industry specialists at Deloitte & Touche LLP.

We also could not have completed this publication without the assistance of Jeff Naumann and Deloitte's Disclosure Analytics team. Deloitte, specifically the Disclosure Analytics team in relation to this publication, continues to focus on innovation and technology to transform the audit; and the statistics developed in this publication are an example of the results of that initiative, for which we are extremely appreciative.

In addition, we are grateful to Morgan Miles for his contributions and efforts in managing the development of this publication. We would also like to thank Teri Asarito, Geri Driscoll, David Eisenberg, Michael Lorenzo, Peter McLaughlin, and Lora Spickler-Alot for delivering the first-class editorial and production effort that brings all of Deloitte's financial reporting publications to life.

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Before the Details — Trends and Priorities

In May 2017, the SEC underwent a leadership change when Jay Clayton was appointed as its 32nd chairman. As has been the case since early 2016, the SEC has only three commissioners, including Chairman Clayton; nominees to fill the two vacant commissioner seats have not yet been confirmed by the U.S. Senate. Nonetheless, the SEC continues to focus on the following priorities that may be helpful for registrants to consider as we start the 2017 annual reporting cycle:

- *Enhancing and facilitating capital formation* — Increasing the attractiveness of the public capital markets is a top priority and includes exploring ways for the SEC to make IPOs more attractive while continuing to protect investors. In accordance with this priority, the SEC recently announced a nonpublic review process available for IPO draft registration statements for all companies, with a goal of encouraging more companies to consider going public.
- *Investor protection* — The SEC's mission to protect investors remains a top priority, with a continued focus on combating financial fraud and protecting retail investors. In addition, the SEC continues to prioritize cybersecurity and (1) recently created a Cyber Unit to target cyber-related misconduct and address growing cyber-based threats and (2) emphasizes the importance of public company disclosures about cyber risks and cyber events.
- *Disclosure effectiveness initiative* — The Commission continues to work on its broad-based staff review of the disclosure requirements in its rules as well as the presentation and delivery of those disclosures. In October 2017, the SEC issued a [proposed rule](#)¹ to modernize and simplify Regulation S-K, and Mr. Clayton further indicated that the Commission has several initiatives under way to improve disclosures available to investors.
- *New accounting standards* — The adoption of new accounting standards, including the new revenue, lease, and credit loss accounting standards, is critical to the financial reporting system given the pervasiveness of the expected changes. Therefore, the Commission continues to focus on the successful implementation of new accounting standards, including the accounting, disclosures, and related ICFR.
- *Non-GAAP measures* — During the past year, there was significant SEC staff scrutiny of non-GAAP measures, and many registrants have improved their disclosures to comply with the SEC's interpretive guidance. While we have started to see fewer comments in this area, the SEC staff is expected to continue to monitor registrants' use of non-GAAP measures.

The Division of Corporation Finance (the "Division") continues to help the SEC meet its responsibilities under the Sarbanes-Oxley Act via its filing review process, in which it selectively reviews filings made under the Securities Act and Exchange Act. Under the filing review process, the Division performs some level of review of each registrant at least once every three years (referred to as a "filing review"). Many registrants are reviewed more frequently, and they may or may not receive a comment letter.

¹ SEC Proposed Rule Release No. 33-10425, *FAST Act Modernization and Simplification of Regulation S-K*.

The comment letter trends and statistics discussed in this edition² are generated from an analysis of the comment letters issued by the Division in connection with its filing reviews of Forms 10-K and 10-Q (and any amendments to those respective forms). Filing reviews that resulted in one or more comment letters are referred to herein as “reviews with comment letters” or simply “reviews.”

Top 10 Topics in Reviews

The following table summarizes comment letter trends by topic in the 12-month periods ended July 31, 2017 (“review year 2017” or the “current year”), and July 31, 2016 (“review year 2016” or the “prior year”):³

Topic	Review Year 2017				Review Year 2016 ⁴		
	Number of Reviews With a Comment on Topic	Percentage of All Reviews	Rank	Change in Rank From Prior Year	Number of Reviews With a Comment on Topic	Percentage of All Reviews	Rank
Non-GAAP measures	474	43%	1	↑ 1	335	27%	2
MD&A:			2	↓ 1			1
Results of operations	198	18%			300	25%	
Critical accounting policies and estimates	80	7%			130	11%	
Liquidity	67	6%			138	11%	
Contractual obligations	18	2%			29	2%	
Fair value	157	14%	3	—	239	20%	3
Segment reporting	138	13%	4	—	166	14%	4
Revenue recognition	117	11%	5	—	165	13%	5 – T
Intangible assets and goodwill	104	9%	6	↑ 1	152	12%	7
Income taxes	102	9%	7	↓ 2	165	13%	5 – T
State sponsors of terrorism	87	8%	8	↑ 8	75	6%	16
Signatures, exhibits, and agreements	79	7%	9	—	105	9%	9
Acquisitions, mergers, and business combinations	72	7%	10	↓ 2	116	9%	8

² Unless noted otherwise, comment letter trend information in this publication:

- Was derived from data provided by Audit Analytics.
- Is related to reviews of Forms 10-K, 10-K/A, 10-Q, and 10-Q/A (which are referred to generally as “filings”).
- Is based on SEC uploads (i.e., comment letters that the SEC issued to registrants) and does not include registrant responses.
- Does not include the SEC’s “closing letter” communicating that its review is complete.
- Includes only information related to reviews that have been closed and subsequently posted to EDGAR. Accordingly, the statistics presented in the tables and charts below may be affected by reviews that are still ongoing or have recently been closed.
- Pertains to 12-month periods ended July 31 (“review years”).
- May be different upon comparisons with the *Supplement to the Ninth Edition* (October 2016) as a result of the facts that (1) additional 2016 reviews have been closed and posted to EDGAR and (2) refinements have been made to the methods used.

³ Reviews that generated more than one comment letter are counted only once in the statistics below and only in the year in which the initial comment letter was issued.

⁴ Additional 2016 reviews have been closed and posted to EDGAR since the *Supplement to the Ninth Edition* of our comment letter publication was issued. Further, the method we used to develop the top 10 rankings in the 2017 edition is a refinement of the method used in the *Supplement to the Ninth Edition*.

While the topics that constitute the top 10 list were generally the same as those in the prior year, we did see some movement in the rankings, with non-GAAP measures surpassing MD&A for the first spot. There was also a noticeable shift in comment letter volume toward non-GAAP measures, which is not surprising given their extensive use by registrants and the SEC's increased focus on this topic over the past year. In addition, we saw an increase in comments related to state sponsors of terrorism, which moved into the top 10 list for the first time.

The top 10 topics in reviews with comment letters issued in review year 2017 are ranked as follows:

1. **Non-GAAP measures** — Beginning in late 2015, SEC officials began discussing non-GAAP measures as a result of several factors, including (1) the increased use and prominence of such measures, (2) the nature of the adjustments to arrive at such measures, and (3) the increasingly large difference between the amounts reported for GAAP and non-GAAP measures. In response to increasing concerns about the use of such measures, in May 2016, the Division updated its C&DIs on non-GAAP measures to provide additional guidance on what it expects from registrants when using these measures. Therefore, it is no surprise that they have taken over the number one spot in the top 10 list. That said, in response to the C&DIs and public remarks by various SEC staff members, many registrants took the initiative to modify their disclosures to comply with the C&DIs. While there was significant SEC scrutiny of these disclosures this past year, the volume of comments in this area is beginning to lessen. Nevertheless, registrants should continue to be mindful of the key focus areas, which include (1) whether there is undue prominence of non-GAAP measures, (2) enhancing the disclosure related to the purpose and use of such measures, (3) clear labeling of non-GAAP measures, (4) whether measures are appropriately characterized as liquidity or performance measures, (5) reconciliation requirements, (6) whether the nature of certain adjustments may be potentially misleading, and (7) the presentation of the tax impact of non-GAAP adjustments.
2. **MD&A** — As the table above indicates, MD&A was replaced by non-GAAP measures as the top source of SEC staff comments. This shift was a result of the SEC's increased focus on non-GAAP measures this past year; however, as noted above, the volume of comments on non-GAAP measures is beginning to lessen, and we expect that MD&A will be back at the top of the chart in the future. Regardless, MD&A continues to be a leading source of SEC staff comments, which reflects the staff's continuing sentiment that registrants should "tell their story" in MD&A to allow investors to see the company "through the eyes of management." While the staff's comments have addressed various topics of MD&A, they have continued to focus on greater transparency in registrants' disclosures about (1) material trends and uncertainties that affect results of operations, (2) estimates in critical accounting policies, (3) liquidity and capital resources, (4) disclosure of contractual obligations, (5) early-warning disclosures, and (6) disclosures related to income taxes.
3. **Fair value** — Fair value has remained a hot topic for the SEC staff, as evidenced by the fact that it is the third leading source of SEC staff comments in review years 2017 and 2016. Although the frequency of SEC staff comments related to fair value has decreased from 20 percent to 14 percent, the SEC staff still asks registrants about (1) valuation techniques and inputs used in fair value measurements, including disclosure requirements for recurring and nonrecurring fair value measurements and (2) the use of third-party pricing services. In addition, the staff frequently comments on fair value estimates, including those related to revenue recognition, goodwill impairment, and share-based payments.

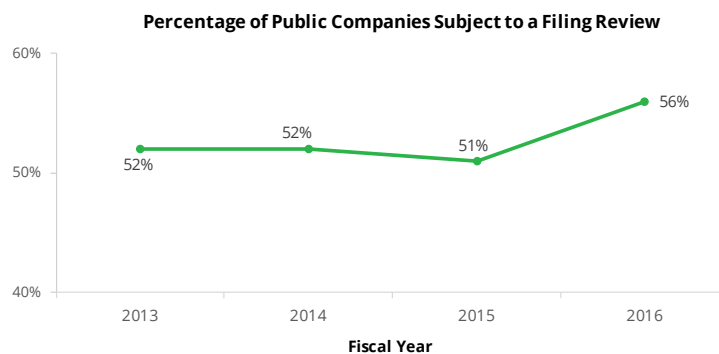
4. *Segment reporting* — Segment reporting is the fourth leading source of SEC staff comments for review years 2017 and 2016 and remains a perennial topic of SEC staff comments. Like those comments issued in previous years, recent ones have specifically addressed (1) the identification and aggregation of operating segments, (2) changes in reportable segments, and (3) entity-wide disclosures.
5. *Revenue recognition* — While many preparers are focused on the forthcoming implementation of the new revenue recognition standard, application of the current standard continues to draw the staff's attention and rounds out the top 5 in review years 2017 and 2016. While the frequency of SEC staff comments in review year 2017 (11 percent) is down from review year 2016 (13 percent), the SEC staff continues to comment on (1) the completeness and consistency of disclosures about revenue recognition policies, (2) accounting for multiple-element arrangements, (3) the principal-versus-agent analysis (i.e., gross versus net reporting), and (4) revenue recognition for long-term construction- and production-type contracts. More recently, the SEC staff has also focused on revenue recognition under the milestone method.
6. *Intangible assets and goodwill* — Although the frequency of reviews with a comment related to intangible assets and goodwill has decreased since review year 2016 (i.e., 12 percent compared with 9 percent), this topic climbed one spot in the top 10 in the current year. The SEC staff continues to comment on (1) goodwill impairment disclosures, including early-warning disclosures and the specific events and circumstances that led to the charge in the period of impairment; (2) asset grouping for goodwill impairment testing (i.e., the identification and composition of reporting units); and (3) whether or why an interim impairment test was performed.
7. *Income taxes* — Although the framework for accounting for income taxes has been in place for many years, it continues to be a focus of SEC comment letters. The SEC staff still asks registrants about (1) the potential tax and liquidity ramifications related to the repatriation of foreign earnings, (2) valuation allowances, (3) disclosures related to the income tax rate (including the rate reconciliation and effective tax rate), (4) tax effects of significant or unusual transactions, and (5) noncompliance with disclosure requirements.
8. *State sponsors of terrorism* — This category is new to the top 10 this year. The SEC staff has increased its focus on registrants that do business with countries designated by the U.S. State Department as state sponsors of terrorism, including Iran, Sudan, and Syria. SEC staff comments focus on disclosure about (1) the nature and extent of these contacts and (2) quantitative and qualitative factors about such activities.
9. *Signatures, exhibits, and agreements* — The SEC has specific requirements related to certain signatures, exhibits, and agreements that must be filed with a registrant's financial statements. With respect to those rules, the SEC staff continues to issue comments related to (1) the form and content of a registrant's quarterly and annual certifications and (2) material contracts, including requests for them to be filed as exhibits.
10. *Acquisitions, mergers, and business combinations* — M&A activity has remained high over the past couple of years, and so has the number of related SEC comments (i.e., moving down only two spots in the top 10). Similar in emphasis to comments in review year 2016 on business combinations, comments in the current year continue to focus on (1) identification of the accounting acquirer, (2) questions about the allocation of the purchase price to identified assets acquired and liabilities assumed, (3) accounting for any contingent consideration, (4) bargain purchases, and (5) required disclosures.

As noted above, only state sponsors of terrorism was added as a new trend in our top 10 for review year 2017. A number of the aforementioned trends are likely to continue in years to come given the

consistency of topics seen year over year. Further, while it is difficult to predict what new comment letter trends are on the horizon, we look to the Commission’s priorities to help us predict topics of focus in the coming year. In light of those priorities, we may see future comments focus on disclosures related to (1) application of the new revenue standard, (2) the impact of new accounting standards (e.g., the new leasing standard, the new credit loss standard), as required by SAB Topic 11.M, and (3) cybersecurity, as set forth in [CF Disclosure Guidance: Topic No. 2](#).

Percentage of Public Companies Reviewed Increased Slightly

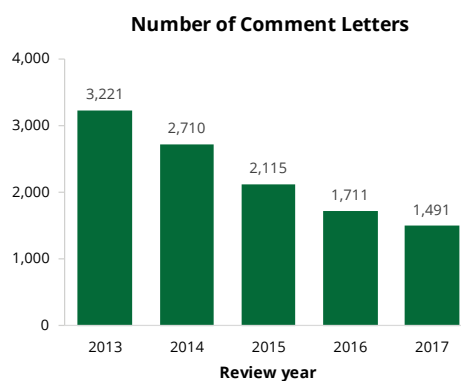
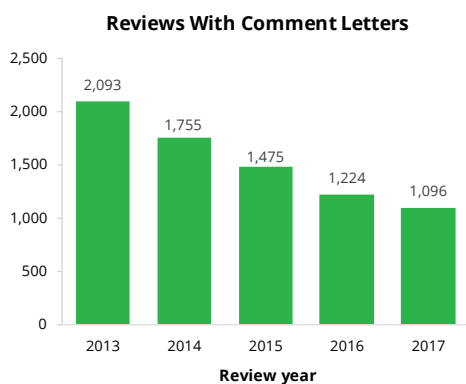
The chart below reflects the percentage of public companies that were subject to a filing review each year from 2013 through 2016.⁵



The Division performed filing reviews, on average, for approximately 52 percent of public companies per year during its fiscal years 2013 through 2015. This figure increased slightly to 56 percent during fiscal year 2016. As previously noted, not all filing reviews result in the issuance of a comment letter. Notwithstanding the increase in percentage of public companies reviewed during 2016, the number of reviews with comment letters and the average number of comment letters issued for each corresponding review has decreased in recent years, as discussed in the next two sections below.

Reviews With Comment Letters and Number of Comment Letters Trending Downward

The following charts show, for each of the review years 2013 through 2017, (1) the number of reviews with comment letters and (2) the total number of SEC comment letters issued:



⁵ The data presented in the chart were obtained from the SEC’s *Summary of Performance and Financial Information (Fiscal Year 2016)*. Further, the SEC’s fiscal year ends on September 30.

As the charts above illustrate, there has been a continued decline over the past five years in both the number of reviews with comment letters and the number of comment letters issued. The SEC staff has commented⁶ that the decline demonstrates the effectiveness of the review process and improved financial reporting by registrants, which the staff suggested may have resulted from the following:

- *Registrants' ability to view comments published on EDGAR and subsequently improve their reporting and disclosures* — To enhance that ability, law firms and accounting firms have issued publications (similar to this publication) that highlight comment letter trends and financial reporting best practices.
- *More frequent filing reviews* — While the Sarbanes-Oxley Act requires the SEC to review registrants at least once every three years, we know that the Division reviews registrants more often. As a result, the Division may be less likely to issue comments from year to year on a particular registrant.
- *Registrants' expectation of review* — Even if no review is conducted in a given year, the potential of being reviewed is incentive for registrants to continually improve their financial reporting.

While we cannot pinpoint exactly what contributes to year-over-year declines in reviews with comment letters and total comment letters, we believe that such declines over the past five years could be attributable to some or all of the following factors in addition to those listed above:

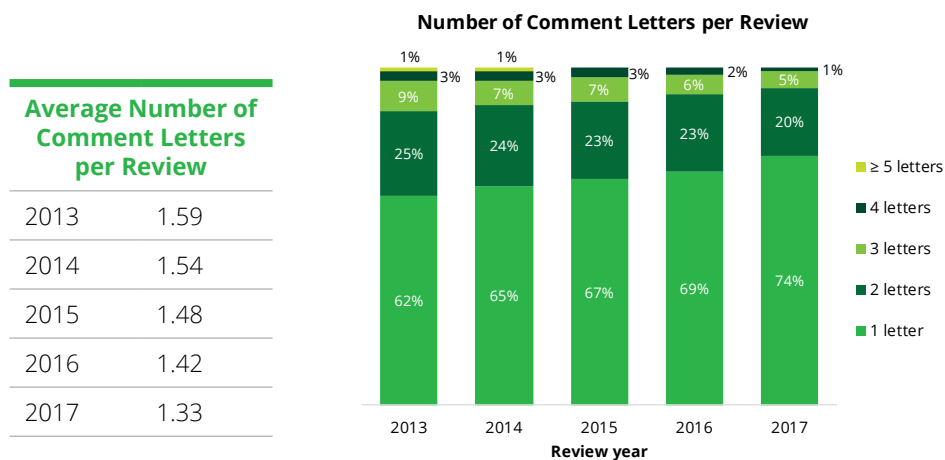
- *More selective use of comments* — Given the SEC's focus on its disclosure effectiveness initiative and the impact that comment letters may have on disclosures in registrants' filings, the Division may be issuing comments more selectively to concentrate on key topics and material disclosures.
- *Less significant changes to accounting and reporting rules* — The SEC staff is likely to scrutinize the accounting and disclosures associated with changes to accounting and reporting rules (e.g., the issuance of a new accounting standard), and the nature and extent of comment letters may be affected by the level of complexity of new standards in a given reporting cycle. Declines in comment letters may be a result of less significant changes to accounting and reporting rules in the most recent review periods noted above. In this regard, we note that recent accounting and reporting rules have been focused on simplification with few additional disclosure requirements rather than on rules with significant financial reporting implications. By comparison, the new revenue standard becomes effective for many registrants on January 1, 2018. Accordingly, we expect the adoption and application of the new revenue standard to be a driver of comment letters in future review periods.
- *More effective communication of the SEC's expectations* — The SEC is increasingly focused on transparency with respect to communicating expectations, an emphasis reflected in SEC staff speeches and remarks. In addition, the Division has consistently maintained its interpretive guidance by routinely updating the [SEC Financial Reporting Manual](#) and expanding its library of [C&Ds](#). While these do not constitute SEC rules, they do provide insight into the SEC staff's views on reporting rules and their application and often address topics that have been the subject of comment letters.
- *Fewer registrants filing a Form 10-K* — Although the Division has continued to review, at a minimum, approximately 50 percent of public companies since 2013, the number of Forms 10-K filed has decreased by approximately 15 percent since 2013.

⁶ From SEC staff speech at the Practising Law Institute Conference in October 2015.

Comment Letters per Review and Days to Complete a Review Continue to Trend Downward

Comment Letters per Review

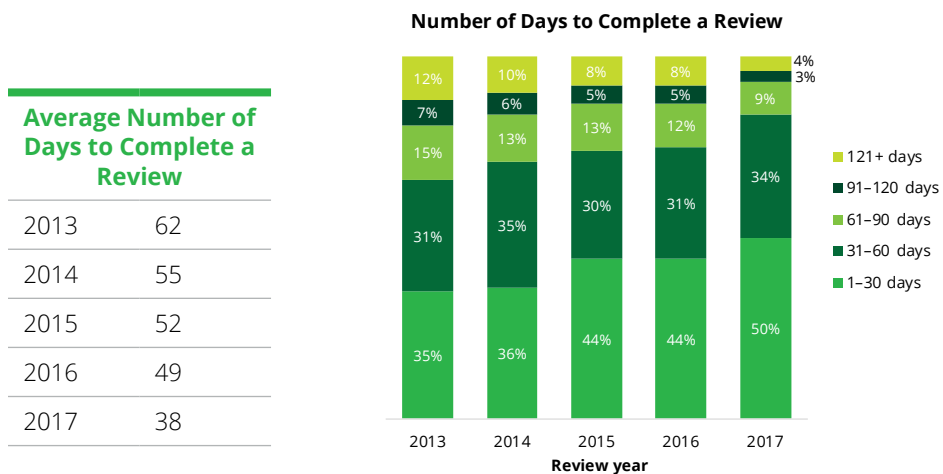
The following charts show, for each of the review years 2013 through 2017, (1) the average number of comment letters per review and (2) the percentage breakdown of completed reviews by number of comment letters per review:



The average number of comment letters issued per review has steadily decreased over the past several years, from 1.59 letters per review in review year 2013 to 1.33 letters per review in the current year. For the past two years, more than 90 percent of all reviews were resolved after one or two comment letters. The decline in the average number of comment letters per review may be partly attributable to some of the reasons noted above for the overall decrease in reviews with comment letters and the number of comment letters (e.g., improved financial reporting by registrants). Further, this trend is consistent with the decrease in the average number of days to complete a review, as illustrated below.

Days to Complete a Review

The following charts present, for each of the review years 2013 through 2017, (1) the average number of days to complete a review⁷ and (2) the percentage breakdown of reviews by the number of days to complete them:



In a manner similar to other trends discussed above, the average number of days to complete a review has continued to decline over the past five years, from 62 days in review year 2013 to 38 days in review year 2017. Further, in the current year, over 80 percent of reviews were completed within 60 days, an increase from approximately 66 percent in review year 2013.

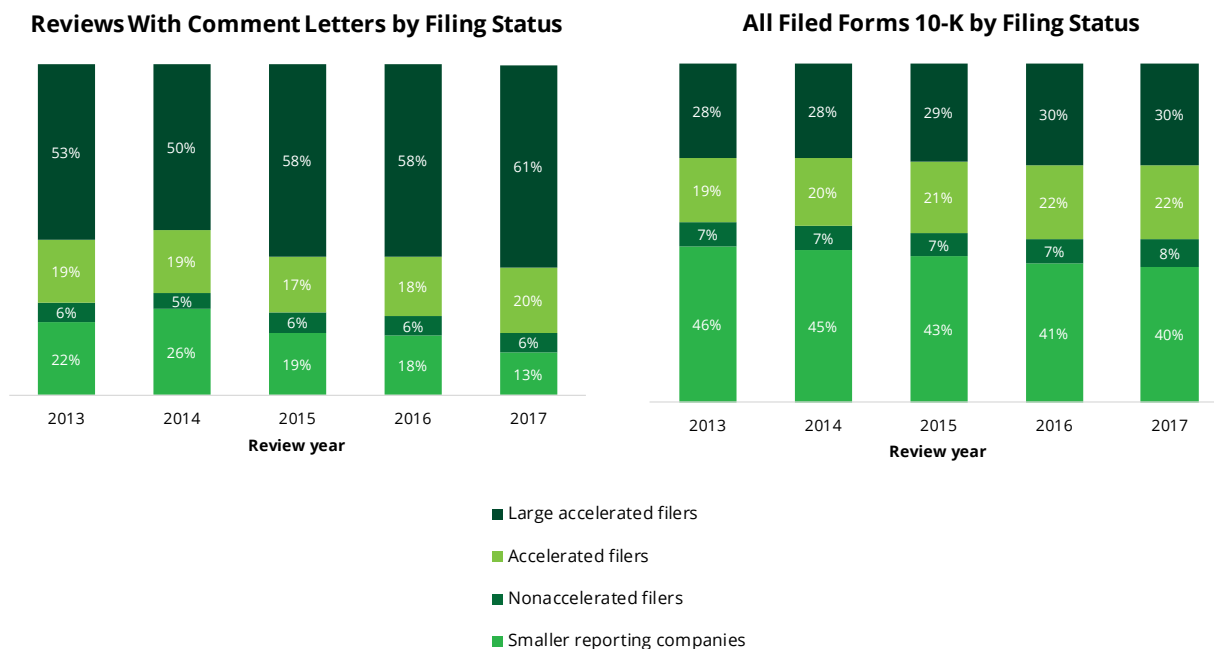
Quick resolution of the comment letter process is important. Applying our best practices for managing unresolved SEC comment letters, as discussed in [Appendix B](#) of this publication, may help registrants resolve any staff comment letters in a timely manner.

⁷ The number of days to complete a review was calculated by determining the number of days between the initial comment letter date and the closing comment letter date.

Observations About Reviews by Filing Status and Revenue

By Filing Status

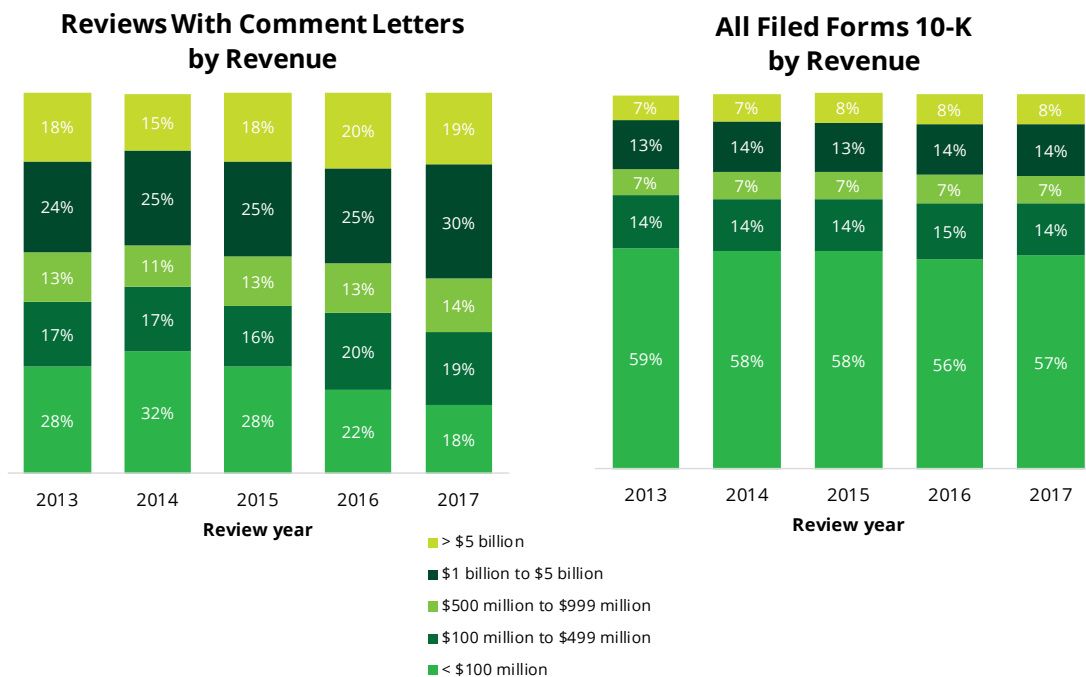
The charts below show, for each of the review years 2013 through 2017, the percentage breakdown of reviews with comment letters and all filed Forms 10-K by filing status (i.e., large accelerated filers, accelerated filers, nonaccelerated filers, and smaller reporting companies):



It is interesting to consider the filing status of registrants in the evaluation of comment letter trends and statistics. For example, as noted above, large accelerated filers have consistently been subject to the most reviews with comment letters over the past five years. That information, however, is more meaningful when considered in relation to the percentage of registrants within each filing status classification. For example, since 2013, large accelerated filers have consistently been subject to a disproportionately higher number of reviews, whereas smaller reporting companies have been subject to disproportionately fewer reviews. More specifically, over the past five years, on average, (1) large accelerated filers were subject to approximately 56 percent of reviews with comment letters although they represented only about 29 percent of the Forms 10-K that were eligible for a filing review, and (2) smaller reporting companies were subject to approximately 19 percent of reviews with comment letters although they represented approximately 43 percent of the Forms 10-K that were eligible for a filing review.

By Revenue

The charts below show, for each of the review years 2013 through 2017, the percentage breakdown of reviews with comment letters and all filed Forms 10-K by revenue reported in registrants' most recent Forms 10-K (i.e., greater than \$5 billion, \$1 billion to \$5 billion, \$500 million to \$999 million, \$100 million to \$499 million, and less than \$100 million):



Although a registrant's filing status is determined on the basis of its public float rather than its revenue, companies with larger public floats generally produce more revenue. As a result, it is no surprise that companies that generate more revenue have been party to a disproportionately higher number of reviews with comment letters than companies that generate less revenue. More specifically, over the past five years, on average, (1) registrants generating \$1 billion or more of revenue were subject to approximately 44 percent of reviews with comment letters although they represented only about 21 percent of the Forms 10-K that were eligible for a filing review, and (2) registrants generating less than \$500 million in revenue were subject to approximately 43 percent of reviews with comment letters although they represented approximately 72 percent of the Forms 10-K that were eligible for a filing review.

One factor that may be contributing to these trends is that while the Sarbanes-Oxley Act requires the SEC to review registrants at least once every three years, large accelerated filers are likely to be subject to more frequent review than smaller reporting companies. Since registrants that have larger market caps and generate higher levels of revenue make up a larger share of the capital markets than smaller companies, the SEC may take a risk-based approach and select larger companies for a filing review more frequently than smaller companies.

Financial Statement Accounting and Disclosure Topics

Business Combinations

The SEC staff's comments about business combinations continue to focus on (1) identification of the accounting acquirer, (2) questions about the allocation of the purchase price to identified assets acquired and liabilities assumed, (3) accounting for any contingent consideration, (4) bargain purchases, and (5) required disclosures.

Determining the Accounting Acquirer

Example of an SEC Comment

We note . . . that upon the completion of the Merger, former [Company A] shareholders own approximately 48.8% of the Surviving Corporation on a fully diluted basis and former [Company B] stockholders hold approximately 51.2% of the Surviving Corporation on a fully diluted basis . . . We also note you concluded that [Company A] is the accounting acquirer. Please provide us the analysis you performed in making this determination, including your consideration of all of the facts and circumstances outlined in ASC 805-10-55-12 through 55-15.

The SEC staff has asked registrants for their analysis on how they determined the accounting acquirer in a recent business combination. When it is difficult to determine which entity has obtained control in accordance with ASC 810,¹ the staff may ask registrants to explain how they considered the additional factors in ASC 805-10-55-10 through 55-15 in determining the accounting acquirer. In performing their analysis, registrants must consider all pertinent facts and circumstances as of the acquisition date and may be required to exercise considerable judgment when making the determination. The staff may also ask similar questions when a business combination is probable and is reflected in pro forma financial statements.

Purchase Price Allocation

Example of an SEC Comment

We note your disclosure of the purchase price allocation for the [merger] and your discussion of the revisions to that purchase price allocation that occurred during 2015, both due to measurement period adjustments and due to the errors described in Note [X]. We have the following comments:

- Please describe to us in more detail how you valued the acquired property, plant and equipment after correction of the errors, and also tell us why you had significant measurement period adjustments to these assets.
- Please describe to us in more detail how you valued the acquired other intangible assets after correction of the errors, your basis for determining that these assets should be amortized over a [X] year life using the straight-line method, and why you had significant measurement period adjustments to these assets.

¹ ASC 810 indicates that one entity controls another if it holds a "controlling financial interest." In addition, ASC 810 prescribes criteria for determining which entity has obtained control.

The SEC staff frequently asks registrants how they have assigned amounts to assets acquired and liabilities assumed in business combinations. In particular, the staff asks registrants that have recorded a significant amount of goodwill why they have not attributed value to identifiable intangible assets. In addition, the staff may ask detailed questions about (1) how a registrant determined that intangible assets would have finite or indefinite useful lives, (2) the useful lives of identified intangible assets determined to have finite useful lives, and (3) how a registrant determined the fair value of tangible assets acquired.

The staff may also ask detailed questions about material revisions to the initial accounting for a business combination, including what significant assumptions have changed to support a revision to the value of acquired assets. For example, the staff may ask why the allocation of the purchase price in the financial statements changed from that shown in a prior quarter's filing or why the allocation differs from disclosures provided in the entity's Form 8-K, press releases, the business section, and MD&A.

Contingent Consideration

Example of an SEC Comment

With respect to the contingent consideration in the arrangement, please respond to the following:

- Describe to us the arrangement and the basis for determining the amount of the payment.
- Provide us an estimate of the range of outcomes (undiscounted) or, if a range cannot be estimated, tell us the reasons why. If the maximum amount of the payment is unlimited, please explain why.
- Revise future filings to provide all of the disclosures required by ASC 805-30-50-1(c). Refer to Example 5 in ASC 805-10-55-37.

The SEC staff often asks registrants to provide additional disclosures about the nature and terms of a contingent consideration arrangement and the conditions that must be met for the arrangement to become payable. Since ASC 805 requires entities to recognize contingent consideration at fair value as of the acquisition date, the staff may ask registrants to disclose how they determined the fair value of the contingent consideration. In addition, the staff may ask whether the change in the fair value of contingent consideration should be reflected as an adjustment to the amount of goodwill (i.e., if the adjustment is due to new information obtained during the measurement period about facts or circumstances that existed as of the acquisition date) or in current earnings. The staff may also ask for disclosure of the total amount of contingent consideration that could become payable under the terms of the arrangement.

Bargain Purchases

A gain from a bargain purchase occurs when the net fair value of the identifiable assets acquired and the liabilities assumed is greater than the sum of the acquisition-date fair value of (1) the consideration transferred,² (2) the noncontrolling interest in the acquiree, and (3) any equity interests previously held by the acquirer. Before recognizing the gain, a registrant is required to perform a reassessment of the bargain purchase gain by verifying that all assets acquired and liabilities assumed were properly identified. Therefore, when a registrant recognizes a gain related to a bargain purchase, the SEC staff will typically ask the registrant to (1) explain its process, (2) provide the results of the reassessment, and (3) disclose that a reassessment was performed. In addition, the staff has inquired about whether any subsequent impairment analyses for the assets acquired have been performed.

² Certain share-based payment awards are not measured at fair value.

Disclosures

Example of an SEC Comment

We note your pro forma disclosure of income before taxes and fully diluted earnings per share based on those amounts. Please tell us your consideration of disclosing pro forma net income and pro forma net income per share. Additionally, tell us your consideration of disclosing the information in ASC 805-10-50-2h.1. related to your acquisitions. Refer to ASC 805-10-S50-1 and ASC 270-10-S-99-1(b)(4) for guidance.

The SEC staff has commented when a registrant fails to provide pro forma disclosures under ASC 805-10-50 about the effects of an acquisition as of the beginning of a reporting period. ASC 805-10-50-2(h)(3) provides disclosure requirements when comparative financial statements are presented, including “the revenue and earnings of the combined entity as though the business combination(s) that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period (supplemental pro forma information).” Registrants must also disclose the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combinations that are recognized in the reported pro forma information.

If certain criteria are met (e.g., if a significant business combination has occurred or is probable), registrants may also be required to (1) comply with Regulation S-X, Rule 3-05, and (2) provide pro forma financial information that complies with Regulation S-X, Article 11, in a registration statement, proxy statement, or Form 8-K. For additional information, see the [SEC Reporting](#) section.

The SEC staff has also asked registrants:

- Whether an acquisition meets the definition of a business under ASC 805-10-20.
- To indicate which specific elements related to their use of the acquisition method of accounting are not yet complete and why they have not been finalized.
- To identify and disclose the income statement classification of acquisition-related costs they incurred (e.g., due diligence fees, legal fees).
- Whether individually immaterial acquisitions are collectively material, which would require them to disclose certain information.
- Whether a transaction is considered to be an acquisition of an entity under common control.

Other Deloitte Resources

[A Roadmap to Common-Control Transactions](#)

[A Roadmap to Accounting for Asset Acquisitions](#)

[A Roadmap to Pushdown Accounting](#)

[January 13, 2017, Heads Up, “FASB Clarifies the Definition of a Business”](#)

Consolidation

ASC 810 provides guidance on entities that are subject to consolidation under either the voting interest entity model or the variable interest entity (VIE) model. Recent SEC comments on this topic have focused primarily on the VIE model. For example, such comments have addressed:

- The consolidation conclusions reached under the VIE model, including those related to:
 - The determination of whether an entity is a VIE.
 - The determination of whether the reporting entity is the primary beneficiary of a VIE (including reassessment of whether the reporting entity continues to be the primary beneficiary).
- Required disclosures for a registrant's interest in VIEs.

Determining Whether an Entity Is a VIE and Whether the Reporting Entity Is a VIE's Primary Beneficiary

Examples of SEC Comments

- We note from your prior response that you believe you should consolidate [the legal entity] under either the variable interest or voting interest models. Please tell us how you considered ASC 810-10-15-14 in determining whether [the legal entity] has the characteristics of a variable interest entity.
- Please describe to us the changes in the capital structure of [the legal entity] and in its contractual relationships with [you, as the reporting entity,] that resulted in your conclusion that you are no longer its primary beneficiary and that you should deconsolidate [the legal entity] as of January 3, 2016. Explain to us in appropriate detail how these specific changes support your conclusion that you are no longer the primary beneficiary of the variable interest entity. Refer to the guidance provided in ASC 810-10, including ASC 810-10-35-4.
- Please tell us how you concluded you are the primary beneficiary of [the VIEs] considering your disclosure that the power to direct the activities of the VIEs is shared. In addition, tell us why the general partners of the limited partnerships do not have standalone power given that they only need your consent over certain activities. Please refer to FASB ASC 810-10-25-38D.

To determine whether it is required to consolidate another entity, a reporting entity must evaluate whether the other entity is a VIE under ASC 810-10 and, if so, whether the reporting entity is the VIE's primary beneficiary. To be the primary beneficiary of a VIE and, therefore, the party that is required to consolidate it, the reporting entity must have (1) the power to direct the activities of the VIE that most significantly affect the VIE's economic performance and (2) the obligation to absorb losses of, or the right to receive benefits from, the VIE that could potentially be significant to the VIE.³ Given that the SEC staff continues to focus on consolidation conclusions under ASC 810-10, it often asks registrants to (1) explain their involvement with, and the structure of, VIEs; (2) provide detailed support for their conclusions about whether an entity is a VIE (including the consolidation model they ultimately used); (3) discuss the basis for their determination of whether they are the primary beneficiary of a VIE; and (4) discuss any events affecting their previous consolidation conclusion (e.g., events that result in deconsolidation).

³ Registrants should consider whether consolidating a VIE meets the significance thresholds for reporting under Item 2.01 of Form 8-K and Rule 3-05 of Regulation S-X. For additional information about Rule 3-05, see the [SEC Reporting](#) section.

Required Disclosures for VIEs

Example of an SEC Comment

We note you consolidate entities in which you have a variable interest and of which you are the primary beneficiary. Please tell us what consideration you gave to disclosing the information required by ASC 810-10-50-2AA regarding your involvement with variable interest entities, the information required by ASC 810-10-50-3 with respect to variable interest entities you consolidate as the primary beneficiary and the information required by ASC 810-10-50-4 with respect to variable interest entities you do not consolidate because you are not the primary beneficiary.

All reporting entities that have a variable interest in a VIE are subject to the disclosure requirements of ASC 810-10. Reporting entities should consider the overall objectives of ASC 810-10-50-2AA and, depending on the circumstances, may need to supplement their disclosures to meet these objectives. Meeting these disclosure requirements can sometimes be challenging because a reporting entity might not be privy to all the information about a VIE, especially if the reporting entity is not the primary beneficiary of the VIE but has a variable interest in the VIE and is subject to some of the VIE's disclosure requirements.

Other Deloitte Resources

[*A Roadmap to Consolidation — Identifying a Controlling Financial Interest*](#)

Contingencies

The SEC staff continues to closely monitor registrants' contingency disclosures, and it comments when such disclosures do not comply with U.S. GAAP or SEC rules and regulations.

The staff has continued to comment on:

- Lack of specificity regarding the nature of the matter.
- Lack of quantification of amounts accrued, if any, and possible loss or range of loss (or disclosure about why such an estimate cannot be made).
- Lack of disclosure or insufficient detail about what triggered a significant current-period accrual for a contingency when no loss or a significantly lower amount was accrued in prior periods (i.e., the lack of "early warning" disclosures in prior periods).
- Insufficient detail about judgments and assumptions underlying significant accruals.
- Insufficient detail about (and untimely reporting of) new developments related to loss contingencies and the effect of such developments on current and future periods.
- Inconsistency among disclosures in the footnotes, in other sections of the filing (e.g., risk factors and legal proceedings), and outside the filing (e.g., in press releases and earnings calls). In addition, if different registrants are parties to a claim, the SEC staff may also review the counterparty's filings and comment if the information is not consistent.
- Use of unclear language in disclosures (e.g., not using terms that are consistent with accounting literature, such as "probable" or "reasonably possible") and failure to consider the disclosure requirements in ASC 450, SAB Topic 5.Y, and Regulation S-K, Item 103.

- Lack of disclosure of an accounting policy related to accounting for legal costs (when material) and uncertainties in loss contingency recoveries, including (1) whether ranges of reasonably possible losses are disclosed gross or net of anticipated recoveries from third parties, (2) risks regarding the collectibility of anticipated recoveries, and (3) the accounting policy for uncertain recoveries.

Loss Contingencies

Examples of SEC Comments

- With respect to the cyber-security incident and related assessments and litigation, please tell us your consideration of the requirement in ASC 450-20-50-4.b. to disclose an estimate of the possible loss or range of loss or to disclose that such an estimate cannot be made.
- We note that you have evaluated your potential exposure related to [Matter A] and have established a loss contingency of \$[X] to cover your probable and estimable liabilities as of September 30, 2016. If there is at least a reasonable possibility that a loss exists in excess of the amount accrued, please revise to either disclose an estimate (or, if true, state that the estimate is immaterial in lieu of providing quantified amounts) of the additional loss or range of loss or state that such an estimate cannot be made. Please refer to ASC 450-20-50-3 to 4 and include your proposed disclosures in your response.

The SEC staff often asks about estimates of reasonably possible losses or comments when a registrant omits disclosure of a loss or range of losses because its estimates lack “precision and confidence.” If an estimate of the loss or range of losses cannot be made, the staff expects registrants to (1) disclose, in accordance with ASC 450-20-50-4, that such an estimate cannot be made and (2) demonstrate that they at least attempted to estimate the loss or range of losses before concluding that an estimate cannot be made. In such cases, the staff has commented that registrants should disclose the specific factors that limited their ability to reasonably estimate the loss or range of losses and has asked about registrants’ quarterly procedures related to such estimates. The factors disclosed should be specific to the loss contingency in question and could include representations that (1) claims do not specify an amount of damages, (2) there are a large number of plaintiffs, or (3) the case is in its early stages.

Further, if a registrant discusses a potential contingency in its earnings calls, the SEC staff is likely to seek more information about the contingency and to inquire about whether the related disclosures are appropriate. The SEC staff encourages registrants to clearly disclose the “full story” regarding their loss contingencies because recognition of such contingencies requires a high degree of professional judgment. Further, the staff has noted that disclosures related to loss contingencies should be continually evaluated over time as facts and circumstances change.

The SEC staff may also ask about (1) the basis for a registrant’s accrual (e.g., factors supporting an accrual, such as trends in claims received and rejected), (2) the timing of a loss contingency’s recognition, and (3) the disclosure of a loss contingency. In addition, when a material settlement is disclosed during the period, the staff may review prior-period disclosures to determine whether such disclosures were appropriate (i.e., whether the registrant should have provided early-warning disclosures about the possibility of incurring or settling a loss in future periods to help users understand these risks and how they could potentially affect the financial statements) or whether an accrual should have been recognized in a prior period. See the [Management’s Discussion and Analysis](#) section for additional information about early-warning disclosures.

Litigation Contingencies

In addition to complying with ASC 450, public entities must separately meet the requirements of Regulation S-K, Item 103, when disclosing litigation matters because while those requirements are similar to the requirements of ASC 450, they are not identical. Also, to address concerns related to a registrant's contention that providing too much information may be detrimental to efforts to litigate or settle matters, the SEC staff has indicated that registrants do not need to separately disclose each asserted claim; rather, they may aggregate asserted claims in a logical manner as long as the disclosure complies with ASC 450.

Asset Retirement Obligations

Examples of SEC Comments

- Please tell us your consideration of recording asset retirement obligations in connection with the future removal of gasoline tanks from your gasoline stations. Refer to ASC 410.
- We note that you had no additional retirement obligations incurred during the six months ended June 30, 2016. However, we note you continued development activities for your mines and total amount capitalized increased from \$[X] to \$[X] during the period. Please explain why there was no increase in asset retirement obligations.

The SEC may ask about a registrant's legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development, and normal operation of such assets. Accordingly, a registrant should carefully evaluate whether, as a result of assets capitalized as long-lived assets, there are asset retirement obligations under ASC 410-20-15-2.

Debt

Restrictions

Example of an SEC Comment

[Y]ou disclose that you are largely dependent on the receipt of distributions and dividends or other payments from your subsidiaries and joint ventures for cash to fund all your operations and expenses. Please address if there are any restrictions on your ability to declare dividends and discuss the potential impact on your liquidity, financial condition and results of operations, including the disclosures required by Rule 4-08(e) of Regulation S-X. Please also tell us what consideration you gave to the need for parent only financial statements under Rules 5-04 and 12-04 of Regulation S-X.

The SEC staff continues to frequently comment on restrictions that limit a registrant's ability to pay dividends or transfer funds within a consolidated group. When the transfer of assets (cash or other funds) to the parent company/registrator from its subsidiary (or subsidiaries) or equity method investee is materially restricted, limited, or in need of a third party's approval, Regulation S-X, Rules 4-08(e), 5-04, and 12-04, may require:

- Footnote disclosure of the restriction or limitation (Rule 4-08(e)).
- Presentation of condensed parent-company financial data in a financial statement schedule (i.e., Schedule I).
- Both footnote and Schedule I disclosures.

Rule 4-08(e) disclosures are intended to inform investors of restrictions on a registrant's ability to pay dividends or transfer funds within a consolidated group. Such restrictions may result from a contractual agreement (e.g., a debt agreement) or a regulatory body. Without appropriate disclosure of such restrictions, an investor may presume that the registrant (at the parent or subsidiary level) has more discretion to transfer funds or pay cash dividends than is actually the case.

If Rule 4-08(e) applies, registrants must disclose in the notes to the financial statements a description of "the most significant restrictions, other than as reported under [Rule 4-08(d)], on the payment of dividends by the registrant, indicating their sources, their pertinent provisions, and the amount of retained earnings or net income restricted or free of restrictions."

Disclosure is also required under Rule 4-08(e)(3) if the total restricted net assets of subsidiaries, plus the parent's equity in the undistributed earnings of 50 percent or less owned entities, exceed 25 percent of consolidated net assets. SAB Topic 6.K provides further guidance on determining the restricted net assets of subsidiaries. Disclosures required under Rule 4-08(e)(3) include:

- The "nature of any restrictions on the ability of consolidated subsidiaries and unconsolidated subsidiaries to transfer funds to the registrant in the form of cash dividends, loans or advances."
- Separate disclosure of "the amounts of such restricted net assets for unconsolidated subsidiaries and consolidated subsidiaries as of the end of the most recently completed fiscal year."

In addition, to give investors separate information about the parent company, registrants are required under Rule 5-04 to file Schedule I "when the restricted net assets [of the registrant's] consolidated subsidiaries exceed 25 percent of consolidated net assets as of the end of the most recently completed fiscal year."

The calculations under Rule 4-08(e) are different from those under Rule 5-04, which governs Schedule I, so registrants must perform both tests to determine what is required. If Schedule I is required, footnote disclosures under Rule 4-08(e) are also required. However, if Rule 4-08(e) disclosures are required, Schedule I may not be required. In addition, a registrant's filing of Schedule I does not necessarily mean that the registrant has satisfied the disclosure requirements of Rule 4-08(e), which are separate and distinct.

Financial Covenant Disclosures

Example of an SEC Comment

We note that [Company A] was in compliance with the terms of their financial covenants in the Credit Agreement and Purchase Agreement as of December 31, 2015 and June 30, 2016. You disclose that due to the low commodity price environment, it is possible that the total leverage ratio financial covenant may not be met at some point during 2016 without further action. Please revise your disclosure to explain the reasonably likely impact of any breach on your financial condition or operating performance and identify any alternate sources of funding. Refer to Item 303(a)(1) of Regulation S-K and, for further guidance, section IV.C. of SEC Release No. 33-8350.

It is important for a registrant to consider providing disclosures about covenant compliance in MD&A to illustrate its financial condition and liquidity. These disclosures may include a discussion of (1) the terms of the most severe covenants and how the registrant has complied with those covenants, (2) waivers obtained from lenders and the likelihood of failing a covenant or obtaining a waiver in the future, and (3) the impact of noncompliance on the registrant's financial condition and liquidity. In addition, a registrant may present a table that compares its most material actual debt covenant ratios as of the

Debt

latest balance sheet date with the minimum and maximum amounts permitted under debt agreements. Such transparent disclosures will enable investors to better understand the risk of future covenant noncompliance by the registrant.

For additional discussion on liquidity, see the [Management's Discussion and Analysis](#) section.

Classification as Debt or Equity

Examples of SEC Comments

- Please elaborate on why you believe the decision by your Board of Directors to either exchange the common units and Class B shares for Class A shares or to redeem them for cash is within your control. In doing so, tell us how you considered the guidance in paragraph 7 of ASC 480-10-S99-3A.
- We note your response to comment 2 and understand that you believe that ASC 480-10-S99-3A does not apply to the classification and presentation of your contingently redeemable preferred stock. As you have filed financial statements with the Securities and Exchange Commission in preparation for the sale of securities you are subject to the provisions of GAAP that apply to public entities including ASC 480-10-S99-3A. Please revise to present your contingently redeemable preferred stock outside of permanent equity.

Under ASC 480, certain financial instruments that embody an obligation of the issuer should be accounted for as liabilities even if their legal form is that of equity or they involve obligations to repurchase or issue the entity's equity shares. In addition, the guidance in ASC 480-10-S99-3A states that "ASR 268 requires preferred securities that are redeemable for cash or other assets to be classified outside of permanent equity if they are redeemable (1) at a fixed or determinable price on a fixed or determinable date, (2) at the option of the holder, or (3) upon the occurrence of an event that is not solely within the control of the issuer." ASC 480-10-S99-3A also notes the SEC staff's belief that ASR 268 can be applied analogously to other redeemable instruments.

Consequently, the SEC staff frequently asks registrants with redeemable securities — including registrants undergoing IPO transactions — to support the basis for their classification of such securities as debt, temporary (mezzanine) equity, or permanent equity. In addition, the staff often asks registrants about the accounting for conversion features in convertible instruments, including convertible preferred securities.

See the [Noncontrolling Interests](#) section for more information about redeemable NCIs. See the [Financial Instruments](#) section for considerations related to embedded conversion features.

Other Deloitte Resources

[A Roadmap to Distinguishing Liabilities From Equity](#)

Discontinued Operations, Assets Held for Sale, and Restructuring Charges

Discontinued Operations and Assets Held for Sale

Examples of SEC Comments

- You disclose you analyzed the quantitative and qualitative factors relevant to the [X] transaction and concluded that the company met the criteria for classification as discontinued operations in accordance with ASC 205-20. Please tell us the factors you considered to conclude that the transaction represented a strategic shift that has (or will have) a major effect on your operations and financial results. In so doing, quantify the major effect on your operations and financial results that has or will occur.
- Please tell us how you determined it was not necessary to classify the assets and liabilities of [Component A] and [Component B] as held for sale as of December 31, 2016. Further, please tell us how you determined it was not necessary to reclassify the [Component A] and [Component B] results of operations as discontinued operations for the periods presented. Please refer to ASC 205-20-45.

In April 2014, the FASB issued [ASU 2014-08](#), which elevates the threshold for presenting a disposal transaction as a discontinued operation under ASC 205-20. Under that revised guidance, an entity presents a disposal as a discontinued operation if it “represents a strategic shift that has (or will have) a major effect on an entity’s operations and financial results.” ASC 205-20 does not define the terms “strategic shift” or “major.” Therefore, determining whether a disposal qualifies for discontinued-operations reporting requires the entity to assess both qualitative and quantitative factors and will require the use of judgment. Accordingly, the SEC staff has asked registrants whether the operations they have disposed of should be accounted for as discontinued operations.

The staff has also asked registrants to discuss whether assets meet the held-for-sale criteria in ASC 360 and to explain how they considered the related required disclosures. The staff may inquire about items such as:

- The timeline of events leading to an asset sale.
- The factors used to determine whether to present assets held for sale separately on the balance sheet.
- Sales agreements and how they affected the determination of whether particular assets should be classified as held for sale.

The SEC staff may also question the appropriateness and timeliness of a registrant’s impairment tests when assets or components (1) are disposed of, (2) are discontinued, or (3) appear misclassified on the basis of other information in the filing. For example, the staff may ask whether assets that the registrant was expected to sell or dispose of were tested for impairment in prior periods or subject to an impairment charge in the current period. See the [Impairments of Goodwill and Other Long-Lived Assets](#) and [Management’s Discussion and Analysis](#) sections for further discussion of long-lived-asset impairment testing and early-warning disclosures, respectively.

Restructuring Charges

Example of an SEC Comment

Please expand your disclosures to discuss the expected completion date of your [restructuring]. Also, for each major type of cost associated with your restructuring activities, please disclose the total amount expected to be incurred, the amount incurred in the period and the cumulative amount incurred to date as required by ASC 420-10-50-1.a and 1.b. Please also expand your disclosures here or within MD&A to indicate whether the actual results of your [restructuring] were in line with management's expectations when the [restructuring] activities were initiated. If the anticipated savings were not achieved as expected or are achieved in periods other than as expected, please disclose as such, the reasons for the differences and the likely effects on future operating results and liquidity. Please refer to SAB Topic 5: P.4 for guidance.

The SEC staff has inquired about corporate reorganizations and restructurings, workforce reductions, facility closures, and registrants' disclosures about such activities. In accordance with ASC 420-10-50-1, registrants should disclose specific information in "notes to financial statements that include the period in which an exit or disposal activity is initiated and any subsequent period until the activity is completed." Such information would include a description of the exit or disposal activity, its expected completion date, where in the income statement the amounts are presented, and quantitative information about each major type of cost associated with the activity and about each reportable segment. Further, in accordance with ASC 420-10-50-1(e), when "a liability for a cost associated with the activity is not recognized because fair value cannot be reasonably estimated," registrants should disclose "that fact and the reasons why."

The SEC staff has also challenged the consistency of registrants' disclosures within MD&A and other filings, and it has directed registrants to comply with the guidance in SAB Topic 5. P.4 on disclosures related to material restructuring activities.

Other Deloitte Resources

[A Roadmap to Reporting Discontinued Operations](#)

Earnings per Share

While SEC comments on EPS have focused on the calculation of EPS and related disclosures, more recent comments have also concentrated on the use of non-GAAP EPS measures. For additional considerations related to non-GAAP measures, see the [Non-GAAP Financial Measures and Key Metrics](#) section.

Two-Class Method

Example of an SEC Comment

You disclose . . . that the holders of your preferred stock are entitled to receive non-cumulative dividends in an amount equal to or greater than those declared to holders of common stock out of funds legally available if and only when declared by the Board of Directors. Disclose how you considered the two-class method under ASC 260-10 for your loss per share calculation purpose. Further tell us how you considered including the preferred stock in the table of potentially dilutive securities that were not included in the calculation of diluted net loss per share.

Under ASC 260-10-45-59A, the two-class method applies to the following securities:

- a. Securities that may participate in dividends with common stocks according to a predetermined formula (for example, two for one) with, at times, an upper limit on the extent of participation (for example, up to, but not beyond, a specified amount per share)
- b. A class of common stock with different dividend rates from those of another class of common stock but without prior or senior rights.

When a filing indicates that the registrant has two classes of common stock (or one class of common stock and participating securities) that have been treated as a single class in the calculation of EPS, the SEC staff often asks whether application of the two-class method in the computation of EPS under ASC 260-10-45-59A through 45-70 is required.

The SEC staff may ask a registrant to substantiate the method used to calculate EPS (e.g., the two-class method or the if-converted method), and it may request additional information or disclosures about each of the registrant's classes of common stock, preferred stock, and common-stock equivalents (such as convertible securities, warrants, or options).

Further, the SEC staff expects that a registrant with two classes of common stock will present both basic and diluted EPS for each class regardless of whether either class has conversion rights. See the [Financial Instruments](#) section for more information about conversion features.

In assessing registrants' conclusions related to the two-class method, the SEC staff has focused on understanding the terms of arrangements, including (1) classes and types of common (or preferred) stock, (2) such stock's dividend rates, and (3) the rights and privileges associated with each class (or type) of stock. When a registrant has preferred shares, the SEC staff may seek to determine whether the preferred stockholders have contractual rights to share in profits and losses of the registrant beyond the stated dividend rate. Similarly, the SEC staff may ask registrants about the dividend rights of restricted stock unit awards or other share-based payment awards and how those rights are considered in the calculation of EPS.

Fair Value

Valuation Techniques and Inputs

Examples of SEC Comments

- It appears that you determined the fair value of your impaired real estate and intangible assets using various methods, some of which are internal valuation methods. For the internal valuation methods, please tell us how you have complied with ASC 820-10-50-2(bbb), or tell us how you determined it was not necessary to provide quantitative information about the significant unobservable inputs.
- In future filings please disclose the specific valuation techniques and inputs used in measuring the fair values of the investment securities classified as Level 2 in your disclosure. Refer to ASC 820-10-50-2bbb.

The SEC staff has requested more specific information from registrants related to valuation techniques and inputs used in fair value measurements. Registrants should consider how the fair value disclosure requirements in ASC 820-10-50 apply to their recurring and nonrecurring fair value measurements. More specifically, registrants should provide information about (1) the methods and techniques used to determine fair value and (2) the inputs to those models.

Under ASC 820-10-50-2(bbb), entities are required to disclose quantitative information about the significant unobservable inputs used in Level 3 fair value measurements. Although this provision contains no explicit guidance on the types of quantitative information an entity should disclose, the example in ASC 820-10-55-103 illustrates quantitative information an entity “might disclose” to meet the requirement in ASC 820-10-50-2(bbb). According to the example, such information includes the entity’s valuation technique, its significant unobservable inputs, and the range and weighted average of those inputs.

Some may have interpreted from the example in ASC 820-10-55-103 that an entity is not required to disclose the weighted average of significant unobservable inputs used in a Level 3 fair value measurement. However, the SEC staff may inquire about weighted averages when registrants do not disclose them.⁴

The staff has suggested that if a weighted average would not be meaningful, a registrant could instead present qualitative information about the distribution of the range of values. Ideally, such qualitative disclosures would address each significant input and describe the reason for the wide range, the drivers of dispersion (e.g., a particular position or instrument type), and data point concentrations within the range.

Use of Third-Party Pricing Services

Example of an SEC Comment

We note your disclosure indicates that the fair value of your agency [mortgage-backed securities (MBS)], nonagency MBS and derivative instruments are based upon pricing service quotations or broker quotations. In future filings, please revise your disclosure to describe the valuation techniques used to determine the fair value of each of these instruments categorized within Level 2. Refer to ASC 820-10-50-2(bbb).

The SEC staff continues to ask registrants to describe the procedures they perform to validate fair value measurements obtained from third-party pricing services. The staff has also asked registrants to clarify when and how often they use adjusted rather than unadjusted quoted market prices and to disclose why prices obtained from pricing services and securities dealers were adjusted. If multiple quotes were obtained, the SEC staff may request information about how the registrant determined the ultimate value used in the financial statements.

Financial Instruments

Because of the complexity associated with determining whether certain financial instruments should be accounted for as derivatives, debt instruments, or equity, SEC staff comments related to financial instruments have focused on (1) accounting for embedded derivatives in hybrid instruments⁵ and (2) classification of financial instruments.

⁴ Such inquiries are consistent with SEC staff remarks at the 2012 AICPA Conference. For more information about the conference, see Deloitte’s December 11, 2012, *Heads Up*.

⁵ The ASC master glossary defines a hybrid instrument as a “contract that embodies both an embedded derivative and a host contract.”

Embedded Derivatives in Hybrid Instruments

Examples of SEC Comments

- Please tell us in sufficient detail how you account for the €[X] million Dublin Convertible Preferred shareholder loans. In doing so, tell us how you analyzed the embedded conversion option and Stakeholder Warrants for derivatives and/or beneficial conversion features, how you account for the conversion option associated with dividends paid-in-kind, and where you classify the warrants on your balance sheet. Tell us the specific provisions of the conversion option and warrants, including the conversion price(s) of the loan principal, whether the warrants are legally detachable and separately exercisable, and how the “specified conversion price” of the warrants is determined.
- We note that the conversion price of most of the convertible debentures is denominated in Canadian dollars while the conversion price of the convertible debentures issued on July 5, 2012 is denominated in US dollars. As such, it appears the conversion feature embedded in the debentures issued in July 2012 is not indexed to your own stock and should be separated from the host contract and accounted for as a derivative pursuant to ASC 815. Please tell us how you accounted for the embedded conversion features and the basis in GAAP for your accounting.

The SEC staff continues to focus on whether registrants have reached appropriate accounting conclusions regarding whether embedded features in hybrid instruments should be bifurcated from the host contract. ASC 815-15-25 provides guidance on whether an embedded feature should be separated from the host contract and accounted for as a stand-alone derivative instrument in accordance with ASC 815-10. If it is determined that an embedded feature is not clearly and closely related to the host contract, the embedded feature may need to be bifurcated from the host contract depending on whether certain other criteria are met and whether the embedded feature qualifies for any scope exceptions. For example, if the features in a hybrid instrument are predominantly debt-like, the entity would conclude that the host contract is more akin to debt; in such a case, an equity-like feature (e.g., a conversion option) would not be considered clearly and closely related to a debt host. Given the complexity involved in determining whether a host contract is debt-like or equity-like, registrants can expect the SEC staff to continue asking about the terms and features of convertible instruments to determine whether the registrant has (1) properly determined the nature of the host contract and (2) accounted for embedded features as stand-alone financial instruments when necessary. As a result of adopting the guidance in [ASU 2014-16](#), registrants should consider the ASU’s disclosure requirements when making disclosures about the nature of the host contract.

Classification of Financial Instruments

Example of an SEC Comment

You disclose that on April 20, 2017, you will be required to repurchase each share of Series B Convertible Preferred Stock that have not been converted into shares of common stock or automatically redeemed. Please tell us how you determined that your Series B Convertible Preferred Stock should be classified as mezzanine equity on your balance sheet and your consideration of the guidance in ASC 480-10-25-4.

Entities should evaluate financial instruments that have both debt- and equity-like characteristics to determine whether the instruments should be classified as liabilities or equities in the financial statements. An entity should first determine whether a financial instrument should be classified as a liability in accordance with ASC 480. If the financial instrument is not classified as a liability under ASC 480, the entity should analyze the financial instrument under other accounting guidance, such as ASC 815. The SEC staff has asked registrants to explain the basis for their determination of how financial instruments should be classified, including the application of relevant accounting literature.

Other Deloitte Resources

[A Roadmap to Distinguishing Liabilities From Equity](#)

[A Roadmap to Accounting for Contracts on an Entity's Own Equity](#)

Financial Statement Classification, Including Other Comprehensive Income

The SEC staff frequently comments on registrants' classification of items in the financial statements; namely, on whether their balance sheets, income statements, statements of cash flows, and statements of comprehensive income comply with the requirements of Regulation S-X and U.S. GAAP.

Balance Sheet Classification

Separate Presentation

Examples of SEC Comments

- Please tell us whether there are any items included in other current assets that exceed five percent of total current assets. If so, please state separately, in the balance sheets or in the notes thereto, any item in excess of five percent of total current assets. Refer to Rule 5-02.8 of Regulation S-X.
- Please revise or confirm the accrued liabilities and other line item does not require disaggregation pursuant to Rule 5-02.20 of Regulation S-X.

In accordance with Regulation S-X, Rule 5-02, commercial and industrial registrants should state separately on the face of the balance sheet or in a note to the financial statements (1) other current assets and other current liabilities in excess of 5 percent of total current assets and total current liabilities, respectively, and (2) other noncurrent assets and other noncurrent liabilities in excess of 5 percent of total assets and total liabilities, respectively. Consequently, the SEC staff may ask a registrant to confirm whether the reported balances of other current assets and other current liabilities (or other noncurrent assets and other noncurrent liabilities) include any items in excess of 5 percent of total current assets and total current liabilities (or total assets and total liabilities). If the registrant confirms that any such items are included, the SEC staff will ask the registrant to state those items individually on the face of the balance sheet or in the notes.

Restricted Cash

Example of an SEC Comment

You do not have full access to a portion of your cash and cash equivalents of \$[X] at June 30, 2016, which is reported as unrestricted cash and cash equivalents. Please disclose the amount that is included in unrestricted cash and cash equivalents that you do not have access to and help us understand why it would not be reflected in restricted cash pursuant to Rule 5.02.1 of Regulation S-X.

Rule 5-02 includes a provision requiring commercial and industrial registrants to (1) separately disclose cash and cash items that are subject to restrictions on withdrawal or usage and (2) describe the provisions of those restrictions in a note to the financial statements. Consequently, the SEC staff has issued comments asking registrants to explain how they considered presenting or disclosing restricted cash in accordance with Rule 5-02.

Income Statement Classification

The SEC staff has frequently commented on registrants' compliance with the technical requirements of Regulation S-X, Rule 5-03, which lists the captions and details that commercial and industrial registrants must present in their income statements.

Separate Presentation of Revenues From Products and Services

Examples of SEC Comments

- We note from your disclosures . . . that following the acquisition of [Business X] you generate revenues from the production and sale of electricity and from providing natural gas gathering and transportation services. Thus it appears that following the acquisition of [Business X] a significant portion of your revenue is derived from the provision of services as opposed to the sale of products. Please tell us how you have complied with Rule 5-03(b)(1) and (b)(2) of Regulation S-X.
- Please tell us what consideration you gave to separately presenting revenue from the sale of products and systems and revenue derived from providing services on the face of your statements of operations. Refer to Rule 5-03(b) of Regulation S-X.

The SEC staff frequently comments when registrants omit certain captions required by Rule 5-03 from the face of their income statements. It has asked registrants to explain their consideration of Rule 5-03 and to revise their income statement presentation accordingly. For example, the SEC staff has commented on the distinction between product and service revenue. If product or service revenue is greater than 10 percent of total revenue, the registrant must disclose such component as a separate line item on the face of the income statement. Costs and expenses related to these revenues should be presented in the same manner.

Cost of Sales

Examples of SEC Comments

- Please describe for us any common characteristics of the costs that you report as cost of product sold as opposed to direct operating expense, and explain your rationale in making a distinction between these two categories of cost. Tell us the extent to which the costs that you report as direct operating expense are inventoriable based on the guidance in FASB ASC 330-10-30-1 through 8, and indicate why you believe these costs are not required to be included in the cost of product sold measure that you separately report pursuant to Rule 5-03.2(a) of Regulation S-X.
- Please tell us your basis for presenting gross margin on the face of the statement of operations. In this regard, we note you exclude depreciation and amortization from gross margin. To avoid placing undue emphasis on cash flow, depreciation and amortization should not be positioned in the income statement in a manner which results in reporting a figure for income before depreciation. Refer to ASC 225-10-S99-8. See also Item 302(a) of Regulation S-K.
- If your computation of gross margin excludes DD&A or other costs that are attributable to costs of revenue, you should identify these figures as non-GAAP measures. Please revise as necessary to follow the guidance in Item 10(e) of Regulation S-K for each distinct non-GAAP measure that you present.

The SEC staff often asks registrants to disclose the types of expenses that are included in or excluded from the cost-of-sales line item and to support their determination of the types of costs included in costs of goods sold in accordance with Regulation S-X, Rule 5-03.2.

As a related matter, the SEC staff has also asked registrants to support their consideration of SAB Topic 11.B when they elect not to allocate depreciation and amortization to cost of sales. SAB Topic 11.B states, in part:

If cost of sales or operating expenses exclude charges for depreciation, depletion and amortization of property, plant and equipment, the description of the line item should read somewhat as follows: "Cost of goods sold (exclusive of items shown separately below)" or "Cost of goods sold (exclusive of depreciation shown separately below)." [D]epreciation, depletion and amortization should not be positioned in the income statement in a manner which results in reporting a figure for income before depreciation.

Under Rule 5-03, a subtotal line item for gross margin (or a similar measure, such as gross profit) is not required on the face of the income statement. However, if a registrant presents a subtotal for the measure, it should not exclude depreciation and amortization since such exclusion would result in the presentation of a "figure for income before depreciation." Often, a registrant will not present a gross margin subtotal on the face of the income statement but will discuss such a measure in MD&A. In those circumstances, the SEC staff will ask registrants to disclose that the measures are non-GAAP financial measures and to consider the disclosure requirements in Regulation S-K, Item 10(e). See the [Non-GAAP Financial Measures and Key Metrics](#) section for more information.

Presentation of Operating Expenses

Examples of SEC Comments

- Please explain how your presentation of operating expenses complies with Rule 5-03 of Regulation S-X. In this regard, tell us what consideration was given to separately presenting costs and expenses applicable to revenues and explain why expenses related to employee compensation and benefits, or portions thereof, are not included within selling, general administrative expenses.
- Please tell us what consideration you gave to disclosing the type of costs and expenses classified as cost of sales and selling, general and administrative expenses.

Among the requirements of Rule 5-03 is separate presentation of certain material (1) other operating costs and expenses; (2) selling, general, and administrative expense; and (3) other general expenses. In comments to registrants, the SEC staff frequently challenges registrants' disclosure of the classification of costs in the income statement. In certain instances, the SEC staff has asked registrants to consider disaggregating the components of such line items on the face of the income statement or in the notes to the financial statements as well as disclosing the type of costs and expenses classified in either cost of sales or selling, general, and administrative expense.

Operating Versus Nonoperating Income

Example of an SEC Comment

Please tell us how your income statement presentation complies with the requirements of Rule 5-03 of Regulation S-X and ASC 360-10-45-5. Specifically, it is unclear why your presentation of "Gain on sale of [X] properties" is classified after income from continuing operations for the periods presented.

The SEC staff has commented about items that registrants have included in, or excluded from, operating income. Under Rule 5-03, a subtotal line item for operating income is not required on the face of the income statement. However, if a registrant presents a subtotal for operating income, it should generally present the following items (which are sometimes incorrectly excluded) in operating income:

- Gains or losses on asset sales.
- Litigation settlements.

- Insurance proceeds.
- Restructuring charges.

The following items should generally be excluded from operating income (but are sometimes incorrectly included):

- Dividends.
- Interest on securities.
- Profits on securities (net of losses).
- Interest and amortization of debt discount and expense.
- Earnings from equity method investments (or unconsolidated affiliates).⁶
- Noncontrolling interest in income of consolidated subsidiaries.

Cash Flow Statement Classification

Examples of SEC Comments

- You present a single line item for the changes in your long-term debt. In future filings, please present the changes in your long-term debt on a gross basis consistent with ASC 230-10-45-7.
- We note that you present the caption Investments in property and equipment, net. Please revise future filings to separately present the cash inflows and cash outflows for property and equipment on a gross basis as discussed in ASC 230-10-45-26.
- We note your presentation of purchase of marketable securities and proceeds from sale of marketable securities in Net cash provided by operating activities of continuing operations section. In that regard, please explain to us why such presentation is appropriate under GAAP in your situation. Refer to ASC 230-10-45-11 and ASC 320-10-45-11.

The SEC staff may challenge whether it is appropriate to report the net amount of certain cash receipts and cash payments on the face of the statement of cash flows. ASC 230-10-45-7 through 45-9 state that although reporting gross cash receipts and cash payments provides more relevant information, financial statement users sometimes may not need gross reporting to understand certain activities. The SEC staff may ask a registrant to revise the presentation or to explain (in accordance with ASC 230) why it is appropriate to report certain cash flows on a net basis rather than on a gross basis.

Comprehensive Income — Disclosure

Example of an SEC Comment

Please tell us what consideration you gave to disclosing the amount of income tax expense or benefit allocated to each component of other comprehensive income, including reclassification adjustments, in accordance with ASC 220-10-45-12.

The SEC staff has commented when registrants have not provided information required by ASC 220 about the amounts reclassified out of accumulated OCI. For example, the staff frequently reminds registrants to “present the amount of income tax expense or benefit allocated to each component of other comprehensive income, including reclassification adjustments,” for each reporting period either on the face of the statement where those items are presented or in the footnotes.

⁶ While it is rare for an entity to classify equity in earnings of an equity method investee as a component of operating income, the SEC staff may not object to such classification if the equity method investee’s operations are “integral” to the investor’s business. In this context, the staff’s definition of “integral” indicates more than that the investor and investee operate in the same line of business (see the [highlights](#) of the March 11, 2003, AICPA SEC Regulations Committee joint meeting with the SEC staff).

Other Deloitte Resources

[A Roadmap to the Preparation of the Statement of Cash Flows](#)

Foreign Currency

Quantification of Foreign Currency Adjustments

Example of an SEC Comment

We note your disclosure throughout the document referencing foreign subsidiaries and foreign operations. Your accounting policies do not appear to address your accounting for foreign currency matters. In future filings, please provide the disclosures required by FASB ASC 830. In your response, please provide us with draft disclosure to be included in future filings.

The SEC staff's comments on quantitative disclosures related to foreign currency adjustments reflect published [staff views](#)⁷ on the topic, under which registrants should:

- “[R]eview management’s discussion and analysis and the notes to financial statements to ensure that disclosures are sufficient to inform investors of the nature and extent of the currency risks to which the registrant is exposed and to explain the effects of changes in exchange rates on its financial statements.”
- Describe in their MD&A “any material effects of changes in currency exchange rates on reported revenues, costs, and business practices and plans.”
- Identify “the currencies of the environments in which material business operations are conducted [when] exposures are material.”
- “[Q]uantify the extent to which material trends in amounts are attributable to changes in the value of the reporting currency relative to the functional currency of the underlying operations [and analyze] any materially different trends in operations or liquidity that would be apparent if reported in the functional currency.”

The foreign operations of many registrants may be subject to material risks and uncertainties that should be disclosed, including those related to the foreign jurisdiction’s political environment, its business climate, currency, and taxation. The effects on a registrant’s consolidated operations of an adverse event related to these risks may be disproportionate relative to the size of the registrant’s foreign operations. Therefore, the registrant’s segment information or MD&A may need to describe the trends, risks, and uncertainties related to its operations in individual countries or geographic areas and possibly supplement such disclosures with disaggregated financial information about those operations.

A registrant’s assessment of whether it needs to provide disaggregated financial information about its foreign operations in its MD&A would need to take into account more than just the percentage of consolidated revenues, net income, or assets contributed by foreign operations. The registrant also should consider how the foreign operations might affect the consolidated entity’s liquidity. For example, a foreign operation that holds significant liquid assets may have an exposure to exchange-rate fluctuations or restrictions that could affect the registrant’s overall liquidity.

⁷ Division of Corporation Finance: Frequently Requested Accounting and Financial Reporting Interpretations and Guidance, Section II.J.

Other Deloitte Resources[A Roadmap to Foreign Currency Transactions and Translations](#)

Impairments of Goodwill and Other Long-Lived Assets

Goodwill

MD&A Disclosures

Examples of SEC Comments

- Please disclose the percentage by which the fair value of your reporting units exceeded their carrying values as of the date of the most recent test or state that fair value substantially exceeds carrying value. To the extent that any of your reporting units have estimated fair values that were not substantially in excess of its carrying values, and to the extent that goodwill for these reporting units, individually or in the aggregate, if impaired, could materially impact your operating results, please provide the following disclosures for each of these reporting units:
 - The percentage by which fair value exceeds the carrying value as of the most-recent step-one test;
 - The amount of goodwill allocated to the reporting unit;
 - A description of the methods and key assumptions used and how the key assumptions were determined;
 - A discussion of the degree of uncertainty associated with the key assumptions. The discussion regarding uncertainty should provide specifics to the extent possible; and
 - A description of potential events and/or changes in circumstances that could reasonably be expected to negatively affect the key assumptions.
- We note that your goodwill balance of \$[X] million relates solely to [Segment A]. We further note . . . that both the revenues and earnings from [Segment A have] declined in each of the last two fiscal years. Additionally, in your 4th Quarter 2016 earnings call you indicated that you continue to see headwinds in this business segment due to ongoing decreases in railcar traffic. In this regard, please tell us whether you were at risk of failing step one of the impairment test at [year-end]. If so, please consider disclosing the percentage by which fair value exceeded its carrying value as of the most recent test within MD&A.

[Section 9510](#) of the SEC Division of Corporation Finance Financial Reporting Manual discusses the SEC staff's views on when goodwill impairment disclosures in the critical accounting estimates section of MD&A are appropriate and the extent of such disclosures. The staff has commented on a registrant's compliance with the disclosure requirements in Regulation S-K, Item 303(a)(3)(ii), to discuss a known uncertainty — specifically, to disclose the potential for a material impairment charge — in light of potential impairment triggers (i.e., whether the registrant should have provided early-warning disclosures about the possibility of an impairment charge in future periods to help users understand these risks and how they could potentially affect the financial statements). The staff has noted that it may use these disclosures to assess whether a registrant's goodwill impairment analysis is reasonable or whether the registrant should have performed an interim goodwill impairment analysis. See the [Management's Discussion and Analysis](#) section for additional information about early-warning disclosures.

While registrants often provide the appropriate disclosures before incurring an impairment charge, the SEC staff has noted instances in which registrants did not disclose the specific events and circumstances that led to the charge in the period of impairment. After performing an interim impairment test, a registrant should consider disclosing (1) that it performed the test, (2) the event that triggered the test, and (3) the test result regardless of whether goodwill was determined to be impaired. Further, registrants should avoid attributing an impairment charge to general factors such as “soft market conditions” or expected reductions in sales price or sales volume. Instead, the disclosures should discuss (1) why the changes occurred, (2) why the change in forecasts or results occurred in the particular period of the impairment charge, and (3) what known developments or other doubts could affect the reporting unit’s fair value estimate.

Reporting Units

Example of an SEC Comment

Your disclosures . . . indicate that you determined you had two operating segments and correspondingly two reporting units at April 30, 2016. Your Form 8-K filed December 1, 2016 indicates that as of January 1, 2017 you now have four operating divisions . . . Please disclose the impact of these recent organizational changes on your determination of operating segments and reportable segments pursuant to ASC 280 as well as the impact on your determination of reporting units for purposes of goodwill impairment testing pursuant to ASC 350-20.

The SEC staff continues to comment on asset grouping for goodwill impairment testing (e.g., the identification and composition of reporting units), especially when a registrant does not clearly state that it tests goodwill at the reporting-unit level or when changes appear to have been made to a registrant’s reportable segments (e.g., as the result of a reorganization or acquisition). Given the interaction between the guidance on reporting units in ASC 350-20 and the guidance on operating segments in ASC 280, the staff may also ask questions to better understand (1) how the reporting units were identified; (2) how many reporting units were identified; (3) how the reporting units align with the registrant’s segment reporting; and (4) whether and, if so, how the registrant aggregated reporting units to perform goodwill impairment testing. For additional information about the identification and aggregation of operating segments, see the [Segment Reporting](#) section.

Interim Impairment Tests

Example of an SEC Comment

Tell us if you performed an interim goodwill impairment test of your goodwill reporting unit in the third quarter as a result of the clinical trial results . . . and the significant decline in your market capitalization. Refer to ASC 350-20-35-30 and 350-20-35-3C. For any interim impairment test performed, tell us the results of the test and the percentage by which fair value exceeded the carrying value. If no interim impairment test was performed, please tell us how you concluded that there were no triggering events necessitating an impairment test.

ASC 350-20 requires entities to test goodwill for impairment annually and also between annual tests if facts and circumstances indicate that goodwill may be impaired. The SEC staff has asked registrants about negative trends that could trigger the requirement to test for impairment between annual tests and often asks them to describe the events leading up to the recording of an impairment charge, including how circumstances changed from prior quarters and from when the registrant had performed its previous annual goodwill impairment test. The staff may also request an explanation of how the impairment had not been reasonably foreseen during management’s prior-period assessments. Specifically, the staff may question why management did not identify an impairment during a previous quarter.

Other Long-Lived Assets

Example of an SEC Comment

We note that [Component A] continues to be your single largest operating challenge based on your [latest] earnings call. . . . We also note that you performed an impairment test due to recent results and the operational challenges related to this facility and concluded that your undiscounted cash flows were sufficient to recover your long-lived assets. To the extent that the assets or asset group associated with this facility had expected undiscounted future cash flows that were not substantially in excess of the carrying values and to the extent that an impairment of these asset amounts, in the aggregate or individually, could materially impact your operating results or total equity, please provide the following disclosures related to those assets or asset groups:

- The percentage by which the undiscounted cash flows exceed the carrying value;
- The carrying value of these assets;
- A description of the methods and key assumptions used and how the key assumptions were determined;
- A discussion of the degree of uncertainty associated with the key assumptions. The discussion regarding uncertainty should provide specifics to the extent possible; and
- A description of potential events and/or changes in circumstances that could reasonably be expected to negatively affect the key assumptions.

In its comments on impairments of long-lived assets, the SEC staff may ask a registrant that is recording, or is at risk of recording, impairment charges to either disclose or inform the staff about the following:

- The adequacy and frequency of the registrant's asset impairment tests, including the date of its most recent test.
- The factors or indicators (or both) used by management to evaluate whether the carrying value of other long-lived assets may not be recoverable.
- The methods and assumptions used in impairment tests, including how assumptions compare to recent operating performance, the amount of uncertainty associated with the assumptions, and the sensitivity of the estimate of fair value of the assets to changes in the assumptions.
- The timing of the impairment, especially if events that could result in an impairment had occurred in periods before the registrant recorded the impairment. In these circumstances, the SEC staff may ask registrants to justify why the impairment was not recorded in the previous period.
- The types of events that could result in impairments.
- In the critical accounting policies section of MD&A, the registrant's process for assessing impairments.
- The facts and circumstances that led to the impairments, along with a reminder that a registrant may be required to disclose in MD&A risks and uncertainties associated with the recoverability of assets in the periods before an impairment charge is recorded. For example, even if an impairment charge is not required, a reassessment of the useful life over which depreciation or amortization is being recognized may be appropriate.

In addition, the SEC staff may ask about the nature of any unusual or infrequent items, such as a sale of assets that resulted in a gain or loss, along with the proper classification of those items (e.g., whether a gain or a loss should be included in the income from operations).

Other Deloitte Resources

February 1, 2017, *Heads Up*, “FASB Eliminates Step 2 From the Goodwill Impairment Test”

Income Taxes

The SEC staff's comments about income taxes continue to focus on (1) the potential tax and liquidity ramifications related to the repatriation of foreign earnings, (2) valuation allowances, (3) disclosures related to the income tax rate, (4) tax effects of significant or unusual transactions that occurred during the period, and (5) noncompliance with disclosure requirements (e.g., omission of required disclosures).

Further, the SEC staff continues to ask registrants to provide early-warning disclosures to help financial statement users understand these items and how they potentially affect the financial statements. The SEC staff also continues to issue comments on non-GAAP measures with a particular focus on the income tax impact of the adjustments made to the GAAP measures. For additional information about early-warning disclosures and non-GAAP measures, see the [Management's Discussion and Analysis](#) and [Non-GAAP Financial Measures and Key Metrics](#) sections, respectively.

At the last three AICPA Conferences, the staff stated that boilerplate language should be avoided with respect to income tax disclosures within MD&A and that approaches more conducive to effective disclosure would include:

- Using the income tax rate reconciliation as a starting point and describing the details of the material items.
- Discussing significant foreign jurisdictions, including statutory rates, effective rates, and the current and future impact of reconciling items.
- Providing meaningful disclosures about known trends and uncertainties, including expectations regarding the countries where registrants operate.

Repatriation of Foreign Earnings and Liquidity Ramifications

Examples of SEC Comments

- During the quarter ended October 2, 2016, you determined that a portion of your foreign earnings were not [indefinitely] reinvested within the meaning of ASC 740-30-25-17. You estimated that approximately \$[X] million would be repatriated to the U.S. in the fourth quarter of 2016. Please help us better understand the facts and circumstances which led to your determination that these funds should be repatriated and correspondingly the amount to repatriate. As of December 31, 2015, undistributed earnings of foreign subsidiaries amounted to \$[X] million and were considered to be indefinitely reinvested and accordingly no provision for U.S. federal and state income taxes was recorded. Upon your planned repatriation of the approximately \$[X] million, please tell us how you were able to conclude that the remainder of your undistributed earnings of foreign subsidiaries should continue to be considered to be indefinitely reinvested pursuant to ASC 740-30-25-17. Please address your specific plans for reinvestment for these undistributed earnings that demonstrate remittance of the earnings would be postponed indefinitely.
- Please revise to disclose the amount of undistributed foreign earnings, if any, for which you have not provided any U.S. income tax. In addition, please revise to disclose the amount of the unrecognized deferred tax liability related to undistributed earnings or include a statement that such determination is not practicable. We refer you to ASC 740-30-50-2b and 50-2c.

In accordance with ASC 740, when the earnings of a foreign subsidiary are indefinitely reinvested, registrants should disclose the nature and amount of the temporary difference for which no DTL has been recognized as well as the changes in circumstances that could render the temporary difference taxable. In addition, registrants should disclose either (1) the amount of the unrecorded DTL related to that temporary difference or (2) a statement that determining that liability is not practicable.

Registrants may need to repatriate cash from foreign subsidiaries. ASC 740-30-25-19 states that “[i]f circumstances change and it becomes apparent that some or all of the undistributed earnings of a subsidiary will be remitted in the foreseeable future but income taxes have not been recognized by the parent entity, [the parent entity] shall accrue as an expense of the current period income taxes attributable to that remittance.”

The SEC staff continues to (1) ask for additional information when registrants claim that it is not practicable to determine the amount of unrecognized DTL and (2) request that registrants expand disclosures in MD&A about their indefinitely reinvested foreign earnings. In addition, the staff has indicated that it evaluates such an assertion by taking into account registrants’ potential liquidity needs and the availability of funds in U.S. and foreign jurisdictions. Recently, the staff has focused on situations in which registrants have repatriated a portion of their foreign earnings but continue to assert that the remaining earnings are considered to be permanently invested.

Disclosures in an MD&A liquidity analysis should include:

- The amount of cash and short-term investments held by foreign subsidiaries that would not be available to fund domestic operations unless the funds were repatriated.
- A statement that the company would need to accrue and pay taxes if the funds are repatriated.
- If true, a statement that the company does not intend to repatriate those funds.

Valuation Allowances

Examples of SEC Comments

- [We] note that cumulative losses are one of the most objectively verifiable forms of negative evidence that may make it difficult to support an assertion that realization of deferred tax assets is more likely than not. Please provide us a more comprehensive analysis that supports your conclusion that realization of your deferred tax assets at December 31, 2015 is more likely than not. Please ensure your analysis specifically addresses the following:
 - Tell us the amount of the taxable loss in your 2015 tax return and explain any material differences between that amount and the estimated loss included in your response;
 - Provide us an evaluation of your reliance on each of the four sources of taxable income identified in your response;
 - More fully explain to us the specific nature of each “extraordinary item” included in your response and how you determined they are not likely to occur in future periods; and
 - Provide us an objectively verifiable estimate of the future income required to fully realize your deferred tax assets.
- We note from your disclosure that cumulative profitable quarters and projected future pretax income are sources of positive evidence that led you to conclude that it is more likely than not you will realize your deferred tax asset. However, we note you recorded pre-tax operating losses in fiscal 2015, 2013 and during the nine months ended September 30, 2016. As it appears that pre-tax cumulative operating losses in recent years exist, please explain to us why you believe it was appropriate to reverse your entire deferred tax asset in fiscal 2015. As part of your response, please provide us with your analysis of the positive and negative evidence considered in determining the likelihood that your deferred tax assets will be realized, including the weight given to each positive and/or negative factor and the extent each factor is objectively verifiable. Additionally, please include the significant assumptions used in your future pretax income projections and why you believe they are reasonable and appropriate.
- With respect to the \$[X] million release of the valuation allowance previously held against a deferred tax asset related to tax losses carried forward in [Country X], please provide us with your analysis of all available evidence considered, both positive and negative, and how this evidence was weighted in determining that a partial release of this valuation allowance was warranted during the fourth quarter of 2016.

ASC 740-10-30-5(e) requires entities to reduce DTAs by “a valuation allowance if, based on the weight of available evidence, it is more likely than not (a likelihood of more than 50 percent) that some portion or all of the [DTAs] will not be realized. The valuation allowance shall be sufficient to reduce the [DTA] to the amount that is more likely than not to be realized.” ASC 740-10-30-16 through 30-23 provide additional guidance. In light of this guidance, the SEC staff has commented when registrants’ filings indicate that no valuation allowance has been recorded, or when it seems that the valuation allowance recorded is insufficient. More recently, the staff has asked registrants about reversals of, or other changes in, their valuation allowances, particularly when registrants reverse only a portion of their valuation allowances.

The staff has reminded registrants that in assessing the realizability of DTAs, they should consider cumulative losses in recent years to be significant negative evidence and that to avoid recognizing a valuation allowance, they would need to overcome such evidence with significant objective and verifiable positive evidence.

The SEC staff has indicated that factors for registrants to consider in making a determination about whether they should reverse a previously recognized valuation allowance would include:

- The magnitude and duration of past losses.
- The magnitude and duration of current profitability.
- Changes in the above two factors that drove losses in the past and those currently driving profitability.

Further, the staff has noted that registrants should bear in mind that the goal of the assessment is to determine whether sufficient positive evidence outweighs existing negative evidence. The staff has emphasized the importance of evidence that is objectively verifiable and has noted that such evidence carries more weight than evidence that is not. In addition, registrants should (1) assess the sustainability of profits in jurisdictions in which an entity was previously in a cumulative loss position and (2) consider their track record of accurately forecasting future financial results. Doubts about the sustainability of profitability in a period of economic uncertainty may give rise to evidence that would carry less weight in a valuation allowance assessment. Likewise, a registrant's poor track record of accurately forecasting future results would also result in future profit projections that may be very uncertain and should carry less weight in the overall assessment.

The SEC staff has also pointed out that registrants' disclosures should include a discussion of the specific factors or reasons that led to a reversal of a valuation allowance to effectively answer the question, why now? Such disclosures would include a comprehensive analysis of all available positive and negative evidence and how the registrant weighed each piece of evidence in its assessment. In addition, the staff has reminded registrants that the same disclosures would be expected when there is significant negative evidence and a registrant concludes that a valuation allowance is necessary.

Income Tax Rate (Including Rate Reconciliation and Effective Tax Rate)

Examples of SEC Comments

- We note that there have been significant changes in your effective tax rate in recent periods. Specifically, the effective rate was [X]% for 2014, [X]% for 2015, and [X]% for the nine months ended October 2, 2016. There appear to be multiple factors contributing to these fluctuations which include foreign losses in [Country X] with no tax benefits, tax benefits on the repatriation of foreign earnings, additional tax expense related to an underaccrual and tax expense on a settlement with [foreign] tax authorities. Please address the following:
 - In your discussion of the effective tax rate, please quantify the extent to which each significant factor contributed to the fluctuation in the effective tax rate from period to period;
 - Please help us better understand the nature of the additional expense recorded related to the underaccrual of tax expense and in a settlement with [foreign] authorities, including what periods the underaccrual and settlement relate to and the extent to which these factors impact the effective tax rate; and
 - Please help us better understand why you are generating tax benefits rather than incurring tax expense on the repatriation of foreign earnings pursuant to ASC 740.
- Please provide us with a breakdown of the tax differential and non-deductible expense line items included in the effective tax rate reconciliation and tell us what consideration you gave to Rule 4-08(h) (2) of Regulation S-X to provide a further quantitative breakdown of such amounts. Also, considering the significant changes in the effective tax rate, please tell us what consideration you gave to providing an expanded discussion of the factors that impacted your tax provision. In this regard, we note the disclosures on . . . only address the impact for the change in the valuation allowance and not the changes in the line items noted herein. Refer to Item 5.D of Form 20-F and Section III.D of SEC Release No. 33-6835.

Registrants often pay income taxes in multiple jurisdictions other than the domestic federal jurisdiction (e.g., domestic state and local jurisdictions, foreign federal and foreign local or provincial jurisdictions), and the applicable income tax rates vary in each jurisdiction and therefore affect the registrant's effective tax rate. Further, tax laws often differ from financial accounting standards; therefore, permanent differences can arise between pretax income for financial reporting purposes and taxable income. Although such differences are not uncommon, the SEC staff often requests that registrants provide greater transparency into the underlying reasons for differences between the federal statutory

Income Taxes

rate and the registrant's effective tax rate. The staff may also request additional details about events that give rise to a significant change in a registrant's effective tax rate as compared with prior periods.

One of the tax rate-related disclosure requirements that have received increased scrutiny in recent years is the obligation to provide a rate reconciliation. In accordance with ASC 740 and Regulation S-X, Rule 4-08(h)(2), registrants must disclose a reconciliation that uses percentages or dollar amounts of income tax expense or benefit attributable to continuing operations with the amount that would have resulted from applying domestic federal statutory tax rates (the regular rate, not the alternative minimum tax rate) to pretax income from continuing operations.

Further, registrants should disclose the estimated amount and the nature of each significant reconciling item. ASC 740-10-50 does not define "significant." However, Rule 4-08(h) states that public entities should disclose (on an individual basis) all reconciling items that constitute 5 percent or more of the computed amount (i.e., income before tax multiplied by the applicable domestic federal statutory tax rate). Reconciling items may be aggregated in the disclosure if they are individually less than 5 percent of the computed amount.

The SEC staff has noted the following issues related to registrants' tax rate reconciliation disclosures:

- Labels related to reconciling items were unclear, and disclosures about material reconciling items did not adequately describe the underlying nature of these items.
- For material reconciling items related to foreign tax jurisdictions, registrants did not disclose in MD&A (1) each material foreign jurisdiction and its tax rate and (2) how each jurisdiction affects the amount in the tax rate reconciliation.
- Registrants have inappropriately aggregated material reconciling items that are greater than 5 percent of the amount they calculated by multiplying the pretax income by the statutory tax rate.
- Amounts reflected in the tax rate reconciliation were inconsistent with related amounts disclosed elsewhere in a registrant's filing.
- Corrections of errors were inappropriately reflected as changes in estimates.

Further, in recent speeches, the staff has remarked that in the tax rate reconciliation, registrants continue to use boilerplate language that does not describe the components shown, and that explaining both why certain events occurred that affected the effective tax rate and how those events will affect the tax rate going forward would provide more meaningful information to investors. The staff also noted that when the "foreign rate differential" and other components of the tax rate reconciliation are not easily understood or transparent, registrants might consider preparing the tax rate reconciliation on a disaggregated basis (e.g., by country) in a tabular format.

Transaction-Specific Disclosures

Examples of SEC Comments

- We note that the decrease in your income tax expense in the first quarter of 2017 was primarily attributable to a tax benefit resulting from the restructuring of certain foreign entities. Please describe for us, in detail, the nature of the restructuring and explain how this resulted in a decrease in your income tax expense. In addition, tell us the impact you expect the restructuring will have on your full year effective tax rate and what consideration you gave to disclosing the potential impact. We refer you to ASC 740-10-50-14.
- Upon your divestiture of [X] business, you recorded [an \$X] million pre-tax loss and [an \$X] million after-tax gain.

Please help us better understand the impact of income taxes on this transaction pursuant to ASC 740 and correspondingly how this resulted in the recording of an after-tax gain in light of the pre-tax loss.

ASC 740-10-50-14 requires all entities to “disclose the nature and effect of any other significant matters affecting comparability of information for all periods presented.” In accordance with this requirement, the SEC staff has reminded registrants that it is looking for disclosures that help the reader understand the company’s big-picture tax situation. That includes helping the reader understand the tax effects of any significant or unusual events that took place during the period. Such events may include significant restructuring activities or acquisitions and divestitures. When disclosing information about these transactions, registrants should provide detailed descriptions of the events and clear explanations of how they affected income taxes during the period and may affect income taxes in future periods. Registrants with such transactions should consider disclosing the following:

- Whether temporary or permanent differences were created as a result of the transactions.
- Accounting impact of the temporary or permanent differences created.
- The expected impact of the transactions on the effective tax rate in future periods.
- The actual or expected impact on the registrants’ assertions related to indefinitely reinvested foreign earnings, if the transactions involved foreign entities.
- The actual or expected impact on the registrants’ conclusions with respect to the realizability of DTAs.

Noncompliance With Disclosure Requirements

Examples of SEC Comments

- You disclose . . . that you received a tax holiday related to your new operating facility in [Country X]. To the extent material, please disclose the aggregate dollar and per share effects. Refer to Staff Accounting Bulletin Topic 11.C for guidance.
- [A]s prescribed in the Instructions to paragraph 303(a) of Regulation S-K, [MD&A] shall focus on material events and uncertainties known to management that would cause reported financial information not to be necessarily indicative of future operating results or of future financial condition. It is the staff’s view that your revised disclosure, even if read in conjunction with the financial statement footnote that you cite, does not appear to address whether the significant decline in your income taxes, and the underlying reasons therefore, are indicative of expected results. Separately, your disclosure does not appear to have quantified the impact of each main driver causing the decline in your income taxes. Expand your disclosure to address these items. See Item 303(a)(3) of Regulation S-K and the guidance in Sections 501.04, 501.12.b.3 and 501.12.b.14 of the Financial Reporting Codification.
- Please tell us the amount of undistributed earnings on your foreign subsidiaries for each period presented. Explain to us why the amount of undistributed earnings on your foreign subsidiaries is immaterial in light of the significant amounts of income from foreign subsidiaries in each period as well as the fact that a majority of your cash and cash equivalents are held in bank accounts outside the U.S.

Leases

As demonstrated in the sample comments above, registrants can expect to receive comments from the SEC staff when (1) required disclosures have been omitted, (2) registrants do not fully comply with the various disclosure requirements, and (3) amounts and descriptions of events are inconsistent with disclosures elsewhere in the report. Registrants should carefully review the numerous disclosures required by U.S. GAAP and Regulations S-K and S-X to ensure that disclosures in the footnotes and in MD&A are complete and accurate. Recent comments have raised the following issues:

- Omission of required disclosures (e.g., expiration dates of operating loss carryforwards).
- Limited or missing description of the income tax effects of any of the following:
 - An accounting change or error, including amounts and classification within the financial statements.
 - The adoption of an accounting standard.
 - Tax elections, tax receivable agreements, and tax holidays.
- Use of inappropriate non-GAAP measures related to income taxes.
- Unclear line-item descriptions in the financial statements or in disclosures (e.g., generic titles in the rate reconciliation).
- Amounts in disclosures that do not reconcile to amounts presented in the financial statements or disclosed elsewhere in the report.
- Limited discussion in MD&A of matters related to income taxes.

Other Deloitte Resources

[A Roadmap to Accounting for Income Taxes](#)

Leases

The SEC staff's comments about leases have focused on (1) classification of the lease and (2) evaluation of sale-and-leaseback transactions.

In addition, the SEC staff may comment on registrants' disclosures related to the adoption of [ASU 2016-02](#) (the "new leasing standard"), which will be effective for PBEs in fiscal years beginning after December 15, 2018. For additional considerations related to disclosures of recently issued accounting standards, see the [SAB Topic 11.M \(SAB 74\) — Disclosures About the Impact of Recently Issued Accounting Pronouncements](#) section.

Lease Classification

Example of an SEC Comment

You disclose non-cancellable operating lease commitments for school and office premises. We also note in your risk factors discussions that you have a 70-year lease agreement with [X] with the local village cooperative. Please tell us how you considered ASC 840-10-25 in determining the appropriate lease classification.

The lease classification criteria in ASC 840-10-25-1 are based on the concept that a lease that transfers substantially all of the benefits and risks incident to the ownership of property should be accounted for (1) as the acquisition of an asset and the incurrence of an obligation by the lessee and (2) as a sale or

financing by the lessor. All other leases should be accounted for as operating leases. The evaluation of the four lease classification criteria in ASC 840-10-25-1 and the subsequent conclusion about whether to classify a particular lease as an operating lease or a capital lease can have material effects on an entity's financial statements and disclosures. A lessee recognizes a capital lease as an asset and obligation on its balance sheet. Operating leases, on the other hand, are not recognized on the balance sheet but result in charges to expense by the lessee (reported as income by the lessor) over the lease term.

The SEC staff has asked registrants to explain their considerations of the lease classification criteria. If a lease transfers title to the lessee by the end of the lease term or shortly thereafter for no additional consideration or for nominal consideration, the lease would be classified by the lessee as a capital lease. Further, if the lease contains a bargain purchase option, it also would be classified by the lessee as a capital lease. Consequently, the SEC staff may ask questions related to how the registrant determined that a bargain purchase option is reasonably assured or, in turn, how the registrant determined that it has not met the bargain purchase option criteria.

In addition, the SEC staff has asked registrants to provide more information about how they considered the lease classification criteria when the lease term is lengthy (particularly when the term approximates or appears to be longer than the useful life of plant, property, and equipment).

Sale-and-Leaseback Transactions

Example of an SEC Comment

Please provide us with a summary of the analysis you performed pursuant to ASC 840-40 to determine the appropriate accounting for the sale-leaseback transaction in April 2016. Please also provide the disclosures required by ASC 840-40-50.

The SEC staff has commented on how registrants evaluated whether a transaction qualifies for sale-and-leaseback accounting. Certain forms of continuing involvement may preclude a real estate transfer from qualifying for sale accounting (in which case, the real estate would remain on the seller's books and be treated as a financing arrangement with the receipt of proceeds recognized as a financing obligation). Renewal options, residual value guarantees, nonrecourse financing, and provision of collateral on behalf of the buyer-lessor are some of the prohibited forms of continuing involvement that would preclude sale-and-leaseback accounting. Accordingly, the staff has inquired about registrants' considerations and assumptions that support sale-and-leaseback accounting and has asked registrants to provide the required disclosures in the footnotes to the financial statements.

Further, SEC staff comments have asked registrants how they considered fixed-price renewal options in evaluating whether a real estate transaction qualifies for sale-and-leaseback accounting. A fixed-price renewal option in a leaseback may preclude a real estate transfer from qualifying for sale accounting. Renewal options that cover substantially all of the useful life of the real estate and enable the seller-lessee to participate in the appreciation of the underlying property (i.e., through favorable rental rates) are a prohibited form of continuing involvement.

Although past comments have focused on fixed-price renewal options, the SEC staff may ask about any renewal terms that allow the seller-lessee to participate in increases in the value of the underlying real estate, including fixed base rents during the renewal period that a registrant calculates by using an inflationary index to adjust the current base rents. While these are not technically fixed-price renewals, they do have the potential to give the seller-lessee upside participation to the extent that market rates for rents exceed the rate of inflation.

Materiality

Example of an SEC Comment

We note your disclosure that you made certain adjustments to fiscal 2016 earnings to correct errors attributable to prior years which you believe are both quantitatively and qualitatively immaterial to the current period and previously reported periods, including quarterly periods. . . . In order to assist us in understanding your disclosure, please provide us with the following additional information:

- Please provide us with your analysis regarding how you determined these errors were both quantitatively and qualitatively immaterial to the current period and all previously reported periods. Please refer to SAB Topics 1.M. and 1.N. when preparing your response.
- Please tell us the specific nature of these errors, how and why you believe they occurred, and when and how you discovered them. . . .
- Please tell us how you considered the potential impact of these errors on your conclusions regarding the effectiveness of your internal controls over financial reporting and disclosure controls and procedures.

Registrants perform materiality analyses to determine the impact of identified misstatements on their (1) financial statements and (2) previous conclusions about ICFR and DC&P.

ASC 250-10-45-27 provides guidance on materiality determinations related to the correction of errors, and SAB Topics 1.M (SAB 99) and 1.N (SAB 108) contain the SEC staff's guidance on assessing the materiality of misstatements identified as part of the audit process or during the preparation of financial statements.

SAB Topic 1.M indicates that a "matter is 'material' if there is a substantial likelihood that a reasonable person would consider it important." The definition of materiality is based on FASB Concepts Statement 2⁸ and on legal precedent in interpretations of the federal securities laws. The SEC staff has noted that in Supreme Court cases, the Court has followed precedent regarding materiality — namely, that the materiality requirement is met when there is a "substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."

SAB Topic 1.M also indicates that registrants should consider (1) each misstatement individually and (2) the aggregate effect of all misstatements. SAB Topic 1.N provides guidance on how a registrant should consider the effects of prior-year misstatements when quantifying misstatements in current-year financial statements.

To understand registrants' materiality assessments and conclusions, the SEC staff frequently asks registrants about the nature of an error, the quantitative and qualitative factors that registrants considered, and an error's impact on their conclusions about the effectiveness of their ICFR and DC&P. Similarly, the staff challenges registrants' conclusions that errors are immaterial (e.g., whether the method of correcting the error is appropriate; whether restatement language is presented; and whether an Item 4.02 Form 8-K, indicating nonreliance on previously issued financial statements, was required).

Accordingly, a registrant should first decide whether an individual error is material by considering (1) the affected line item subtotals and totals in the financial statements and (2) the financial statements as a whole — keeping in mind what metrics are most important to the users of the financial statements. Then,

⁸ FASB Concepts Statement 2, which has been superseded by FASB Concepts Statement 8, defined materiality as the "magnitude of an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or misstatement."

if the registrant concludes that an individual error has not caused the financial statements as a whole to be materially misstated, it should consider other errors, including offsetting errors, in determining whether the errors taken as a whole are materially misleading. In reaching this conclusion, the registrant should consider individual line items, subtotals and totals in the financial statements, and the financial statements as a whole. The SEC staff has cautioned registrants to avoid bright-line rules or litmus tests and “not to succumb” to rules of thumb or percentage thresholds when determining materiality because no one factor can be viewed as determinative.

SAB Topic 1.M specifies quantitative and qualitative factors a registrant should consider when assessing the materiality of known errors to its financial statements. However, in observing that registrants’ materiality assessments are often presented in a “checklist” fashion in which only the factors in SAB Topic 1.M are considered, the SEC staff has indicated that registrants should (1) describe all factors that are relevant to their materiality assessment (i.e., not just those factors noted in SAB Topic 1.M) and (2) explain how each of those factors was considered. That is, a registrant should provide a detailed, thoughtful analysis that takes into account the registrant’s specific circumstances and what is determined to be relevant to its financial statement users. In addition, the SEC staff has stressed that quantitative considerations in registrants’ materiality assessments continue to be overemphasized while qualitative factors are often insufficiently evaluated.

The SEC staff has also indicated that registrants should consider company-specific trends, performance metrics that may influence investment decisions, and the effects of unrelated circumstances on factors that are important to reasonable investors (such as the magnification of an error in the income statement simply because it occurs in a period in which net income is “abnormally small” relative to historical and expected trends).

In considering company-specific trends and performance metrics, a registrant should address in its materiality assessments what metrics it deemed important enough to include in press releases and earnings calls, what metrics are used in debt covenants, and what analysts use to value the registrant in their reports. The SEC staff often considers analysts’ reports and investor calls as it assesses the registrant’s assertion of what is important to investors.

When considering whether net income is abnormally small, management should determine whether a decline in operating performance is an abnormal event or whether it represents a new normal. Management should also determine whether “unusual” or infrequent events or transactions, such as an asset sale or impairment that would affect trends, are reflected in the results. In those instances, it sometimes may be appropriate to evaluate the relative significance of the identified error by using “normalized” metrics, which may cause an otherwise quantitatively significant error to be less significant. Documentation of such considerations should be included in management’s analysis.

The SEC staff has also observed that certain registrants have argued that a quantitatively large error in the GAAP financial statements is immaterial when it has a quantitatively small impact on non-GAAP metrics. While the staff has indicated that it may be appropriate for a registrant to look at metrics other than those that are GAAP-based in determining whether the financial statements taken as a whole are materially misstated, the SEC staff will most likely focus on the GAAP metrics until a registrant can demonstrate why other metrics are more important to its investors. In addition, the SEC staff has acknowledged that while it is possible for quantitatively small errors to be material and for quantitatively large errors to be immaterial, a quantitatively material GAAP error does not become immaterial simply because of the presentation of non-GAAP measures. Further, there may be circumstances in which an error that is otherwise immaterial to the GAAP financial statements — when taken as a whole and

Noncontrolling Interests

depending on the focus that management, investors, and financial statement users have historically placed on non-GAAP information — is material in the context of non-GAAP information.⁹

In addition to inquiring about a registrant's materiality analysis under SAB Topics 1.M and 1.N, the SEC staff often asks questions about the errors themselves. Registrants should consider the impact that misstatements (and immaterial restatements) may have on their previous conclusions about ICFR and DC&P. As a result of such misstatements, the SEC staff may question whether a material weakness existed at the time of the initial assessment. For additional considerations, see the [Disclosure Controls and Procedures](#) and [Internal Control Over Financial Reporting](#) sections.

After reaching a materiality conclusion, registrants should also consider whether they are required to file Form 8-K. Under Item 4.02(a) of Form 8-K, a registrant must file Form 8-K when it has concluded that previously issued financial statements, covering either an annual or an interim period, should no longer be relied on because of an error.

Noncontrolling Interests

Examples of SEC Comments

- [T]ell us how you attribute interests in [Company A] to noncontrolling interest.
- Please provide us with a detailed analysis of the balance sheet classification of the noncontrolling interest associated with the mandatory open offer as of March 31, 2016. Address how you considered the guidance in ASC 810-10-45-17, ASC 480-10-30-1, and ASC 480-10-55-54. Also tell us what consideration you gave to the classification guidance in ASC 480-10-S99-3A.

SEC staff comments related to NCIs continue to focus on the allocation of net income (loss) to the NCI and the parent. Consequently, the staff frequently asks registrants to provide it with detailed information about how the registrant determined the allocation, particularly when the allocation is disproportionate to the NCI holder's investment.

The SEC staff also continues to comment on registrants' accounting for redeemable NCIs since SEC rules still prohibit registrants from including redeemable equity in any caption titled "total equity." ASC 480-10-S99-3A(2) indicates that equity instruments are required to be classified outside of permanent equity if they are redeemable for cash or other assets in one of the following ways:

- "[A]t a fixed or determinable price on a fixed or determinable date."
- "[A]t the option of the holder."
- "[U]pon the occurrence of an event that is not solely within the control of the issuer."

Thus, the SEC staff has indicated that "registrants with redeemable noncontrolling interests, redeemable preferred stock or other redeemable equity classified outside permanent equity should not include these items in any total or subtotal caption titled 'total equity.'" Further, changing "the caption in the statement of changes in shareholders' equity [from] 'total equity' to 'total' does not make the inclusion of redeemable equity acceptable."¹⁰

For additional information about classification of redeemable securities, see the [Debt](#) section.

⁹ In its October 2010 joint webcast with the CAQ, the SEC staff also discussed non-GAAP financial measures in the context of materiality.

¹⁰ Quoted text is from the [highlights](#) of the June 2009 CAQ SEC Regulations Committee joint meeting with the SEC staff.

Other Deloitte Resources[A Roadmap to Accounting for Noncontrolling Interests](#)

Pensions and Other Postretirement Benefits

The SEC staff continues to comment on disclosures related to how registrants account for pension and other postretirement benefit plans and how key assumptions and investment strategies affect their financial statements. Further, registrants may be asked how they concluded that assumptions used for their pension and other postretirement benefit accounting are reasonable relative to (1) current market trends and (2) assumptions used by other registrants with similar characteristics.

Critical Accounting Estimates

Examples of SEC Comments

- In future filings, please provide a more robust discussion of your critical accounting policies and estimates to focus on the assumptions and uncertainties that underlie your critical accounting estimates. Please quantify, where material, and provide an analysis of the impact of critical accounting estimates on your financial position and results of operations for the periods presented. In addition, please include a qualitative and quantitative analysis of the sensitivity of reported results to changes in your assumptions, judgments, and estimates, including the likelihood of obtaining materially different results if different assumptions are applied. For example, if reasonably likely changes in the discount rate or long-term rate of return used in accounting for your pension and other post-retirement benefit plans would have a material effect on your financial condition or results of operations, the impact that could result given the range of reasonable outcomes should be disclosed and quantified. Please refer to SEC Release No. 33-8350. In your response, please show us what your disclosure would have looked like if these changes were made in your most recently filed Form 10-K.
- You determine your discount rate based on a review of published financial data and discussions with your actuary regarding rates of return on high-quality, fixed-income investments currently available and expected to be available during the period to maturity of your pension and postretirement plan obligations. We note that there was minimal change in the discount rate used to determine the net periodic benefit obligations at December 31, 2014 and December 31, 2015 for your pension benefits. . . . Similarly there was no change in the weighted average discount rate assumption used to determine net periodic benefit cost for the years ended December 31, 2014 and December 31, 2015. We also note that [an X%] increase in your discount rate based on the sensitivity analysis provided . . . could cause [an \$X million] decrease in pension expense compared to pre-tax income of [\$Y million] recorded during the year ended December 31, 2015. In this regard, please help us better understand how you arrived at the appropriate discount rate to use each period in accounting for your pension plans pursuant to ASC 715.

Because of factors such as the low-interest-rate environment, optionality in U.S. GAAP accounting methods, and significant assumptions used in benefit obligation valuation, the SEC staff has continued to ask registrants about assumptions related to their pension and other postretirement benefit plans. For example, the staff has requested more quantitative and qualitative information about the nature of registrants' assumptions. In particular, the staff has focused on the discount rate and the expected return on plan assets. Further, the staff has asked registrants how their disclosures in the critical accounting estimates section of MD&A align with their accounting policy disclosures in the notes to the financial statements.

Pensions and Other Postretirement Benefits

In addition, the SEC staff has indicated that it may be appropriate for a registrant to disclose the following:

- Whether a corridor¹¹ is used to amortize the actuarial gains and losses and, if so, how the corridor is determined and the period for amortization of the actuarial gains and losses in excess of the corridor.
- A sensitivity analysis estimating the impact of a change in expected returns on income. This estimate should be based on a reasonable range of likely outcomes.
- Regarding the extent to which historical performance was used to develop the expected rate of return assumption, if use of the arithmetic mean to calculate the historical returns produces results that are materially different from the results produced when the geometric mean is used to perform this calculation, it may be appropriate for the registrant to disclose both calculations.
- The reasons why the expected return has changed or is expected to change in the future.
- The effect of plan asset contributions during the period on profit or loss, when this effect is significant. The SEC staff has indicated that additional plan asset contributions reduce net pension costs even if actual asset returns are negative because the amount included in profit or loss is determined through the use of expected and not actual returns. Consequently, such information can provide an understanding of unusual or nonrecurring items or other significant fluctuations so that investors can ascertain the likelihood that past performance is indicative of future performance.

Alternatives to Applying Discount Rates for Defined Benefit Plans

Example of an SEC Comment

We note your disclosure that you changed the method you use to estimate the service and interest components of net periodic benefit costs for pension and other postretirement benefits. You disclose that you have elected to utilize a full yield curve approach in estimation of these components. Please compare and contrast for us in greater detail the previous method with the current method, and explain to us how the current method complies with ASC 715-10-35 and ASC 715-60-35.

As noted in Deloitte's [December 21, 2015](#), and [November 16, 2016](#), *Financial Reporting Alert* newsletters, entities and their actuaries have recently started to use alternative approaches to measure the interest and service cost components of net periodic benefit cost for defined benefit retirement plan obligations under ASC 715. Traditionally, entities have used a single weighted-average discount rate approach, also referred to as the aggregated approach, to measure the interest and service cost components of net periodic benefit cost. Now, rather than estimating interest and service cost by using a single weighted-average discount rate, entities are adopting an approach that uses individual spot rates (the "spot rate approach") derived from an acceptable high-quality corporate bond yield curve and matched with the separate cash flows for each future year. Under the spot rate approach, an entity measures interest cost by applying duration-specific spot rates to the year-by-year projected benefit payments.

The amounts of service cost, interest cost, and actuarial gains and losses recognized under the spot rate approach would generally differ from those recognized under the single weighted-average discount rate approach. For example, in an upward-sloping yield curve environment, the spot rate approach would generally result in lower interest cost and higher actuarial loss (or lower actuarial gain) than the single weighted-average discount rate approach. Because the measurement of the benefit obligation as of

¹¹ ASC 715-30-35-24 provides guidance on net periodic pension benefit cost and defines the corridor as "10 percent of the greater of the projected benefit obligation or the market-related value of plan assets." Similarly, ASC 715-60-35-29 provides guidance on net periodic postretirement benefit cost and defines the corridor as "10 percent of the greater of the accumulated postretirement benefit obligation or the market-related value of plan assets."

each measurement date under the single weighted-average discount rate approach is the same as that under the spot rate approach, any change in the service cost or interest cost component would result in a different expected benefit obligation, which — compared with the remeasured benefit obligation (as of the next measurement date) — would give rise to an additional actuarial gain or loss so that the beginning-of-the-year benefit obligation is reconciled to the end-of-the-year benefit obligation. This actuarial gain or loss would be included with the other gains or losses and would then be recognized in net income in accordance with the entity's accounting policy for recognizing actuarial gains and losses in earnings (i.e., either immediate recognition or some other acceptable method of amortization under ASC 715). Accordingly, a change to the spot rate approach for measuring service cost and interest cost and the resulting differences in service cost, interest cost, and actuarial gains and losses could materially affect an entity's financial statements as well as a registrant's non-GAAP financial performance disclosures (to the extent that those items are reflected in non-GAAP measures). The SEC staff has indicated that it would not object if entities that use a yield curve approach (rather than bond matching or another method) to measure their defined benefit obligation change from the single weighted-average discount rate approach to a spot rate approach for measurement of interest cost.¹² The staff has further indicated that it would not object to accounting for that change in approach as a change in estimate in such circumstances.

As a result of these alternative approaches, the SEC staff may comment on a registrant's disclosures about the approaches for measurement of interest cost, particularly when a change in approach occurs. In discussions held in September 2015 with representatives of the Big Four accounting firms, the SEC staff stressed that it is important for registrants that change to the spot rate approach to comply with the disclosure requirements in the following ASC paragraphs:

- ASC 250-10-50-4, which requires disclosure of the material effect of changes in accounting estimates on income statement and earnings-per-share measurements.
- ASC 715-20-50-1(k) and ASC 715-20-50-1(r), as supplemented by ASC 715-30-35-45, which require disclosure of the discount rates used for the benefit obligation and net periodic benefit cost.

In addition, the staff highlighted the required MD&A disclosures under Regulation S-K, Item 303, regarding changes in results of operations as well as trends or events that will materially affect income from continuing operations.

Further, the staff discussed the transparency of required non-GAAP disclosures under Regulation G. The staff highlighted that it expects registrants to disclose any significant impact of a change in the approach used to measure net periodic benefit cost on any non-GAAP measures. Specifically, registrants should explain how the change in approach affected components of net periodic benefit cost and actuarial gains and losses in the current period and on a prospective basis to the extent that those items are reflected in non-GAAP measures. For more information, see the [Non-GAAP Financial Measures and Key Metrics](#) section.

In accordance with these guidelines from the SEC staff, registrants should consider quantifying and disclosing the impact of a change to the spot rate approach in the year the change in estimate is recognized. Specifically, a registrant should consider disclosing the difference between service cost, interest cost, and actuarial gains and losses under the current approach (e.g., spot rate approach) and those under the prior approach (i.e., aggregated approach). Because ASC 715 requires disclosure of weighted-average discount rates used to determine the benefit obligation and net periodic benefit cost, a registrant should consider that the weighted-average rate used to determine the benefit obligation is likely to be different from the weighted-average rates associated with service cost and interest

¹² See the December 9, 2015, [speech](#) delivered by Ashley Wright, then professional accounting fellow in the OCA, at the 2015 AICPA Conference.

cost components under the spot rate approach. In thinking about the financial statement disclosure requirements related to assumptions under ASC 715 as well as disclosures by registrants regarding critical accounting policies under [Section II.J](#) of the SEC's *Current Accounting and Disclosure Issues in the Division of Corporation Finance* (updated November 30, 2006), registrants should consider disclosing a narrative description of how discount rates were determined along with the approach for how such discount rates have been applied to measure service cost and interest cost components.

In August 2016, the SEC staff further communicated to representatives of the Big Four accounting firms that it would object to a proposed approach to adapting bond matching that would facilitate the use of a similar spot rate method for measuring interest cost. For additional information about developments related to this proposed approach, refer to Deloitte's August 24, 2016, [Financial Reporting Alert](#).

Liquidity and Capital Resources

Example of an SEC Comment

We note . . . that you had changes in both your discount rate and mortality assumptions . . . that have significantly affected your benefit obligations and related funding status. Particularly, your unfunded obligations have increased by approximately \$[X] million We further note from your risk factor . . . that you "could" experience increases in your pension expense due to such changes as decreases in discount rates. In this regard, please revise your Liquidity section of MD&A to identify and discuss any known trends, demands, commitments, events, or uncertainties that will result in or that are reasonably likely to result in your liquidity increasing or decreasing in any material way. Your revised disclosure should clearly explain the significant increase in both your benefit obligations at [year-end] and your unfunded status and the related impacts on your financial statements and liquidity. Please refer to Item 303(a)(1) of Regulation S-K.

Registrants should sufficiently disclose how changes to their plan assets and obligations may affect their liquidity and capital resources. The SEC staff has encouraged registrants to explain the trends and uncertainties related to pension or other postretirement benefit obligations (e.g., a registrant's funding requirements may be affected by changes in the measurement of its plan obligations and assets). A registrant also may want to disclose in both qualitative and quantitative terms what its plan contributions have been in the past and the expected changes to those contributions.

Registrants may take steps to "de-risk" their pension plans by acquiring bonds for their plan asset portfolios whose expected maturities match the expected timing of the plans' obligations. The SEC staff has reminded registrants that they are required to disclose their plan investment strategy. MD&A should inform investors about any changes to that investment strategy, the reasons for those changes, and how a change in strategy affects the underlying plan assumptions and the registrant's ability to fund the plans. For example, a decision to invest more in fixed-income securities could be expected to lower the overall rate of return on plan assets.

When a pension plan is funded with a noncash transaction (e.g., the registrant's own stock), it may be appropriate to disclose how management funded the pension plan, with a reference to the associated cash flow statement line items affected by the contribution.

When commenting on other postretirement benefit plans, which are usually funded as the related benefit payments become due, the SEC staff has noted that the footnote disclosures should include the plan's expected future benefit payments for each of the next five years and in the aggregate for the five years thereafter. This information may provide insight into a registrant's expected liquidity requirements, which could then warrant discussion in the liquidity section of MD&A or in the contractual obligations table.

Fair Value of Plan Assets

The disclosures required by ASC 715 for fair value measurements for retirement plan assets are similar to the disclosures about fair value measurements required by ASC 820. These disclosures include employers' investment strategies, major categories of plan assets, concentrations of risk within plan assets, and valuation techniques used to measure the fair value of plan assets. The SEC staff may ask registrants about their compliance with such disclosure requirements. For more information, see the [Fair Value](#) section. A registrant also should disclose whether the fair value or calculated value¹³ of plan assets is used to determine the expected return on plan assets and, if the calculated value is used, how this value is determined.

Immediate Recognition of Gains and Losses

The SEC staff has noted instances in which registrants have changed their method of accounting for the amortization of actuarial gains and losses in net periodic pension or other postretirement benefit cost. For example, some registrants have decided to move to an approach under which they immediately recognize all actuarial gains and losses or, alternatively, all actuarial gains and losses outside the corridor, as a component of net periodic pension cost. In accordance with ASC 250, such registrants have retrospectively applied this change in accounting principles to their financial statements.

Once an entity adopts a policy of immediately recognizing gains and losses, changing to a less preferable method (i.e., a subsequent change to a method that results in slower amortization) would be difficult to support. When entities adopt a policy of immediately recognizing actuarial gains and losses as a component of net periodic pension cost, they often present non-GAAP financial measures that "remove the actual gain or loss from the performance measure and include an expected long-term rate of return."¹⁴

The SEC staff will generally comment when (1) the disclosures are not clear and the pension-related adjustment (e.g., actuarial gains or losses) is not labeled; (2) an adjustment is labeled as a "noncash" pension expense, because the pension liability will ultimately be settled in cash; and (3) context about adjustments related to actuarial gains and losses is not provided.

Disclosures Related to Non-U.S. Plans

ASC 715-20-50-4 states that a "U.S. reporting entity may combine disclosures about pension plans or other postretirement benefit plans outside the United States with those for U.S. plans unless the benefit obligations of the plans outside the United States are significant relative to the total benefit obligation and those plans use significantly different assumptions." The SEC staff may ask registrants to explain the basis for combining pension and other postretirement benefit plan disclosures related to U.S. and non-U.S. plans. When there are significant differences in trends and assumptions between the U.S. and non-U.S. plans and the benefit obligation of the foreign plan is significant, the SEC staff has required registrants to provide disaggregated footnote disclosures for the U.S. and non-U.S. plans.

¹³ ASC 715-30-20 defines the market-related value of plan assets as follows: "A balance used to calculate the expected return on plan assets. The market-related value of plan assets is either fair value **or a calculated value** that recognizes changes in fair value in a systematic and rational manner over not more than five years. Different ways of calculating market-related value may be used for different classes of assets" (emphasis added).

¹⁴ For more information, see the [highlights](#) of the June 2012 CAQ SEC Regulations Committee joint meeting with the SEC staff.

Other Deloitte Resources

August 14, 2015, *Heads Up*, “FASB Issues ASU on Employee Benefit Plan Accounting”

February 22, 2011, *Financial Reporting Alert*, “Pension Accounting Considerations Related to Changes in Amortization Policy for Gains and Losses in the Market-Related Value of Plan Assets”

Revenue Recognition

The SEC staff’s comments about revenue recognition have focused on (1) the relevant disclosure requirements, (2) multiple-element arrangements, (3) principal-versus-agent considerations, (4) revenue recognition for long-term construction-type and production-type contracts, and (5) the milestone method.

In addition, the SEC staff has commented on registrants’ disclosures related to the adoption of [ASU 2014-09](#) as amended (the “new revenue standard”), which will be effective for public business entities in fiscal years beginning after December 15, 2017. Such comments have asked registrants for quantitative and qualitative disclosure of the expected impact when the new standard is effective. Accordingly, registrants should consider disclosing (1) the registrant’s status of adoption, (2) how revenue recognition policies may differ from current GAAP (including timing of revenue recognition), and (3) expected changes in amounts of revenue recognized. For additional considerations related to disclosures of recently issued accounting standards, see the [SAB Topic 11.M \(SAB 74\) — Disclosures About the Impact of Recently Issued Accounting Pronouncements](#) section.

Revenue Recognition Disclosures

Examples of SEC Comments

- We note your disclosure that revenue is generally recognized upon shipment. Please tell us why you believe the earnings process is complete and revenue recognition is appropriate upon shipment of the product rather than delivery. Your response and revised disclosure should specifically address the point at which title to the product and all risks of ownership, including risk of loss, pass to the customer. Please refer to Staff Accounting Bulletin Topic 13.
- Please address each of the following issues by referencing the authoritative literature you rely upon to support your policy and provide us proposed revised policy disclosure, where appropriate, to be included in future periodic reports:
 - Revise the second criterion under your product sales policy to indicate that the price is substantially fixed or determinable as stipulated in ASC 605-15-25-1a. In this regard the price does not need to be both fixed and determinable.
 - Tell us when and how you recognize licensing revenue “based on the contractual terms of each agreement and [y]our application of pertinent GAAP.” Given your disclosure of the existence of upfront fees, milestone payments and royalties tell us your consideration of the multiple-element arrangements guidance in ASC 605-25 and the milestone method guidance in ASC 605-28.
 - Tell us when and how you recognize service revenue “when the corresponding milestone is achieved” as compared to when “the revenue is otherwise earned and due [you] through [y]our on-going activities.”

In addition to requesting general policy information, the SEC staff often asks that registrants clearly state whether and, if so, how a revenue recognition policy complies with SAB Topic 13, particularly the four criteria that generally must be met for revenue to be recognized. The staff may also ask how a criterion has been applied in the context of a particular transaction or group of transactions. For example, the SEC staff may inquire about whether collectibility is “reasonably assured” and whether the sales price the registrant charges resellers for products is “fixed or determinable.”

When reviewing the disclosures in a registrant’s revenue policy footnote, the SEC staff often checks for completeness and consistency with the revenue streams described in the business section, in MD&A, and on the registrant’s Web site. Registrants should consider expanding or clarifying their revenue recognition disclosures to include:

- The type, nature, and terms of significant revenue-generating transactions.
- The specific revenue recognition policy (including the manner in which revenue is recognized) for each type of revenue-generating transaction, including policies related to discounts, promotions, sales returns, post-shipment obligations, customer acceptance, warranties, credits, rebates, and price protection.
- The specific events or actions that trigger revenue recognition (i.e., avoid “boilerplate language”).
- Relevant information about significant uncertainties related to revenue recognition (e.g., rights of return or variable consideration).
- A detailed breakdown of revenue by product/service line or business segment when the disclosure of revenue in the filing is less granular than the discussion of the registrant’s results of operations in other publicly available information in or outside the filing.

The SEC staff may request more specific disclosures on the basis of the complexity or subjectivity of registrants’ revenue recognition policies.

Multiple-Element Arrangements

Examples of SEC Comments

- Please tell us the nature of your multiple-deliverable arrangements, the significant deliverables within the arrangements, and the general timing of revenue recognition for the significant units of accounting. Tell us the general timing of delivery or performance of service for the deliverables within the arrangements and any performance-, cancellation-, termination-, and refund-type provisions. Discuss how you considered ASC 605-25-25-5. Revise future filings to provide all of the disclosures required by ASC 605-25-50-2. . . . Please tell us the significant factors, inputs, assumptions, and methods used to determine selling price (whether vendor-specific objective evidence, third-party evidence, or estimated selling price) for each of the significant deliverables. Refer to ASC 605-25-30-2 and 605-25-50-2.
- Please tell us your consideration for disclosing how you determine whether collaboration agreements with multiple deliverables can be separated into individual units of accounting. In this regard, we note no disclosure of the standalone value concept in ASC 605-25-25-5.

Revenue Recognition

The SEC staff often asks registrants about the nature of, and accounting for, their multiple-element arrangements and whether they evaluated these arrangements under ASC 605-25. The staff typically asks for additional information, and sometimes requests more disclosure, about multiple-element arrangements, including:

- A description of the registrant's rights and obligations under the arrangement.
- The registrant's method for determining whether certain deliverables in an arrangement qualify as separate units of accounting and the factors the registrant considered in making this assessment.
- The registrant's accounting policy for allocating and recognizing revenue for each deliverable.
- The registrant's support for its conclusion that a delivered item has stand-alone value.
- An analysis of how the transaction price was allocated to each deliverable, including how the selling price used for each unit of accounting was determined (i.e., VSOE, TPE, or estimated selling price).
- The period over which each unit of accounting is recognized.

Principal-Versus-Agent Considerations

Example of an SEC Comment

We note your presentation of revenues on a gross basis with commission expense presented as an operating expense. Please tell us how you considered reporting revenues net as an agent versus gross as a principal. In doing so, please provide us with a detailed gross versus net analysis pursuant to ASC 605-45-45 to support your current presentation.

The SEC staff often inquires about principal-versus-agent considerations. ASC 605-45 discusses factors that an entity should consider in determining whether it acts as a principal (and presents revenue at the gross amount billed to a customer) or as an agent (and presents revenue at the net amount retained). Specifically, the staff has asked registrants to explain how they determined gross or net presentation to be appropriate for certain revenue transactions under ASC 605-45. Further, the SEC staff may request detailed information about the rights and obligations of the parties involved in a registrant's revenue transactions.

In addition, the staff may ask registrants to provide expanded disclosures that describe the nature of these transactions and the factors they considered when determining whether revenue from such transactions should be presented on a gross or a net basis. The focus of these disclosures is to provide information that would enable an investor to understand whether title is transferred and who is the primary obligor. The SEC staff has stated that the analysis it applies to identify the primary obligor focuses on (1) identifying the product or service that is desired by the customer and (2) determining whether the registrant is responsible for providing that product or service.

Revenue Recognition for Long-Term Construction-Type and Production-Type Contracts

Examples of SEC Comments

- We note that you provide online decoration services under fixed fee arrangements that are recognized using the percentage-of-completion method. Please tell us your consideration of disclosing the method or methods used to measure progress toward completion. We refer you to ASC 605-35-50. In addition, please explain whether losses on fixed fee arrangements are recognized during the period in which the loss first becomes probable and reasonably estimable.
- We note your disclosure that revenue from equipment sale contracts is recorded using **either** the completed contract or percentage-of-completion method. Please fully explain when and why you use each method, including how you determined using both methods is appropriate.

ASC 605-35 provides guidance on how and when to recognize revenue and costs for certain long-term construction-type and production-type contracts. The SEC staff may ask registrants to clarify their treatment of these contracts under ASC 605-35. For instance, the staff may inquire about:

- How the registrant developed its estimate of total contract costs and how those costs are directly related to contract performance.
- How the registrant treated precontract and early-stage contract costs, which should normally be expensed.
- The nature, status, amounts, and types of change orders and claims that occurred during the periods presented and how the registrant accounted for those change orders and claims.
- Policy disclosures, including which contract accounting method was used (i.e., percentage-of-completion or completed-contract), why such method was appropriate, and the basis used to measure progress toward completion (e.g., cost-to-cost, units of work).
- The historical accuracy of the registrant's past estimates and the likelihood of changes in its estimates in the future.
- The amount of contract losses recorded during each period presented.
- Disclosures (under ASC 250-10-50-4) related to the effect of any changes in estimates in the financial statements (e.g., the estimate of percentage complete or amount of profit recognized on claims).
- For transactions for which revenue is recognized under the completed-contract method, the specific criteria used to determine when a contract is substantially completed.

In addition, registrants that use the percentage-of-completion method should be aware that the SEC staff has asked some registrants to enhance their disclosures in MD&A about the effect of changes in contract estimates. For example, the SEC staff may ask registrants to add disclosures in MD&A about gross aggregate favorable and gross aggregate unfavorable changes in contract estimates for each period presented.

Milestone Method

Examples of SEC Comments

- Please tell us how your policy to recognize milestone consideration upon achievement of the associated milestone complies with the guidance in ASC 605-28-25-1 and 25-2. This comment also applies to your policy related to milestones in your collaborative licensing and development revenue policy.
- Please address the following:
 - Tell us how your sales based “milestones” meet the GAAP definition of milestones under ASC 605-28-20. If you believe these milestones meet the GAAP definition, demonstrate to us how these milestones are substantive in order to recognize revenue immediately under ASC 605-28-25-1.
 - If your sales-based “milestones” do not meet the GAAP definition of milestones, revise the sales and regulatory milestone portion of your proposed revised policy disclosure to differentiate between your regulatory milestones and sales-based contingent payments and separately explain why recognition upon achievement is appropriate.

ASC 605-28 provides guidance on how and when entities should recognize revenue under the milestone method for performance obligations that are satisfied over a certain period, and when a portion or all of the consideration is contingent upon uncertain future events or circumstances, such as the achievement of a milestone. The SEC staff may ask registrants to clarify:

- Whether the contingent receipts represent milestones.
- How the registrant determined whether the milestone was substantive.
- The amount of each milestone and its triggering events.
- Policy disclosures related to each milestone, including substantive and nonsubstantive milestones as well as descriptions related to contingent considerations.
- Disclosures under ASC 605-28-50-2 for each milestone.

Other Deloitte Resources

[*A Roadmap to Applying the New Revenue Recognition Standard*](#)

[*Software Revenue Recognition — A Roadmap to Applying ASC 985-605*](#)

[*Multiple-Element Arrangements — A Roadmap to Applying the Revenue Recognition Guidance in ASU 2009-13*](#)

SAB Topic 11.M (SAB 74) — Disclosures About the Impact of Recently Issued Accounting Pronouncements

Example of an SEC Comment

You disclose that the new revenue standard could change the amount and timing of revenue and costs under certain arrangement types, but you have not completely determined what effect, if any, the new guidance will have on the financial statements and related disclosures. Please revise to provide qualitative financial statement disclosures of the potential impact that this standard will have on your financial statements when adopted. In this regard, include a description of the effects of the accounting policies that you expect to apply, if determined, and a comparison to your current revenue recognition policies. Also, further describe the status of your process to implement the new standard and the significant implementation matters yet to be addressed. In addition, to the extent that you determine the quantitative impact that adoption of Topic 606 is expected to have on your financial statements, please also disclose such amounts. Please refer to ASC 250-10-S99-6 and SAB Topic 11.M.

SAB Topic 11.M (SAB 74) indicates that a registrant should disclose the effects of recently issued ASUs and SABs that are not yet effective “unless the impact on [the registrant’s] financial position and results of operations is not expected to be material” (footnote omitted). These disclosures, which should take into account the impact of the full scope of the new standard, including recognition, measurement, presentation and disclosures, are meant to help financial statement users assess the effect that new standards will have once adopted.

According to SAB Topic 11.M, a registrant should consider including the following disclosures in MD&A and the footnotes to the financial statements:

- A brief description of the new standard, the date that adoption is required and the date that the registrant plans to adopt, if earlier.
- A discussion of the methods of adoption allowed by the standard and the method expected to be utilized by the registrant, if determined.
- A discussion of the impact that adoption of the standard is expected to have on the financial statements of the registrant, unless not known or reasonably estimable. In that case, a statement to that effect may be made.
- Disclosure of the potential impact of other significant matters that the registrant believes might result from the adoption of the standard (such as technical violations of debt covenant agreements, planned or intended changes in business practices . . .).

The SEC staff has been reminding registrants about best practices to apply in the periods leading up to the adoption of [ASU 2014-09](#) as amended (the “new revenue standard”), [ASU 2016-02](#) (the “new leasing standard”), and [ASU 2016-13](#) (the “new credit loss standard”). The staff’s comments reiterate themes it has addressed over the past year that have focused on disclosures related to implementation activities.

In September 2016, as reflected in the [minutes](#) of the September 22, 2016, EITF meeting, the SEC staff made an announcement¹⁵ (the “2016 Announcement”) regarding SAB Topic 11.M. The 2016 Announcement stated that when a registrant is unable to reasonably estimate the impact of adopting the new revenue standard, the new leasing standard, or the new credit loss standard, the registrant should consider providing additional qualitative disclosures about the significance of the impact on its financial statements. The SEC staff would expect such disclosures to include a description of:

¹⁵ SEC Staff Announcement, September 22, 2016, “Disclosure of the Impact That Recently Issued Accounting Standards Will Have on the Financial Statements of a Registrant When Such Standards Are Adopted in a Future Period (in Accordance With Staff Accounting Bulletin (SAB) Topic 11.M).”

Segment Reporting

- The effect of any accounting policies that the registrant expects to select upon adopting the new standard(s).
- How such policies may differ from the registrant's current accounting policies.
- The status of the registrant's implementation process and the nature of any significant implementation matters that have not yet been addressed.

Since the 2016 Announcement, the SEC staff has continued to emphasize the importance of providing these transition disclosures for new standards. The staff has also explained that it would expect these disclosures to become more informative to the financial statement users as a company's required adoption dates come closer.

The volume of SEC comments to registrants on SAB Topic 11.M disclosures related to the new standards is expected to increase as the required adoption dates near.¹⁶

Other Deloitte Resources

[September 22, 2016, *Financial Reporting Alert*, "SEC Reminds Registrants of Best Practices for Implementing New Revenue, Lease, and Credit Loss Accounting Standards"](#)

Segment Reporting

Segment reporting remains a perennial topic of SEC staff comments. Like those issued in previous years, recent staff comments have specifically addressed (1) the identification of operating segments, (2) the aggregation of operating segments, (3) changes in reportable segments, and (4) entity-wide disclosures.

Segments as defined by ASC 280 provide a basis for an SEC registrant's required disclosures in the business and MD&A sections of the registrant's filing. Accordingly, registrants should also be mindful of the SEC's guidance on non-GAAP measures applicable to the financial information presented in their filings. Financial measures that a registrant must disclose under U.S. GAAP are not considered non-GAAP measures under the SEC's guidance. The most common examples of such measures are related to segment financial information such as revenue, profit or loss, and total assets for each reportable segment. However, a registrant should ensure that reported amounts are consistent with the measures required to be reported under ASC 280. Any aggregation of individual segment amounts or other segment information voluntarily provided would be within the scope of the SEC's guidance on non-GAAP measures. For additional considerations, see the [Non-GAAP Financial Measures and Key Metrics](#) section.

¹⁶ See Deloitte's December 12, 2016, [Heads Up](#) for comments by SEC Chief Accountant Wesley Bricker and OCA Professional Accounting Fellow Sylvia Alicea at the 2016 AICPA Conference.

Identification of Operating Segments

Example of an SEC Comment

[It] appears that you maintain discrete financial information for your two reporting units We also note from your website that you have executive management, e.g. presidents, for both your business units. Please refer to ASC 280-10-50 and provide us with the following information with respect to your organization and business units:

- Describe the company's internal management reporting process, including organization and reporting structure and provide us with an organizational chart;
- Identify the company's chief operating decision maker or makers ("CODM") and describe the basis for this determination;
- Identify the individuals that reports directly to the CODM;
- Identify each of the business units, the business unit managers and describe their responsibilities;
- Describe how budgets are developed and resources are allocated throughout your organization;
- Describe the level of detail communicated to the CODM when actual results differ from budgets and annual operating targets, and who is involved in meetings with the CODM to discuss budget/target-to-actual variances;
- Describe how performance of the business units is evaluated;
- Describe how performance of the business unit managers is evaluated, including consideration of bonuses;
- Tell us how often the CODM meets with his direct reports, the financial information he reviews to prepare for those meetings, the financial information discussed in those meetings, and who attends; and
- Describe the nature of the financial information regularly reviewed by your CODM to make decisions about allocating resources and assessing performance. As part of your response, please describe the financial information that the CODM reviews for each of the business units.

ASC 280 prescribes the "management approach" for the identification of segments in a public entity's financial statements. The objective of the management approach is to allow financial statement users to (1) see the entity's performance through the eyes of management, (2) assess the entity's prospects for future cash flows, and (3) make more informed judgments about the entity as a whole. Accordingly, the SEC staff will consider a number of factors when evaluating a registrant's identification of operating segments, including (1) what financial information is regularly reviewed by the CODM (i.e., the "CODM package"), (2) a registrant's organizational chart and overall management structure, (3) the basis on which budgets and forecasts are prepared and reviewed, and (4) the basis on which executive compensation is determined. A registrant should also expect that the staff will review other publicly available information for consistency with the registrant's segment disclosures; such information may include the forepart of Form 10-K (i.e., the business section and MD&A), the registrant's Web site, analysts' reports, and press releases.

Registrants should also be aware that incorrect identification of operating segments can affect goodwill impairment testing. Goodwill is tested at the reporting-unit level in accordance with ASC 350-20, and reporting units are identified as either operating segments or one level below. If a registrant has not correctly identified its operating segments, it could incorrectly identify its reporting units and, as a result, improperly test goodwill for impairment. See the [Impairments of Goodwill and Other Long-Lived Assets](#) section for additional information.

Aggregation of Operating Segments

Example of an SEC Comment

We note you have aggregated four operating segments into one reportable segment. Please address the following:

- Please help us understand why the company is organized into these four operating segments;
- Please provide us with your analysis of the aggregation criteria in ASC 280-10-50-11. Please compare and contrast your operating segments relative to the areas listed in ASC 280-10-50-11(a) to (e). Regarding any differences among your operating segments, please tell us why you determined that disaggregation was not warranted; and
- As part of your analysis of similar economic characteristics, please provide us with net sales, gross profit margin, and the profit measure used by the CODM for the last five fiscal years, along with any other information you believe would be useful for each of your operating segments to help us understand how these operations are economically similar and aggregation is appropriate. Please also address any differences in any trends these financial indicators may depict (e.g., net sales are decreasing for one operating segment but increasing for another, or there is a material gap in gross profit margins between the operating segments).

Under ASC 280-10-50-11, entities may aggregate operating segments into a single operating segment if (1) aggregation is consistent with the objectives and principles of ASC 280, (2) the operating segments exhibit similar economic characteristics (e.g., similar historical and expected future performance, such as through similar long-term average gross margins), and (3) the operating segments are similar with respect to all of the following qualitative characteristics:

- a. The nature of the products and services
- b. The nature of the production processes
- c. The type or class of customer for their products and services
- d. The methods used to distribute their products or provide their services
- e. If applicable, the nature of the regulatory environment, for example, banking, insurance, or public utilities.

ASC 280 does not define the term “similar” or provide extensive guidance on the aggregation criteria. Therefore, determination of whether two or more operating segments are similar depends on facts and circumstances and is subject to judgment. As a result, the SEC staff may ask a registrant to provide an analysis on how it determined that its aggregation of operating segments complies with both the quantitative and qualitative requirements in ASC 280.

In the assessment of whether operating segments may be aggregated, determining the basis for economic similarity is particularly difficult for registrants that have complex business models and reporting structures. Accordingly, the SEC staff may ask registrants that have aggregated segments how they satisfied the quantitative requirements of ASC 280 and may request historical and projected financial information by operating segment.

The staff has also emphasized that registrants should focus on the qualitative factors in ASC 280 (e.g., similar products and customers) when assessing whether operating segments are similar for aggregation purposes.

Changes in Reportable Segments

Example of an SEC Comment

We note that effective January 1, 2017, the results of [Business Unit A have] been included within your former [Segment A] instead of your former [Segment B]. We note from your disclosure [in] your Form 10-K for the year ended December 31, 2016, that you determined you had eight reporting units in 2016 Please tell us and disclose in future filings:

- The reason for this change;
- How the change impacts your determination of your reporting units for purposes of goodwill impairment testing pursuant to ASC 350-20; and
- How the change impacts your determination of operating segments as well as your aggregation of operating segments in determining your reportable segments. Please also provide the disclosures required by ASC 280-10-50-21.

Registrants should continually monitor any changes in facts and circumstances that may affect the identification or aggregation of operating segments. Changes that may prompt the SEC staff to seek additional information about registrants' reportable segments include changes in internal reporting after an acquisition and changes in the CODM.

If a registrant changes the structure of its business in a manner that causes the composition of its reportable segments to change, it is required, in accordance with ASC 280-10-50-34 and 50-35, to restate segment information from prior periods for consistency with current reportable segments unless doing so would be impracticable. If a registrant changes the structure of its business after year-end or quarter-end, the new segment structure should not be presented in financial statements until operating results managed on the basis of that structure are reported (typically in a periodic filing such as a Form 10-K or 10-Q). [Paragraph 13310.1](#) of the SEC Financial Reporting Manual indicates that “[i]f annual financial statements are required in a registration or proxy statement that includes subsequent periods managed on the basis of the new organization structure, the annual audited financial statements should include a revised segment footnote that reflects the new reportable segments.” A registrant can include the revised financial statements (1) in the registration or proxy statement or (2) in a Form 8-K, which can be incorporated by reference.

In addition, a change in identified operating segments may also result in a change to a registrant's reporting units for goodwill impairment testing purposes. See the [Impairments of Goodwill and Other Long-Lived Assets](#) section for additional information.

Entity-Wide Disclosures

Examples of SEC Comments

- Please provide entity-wide disclosure with respect to your revenues from external customers for each product or service or each group of similar products or services. Refer to ASC 280-10-50-40.
- Please tell us and disclose the amount of revenues and long-lived assets domestically and attributable to foreign countries. If assets in [Country A] are material, they should be disclosed separately. Please refer to ASC 280-10-50-41 and 50-42.

Share-Based Payments

ASC 280 also requires disclosure of revenue by product or service on an entity-wide basis. Therefore, registrants should remember to identify the “[t]ypes of products and services from which each reportable segment derives its revenues” and to report the total “revenues from external customers for each product and service or each group of similar products and services” in accordance with ASC 280-10-50-21 and ASC 280-10-50-40, respectively. The SEC staff has objected to overly broad views of what constitutes “similar” products and services.

The staff has also frequently asked registrants to include disclosures about geographic information in accordance with ASC 280-10-50-41 unless it is impracticable to do so.

Other Deloitte Resources

[A Roadmap to Segment Reporting](#)

Share-Based Payments

Disclosures

Example of an SEC Comment

Please review the disclosure requirements for stock-based compensation found at ASC 718-10-50 and provide the following disclosures in future annual filings:

- [Please] revise future filings to include the total intrinsic value of options exercised during the year pursuant to ASC 718-10-50-2d2;
- Please disclose the weighted-average remaining contractual term of options currently exercisable pursuant to ASC 718-10-50-2e; and
- Please revise future filings to include the method used to estimate the fair value of all of your options, as well as, the significant assumptions used to determine fair value pursuant to ASC 718-10-50-2b & f.

Registrants should ensure that their disclosures address the following objectives outlined in ASC 718-10-50-1:

- The “nature and terms” of share-based payment arrangements.
- The “effect of [the related] compensation cost . . . on the income statement.”
- The “method of estimating . . . the fair value of the equity instruments granted.”
- The “cash flow effects resulting from share-based payment arrangements.”

Accordingly, the SEC staff’s comments on share-based payment disclosures have focused on items such as:

- The nature of, and reason for, a modification in the share-based payment award’s terms and how the registrant accounted for that modification.
- The terms and conditions of awards, including vesting conditions and whether award holders are entitled to dividends or dividend equivalents.
- The number of awards that are expected to vest, and the assumptions that were used to determine that number.

- The registrant’s valuation method, including significant assumptions used (e.g., volatility, expected term, dividend yield).
- The “weighted-average grant-date fair value” of equity instruments granted during the year.
- The “total intrinsic value of options exercised.”

In its comments about disclosures, the SEC staff frequently refers to ASC 718-10-50-2, which describes the “minimum information needed to achieve the objectives in [ASC 718-10-50-1].”

In addition, the SEC staff often asks registrants about share-based payment information they are required to include in a proxy statement (e.g., those disclosures required by Regulation S-K, Item 402). See the [Executive Compensation and Other Proxy Disclosures](#) section for more information about SEC staff comments on registrants’ proxy statements.

Share-Based Payment Awards Issued by Privately Held Companies

Example of an SEC Comment

Please tell us the estimated IPO price range. To the extent there is a significant difference between the estimated grant-date fair value of your common stock during the past twelve months and the estimated IPO price, please discuss for us each significant factor contributing to the difference.

Calculating share-based compensation for privately held companies can be complex and may require registrants to use significant judgment in determining the fair value of the equity instrument because there is typically no active market for the common stock of such companies. The SEC staff continues to comment on registrants’ accounting and valuation assumptions for equity securities issued as compensation in periods before an IPO (commonly referred to as “cheap stock” considerations). The AICPA’s accounting and valuation guide [Valuation of Privately-Held Company Equity Securities Issued as Compensation](#) (known as the “Cheap Stock Guide”) contains guidance on these accounting considerations.

A registrant preparing for an IPO should also refer to [paragraph 7520.1](#) of the SEC Financial Reporting Manual, which outlines considerations for registrants when the “estimated fair value of the stock is substantially below the IPO price.” In such situations, registrants should be able to reconcile the change in the estimated fair value of the underlying equity between the award grant date and the IPO by taking into account, among other things, intervening events and changes in assumptions that support the change in fair value.

Whereas the SEC staff had historically asked registrants to expand the disclosures in their critical accounting estimates to provide additional information about the valuation methods and assumptions used for share-based compensation in an IPO, it updated its SEC Financial Reporting Manual in 2014 to indicate that registrants should significantly reduce such disclosures. Specifically, [Section 9520](#) of the SEC Financial Reporting Manual was revised to clarify what disclosures are expected in an IPO registration statement and thereby encourage registrants to provide less information about cheap stock. However, [paragraph 9520.2](#) of the SEC Financial Reporting Manual notes that the staff may continue to “issue comments asking companies to explain the reasons for valuations that appear unusual (e.g., unusually steep increases in the fair value of the underlying shares leading up to the IPO).” Such requests are meant to ensure that a registrant’s analysis and assessment support its accounting for share-based compensation and do not necessarily indicate that the registrant’s disclosures need to be enhanced.

Share-Based Payments

At the Practising Law Institute's "SEC Speaks in 2014" Conference, the SEC staff provided insights into how registrants would be expected to apply the guidance in [paragraph 9520.1](#) of the SEC Financial Reporting Manual (and thereby reduce their share-based compensation disclosures):

- The staff does not expect much detail about the valuation method registrants used to determine the fair value of their pre-IPO shares. A registrant need **only** state that it used the income approach, the market approach, or a combination of both.

Further, while registrants are expected to discuss the nature of the material assumptions they used, they would **not** be required to quantify such assumptions. For example, if a registrant used an income approach involving a discounted cash flow method, it would only need to provide a **statement** indicating that "a discounted cash flow method is used and [such method] involves cash flow projections that are discounted at an appropriate rate"; no additional details would be needed.

- Registrants would have to include a **statement** indicating that the estimates in their share-based compensation valuations are "highly complex and subjective." They would not need to provide additional details about the estimates.
- Registrants would also need to include a **statement** disclosing that such "valuations and estimates will no longer be necessary once the company goes public [because] once it goes public, it will rely on the market price to determine the market value of [its] common stock."

For a discussion of SEC staff comments related to IPOs, see the [Initial Public Offerings](#) section.

Significant Assumptions

Examples of SEC Comments

- Please more fully explain to us why you believe it is appropriate to use the simplified method to estimate the expected life of your stock options. Please also tell us when you expect sufficient historical information to be available to you to determine expected life assumptions and address the impact that your current approach has had on your financial statements. Refer to SAB Topic 14.D.2.
- We note that the expected volatility of your Class A common stock is based on a peer group in the industry in which the Company does business. Please tell us what consideration you gave to using the Company's historical pricing data in arriving at a volatility assumption. In addition, tell us what consideration you gave to disclosing the reason for the continued reliance on a peer group in the industry in arriving at this assumption. We refer you to ASC 718-10-55-37 and SAB Topic 14.D.1.

As noted above, the SEC staff's comments have focused on significant assumptions used in a registrant's valuation of share-based payment awards, such as volatility, expected term, and dividend yield. For example, there were a number of comments related to the use of the "simplified method" to calculate the expected term of employee share options. Under ASC 718, the expected term of an option is a key factor for measuring the option's fair-value-based amount and the related compensation cost. In SAB Topic 14, Question 6 of Section D.2 discusses the simplified method¹⁷ of estimating the expected term of "plain-vanilla" share options and permits a registrant to use the simplified method under certain circumstances if the registrant "concludes that its historical share option exercise experience does not provide a reasonable basis upon which to estimate expected term." The SEC staff's comments have focused on a registrant's use of the simplified method, and in certain instances, registrants were asked to explain why they believe that their historical share option experience does not provide a reasonable basis for estimating the expected term.

¹⁷ Question 6 states that under the simplified method, the "expected term = ((vesting term + original contractual term) / 2)."

In accordance with the staff's guidance in Question 6, a registrant that uses the simplified method should disclose in the notes to its financial statements (1) that the simplified method was used, (2) the reason the method was used, (3) the types of share option grants for which the simplified method was used if it was not used for all share option grants, and (4) the period(s) for which the simplified method was used if it was not used in all periods presented.

The estimated volatility of an option is also a key factor for measuring the option's fair-value-based amount and the related compensation cost. In SAB Topic 14, Question 6 of Section D.1 permits a registrant to base its estimate of expected volatility on the historical, expected, or implied volatility of similar entities whose share or option prices are publicly available for those periods for which it does not have sufficient information available.

The SEC staff's comments have focused on a registrant's use of the historical volatility of similar entities, and in certain instances, registrants were asked to explain why they believe that they did not have sufficient information about the volatility of their own share price on which to base an estimate of expected volatility. In accordance with the staff's guidance in Question 1 of SAB Topic 14.D.1, "[w]hen circumstances indicate the availability of new or different information that would be useful in estimating expected volatility, a company should incorporate that information." That is, once the registrant has either a sufficient amount of historical information regarding the volatility of its share price or other traded financial instruments are available to derive an implied volatility to support an estimate of expected volatility, the registrant "should make good faith efforts to identify and use sufficient information in determining whether taking historical volatility, implied volatility or a combination of both into account will result in the best estimate of expected volatility."

Further, in accordance with the staff's guidance in Question 5 of SAB Topic 14.D.1, registrants should disclose in the notes to their financial statements how they determined the expected volatility assumption for the assessment of the fair value of their share options. Further, registrants should consider disclosing in their MD&A a discussion of the basis for their conclusions about the extent to which they used historical volatility, implied volatility, or a combination of both, including their evaluation of the factors considered in the computation of historical volatility and implied volatility as listed in Questions 2 and 3 of SAB Topic 14.D.1.

Financial Statement Presentation

Example of an SEC Comment

Please tell us how your presentation of a separate line item for stock-based compensation complies with SAB Topic 14F.

Under SAB Topic 14.F, share-based compensation expense should be classified in the same manner as other cash compensation costs, and the presentation should not be driven by the form of consideration paid. Share-based compensation expense should be allocated to items such as cost of sales, R&D, and SG&A (as applicable) and should not be separately presented in a single share-based compensation line item. Further, SAB Topic 14.F states, "Disclosure of this information might be appropriate in a parenthetical note to the appropriate income statement line items, on the cash flow statement, in the footnotes to the financial statements, or within MD&A."

Other Deloitte Resources

A Roadmap to Accounting for Share-Based Payment Awards

May 11, 2017, *Heads Up*, "FASB Amends the Scope of Modification Accounting for Share-Based Payment Arrangements"

March 10, 2017, *Heads Up*, "FASB Proposes Improvements to the Accounting for Share-Based Payment Arrangements With Nonemployees"

June 20, 2016, *Heads Up*, "Frequently Asked Questions About ASU 2016-09"

April 21, 2016, *Heads Up*, "FASB Simplifies the Accounting for Share-Based Payments"

April 28, 2014, *Heads Up*, "MD&A Disclosures About 'Cheap Stock' in IPO Transactions"

March 20, 2014, *Heads Up*, "Highlights of the 'SEC Speaks in 2014' Conference"

SEC Disclosure Topics

Management's Discussion and Analysis

Regulation S-K, Item 303, provides guidance on the information a registrant should consider providing in its discussion of financial condition and results of operations in MD&A. MD&A is one of the leading sources of SEC staff comments, many of which focus on the results of operations section. While the SEC staff's comments have addressed various topics of MD&A,¹ they have continued to focus on greater transparency in registrants' disclosures about (1) material trends and uncertainties that affect results of operations, (2) liquidity and capital resources, (3) estimates in critical accounting policies, (4) disclosure of contractual obligations, (5) early-warning disclosures, (6) changes in the effective tax rate, and (7) cash held in foreign jurisdictions that a company has asserted will be permanently reinvested under ASC 740.

The staff continues to stress that registrants should focus on providing disclosures that are material and relevant to their operations. In addition, the SEC staff continues to recommend that registrants consider including an executive overview section in MD&A that contains a balanced discussion of the key drivers, challenges, and risks that affect results of operations and liquidity.²

Results of Operations

The SEC staff frequently comments on how a registrant can improve its discussion and analysis of known trends, demands, commitments, events, and uncertainties and their impact on the results of operations. Such discussion and analysis is crucial to a financial statement user's understanding of the quality of, and potential variability in, a company's earnings and cash flows as well as the extent to which reported results indicate future performance. A determination of the appropriate disclosure generally should include (1) consideration of financial, operational, and other information; (2) identification of known trends and uncertainties; and (3) an assessment of whether these trends and uncertainties will have, or are reasonably likely to have, a material impact on the company's financial condition and operating performance.

Examples of SEC Comments

- We note your international sales had decreased almost [X]% compared to the same periods in prior year, a trend that appears to have continued into the second quarter. In this regard, please enhance your MD&A disclosure to include a more robust discussion of known trends or uncertainties in your international markets that you reasonably expect have had, or will have, a material impact on your international sales. Refer to Item 303(a)(3)(ii) of Regulation S-K and SEC Release No. 33-8350.
- Revise to describe and quantify all material activities that generated income statement variances between periods. Your revised disclosure should quantify the effect of each causal factor identified for material changes in your financial statement amounts and should fully address the change between periods. Refer to Item 303(a)(3) of Regulation S-K, and for additional guidance, Section III.D. of Release No. 33-6835.

¹ See [paragraphs 9110.1 and 9110.2](#) of the SEC Financial Reporting Manual for the SEC staff's interpretive views on the objectives of a registrant's MD&A.

² See [SEC Interpretive Release No. 33-8350 \(34-48960\), Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations](#), for additional information.

Under Item 303(a)(3), registrants are required to disclose in MD&A material known trends or uncertainties that may affect future performance (whether favorable or unfavorable). Registrants are commonly asked to (1) quantify components of overall changes in financial statement line items and (2) enhance their analysis of the underlying factors that cause such changes or the reasons for the components affecting the overall change — including an analysis of changes at the segment level because such an analysis is often meaningful in MD&A. The SEC staff has suggested that in addition to discussing how volume and product mix affect their results of operations, registrants should consider explaining other potential influences, such as pricing changes, acquisitions, new contracts, inflation, and foreign exchange rates.

The SEC staff has also encouraged registrants to:

- Use appropriate metrics to help them “tell their story” — including those that may be common to their industry (e.g., same-store sales, average subscribers). However, the SEC staff distinguishes such metrics from non-GAAP measures that are adjusted GAAP measures. See the [Non-GAAP Financial Measures and Key Metrics](#) section for additional information.
- Present changes in a tabular format (e.g., a table that summarizes disaggregated cost of sales components by reportable segment).

Further, the SEC staff has asked registrants to separately discuss the impact of online sales on their results of operations.

Liquidity and Capital Resources

Examples of SEC Comments

- Please discuss whether working capital, cash from operations, and other sources of liquidity will be sufficient to fund operations within the next twelve months and the ramifications if you are unable to meet your liquidity needs. Please also discuss working capital needs and the significance and timing of cash generated from operations within the context of your business and industry. Refer to Instruction 5 to Item 303(a) of Regulation S-K.
- Your discussion of cash flows from operating activities appears to be a recitation of the changes in line items and other information evident from your financial statements. Please revise your disclosures to focus on the primary drivers of and other material factors necessary to an understanding of your underlying cash flows and the indicative value of historical cash flows. In this regard, we note significant fluctuations of your accounts receivable, unbilled revenue, accounts payable, customer advances, and deferred revenue balances. It may be appropriate to separately quantify the impacts from the transaction volume changes, the timing and amounts of cash receipts from customers for revenue sharing agreements, days sales outstanding, and the timing and amounts of cash payments to vendors, etc. Your discussion should focus on the underlying reasons for the changes as well as their reasonably likely impact on future cash flows. See Instruction 4 to Item 303 of Regulation S-K and Section IV.B of SEC Release No. 33-8350.

The SEC staff frequently requests more meaningful analysis in a registrant’s MD&A of material cash requirements, historical sources and uses of cash, and material trends and uncertainties so that investors can understand the registrant’s ability to generate cash and meet cash requirements. In addition, rather than repeating items that are reported in the statement of cash flows, registrants should (1) concentrate on disclosing the primary drivers of cash flows and the reasons for material changes in specific items underlying the major captions reported in their financial statements and (2) disclose significant developments in liquidity or capital resources that occur after the balance sheet date.

Management's Discussion and Analysis

The SEC staff has noted that it is important for registrants to “accurately and comprehensively explain [their] liquidity story” and has advised registrants to consider including discussions of key liquidity indicators, such as leverage ratios and other metrics that management uses to track liquidity.³ In addition, the SEC staff has indicated that MD&A disclosures should take into account how the following factors, among others, affect a registrant’s liquidity:

- Any changes in leverage strategies.
- Any strains on liquidity caused by changes in availability of previously reliable funding.
- Sources and uses of funds.
- Intraproduct debt levels.
- Restrictions on cash flows between the registrant (i.e., the parent) and its subsidiaries. See the [Debt](#) section for more information.
- The impact of liquidity on debt covenants and ratios.

Registrants should also consider whether they need to provide enhanced disclosures about:

- Significant debt instruments, guarantees, and covenants. See the [Debt](#) section for more information.
- Effects on liquidity of material cash balances that are held. See the [Income Taxes](#) section for more information.

Critical Accounting Estimates

Example of an SEC Comment

Please revise to include a discussion of critical accounting estimates that addresses the material implications of uncertainties associated with the methods, assumptions and estimates underlying your critical accounting measurements. Your disclosures should address estimates and assumptions that are material due to the levels of subjectivity and judgment necessary to account for highly uncertain matters or the susceptibility of such matters to change, and that have a material impact on financial condition or your operating performance. Refer to Item 303 of Regulation S-K and the Commission’s Guidance Regarding Management Discussion and Analysis of Financial Condition and Results of Operations, Release 34-48960 available on our web site at <http://www.sec.gov>.

The critical accounting policies section of MD&A is intended to highlight only those financial statement items that require significant management estimates and judgment. When reviewing the section, the SEC staff has frequently focused on the estimates that management used in valuations (e.g., estimates used in the valuation of pension assets, impairment of long-lived assets, income taxes including DTAs and uncertain tax positions, and fair value determinations). Registrants should not simply copy their accounting policy disclosures from the footnotes to the financial statements. Instead, the SEC staff expects discussion and analysis of material uncertainties associated with assumptions underlying each critical accounting estimate.

³ Refer to [Section 9210](#) of the SEC Financial Reporting Manual.

To provide comprehensive and meaningful disclosures, management should consider disclosing the following items in the critical accounting policies section of MD&A:

- The method(s) used to determine critical accounting estimates.
- The accuracy of past estimates or assumptions.
- The extent to which the estimates or assumptions have changed.
- The drivers that affect variability.
- Which estimates or assumptions are reasonably likely to change in the future.

In addition, registrants should include an analysis of the sensitivity of estimates to change on the basis of outcomes that are reasonably likely to occur and that would have a material effect. The sensitivity analysis should be quantitative if it is reasonable for registrants to obtain such information.

For more information, see the [Pensions and Other Postretirement Benefits](#) and [Impairments of Goodwill and Other Long-Lived Assets](#) sections.

Tabular Disclosure of Contractual Obligations

Example of an SEC Comment

Please revise future annual reports to include a table of contractual obligations in substantially the format outlined within the requirements of Item 303(A)(5) of Regulation S-K. As part of such presentation, please disclose your cash requirements for interest on your debt obligations. Reference is made to footnote 46 of SEC Interpretive Release 33-8350 "Interpretation: Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations". To the extent material changes occur between the annual and interim period ends, such changes may be discussed in narrative during the interim period.

The SEC staff's comments on the contractual obligations table and the associated footnotes and disclosures continue to focus on a registrant's omission of (1) material obligations, such as interest payments on debt, pension obligations, and uncertain tax position liabilities, and (2) disclosures about the terms of obligations, such as those related to purchase obligations.

Some registrants have questioned how obligations subject to uncertainties about timing or amount should be presented in the table of contractual obligations. The SEC staff has noted that registrants should consider their circumstances and use judgment in determining whether to include such information in the table or the footnotes to the table.⁴ The staff has also indicated that the footnotes should be used to clarify amounts in the table and to (1) explain the nature of the obligations, including whether they were included in, or excluded from, the table (and the reasons for inclusion or exclusion); (2) describe whether the obligations are subject to uncertainty; and (3) describe the uncertainty.⁵

⁴ See the [highlights](#) of the September 2012 CAQ SEC Regulation Committee joint meeting with the SEC staff for discussion of a registrant's use of judgment related to disclosures in the table of contractual obligations.

⁵ To the extent that the obligations cannot be quantified, the SEC staff expects registrants to disclose information that investors and users need to understand the nature and extent of the registrant's obligations. As indicated in [paragraph 9240.7](#) of the SEC Financial Reporting Manual, registrants may include footnotes "to describe provisions that create, increase or accelerate obligations, or other pertinent data to the extent necessary for an understanding of the timing and amount of the registrant's specified contractual obligations."

Early-Warning Disclosures

Example of an SEC Comment

We note that you recorded [an \$X] million goodwill impairment loss related to your [Reporting Unit A] during the quarter ended March 31, 2016. Please tell us in sufficient detail why an impairment occurred in this quarter and was not necessary prior to the three months ended March 31, 2016 such as the quarter ended December 31, 2015, or the year ended September 30, 2015. In this regard, you cite negative developments in bad debt experience at [Reporting Unit A] which appears to have been the primary factor which triggered the interim impairment test. Please describe and analyze your historical quarterly bad debt experience leading up to this impairment, and what specifically changed in the March 31, 2016 quarter which triggered the interim impairment test and related charge. As part of your response, explain to us what caused the swift decline in [Reporting Unit A's] fair value since September 30, 2015.

Item 303 requires disclosure of “any known trends or uncertainties that . . . the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations.” Early-warning disclosures may give investors insight into (1) when charges may be incurred in the future; (2) whether a charge is related to contingencies, restructuring activities, impairment of goodwill or other long-lived assets, or the settlement of uncertain tax positions; (3) when revenue growth or profit margins may not be sustainable because of underlying economic conditions; or (4) when the registrant will be unable to comply with debt covenants. Accordingly, such disclosures may alert investors to the underlying conditions and risks that the company faces before a material charge or decline in performance is reported.

Disclosures Related to Income Taxes

In recent years, the SEC staff has frequently reminded registrants that it is looking for improvement in disclosures that help the reader understand the company's big-picture tax situation and the trends and uncertainties associated with:

- The historical ETR and the extent to which it is expected to be indicative of the future ETR.
- Income tax expense.
- Cash tax obligations and how they affect liquidity.
- Unrecognized tax benefits and changes related to those benefits.
- Cash held in foreign jurisdictions that the company has asserted will be indefinitely reinvested under ASC 740.
- The decision to reverse a valuation allowance.

See the [Income Taxes](#) section for additional considerations and example comments.

SEC Reporting

SEC authoritative literature includes a number of requirements in Regulation S-X that govern the form and content of a registrant's financial statements and other information that must be included in filings with the SEC, including financial statements and financial information of other entities. The SEC staff often comments on these requirements, and they have been the subject of discussion at a variety of forums, including the annual AICPA Conference, various industry conferences, and joint meetings of the SEC staff and the CAQ SEC Regulations Committee. However, there may be situations in which registrants seek relief from complying with certain SEC reporting requirements. With this in mind, the SEC staff has acknowledged that relief may be warranted in some cases and that registrants may seek to obtain a

waiver from the CF-OCA. SEC Chairman Jay Clayton, in a July 12, 2017, [speech](#),⁶ encouraged registrants to request modifications to their financial reporting requirements under Regulation S-X, Rule 3-13, when such requirements may not be material to the total mix of information available to investors. At the 2016 AICPA Conference,⁷ the SEC staff discussed best practices for registrants to consider when seeking reporting relief. For more information, see [Rule 3-13 Waivers and Other Requests](#) in Appendix B.

In 2015, the SEC requested public comment on the effectiveness of financial disclosure requirements in Regulation S-X, including those related to the form and content of financial disclosures about (1) acquired businesses and the accompanying pro forma financial information, (2) equity method investees, and (3) guarantors and issuers of guaranteed securities.⁸ These disclosure requirements are an important part of the SEC's disclosure effectiveness initiative. We understand the staff is continuing to evaluate the public comments it received in these areas; however, at this time, no further rulemaking activities have been announced.

Private-Company Accounting Alternatives

As noted above and discussed further below, there are instances in which a registrant must provide the financial statements of other entities in its registration statements or periodic filings. Among the entities that meet the definition of a public business entity (PBE) under [ASU 2013-12](#) are those that are "required by the [SEC] to file or furnish financial statements, or [do] 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)." Therefore, other entities whose financial statements are provided under Regulation S-X, Rules 3-05, 3-09, and 4-08(g), for example, generally meet the definition of a PBE. As a result, these PBEs are not permitted to adopt private-company accounting alternatives. Accordingly, the effects of any previously elected private-company accounting alternatives would have to be eliminated from the historical financial statements of an entity whose financial statements are included in the SEC filing of a registrant.

In July 2017, the SEC staff announced that it would not object to elections by certain PBEs to use the non-PBE effective dates for the sole purpose of adopting the FASB's new standards on revenue (ASC 606) and leases (ASC 842).⁹ While the SEC staff's announcement provides considerable and welcome relief to registrants preparing to adopt ASC 606 and ASC 842, it is purposely narrow in scope and should not be applied by analogy to the adoption-date assessment for any other standard.

Significant Business Acquisitions (Rule 3-05)

Examples of SEC Comments

- We note that you consummated the [Company A] acquisition . . . but to date you have not filed audited financial statements of the acquired business or pro forma information relating to the acquisition. Please provide us with your calculations of the significance tests outlined in Rule 1-02(w) of Regulation S-X that you used in applying the requirements of Rule 3-05 and Article 11 of Regulation S-X.
- The company filed a Form 8-K . . . indicating that it intends to file by amendment the historical financial statements of [Company A], and pro formas reflecting the acquisition, not later than 71 calendar days after the date the Form 8-K was required to be filed. Your registration statement may not be declared effective before the financial statements meeting the requirements of Rule 3-05 of Regulation S-X are provided, if the transaction exceeds the 50% significance level. Please provide us with a reasonably detailed presentation of your significance level computations.

⁶ SEC Chairman Jay Clayton, "Remarks at the Economic Club of New York," July 12, 2017.

⁷ For more information, see Deloitte's December 12, 2016, [Heads Up](#).

⁸ For more information about the SEC's request for comment, see Deloitte's October 6, 2015, [Heads Up](#).

⁹ For more information, see Deloitte's July 20, 2017, [Heads Up](#).

SEC Reporting

When a registrant consummates, or it is probable that it will consummate, a significant business acquisition, the SEC staff may require the registrant to file certain financial statements for the acquired or to be acquired business (acquiree) in accordance with Regulation S-X, Rule 3-05, in a Form 8-K, registration statement, or proxy statement. The following factors govern whether, and for what period, financial statements for the acquiree are required:

- Whether the acquired or to be acquired assets and liabilities meet the definition of a business for SEC reporting purposes. The definition of a business for SEC reporting purposes under Regulation S-X is not the same as the definition under ASC 805 for U.S. GAAP purposes. This holds true even after changes were made to the definition of a business for U.S. GAAP purposes after the issuance of [ASU 2017-01](#).
- The significance of the acquired or to be acquired business. The significance is calculated on the basis of three tests: the investment (purchase price) test, the asset test, and the income test.
- Whether consummation of the business acquisition is probable or has occurred.

The SEC staff comments on the application of Rule 3-05 in connection with significant business acquisitions when registrants:

- Incorrectly determine that the acquired or to be acquired assets and liabilities do not meet the definition of a business for SEC reporting purposes.
- Do not perform the significance calculations correctly. Some of the most common mistakes are misapplications of the income test, such as excluding unusual or one-time gains or losses from the test.
- Do not realize that Rule 3-05 also applies, in a registration statement or certain proxy statements, to probable acquisitions whose significance is greater than 50 percent.
- Do not consider, in a registration statement or proxy statement, the cumulative significance of previously consummated individually insignificant acquisitions.

The staff may also question the financial statements provided by a registrant under Rule 3-05 when the registrant has acquired only selected parts of an entity. In such situations, it may be appropriate, on the basis of the facts and circumstances, for the registrant to include (1) full financial statements of the entity, (2) carve-out financial statements of the assets and operations acquired, or (3) abbreviated financial statements (i.e., Statement of Assets Acquired and Liabilities Assumed; Statement of Revenue and Direct Expenses). For additional information about how to determine what financial statements are appropriate when the registrant has acquired selected parts of an entity, see [Section 2065](#) of the SEC Financial Reporting Manual.

Investments in Equity Method Investees (Rules 4-08(g) and 3-09)

Examples of SEC Comments

- Please confirm supplementally that . . . the Company will monitor the three tests described in Regulation S-X 1-02(w) to determine if [Company A] is considered a “significant subsidiary.” Please confirm additionally that if [Company A] is considered a “significant subsidiary” the Company will provide separate audited financial statements or summarized financial information of [Company A] in accordance with Rules 3-09 and 4-08(g) of Regulation S-X, respectively.
- Please demonstrate how the denominator used in your significance calculation complies with Rule 3-09 of Regulation S-X. Please note that the denominator should begin with the amount identified in Rule 5-03(b)10 of Regulation S-X, which is a figure that excludes equity in earnings of unconsolidated affiliates. The Rule 5-03(b)10 figure should be adjusted to include your equity in the pre-tax earnings of unconsolidated affiliates, exclusive of amounts attributable to any noncontrolling interests of the investees, and exclude the portion of your pre-tax income attributable to any noncontrolling interests in your subsidiaries. Please recalculate the denominator used in your [Company A] significance test or clarify how the \$[X] million figure you used in your calculation was appropriate.

When a registrant has a significant equity method investment, Regulation S-X, Rules 4-08(g) and 3-09, may require the registrant to provide summarized financial information of the investee in the footnotes to the financial statements, separate financial statements of the investee, or both. To determine whether summarized information is required under Rule 4-08(g), a registrant must perform all three significance tests: the investment test, the asset test, and the income test.

Under Rule 3-09, significance is calculated for equity method investees on the basis of only two tests performed annually: the investment test and the income test. If an investee is significant, its separate financial statements must be filed in the registrant’s Form 10-K or in a related amendment. Thus, a registrant’s compliance with Rule 3-09 is particularly important because its failure to file the financial statements of a significant investee may cause it to become a delinquent filer and lose Form S-3 eligibility.

Common errors that registrants make when performing the significance tests under Rules 4-08(g) and 3-09 include:

- Failure to document the tests each year. This is most common when an equity method investee has been clearly insignificant in the past. In certain situations, such as a near-break-even year for the registrant or a large income or loss at the investee level, the current year’s significance may change, making the equity method investee significant for the first time and thus requiring audited financial statements for the current year and unaudited financial statements for prior years.
- Failure to update the tests each year. Registrants should update and reassess the significance tests for all years presented in a Form 10-K after they report a retrospective change for the classification of a component as a discontinued operation. See [paragraph 2410.8](#) of the SEC Financial Reporting Manual.

For additional SEC staff interpretations of Rules 4-08(g) and 3-09, see [Section 2400](#) of the SEC Financial Reporting Manual.

Restrictions on Dividends (Rules 4-08(e), 5-04, and 12-04)

Registrants must consider the requirements of Regulation S-X, Rules 4-08(e), 5-04, and 12-04, when the transfer of assets (cash or other funds) to the parent company/registrator from its subsidiary (or subsidiaries) or equity method investee (1) is materially restricted, (2) is limited, or (3) requires a third party's approval.

For additional discussion, see the [Debt](#) section.

Guarantors of Registered Securities (Rule 3-10)

Regulation S-X, Rule 3-10, requires a registrant to provide separate financial statements for each subsidiary issuer or guarantor of debt securities registered or being registered unless certain criteria are met. The information required under Rule 3-10 must be presented in registration and proxy statements as well as Forms 10-K and 10-Q. Therefore, a registrant should consider the requirements under Rule 3-10 if (1) the registrant registers debt and the debt is guaranteed by one or more of its subsidiaries or (2) one of the registrant's subsidiaries registers debt and the debt is guaranteed by the parent company or one or more of its other subsidiaries.

Rule 3-10 contains certain exceptions under which a registrant may provide more limited financial information in lieu of full financial statements. If the registrant meets the exception criteria, it may be eligible to provide, in a footnote to the parent company's financial statements, either of the following types of modified financial information in lieu of separate financial statements:

- Condensed consolidating financial information.
- Narrative disclosures about each subsidiary issuer or guarantor.

While each of the exceptions under Rule 3-10 has additional provisions that must be met for a registrant to qualify for the relief, all of them require (1) the subsidiary issuer and guarantors to be "100 percent owned" by the registrant and (2) the guarantee to be "full and unconditional." The SEC staff sometimes comments on whether the registrant specifically meets these and other criteria necessary for the presentation of modified financial information.

For additional SEC staff interpretations of Rule 3-10, see [Section 2500](#) of the SEC Financial Reporting Manual.

Definition of 100 Percent Owned

Example of an SEC Comment

We note that your subsidiary guarantors are wholly owned domestic subsidiaries of the Company. If true, please confirm to us that the subsidiary guarantors are 100% owned and clarify this in future filings. Refer to Rule 3-10 of Regulation S-X.

Registrants must disclose that a subsidiary is 100 percent owned to meet one of the conditions for relief under Rule 3-10. The SEC staff has reminded registrants that under Regulation S-X, "100 percent owned" does not mean the same thing as "wholly owned" and that the terms are therefore not interchangeable. The staff has indicated that wholly owned under Regulation S-X, Rule 1-02, means that the parent owns substantially all of the outstanding voting stock of the subsidiary whereas 100 percent owned is defined as ownership of all outstanding shares of the subsidiary. For further clarification of the definition of 100 percent owned, see Rule 3-10(h)(1).¹⁰

¹⁰ Registrants may wish to consult legal counsel when interpreting Rule 3-10(h)(1).

Full and Unconditional Guarantees and Release Provisions

Example of an SEC Comment

You state that [Company A] is providing guarantees of the [20XX] Notes and [20XX] Notes, respectively, “for purposes of financial reporting.” Please explain to us the nature and purpose of the [Company A] parent guarantee and tell us whether this guarantee is full and unconditional. To the extent the [Company A] parent guarantee is not full and unconditional, please tell us your basis for not including the condensed consolidating financial information for [Company A] called for by Article 3-10(f) of Regulation S-X. For guidance, refer to sections 2500.2 and 2510 of the Division of Corporation Finance Financial Reporting Manual.

A guarantee must be full and unconditional to allow the registrant to provide limited financial information in lieu of full financial statements under Rule 3-10. [Paragraph 2510.4](#) of the SEC Financial Reporting Manual clarifies that an “arrangement that permits a guarantor to opt out of its obligation prior to or during the term of the debt is not a full and unconditional guarantee.” However, a subsidiary whose guarantee is released automatically by one of the customary release provisions referred to in [paragraph 2510.5](#) of the SEC Financial Reporting Manual may rely on the relief provided by Rule 3-10. Accordingly, registrants should disclose any qualifications of subsidiary guarantees and should not characterize a subsidiary guarantee as full and unconditional without disclosing the circumstances under which it can be released.

The SEC Financial Reporting Manual's guidance on customary release provisions applies only to subsidiary guarantees, not to parent guarantees. The SEC staff has clarified that to qualify for Rule 3-10 relief, a registrant must meet certain conditions specified in the rule, one of which is the filing of the parent company's financial statements for the periods indicated. Therefore, if the parent could be released from its guarantee, there would be no basis for relief under Rule 3-10. However, the staff has allowed limited exceptions to parent release provisions, such as situations in which the parent's guarantee is released when the debt is repaid. Registrants are encouraged to contact the staff regarding any parent release provisions in their debt indentures.

Condensed Consolidating Financial Information

Examples of SEC Comments

- Please confirm that you meet the criteria of Rule 3-10(f)(1-3) of Regulation S-X to provide condensed consolidating financial information.
- Please tell us your consideration of providing a Condensed Consolidating Statement of Operations and Cash Flows for the [fiscal year]. Refer to Rule 3-10(f)(4) of Regulation S-X for guidance.

If a registrant presents condensed consolidating financial information, it should use a columnar format and include certain or all of the following as applicable: (1) the parent, (2) subsidiary issuer(s) of the security, (3) subsidiary guarantor(s), (4) nonguarantor subsidiaries, and (5) consolidating adjustments. Registrants should also provide sufficient detail about the assets, liabilities, operations, and cash flows for each of the parent, issuer, subsidiary guarantors, and nonguarantor subsidiaries, as appropriate.

The SEC staff often discusses form and content considerations related to the preparation of condensed consolidating financial information under Rule 3-10 and has highlighted that under this rule:

- The information should be presented at the same level of detail (i.e., the major financial statement captions) as interim financial statements prepared in accordance with Regulation S-X, Article 10.

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- The information should be presented in accordance with U.S. GAAP¹¹ (e.g., intercompany receivables should be shown as an asset and not as a negative liability).
- The classifications in the condensed consolidated statement of cash flows should also comply with U.S. GAAP (i.e., gross versus net reporting, investing versus financing classification).
- A total for comprehensive income should be presented in either a single continuous statement or two separate but consecutive statements.¹²

The SEC staff may also comment when a registrant:

- Incorrectly assumes that certain exceptions in Rule 3-10 are met and therefore concludes that it does not have to provide separate financial statements, condensed consolidating financial information, or narrative disclosures.
- Incorrectly prepares the required condensed consolidating financial information by not presenting subsidiaries under the equity method of accounting, or not presenting information in sufficient detail to allow investors to determine the assets, results of operations, and cash flows of each of the consolidating groups.

The SEC staff has also commented when the parent (or guarantor) has recorded positive operating cash flows in a particular period in the absence of any revenue-generating activities during that time frame. Positive cash flow from operations often results when the parent (or guarantor) classifies dividends received from its subsidiaries as a “return on its investment.” In accordance with ASC 230, the parent (or guarantor) should consider its particular facts and circumstances when determining whether the cash flows resulting from a dividend distribution represent a “return on” or a “return of” the related investment in the underlying subsidiary. The SEC staff may ask registrants to disclose (1) how they have accounted for such dividends and (2) the amount of dividends received from subsidiaries included in cash flows from operations.

Recently Acquired Subsidiary Issuers or Subsidiary Guarantors (Rule 3-10(g))

Under Rule 3-10(g), which applies to recently acquired subsidiary issuers or subsidiary guarantors, a registrant must provide separate financial statements of a significant subsidiary issuer or guarantor if the subsidiary's historical results have not been included in the parent's audited financial statements for at least nine months of the most recent fiscal year. The SEC staff has noted that the significance test under Rule 3-10(g) is different from the tests under Rule 3-05 for businesses acquired or to be acquired (see [Significant Business Acquisitions \(Rule 3-05\)](#) above). To determine significance under Rule 3-10(g), a registrant should compare the subsidiary's net book value or purchase price (whichever is greater) with the principal amount of the securities being registered. If the test result equals or exceeds 20 percent, the registrant must file separate financial statements of the acquired subsidiary that are (1) audited in accordance with the standards of the PCAOB for the most recent fiscal year and (2) unaudited for the appropriate interim period preceding the acquisition.

In computing significance under Rule 3-10(g), a registrant must aggregate the acquisitions of a group of related subsidiary issuers or guarantors before their acquisition. A registrant is also required to include such financial statements under Rule 3-10(g) in registration statements but not in periodic reports filed under the Exchange Act (e.g., Forms 10-K and 10-Q).

¹¹ One exception is that investments in subsidiaries should be presented under the equity method of accounting. See Rule 3-10(i)(5).

¹² The SEC staff has clarified that a registrant should present total comprehensive income in a manner consistent with the interim requirements for the registrant's primary financial statements. See [paragraphs 2515.2](#) and [2810.1](#) of the SEC Financial Reporting Manual for additional information.

Pro Forma Financial Information (Article 11)

Examples of SEC Comments

- Tell us how adjustment (i) for the recognition of pro forma stock-based compensation meets the requirements for a pro forma income statement adjustment (i.e., directly attributable to the transaction, expected to have a continuing impact, and factually supportable). Refer to 11-02(b)(6) of Regulation S-X.
- You disclose in [a footnote] that earnings per unit assumes [X] common units are issued in your planned offering at the closing price on February 22, 2017 of \$[X] per unit. Since it appears that the number of units to be sold and the related offering price are subject to change, please revise to include a sensitivity analysis indicating how your earnings per share would be impacted in the event the number of units issued or related offering price changes. Refer to the guidance in Rule 11-02(b)(8) of Regulation S-X.

Pro forma information is required under Regulation S-X, Article 11, when (1) it is material to an understanding of a significant consummated or probable transaction, such as a business combination; (2) a transaction is subject to a shareholder vote; or (3) other conditions outlined in Article 11 are met. Pro forma financial information under Article 11 may be required in a registration statement, proxy statement, or Form 8-K, but it is not required in a Form 10-K or 10-Q. Although Article 11 pro forma financial statements are not required in a registrant's Form 10-K or 10-Q, a registrant must separately evaluate the need for supplemental pro forma disclosures under ASC 805 (related to business combinations) in its financial statements included in a Form 10-K or 10-Q. See the [Business Combinations](#) section for more information about supplemental pro forma disclosures that are required under U.S. GAAP.

Registrants should generally present Article 11 pro forma financial statements in columnar form with separate columns for historical financial information, pro forma adjustments, and pro forma results. In limited circumstances, registrants may present narrative disclosures in lieu of pro forma financial statements. Further, Article 11 requires pro forma balance sheet adjustments to reflect events that are (1) factually supportable and (2) directly attributable to the transaction. In addition, pro forma income statement adjustments must have a "continuing impact" on the registrant's operations (i.e., they are not "one time").¹³ The SEC staff continues to comment on certain form and content matters, such as when a registrant fails to clearly explain each financial statement adjustment or does not clearly demonstrate how the above requirements are met.

When calculating pro forma adjustments, registrants should assume that the transaction occurred (1) as of the date of the most recent balance sheet for the pro forma balance sheet and (2) at the beginning of the fiscal year presented for the pro forma income statement. In the past, the SEC staff has clarified that this guidance applies only to calculating the amount of the pro forma adjustment and should not be used to determine whether an adjustment is appropriate. For example, in the preparation of a pro forma income statement, it would be inappropriate for a registrant to make a pro forma adjustment for a charge in the historical financial statements on the basis of an assertion that if the transaction had been consummated at the beginning of the year, the charge would not have been incurred.

For companies doing an IPO, the SEC staff has clarified that it would be rare for costs "that a company expects to incur as a public company" to be pro forma adjustments "since such costs are not directly attributable to the transactions for which pro forma information is presented."¹⁴ However, the staff has noted that depending on the facts and circumstances, a registrant may disclose the types and ranges of such costs in the notes to the pro forma financial information. For additional reporting considerations related to IPOs, see the [Initial Public Offerings](#) section.

¹³ The SEC staff has expanded on its view of what would constitute continuing impact. See the highlights of the June 2012 and March 2013 CAQ SEC Regulations Committee joint meetings with the SEC staff for additional information.

¹⁴ Quoted text is from the [highlights](#) of the March 2012 CAQ SEC Regulations Committee joint meeting with the SEC staff.

Disclosures About Risk

Further, transactions may be structured in a manner such that significantly different results may occur. In these instances, registrants should comply with the requirement under Regulation S-X, Rule 11-02(b)(8), to disclose additional pro forma information that gives effect to the range of possible outcomes resulting from the transaction.

[Section 3300](#) of the SEC Financial Reporting Manual summarizes issues that are often associated with pro forma financial information.

Disclosures About Risk

The SEC staff continues to expect registrants to provide investors with tailored, comprehensive, and transparent risk disclosures.

Risk Factors

Examples of SEC Comments

- The risk factors that you present appear to apply to nearly any issuer in any industry. Please significantly revise the risk factors to ensure that they are tailored to the [Type A] business.
- This risk factor appears to combine two risks: the general risk of business failure and the company's lack of a saleable product now and in the future. Please consider revising to present these risks separately.
- Please add a risk factor discussing the going concern, as discussed in [a footnote] to the financial statements.

Regulation S-K, Item 503(c), requires registrants to provide "a discussion of the most significant factors that make the offering speculative or risky." Certain indicators of risk may be present in the footnotes to the financial statements, in MD&A, or elsewhere in investor presentations or other periodic filings. The SEC staff commonly requests that registrants include new or more detailed risk factors specific to matters identified elsewhere in the filing. Registrants should be diligent in ensuring that risk factors are comprehensive and are related to their particular circumstances.

Further, instead of combining separate risk factors under a single heading and providing a general discussion, registrants are asked to review each risk factor heading to ensure that it clearly conveys and adequately describes a separate, detailed risk to investors. In addition, the SEC staff requests more specific discussion and enhanced explanations of how the risks could materially affect the registrant's business. This discussion may be supplemented with quantitative information to provide additional context about the risks. In addition, the staff often asks registrants whether they have (1) discussed all relevant risk factors and (2) provided sufficient MD&A discussion when a risk constitutes a material trend or uncertainty.

Cybersecurity

Example of an SEC Comment

We note your disclosure that you continue to face a host of cyber threats; your disclosure that cyber-crimes and denial of service attacks have increased; and your identification of cyber-attacks as a key risk. Please clarify whether you have knowledge of the occurrence of any such attacks in the past. If attacks have occurred, and were material either individually or in the aggregate, revise to discuss the related costs and consequences. Also, describe the particular aspects of your business and operations that give rise to material cybersecurity risks and the potential costs and other consequences of such risks to those businesses and operations. For additional guidance, please refer to CF Disclosure Guidance Topic No. 2 on Cybersecurity.

The SEC staff has noted the increasingly frequent occurrence of cyberincidents, which may cause registrants to incur significant remediation and other costs for (1) direct damages (both real and reputational), (2) the impact on their customers, and (3) increased protection from future cybersecurity attacks. It is important for registrants to consider the nature of any cyberincidents that occur and to provide the appropriate level of disclosure about such incidents in their filings. In his first public [speech](#) as chairman of the SEC, Jay Clayton spoke about the importance of disclosure of material information about cyber risks and cyber events and emphasized that “I expect [public companies] to take this requirement seriously.”

The SEC also [announced](#) the formation of a Cyber Unit within the Division of Enforcement that will target cyber-related misconduct. Given the increased emphasis on cybersecurity, the SEC staff is expected to continue its focus on these disclosures.

[CFDG Topic 2](#) provides the SEC staff’s views on potential disclosures related to material cybersecurity matters. CFDG Topic 2 indicates that under existing SEC requirements, registrants may need to provide disclosures in various sections of an SEC filing, including risk factors, legal proceedings, MD&A, and the financial statements. For example, cybersecurity risks and cyberincidents may constitute material known trends and uncertainties that registrants should consider disclosing in MD&A in accordance with Regulation S-K, Item 303(a)(3)(ii).

In cybersecurity disclosures, registrants should avoid using boilerplate language and instead should include information such as (1) the aspects of the business that are subject to cybersecurity risks, (2) updates for new information, and (3) cost estimates, if possible and material. Registrants should not state that there is a risk of a cybersecurity breach after the occurrence of an actual cyberattack; rather, such registrants should disclose that they have experienced security breaches or cyberattacks. Accordingly, the SEC staff may monitor information outside a registrant’s filings and ask why certain cyberincidents are not disclosed. Further, a registrant may be asked to confirm that it has disclosed the occurrence of material cyberincidents in its filings.

Other Deloitte Resources

[December 12, 2016, *Heads Up*, “Highlights of the 2016 AICPA Conference on Current SEC and PCAOB Developments”](#)

Non-GAAP Financial Measures and Key Metrics

The SEC's [final rule](#)¹⁵ on the conditions for use of non-GAAP financial information defines a non-GAAP financial measure as a “numerical measure of a registrant’s historical or future financial performance, financial position or cash flows” that includes amounts that are not part of the most directly comparable GAAP measure or excludes amounts that are part of the most directly comparable GAAP measure. Common non-GAAP financial measures include operating income that excludes one or more expense items, adjusted revenues, adjusted net income, EBITDA or adjusted EBITDA, free cash flows, core earnings, net debt, funds from operations, and measures presented on a constant-currency basis.

A [study](#)¹⁶ published by Audit Analytics noted that 96 percent of S&P 500 companies used non-GAAP measures in earnings releases during the fourth quarter of 2016. Many registrants assert that non-GAAP measures are meaningful and provide valuable insight into the information that management considers important in running the business. Registrants may believe that GAAP numbers alone do not provide a full picture of their business or their results of operations and liquidity unless they are supplemented with non-GAAP measures that they believe are useful. While the SEC staff allows registrants to use non-GAAP measures “to tell their story,” registrants must apply the appropriate SEC guidance and provide disclosures.

The use of non-GAAP financial information is primarily governed by the following rules (the “Rules”) that the SEC adopted in 2003:

- [Regulation G](#), which contains general rules requiring registrants to provide certain information whenever they disclose or release non-GAAP financial measures.
- Amendments to Regulation S-K, Item 10, and Exchange Act Form 20-F, which provide guidance on non-GAAP measures included in SEC filings.
- Amendments that require registrants to furnish to the SEC, on Exchange Act Form 8-K, earnings releases or similar announcements, with furnished press releases also having to comply with Item 10(e)(1)(i).

The SEC has also issued [Compliance and Disclosure Interpretations](#) (C&Dis) that clarify the guidance on non-GAAP measures.

¹⁵ SEC Final Rule Release No. 33-8176, *Conditions for Use of Non-GAAP Financial Measures*.

¹⁶ Audit Analytics, “A Look at Non-GAAP Reporting After New SEC Guidance” (January 2017).

The following table summarizes the disclosure requirements that apply to domestic¹⁷ registrants under the Rules:

Disclosure Requirements Applicable to Domestic Registrants

Disclosure Requirements	All Disclosure of Non-GAAP Financial Measures (Regulation G ^{18, 19})	SEC Filings (Item 10(e) of Regulation S-K ^{20, 21})	Press Releases Furnished to the SEC (Item 2.02 of Form 8-K ²²)
<ul style="list-style-type: none"> Presentation of the most directly comparable GAAP financial measure 	X		
<ul style="list-style-type: none"> Presentation, with equal or greater prominence, of the most directly comparable GAAP financial measure 		X	X
<ul style="list-style-type: none"> Quantitative reconciliation of the non-GAAP financial measure to the most directly comparable GAAP financial measure 	X	X	X
<ul style="list-style-type: none"> Statement disclosing the reasons why management believes the non-GAAP financial measure provides useful information to investors 		X	X
<ul style="list-style-type: none"> To the extent material, a statement disclosing the additional purposes for which management uses the non-GAAP financial measure 		X	X

Beginning in late 2015, SEC officials started discussing non-GAAP measures at various public venues, prompted in part by concerns about companies' extensive use of these measures. Press coverage increased as well, sometimes focusing on a specific registrant's use of non-GAAP measures and other times concentrating more broadly on the propriety and usefulness of non-GAAP measures for a wide variety of industries. This renewed focus of the SEC was the result of several factors, including (1) the increased use and prominence of such measures, (2) the nature of the adjustments, and (3) the increasingly large difference between the amounts reported for GAAP and non-GAAP measures.

In response to these increasing concerns, in May 2016, the SEC issued new and updated C&DIs to provide additional guidance on what it expects from registrants when using these measures. The SEC staff noted its expectation that the updated C&DIs would promote changes in the use of non-GAAP measures, particularly related to the undue prominence placed on such measures and to the presentation of potentially misleading measures, as well as compliance with other presentation and disclosure requirements. Given the staff's focus on non-GAAP measures, it is no surprise that they have taken over the number one spot on the list of top 10 topics in reviews with comment letters.

¹⁷ For guidance on FPIs, see Regulation G; Regulation S-K, Item 10(e); [Section 106](#) of the C&DIs; and [Section 8140](#) of the SEC Financial Reporting Manual.

¹⁸ Regulation G applies whenever a registrant, or person acting on its behalf, publicly discloses or releases material information that includes a non-GAAP financial measure, whether that information is furnished to, or filed with, the SEC.

¹⁹ In certain situations, Regulation G and Item 10(e) do not apply. For example, they do not apply to non-GAAP measures related to a proposed business combination or measures required to be disclosed by a governmental authority.

²⁰ Item 10(e) applies to all SEC filings that include non-GAAP financial measures.

²¹ See footnote 19.

²² Form 8-K, Item 2.02, requires registrants to furnish to the SEC all releases or announcements disclosing material nonpublic financial information about completed annual or quarterly fiscal periods, regardless of whether the release or announcement includes disclosure of a non-GAAP financial measure.

Recent SEC comments have covered a wide range of matters related to non-GAAP measures. Of particular concern to the staff is the prominence of non-GAAP measures. Comments have also focused on enhancing the disclosure related to the purpose and use of such measures, reconciliation requirements, and clear labeling. In addition, the SEC has questioned the nature of certain adjustments that may be potentially misleading and has commented on the presentation of the tax impact of non-GAAP adjustments. Deloitte's *A Roadmap to Non-GAAP Financial Measures*, which combines the SEC's guidance on non-GAAP measures with Deloitte's interpretations and examples in a comprehensive, reader-friendly format, provides further guidance on each of these areas of SEC focus, which are also discussed further below.

Undue Prominence

Examples of SEC Comments

- We note that in your executive summary you focus on key non-GAAP financial measures and not GAAP financial measures which may be inconsistent with the updated Compliance and Disclosure Interpretations issued on May 17, 2016 (specifically Question 102.10). We also note issues related to prominence within your earnings release Please review this guidance when preparing your next earnings release.
- We note that your reconciliation of EBITDA starts with the non-GAAP measure and reconciles to the GAAP measure (net income). In future filings please revise your presentation to start with the GAAP measure so that the GAAP measure is presented with equal or greater prominence. This comment also applies to any non-GAAP measures presented in an earnings release. Refer to Question 102.10 of the Compliance and Disclosure Interpretations.
- We note you present full GAAP to Non-GAAP Adjusted Statements of Earnings Please note that the presentation of a full non-GAAP income statement may place undue prominence to the non-GAAP information and may give the impression that the non-GAAP income statement represents a comprehensive basis of accounting. Please confirm to us that you will not present non-GAAP consolidated income statements in future filings. Please refer to Question 102.10 of the Non-GAAP Financial Measures Codification and Disclosure Interpretation As an alternative, you may present a non-GAAP performance measure reconciled to the most comparable measure calculated in accordance with GAAP.

In assessing prominence, a registrant should consider, among other items, the order of presentation, degree of emphasis, style of presentation, and volume of disclosures in a filing. C&DI Question 102.10 provides examples illustrating when the presentation of a non-GAAP measure is more prominent than that of a comparable GAAP measure. Since the SEC staff's publication of the updated C&DIs on non-GAAP measures, C&DI Question 102.10 has been a leading source of SEC comments on such measures. Accordingly, it may be helpful for a registrant to note the following:

- If GAAP and non-GAAP measures are presented in a particular section of a document, the GAAP measures should be presented before the non-GAAP measures. For example, if a registrant wants to use certain non-GAAP measures in its discussion of results of operations, it should discuss the GAAP results before the non-GAAP measures.
- In public forums and in SEC comment letters, the SEC staff has clearly indicated that when a registrant reconciles a non-GAAP measure to the most comparable GAAP measure, it should start with the GAAP measure.
- The registrant should not present the non-GAAP measure in more detail or emphasize it more than it does the comparable GAAP measure. For example, use of phrases such as "exceptional" or "record" in a discussion of the non-GAAP measure would place undue emphasis on that measure if such phrases were not used to describe the comparable GAAP measure.

- The disclosures related to the purpose and use of non-GAAP measures should not state or imply that the non-GAAP measures are superior to, provide better information about, or more accurately represent the results of operations than GAAP measures.
- Certain presentations that give undue prominence to non-GAAP information, such as a full non-GAAP income statement, are prohibited.

Finally, if a registrant presents forward-looking non-GAAP financial measures, it should provide a quantitative reconciliation unless it qualifies for the “unreasonable efforts” exception in Regulation G and Regulation S-K, Item 10(e). A registrant that qualifies for the exception should disclose that fact in a prominent location, identify the information that is not available, and indicate the probable significance of this information.

Disclosures About Purpose and Use

Example of an SEC Comment

Please revise to disclose the reasons why you believe your presentation of each of the non-GAAP financial measures provides useful information to investors regarding your financial condition and results of operations. The justification for the use of the non-GAAP financial measure must be substantive. Merely indicating that you provide such non-GAAP financial measures to give investors additional data to evaluate your operations is not sufficient support for disclosure of the non-GAAP financial measures. Please also revise to expand your disclosure of the additional purposes for which management uses each of the non-GAAP financial measures. Please refer to Item 10(e) of Regulation S-K.

A registrant should include transparent disclosures that clearly demonstrate (1) the usefulness of the non-GAAP measure to investors and (2) the additional purposes for which management uses such measure (e.g., for incentive and compensation arrangements, to manage its business, to allocate resources, or as a debt covenant). A registrant should avoid providing boilerplate disclosures related to the usefulness and purpose of the measure. Rather, the disclosures should be specific to the measure used, to the registrant and the nature of its business and industry, and to the manner in which management assesses the non-GAAP measure. The SEC staff has commented on the extent of a registrant’s disclosures and whether the disclosures demonstrate the purpose of the measures (i.e., their usefulness to investors and how management uses them).

Clear Labeling

Examples of SEC Comments

- [I]n your summary table of non-GAAP results, you label the items using the same name as your GAAP measures while in your discussion of the non-GAAP measures you refer to the non-GAAP measures with different titles, such as non-GAAP gross profit. In future filings when disclosing non-GAAP financial measures, please revise your presentation to use titles consistently and to use titles or descriptions for your non-GAAP financial measures that are not the same as, or confusingly similar to, titles or descriptions used for GAAP financial measures. Refer to Item 10(e)(1)(ii)(E) of Regulation S-K.
- Within your discussion of modified net operating income, we note you have indicated that some of your adjustments are non-recurring. Given the nature of these adjustments, it is not clear why they are non-recurring. Please clarify and/or revise to remove the reference to non-recurring from your disclosure. Reference is made to Question 102.03 of the Division’s Compliance and Disclosure Interpretations for Non-GAAP Financial Measures.

The SEC staff focuses on whether registrants have (1) clearly labeled and described non-GAAP measures and adjustments, (2) used appropriate conventional accounting terminology, and (3) provided context for their presentation of non-GAAP measures.

When labeling a non-GAAP financial measure, a registrant may not use titles or descriptions that are the same as, or are confusingly similar to, titles or descriptions used for GAAP financial measures or amounts presented in accordance with Regulation S-X.

For example, a registrant should not:

- Use GAAP titles such as “gross margin” or “operating income” for amounts presented that exclude costs that would generally be included in these totals under GAAP or Regulation S-X, Article 5. If such costs are excluded, the label attached to the amount should clearly indicate that such amounts are adjusted (e.g., “adjusted operating earnings” if a registrant excludes restructuring charges from its non-GAAP “operating earnings” measure).
- Label a measure “pro forma” if the measure was not calculated in a manner consistent with the concepts in Regulation S-X, Article 11, or in ASC 805.

Further, as discussed in C&DI Question 102.03, if management concludes that an adjustment to a non-GAAP performance measure is appropriate but that the adjustment is reasonably likely to recur within two years or there was a similar charge in the past two years, it may adjust the non-GAAP performance measure (subject to Regulation G and the other requirements in Regulation S-K, Item 10(e)) but may not describe the adjustment as “nonrecurring,” “infrequent,” or “unusual” because the adjustment does not meet the specified criteria.

Liquidity Versus Performance Measures

Example of an SEC Comment

We continue to question whether your disclosure of non-GAAP diluted EPS is consistent with C&DI 102.05. In particular, you point out that the reconciling items from GAAP net income to non-GAAP net income will not require cash settlement. By adjusting your net income to exclude only non-cash items, it appears that you are attempting to present a cash-based earnings measure. Furthermore, we note that for the periods presented in . . . earnings releases, your non-GAAP net income was within 10% of your cash provided by operating activities in your Statements of Cash Flows for the same periods. In light of the above, please explain how you determined that your non-GAAP net income measure could not be used as a liquidity measure. Alternatively, please remove non-GAAP diluted EPS from your future earnings releases.

A registrant must determine whether a non-GAAP measure’s purpose is to assess the registrant’s performance or its liquidity or, in some cases, both. This determination will affect (1) which GAAP measure is most directly comparable to the non-GAAP measure and (2) any prohibitions against presentation, such as per-share amounts or adjustments. For example, a performance measure should generally be reconciled to a line item from the statement of operations such as net income or income from continuing operations or, if a per-share performance measure is presented, to GAAP earnings per share. A liquidity measure should be reconciled to an amount from the statement of cash flows, such as cash provided by operating activities, and is prohibited from being presented on a per-share basis.

Registrants should consider whether the classification of a non-GAAP measure as a performance measure is appropriate if the non-GAAP measure is, in substance, a liquidity measure. The SEC staff may focus on the substance of the non-GAAP financial measure and not on management’s characterization, and it may challenge a measure designated as a performance measure that appears to be more like a liquidity measure. The context of the non-GAAP disclosure may be an important consideration.

Depending in part on the size and nature of the adjustments to the corresponding GAAP measure, a registrant may need to use judgment in assessing whether a non-GAAP performance measure can be used as a liquidity measure. The SEC staff may comment if, for example:

- A non-GAAP measure is located in the registrant's discussion of financial condition and liquidity even though the registrant considers the measure to be a performance measure and reconciles it to net income.
- Several adjustments (many of which are noncash amounts) must be made to reconcile a non-GAAP measure that a registrant purports to be a performance measure to the most comparable GAAP income measure, and only one or two adjustments would be needed to reconcile it to a GAAP measure from the statement of cash flows, such as operating cash flow.
- The total dollar amount of the non-GAAP adjustments consists of a large percentage of non-cash charges.

If the measure could be used as a liquidity measure and is ultimately determined to be a liquidity measure, a registrant would be prohibited from disclosing a per-share amount (e.g., free cash flow is a liquidity measure, and per-share presentation is expressly prohibited).

Reconciliation

Examples of SEC Comments

- You present a summary table of non-GAAP results that includes revenues and operating expenses but we note that you did not reconcile these items to the most directly comparable GAAP financial measures as required by Item 10(e)(1)(i)(B) of Regulation S-K. In future filings when you present non-GAAP measures, please include all of the disclosures required by Item 10(e) of Regulation S-K, including the required reconciliations.
- Please revise your reconciliation of EBITDA and Adjusted EBITDA to begin with net income rather than operating income. Please refer to Question 103.01 of the Non-GAAP Financial Measures Compliance & Disclosure Interpretations for guidance.

The SEC staff has continued to comment on instances when non-GAAP financial measures were presented without providing the required quantitative reconciliation or when registrants improperly reconcile a non-GAAP financial measure to a GAAP financial measure that was not the most directly comparable GAAP financial measure. C&DI Question 103.02 indicates that EBIT and EBITDA, if presented as a performance measure, should be reconciled to net income and not operating income. In other circumstances, registrants should use judgment in determining the most directly comparable GAAP measure.

Nature of Adjustments

Examples of SEC Comments

- Please explain to us why it is appropriate to remove restructuring, integration and deal costs, termination of certain supply and distribution agreements costs and legal settlement and legal proceedings, investigations and inquiries costs from your adjusted non-GAAP income measure when they appear to be normal, recurring operating expenses that will be settled in cash. See CDI 100.01. In your response, please tell us the significant components of each of the expenses for each of the last three years and the latest interim periods with comparable amounts.
- The adjustment “change in deferred [Type A] revenue and [Type B] liability” in arriving at your non-GAAP measure “adjusted EBITDA” appears to accelerate the recognition of revenue associated with the deferred [Type A] and [Type B] liability that otherwise would not be recognized in any of the periods for which adjusted EBITDA is presented. Accordingly, adjusted EBITDA substitutes a tailored revenue recognition method for that prescribed by GAAP and does not comply with Question 100.04 of the staff’s Compliance & Discussion Interpretations on Non-GAAP Financial Measures. Please remove this adjustment from your computation.

An overriding theme of the SEC’s guidance on non-GAAP measures is that such measures should not be misleading regardless of whether they are used in a filing (e.g., Form 10-K or Form 10-Q) or elsewhere (e.g., a press release). As described in Section 100 of the C&DIs, non-GAAP measures that could mislead investors include those that:

- Exclude normal, recurring cash operating expenses necessary for business operations.
- Are presented inconsistently between periods, such as by adjusting an item in the current reporting period, but not a similar item in the prior period, without appropriate disclosure about the change and an explanation of the reasons for it.
- Exclude certain nonrecurring charges but do not exclude nonrecurring gains (e.g., “cherry picking” non-GAAP adjustments to achieve the most positive measure).
- Are based on individually tailored accounting principles, including certain adjusted revenue measures.

In addition to the examples discussed in the C&DIs, various other presentations could be considered misleading depending on the facts and circumstances. The SEC staff has primarily used the SEC comment letter process, various speeches, and the C&DIs to publicize its conclusions that certain measures are misleading and that it objects to their use.

For example, if a registrant has recurring restructuring charges or frequent routine business acquisitions (i.e., a “serial” restructurer or acquirer), the SEC staff may ask about the facts and circumstances supporting an adjustment for what may appear to be a recurring cost. Depending on its specific circumstances, the registrant may be able to support why such an adjustment is appropriate. However, the registrant may wish to consider whether enhancements to its disclosures about the nature and purpose of the adjustment or resulting non-GAAP measure would help clarify the intent of the measure or its use by management and investors.

Income Tax Effects

Example of an SEC Comment

We note that you separately adjust for the change in U.S. Tax Law in your non-GAAP reconciliations but appear to show all other adjustments net of tax. Please present the income tax effects of your non-GAAP adjustments as a separate adjustment and explain how you calculated the income tax effects related to these adjustments in your next earnings release. Refer to Question 102.11 of the Non-GAAP Compliance and Disclosure Interpretations.

In certain circumstances, a registrant may reflect a non-GAAP measure after taxes and therefore show the tax adjustments when reconciling a non-GAAP measure to the appropriate GAAP measure. A registrant should present its reconciling adjustments gross of tax and should disclose how the tax adjustments were determined. If other tax adjustments are included in the reconciliation, such as the removal of discrete tax adjustments, a registrant should separately disclose the income tax effects of the non-GAAP adjustments from other adjustments. The SEC staff frequently reminds registrants to revise their disclosures and tabular presentations to separately present the income tax impact of their non-GAAP adjustments and to disclose how the tax impact of the non-GAAP adjustments was calculated.

Certain Financial or Operating Metrics

Example of an SEC Comment

We note your discussion . . . of the number of your customers and your annual dollar-based net expansion rate. Please tell us what consideration you have given to discussing these metrics, as well as other measures you use to evaluate your business, in a separately titled section and discussing any trends in such metrics and related material impacts on your business. For example, it appears that the growth rates of property manager customers and law firm customers are slowing. See Item 303(a) of Regulation S-K, and for additional guidance, refer to Section III.B of SEC Release No. 33-8350.

A registrant may include in its SEC filings certain ratios or statistical measures such as “same-store sales,” “number of likes,” “occupancy rates,” and “average room rates” — often referred to as key performance indicators (KPIs), key operating metrics, or simply metrics — to illustrate, for example, the size and growth of its business. Such measures are not included in the financial statements or the notes; nor are they necessarily derived from any underlying financial statement amounts. While these customized metrics are generally not considered non-GAAP measures, the SEC staff has indicated that a registrant should provide certain disclosures about them, many of which are similar to those the registrant would provide for non-GAAP measures under the Rules.

At the “SEC Speaks in 2015” Conference, the SEC staff indicated that because not all investors may be familiar with a registrant’s metrics, such metrics should be discussed informatively. Accordingly, a registrant should (1) clearly define the metrics used and how they are calculated, (2) describe any important assumptions and limitations of the metrics (e.g., whether the metric is a “hard” amount or an estimate), (3) present a metric within a balanced discussion, and (4) clearly describe how a metric is related to current or future results of operations. A registrant should also consider disclosing how management uses specific metrics and why they are important to investors. In addition, the staff indicated that because metrics evolve over time, it expects registrants to disclose what the changes are and the reasons for using a new metric.

Disclosure Controls and Procedures

The SEC staff noted that registrants should use judgment when determining whether to include these metrics in filings and should consider the following questions in making this determination:

- Is the metric integral to the registrant's story?
- Does the metric help investors understand changes quickly and effectively?
- Is the metric discussed outside of periodic filings (e.g., in earnings calls or supplemental packages)?

Other Deloitte Resources

[A Roadmap to Non-GAAP Financial Measures](#)

Disclosure Controls and Procedures

In discussions of DC&P,²³ registrants must use language that conforms to the requirements in Rule 13a-15(e) or Rule 15d-15(e) of the Exchange Act.²⁴ The SEC staff often comments when registrants do not use the proper definition of DC&P or omit certain language in reaching conclusions about the effectiveness of their DC&P. In these situations, the staff frequently requires registrants to confirm that their DC&P are effective in the current year and to revise their disclosures in future filings.

Inappropriate Conclusion About DC&P

Example of an SEC Comment

We note your statement that your disclosure controls and procedures are not effective for a company your size. Please revise to remove the qualifier "for a company our size." Refer to Item 307 of Regulation S-K, which requires a clear and unqualified statement as to whether your disclosure controls and procedures are effective or ineffective.

The SEC staff has noted that management must clearly state, without using any qualifying or alternative language, its conclusion about whether DC&P are "effective" or "ineffective" as of the end of the respective quarter. Examples of unacceptable language include phrases such as "adequate," "effective except for," "effective except as disclosed below," or "reasonably effective."

The SEC staff has also commented when registrants refer to the level of assurance of the design of their DC&P. Although registrants are not required to discuss such assurance, the staff has asked registrants that choose to do so to also state clearly whether the DC&P are, in fact, effective at the "reasonable assurance" level.

In addition, when registrants have concluded that their DC&P are ineffective, the staff has asked them to discuss how they intend to remedy the deficiencies identified.

²³ Under Part I, Item 4, of Form 10-Q and Part II, Item 9A, of Form 10-K.

²⁴ As required by Regulation S-K, Item 307.

Incomplete, Inconsistent, or Inaccurate Information in Disclosure About DC&P

Examples of SEC Comments

- Please note that pursuant to Item 307 of Regulation S-K disclosure controls and procedures is defined as controls and procedures that are designed “to ensure information required to be disclosed by the issuer in the reports that it files or submits under the Act . . . is recorded, processed, summarized and reported, within the time periods specified in the Commission’s rules and forms” and controls and procedures that are designed “to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Act is accumulated and communicated to the issuer’s management including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decision regarding required disclosure.” We note that the Company’s conclusions regarding the effectiveness of your disclosure controls and procedures refer to only half of the definition. If you choose to refer to the definition of disclosure controls and procedures when concluding as to the effectiveness of your disclosure controls and procedures then you should provide the entire definition. Alternatively, you may conclude that your disclosures controls and procedures were “effective” or “not effective” without providing any part of the definition. Please revise your filings accordingly.
- Please tell us how you considered your disclosure controls and procedures to be effective . . . despite identifying that you did not maintain effective internal control over financial reporting due to a material weakness in your controls related to [Topic X].

Registrants are not required to define DC&P in their conclusion (they may refer to the definition in the Exchange Act Rules instead). However, if they choose to define the term, they must use the entire definition in Rule 13a-15(e) or Rule 15d-15(e). The SEC staff has commented when registrants (1) define DC&P but do not use the entire definition or (2) neither fully define DC&P nor refer to the definition in the Exchange Act. In addition, the staff has commented when a registrant’s DC&P disclosure (1) is inconsistent with other disclosures in the filing or previous filings or (2) does not contain all of the required information.

Conclusion That DC&P Were Effective If a Restatement Is Required, a Material Weakness Exists, or Reports Were Not Filed in a Timely Manner

Examples of SEC Comments

- Please explain to us how you concluded that your disclosure controls and procedures were effective . . . considering that your internal control over financial reporting was not effective as of the same date. Specifically, please explain why the material weakness you identified in your internal control over financial reporting did not impact the effectiveness of your disclosure controls and procedures.
- [P]lease consider whether management’s failure to perform or complete its report on internal control over financial reporting impacts its conclusions regarding the effectiveness of your disclosure controls and procedures . . . and revise your disclosure as appropriate.

[Paragraph 4310.9](#) of the SEC’s Financial Reporting Manual states, “Because of the substantial overlap between ICFR and [DC&P], if management concludes that ICFR is ineffective, it must also consider the impact of the material weakness on its conclusions related to [DC&P].” If a registrant concludes that its DC&P are effective when a material weakness exists, the SEC staff often asks for information on the factors the registrant considered in reaching such a conclusion. In addition, when a registrant is required to file amended periodic reports containing restated financial statements, the SEC staff generally asks the registrant to reconsider its conclusions about the effectiveness of its DC&P.

The SEC staff has also asked about management's conclusion that DC&P were effective when a registrant did not file periodic reports in a timely manner. A registrant should design DC&P to ensure that information disclosed in its reports filed or submitted under the Exchange Act is recorded, processed, summarized, and reported within the periods specified in the SEC's rules. If the registrant does not report such information within these periods, the staff may request that the registrant supply additional information to support management's conclusion.

A Change in the Conclusion That DC&P Were Effective If No Changes to ICFR Were Disclosed

Example of an SEC Comment

You state that your disclosure controls and procedures were effective as of May 31, 2016. Given that your disclosure controls and procedures appear to have been ineffective as of November 31, 2015, please tell us what changed from November 31, 2015 to May 31, 2016 that allowed you to reach a different conclusion about the effectiveness of your disclosure controls and procedures as of May 31, 2016.

If a registrant concludes that its DC&P were effective after a period in which the DC&P had been deemed ineffective, the SEC staff may ask the registrant to explain the basis for its conclusion. The SEC staff is especially likely to do so if the registrant has disclosed in the same period that there have been no changes to its ICFR.

Internal Control Over Financial Reporting

In addition to disclosing material changes in ICFR on a quarterly basis,²⁵ a registrant must annually provide management's report on ICFR and, if applicable, the attestation report of the registrant's registered public accounting firm.²⁶ These reports are not required in registration statements or Form 11-K.²⁷ Further, newly public companies generally do not need to provide management's report on ICFR in the first Form 10-K that they file after their initial public registration statement is declared effective.²⁸ In addition, the JOBS Act amended Section 404(b) of the Sarbanes-Oxley Act by exempting EGCs from the requirement to obtain an attestation report on ICFR for as long as such entities retain their EGC status. See the [Emerging Growth Companies](#) section for considerations related to EGCs.

Entities should be mindful of the SEC's [interpretive release](#)²⁹ regarding management's assessment of ICFR, particularly the guidance on the evaluation of control deficiencies. The SEC staff has stated that internal control reporting is a focus in its reviews and enforcement actions, and this focus is demonstrated by past SEC cases. For example, in one case, the SEC's Division of Enforcement brought an [enforcement action](#) against the CEO and former CFO of a computer equipment company alleging internal control violations, including (1) the failure to disclose to their company's auditors significant deficiencies in internal control and (2) falsely representing in their signed certifications under Section 302 of the Sarbanes-Oxley Act that they disclosed all such deficiencies to the auditors. In another case, an [enforcement action](#) was brought against a corporation for FCPA violations, including internal control

²⁵ Under Part I, Item 4, of Form 10-Q and Part II, Item 9A, of Form 10-K.

²⁶ The requirement for an attestation report applies only to large accelerated and accelerated filers because nonaccelerated filers are exempt from this requirement under Section 404(b) of the Sarbanes-Oxley Act.

²⁷ Form 11-K is used to file the annual reports for employee stock purchase, savings, and similar plans.

²⁸ However, [paragraph 4310.6](#) of the SEC Financial Reporting Manual states, "A company that historically reported under the Exchange Act as a voluntary filer or because of registered debt, and therefore filed annual reports up to and through the date of its [equity] IPO, in which it was required to comply with . . . Item 308(a) of Regulation S-K, is therefore required to provide management's report on ICFR in its first annual report following the IPO."

²⁹ SEC Interpretive Release No. 33-8810, *Commission Guidance Regarding Management's Report on Internal Control Over Financial Reporting Under Section 13(a) or 15(d) of the Securities Exchange Act of 1934*.

violations of the Exchange Act, with the chief of the Division of Enforcement's FCPA Unit noting that the FCPA violations were the result of a "lax internal control environment."

Evaluation of Severity of Control Deficiencies

Examples of SEC Comments

- Please describe in detail your evaluation of the severity of the key control deficiency. Refer to the guidance for evaluation of control deficiencies beginning on p. 34 of SEC Release No. 33-8810 "Commission Guidance Regarding Management's Report on Internal Control Over Financial Reporting Under Section 13(a) or 15(d) of the Securities Exchange Act of 1934." Include in your analysis a description of the maximum potential amount or total of transactions exposed to the deficiency and how that determination was made.
- [W]e note that you identified a misstatement in the accounting for certain partnership interests . . . , which resulted in a reduction to Retained Deficit of [\$X] million, an increase in Additional Paid-In Capital of [\$Y] million and a decrease in Redeemable Non-Controlling Interests of [\$Z] million. We also note that you concluded the misstatement to be immaterial to the prior periods and revised the historical consolidated financial information within this Form 10-Q. Please [d]escribe the nature of the error, how it was identified and how the error impacted your conclusion on the effectiveness of the Company's disclosure controls and procedures ("DC&P") and internal control over financial reporting ("ICFR"). In this regard, please note that a material weakness as defined in Rule 1-02(a) of Regulation S-X is not limited to the existence of a material financial statement misstatement but rather considers whether there is a reasonable possibility that a material misstatement of the annual or interim financial statements will not be prevented or detected on a timely basis.

The SEC staff has continued to issue comments to registrants that have identified numerous control deficiencies without reporting a material weakness to understand how the registrants evaluated the severity of the deficiencies in the aggregate. The SEC staff has reiterated that the existence of a material weakness does not depend on the actual magnitude of an error (or whether an error existed) but instead depends on whether there was a reasonable possibility that a material misstatement could have occurred without being detected or prevented by the registrant's ICFR. In the interpretive release discussed above, the SEC stated that management needs to consider "whether each deficiency, individually or in combination, is a material weakness as of the end of the fiscal year . . . even though such deficiencies may be individually less severe than a material weakness"; in addition, the SEC noted an increased likelihood of misstatement when there are "[m]ultiple control deficiencies that affect the same financial statement amount or disclosure."

At the 2013 AICPA Conference, Brian Croteau, then SEC deputy chief accountant, questioned whether all material weaknesses are being properly identified and noted that only in rare instances does management identify a material weakness in the absence of a material misstatement. He attributed this to the following possibilities: (1) "the deficiencies are not being identified in the first instance" or (2) "the severity of deficiencies is not being evaluated appropriately."

At the 2015 AICPA Conference, then SEC Chair Mary Jo White, then SEC Chief Accountant James Schnurr, and Mr. Croteau reiterated the importance of ICFR, noting that some of the recent PCAOB inspection findings related to ICFR may not solely rest on audit execution but may indicate underlying issues involving management controls and assessments. Mr. Croteau reminded auditors and management that before the severity of a control deficiency is assessed, it is important to properly identify and describe the nature of the deficiency in the context of the complete population of transactions that the control addresses. He noted that when the severity of the deficiency is evaluated, consideration of the likelihood and magnitude of the misstatement is important; this analysis often rests on the "could factor" aspect of evaluation, which frequently requires management to look at additional information that is not otherwise part of the control.

ICFR was also a key topic at the 2016 AICPA Conference. Kevin Stout, OCA senior associate chief accountant, stated at the conference that although companies' identification of material weaknesses is improving, improvement is still needed with respect to the timing of identifying deficiencies and the evaluation of their severity, noting that this continues to be a focus of the SEC.

Evaluation of Control Deficiencies Related to Immaterial Misstatements

Example of an SEC Comment

We note that you concluded that the errors related to deferred tax assets were immaterial to the previously reported amounts contained in your periodic reports. Please tell us the following concerning these errors:

- Explain to us in greater detail the nature of the errors and how they were determined and remediated;
- Tell us if there was any impact on the evaluation of your disclosure controls and procedures and your conclusion on Internal Control over Financial Reporting; and
- Provide us with your SAB 99 materiality analysis beginning with the initial time period in which the errors were detected, addressing how you concluded that these errors were immaterial to the previously reported amounts contained in your periodic reports.

At the September 2014 AICPA Banking Conference, the SEC staff indicated that it will continue to question how registrants have considered and evaluated the severity of deficiencies in ICFR related to immaterial misstatements that were corrected by immaterial restatements.³⁰ The staff reminded registrants that the severity of a deficiency does not depend on whether a misstatement actually has occurred; rather, it depends on whether there is a reasonable possibility that the deficiency could have resulted in a misstatement. The evaluation of the severity warrants consideration of risk factors including, but not limited to, the potential future consequences of the deficiency.³¹ Accordingly, it is possible that an immaterial restatement represents a material weakness in ICFR even though the actual magnitude of an error was not material. The SEC's interpretive release states:

Management evaluates the severity of a deficiency in ICFR by considering whether there is a reasonable possibility that the company's ICFR will fail to prevent or detect a misstatement of a financial statement amount or disclosure; and the magnitude of the potential misstatement resulting from the deficiency or deficiencies. The severity of a deficiency in ICFR does not depend on whether a misstatement actually has occurred but rather on whether there is a reasonable possibility that the company's ICFR will fail to prevent or detect a misstatement on a timely basis.

³⁰ An immaterial restatement is a restatement of previously issued financial statements for the correction of a misstatement that is either (1) not material to the prior period being changed but would be material to the current period if corrected in the current period or (2) not material to any periods being presented.

³¹ At the December 2014 AICPA Conference, the SEC staff indicated that "[c]onsidering the nature of the deficiency is an important next step in determining the magnitude of the potential misstatement." This evaluation should include consideration of both the nature and current number of transactions affected by the deficiency and the expected amount or volume of transactions that may be affected in the future.

Evaluation of Deficiencies Identified in the Other COSO Components

Example of an SEC Comment

We continue to question your evaluation of the deficiencies in ICFR and your determination that it was not reasonably possible that a material misstatement of your financial statements would not be prevented or detected on a timely basis as a result of certain control deficiencies. In this regard, please address the following:

- Tell us how you considered the various errors identified at your corporate location and across multiple geographic regions, some of which were the result of control deficiencies, including significant deficiencies, in different components of the COSO Framework, in evaluating the effectiveness of the control environment component of COSO, especially as it relates to the factor regarding competence (i.e., knowledge, skills, training, and experience of the relevant employees).
- For the significant deficiencies you identified in the risk assessment, monitoring, and information and communication components, tell us why the severity of each is limited to the specific, individual process-level errors you describe in your response and how you determined that the reasonably possible potential error for each is limited to the various errors identified. For example, how was it determined that the significant deficiency in the risk assessment component related to “not having the appropriate resources” is limited to only being manifested through an immaterial error in a specific type of revenue transaction?
- Tell us how you concluded that the significant deficiency resulting in the embedded derivative error is appropriately classified within the information and communication component, as opposed to the failure to identify the relevant clauses in the contracts resulting from, for example, a lack of appropriate employee technical skill (control environment), an improper risk assessment of the types of activities that could lead to embedded derivatives, or the ineffective monitoring of the regional accounting team by the corporate accounting team.

The SEC staff has questioned whether deficiencies in control activities may be related to deficiencies in one or more of the following components of ICFR:

- Control environment.
- Information and communication.
- Risk assessment.
- Monitoring.

Specifically, the SEC staff may ask a registrant to provide a detailed analysis on how it concluded that the controls related to each of the other four COSO components were effective. This point was illustrated at the 2014 AICPA Conference by Mr. Stout, who cited an example in which a growing company had “not employed sufficient resources in the finance department to keep up.” Mr. Stout stated that such a situation “raises questions about what other amounts or disclosures could be impacted by the lack of resources and how the Control Environment and Risk Assessment components of COSO had been evaluated.” Mr. Stout explained that if management does not understand the nature of all deficiencies, it “is more likely to overlook the possibility that there is a deficiency in another COSO component that may already represent, or could otherwise be developing into, a material weakness.”

Disclosure of Material Changes in ICFR

Example of an SEC Comment

You disclose that you substantially completed the implementation of your new Enterprise Resource Planning System ("ERP") by the end of 2015 and the implementation of this System has affected and will continue to affect your internal controls over financial reporting. We remind you that if your ERP implementation results in any material changes to internal controls over financial reporting, you should provide disclosures required by Item 308(c) of Regulation S-K.

The SEC staff has commented when a registrant has not explicitly and clearly asserted whether there has been a change in ICFR in the last fiscal quarter that had or could have a material effect on its ICFR, as required by Regulation S-K, Item 308(c). Registrants should state clearly whether there were changes in ICFR for the quarter and, if so, should disclose the nature of the changes. The staff has stressed that registrants should avoid "boilerplate" disclosure that there have been no material changes affecting ICFR in a period, particularly when there have been identifiable events such as layoffs, changes in outsourcing arrangements, or changes in accounting policies. At the 2016 AICPA Conference, SEC Chief Accountant Wesley Bricker noted that updating and maintaining internal controls will be particularly important as companies implement new accounting standards. It will be important for management to evaluate whether changes to internal controls in response to the adoption of a new accounting standard should be disclosed as a material change in ICFR.

Consequently, the SEC staff expects to see increased disclosures regarding changes in ICFR, specifically those related to remediation of material weaknesses. For example, the staff has reminded registrants that it is important for management to monitor and consider disclosing a change in ICFR in the quarter in which management remediates a material weakness.³²

In reviewing registrants' filings, the SEC staff looks for indicators of potential ICFR deficiencies. Common indicators include disclosures about changes in ICFR and corrections of errors. If indicators are observed, the staff routinely asks registrants about management's consideration of such indicators in relation to its conclusions about the effectiveness of ICFR (i.e., whether a deficiency in internal control represents a material weakness that should have been identified and disclosed). For the quarter in which any material changes in ICFR occur, registrants should provide disclosures about such material changes, including (1) the identification of any material weaknesses and (2) changes made to remediate material weaknesses.

³² The SEC staff discussed remediation of material weaknesses and related disclosure considerations at the 2010 AICPA Conference. For additional information, see Deloitte's December 16, 2010, [Heads Up](#).

Disclosures About the Impact and Remediation of Material Weaknesses

Example of an SEC Comment

We note your disclosure that your independent registered public accounting firm identified material weaknesses in the internal control over financial reporting during the . . . audits. Please revise to address the following:

- Please provide information surrounding each of the material weaknesses identified. Quantify the effects of each one on your financial statements.
- Please provide an expanded discussion of the specific steps you have taken and put into place to resolve each material weakness. Identify which material weaknesses have been resolved and which have not been resolved.
- Please revise MD&A to provide a discussion of the material weaknesses that includes the information requested in the first two bullets points of this comment and that includes a discussion of how the material weaknesses affected your financial condition, results of operations and cash flows.

The SEC staff has indicated that management's disclosures about material weaknesses are expected to go beyond merely identifying the existence of one or more material weaknesses or providing a limited description. Rather, such disclosures should contain enough information to allow investors to understand the cause of a material weakness and determine the pervasiveness of its effect on ICFR. Such expectations apply when a company discloses a material weakness outside of management's report of ICFR, including in Form S-1 and Form 10-Q filings.

Similarly, the staff has called for more transparent disclosures about the pervasiveness of a material weakness's impact on the registrant's financial reporting and its ICFR. The staff has stressed that registrants need to avoid narrowly focusing their disclosures on a particular financial statement line item affected by a material weakness and should consider other financial statement line items that may also be affected.³³

Registrants that have identified a material weakness have been asked to discuss (1) management's plans to remediate the weakness, (2) the estimated timing of management's remediation efforts, and (3) the related material costs.

In addition, in certain instances, the SEC staff has observed that questions about the validity and completeness of management's disclosures regarding material weaknesses have arisen as a result of management's discussion of its remediation plans. Sometimes the remediation plans are broader than the material weakness identified, potentially indicating that the actual material weakness is more pervasive than the material weakness disclosed or that there may be another material weakness that was not identified and disclosed. In providing disclosures about remediation plans, registrants should therefore consider the root cause of a material weakness and whether it highlights a more pervasive material weakness in their ICFR or deficiencies in other controls.

Further, the SEC staff has commented when registrants identified one or more material weaknesses in ICFR but either refrained from concluding on the effectiveness of ICFR or concluded that their ICFR is effective. In such instances, the staff has reminded registrants that Regulation S-K, Item 308(a)(3), prohibits a conclusion that ICFR is effective when one or more material weaknesses exist and has asked registrants to amend their filings to state that their ICFR is not effective as a result of the material weaknesses that were identified.

³³ This issue was discussed at the Forums on Auditing in the Small Business Environment hosted by the PCAOB in December 2012.

Conclusion That ICFR Remains Effective After a Restatement

Example of an SEC Comment

We note that in your response you indicate that you believe that the restatement of your earnings per share (EPS) information was not indicative of a material weakness in your internal control over financial reporting. It is unclear to us how you have concluded that there was not a material weakness considering that there was a material restatement of earnings per share, which is disclosed on your primary financial statements. Please explain to us, in greater detail, how you concluded that you do not have a material weakness in light of the restatement of EPS.

Because a restatement is typically indicative of a material weakness in ICFR, the SEC staff may challenge registrants when they conclude that their ICFR and DC&P are effective after restating their financial statements. In addition, since most elements of ICFR are subsumed in the definition of DC&P and it is therefore typically difficult for a registrant to conclude that its DC&P are effective when its ICFR is ineffective, the SEC staff may ask registrants after a restatement has occurred to explain why they concluded that their DC&P are effective.

At the 2013 AICPA Conference, Mr. Croteau discussed a registrant's responsibility to maintain effective DC&P and directed registrants' management to (1) review an SEC [enforcement order](#)³⁴ that addresses a registrant's failure to maintain effective controls and (2) consider whether its own DC&P and ICFR processes and procedures could be improved in light of the issues raised in that order. He also indicated that the adequacy of such controls and management's evaluations and conclusions about them are likely to be a focus of future Enforcement Division investigations.

Registrants should consider [paragraphs 4310.16 and 4310.17](#) of the SEC's Financial Reporting Manual regarding the restatement of financial statements, which state, in part:

There is no requirement for a company to reevaluate the effectiveness of its internal controls and/or reissue a revised management's report on ICFR when a company restates its financial statements to correct errors However, a company may need to consider whether or not its original disclosures in management's report continue to be appropriate in light of these errors, and should modify or supplement its original disclosure to include any other material information that is necessary for such disclosures not to be misleading in light of the restatement. . . . If a company's management concludes that its original assessment of ICFR was incorrect, it should consider whether or not to revise its original report on ICFR.

Disclosure of the Framework Used to Evaluate ICFR

Example of an SEC Comment

We note that management has conducted an evaluation of the effectiveness of your internal control over financial reporting as of December 31, 2016 based on the "Internal Control-Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Please tell us and revise future filings to disclose whether you applied the 1992 or 2013 COSO framework in your assessment. Reference is made to Item 308(a)(2) of Regulation S-K.

The COSO framework is one of the most widely applied frameworks used by registrants in evaluating the effectiveness of their ICFR. On May 14, 2013, COSO released an updated version of its *Internal Control — Integrated Framework* to reflect the significant changes in business and operational environments that have occurred since the original framework was introduced in 1992. Although the components of internal control under the framework remain unchanged, the update introduced 17 new principles that explicitly articulate and describe the components of internal control.³⁵ At the 2013

³⁴ SEC Accounting and Auditing Enforcement Release No. 3490, *In the Matter of JPMorgan Chase & Co., Respondent*.

³⁵ For additional information, see Deloitte's June 10, 2013, [Heads Up](#) on the revised COSO framework.

AICPA Conference, the SEC staff stated that registrants must disclose the internal control framework they applied in assessing the effectiveness of their ICFR in accordance with [paragraph 4310.7](#) of the SEC Financial Reporting Manual. COSO's transition guidance stated that the 1992 framework would be available until December 15, 2014, after which COSO would consider the 1992 framework to be superseded by the 2013 framework. However, because COSO is not a standard setter or a regulator, registrants may view the adoption of the 2013 framework as optional. Accordingly, when issuers have disclosed their use of the 1992 framework after the December 15, 2014, transition date, the SEC staff has questioned why they continue to use the 1992 framework.

The SEC staff often comments when registrants do not disclose the framework used to evaluate the effectiveness of ICFR. The staff has cited specific examples in which management did not identify the framework used, as well as instances in which management inappropriately referred to SEC guidance or COSO's small-company guidance as the framework used for the evaluation. As a result, when a registrant has not disclosed the framework it used, it may be asked to advise the SEC staff of the framework it used in the current year and to revise its disclosures in current and future filings.

Incomplete or Missing ICFR Evaluation

Examples of SEC Comments

- [Y]ou did not include your conclusion regarding the effectiveness of your internal control over financial reporting. Please confirm to us that you intended to state . . . that your internal control over financial report is not effective, if correct, and confirm that you will include your conclusions for your assessments of the effectiveness of your disclosure controls and procedures and internal control over financial reporting in all future Forms 10-K.
- Please revise this report in future Forms 10-K to include all the statements required by Item 308(a)(1) of Regulation S-K, including a statement of management's responsibility for establishing and maintaining adequate internal control over financial reporting.

Regulation S-K, Item 308(a)(3), requires registrants to assess and conclude on the effectiveness of their ICFR as of the end of their most recent fiscal year. In several instances, the SEC staff has issued comments to registrants that omitted a conclusion or provided one that did not contain all of the required information. The staff has also issued comments to registrants that failed to indicate a date for their ICFR evaluation or included in their filing a date other than the end of their most recent fiscal year. Registrants should ensure that the appropriate date of their ICFR evaluation is prominently displayed in any filing with the SEC.

Other Deloitte Resources

December 12, 2016, *Heads Up*, “Highlights of the 2016 AICPA Conference of Current SEC and PCAOB Developments”

December 15, 2015, *Heads Up*, “Highlights of the 2015 AICPA Conference of Current SEC and PCAOB Developments”

December 15, 2014, *Heads Up*, “Highlights of the 2014 AICPA Conference on Current SEC and PCAOB Developments”

September 5, 2014, *Heads Up*, “Challenges and Leading Practices Related to Implementing COSO’s *Internal Control — Integrated Framework*”

December 16, 2013, *Heads Up*, “Highlights of the 2013 AICPA Conference on Current SEC and PCAOB Developments”

Executive Compensation and Other Proxy Disclosures

Proxy disclosure, particularly executive compensation, remains a topic of focus in SEC staff comments to registrants, including those issued to smaller reporting companies. Many of the staff’s comments are related to (1) disclosures in CD&A, including disclosures about how performance is assessed and the use of performance targets, and (2) executive compensation table disclosures.

Further, the SEC continues to evaluate executive compensation and other proxy disclosure requirements through its rulemaking. In 2015, the Commission adopted a [final rule](#)³⁶ that requires a public company to disclose the ratio of the median of the annual total compensation of all employees to the annual total compensation of the CEO (the “pay ratio rule”). In the two years since the release of the final rule, stakeholders have raised concerns about its implementation. In response to those concerns and to clarify the final rule as well as revise some of the interpretations that the SEC issued on October 16, 2016, the SEC issued [Commission Guidance on Pay Ratio Disclosure](#), a revised set of [C&DIs](#) on the final rule, and [Staff Guidance on Calculation of Pay Ratio Disclosure](#) on September 21, 2017. The pay ratio rule is scheduled to go into effect for disclosures required for the first full fiscal year beginning on or after January 1, 2017.³⁷ See Deloitte’s October 17, 2017, [Heads Up](#) for more information on the pay ratio rule.

³⁶ SEC Final Rule Release No. 33-9877, *Pay Ratio Disclosure*.

³⁷ In a manner consistent with the treatment of other Item 402 information, the final rule treats the pay ratio disclosure as “filed” for purposes of the Securities Act and Exchange Act. Therefore, a registrant making the disclosure is subject to potential liability (e.g., for making misleading statements under Section 18 of the Exchange Act).

Determining Compensation — Assessment of Performance

Examples of SEC Comments

- We note that . . . you disclose your company-wide net income targets and named executive officer base salary target percentages associated with threshold, target and high-end levels for net income. However, . . . you cite net sales and return on average assets as additional formula-based factors used to determine payment amounts under the management incentive plan. In these cases, you have not disclosed any target or formula relating to these factors. You also have not disclosed the actual amount of net income, net sales or return on assets used to determine the amount of the payments. . . . [I]n future filings, please disclose all of the company-wide targets and formulas that form the basis of incentive compensation payments, as well as the actual amount of each related measure of company performance, so that it is clear how the Compensation Committee determined the specific amounts of incentive compensation paid to each named executive officer. In your response, please show us what your disclosure would have looked like for fiscal year 2017. In addition to your narrative explanation, please consider providing an illustrative example.
- [W]e note your disclosure . . . that the 2015 award of performance units to Mr. [A] “represent[s] the right to receive a cash payment equal to \$[X] multiplied by certain performance factors.” Please expand your disclosure to identify the performance factors upon which the award of performance units is to be based. We note the related disclosure you include in the Form 8-K that you filed . . . Also discuss how difficult it will be for Mr. [A] or how likely it will be for the company to achieve the target levels or other factors.

The SEC staff frequently asks registrants that use performance targets to disclose them and provide information about their use.³⁸ Under Regulation S-K, Item 402(b), a registrant is required to discuss any compensation awarded to NEOs in its CD&A. The discussion should include (1) the objectives of the compensation program, (2) what the compensation program is designed to reward, (3) the elements of the compensation, (4) the registrant’s reasons for paying each element, (5) how each element is calculated (including any formula used), and (6) how the program fits into the registrant’s objectives. The SEC staff frequently comments on how certain performance factors affect compensation arrangements for NEOs as well as how nonequity incentive compensation granted to NEOs is calculated.

To help financial statement users understand the registrant’s compensation policies and decisions, the SEC staff has asked registrants to:

- Quantify and disclose the performance target, and identify and explain the purpose of performance factors.
- Disclose actual performance results, and detail the specific elements of individual performance and contributions that affected the compensation received.
- Discuss the correlation between achievement of performance targets and the compensation ultimately awarded.
- Disclose the estimated payouts under the annual incentive plan when the performance threshold is achieved.
- Indicate whether the compensation committee or others had discretion or additional qualitative input when determining the final amount of compensation awarded, and disclose the factors that affected the determination.

³⁸ Registrants may exclude performance targets (and other confidential information) if disclosing such material would result in competitive harm. However, registrants must satisfy “confidential-treatment” criteria and demonstrate to the SEC staff, upon request, that they have done so. Even when omission of targets or other factors or criteria is appropriate, a registrant should disclose how difficult it will be for the executive, or how likely it will be for the registrant, to achieve the undisclosed target levels or other criteria.

Executive Compensation Tables

Examples of SEC Comments

- You disclose that you did not increase base salaries in fiscal year 2017 due to the Company's financial performance, but your Summary Compensation Table shows salary increases for all named executive officers. Please tell us the reason for this discrepancy, and in future filings, please explain any changes in your base salaries.
- It appears that the amounts which you have disclosed in the "Bonus" column of this [summary compensation] table should have been disclosed under the "Non-Equity Incentive Compensation Plan" column because the amounts reflect the performance of your executives under your non-equity incentive plan, as defined in Item 402(a)(6)(iii) of Regulation S-K. If, in the exercise of discretion, an amount is paid over and above the amounts earned by meeting the performance measure in the non-equity incentive plan, that amount should be reported in the "Bonus" column. It appears that Mr. [B]'s discretionary bonus increase in the amount of \$[X] should have been disclosed in the Bonus column. Please explain to us why the payments under the annual incentive bonus awards are being disclosed in the "Bonus" column. For guidance refer to Question 119.02 of Regulation S-K Compliance and Disclosure Interpretations. Please ensure that in future filings you disclose payments under your annual incentive bonus as earned under a non-equity incentive plan and provide appropriate disclosure in your Grant of Plan-Based Awards Table.
- In [a footnote] to your summary compensation table . . . , you state that the amounts for [the CEO] for 2015 and 2013 reflect "the aggregate grant date fair value for certain performance units granted in December 2015 and 2013 that are valued based on a performance factor that is tied to certain operational performance metrics." Given that the non-equity plan compensation represented [X]% and [Y]% of [the CEO]'s 2013 and 2015 total compensation, respectively, please expand [the footnote] to quantify the grant date fair values for both 2013 and 2015.

The SEC staff continues to focus on executive compensation tables because they give investors important information about a registrant's compensation policies and decisions. Frequently, the staff asks about inconsistencies between the amounts disclosed in the financial statements or other filings of the registrant and the amounts disclosed in the summary compensation table for NEOs.

Regulation S-K, Item 402(c), requires that for each NEO, registrants include tabular disclosures specifying (1) the NEO's name and principal position, (2) the fiscal year covered, (3) the base salary earned, (4) the bonus earned, (5) the stock/option awards, (6) nonequity incentive plan compensation, (7) the change in pension value and nonqualified deferred compensation earnings, (8) all other compensation, and (9) the total amount of compensation. Both the cash portion and the noncash portion of salary and bonus must be included.

Accordingly, the SEC staff often comments when registrants disclose amounts in incorrect columns of, or exclude types of compensation from, the table. For example, the staff often asks why bonuses paid to NEOs (on the basis of achieved performance targets) are disclosed in the bonus column instead of in the nonequity incentive plan compensation column.

In addition, for stock awards included in the summary compensation table for NEOs, the SEC staff often asks for the aggregate grant-date fair value of the awards as computed in accordance with ASC 718 and for disclosure of all assumptions used in the valuation of share-based compensation, which the registrant can provide by including a reference to its footnotes to the financial statements or to the critical accounting policies section of its MD&A. Regulation S-K, Item 402(k)(2)(iii), requires disclosure of the aggregate grant-date fair value as computed in accordance with ASC 718 as well as disclosure of the aggregate number of stock awards outstanding as of the fiscal year-end for each director.

Emerging Growth Companies

An EGC is a new type of issuer created by the JOBS Act to encourage public offerings by small and developing companies. The regulatory and reporting requirements for EGCs are less stringent than they are for other types of issuers and include the following:

- Only two years of audited financial statements are required in an IPO for common equity.
- The periods required for selected financial data in both registration statements and periodic filings do not extend to periods before the first year presented in the EGC's equity IPO registration statement.
- EGCs are not required to adopt new accounting standards as of the effective dates for public entities.
- EGCs may omit financial information (including certain annual and interim periods) from its draft and publicly filed IPO registration statements if that financial information is related to periods not reasonably expected to be required at the time of the offering.³⁹
- EGCs are exempt from the requirement to obtain an attestation report on ICFR from their auditor.

EGCs may also submit a draft IPO registration statement to the SEC for confidential review. If an EGC elects to submit its IPO registration statement to the SEC on a confidential basis, the submission and related comment letters and responses will not immediately be posted on EDGAR. However, a "public" filing of the IPO registration statement must be made at least 15 days before the EGC's "road show," after which any confidential draft registration statements, along with related comment letters and responses, will also be publicly released by the SEC staff on EDGAR. Effective July 10, 2017, the Division [extended to non-EGCs similar benefits](#) for nonpublic reviews of IPO registration statements. See the [Disclosure Topics in Initial Public Offerings](#) section for additional information.

The staff in the Division has issued FAQs on numerous aspects of the JOBS Act, many of which are related to qualifying for EGC status and the filing requirements for EGCs. In addition, the SEC staff has incorporated EGC-related guidance in [Section 10000](#) of the SEC Financial Reporting Manual.

In its comment letters to EGCs, the SEC staff primarily has asked companies to disclose (1) that they qualify for EGC status, (2) how and when they may lose their EGC status, (3) the elections they made under Title I of the JOBS Act, and (4) their qualification for an exemption from Section 404(b) of the Sarbanes-Oxley Act.

³⁹ On August 17, 2017, the Division updated Question 1 of its C&DIs on the FAST Act and added a corresponding C&DI ([Question 101.04](#)) to the C&DIs on Securities Act forms to clarify the interim financial information that may be omitted from a draft registration statement submitted by an EGC. For additional information, see Deloitte's August 24, 2017, [Heads Up](#) (originally issued July 11, 2017).

EGC Status and Elections

Example of an SEC Comment

It appears that you qualify as an “emerging growth company,” as defined in the Jumpstart Our Business Startups Act. If true, in an appropriate section of the filing please disclose that you are an emerging growth company and revise your registration statement to:

- Describe how and when a company may lose emerging growth company status;
- Briefly describe the various exemptions that are available to you, such as [an exemption] from Section 404(b) of the Sarbanes-Oxley Act of 2002 . . . ; and
- State your election under Section 107(b) of the JOBS Act:
 - If you have elected to opt out of the extended transition period for complying with new or revised accounting standards pursuant to Section 107(b), include a statement that the election is irrevocable; or
 - If you have elected to use the extended transition period for complying with new or revised accounting standards under Section 102(b)(2), provide a risk factor explaining that this election allows you to delay the adoption of new or revised accounting standards that have different effective dates for public and private companies until those standards apply to private companies. Please state in your risk factor that, as a result of this election, your financial statements may not be comparable to companies that comply with public company effective dates. Include a similar statement in your critical accounting policy disclosures.

Filing Status

Because a key objective of the JOBS Act is to promote smaller companies’ access to capital markets, some of the JOBS Act’s accommodations for EGCs resemble reporting requirements for smaller reporting companies (e.g., annual financial statement requirements in an IPO registration statement under Regulation S-X, Article 8). However, the rules are not the same, and the SEC staff has asked EGC filers to clarify descriptions of their filing status. Further, a company can maintain EGC status for up to a maximum of five years after an equity IPO as long as certain conditions apply.⁴⁰ The SEC staff has asked EGC filers to disclose information about their filing status, including how and when the company may lose EGC status.

Extended Transition Period to Adopt New or Revised Accounting Standards

EGCs are not required to adopt new or revised accounting standards as of the effective dates for public entities (if nonpublic entities have a delayed effective date) for ASUs issued after April 5, 2012 (i.e., the date of the enactment of the JOBS Act). Consequently, the SEC staff has asked EGC filers to indicate the basis on which they are adopting accounting standards. Further, the SEC staff has asked EGCs that elect to adopt accounting standards on the basis of adoption and transition dates that apply to private companies to disclose as a risk factor that their financial statements may not be comparable with those of registrants that elect (or are required) to adopt accounting standards on the basis of adoption and transition dates that apply to public companies. The SEC staff has also asked registrants to include similar disclosures in their critical accounting policy section of MD&A.

⁴⁰ For example, the EGC’s total gross revenues do not exceed \$1.07 billion during the five-year period, the EGC’s market capitalization does not exceed \$700 million (i.e., the EGC does not meet the definition of a large accelerated filer), and the EGC does not issue more than \$1 billion in nonconvertible debt in a three-year period (which is not limited to calendar or fiscal years and is a rolling three-year period from the date of the EGC’s last debt issuance).

Section 404(b) Exemption

The JOBS Act amends Section 404(b) of the Sarbanes-Oxley Act by exempting EGCs from the requirement to obtain an attestation report on the company's ICFR from its registered public accounting firm. The SEC staff has required registrants to disclose that they are exempt from obtaining an audit of their ICFR (for as long as they maintain EGC status).⁴¹

Other Considerations

Reduced Financial Reporting Requirements

Examples of SEC Comments

- You state here that you have not made a final decision to take advantage of certain of the exemptions available to you as an emerging growth company. Please tell us when you intend [to] make that decision and whether your current executive compensation disclosures reflect the reduced disclosure obligations applicable to a smaller reporting company.
- Briefly describe . . . exemptions [from the requirements related to obtaining shareholder approval of executive compensation under] Section 14A(a) and (b) of the Securities Exchange Act of 1934.

An EGC is required to present only two years of audited financial statements in its equity IPO registration statement. In addition, the periods for which an EGC presents select financial data in its registration statements and periodic filings may be limited to the earliest year presented in its equity IPO registration statement. Further, certain JOBS Act provisions related to scaled disclosures may interact with certain SEC rules (e.g., other entities' financial statements may be required under Regulation S-X, Rules 3-05 and 3-09); accordingly, the SEC staff has issued comments on reduced disclosure requirements. For example, under the JOBS Act, EGCs can comply with the SEC's proxy requirements regarding executive compensation by providing the same reduced disclosures that are required of smaller reporting companies.⁴² Consequently, the SEC staff has asked whether EGCs' executive compensation disclosures reflect reduced disclosure requirements. EGCs should therefore consider the SEC staff's [FAQs](#) on the JOBS Act to assess whether reduced reporting requirements apply in these situations. For additional information on Rules 3-05 and 3-09, see the [SEC Reporting](#) section.

Requests for Written Communications

Example of an SEC Comment

We note that you are an "emerging growth company," as defined in the Jumpstart Our Business Startups Act. Please supplementally provide us with the following:

- [C]opies of all written communications, as defined in Rule 405 under the Securities Act, that you, or anyone authorized to do so on your behalf, present to potential investors in reliance on Section 5(d) of the Securities Act, whether or not they retain copies of the communications; and
- [A]ny research reports about you that are published or distributed in reliance upon Section 2(a)(3) of the Securities Act of 1933 added by Section 105(a) of the Jumpstart Our Business Startups Act by any broker or dealer that is participating or will participate in your offering.

⁴¹ EGCs are also exempt from any future PCAOB rules that may require (1) auditor rotation or (2) expansion of the auditor's report to include an auditor's discussion and analysis of the company under audit.

⁴² EGCs are also exempt from certain proxy provisions of the Dodd-Frank Act.

Other SEC Reporting Matters

The JOBS Act significantly changed the rules governing communication between EGCs and certain potential investors. Under the JOBS Act, an EGC, or any person authorized to act on behalf of an EGC, may engage in oral or written communications with potential investors that are qualified institutional buyers or institutional accredited investors to “test the waters” before the EGC files its registration statement. Consequently, the SEC staff has requested copies of such communications.

Other Deloitte Resources

July 11, 2017, *Heads Up*, “SEC Makes Nonpublic Review Process for Draft IPOs and Initial Registration Statements Available to All Companies”

April 15, 2014, *Heads Up*, “Two Years After the JOBS Act”

Other SEC Reporting Matters

Certifications

Example of an SEC Comment

We note that the beginning of the certifications filed . . . are missing the first line of text relating to the individual certifying the filing as required by Item 601(b)(31) of Regulation S-K (i.e., the declaration that the party is certifying). We also note that you have omitted the introductory language in paragraph 4 referring to internal control over financial reporting. Accordingly, please file an amendment to your Form 10-K that includes the entire filing together with the certifications of each of your current CEO and CFO in the form currently set forth in Item 601(b)(31) of Regulation S-K.

Registrants must provide quarterly and annual certifications in the form specified by Regulation S-K, Item 601(b)(31). When these certifications contain errors, registrants are often asked to file an amendment to an entire periodic filing in addition to submitting a corrected certification.

[Interpretation 246.14 of the C&DIs of Regulation S-K](#) states:

The following errors in a certification required by Item 601(b)(31) are examples of errors that will require the company to file a corrected certification that is accompanied by the entire periodic report: (1) the company identifies the wrong periodic report in paragraph 1 of the certification; (2) the certification omits a conformed signature above the signature line at the end of the certification; (3) the certification fails to include a date; and (4) the individuals who sign the certification are neither the company's principal executive officer nor the principal financial officer, or persons performing equivalent functions.

The SEC staff often comments when registrants' certifications, including punctuation marks and parenthetical phrases, do not appear exactly as specified in Item 601(b)(31). The staff routinely notes that including the title, rather than the name, of the certifying officer in the first sentence of the certification constitutes an inappropriate modification. In addition, the staff regularly comments on certifications that are dated incorrectly. The staff also comments frequently on the exclusion of language regarding ICFR from the certifications.

Registrants must include certifications when they are filing amendments to periodic reports. See [Question 161.01](#) of the C&DIs of Exchange Act Rules for guidance on what paragraphs can be excluded from certifications filed with amendments to periodic reports.

Use of Experts and Consents

Example of an SEC Comment

Please tell us whether you commissioned any third party research for use in connection with this offering. If so, please tell us what consideration you gave to filing the third party's consent as an exhibit to the registration statement as required by Section 7 of the Securities Act and Securities Act Rule 436.

In their registration statements under the Securities Act and periodic reports under the Exchange Act (e.g., Forms 10-K and 10-Q), registrants sometimes refer to an “independent valuation firm” or other third party. The SEC staff has asked such registrants whether management or the board relied on a third-party expert and will sometimes infer reliance on a third-party expert even when the registrants do not refer to one. Examples of third-party experts that registrants commonly consider or rely on include the following:

- Valuation firms, about:
 - The valuation of a registrant's common and preferred stock in an IPO.
 - The fair value determination of goodwill and assets acquired and liabilities assumed in a business combination.
 - The determination of goodwill impairment.
 - The determination of an environmental liability.
- An independent actuary, about the estimation of workers' compensation liability.
- Petroleum engineers, about the evaluation of oil and gas reserves.
- Pricing services or brokers that provide information used to determine the fair values of financial assets or liabilities. See the [Fair Value](#) section for additional considerations.
- Counsel providing legal opinions.
- Tax specialists providing tax opinions.

The SEC staff has stated that in registration statements or periodic reports, registrants generally are not required to refer to an independent valuation firm or other expert. If a registrant does not refer to the expert in its filing, the registrant is not required to name the expert or obtain the expert's consent; however, certain SEC requirements may compel the registrant to include or summarize an expert's report or opinion in its filing and could trigger a consent requirement. Registrants that refer to experts in their filings should consider the implications related to periodic reports and registration statements.

Periodic Reports (Exchange Act)

Consents are not required for Form 10-K or 10-Q. However, the guidance below on registration statements should be applied if the registrant (1) refers to an independent valuation firm or other expert in a periodic report and attributes statements in the report to the expert and (2) incorporates that periodic report by reference into a registration statement.

Registration Statements (Securities Act)

Historically, if a registrant has referred to third-party experts in a registration statement, the SEC staff has asked the registrant to provide the experts' consents, including those from the registrant's independent registered public accounting firm. However, C&DIs issued by the staff appear to indicate that the key to assessing whether a consent will be required is determining the degree to which management takes responsibility for statements related to work performed by a third-party expert that

are included in or incorporated into the registration statement. The SEC staff typically evaluates the totality of the disclosure provided when determining whether management is taking responsibility for the conclusion.⁴³

Scope

The SEC staff has also commented on the use of “limiting” language in consents provided by third-party experts. The staff has emphasized that an expert’s consent should not contain any language that limits the use of the consent to the registrant or suggests that there is a limit on potential investor reliance.

Material Contracts

Example of an SEC Comment

We note your disclosure in the risk factors . . . and also your later disclosure in the MD&A section regarding the significance of your recurring arrangements with [certain customers]. Please file the respective master service agreement for each customer in accordance with Item 601(b)(10) of Regulation S-K, or tell us why you believe you are not required to file the agreements. Further, please disclose the material terms of the agreements, and discuss any material adverse impact on your operations if either agreement were to be terminated.

Regulation S-K, Item 601, requires registrants to file certain material contracts as exhibits if, during the reporting period, such contracts (1) become effective or (2) are executed, amended, or modified. For example, Item 601(b)(10) requires a registrant to file:

- Every material contract that is “not made in the ordinary course of business.”
- Any material contract “made in the ordinary course of business”:
 - With certain parties, such as directors, officers, promoters, voting trustees, certain security holders, or underwriters, other than contracts involving only the purchase or sale of current assets at a price that equals a determinable market price.
 - On which the registrant’s business substantially depends.
 - For the acquisition or disposition of any property, plant, or equipment for consideration exceeding 15 percent of the registrant’s total consolidated fixed assets.
 - For a lease under which part of the property is held by the registrant.
- Generally, any management contract or compensatory plan, contract, or arrangement in which a director or NEO of the registrant participates (such contracts are considered material) and any other material management contract or any other compensatory plan, contract, or arrangement in which any other executive officer of the registrant participates.⁴⁴
- Any other material compensatory plan, contract, or arrangement “adopted without the approval of security holders pursuant to which equity may be awarded” in which any employee of the registrant (i.e., regardless of whether the employee is an executive officer) participates.

⁴³ Registrants may look to [Question 233.02](#) of the C&DIs of the Securities Act Rules that were issued by the SEC staff in November 2008 but should be aware that other consent-related C&DIs of the Securities Act Rules may apply to their specific circumstances and that they should therefore review such C&DIs periodically.

⁴⁴ For examples of management contracts or compensatory plans, contracts, or arrangements that are exempt from this filing requirement, see Item 601(b)(10)(iii)(C).

Accordingly, the SEC staff issues comments when registrants omit certain material agreements. Recent comment letters have instructed registrants to do either of the following:

- File the material agreements in their entirety, including schedules and related exhibits, as exhibits to Form 10-K or 10-Q or separately on Form 8-K in accordance with Item 601.
- Explain why they have not filed the agreements.

For SEC staff views on when registrants may be required to file agreements as exhibits under Item 601, see Sections 146, 206, and 246 of the [C&DIs of Regulation S-K](#).

Backlog Disclosures

Examples of SEC Comments

- We note your disclosure . . . that the majority of your revenue is derived from contracts that generally have terms of three to five years. Please tell us the consideration given to disclosing the amount of firm backlog as of December 31, 2016 and 2015, along with the portion not reasonably expected to be filled within the current fiscal year. We refer you to Item 101(c)(1)(viii) of Regulation S-K.
- Please more fully explain to us the specific facts and circumstances that resulted in you modifying your backlog policy in the second quarter of 2015 for long term contracts associated with the [Country A] government's privately financed initiatives or projects. Please explain to us how you estimate the total value of work to be performed and clarify whether that amount is equal to or greater than the amount clients are required to pay you. Also, based on your inclusion of your share of work to be performed by unconsolidated joint ventures in your backlog, please revise future filings to quantify the amount of backlog to be executed within one year that will be recognized as revenue and the amount that will be recorded by your unconsolidated joint ventures.

Regulation S-K, Item 101(c)(1)(viii), requires disclosure of the “dollar amount of backlog orders believed to be firm, as of a recent date and as of a comparable date in the preceding fiscal year, together with an indication of the portion thereof not reasonably expected to be filled within the current fiscal year, and seasonal or other material aspects of the backlog.” Disclosures about a registrant’s contracts and order process included elsewhere in an annual report may prompt the SEC staff to ask the registrant to consider the need for certain backlog disclosures when such disclosures appear to be omitted. Further, it is possible that a company computes backlog information differently from others in the same industry. The SEC staff has requested expanded disclosures about backlog information, including (1) the methods used (or changes in methods used) to determine backlog, (2) specific facts and circumstances that resulted in a change in the registrant’s method of determining backlog, and (3) changes in backlog that resulted from new contracts, canceled contracts, and contracts recognized in revenue. In addition, the SEC staff has reminded registrants to disclose in accordance with Item 101(c)(1)(viii) the backlog not reasonably expected to be filled within the current fiscal year.

Disclosures Regarding State Sponsors of Terrorism

Examples of SEC Comments

- [Y]ou identify [Company A] as one of your customers. [Company A] is reported to have sold products into Sudan and Syria. Sudan and Syria are designated as state sponsors of terrorism by the State Department and are subject to U.S. economic sanctions and export controls. You do not include disclosure in the Form 10-K about contacts with Sudan and Syria. Please describe to us the nature and extent of any past, current and anticipated contacts with Sudan and Syria, whether through subsidiaries, distributors, resellers, customers or other direct or indirect arrangements. You should describe any products, technology or services you have provided into Sudan or Syria, directly or indirectly, and any agreements, arrangements or other contacts you have had with the governments of those countries or entities they control.
- Please discuss the materiality of any contacts with Sudan and Syria you describe in response to the comment above, and whether [those] contacts constitute a material investment risk for your security holders. You should address materiality in quantitative terms, including the approximate dollar amounts of any revenues, assets and liabilities associated with Sudan and Syria for the last three fiscal years and the subsequent interim period. Also, address materiality in terms of qualitative factors that a reasonable investor would deem important in making an investment decision, including the potential impact of corporate activities upon a company's reputation and share value. Various state and municipal governments, universities and other investors have proposed or adopted divestment or similar initiatives regarding investment in companies that do business with U.S.-designated state sponsors of terrorism. You should address the potential impact of the investor sentiment evidenced by such actions directed toward companies that have operations associated with Sudan and Syria.

The U.S. Secretary of State has designated three countries as state sponsors of terrorism — Iran, Sudan, and Syria. These countries are subject to U.S. sanctions in four main categories: restriction on U.S. foreign assistance, a ban on defense export and sales, certain controls over exports of dual-use items, and miscellaneous financial and other restrictions. Generally, registrants that do business in these countries are required to disclose material operations conducted in them (whether through subsidiaries, affiliates, distributors, resellers, partners, customers, joint ventures, or other direct or indirect arrangements) and any agreements, commercial arrangements, or other contacts with the countries' respective governments or with entities controlled by such governments.⁴⁵ The SEC staff regularly comments on this subject and believes that such disclosures are important to investors in making investment decisions. The staff has asked registrants to disclose the nature and extent of these contacts (past, present, and probable) — as well as to provide a detailed analysis of the materiality of contacts with these countries — on the basis of both quantitative and qualitative factors. In addition to providing quantitative disclosures of revenues, assets, and liabilities associated with these countries, registrants are encouraged to disclose any related qualitative factors that may have a significant impact on their activities.⁴⁶

⁴⁵ In 2007, the SEC issued [Concept Release No. 33-8860, Concept Release on Mechanisms to Access Disclosures Relating to Business Activities in or With Countries Designated as State Sponsors of Terrorism](#), which requested input on certain matters related to sponsors of state terrorism. The concept release indicates that the "federal securities laws do not impose a specific disclosure requirement that addresses business activities in or with a country based upon its designation as a State Sponsor of Terrorism." However, as with other requirements to disclose material information, the "federal securities laws do require disclosure of business activities in or with a State Sponsor of Terrorism if this constitutes material information that is necessary to make a company's statements, in the light of the circumstances under which they are made, not misleading." [Footnote omitted]

⁴⁶ Further, the [Iran Threat Reduction and Syria Human Rights Act of 2012 \(the "Act"\)](#) requires registrants to include certain disclosures about sanctionable activities with those countries in all quarterly and annual reports. There is no materiality threshold for such reporting; therefore, a registrant may be required to disclose immaterial transactions meeting the criteria specified in the Act. For implementation guidance, see [Questions 147.01 through 147.07 of the C&DIs of Exchange Act Sections](#).

Interactive Data — eXtensible Business Reporting Language (XBRL)

SEC Staff's Review and Observations

Examples of SEC Comments

- The staff notes that you have not submitted electronically and posted on your corporate Web site every Interactive Data File required to be submitted and posted during the preceding 12 months. Please file this information pursuant to Rule 405 of Regulation S-T.
- The XBRL Document and Entity Identification Information rendered as part of your filing appears to contain a number of data element errors, including but not limited to, your classification as a nonaccelerated filer. Please revise to comply with the requirements of Section 405 of Regulation S-T and the EDGAR Filer Manual.
- Please amend your quarterly report to include the interactive data exhibits required by Item 601(b)(101) of Regulation S-K.

The SEC staff continues to monitor registrants' interactive data file (i.e., XBRL) submissions for completeness and compliance with the provisions of Regulation S-T, Rule 405. The staff often asks whether the registrant has (1) submitted its interactive data files as an exhibit to Form 10-K and Form 10-Q in accordance with Regulation S-K, Item 601(b)(101); (2) checked the appropriate box on the cover page of its Form 10-K or 10-Q to indicate that all required interactive data files have been submitted; and (3) posted its interactive data files on its Web site. When a registrant has omitted a required interactive data file exhibit, the staff may ask why and request an amended filing that includes the missing information.

The SEC staff also considers the quality of interactive data filings and has commented broadly on the problems encountered in that regard. For example, the staff has indicated that it continues to see basic errors in interactive data submissions and has directed registrants to its observations on the SEC's Web site for additional details. Specifically, the staff has reminded registrants to (1) use negative values properly, (2) ensure the completeness of tagging, and (3) use custom tags only when appropriate.

In its July 2014 report [Staff Observations of Custom Tag Rates](#), the SEC staff noted that although it has seen a steady decline in custom tag use by larger filers, it has not observed a similar decline in usage by smaller filers.⁴⁷ Further analysis revealed that this trend may be partially attributable to smaller filers' use of certain third-party providers. The staff expressed its intention to continue monitoring registrants' use of custom tags and indicated that it may issue further guidance or take additional action in the future.

In June 2016, the SEC issued an [order](#)⁴⁸ allowing operating companies to voluntarily use inline XBRL to file structured financial statement data through March 2020. For more information about the order, see the [press release](#) on the SEC's Web site.⁴⁹

⁴⁷ The staff used the term "smaller filers" to refer to U.S. GAAP filers that are not large accelerated filers.

⁴⁸ SEC Release No. 34-78041, *Order Granting Limited and Conditional Exemption Under Section 36(a) of the Securities Exchange Act of 1934 From Compliance With Interactive Data File Exhibit Requirement in Forms 6-K, 8-K, 10-Q, 10-K, 20-F and 40-F to Facilitate Inline Filing of Tagged Financial Data.*

⁴⁹ In March 2017, the SEC issued [Proposed Rule Release No. 33-10323, Inline XBRL Filing of Tagged Data](#), which would require SEC filers to use inline XBRL format when submitting operating company financial statement information and mutual fund risk/return summaries.

Requirement to Include Calculation Relationships

Sections 6.14 and 6.15 of the EDGAR Filer Manual provide guidance on complying with the requirement to include calculation relationships in an interactive data file. In addition, the SEC staff's "Dear CFO" letter,⁵⁰ which was posted to the SEC's Web site in July 2014 and has been sent to a number of public companies, reminds registrants that the XBRL rules require them to "include calculation relationships for certain contributing line item elements for [the] financial statements and related footnotes." The letter advises registrants to "take the necessary steps to ensure that [they] are including all required calculation relationships" in their XBRL files.

Interactive Data Requirements in Other Filings

Example of an SEC Comment

Please provide the XBRL interactive data file that is required to be submitted pursuant to Item 601(b)(101)(i) of Regulation S-K. For guidance, please refer to Regulation S-K Compliance and Disclosure Interpretations Question 146.17, available at: <http://www.sec.gov/divisions/corpfin/guidance/regs-kinterp.htm>.

Under Regulation S-T and Regulation S-K, Item 601(b)(101)(i), registrants must submit an interactive data file as an exhibit to a registration statement if the statement contains (1) financial statements and (2) a price or price range. For purposes of Item 601(b)(101)(i), the disclosure of the "offering price" of a shelf offering, an at-the-market offering, an exchange offer, or a secondary offering in a filed registration statement is construed as a price or price range.

In addition, Item 601(b)(101)(i) highlights that an interactive data file would be required for a Form 8-K filing "when the Form 8-K contains audited annual financial statements that are a revised version of financial statements that previously were filed with the [SEC] that have been revised pursuant to applicable accounting standards to reflect the effects of certain subsequent events, including a discontinued operation, a change in reportable segments or a change in accounting principle."

Further, registrants should monitor new rules issued by the SEC as a result of the Dodd-Frank Act or other legislation to see whether they require XBRL tagging of specified information that otherwise would be outside the scope of the SEC's interactive data requirements.

Other Deloitte Resources

July 12, 2017, *Heads Up*, "XBRL Requirements for Companies Reporting Under IFRSs"

July 8, 2014, *Deloitte Accounting Journal*, "SEC Staff Issues Communications to XBRL Filers"

December 16, 2013, *Heads Up*, "Highlights of the 2013 AICPA Conference on Current SEC and PCAOB Developments"

September 19, 2013, *Heads Up*, "XBRL — Past, Present, and Future"

⁵⁰ Sample Letter Sent to Public Companies Regarding XBRL Requirement to Include Calculation Relationships.

Audit Report Requirements

Examples of SEC Comments

- We note that in the third paragraph of the report your auditor has only opined on the financial statements as of and for the year ended October 2, 2016. Please file an amendment to your Form 10-K, including the complete Item 8 and updated certifications, to provide an audit report that opines on all the periods presented in your financial statements — i.e., as of and for the years ended October 2, 2016 and September 27, 2015, respectively. Refer to Rules 2-02 and 8-02 of Regulation S-X.
- [P]lease have your auditor indicate the city and state where the [audit] report was issued. Refer to Rule 2-02(a) of Regulation S-X.

The SEC staff continues to comment when a registrant does not comply with Regulation S-X, Rule 2-02(a), and Regulation S-T, Rule 302. For example, the staff has commented when:

- A signature does not conform to Regulation S-X and S-T requirements.
- A public accounting firm's city and state are omitted from the audit report.
- A registrant includes a report from its auditor that does not appropriately identify all financial statements covered by the audit report.

The SEC staff will generally ask the registrant to amend its filing or provide a revised audit report if the report is not in compliance with the technical requirements of Regulation S-X, Rule 2-02(a), or Regulation S-T, Rule 302, including the requirements related to typed "signatures" in electronic submissions.

In addition, the CAQ issued [Alert 2012-16](#) to remind auditors that it "**would not** be appropriate for the auditor's report for issuers or other entities that require compliance with PCAOB requirements to reference only the **auditing standards** of the PCAOB" since this qualifying language may imply that the auditor did not adhere to other standards of the PCAOB (e.g., its independence standards). The alert also encouraged registrants and auditors to review [paragraph 4110.5](#) of the SEC Financial Reporting Manual for additional information about the applicability of certain PCAOB requirements to various SEC filings.

Other Deloitte Resources

[June 20, 2017, Heads Up, "PCAOB Adopts Changes to the Auditor's Report"](#)

Selected Quarterly Financial Data

Example of an SEC Comment

During both fiscal years presented, the quarterly data shows significant fluctuation in the operating results between the quarters. Please revise your disclosure to discuss the nature of any unusual or infrequently occurring items that impacted your quarterly results of operations between the periods presented. Refer to Item 302(a)(3) of Regulation S-K.

The SEC staff has issued comments on the sufficiency of disclosures about selected quarterly financial information under Regulation S-K, Item 302(a). For example, the staff has asked registrants to revise such disclosures when the disclosures fail to mention the effects of items recognized during quarters within the two most recent fiscal years, such as (1) the disposal of a segment of a business or (2) unusual or infrequently occurring items.

A registrant is generally not required to provide selected quarterly financial data in its initial registration statement on Form S-1 because the requirement does not apply until a company has registered securities in accordance with Section 12(b) or Section 12(g) of the Exchange Act. However, at the March 2015 CAQ SEC Regulations Committee [joint meeting](#) with the SEC staff, the staff clarified that registrants that file a follow-on registration statement⁵¹ before filing their first Form 10-K would generally be required to provide selected quarterly financial data because their securities are typically registered under Section 12(b) or Section 12(g) at the time the follow-on registration statement is filed.

⁵¹ That is, a registration statement filed after the IPO.

Disclosure Topics in Initial Public Offerings

Initial Public Offerings

An IPO is most commonly thought of as the initial sale of equity or debt securities to the public by a private company that registers its securities on Form S-1. However, there are other situations in which a company can register debt or equity securities with the SEC for the first time, such as by exchanging debt securities previously issued in a private transaction for registered debt securities (typically on a Form S-4), registering currently outstanding equity securities, or distributing shares in a spin-off transaction by a public company (typically on a Form 10). All such transactions are referred to as IPOs in this discussion. However, as a result of the JOBS Act, which was signed into law on April 5, 2012, certain companies that meet the requirements for EGC status are eligible to raise capital and register as new issuers by complying with less stringent regulatory and reporting requirements than those required for a typical IPO. See the [Emerging Growth Companies](#) section for additional information on such requirements.

On August 17, 2017, in a manner consistent with SEC Chairman Jay Clayton's priorities to enhance capital formation, the SEC's Division of Corporation Finance updated its June 29, 2017, [announcement](#) that the SEC would allow all companies to voluntarily submit draft registration statements to the SEC staff for nonpublic review before the companies' public filing. Previously, similar benefits were available only to EGCs. The SEC also issued two new C&DIs on Securities Act forms ([Questions 101.04](#) and [101.05](#)) and an updated C&DI on the Fixing America's Surface Transportation (FAST) Act ([Question 1](#)) that allow registrants to omit from draft registration statements interim and annual financial information that a company reasonably believes will not need to be presented separately at the time its registration statement is filed publicly or, for EGCs, at the time of the offering. While the SEC provided these accommodations to help increase IPO activity, a registrant should consider the potential effects of omitting the appropriate interim financial statements before choosing to do so. For example, such omission could prolong the review process when a company submits its registration statement with updated financial information or could give rise to significant comments late in the review process, potentially affecting the timing of the IPO. For more information, see Deloitte's August 24, 2017, [Heads Up](#) (originally issued July 11, 2017).

Because an IPO typically represents a company's first filing with the SEC, the SEC staff almost always reviews the related registration statement. The staff's review is typically comprehensive, covering reporting, accounting, and legal issues. In addition, the SEC staff's comments often focus on the following reporting topics (most of which are further discussed in the [SEC Reporting](#) section):

- Significant business acquisitions (Regulation S-X, Rule 3-05).
- Investments in equity method investees (Regulation S-X, Rule 3-09).
- Guarantors of registered securities (Regulation S-X, Rule 3-10).
- Issuers of securities that collateralize registered securities (Regulation S-X, Rule 3-16).
- Pro forma financial statements (Regulation S-X, Article 11).

It is also common for SEC staff comments on IPO registration statements to address accounting and disclosure topics such as (1) complex equity instruments; (2) share-based compensation, including equity securities issued as compensation in periods before an IPO (commonly referred to as "cheap

stock” considerations); and (3) revenue recognition. For more information, see the [Debt, Financial Instruments, Share-Based Payments](#), and [Revenue Recognition](#) sections. The SEC staff also comments on certain issues that are more specific to IPO registration statements. Such issues are discussed in this section.

Registrant Financial Statements

A company undergoing an IPO is required to present its financial statements, footnotes, and schedules for certain annual and interim periods in its registration statement. Regulation S-X, Rules 3-01 through 3-04, describe the general financial statement requirements for the registrant and its predecessors. Registrants must determine which financial statements to include in their initial registration statement on the basis of their individual facts and circumstances and must continue to update the financial statements throughout the registration process to provide current financial information. The SEC staff often comments when registrants do not include the required financial statements in the registration statement.

Age of Financial Statements

Example of an SEC Comment

Please update your audited financial statements for the most recently completed fiscal year in accordance with Rule 3-12 of Regulation S-X.

A registrant’s financial statements must meet the “age of financial statements” requirements as of every filing date as well as when the registration statement is declared effective. The age of financial statements generally refers to the specific annual and interim periods for which financial statements are required in a filing. Regulation S-X, Rule 3-12, provides guidance on such periods and on when the financial statements become stale (i.e., should be updated). As noted above, companies may omit certain interim and annual periods from their draft registration statements; however, the appropriate interim financial information would still be required in a registration statement that is publicly filed.

Recently Organized Registrant

Example of an SEC Comment

We note your disclosure . . . that [Company A] was formed for the purpose of becoming the stock holding company and currently holds minimal assets and has not conducted any business. However, we do not believe this provides a sufficient basis to omit the audited financial statements of the registrant. Please provide audited financial statements of the registrant [Company A] as required by Rule 3-01(a) of Regulation S-X, or tell us why you believe such financial statements are not required.

Sometimes the legal entity registering securities in an IPO is a newly formed company that will succeed to the operations of an existing business before the effective date of the initial registration statement. In such cases, the entity may need to include the balance sheet of the recently organized registrant in addition to the financial statements of the existing business. See [Section 1160](#) of the SEC Financial Reporting Manual for additional guidance on newly formed entities. In addition, Regulation S-X, Rule 3-01, provides guidance on a registrant’s balance sheet requirements.

Predecessor Financial Statements

Example of an SEC Comment

We note you sold 100% of your interest in [Entity A] in December 2014 in order to reduce your reliance on sales of [Product X] and focus on new business opportunities. We note your previous operations now appear insignificant in relation to the acquired operations of [Entity B]. Please tell us your consideration of whether [Entity B] is your predecessor entity for which predecessor financial statements would be required. In your response, please discuss in detail the portion of your business that remained after the sale of [Entity A] and before the acquisition of [Entity B].

[Section 1170](#) of the SEC Financial Reporting Manual addresses the requirements for predecessor financial information. It states that the designation “predecessor” is required when “a registrant succeeds to substantially all of the business (or a separately identifiable line of business) of another entity (or group of entities) and the registrant’s own operations before the succession appear insignificant relative to the operations assumed or acquired.” Because a predecessor’s historical financial information is considered important to an investing decision, when a predecessor is identified, the registration statement must also present the predecessor’s financial information and reflect such information as if it were the registrant’s. That is, financial statements for both the registrant and its predecessor should be presented as of and for all periods required by Regulation S-X.

In addition, at the 2015 AICPA Conference, the SEC staff indicated that it has noticed an increase in put-together transactions in which a newco is formed to acquire multiple entities. In such transactions, some of the entities are acquired before the IPO and others are acquired with the proceeds of the IPO. This has led to questions about how to identify the predecessor and the appropriate financial statements to include in an IPO registration statement. The staff believes that instances in which there is no predecessor would generally be rare, even if the newco is substantive and was deemed the accounting acquirer. The staff highlighted a number of factors for registrants to consider in determining the predecessor, including (but not limited to) (1) the order in which the entities are acquired, (2) the size of the entities, (3) the fair value of the entities, and (4) the ongoing management structure. The staff indicated that no one item is determinative on its own and that there could also be more than one predecessor.

In summary, the reasoning behind an entity’s conclusion on what should be included in its predecessor financial statements — and on whether the entity has a single predecessor or multiple predecessors — remains a focus of the SEC staff.

Carve-Out Financial Statements

Example of an SEC Comment

Please clearly disclose, if true, that the financial statements provided reflect all of the costs of doing business related to these operations, including expenses incurred by other entities on your behalf. Please disclose management’s estimates of what the expenses would have been on a stand-alone basis, if practicable. Please provide this disclosure for each year for which a statement of operations was required when such basis produced materially different results. Refer to SAB Topic 1:B.1.

“Carve-out financial statements” is a generic term used to describe separate financial statements that are derived from the financial statements of a larger parent company. A carve-out occurs when a parent company segregates a portion of its operations and prepares a distinct set of financial statements for

the segregated portion in preparation for a sale, spin-off,¹ or IPO of the “carve-out entity.” Examples of a carve-out entity may include (1) all or part of a subsidiary of a parent company or (2) a line of business that was previously part of a larger parent company.

Often, the parent may not have historically accounted for the carve-out entity separately, and the registrant (i.e., the carve-out entity) may have relied on the parent for certain functions. SAB Topic 1.B indicates that the registrant’s historical income statements should present all of the costs of doing business, including expenses incurred by the parent on behalf of the registrant. Examples of such costs include salary, rent, depreciation, advertising, accounting and legal services, and other SG&A. Registrants must use a reasonable method to allocate the common expenses from the parent to the registrant if specific identification is not practicable. The method for such allocation must also be disclosed in the notes to the financial statements, with an explanation of why management believes such method is reasonable. To the extent that the registrant and the parent have shared functions (e.g., treasury or cash management), these shared functions need to be evaluated so that the appropriate amount of expense to be allocated to the carve-out entity can be determined.

When financial statements of a carve-out entity are used in an IPO, it is critical that the carve-out financial statements identify the appropriate assets and operations of the registrant. A registrant’s determination of the composition of the carve-out financial statements depends on its specific facts and circumstances and may require significant judgment because the process of identifying appropriate assets and operations of the registrant in an IPO transaction is complicated. At the 2014 AICPA Conference, the SEC staff acknowledged that determining what financial statements to include in a registration statement can be complex and that registrants need to use judgment when doing so, particularly because (1) there may not be SEC guidance directly on point and (2) accounting guidance (e.g., the guidance in ASC 505-60 on determining the accounting spinor and spinnee) may not be wholly determinative of the SEC’s reporting requirements. Further, at the 2015 AICPA Conference, the staff reminded conference participants to consider the legal form of the arrangement when identifying a predecessor in a carve-out or spin-off transaction. The staff noted that the financial statements of the predecessor may consist of more than the entity in which the investor ultimately invests.

Accordingly, registrants should consider the context of their Description of Business section and MD&A and whether that information, along with the financial statements, provides a full picture for investors. At the 2014 AICPA Conference, the SEC staff encouraged registrants to submit a pre-filing letter to resolve any complex issues ahead of time and thereby potentially avoid having to address them during the staff’s review of their IPO filing.

Spin-off transactions can be highly complex and involve numerous legal and accounting decisions that registrants must consider, including the accounting for the transaction (i.e., spin-off or reverse spin-off) in accordance with ASC 505-60. Registrants should also consider other aspects of carve-out financial statement reporting, including (1) the allocation of items such as pension and postretirement benefit plans, income taxes, impairment of goodwill and other intangible assets, and debt and contingencies and (2) treatment of intercompany transactions. In addition, carve-out entities in an IPO will need to consider their ongoing compliance with Regulation S-X, Rules 3-05 and 3-09, for acquisitions and equity method investments, respectively, whose level of significance may differ from that of the parent’s acquisitions and equity method investments. Further, the SEC staff may ask about segment reporting and EPS in these complex transactions.

¹ ASC 505-60-20 defines a spin-off as the “transfer of assets that constitute a business by an entity (the spinor) into a new legal spun-off entity (the spinnee), followed by a distribution of the shares of the spinnee to its shareholders, without the surrender by the shareholders of any stock of the spinor.”

For additional considerations related to carve-out transactions, see Deloitte's [A Roadmap to Accounting and Financial Reporting for Carve-Out Transactions](#).

Public-Entity Disclosures and Transition Provisions

A nonpublic entity's previously issued financial statements may not be sufficient for an IPO. Nonpublic entities may need to revise their financial statements to include the public-entity accounting and disclosures required under U.S. GAAP and Regulation S-X. In addition, such entities will need to obtain an auditor's report on their financial statements that (1) is issued by a PCAOB-registered accounting firm and (2) refers to the PCAOB's standards.²

U.S. GAAP

Certain provisions of U.S. GAAP differ for public and nonpublic entities. A registrant's financial statements in an IPO must adhere to accounting principles and disclosures required for public entities for all periods presented. The term "public entity" generally refers to an entity that files its financial statements with the SEC. However, there are different definitions of "public entity" under U.S. GAAP. Accounting principles and disclosures that apply to public entities but not nonpublic entities include EPS (under ASC 260); segment reporting (under ASC 280); temporary equity classification of redeemable securities (under ASC 480-10-S99-3A); and pensions and other postretirement benefits, such as defined benefit plans (under ASC 715-20).

In addition, the effective date of a new accounting pronouncement may be sooner for public entities than for nonpublic entities. Since registrants must apply public-entity guidance for all periods presented in the IPO financial statements, a nonpublic entity may be required to retrospectively change its date of adoption of a new standard to that required for a public entity. Some ASC topics may refer to a "public business entity" as defined in [ASU 2013-12](#). However, EGCs are not required to adopt new or revised accounting pronouncements as of the effective dates for public entities if nonpublic entities have delayed effective dates. See the [Emerging Growth Companies](#) section for additional information.

Further, a company that is preparing to go public — or that may consider going public in the future — should be cautious about electing the alternatives developed by the PCC. Once a company is considered a PBE, it would no longer be permitted to apply PCC accounting alternatives. Consequently, any previously elected PCC alternatives would need to be eliminated from the company's historical financial statements before such statements can be included in its IPO registration statement. See the [SEC Reporting](#) section for additional information about PBEs.

² In certain circumstances, auditors are required to refer to **both** auditing standards generally accepted in the United States (i.e., AICPA standards) and the standards of the PCAOB for certain nonissuers, including, but not limited to, (1) entities making confidential submissions of an initial public registration statement under the JOBS Act, (2) entities that voluntarily submit a registration statement to the SEC staff for nonpublic review before the company's public filing, and (3) entities filing a Form 10 to effect an initial registration of securities. See [paragraph 4110.5](#) of the SEC Financial Reporting Manual for additional information.

SEC Rules and Regulations

Example of an SEC Comment

Please expand your disclosure to provide the components of income (loss) before income taxes attributable to each of your domestic and Chinese operations. Refer to Rule 4-08(h)(1) of Regulation S-X.

In an IPO, the registrant's financial statements should also comply with the applicable requirements of Regulation S-X, and SEC staff views in SABs, for each period presented in the financial statements. Because such requirements and views are new to the registrant, its disclosures may not be fully compliant; as a result, the SEC staff frequently requests additional disclosures. Regulation S-X prescribes the types, form, and content of the financial information that registrants must file. Many of these requirements expand on the disclosures directly required by U.S. GAAP. SABs provide staff views on 14 broad topics, including business combinations, revenue recognition, and share-based payment arrangements.

Requirements addressed by Regulation S-X and SABs that often affect nonpublic-entity financial statements during the IPO process include:

- Balance sheet and income statement presentation requirements (Regulation S-X, Rules 5-02 and 5-03) and age of financial statement requirements (Regulation S-X, Rule 3-12).
- Summarized financial information of subsidiaries not consolidated and 50 percent or less owned persons (Regulation S-X, Rule 4-08(g)).
- Income tax expense (Regulation S-X, Rule 4-08(h)).
- Related-party disclosures (Regulation S-X, Rule 4-08(k)).
- Audited financial statement schedules (Regulation S-X, Articles 5 and 12).
- Preferred stock and other securities (e.g., common stock) subject to mandatory redemption requirements or whose redemption is outside the issuer's control (Regulation S-X, Rule 5-02.27; ASR 268; ASC 480-10-S99-3A).

For additional reporting considerations related to these topics, see the [Financial Statement Classification, Including Other Comprehensive Income](#); [Debt](#); [Income Taxes](#); and [SEC Reporting](#) sections.

Distributions to Owners

Example of an SEC Comment

We note your disclosure . . . that a portion of the proceeds of this offering will be used to pay the holder of all of the shares of the Series A convertible preferred stock a cash payment in lieu of, and in excess of, accrued dividends on the Series A convertible preferred stock. As it does not appear the cash payment in excess of accrued dividends is reflected in your balance sheet, to the extent the excess is significant relative to reported equity, please revise the face of your balance sheet to present a pro forma balance sheet alongside the historical balance sheet reflecting the distribution accrual. Refer to SAB Topic 1B3.

It is common for registrants to plan dividends or distributions to owners as of, or immediately before, the closing of an IPO. The SEC staff often comments on the need for pro forma information related to such distributions.

SAB Topic 1.B.3 and [paragraph 3420.1](#) of the SEC Financial Reporting Manual express the SEC staff's view that a significant planned distribution that is not reflected in the latest historical balance sheet should be presented in a pro forma balance sheet regardless of whether it has been declared or will be paid from the proceeds of the offering. The pro forma balance sheet should be presented alongside the most recent historical balance sheet in the filing and should reflect the distribution (but not give effect to the offering proceeds).

In addition, SAB Topic 1.B.3 indicates that if a distribution will be paid to owners from the proceeds of the offering rather than from the earnings in the current year, the registrant should present pro forma EPS data for the latest year and interim period in addition to historical EPS. [Paragraph 3420.2](#) of the SEC Financial Reporting Manual provides additional interpretive guidance on the calculation of such pro forma per share data.

Changes in Capitalization

Entities often have other capitalization changes that occur before, or concurrently with, the effective date or closing of an IPO. Some changes, such as a stock split, are reflected retrospectively in all periods presented in the financial statements. Other changes, which may include (but are not limited to) the redemption or automatic conversion of preferred stock into common stock or the conversion of debt to equity, are only recorded prospectively and may not be reflected in the financial statements presented in an IPO filing. Registrants should present such changes in capitalization as part of the pro forma information. The SEC staff often focuses on the presentation of such pro forma information.

Pro Forma Information

Example of an SEC Comment

Please revise to include a pro forma balance sheet presented alongside the historical balance sheet giving effect to the conversion of your A, B and C preferred shares. Also if the conversion will result in a material reduction of earnings per share, please include pro forma EPS for the latest year and interim period giving effect to the conversion.

The SEC staff asks registrants to present pro forma information when changes in capitalization will occur after the date of the latest balance sheet. [Paragraph 3430.2](#) of the SEC Financial Reporting Manual indicates that when such changes will result in a material reduction in permanent equity or are the result of a redemption of a material amount of securities in conjunction with the offering, a filing should include a pro forma balance sheet (presented alongside the historical balance sheet) that takes into account the change in capitalization but not the effects of the offering proceeds.

In addition, [paragraph 3430.3](#) of the SEC Financial Reporting Manual indicates that when a conversion of outstanding securities occurs after the latest balance sheet date and will result in a material reduction in EPS exclusive of the effects of the offering, registrants should present pro forma EPS (but should exclude the effects of the offering). Such pro forma EPS should be presented for the latest fiscal year and interim period.

Further, SEC staff comments have noted that to the extent that proceeds of an offering are used for the repayment of outstanding borrowings, registrants should include the impact of such repayments in their pro forma EPS amounts by (1) increasing the denominator by the number of shares necessary to repay the outstanding borrowings and (2) adjusting interest expense in the numerator.

Draft Audit Reports

Example of an SEC Comment

Your disclosures indicate that a stock split will occur immediately prior to this offering. Please revise your financial statements to give retroactive effect to the expected stock split. If your auditors believe that only a "draft" report can be presented, due to a pending future event such as the stock split, they can include in the filing a signed and dated preface to their "draft" report stating the reason for the "draft" report and that they expect to be in a position to issue the report in the form presented prior to effectiveness. A signed, dated, and unrestricted auditor's report must be included in the filing prior to effectiveness. [See Rule 2-02 of Regulation S-X.](#)

In accordance with Regulation S-X, Rule 2-02, and interpretive guidance (e.g., [Section 4710](#) of the SEC Financial Reporting Manual), the auditor's report should be dated and signed by the auditor and should not contain restrictive language (e.g., "draft"). The SEC staff will generally not commence its review of a registrant's filing if the registrant has filed a registration statement that does not meet these requirements. However, if a transaction (e.g., a stock split) is expected to occur immediately before the registration statement is declared effective, the registrant may wish to give effect to the transaction before it occurs. When such an anticipated transaction has been included in the historical financial statements, the SEC staff has accepted the filing of a "draft report" in the form in which the report will be expressed at the time the registration statement becomes effective. The draft report is allowed since the anticipated transaction prevents the auditor from expressing an opinion regarding the financial statements at the time of filing (because the filing took place before the transaction occurred and before the registration statement was declared effective). Such a report would include a preface indicating that the report will not be final until the transaction is completed. The SEC staff will remind registrants to remove the preface from a registration statement that was filed before being declared effective because no registration statement can be declared effective until the preface is removed and the accountant's report is finalized.

Dilution Disclosure

Example of an SEC Comment

We note you [disclose] that the net tangible book value per share before the offering is \$[X]. Please refer to Item 506 of Regulation S-K and revise to disclose the net tangible book value per share before the distribution. Please also revise to update your dilution disclosure as of June 30, 2016.

Under Regulation S-K, Item 506, certain disclosures (including net tangible book value per share before and after a distribution) are required when “common equity securities are being registered and there is substantial disparity between the public offering price and the effective cash cost to officers, directors, promoters and affiliated persons of common equity acquired by them.”

[Section 8300](#) of the SEC Financial Reporting Manual acknowledges that there is no authoritative definition of “tangible book value” but notes that the metric “is used generally as a conservative measure of net worth, approximating liquidation value.” The interpretive guidance (1) indicates what tangible assets should exclude and (2) cites examples of when the SEC staff has allowed dual calculation of tangible book value. Accordingly, the staff may question a registrant’s calculation of dilution and its related disclosures, particularly if net tangible book value reported in the dilution section of the registration statement appears to be inconsistent with the historical financial statements.

Foreign Private Issuers

Foreign Private Issuers Using IFRSs

The SEC staff's comments to FPIs have addressed a number of financial accounting and disclosure topics. Many of the comments are generally consistent with those issued to domestic filers and raise topics discussed in other sections of this publication (although staff comments to FPIs on such financial statement topics refer to IFRSs). FPIs have received staff comments about (1) the presentation of financial statements (i.e., under IAS 1), (2) impairment (i.e., under IAS 36), and (3) non-GAAP financial measures.

Presentation of Financial Statements

Examples of SEC Comments

- In your statements of comprehensive (loss) income, you present the loss for the period from operations subtotal. Please tell us how you considered the guidance in IAS 1.BC56 in determining that the accretion expense on your decommissioning and restoration liability would not be regarded as operating in nature and, thus, could be excluded from the loss for the period from operations subtotal.
- We note your disclosure of [£X million] of other operating expenses for 2016. In light of its significance, please tell us and disclose the component amounts making up this subtotal. Refer to paragraphs 85 and 97 of IAS 1.

The SEC staff's comments have often focused on the exclusion of certain expenses from, or the inclusion of certain gains in, amounts presented as results of operating activities (i.e., operating income). In addition, the staff has asked FPIs to present additional line items in the statement of profit or loss and OCI when such presentation is relevant to an understanding of the issuer's financial performance.

Paragraphs 82 and 82A of IAS 1 each list line items that an entity should include, at a minimum, in its statement of profit or loss and OCI. Disclosure of the results of operating activities as a separate line item in the statement of profit or loss and OCI is not required; however, an entity that decides to present the results of operating activities or a similar line item should refer to paragraph BC56 of IAS 1, which notes that "it would be misleading and would impair the comparability of financial statements if items of an operating nature were excluded from the results of operating activities, even if that had been industry practice."

In addition, paragraph 85 of IAS 1 requires an entity to present additional line items, headings, and subtotals on the face of the statement of comprehensive income "when such presentation is relevant to an understanding of the entity's financial performance." Further, paragraph 97 of IAS 1 requires that "[w]hen items of income or expense are **material**, an entity shall disclose their nature and amount separately" (emphasis added). When including such line items and subtotals, an entity should consider providing transparent disclosures that clearly convey the relevance of the items to financial statement users. In such cases, an entity may amend the description of the line items and reorder them to explain the particular element of financial performance.

Impairment

Examples of SEC Comments

- You recognized an impairment loss of approximately [RMB X] million during the fiscal year ended December 31, 2015 and an impairment loss of approximately [RMB Y] million during the six months ended June 30, 2016 related to your oil and gas properties. Tell us how the estimated future cash flows used in assessing value in use changed from December 31, 2015 to June 30, 2016. Your response should address your expectations for possible variations in the amount or timing of those future cash flows as of both dates. Also, describe the range of economic conditions you expected to exist over the remaining useful lives of your properties. Include sufficient detail that will enable us to understand the key assumptions utilized in your estimates. Refer to paragraphs 30 and 33 of IAS 36.
- We note you recognized impairment losses of [\$X million] and [\$Y million] for prepayments for acquisition of land use rights and the related prepayments for construction on such land, respectively, during the year ended December 31, 2015. We also note . . . that the carrying value of these assets is [\$XX million] and [\$YY million] and that the company expected the project would be delayed, or in the worst case, be terminated due to certain ongoing disputes. Please clarify whether the recoverable amount of these assets is the fair value less cost of disposal or its value in use and provide the corresponding disclosures per IAS 36 paragraph 130.

Under IFRSs, IAS 36 is the primary source of guidance on the impairment of assets to be held and used (e.g., property, plant, and equipment; goodwill and other intangibles; equity method investments; joint ventures; and investment properties carried at cost). If an entity determines that an impairment indicator exists as of a reporting date, the entity should test for recoverability. Paragraphs 18 through 23 of IAS 36 indicate that an entity should measure an asset's recoverable amount by comparing the asset's carrying amount with the greater of its (1) fair value less costs of disposal or (2) value in use. However, it may not be necessary to calculate both the fair value less costs of disposal and the value in use. If one of these two estimates is greater than the carrying amount, no further calculations are needed. As discussed in paragraphs 58 through 64 of IAS 36, if an asset's carrying amount is greater than its recoverable amount, an impairment loss should be recorded.

When measuring the recoverable amount by using value in use, registrants should (1) measure the asset's future cash inflows and outflows and future cash flows from the ultimate disposal of the asset and (2) apply an appropriate discount rate; both of which may be based on entity-specific information. The SEC staff frequently asks FPIs to (1) clarify whether they calculate the recoverable amount by using the asset's fair value less cost of disposal or its value in use and (2) provide the corresponding disclosures. In addition, when an FPI calculates the recoverable amount by using value in use, the staff frequently asks:

- For a summary of all material assumptions underlying the value in use calculations, such as projected cash flows (number of years covered, price assumptions, cost assumptions, and sale volume assumptions).
- About the process the FPI uses to estimate future cash flows for periods beyond those for which the FPI has an approved budget.
- About the process through which key economic conditions are taken into account.
- How the FPI examines the causes of the differences between past cash flow projections and actual cash flows.
- How individual assets are grouped into cash generating units.

Non-GAAP/Non-IFRS Measures

Examples of SEC Comments

- We note you present the measure “Income on Transportation before loss from revaluation of vessels” here and elsewhere in your filing. This appears to be a non-IFRS measure, and therefore is subject to the presentation and disclosure of Item 10(e) of Regulation S-K. Specifically, in future filings, please present the most directly comparable IFRS measure with equal or greater prominence, a reconciliation to the most directly comparable IFRS measure, and a discussion of the measure’s usefulness to investors.
- We note that . . . the Form F-3ASR filed on September 30, 2014 indicates that the registration statement incorporates by reference any future filings made under Section 13(a), 13(c) or 15(d) of the Securities Exchange Act of 1934, as well as any Forms 6-K furnished until the offering is completed. In this regard, it would appear that the guidance of Item 10(e) of Regulation S-K would apply to your presentation of non-GAAP measures in your Form 6-K. We note the headlines to your earnings release appear to give more prominence to non-GAAP measures. Please revise your disclosures as appropriate pursuant to Question 102.10 of the updated Compliance and Disclosure Interpretations issued on May 17, 2016.

The SEC staff frequently asks FPIs that use non-GAAP financial measures (or non-IFRS financial measures for those that report under IFRS) to provide the necessary disclosures and comply with the relevant presentation requirements. FPIs are subject to Regulation S-K, Item 10(e), if they file Forms 20-F or registration statements (including any Forms 6-K incorporated by reference into such registration statements) under the Securities Act. However, as clarified in Question 106.04 of the [C&DIs related to non-GAAP financial measures](#), Item 10(e) does not apply to filers that use Form 40-F under the Multi-Jurisdictional Disclosure System (which applies to eligible Canadian issuers). The comments on non-GAAP measures issued by the staff to FPIs are generally consistent with those issued to domestic filers. For additional considerations, see the [Non-GAAP Financial Measures and Key Metrics](#) section.

Industry-Specific Topics

Consumer and Industrial Products

Retail and Distribution

The SEC staff's comments to registrants in the retail and distribution industry have focused on the convergence of digital technology with the traditional "brick-and-mortar" and direct channels. Retailers citing an omnichannel customer experience have received comments on MD&A related to the impact of multiple distribution channels on trends in results of operations and in liquidity and capital resources. Other frequent comments include (1) questions about the accounting for and disclosure of certain revenue recognition items and (2) requests for additional disclosures related to sales returns and allowances.

In addition, given that registrants in the industry typically have multiple distribution channels (e.g., stores, catalogs, the Internet), geographic locations, and store concepts and brands, the SEC staff frequently asks such registrants about the identification and aggregation of their operating segments, particularly when they disclose only one reportable segment. Further, many retailers have received comments related to the disclosure of revenue by products and services in accordance with ASC 280-10-50-40. See the [Segment Reporting](#) section for additional information.

MD&A

Example of an SEC Comment

We note that you include e-commerce sales in your determination of comparable retail sales and that you attribute increases to your revenues for both the year ended January 28, 2017 and the thirteen weeks ended April 29, 2017 to the growth in this metric. To the extent that e-commerce sales have a measurable effect on your comparable retail sales, please quantify your e-commerce sales or provide transparent disclosure regarding the impacts that e-commerce sales had on your comparable retail sales metric.

The SEC staff frequently asks registrants to improve their MD&A (e.g., by including operational and statistical measures) to help investors see registrants' performance through the eyes of management. Many retailers consider same-store sales a key operating metric; accordingly, same-store sales are often discussed in MD&A to help explain fluctuations in results of operations. Because there can be variability in the way same-store sales are calculated, the SEC staff often asks registrants to enhance their disclosures about such metrics and elaborate on any factors that could affect year-to-year comparability.

Further, the SEC staff has also frequently commented on a registrant's non-GAAP measures, including when adjustments appeared to be recurring in nature (e.g., excluding rent expense from EBITDAR) and when a registrant presented non-GAAP financial measures without providing the required quantitative reconciliation to the most directly comparable GAAP financial measure.

See the [Management's Discussion and Analysis](#) and [Non-GAAP Financial Measures and Key Metrics](#) sections for additional information.

Revenue Recognition — Accounting and Disclosure

Examples of SEC Comments

- Please tell us how you determined that it was appropriate to classify income from unredeemed gift cards as a reduction of selling, general and administrative expenses as opposed to within net sales or other operating income. Further, tell us and, if material, disclose the amount of breakage income recognized during the periods presented.
- We note your disclosure that you recognize revenue from the rental of digital textbooks at the time of sale and that once the digital content is delivered to the customer your performance obligation is complete. Please explain how your performance obligation is complete at the time of sale. Also clarify whether you recognize revenue from the rental of digital textbooks gross as a principal or net as an agent and the reasons supporting your accounting treatment. If such revenues are recognized net, please disclose such information in future filings.

The SEC staff may ask registrants to clarify the key terms and related accounting and disclosure for certain revenue recognition items common among retailers, including matters related to direct sales, customer loyalty programs, and gift card breakage. For example, since there is diversity in practice regarding the classification of gift card breakage (i.e., classification as a reduction of SG&A versus within net sales or other operating income), the SEC staff frequently asks registrants to explain the rationale for their classification.

See the [Revenue Recognition](#) section for additional information.

Sales Returns and Allowances

Examples of SEC Comments

- It appears that the information provided for your sales return reserve may be presented on a net basis rather than on a gross basis. Please revise future filings to provide this information on a gross basis or advise us why you believe no revision is required.
- Please disclose your sales return policy and address how you make estimates of the amounts of future returns. In addition, please provide a rollforward of the activity in your sales return allowance here or in Schedule II, or provide to us your materiality assessment indicating why such disclosure is not necessary. Refer to Rules 5-04 and 12-09 of Regulation S-X.

The SEC staff has focused on sales returns and allowances for retailers. Given that retailers' online sales are increasing significantly, trends in sales returns may become more important since the rate of sales returns is frequently greater in retailers' direct channels (e.g., online sales) than in their brick-and-mortar channels. Accordingly, registrants whose sales returns have a material impact on their financial statements should consider providing expanded disclosures about their accounting policy in the notes to the financial statements as well as additional quantitative and qualitative information about sales returns in MD&A. Further, some registrants may provide a rollforward of sales returns and allowances in Schedule II under Regulation S-X, Rule 12-09, or similar disclosure in the notes to the financial statements.

Travel, Hospitality, and Leisure

The SEC staff's comments to registrants in the THL industry have focused on (1) revenue recognition and (2) non-GAAP measures.

Revenue Recognition

The SEC staff often asks THL registrants to clarify and support their revenue recognition policies by disclosing in MD&A or footnotes information such as (1) estimates used in the determination of deferred or recognized revenue and (2) the specific inputs and assumptions used to calculate estimates for revenues recognized over time. For additional considerations, see the [Revenue Recognition](#) section.

The SEC staff has also asked registrants how they have considered the requirements in Regulation S-X, Rule 5-03(b)(1) and (2), to separately present product and service revenues and their related costs on the face of the income statement. See the [Financial Statement Classification, Including Other Comprehensive Income](#) section for more information.

Non-GAAP Measures and Key Operating Metrics

Examples of SEC Comments

- We note that in your calculation of ROIC you utilize an assumption of seven times the amount of aircraft rent. Please clarify the basis for this assumption and tell us whether the multiple of seven compares to contractual terms. If it is significantly different, please clarify why it would be meaningful to an investor if it does not depict a realistic picture of your facts and circumstances.
- Refer to your tabular presentation of Domestic Same-[R]estaurant Sales In the introductory paragraph, please disclose that the percentage change in sales at the Effective Restaurants is based on non-GAAP sales data as it combines restaurant sales of franchisees and area licensees as well as company-owned restaurants. Also refer to the table of unaudited reported sales in footnote (b). In that regard, please provide sufficient context in footnote (b) of the impact, favorable or unfavorable, of the franchisees' reported sales on your earning trend regarding franchise fees income.

Registrants in the THL industry continue to receive comments from the SEC staff on the use of non-GAAP measures as well as key operating metrics. For example, when registrants have used a return on invested capital measure, the staff has questioned certain assumptions within that measure.

The staff has also commented on metrics such as systemwide sales, which is a non-GAAP financial measure commonly used by registrants in the THL industry and is generally defined as the combination of sales generated by corporate-owned and franchised locations. Although the SEC staff had historically objected to the presentation of systemwide sales, it indicated at the 2015 AICPA Conference that it did not object to the use of this non-GAAP measure in certain situations (when the registrant has complied with all other non-GAAP requirements and disclosures) since it is generally understood in the marketplace and used by investors (e.g., to assess the strength of the overall brand).

For additional considerations, see the [Non-GAAP Financial Measures and Key Metrics](#) section.

Energy and Resources

Oil and Gas

The SEC staff's comments to registrants in the oil and gas industry continue to focus on (1) distributable cash flow and maintenance capital expenditures for MLPs; (2) oil and gas reserves; (3) disclosures about drilling activities, wells and acreage data, and delivery commitments; (4) income statement classification; (5) production, revenues, and price history; and (6) impairment considerations.

Distributable Cash Flow and Maintenance Capital Expenditures for MLPs

Example of an SEC Comment

We note that you began deducting development capital expenditures instead of estimated maintenance capital expenditures in calculating the non-GAAP measure "Distributable Cash Flow" in 2015. Revise to explain the reasons for this change and to compare the usefulness of the revised measure of "Distributable Cash Flow" to the measure previously provided. As part of your revised disclosure, provide additional information describing the basis on which you calculate development capital expenditures. Please include your proposed revisions as part of your response.

The partnership agreements of MLPs typically define distributable cash flow and often call for a distinction between capital expenditures related to maintenance and those related to growth. In turn, MLPs frequently disclose distributable cash flow and capital expenditure amounts. Consequently, because distributable cash flow is not determined on the basis of SEC rules or U.S. GAAP, SEC staff comments to registrants in the oil and gas industry may focus on:

- Providing (1) greater clarity about how distributable cash flow is calculated and (2) disclosure of any changes in the calculation of distributable cash flows from prior periods.
- How maintenance capital expenditures are defined, and how they affect distributable cash flow.
- Describing the relationship between the calculated amount of distributable cash flow and actual distributions.
- Understanding the liquidity ramifications of cash distribution requirements, including the risk that the registrant will be unable to maintain the same level of distributions in the future.
- Compliance with the requirements of Regulation S-K, Item 10(e), related to non-GAAP financial measures.

Oil and Gas Reserves

PUD Reserves

Examples of SEC Comments

- We note your response to prior comment [X] and your disclosure stating that all PUDs will be drilled within five years of their initial booking date. Please expand on this statement to provide additional detail regarding [Company A's] development program and to describe how it results in the drilling of these PUDs in a timely manner. Your revised disclosure should address your ability to execute a development plan and estimate the costs to drill and develop these reserves considering that no development activity occurred during the prior two years. Refer to Item 1203(c) of Regulation S-K and Rule 4-10(a)(31) of Regulation S-X.
- Your disclosure indicates the proved undeveloped reserves that have remained undeveloped for five years or more were not material to the Company's total proved reserves. Please expand your disclosure to clarify the extent to which those reserves are material to the Company's total proved undeveloped reserves as of December 31, 2015. As part of your expanded disclosure, clearly explain the reasons for a time period longer than five years to convert these reserves to developed status. Your discussion should relate the anticipated timing of converting these reserves to the associated activities resulting in their conversion to developed status. Refer to Item 1203(d) of Regulation S-K.

Under Regulation S-X, Rule 4-10(a)(22), a registrant should be reasonably certain when estimating proved reserves that the reserves can be recovered in future years under existing economic conditions. In accordance with Rule 4-10(a)(31)(ii), “[u]ndrilled locations can be classified as having undeveloped reserves only if a development plan has been adopted indicating that they are scheduled to be drilled within five years, unless the specific circumstances, justify a longer time.”

At the 2014 AICPA Conference, the SEC staff referred registrants to Rule 4-10(a) and [Question 131.04 of the C&Ds of the oil and gas rules](#) for the definition of PUD oil and gas reserves and staff views on the interaction of that definition with a registrant’s development plan. The staff noted that a mere intent to develop reserves does not constitute adoption of a development plan, which would require a final investment decision. Further, a registrant’s scheduled drilling activity should reconcile to its investment plans that have been approved by management.

The SEC staff may ask registrants to justify recorded PUD reserves that will remain undeveloped for more than five years because a registrant’s decision not to develop PUD reserves for such a long period may indicate uncertainty regarding development and ultimate recoverability. In accordance with Regulation S-K, Item 1203(d), a registrant may be asked to explain why the reserves have not been or will not be developed, why it believes that the reserves are still appropriate, and how it plans to develop the reserves within five years given the registrant’s historical conversion rate. The SEC staff may also ask registrants to support engineering assumptions, such as terminal decline rates, used in proved reserve estimates, as well as assumptions used in future cash flow analyses (e.g., estimated future well costs).

Separate Disclosure of NGL Reserves

Example of an SEC Comment

We note you have not provided separate disclosure of natural gas liquids (NGL) production. The staff considers natural gas liquids to be a separate product type under Item 1204(a) of Regulation S-K. Please revise [your tables] to disclose production by final product sold of oil/condensate and natural gas liquids as separate figures.

Although NGLs are not separately identified as a product type in Regulation S-K, Item 1202(a), they are discussed in ASC 932-235-50-4. Accordingly, the SEC staff may ask registrants to disclose NGLs separately if they aggregate significant NGLs with other product types in their disclosures of proved reserves.

Significant Changes in Reserves and Standardized Measures

Examples of SEC Comments

- To the extent that you continue to disclose dry gas locations as proved undeveloped reserves as of December 31, 2015, please quantify for us and expand your disclosure to provide the total number of locations and net proved reserve amounts pursuant to FASB ASC 932-235-50-10.
- The projected unit development cost from the 2015 subsidiaries standardized measure is \$[X]/BOE (= \$[X] million/[X] MMBOE). Your 2015 incurred unit development cost appears to be \$[X]/BOE (= \$[X] million/[X] MMBOE . . .). We see similar differences for 2014 and 2013. Please explain the reason(s) for these variances between your projected and incurred unit development costs.

The SEC staff has commented on registrants' disclosures about (1) changes in proved reserves and standardized measures and (2) their compliance with ASC 932-235-50. Accordingly, the SEC staff may ask registrants to:

- Describe the technical factors (e.g., the activities, findings, and circumstances) that led to significant changes in proved reserves.
- Address negatively revised estimates attributable to performance separately from negatively revised estimates attributable to price reductions.
- Explain significant changes in extensions and discoveries.
- Disclose prices used in the calculation of standardized measures.
- Discuss how certain tax attributes were used to determine the future income tax expenses.

Further, the SEC staff may (1) ask registrants whether abandoned assets have been included in the standardized measure and, if so, to provide information about them and (2) refer registrants to a [sample letter](#) expressing views of the Division on the required disclosures.

Reserve Reports

Example of an SEC Comment

The reserve report does not include certain disclosures required by Item 1202(a)(8) of Regulation S-K. Please obtain and file a revised reserves report to include the following information in order to satisfy your filing obligations.

- The purpose for which the report was prepared (e.g. for inclusion as an exhibit in a filing made with the U.S. Securities and Exchange Commission (SEC) (Item 1202(a)(8)(i)).
- The proportion of the Company's total proved reserves covered by the report (1202(a)(8)(iii)).
- A statement that the assumptions, data, methods and procedures used in the preparation of the report are appropriate for the purpose served by the report (Item 1202(a)(8)(iv)).
- A statement that the third party has used all methods and procedures as it considered necessary under the circumstances to prepare the report (Item 1202(a)(8)(viii)).

Under Regulation S-K, Item 1202(a)(8), a registrant must file a third-party report as an exhibit to its periodic report or registration statement when it “represents that a third party prepared, or conducted a reserves audit of, the registrant’s reserves estimates, or any estimated valuation thereof, or conducted a process review.” Accordingly, certain disclosures are required under Item 1202(a)(8). The SEC staff issues comments when these required disclosures are omitted. Often, the staff’s comments are related to the requirement in Item 1202(a)(8)(iv) to disclose the “assumptions, data, methods, and procedures used, including the percentage of the registrant’s total reserves reviewed in connection with the preparation of the report, and a statement that such assumptions, data, methods, and procedures are appropriate for the purpose served by the report.”

Drilling Activities, Wells, Acreage, and Delivery Commitments

Examples of SEC Comments

- Please expand the disclosure of your expiring acreage to provide the gross amounts of such acreage. Refer to the disclosure requirements pursuant to Item 1208(b) of Regulation S-K.
- We note the tabular presentations . . . that set forth the net sales volumes of natural gas liquids, crude oil and condensate and the average sales price per unit of natural gas liquids, crude oil and condensate produced are provided solely as gas equivalent figures. Please refer to the disclosure requirements pursuant to Item 1204(a) and Item 1204(b)(1) of Regulation S-K and expand your disclosure to present the production figures and average sales prices for natural gas liquids, crude oil and condensate in terms of the barrels of liquids produced and sold.

The SEC staff has continued to focus on registrants’ disclosures about production information, drilling activities, wells and acreage data, and delivery commitments under Regulation S-K, Items 1204 through 1208. Additional disclosures that may be requested include (but are not limited to) the following:

- Production by geographic area and for each country and field that contains 15 percent or more of the registrant’s total proved reserves.
- Drilling activities for each of the last three years by geographic area.
- Steps to be taken to meet significant delivery commitments.
- The number of wells that the registrant operates, including the total gross and net productive wells, expressed separately for oil and gas by geographic area.
- Information related to undeveloped acreage regarding minimum remaining terms of leases and concessions for material acreage concentrations, including significant undeveloped acreage that will be expiring over the next three years.

Income Statement Classification

Under Regulation S-X, Rule 5-03, if product or service revenue is greater than 10 percent of total revenue, disclosure of such component is required as a separate line item on the face of the income statement, and costs and expenses related to the product or service revenue should be presented in the same manner. Revenue streams vary by sector within the oil and gas industry. For example, in the midstream sector, revenue streams could include transportation and storage of crude or refined petroleum products, processing of natural gas, and marketing fees generated from the sale of such products. In connection with these services, midstream companies may purchase, take title to, or otherwise have risk of ownership for the related products they are transporting, storing, or processing. If revenues from these product sales exceed 10 percent of total revenues, registrants are required to disclose such revenues and costs and expenses separately in the income statement. For more information, see the [Financial Statement Classification, Including Other Comprehensive Income](#) section.

Production, Revenues, and Price History

Example of an SEC Comment

Please revise your presentation to disclose the figures for production and the average sales price by final product sold of condensate and natural gas liquids to comply with Items 1204(a) and 1204(b)(1) of Regulation S-K.

For public entities (as defined by the SEC) with material oil and gas operations, the SEC requires certain additional nonfinancial disclosures to be included in the securities registration statements and annual reports on Form 10-K filed with the SEC. Regulation S-K, Item 1204, requires registrants to provide disclosures as follows:

- (a) For each of the last three fiscal years disclose production, by final product sold, of oil, gas, and other products. Disclosure shall be made by geographical area and for each country and field that contains 15% or more of the registrant's total proved reserves expressed on an oil-equivalent-barrels basis unless prohibited by the country in which the reserves are located.
- (b) For each of the last three fiscal years disclose, by geographical area:
 - (1) The average sales price (including transfers) per unit of oil, gas and other products produced; and
 - (2) The average production cost, not including ad valorem and severance taxes, per unit of production.

The SEC staff issues comments when the disclosures required under Item 1204(a) and (b) are omitted. Often, the staff's comments are related to revising the registrant's presentation to disclose production, by final product sold, for each field that contains 15 percent or more of the registrant's total proved reserves.

Impairment

Example of an SEC Comment

A downward revision of your long-term commodity price assumptions triggered an assessment of certain long-lived assets related to producing properties in the quarter ended September 30, 2016. As a result, you recorded impairment charges to reduce the carrying value of certain conventional non-core proved properties in Oklahoma. Your disclosure states that further changes in forecasted commodity prices may result in future impairment charges. Expand your disclosure to discuss the percentage or amount by which the undiscounted cash flows related to your remaining long-lived assets exceeded their carrying values as of the date of the most recent impairment test. In addition, provide additional quantitative disclosure addressing the degree of uncertainty resulting from commodity price trends. Your revised disclosure should also discuss uncertainty in the key assumptions underlying your impairment assessment and address the effect of reasonably likely changes to these assumptions. Refer to Section V of SEC Release No. 33-8350.

SEC staff comments focus on the degree of uncertainty associated with the key assumptions used in impairment assessment and potential events that could negatively affect assumptions.

Section V of [SEC Interpretive Release No. 33-8350 \(34-48960\)](#) states that "[m]any estimates and assumptions involved in the application of GAAP have a material impact on reported financial condition and operating performance and on the comparability of such reported information over different reporting periods." In addition, Section V states that when registrants prepare disclosures under the current requirements, they should consider whether they have made accounting estimates or assumptions that meet the following conditions:

- The "nature of the estimates or assumptions is material due to the levels of subjectivity and judgment necessary to account for highly uncertain matters or the susceptibility of such matters to change."

Energy and Resources

- The “impact of the estimates and assumptions on financial condition or operating performance is material.”

Section V specifies that if the conditions above are met, “companies should provide disclosure about those critical accounting estimates or assumptions in their MD&A.”

For additional information, see the [Impairments of Goodwill and Other Long-Lived Assets](#) section.

Power and Utilities

The focus of recent SEC staff comments to registrants in the P&U industry is largely consistent with that of staff comments issued in past years, which include (1) dividend restrictions; (2) accounting for the impact of rate making; (3) regulatory disallowance of property, plant, and equipment; and (4) timing of impairment.

Comments from registrants in the P&U industry have also focused on the use of non-GAAP measures. For additional information, see the [Non-GAAP Financial Measures and Key Metrics](#) section.

Dividend Restrictions

Example of an SEC Comment

Reference is made to your disclosure . . . of [Company A’s] maximum ratio of consolidated financial indebtedness to consolidated total capitalization imposed by a credit agreement. Please tell us whether this covenant, other financial covenants and/or restrictions imposed by regulatory commissions restrict the ability of your subsidiaries or investments accounted for by the equity method to transfer funds to you in the form of loans, advances or cash dividends. If so, please tell us: (i) the amount of restricted net assets of consolidated subsidiaries and your equity in the undistributed earnings of investments accounted for by the equity method . . . and how you computed the amount; (ii) your consideration of providing the disclosures required by Rule 4-08(e)(3)(i) and (ii) of Regulation S-X; and (iii) your consideration of providing the condensed financial information prescribed by Rule 12-04 of Regulation S-X in accordance with Rule 5-04 of Regulation S-X.

Given the nature of regulation in the P&U industry, there may be constraints on a P&U registrant’s financial flexibility and its relationships with affiliated parties, including the parent company. For example, a utility subsidiary may be subject to requirements imposed by federal and state regulators that establish a minimum equity capitalization ratio or set limits on the payment of dividends. In addition, the capital-intensive demands of the P&U industry require significant financing agreements at the subsidiary level that may restrict (1) a subsidiary’s transfer of assets in the form of advances, loans, or dividends to the parent company or another affiliated party or (2) other types of transactions between a subsidiary and its affiliates. The inability of a subsidiary to transfer assets to the parent company could, in turn, restrict the parent company’s ability to pay dividends to its own shareholders.

Consequently, several P&U registrants have received comments from the SEC staff about their compliance with Regulation S-X, Rules 4-08(e) and 5-04. Those comments have included inquiries about whether consideration was given to regulatory or other limitations (e.g., debt agreements) that could restrict the transfer of assets from a subsidiary to the parent company through dividends, loans, advances, or returns of capital. As a result of the staff’s comments, several P&U registrants have been required, or have agreed, to prospectively (1) expand their notes to the financial statements about potential dividend restrictions in accordance with Rule 4-08(e) and (2) include a Schedule I in their annual Form 10-K filing in accordance with Rule 5-04. Registrants should be aware that the calculations for determining the note disclosures required under Rule 4-08(e) should be performed independently of

the calculations for determining the required Schedule I disclosures, and that compliance with one set of disclosure requirements does not satisfy the requirements of the other.

For additional considerations about dividend restrictions, see the [Debt](#) section.

Accounting for the Impact of Rate Making

Example of an SEC Comment

We noted a significant increase in your regulatory asset related to [Matter X] . . . We also note your disclosure . . . that the [state legislation] leaves the decision on cost recovery determinations related to [Matter Y] to the normal ratemaking processes before utility regulatory commissions and your disclosure . . . that you believe recovery is probable. We further note your disclosure in multiple instances . . . that an order from the regulatory authorities disallowing recovery of costs related to [Matter Z] could have an adverse impact on your financial statements. As it appears you do not have a regulatory order supporting the deferral of these costs, please tell us why you believe the amounts you have deferred as regulatory assets are probable of recovery under U.S. GAAP and provide us with your detailed analysis supporting this conclusion including both positive and negative evidence you considered. Refer to ASC 980-340-25-1.

The SEC staff's comments have focused on (1) ensuring that P&U registrants are thoughtful in determining the initial and continuing probability of cost recovery inclusive of the expected recovery period, (2) providing supplemental explanations or separate detailed analysis and evidence that support the P&U registrant's recognition of regulatory assets, and (3) whether a particular regulatory asset of the P&U registrant is earning a rate of return. Further, the SEC staff continues to issue comments on (1) how the P&U registrant's current regulated rates are designed to recover its specific costs of providing service, (2) the nature of the P&U registrant's material regulatory assets and liabilities, and (3) the P&U registrant's accounting policies for revenues subject to refund.

Regulatory Disallowance of Property, Plant, and Equipment

SEC staff comments to public utility registrants continue to focus on the guidance in ASC 980-360-35 on subsequent measurement and recognition of property, plant, and equipment related to regulated operations. Under that guidance, an entity should record a disallowance related to a recently completed plant if it determines that a disallowed amount is probable and reasonably estimable; the entity must use judgment to make that determination. In light of recent regulatory orders by state public utility commissions that limit a public utility entity's cost recovery, registrants have been asked to explain their considerations related to the timing of recording a disallowance, particularly when a disallowance was not recorded until a rate order was received.

Timing of Impairment

Example of an SEC Comment

Please identify the impaired assets for us and tell us whether or not you tested them for impairment during the [preceding quarter]. If you did not test these assets for impairment during the [preceding quarter], explain to us your basis for concluding that an impairment test was not necessary. If you did test these assets for impairment during the [preceding quarter], describe for us in reasonable detail all material assumptions used in and the results of your test. See ASC 360-10-35-21(f).

Recently, the SEC staff has increased its focus on impairment of long-lived assets, including comments on whether a registrant has recorded, or is at risk of recording, an impairment charge.

The SEC staff may also provide a reminder that a registrant may be required to disclose in MD&A risks and uncertainties associated with the recoverability of assets in the periods before an impairment charge is recorded. For example, even if an impairment charge is not required, a reassessment of the useful life over which depreciation or amortization is being recognized may be appropriate.

For additional considerations, see the [Impairments of Goodwill and Other Long-Lived Assets](#) section.

Financial Services

Banking and Securities

The SEC staff's comments to registrants in the banking and securities industry have significantly declined in the past couple of years. However, as is the case with several other industries, non-GAAP measures remain a key topic of interest for the SEC staff.

In addition, the impact of [ASU 2016-13](#) (the "credit loss ASU") will be significant to the banking and securities industry. The SEC staff has been reminding registrants about best practices to apply in the periods leading up to the adoption of the credit loss ASU. The staff's comments reiterate themes it has addressed over the past year that have focused on disclosures related to implementation activities. For expanded discussion on this topic, see the [SAB Topic 11.M \(SAB 74\) — Disclosures About the Impact of Recently Issued Accounting Pronouncements](#) section.

Non-GAAP Measures — Adjusted Allowance for Loan and Lease Loss Disclosures

Example of an SEC Comment

Please tell us how you considered whether the non-GAAP measure "Allowance for loan losses plus discount for credit losses on purchased loans to total loans plus discount for credit losses on purchased loans" uses an individually tailored recognition and measurement method which could violate Rule 100(b) of Regulation G. Please refer to Question 100.04 of the Compliance and Disclosure Interpretations for guidance.

Some comment letters to registrants in the banking industry have focused on certain non-GAAP financial measures commonly used by banks, such as those related to the allowance for loan and lease losses. For example, the SEC staff has objected to certain measures that remove the impact of purchase accounting ("fair value") adjustments for acquired loans from the GAAP measure and therefore may be considered individually tailored accounting measures prohibited under Rule 100(b) of Regulation G and Question 100.04 of the CD&Is related to non-GAAP financial measures. Situations involving the use of such prohibited measures include those in which:

- An "adjusted allowance for loan losses to total loans" ratio is presented in such a way that the remaining discount on purchased loans is added to both the numerator and denominator.
- Interest income is reduced by the amount of accretion income on purchased loans to compute the related loan yield or net interest margin.

Further, the SEC staff has requested disclosures that clearly articulate the information required under Regulation G, Item 10(e) of Regulation S-K, and the related C&DIs.

For additional considerations, see the [Non-GAAP Financial Measures and Key Metrics](#) section.

Insurance

In many of its comments issued to registrants in the insurance industry over the past year, the SEC staff has focused on various new topics, including the disclosure requirements of [ASU 2015-09](#). In addition to addressing insurance-related matters (discussed below), recent SEC comments to registrants in the insurance industry have focused on (1) non-GAAP measures and (2) contacts with Syria and Sudan given that these countries are designated as state sponsors of terrorism by the U.S. Department of State and are therefore subject to U.S. economic sanctions and export controls. See the [Non-GAAP Measures and Key Metrics](#) and [Disclosures Regarding State Sponsors of Terrorism](#) sections for more information.

Disclosure Requirements of ASU 2015-09

Examples of SEC Comments

- Please tell us:
 - why you did not disaggregate liability from physical damage for auto insurance in the tables presenting incurred claims and cumulative paid claims for 2012–2016; and
 - why you did not provide tables for “other personal lines” and “commercial lines.”

Provide us the information that would be provided in the separate tables for auto liability, auto physical damage, other personal lines and commercial lines, if available.
- Regarding the information in the tables you state . . . “To the extent the Company enters into a commutation, the transaction is reported on a prospective basis.” Explain to us your basis for reporting commutations on a prospective basis and tell us why you did not report commutations on a retrospective basis. In your response, confirm that you were the ceding party in the reinsurance agreements that were commuted, tell us how you reconciled presenting the table net of reinsurance that does not exist as of the date of the latest statement of financial position presented with ASC 944-40-50-4B, and explain how presenting commutations on a prospective basis provides a meaningful trending analysis when the claims incurred estimates and claims payment information in the historical columns of your claims development tables are not directly comparable to the post-commutation information.

The SEC staff has asked registrants in the insurance industry to clarify how they complied with the new disclosure requirements of ASU 2015-09 for short-duration insurance contracts. SEC comments on this topic have primarily focused on the claims development tables, including aggregation of claim data, disclosures related to the basis for reporting commutations, presentation of foreign operations, and presentation of reinsurance. Other comments have addressed the need to provide additional disclosure about (1) the determination of the amounts presented in liabilities incurred but not reported and (2) expected development on reported claims.

Investment Management

The SEC staff’s recent comments to investment advisers and business development companies in the investment management industry have continued to focus on topics such as (1) fair value measurement, (2) non-GAAP disclosures related to AUM, and (3) commitments and contingencies.

In addition, the SEC’s OCIE highlighted the examination priorities of the SEC’s 2017 National Exam Program for investment advisers and investment companies, which include issues such as conflicts of interest and fund marketing and performance. This year, the OCIE’s examination priorities are organized into three themes: (1) examining matters of importance to retail investors, (2) focusing on risks specific to elderly and retiring investors, and (3) assessing market-wide risks. For more information about these priorities, see the [OCIE’s examination priorities for 2017](#).

Fair Value Measurement

Examples of SEC Comments

- In your fair value footnote, provide the disclosures outlined in ASC 820-10-50-1 to 50-2 for your recurring fair value measurement of . . . including your significant unobservable inputs . . . as of the acquisition date and the reporting date.
- As it relates to your 2016 and 2015 goodwill impairment testing, tell us the percentage by which the fair value exceeded the carrying value. In addition, provide us with a description of the methods and key assumptions used and how the key assumptions were determined. Explain to us how underperformance within your AUM products or discipline has impacted key assumptions used in your impairment model or method.

The SEC staff continues to focus on fair value measurement and related disclosures in comments to investment advisers in the investment management industry. In particular, the SEC staff will frequently ask investment advisers to disclose additional qualitative information about their processes for determining fair value associated with financial instruments, goodwill, and disclosures. Specifically, it will ask a registrant for additional information about (and, potentially, additional disclosures related to) Level 3 inputs, adjustments to quoted market prices, and investments for which the investment adviser's recorded balance does not represent fair value. Further, the SEC staff has asked investment advisers to disclose additional information about the procedures they use to validate values obtained from external sources (e.g., broker quotes). In addition, the SEC staff has often asked investment advisers to expand quantitative disclosures, such as a weighted average or range of inputs in the tabular disclosure of Level 3 unobservable inputs. For more information, see the [Fair Value](#) section.

Disclosures Related to AUM

Examples of SEC Comments

- We note your discussion . . . that your AUM decreased due to \$[X] billion of net new outflows, which primarily were in global/international products with long-term investment objectives. Please revise your discussion in future filings to provide additional qualitative factors that drove the net outflows. For example, discuss whether the outflows are primarily occurring in one or across multiple funds, a single or multiple customers, whether due to poor performance, fee rate pressure or reallocation into other investment objectives, among other possible factors. Refer to Item 303(a)(3) of Regulation S-K for guidance.
- Please revise your segment analysis (for all segments) in future filings to provide a more granular discussion of the relationship (or correlation, if any) between Fee-Earning AUM and base management fees. To the extent that the changes are not proportional, address the underlying reasons for the variability (e.g. lower or higher fee rates on Fee-Earning AUM inflows vs. outflows, timing of realizations, market appreciation (depreciation), etc.) and disclose the average or weighted-average fee rates.

Registrants are required to disclose any significant economic changes that materially affected the amount of reported income under Regulation S-K, Item 303(a)(3). The SEC staff may ask an investment adviser in the investment management industry to elaborate on the underlying reasons for the variability of fee-earning AUM. Further, the staff may ask for a more granular discussion of the relationship between fee-earning AUM and base management fees.

Commitments and Contingencies

Example of an SEC Comment

To the extent material, please expand your disclosures in future filings to address the effects of various outstanding legal proceedings and claims on the company's results of operations. Refer to ASC 450-20-50.

Recently, the SEC staff has asked registrants to include disclosures required by ASC 450-20-50. Specifically, the staff has asked registrants to revise future filings by including a discussion regarding the reasonable possible loss or range of loss, if any, in excess of amounts accrued consistent with ASC 450-20-50-3. For more information, see the [Contingencies](#) section.

Real Estate

The SEC staff's recent comments to registrants in the real estate industry have focused heavily on non-GAAP financial measures. While such registrants have seen a decline in the number of comments issued on other topics, they should continue to be aware of comments related to matters such as (1) whether, for U.S. GAAP purposes, real estate acquisitions represent business combinations or asset acquisitions and whether, for SEC reporting purposes, a registrant has acquired a business or real estate operations; (2) capitalization of real estate development, construction, and leasing costs; (3) liquidity considerations associated with distributions; and (4) consolidation.

Non-GAAP Financial Measures

Examples of SEC Comments

- We note that you focus on non-GAAP financial measures such as "Company Same Store NOI" and "Company EBITDA" in your highlights section. Such a presentation causes your Non-GAAP measure to be more prominent than the most directly comparable GAAP measure. Please revise accordingly in future filings. Reference is made to Question 102.10 of the updated Compliance and Disclosure Interpretations issued on May 17, 2016.
- We note that you adjust your non-GAAP pro rata balance sheet and income statement for your proportionate economic ownership of each asset in your portfolio that [is] not wholly-owned which substitutes an individually tailored accounting principle for the one in GAAP. Please describe the changes you expect to make to your presentation in light of the new guidance in Question 100.04 of the updated Non-GAAP Compliance and Disclosure Interpretations issued on May 17, 2016.
- In arriving at [funds from operations (FFO)], you start with net income attributable to [Company A] and make adjustments for redeemable non-controlling interests and preferred stock dividends. As a result, it appears FFO[,] and ultimately Company FFO, are attributable to common shareholders and redeemable non-controlling interest holders. Please clarify and/or revise the labeling of your non-GAAP financial measures in future filings to adequately reflect what is being presented.

The SEC staff has concentrated on non-GAAP financial measures in its recent comments to registrants in the real estate industry. Issues addressed in such comments have included (1) the presentation of non-GAAP financial measures more prominently than GAAP measures and (2) pro rata consolidation adjustments. See the [Non-GAAP Financial Measures and Key Metrics](#) section for additional information.

Registrants in the real estate industry should also be aware of Questions 102.01 and 102.02 of the [C&DIs on non-GAAP financial measures](#), which indicate that FFO as defined by the NAREIT as of May 17, 2016, as well as FFO per share, will continue to be accepted as a performance measure. The presentation of any FFO measure in a manner that departs from NAREIT's definition (e.g., adjusted FFO, core FFO), or as a per-share amount based on such a modified measure, is subject to the prohibitions

in Regulation S-K, Item 10(e). Accordingly, that measure must comply with the requirements in Item 10(e) for a performance measure or a liquidity measure. If modified FFO is considered a performance measure, it may be presented on a per-share basis; if a modified FFO per share is, in substance, a liquidity measure, presentation on a per-share basis is prohibited. Acceptability of FFO per-share measures, or modified FFO per share, does not override the prohibition against the presentation of cash flow per-share data and other per-share measures of liquidity.

FFO may be reported gross or net of noncontrolling interest adjustments. When the FFO calculation takes into account noncontrolling interest adjustments, the registrant should clearly label the measure to reflect “FFO attributable to common stockholders” or “FFO attributable to the company.”

Real Estate Acquisitions

Examples of SEC Comments

- Given the acquisition of the industrial property in [Location A on Date X], please tell us why you did not provide financial statements in compliance with Rule 3-14 of Regulation S-X for this property or pro forma financial statements showing the effects this transaction will have on the registrant.
- We note that your acquisition of [Property A] was recorded as an asset acquisition. We further [note] your disclosure . . . that acquisitions of properties with in-place leases are accounted for as a business combination. Please tell us how recording the [Property A] acquisition as an asset acquisition complies with your policy.

Regulation S-X, Rule 3-05, requires a registrant to provide full financial statements (and pro forma financial information) for significant acquired or to be acquired businesses. However, Regulation S-X, Rule 3-14, permits a registrant to file only abbreviated income statements (and pro forma financial information) for significant acquired or to be acquired real estate operations that meet certain requirements. Because the requirements of Rules 3-05 and 3-14 are different, it is important for a registrant to determine whether it acquired a real estate operation. As a result, from an SEC reporting standpoint, the SEC staff may ask a registrant to provide an analysis supporting its conclusion that its acquisitions are real estate operations under Rule 3-14. When a registrant has not provided financial statements for an acquired or to be acquired real estate operation under Rule 3-14, the SEC staff may ask the registrant to provide an analysis in support of its conclusion that the acquisition or potential acquisition did not trigger the rule’s requirement to file related financial statements.

In addition, from an accounting standpoint, the SEC staff has asked registrants with material acquisitions to elaborate on their process and policies for determining whether the acquired assets, including acquired real estate that is subject to a lease, qualify as a business or an asset acquisition under U.S. GAAP. This determination is important because the accounting for an asset acquisition differs from the accounting for a business combination. In acquisitions accounted for as business combinations, all transaction costs must be expensed as incurred. In asset acquisitions, however, transaction costs are capitalized as part of the purchase price. The SEC staff has asked registrants to enhance their disclosures to discuss the accounting policies they apply to property acquisitions, including policies for allocating value to identified intangible assets and for recognizing acquisition-related costs.

Capitalization of Real Estate Development, Construction, and Leasing Costs

Example of an SEC Comment

We note that you capitalize indirect costs clearly related to the construction and improvements of investment properties and that for the fiscal year ended December 31, 2015 invested approximately \$[X] million in development properties as well as approximately \$[X] million in capital expenditures and tenant improvements. Please disaggregate the amounts between development, redevelopment and leasing of real estate and tell us the amount of indirect costs capitalized by segment for each year presented, or tell us why you believe such disclosure is not beneficial for investors.

The SEC staff frequently asks registrants to enhance their disclosures about the capitalization of real estate development, construction, and leasing costs (including their accounting for these costs). For example, the SEC staff has asked registrants to clarify their accounting policy for capitalizing or deferring costs in accordance with ASC 835-20, ASC 840-20-25-16, and ASC 970-10. It has also requested quantitative disclosures of certain expenses that are being capitalized, such as soft costs (e.g., interest and payroll).

In addition, the SEC staff has asked registrants to expand their disclosures about capital expenditures (either on the face of the statement of cash flows or in MD&A) to separately disclose expenditures related to acquisitions, new development, redevelopment, and improvements to existing properties.

Liquidity and Capital Resources — Distributions

Example of an SEC Comment

We note your disclosure . . . that you paid \$[X] million, comprised of \$[X] million of cash dividends and \$[X] million reinvested by stockholders, in cash. We further note your disclosure [in] the Form 10-Q for the period ended September 30, 2016 where you indicate that cash distributions exceeded net income for the reporting period. In future Exchange Act reports, please revise your disclosure to provide the relationship between distributions paid and cash flow from operations, and disclose the source of any shortfall.

The SEC staff frequently requests disclosures that investors can use to evaluate the registrant's ability to maintain or increase its historical distribution yield. When GAAP cash flow from operations is insufficient to cover the total distributions paid during a particular period, the SEC staff may inquire about the cash resources used to cover the shortfall, such as borrowings or offering proceeds. Registrants should adequately disclose the risks associated with paying distributions in excess of GAAP cash flow from operations. In addition, the SEC staff may request disclosures that compare earnings (or FFO) with paid distributions, including amounts reinvested through a distribution reinvestment plan. The staff sometimes asks registrants to disclose these items on a cumulative basis so that financial statement users can better understand the relationship between earnings (or FFO) and distributions.

Consolidation

Example of an SEC Comment

We note that you have [an X percent] interest in [Entity A]. Please provide to us an analysis discussing your basis in accounting for the joint venture investment using the equity method, and cite the accounting literature [relied] upon. In your response, elaborate how [Entity A Investee]'s ability to participate in major decisions equates to shared decision making ability, detailing the characteristics of [its] participation rights and how such rights are substantive. Further, clarify what happens in situations where the parties do not agree and whether contractually one party has the ability to break any deadlock.

The SEC staff continues to focus on registrants' involvements with VIEs and joint ventures and has inquired about consolidation assessments.

The SEC staff also routinely asks for additional information and disclosures about non-VIE joint ventures, particularly when (1) a registrant uses the equity method of accounting and either has a majority ownership interest or is the general partner or managing member or (2) the qualitative disclosures about such arrangements are not robust. Disclosures about these arrangements should include a discussion of the ownership structure as well as the governance provisions that led the registrant to conclude that it does not have a controlling financial interest in the joint venture. In addition, the SEC staff routinely asks for clearer qualitative disclosures when there are amendments to management agreements or changes in ownership structure or percentages that do not result in a change to a registrant's consolidation conclusion.

See the [Consolidation](#) section for additional information.

Health Sciences

Life Sciences

The SEC staff's comments to registrants in the life sciences industry have focused on a number of topics, including (1) revenue recognition, (2) segment disclosures, (3) business combinations, (4) the use of non-GAAP measures, and (5) MD&A disclosures.

Revenue Recognition

Gross-to-Net Accounting

Examples of SEC Comments

- We note that you sell to distributors. Please disclose whether you offer your distributors rights of return, price protection, or other similar rights. If so, please disclose the accounting for these rights.
- You disclose that you provide discounts, special pricing, sales rebates, and price-breaks and you record the costs of all such programs as an adjustment to revenue. Please tell us, and disclose in future filings, when you record these amounts. Refer to ASC 605-50-25-3 and 605-50-45-2. Please explain and quantify for us the extent to which you recognize the consideration given to your customers at the date at which the sales incentive is offered instead of the date on which you recognize revenue.
- Tell us the amounts recognized in your statements of operations for the incentive programs and their related classification for each period presented. Please refer to ASC 605-50-50-1 and confirm that you will disclose this information in future filings.
- Please tell us the extent to which you make estimates of the amount of your sales incentives. Refer to ASC 605-50-25-4, 25-7, 25-8, and 25-9.
- We note that you sell your products to distributors Please revise your disclosure to summarize the significant terms of these arrangements with distributors, including any post shipment obligations and acceptance provisions that may exist and how you account for such obligations. Within your discussion, please explain if you grant price concessions to your distributors and, if so, how you account for price concessions. Refer to SAB Topic 13.B.
- We . . . note that you recognized revenue net of allowances, discounts, and other adjustments. Please tell us and revise your filing to explain the nature of the allowances, discounts, and other adjustments for which you adjust revenue. Explain how you account for these allowances, discounts, and other adjustments.

The recognition of revenue in the life sciences industry relies heavily on estimates and assumptions about returns and other potential adjustments to revenue, all of which underscore the need for entities to (1) focus on the criteria for recognizing revenue on the sale of goods or services and (2) consider various factors in estimating returns, chargebacks, rebates, discounts, promotions, shelf stock adjustments, and other adjustments to revenue. The SEC staff has commented on registrants' accounting for their revenue arrangements and has required registrants to provide enhanced disclosure in future filings.

Multiple-Element Arrangements

Examples of SEC Comments

- Please tell us the significant deliverables within your multiple-element arrangements and any performance-, cancellation-, termination-, and refund-type provisions. Discuss how you considered ASC 605-25-25-5 and revise future filings to provide all of the disclosures required by ASC 605-25-50-2.
- Please tell us the significant factors, inputs, assumptions, and methods used to determine selling price (whether vendor-specific objective evidence, third-party evidence, or estimated selling price) for each of the significant deliverables. Refer to ASC 605-25-30-2 and 605-25-50-2.

The SEC staff often asks registrants in the life sciences industry about the nature of, and accounting for, their multiple-element arrangements and how they accounted for those arrangements under ASC 605-25. The staff typically asks for additional information and sometimes requests more disclosure about multiple-element arrangements, including:

- A description of the registrant's rights and obligations under the arrangement.
- The registrant's method for determining whether certain deliverables in an arrangement qualify as separate units of accounting and the factors the registrant considered in making this assessment.
- The registrant's accounting policy for allocating and recognizing revenue for each deliverable.
- The registrant's support for its conclusion that a delivered item has stand-alone value.
- An analysis of how the transaction price was allocated to each deliverable, including how the selling price used for each unit of accounting was determined (e.g., vendor-specific objective evidence, third-party evidence, or estimated selling price).
- The period over which each unit of accounting is recognized.

Collaborative Arrangements

Collaborative arrangements are common among biotech and pharmaceutical companies. In the past, the SEC staff has asked registrants about the nature of, and accounting for, their collaborative arrangements and has probed to better understand the basis for such accounting under U.S. GAAP. Inquiries to registrants have focused on:

- The registrant's conclusion about whether certain transactions with the collaboration partner represent true vendor-customer activities.
- The registrant's accounting policies regarding separation (i.e., unit of accounting) and allocation (i.e., when multiple units exist) for collaborative arrangements.

- Supplemental explanation of the registrant's determination and disclosure of:
 - The separation, allocation, recognition, and classification principles that were used to account for payments between collaboration partners.
 - The factors that led the registrant to conclude that it is the principal (or agent) in transactions with third parties.

The SEC staff has also requested enhanced disclosure about registrants' collaborative arrangements, including the overall effect of collaborative arrangements on the financial statements.

We have observed that the frequency of staff comments on registrants' collaborative arrangements has decreased over the past few years. However, as part of registrants' implementation of the new revenue recognition standard (codified primarily in ASC 606), they need to evaluate whether transactions between partners in a collaborative arrangement are within the scope of the new revenue standard. While ASC 606 does not change the guidance in ASC 808 on the income statement presentation, classification, and disclosure applicable to collaborative arrangements, it is important that registrants understand and consider that an existing contract could be within the scope of both ASC 606 and ASC 808. As indicated in paragraph BC55 of ASU 2014-09:

The Boards noted that a contract with a collaborator or partner (for example . . . a collaborative arrangement within the scope of Topic 808, Collaborative Arrangements) also could be in the scope of Topic 606 if that collaborator or partner meets the definition of a customer for some or all the terms of the arrangement.

This is important because companies may have to assess the scope of both ASC 606 and ASC 808 for these types of arrangements. In addition, the Basis for Conclusions of ASU 2014-09 does not preclude companies from analogizing to the guidance in ASC 606 when accounting for collaborative arrangement transactions within the scope of ASC 808. Consequently, registrants should be mindful that the SEC staff may continue to ask registrants about their accounting policies for collaborative arrangements when ASC 606 is adopted.

At the November 16, 2016, FASB meeting, the Board determined that it would commence a project aimed at making improvements to clarify when transactions between partners in a collaborative arrangement are within the scope of the new revenue standard. The project is intended to give preparers guidance that will promote consistency in recognition, measurement, and income classification for these types of transactions. Please refer to the [Collaborative Arrangements — Targeted Improvements](#) FASB project update page for further information.

Segment Reporting

The SEC staff has been increasingly commenting on life sciences industry registrants' identification and disclosure of reportable segments in accordance with ASC 280. In certain circumstances, the staff has requested internal management reports and information to support the registrants' identification of their operating and reportable segments. Registrants should also be aware that the staff reviews registrants' public statements, Web sites, and earnings releases and asks registrants to reconcile their reportable segments to specific business units or channels as described in other reporting mediums.

As life science entities' businesses evolve (e.g., through business combinations that create additional and diversified revenue streams) or are reorganized or restructured, registrants should ensure that the impact on segment disclosure is thoroughly evaluated and updated as appropriate.

For additional considerations, see the [Segment Reporting](#) section.

Business Combinations

Definition of a Business

The life sciences industry in recent years has seen an increase in M&A activity. While many entities in the industry have sought ways to expand their pipeline of products in development or acquire additional commercial products, others have explored how to generate additional returns on assets that are no longer a strategic focus.

Accounting for a transaction as a business combination differs significantly from accounting for a transaction as an asset acquisition, as described in the “Determining Whether an Asset Group Constitutes a Business” section in Deloitte’s *Life Sciences Accounting and Reporting Update — Including Interpretive Guidance (March 2017)*. Accordingly, the SEC staff has often issued comments to life sciences companies related to whether the acquired set meets the definition of a business and has further inquired about the basis for the registrants’ conclusions.

In January 2017, the FASB issued [ASU 2017-01](#), which clarifies the definition of a business in ASC 805 and provides a framework that an entity can use to determine whether a set of activities and assets constitutes a business. The ASU includes several examples that illustrate how a life sciences entity would apply the guidance in the standard. The ASU is effective for public business entities in annual periods after December 15, 2017, including interim periods therein. Early application is allowed for transactions for which the acquisition or disposal date occurs in a period for which financial statements have not been issued or made available for issuance. Given the SEC staff’s historical focus on how life sciences entities have applied the definition of a business, registrants should be mindful that the staff may continue to ask registrants about whether an acquired set meets the definition of a business when ASU 2017-01 is adopted.

Contingent Consideration

Contingent consideration arrangements in business combinations between life sciences companies are common. For example, the buyer may owe the seller future development milestones and royalties and sales-based milestones. Uncertainty associated with these payments arises from a number of factors:

- Before regulatory approval, uncertainty may arise from potential delays with clinical trials, success of competitor trials, or an inability to obtain regulatory approvals.
- After regulatory approval, uncertainty may arise from product safety concerns, manufacturing issues, potential product recalls, the introduction of competitor products, or possible sales and distribution channel issues.

The SEC staff often asks registrants to provide additional disclosures about the nature and terms of a contingent consideration arrangement and the conditions that must be met for the arrangement to become payable. Since ASC 805 requires entities to recognize contingent consideration at fair value as of the acquisition date, the staff may ask registrants to disclose how they determined the fair value of the contingent consideration. In addition, the staff may ask whether the change in the fair value of the contingent consideration should be reflected as an adjustment to the amount of goodwill (i.e., if the adjustment is made because of new information obtained during the measurement period about facts or circumstances that existed as of the acquisition date) or in current earnings under ASC 805-10-25-13 through 25-19 and ASC 805-10-30-3. The staff may also ask for disclosure of the total amount of contingent consideration that could become payable under the terms of the arrangement.

For additional considerations, see the [Business Combinations](#) section.

Non-GAAP Measures

Examples of SEC Comments

- Your statements that your non-GAAP measures reflect adjustment for items that are not indicative of your on-going core operating performance and are important components of how you measure your internal performance [do] not satisfy Item 10(e)(1)(i)(C) and (D) of Regulation S-K. . . . In this regard, we note that you disclose in your reconciliation table amounts for many of the line items in your statement of operations, including total revenues, selling, general, and administrative expenses, research and development expenses, etc., and you do not explain why each of these non-GAAP amounts is relevant and useful to investors. Also, it is unclear why the removal of large expenses as non-GAAP adjustments for items that relate to prior acquisitions (such as amortization of intangibles, milestone payments and the change in fair value of contingent consideration) is not indicative of your core operating results given that part of your stated primary strategy relates to the acquisition of products.
- As you appear to incur upfront collaboration expenses in each period and have historically incurred these expenses in multiple periods, it appears that these expenses are normal, recurring, cash operating expenses whose exclusion from your non-GAAP income may be prohibited under CDI 100.01.

Over the past two years, we have seen an exponential increase in SEC scrutiny and press coverage regarding non-GAAP measures, including cases specific to the life sciences industry. The press coverage has been driven by numerous published studies that generally conclude two things: (1) the number of companies that use non-GAAP measures is significant and increasing and (2) the difference between GAAP and non-GAAP measures is increasing. For example, a study of seven large U.S. drug companies demonstrated that for the 13 quarters ended March 31, 2016, non-GAAP net income was 40 percent higher than net income reported in accordance with U.S. GAAP.¹

Common non-GAAP measures include adjusted earnings, EBITDA, core earnings, and free cash flow. Among life sciences companies, common non-GAAP adjustments in these measures include up-front and milestone payments for license and asset acquisitions, amortization and impairment of intangibles and adjustment of contingent consideration arising from prior business combinations, restructuring and litigation charges, and gains or losses from divestitures.

Certain registrants in the life sciences industry may use multiple non-GAAP measures. Over the past year, registrants in this industry have received comments addressing a broad range of non-GAAP measure disclosure matters including, but not limited to, (1) prominence of non-GAAP measures, (2) the presentation of a full non-GAAP income statement, (3) reconciliation requirements, (4) disclosure of the purpose and use of non-GAAP measures, and (5) the use of potentially misleading measures, including those that may include normal recurring cash operating expenses. Example comments covering these non-GAAP reporting matters are provided in the [Non-GAAP Financial Measures and Key Metrics](#) section.

¹ Tatyana Shumsky, "Non-GAAP Accounting Lifts Adjusted Earnings by 38% in Pharmaceuticals — Credit Suisse," Wall Street Journal (July 15, 2016).

Management's Discussion and Analysis

Results of Operations

Examples of SEC Comments

- We note that your comparative discussions of revenues and cost of services identifies multiple key variables as the primary reasons for the year to year changes in your operating results. We also note that your discussion does not provide any quantification of the impact of each of these variables. Please confirm that you will revise your discussion in future filings to quantify the impact that each material variable or factor referenced in your discussion had on your results of operations. Please provide your proposed disclosure . . . as part of your response. Refer to the guidance in SEC Release 33-8350 available on the SEC website at www.sec.gov/rules/interp/33-8350.htm.
- We note your disclosure in your Form 10-K that your revenue derived from North American sales increased [X]% [year over year] due to sales from new products and due to "strong sales" of existing products . . . We also note that revenue derived from sales outside of North America decreased [X]% due to "unfavorable exchange rates" and "a lower number of units sold." When individual line items disclosed in your statements of operations significantly fluctuate in comparison to the comparable prior period, you should quantify the extent to which each item contributed to the significant change. Your disclosure should also clarify the effect changes in price and volume had on your disclosed results, such as the "strong sales" to which you refer, as well as the reasons underlying those changes. Please revise future filings in response to this comment. For further guidance, please refer to Item 303 and the related instructions in Regulation S-K as well as SEC Interpretive Release No. 34-48960 (December 19, 2003).

The staff has recently commented on registrants' disclosures regarding period-over-period changes within the Results of Operations section of MD&A. While the specific provisions of Regulation S-K, Item 303(a)(3), constitute a general framework for management to discuss operational performance and trends, the staff frequently asks for detailed quantitative information regarding the extent to which fluctuations are attributable to (1) changes in pricing, volume, or the amount of goods or services being sold or (2) the introduction of new products or services.

Liquidity

Example of an SEC Comment

We note the disclosures in your income taxes note to the financial statements relating to unremitted foreign earnings. To help investors better understand your liquidity position, please revise this section in future filings to quantify the amount of cash and cash equivalents and short-term marketable securities held at foreign subsidiaries at each year-end. Discuss whether such amounts are available for use in the U.S. without incurring U.S. taxes and, if so, describe any strategies you currently undertake to make the amounts available.

Life sciences companies typically have manufacturing and distribution sites, as well as holding company subsidiaries, domiciled outside the United States in jurisdictions with comparatively favorable tax rates. If a life sciences registrant discloses that it will reinvest undistributed earnings of its foreign subsidiaries indefinitely in accordance with the "indefinite reversal criteria" in ASC 740-30-25-17 (formerly APB 23), the SEC staff is likely to examine the registrant's liquidity disclosure to determine whether its cash holdings are sufficient to meet its long- and short-term liquidity needs. Therefore, the disclosures in the liquidity section of MD&A about how the registrant plans to meet its funding obligations should be clear and robust.

For additional considerations, see the [Management's Discussion and Analysis](#) section.

Other Deloitte Resources

[March 2017, Life Sciences Accounting and Reporting Update — Including Interpretive Guidance](#)

Technology, Media, and Telecommunications

Technology

Capitalized Software Development Costs

Example of an SEC Comment

We note your policy disclosure regarding internally developed software costs and that no internally developed software costs were capitalized during the periods presented. Please describe for us the development process related to your internal-use software, highlighting recently developed offerings and added functionality, and explain why there was no development costs capitalized during the periods presented. Also, describe for us how you apply the guidance in ASC 350-40-25 and what consideration was given to disclosing your policies for internal-use software development costs particularly since your software is provided in a software-as-a-service platform.

ASC 985-20 provides guidance on accounting for costs incurred to purchase or internally develop software that will be sold, leased, or marketed. Under this guidance, costs incurred to establish technological feasibility of the software are expensed as incurred and subsequent production costs, such as those for testing or producing master copies, are capitalized.

ASC 350-40 details how to (1) determine whether purchased or internally developed software is for internal use and (2) account for costs incurred for developing or obtaining internal-use software. Under this guidance, costs incurred during the preliminary project and post-implementation stages are generally expensed as incurred, while certain costs incurred during the application development stage are capitalized. Internal-use software is described as being “acquired, internally developed, or modified solely to meet the entity’s internal needs” and as being developed with no substantive plan to “market the software externally.” Therefore, if the software is used to produce a product or in a process to provide a service to the customer, but the customer is not given the right to obtain or use the software, the related costs would be accounted for in accordance with ASC 350-40.

The accounting for software development costs can be complex and challenging and the costs that are eligible for capitalization may depend on whether the costs are accounted for in accordance with ASC 985-20 or ASC 350-40.

Revenue Recognition — Multiple-Element Arrangements

Accounting Policies and Disclosures Regarding Multiple-Element Arrangements

Examples of SEC Comments

- We note from your disclosure that when multiple deliverables qualify as separate units of accounting you may recognize revenue based on the value of the respective deliverables. Please clarify how the value of the deliverables is determined, explain if the allocation is based on the relative selling price, and clarify how the policy complies with ASC 605-25-30. Revise future filings to provide the disclosures required by ASC 605-25-50-2.
- Your disclosure . . . indicates that a majority of your services revenue is derived from the professional services that are related to the development and delivery of new applications using your platform, after a customer has made an initial or additional software purchase. Please tell us what consideration was given to ASC 605-25-25-3.
- We note that your term-based subscriptions can be deployed on premise or in the cloud. Please clarify whether your cloud-based offerings represent hosting arrangements and, if so, tell us how you considered the guidance in ASC 985-605-55-119 to 55-125 in accounting for these arrangements. To the extent these arrangements scope out of the software revenue recognition guidance, tell us how you determine the selling price for each deliverable in accordance with ASC 605-25-30-2.

Under ASC 605-25, consideration in multiple-element arrangements must be allocated to the deliverables on the basis of their relative selling price. To determine the selling price of each deliverable, entities apply a hierarchy that requires them to use VSOE if available, TPE if VSOE is not available, or their best estimate of the selling price if neither VSOE nor TPE is available. The SEC staff focuses on how technology registrants allocate consideration to elements in such arrangements and may request additional information about the factors, inputs, and assumptions used to determine the selling price of each element.

Separate contracts with the same entity or related parties that are entered into at or near the same time are presumed under ASC 605-25-25-3 to have been negotiated as a package and should be evaluated as a single arrangement in the determination of whether there are one or more units of accounting. Similarly, under ASC 985-605-55-4, in situations in which a software vendor executes more than one contract with a customer, that group of contracts or agreements may be so closely related that it is, in effect, part of a single arrangement and should be viewed as one multiple-element arrangement in the determination of the appropriate amount and timing of revenue to be recognized. Important consideration should be given to the fact that the form of an arrangement is not necessarily the only indicator of an arrangement's substance. With such disclosures, the SEC staff focuses on the appropriate determination of the unit of accounting, as well as the allocation of arrangement considerations to underlying elements of the arrangement when contracts may appear to be negotiated in contemplation of one another.

If registrants provide hosting services through a cloud-based offering, ASC 985-605-55-121 prescribes two required criteria in the determination of whether a software element is present in a hosting arrangement. These include (1) the customer's having the contractual right to take possession of the software at any time during the hosting period without incurring a significant penalty and (2) its being feasible for the customer to either run the software on its own hardware or contract with another party to host the software. If an arrangement does not give the customer such an option, it would be outside the scope of ASC 985-605 and accounted for as a service contract. Given the increasing prevalence of cloud-based computing, registrants should consider these two criteria in the application of the appropriate accounting policies for revenue recognition when a hosting arrangement may contain a software element.

Given the prevalence of multiple-element arrangements in the industry, when the SEC staff reviews the filings of technology registrants, it may comment on the manner in which revenue is measured and recognized in such arrangements as well as on the related disclosures. Historically, registrants have been asked to clarify the descriptions of the elements or deliverables in an arrangement, how they determined that deliverables have stand-alone value, and the timing of each element's delivery or performance.

Disclosures About VSOE

Examples of SEC Comments

- We note your disclosure regarding multiple element arrangements that include only software and software related elements. Please tell us in greater detail your methodology for establishing VSOE for professional services and post contract support. For those elements where VSOE is based on stated renewal rates please tell us how you determined the renewal rates are substantive. In this regard, please provide the range of renewal rates and tell us the percentage of customers that actually renew at such rates. Alternatively, when VSOE is based on stand-alone sales, please provide the volume and range of stand-alone sales used to establish VSOE.
- Please explain further what you mean by the "normal pricing and discounting practices" that you use for establishing VSOE. Describe the methodology, including the volume and range of stand-alone sales used to establish VSOE. We refer you to ASC 985-605-25-6. Also, please clarify for which services you are unable to establish VSOE.

ASC 985-605-25-6 provides the following guidance for revenue recognition for multiple-element arrangements:

If an arrangement includes multiple elements, the fee shall be allocated to the various elements based on vendor-specific objective evidence of fair value, regardless of any separate prices stated in the contract for each element. Vendor-specific objective evidence of fair value is limited to the following:

- a. The price charged when the same element is sold separately
- b. For an element not yet being sold separately, the price established by management having the relevant authority; it must be probable that the price, once established, will not change before the separate introduction of the element into the marketplace.

Given this guidance, a registrant should establish VSOE of fair value for each element in an arrangement. If the registrant has done so, it would recognize the revenue for each element once delivery of such element has occurred. However, when the registrant is unable to establish VSOE of fair value for one or more of the elements within the arrangement, different revenue recognition rules apply that could significantly affect how revenue is recognized under ASC 985-605. To recognize revenue for a delivered element (e.g., a software license) in a software arrangement, a vendor must first establish VSOE for any undelivered elements (e.g., PCS or professional services). If the vendor cannot establish VSOE of fair value for undelivered elements, it generally must defer all revenue in the arrangement until VSOE is established, the undelivered elements are delivered, or the last remaining deliverable is PCS. The SEC staff may ask registrants that have multiple-element arrangements within the scope of ASC 985-605 questions related to the determination of VSOE of fair value for elements of their arrangements. Such questions may include what method the registrant used to determine VSOE of fair value if the stated renewal rate or bell-shaped curve analyses were not used, a quantitative description of the volume and range of stand-alone sales used to establish VSOE of fair value and how the registrant accounts for outlier transactions, or how VSOE of fair value is determined when different levels of renewable rates exist.

Disclosures About Key Metrics in MD&A

Examples of SEC Comments

- Your revised disclosure . . . indicates that the Daily Active User growth was relatively flat in the latter part of the quarter ended September 30, 2016. Expand your disclosure to explain the factors that impacted your user growth rate during this period. . . . You state . . . that in the past you relied on third-party analytics to calculate your metrics and that your metrics may not be comparable to prior periods. To understand comparability among periods, revise to disclose when you shifted to using internally generated analytics, particularly Daily Active Users.
- We note that in your earnings releases and calls you discuss changes in monthly average users (“MAUs”). For example you indicated that “in the fourth quarter, our [MAUs] grew to our highest level ever at over [X] million users” and “for the full year, MAUs grew [X%] over 2014.” We also note that in your [Q4] earnings release you indicate that “we monitor MAUs as a key measure of the overall size of our user base and their regular engagement with our portfolio of games.” Please tell us what consideration was given to quantifying this metric in your periodic filings. Refer to Section II.B.1 of SEC Release No. 33-8350.
- You disclose that your subscription fees are based primarily on the number of users and that you seek to generate additional revenue from existing customers by adding new users to your platform. Please consider disclosing the total number of users for each period presented and the average number of users per customer. See Section III.B.1 of SEC Release 33-8350.

Within MD&A, technology registrants often use metrics to convey additional relevant information to investors. Those metrics may differ significantly among registrants within the industry given the different service offerings provided. Examples of metrics common to registrants in the technology industry include (1) number of “likes,” (2) revenue per user, (3) daily or monthly active users, and (4) weighted average duration of contracts. The SEC staff has questioned registrants when certain metrics are not explained in MD&A, changes are not appropriately quantified, and it is unclear whether metrics represent KPIs. Accordingly, the staff may ask registrants to provide a detailed quantitative and qualitative discussion and analysis of the impact of changes in their key metrics disclosed in MD&A, in a manner consistent with Sections III.B.1 and III.B.2 in SEC Interpretive Release No. 33-8350 (34-48960) and Regulation S-K, Item 303(a)(3)(iii).

Because of the vast volume of the metrics used, the SEC staff has been concerned that (1) metrics may not be presented with appropriate context and (2) the link between registrants’ key metrics and their income and future profitability may not be clear. Registrants should review their metrics to ensure that the metrics are clearly defined and portray a balanced discussion and remain relevant. For additional considerations related to certain financial or operating metrics, see the [Non-GAAP Financial Measures and Key Metrics](#) section.

Media and Entertainment

The SEC staff’s comments to registrants in the media and entertainment industry have focused on a range of topics. However, as is true of SEC comments to registrants in several other industries, non-GAAP measures and segment reporting remain key topics.

Further, SEC staff comments to registrants in the media and entertainment industry have concentrated on disclosures about income taxes and fair value measurements. See the [Income Taxes](#) and [Fair Value](#) sections for information about comments on those topics.

Non-GAAP Measures

Example of an SEC Comment

It appears that you use free cash flow as a liquidity measurement. Please disclose how management uses this measure and why you believe it is useful to investors. Also reconcile this measure to cash flows from operating activities, the most directly comparable GAAP financial measure.

Media and entertainment companies frequently disclose free cash flow, which is commonly defined as cash flows from operating activities as presented in the statement of cash flows less capital expenditures. In accordance with C&DI Question 102.07, the measure does not violate the liquidity measure prohibition of Item 10(e) even though some of the capital expenditures may have been or will be paid in cash. In addition to capital expenditures, other adjustments may also be used to derive free cash flow. C&DI Question 102.07 notes that the measure is not uniformly defined and that its title does not describe how it is calculated. Therefore, registrants must clearly describe how free cash flow is calculated and disclose the other information required under Item 10(e), including a reconciliation.

Companies in the media and entertainment industry will also often use other non-GAAP financial measures. The SEC staff has focused on such measures, including how they comply with the disclosure requirements in Regulation S-K, Item 10(e), as well as the staff's [C&DIs related to non-GAAP financial measures](#).

For additional considerations, see the [Non-GAAP Financial Measures and Key Metrics](#) section.

Segment Reporting

Example of an SEC Comment

Please tell us if Mr. [X], in his capacity as the CODM or the segment manager, reviews any measure of profitability of the three groups within [Networks] operating segment . . . and if so, tell us the measure of profitability. Also, please explain to us your consideration of whether the three [Networks] group presidents are segment managers.

When reviewing filings of registrants in the media and entertainment industry, the SEC staff has been increasingly commenting on the identification and disclosure of reportable segments under ASC 280. In certain circumstances, the staff has requested internal management reports and information to support the registrant's identification of its operating and reportable segments. Registrants should also be aware that the staff reviews registrants' public statements, Web sites, and earnings releases and asks registrants to reconcile their reportable segments to specific business units or channels as described in other reporting media.

As companies evolve, including through business combinations that create additional and diversified revenue streams, registrants should ensure that the impact on the segment disclosure is thoroughly evaluated and updated as appropriate. For additional considerations, see the [Segment Reporting](#) section.

Telecommunications

The SEC staff's comments to registrants in the telecommunications industry have focused on topics such as revenue recognition and long-lived asset impairment.

Revenue Recognition

Examples of SEC Comments

- We note that due to the reclassification of handset devices from inventory to property, plant and equipment in [the period], cost of products may not be comparable as customers are choosing to lease devices instead of purchasing them. To improve clarity, for all applicable periods, please quantify and disclose the amount of depreciation expense incurred on leased handsets.
- We note that the equipment revenues include post and pre-paid sales, equipment installment billings, and lease revenues. In order to provide clarity to the relative significance and trends of each equipment revenue stream, please consider quantifying and disclosing separately equipment revenue amounts related to postpaid and prepaid handsets sales, monthly equipment installment billings and lease revenue.

The SEC staff often asks registrants in the telecommunications industry to expand or clarify their disclosures about revenue recognition. For example, the SEC staff may ask registrants for details about their compliance with the four criteria for revenue recognition contained in SAB Topic 13. The staff has indicated that registrants must carefully monitor these criteria when selling products to resellers and distributors and, in particular, should evaluate whether the substance of an arrangement is such that the price is not fixed or determinable until the product is sold to the end customer. When revenue is deferred because a criterion was not satisfied, registrants should specify which criterion was not met and disclose how and when the transaction will be recognized.

As the telecommunications industry continues to evolve, registrants in the industry must consider the revenue recognition implications of new business practices and ensure transparent disclosure. Wireless operators, for example, are increasingly offering subscribers more flexible handset-purchase options, such as installment plans and exchange rights as well as leasing. Such offerings can have significant revenue recognition implications. New offerings also may (1) trigger a requirement for registrants in the industry to provide financial statement disclosures not previously considered significant or (2) make it necessary for registrants to provide clarifying guidance to investors for comparability. New business practices are likely to draw SEC staff scrutiny if the registrants' relevant revenue recognition policies and considerations are not clearly disclosed.

In addition, in light of the prevalence of multiple-element arrangements in the telecommunications industry and the complexities associated with accounting for them, the SEC staff frequently issues comments related to such arrangements. Further, registrants in the industry have received staff comments requesting an analysis that supports the registrant's conclusion about whether it is a principal or an agent in certain transactions.

For information on multiple-element arrangements and other revenue-related considerations, see the [Revenue Recognition](#) section.

Long-Lived Asset Impairment

Example of an SEC Comment

We note that you conducted a long-lived asset impairment analysis in the fourth quarter of [each of the past two calendar years] and in each case concluded that your long-lived assets were not impaired. In this regard, please disclose events or changes in circumstances that occurred during those periods that indicated that the carrying value of your assets or assets groupings may not be recoverable. Disclose the extent to which the fair value of your assets or asset groups exceeded their carrying value. Disclose if any of your assets are at risk of impairment.

Technology, Media, and Telecommunications

As future technologies become viable, the SEC staff may question registrants in the telecommunications industry about the recoverability of their long-lived assets, including physical network assets and spectrum licenses. For example, the staff asks about the reasonableness of the useful-life estimates used by registrants to determine whether their long-lived assets are potentially impaired. Such assets may be subject to a greater risk of impairment as a result of the rapid rate of technological innovation. In addition, the staff has asked registrants to disclose the carrying value of significant types of assets and the methods used to estimate the assets' useful lives.

For additional information, see the [Impairments of Goodwill and Other Long-Lived Assets](#) section.

Appendixes

Appendix A — SEC Staff Review Process

The SEC's Division of Corporation Finance (the "Division") selectively reviews filings made under the Securities Act and the Exchange Act. The SEC's Web site includes an [overview](#) that explains its filing review and comment letter process.¹ The overview aims to increase transparency in the review process and expresses the staff's willingness to discuss issues with registrants. For example, the overview indicates that the "[staff] views the comment process as a dialogue with a company about its disclosure" and that a "company should not hesitate to request that the staff reconsider a comment it has issued or reconsider a staff member's view of the company's response to a comment at any point in the filing review process."

The overview is divided into two main sections:

- *The filing review process* — This section explains that the Division comprises 11 offices staffed by experts in specialized industries, accounting, and disclosures. The section includes background on the different types of review (required and selective) and covers the comment process, indicating that "[m]uch of the [staff's] review [process] involves evaluating the disclosure from a potential investor's perspective and asking questions that an investor might ask when reading the document." The section also addresses how to respond to staff comments and close a filing review.
- *The reconsideration process* — This section emphasizes that "staff members, at all levels, are available to discuss disclosure and financial statement presentation matters with a company and its legal, accounting, and other advisors." In addressing a registrant's potential request for the SEC staff to reconsider a staff member's comment or view on a registrant's response, the staff emphasizes that registrants do not have to "follow a formal protocol." However, the staff explains where registrants should start and the steps involved in the normal course of the reconsideration process. The staff also specifies contact information for each office for both accounting and financial disclosure matters and legal and textual disclosure matters.

Registrants may involve the SEC's Office of the Chief Accountant (OCA) during any stage of the review process. Unlike the Division's role, which is to address matters related to the age, form, and content of registrants' financial statements that are required to be filed, the OCA's role is to address questions concerning a registrant's application of GAAP. [Guidance](#) on consulting with the OCA is available on the SEC's Web site.

A registrant that receives an SEC comment letter should generally respond within the time frame indicated in the letter. See [Appendix B](#) for more information about responding to SEC comment letters. The registrant should continue to respond to any requests for more information until it receives a letter from the Division stating that the Division has no further comments. A registrant that does not receive a completion letter within a reasonable amount of time after submitting a response letter should call its SEC staff reviewer (named in the letter) to ask about the status of the review. If the review is complete, the registrant should request a completion letter.

¹ An [overview of the legal, regulatory, and capital markets offices](#) is also available on the SEC's Web site.

To increase the transparency of the Division's review process, comment letters and company responses to those letters are made public, via the SEC's Web site, at least 20 business days after the Division has completed its review of a periodic or current report or declared a registration statement effective. See [Appendix C](#) for tips on searching the SEC's comment letter database.

Appendix B — Best Practices for Working With the SEC Staff

Managing Unresolved SEC Comment Letters

The best practices below are intended to help registrants resolve any staff comment letters in a timely manner. Unresolved comments may affect a registrant's ability to issue financial statements and an auditor's ability to issue the current-year audit report. In addition, when responding to staff comment letters, registrants should be mindful of their responses because all responses to staff comment letters are made publicly available and become part of a registrant's "total mix of information" and disclosure records (i.e., investors may read such responses similarly to how they interpret a registrant's other filings and publicly available information).¹ A registrant should therefore do the following:

- Review the comment letter immediately and respond to the SEC staff reviewer (named in the letter) within the time indicated in the comment letter (usually 10 business days). If possible, the registrant should not request an extension, since this may delay resolution of the comment letter. However, in certain circumstances, the registrant should consider requesting an extension to provide a more thorough and complete response that addresses all of the staff's comments.
- If the registrant does not fully understand any specific comment, it should contact its SEC staff reviewer quickly for clarification so that it can provide an appropriate response.
- Consider the impact the comment letter may have on its ability to issue the financial statements.
- Consult with its SEC legal counsel about the impact the comment letter may have on the certifications contained in its Form 10-K.
- Consult with its auditors to discuss the impact the comment letter may have on their ability to issue the current-year audit report.
- Include in the response a discussion of supporting authoritative accounting literature and references to the specific paragraph(s) from the standard(s).
- Because some comments may request disclosure in future filings, the registrant should consider including such disclosure in the response letter to potentially eliminate additional requests from its SEC staff reviewer.
- If an immaterial disclosure is requested, the registrant should consider explaining why the disclosure is immaterial instead of including the immaterial disclosure in future filings.
- Maintain contact with its SEC staff reviewer and make the reviewer aware of the registrant's required timing (on the basis of its current-year filing deadlines).
- If the registrant has not received a follow-up letter or been contacted within two weeks of filing the initial response letter, the registrant should contact its SEC staff reviewer to determine the status of the comments. The registrant should promptly address any follow-up questions.

¹ The SEC staff discussed this topic at the 2012 AICPA Conference. Refer to Deloitte's December 11, 2012, [Heads Up](#) for more information.

- If the registrant is uncertain about whether its review has been completed without further comments, it should ask the SEC staff reviewer about the status of the review. If the review is complete, the registrant should ask the reviewer for a completion letter.

Further, at the 2016 AICPA Conference, the SEC provided the following additional recommendations for registrants to consider when communicating with the SEC staff during the comment letter process:

- Just because the staff asks a question does not mean that it has reached a conclusion or that a change is required.
- A registrant should not agree to include a disclosure in future filings solely to expedite the completion of a review.
- If a registrant believes that a comment concerns an immaterial matter, the registrant should communicate that belief to the staff early in the review process.
- A registrant should use caution when analogizing to other registrants' fact patterns since a small difference in facts could make a meaningful difference in the response.
- A registrant should ensure that the SEC is provided enough time to appropriately evaluate substantive new information during the review process.

Oral Comments

In certain circumstances, the SEC staff may provide oral comments to a registrant instead of a written comment letter. The registrant should ask the SEC staff reviewer how he or she would like to receive the registrant's response to the oral comments. If the reviewer requests a response via EDGAR, a registrant should respond with a written letter. If the reviewer requests an oral response or identifies no preference, a registrant should still, although it is not required to do so, consider responding to the staff's comments with a letter to formally document the registrant's understanding of the staff's comments and the discussions held as well as the registrant's response.

Disclosure Requirements

Under the Securities Offering Reform, large accelerated filers, accelerated filers, and well-known seasoned issuers must disclose in their Forms 10-K the substance of any material unresolved SEC staff comments that were issued 180 or more days before the end of the current fiscal year.

Rule 3-13 Waivers and Other Requests

As stated in the SEC Financial Reporting Manual, the CF-OCA performs the following functions that may result in communications with companies and their advisers:²

- Acts on behalf of the Commission to grant relief under Rule 3-13 of Regulation S-X. The staff has authority, where consistent with investor protection, to permit registrants to omit, or substitute for, required financial statements. . . .
- Answers interpretive request letters and provides informal interpretive advice about the form and content of financial statements and other financial information required to be included in Commission filings. . . .

² Page 2 of the SEC Financial Reporting Manual provides contact information for each of the respective CF-OCA functions listed.

- Helps identify and explain the applicable rules, regulations, forms, and guidance that affect the form and content of financial statements and other financial information required to be included in Commission filings.

Rule 3-13 Waivers

In recent [remarks](#)³ that were consistent with the Commission's focus on capital formation, Chairman Clayton encouraged registrants to seek modifications to their financial reporting requirements under Regulation S-X, Rule 3-13, particularly when the requirements are burdensome but may not be material to the total mix of information available to investors. Rule 3-13 has historically given the staff the authority to permit the omission or substitution of certain financial statements otherwise required under Regulation S-X "where consistent with the protection of investors," and Chairman Clayton's recent remarks indicate that the SEC staff is placing a high priority on such requests.

The SEC staff has recommended that when a registrant prepares a prefiling letter to request a waiver from the CF-OCA, the registrant should consider the following to facilitate a prompt response:

- Be concise and focus on relevant facts and circumstances.
- Propose solutions and adequate support for the proposals.
- Show the letter to the registrant's auditors and have them weigh in before sending.

The SEC staff has also indicated that it is available to discuss potential waiver fact patterns telephonically in advance of a registrant's submission of a written request.

Examples of waiver requests under Rule 3-13 include:

- Provision of abbreviated financial statements (e.g., statement of revenues and direct expenses) in lieu of full financial statements for a recently acquired business under Regulation S-X, Rule 3-05.
- Omission of one or more years of historical financial statements for a recently acquired business subject to Rule 3-05.
- Omission of certain financial statements of an equity method investment under Regulation S-X, Rule 3-09.

Separately, registrants may also be faced with complex accounting matters. Registrants are encouraged to submit a prefiling letter to the OCA on the proposed application of U.S. GAAP to resolve these complex issues before filing. For best practices related to consulting with the OCA, see the [guidance](#) on the SEC's Web site.

Requests for Informal Interpretive Guidance

Registrants may reach out to the CF-OCA to seek informal interpretive guidance on a named or no-named basis by e-mail, by telephone, or by [online form](#). Given the nature of the informal discussions, statements made by the staff are intended to be helpful but cannot be relied upon since they are not binding.

³ SEC Chairman Jay Clayton, "Remarks at the Economic Club of New York," July 12, 2017.

Requests for Omission of Selected Financial Data

In certain circumstances (e.g., certain filings that include the financial statements of a recently carved-out business), a non-EGC⁴ domestic registrant may wish to request omission of the earliest two years of the five years of selected financial data required by Regulation S-K, Item 301. The SEC staff has advised registrants seeking to omit selected financial data to contact either CF-OCA or their respective associate-director industry review office to discuss whether such information may be omitted without comment or objection from the staff.

Requests to Expedite the Processing of Draft or Filed Registration Statements

The Division staff will consider reasonable requests to expedite the processing of both draft and filed registration statements. Companies and their advisers are encouraged to review the timing of the related offering with the staff members assigned for review. Requests to expedite the processing of both draft and filed registration statements should be directed to the relevant assistant-director office in the Division that is responsible for performing the review.

⁴ An EGC is not required to present selected financial data in accordance with Regulation S-K, Item 301, for any period before the earliest audited period presented.

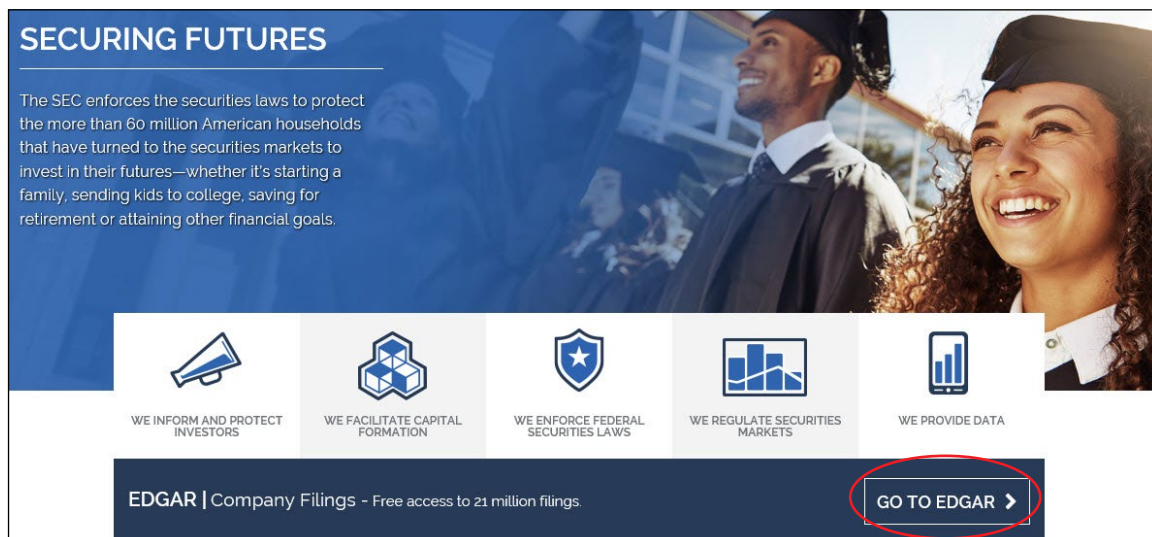
Appendix C — Tips for Searching the SEC’s Database for Comment Letters

The SEC adds comment letters (and responses from registrants) to its EDGAR database no earlier than 20 days after its review of a filing is complete. Registrants can refer to such comments as part of their financial statement review process and to improve their own accounting and overall disclosure.

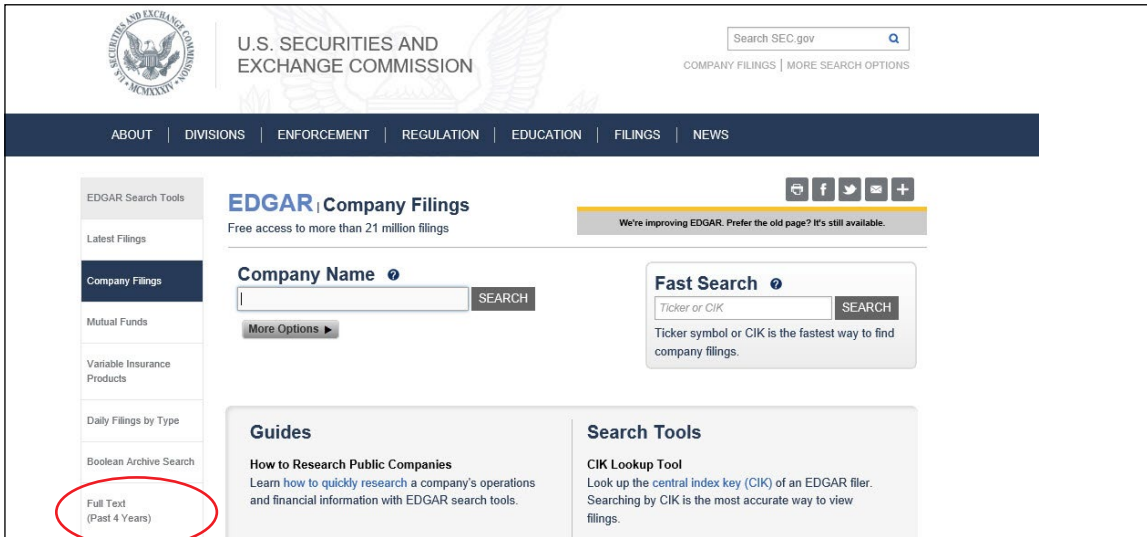
Although the SEC has updated the EDGAR search engine to simplify searches of corporate filings, users may still wish to use the “full-text” search feature to find the text of specific comment letters posted within the last four years and to generally narrow their search results. The process of performing a full-text search is discussed below.

Full-Text Searching

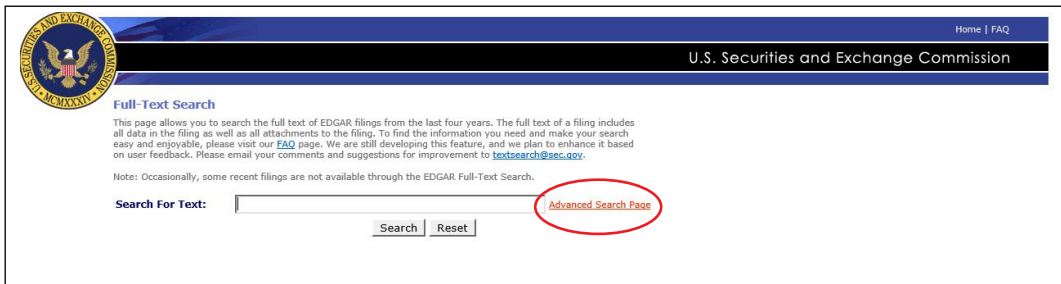
To perform a full-text search, first go to the SEC’s home page (www.sec.gov) and click the “GO TO EDGAR” image:



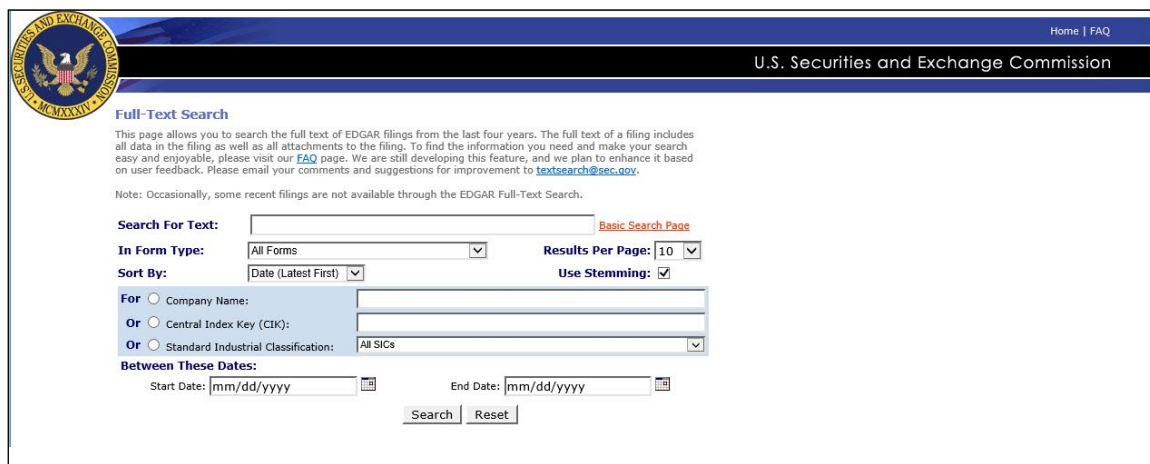
Then, click the “Full Text (Past 4 Years)” link in the left sidebar on the “EDGAR | Company Filings” page:



On the “Full-Text Search” page, select “Advanced Search Page”:



This brings up the following form:



In the form, limit the search results to SEC comment letters by using the drop-down menu next to “**In Form Type**” and choosing “UPLOAD” (or select “CORRESP” to include registrant responses as well).

Then, enter search terms in the “**Search for Text**” field. The documents found will contain at least one of the words entered as well as variations of the key word(s). To search for specific phrases, enclose the phrase in quotation marks (e.g., “management’s discussion and analysis”). Results will include documents that contain the quoted phrase as well as conceptually related phrases, such as “managerial discussion & analysis.”

Enhancing Search Results

Searches can be further refined by using Boolean operators such as AND, OR, and NOT (capitalization of these terms is required). For an operator to work effectively, a key word or phrase generally must be included before and after it (e.g., goodwill AND impairment). Searches in which operators are used will produce results as follows:

- *AND* — Documents will contain **all** terms connected (but not necessarily in the same sentence or paragraph) by the AND operator. The terms can appear in any order in the document.
- *OR* — Documents will contain **any** terms connected by the OR operator.
- *NOT* — Documents will contain one term but **not** another term.

Using wildcards or the “nearness” feature can also enhance search results:

- *Wildcards* — While certain variations of key words are automatically included in search results, using an asterisk (*) can ensure that all variations are included. For example, the wildcard “impair*” can be used to find documents that contain the words “impair,” “impaired,” “impairing,” “impairment,” or “impairs.”
- *Nearness* — Key words or phrases within a certain distance of each other can be searched by stipulating a range. The range is determined by using the term “NEARn,” with “n” representing the maximum number of words in the range (e.g., “impairment NEAR5 test” would find documents with “impairment” and “test” within five words of each other).

Advanced search features can frequently be combined. For example, quotations used to find a specified phrase can be combined with Boolean operators (e.g., goodwill AND “impairment test”).

Note that numbers are ignored in searches. Thus, a search for “Final Rule 108” will locate only documents that contain the terms “Final” and “Rule.” Searches can, however, be sorted by other criteria, such as dates, as discussed below.

Sorting by Dates and Other Specific Criteria

On the full-text search form, selections can also be made to limit results to a specified:

- Company name.
- Central index key (CIK).¹
- Standard industrial classification (SIC) code.²
- Date range.

¹ According to the SEC's Web site, a “CIK is the unique number that the SEC's computer system assigns to individuals and corporations [that] file disclosure documents with the SEC. All new electronic and paper filers, foreign and domestic, receive a CIK number.”

² An SIC code is an industry designation. Note that some of the SIC code descriptions are similar, so narrowing results by SIC code may not include certain issuers that are in a similar industry yet have a different assigned SIC code.

Note that clicking the SIC code in the list of search results will display a list of additional companies that have the same SIC code.

Controlling and Displaying Search Results

The “**Results per Page**” drop-down list can be used to limit the number of search results that display. To open a comment letter, click on the underlined title of the form to the right of the date. The comment letters will include any attachments or exhibits.

Example of the Benefits of Using Full-Text Search Features

Assume that a user is interested in SEC comments issued over the past two years that are related to results of operations in the hotel industry. By searching for the words “results” and “operations” with “All Forms” selected and no dates specified, the user would obtain over 8,000 results, many of which are not relevant.

However, if the user narrowed his or her search by (1) selecting the form type UPLOAD, (2) entering the search term “results of operations” in quotation marks, (3) entering the industry code for the hotel/motel industry (SIC 7011), and (4) providing a date range spanning the last two years, the number of results will be more relevant and manageable.

Additional Information

For more information about full-text searching, click on the FAQ link in the search form:

Full-Text Search

This page allows you to search the full text of EDGAR filings from the last four years. The full text of a filing includes all data in the filing as well as all attachments to the filing. To find the information you need and make your search easy and enjoyable, please visit our [FAQ](#) page. We are still developing this feature, and we plan to enhance it based on user feedback. Please email your comments and suggestions for improvement to textsearch@sec.gov.

Note: Occasionally, some recent filings are not available through the EDGAR Full-Text Search.

Search For Text: [Basic Search Page](#)

In Form Type: **Results Per Page:**

Sort By: **Use Stemming:**

For Company Name:

Or Central Index Key (CIK):

Or Standard Industrial Classification:

Between These Dates:

Start Date: End Date:

Appendix D — Glossary of Standards and Other Literature

The standards and literature below were cited or linked to in this publication.

AICPA Accounting and Valuation Guide

Valuation of Privately-Held-Company Equity Securities Issued as Compensation ["Cheap Stock Guide"]

FASB Accounting Standards Codification (ASC) Topics

ASC 205, Presentation of Financial Statements

ASC 220, Comprehensive Income

ASC 225, Income Statement

ASC 230, Statement of Cash Flows

ASC 250, Accounting Changes and Error Corrections

ASC 260, Earnings per Share

ASC 270, Interim Reporting

ASC 280, Segment Reporting

ASC 320, Investments — Debt and Equity Securities

ASC 330, Inventory

ASC 350, Intangibles — Goodwill and Other

ASC 360, Property, Plant, and Equipment

ASC 410, Asset Retirement and Environmental Obligations

ASC 420, Exit or Disposal Cost Obligations

ASC 450, Contingencies

ASC 480, Distinguishing Liabilities From Equity

ASC 505, Equity

ASC 605, Revenue Recognition

ASC 606, Revenue From Contracts With Customers

ASC 715, Compensation — Retirement Benefits

ASC 718, Compensation — Stock Compensation

ASC 740, Income Taxes

ASC 805, *Business Combinations*

ASC 808, *Collaborative Arrangements*

ASC 810, *Consolidation*

ASC 815, *Derivatives and Hedging*

ASC 820, *Fair Value Measurement*

ASC 830, *Foreign Currency Matters*

ASC 835, *Interest*

ASC 840, *Leases*

ASC 842, *Leases*

ASC 932, *Extractive Activities — Oil and Gas*

ASC 944, *Financial Services — Insurance*

ASC 970, *Real Estate — General*

ASC 980, *Regulated Operations*

ASC 985, *Software*

FASB Accounting Standards Updates (ASUs)

ASU 2017-01, *Business Combinations (Topic 805): Clarifying the Definition of a Business*

ASU 2016-13, *Financial Instruments — Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*

ASU 2016-09, *Compensation — Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*

ASU 2016-02, *Leases (Topic 842)*

ASU 2015-09, *Financial Services — Insurance (Topic 944): Disclosures About Short-Duration Contracts*

ASU 2014-16, *Derivatives and Hedging (Topic 815): Determining Whether the Host Contract in a Hybrid Financial Instrument Issued in the Form of a Share Is More Akin to Debt or to Equity* — a consensus of the FASB Emerging Issues Task Force

ASU 2014-09, *Revenue From Contracts With Customers (Topic 606)*

ASU 2014-08, *Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity*

ASU 2013-12, *Definition of a Public Business Entity — An Addition to the Master Glossary*

ASU 2009-13, *Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements* — a consensus of the FASB Emerging Issues Task Force

FASB Concepts Statements

No. 8, *Conceptual Framework for Financial Reporting: Chapter 1, The Objective of General Purpose Financial Reporting, and Chapter 3, Qualitative Characteristics of Useful Financial Information* — a replacement of FASB Concepts Statements No. 1 and No. 2

No. 2, *Elements of Financial Statements of Business Enterprises* (superseded)

SEC ASR

Accounting Series Release No. 268, *Presentation in Financial Statements of “Redeemable Preferred Stocks”* (Rule 5-02.28 of SEC Regulation S-X)

SEC C&DI Topics

Exchange Act Rules

Exchange Act Sections

Fixing America’s Surface Transportation (FAST) Act

Non-GAAP Financial Measures

Oil and Gas Rules

Regulation S-K

Securities Act Forms

Securities Act Rules

SEC Concept Release

33-8860, *Mechanisms to Access Disclosures Relating to Business Activities in or With Countries Designated as State Sponsors of Terrorism*

SEC Division of Corporation Finance Disclosure Guidance

Topic 2, “Cybersecurity”

SEC Division of Corporation Finance EDGAR Filer Manual

Volume II, *EDGAR Filing*

- Section 6.14, “Syntax of Calculation Linkbases.”
- Section 6.15, “Content of Calculation Linkbases.”

SEC Division of Corporation Finance Financial Reporting Manual

Topic 1, “Registrant’s Financial Statements”

Topic 2, “Other Financial Statements Required”

Topic 3, “Pro Forma Financial Information”

Topic 4, “Independent Accountants’ Involvement”

Topic 7, “Related Party Matters”

Topic 8, “Non-GAAP Measures of Financial Performance, Liquidity, and Net Worth”

Topic 9, “Management’s Discussion and Analysis of Financial Position and Results of Operations (MD&A)”

Topic 10, “Emerging Growth Companies”

Topic 13, “Effects of Subsequent Events on Financial Statements Required in Filings”

SEC Final Rules

33-9877, *Pay Ratio Disclosure*

33-8176, *Conditions for Use of Non-GAAP Financial Measures*

34-78041, *Order Granting Limited and Conditional Exemption Under Section 36(a) of the Securities Exchange Act of 1934 From Compliance With Interactive Data File Exhibit Requirement in Forms 6-K, 8-K, 10-Q, 10-K, 20-F and 40-F to Facilitate Inline Filing of Tagged Financial Data*

SEC Proposed Rules

33-10425, *FAST Act Modernization and Simplification of Regulation S-K*

33-10323, *Inline XBRL Filing of Tagged Data*

SEC Interpretive Releases

33-10415, *Commission Guidance on Pay Ratio Disclosure*

33-8810, *Commission Guidance Regarding Management's Report on Internal Control Over Financial Reporting Under Section 13(a) or 15(d) of the Securities Exchange Act of 1934*

33-8350 (34-48960), *Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations*

33-6835, *Management's Discussion and Analysis of Financial Condition and Results of Operations; Certain Investment Company Disclosures*

SEC Regulation G

Rule 100, "General Rules Regarding Disclosure of Non-GAAP Financial Measures"

SEC Regulation S-K

Item 10, "General"

Item 101, "Description of Business"

Item 103, "Legal Proceedings"

Item 301, "Selected Financial Data"

Item 302, "Supplementary Financial Information"

Item 303, "Management's Discussion and Analysis of Financial Condition and Results of Operations"

Item 307, "Disclosure Controls and Procedures"

Item 308, "Internal Control Over Financial Reporting"

Item 402, "Executive Compensation"

Item 503, "Prospectus Summary, Risk Factors, and Ratio of Earnings to Fixed Charges"

Item 506, "Dilution"

Item 601, "Exhibits"

Item 1202, "Disclosure of Reserves"

Item 1203, "Proved Undeveloped Reserves"

Item 1204, "Oil and Gas Production, Production Prices and Production Costs"

Item 1205, "Drilling and Other Exploratory and Development Activities"

Item 1206, "Present Activities"

Item 1207, "Delivery Commitments"

Item 1208, "Oil and Gas Properties, Wells, Operations, and Acreage"

SEC Regulation S-T

Rule 302, "Signatures"

Rule 405, "Interactive Data File Submissions and Postings"

SEC Regulation S-X

Rule 1-02, "Definitions of Terms Used in Regulation S-X"

Rule 2-02, "Accountants' Reports and Attestation Reports"

Article 3, "General Instructions as to Financial Statements"

Rule 3-01, "Consolidated Balance Sheets"

Rule 3-02, "Consolidated Statements of Income and Changes in Financial Position"

Rule 3-03, "Instructions to Income Statement Requirements"

Rule 3-04, "Changes in Stockholders' Equity and Noncontrolling Interests"

Rule 3-05, "Financial Statements of Businesses Acquired or to Be Acquired"

Rule 3-09, "Separate Financial Statements of Subsidiaries Not Consolidated and 50 Percent or Less Owned Persons"

Rule 3-10, "Financial Statements of Guarantors and Issuers of Guaranteed Securities Registered or Being Registered"

Rule 3-12, "Age of Financial Statements at Effective Date of Registration Statement or at Mailing Date of Proxy Statement"

Rule 3-13, "Filing of Other Financial Statements in Certain Cases"

Rule 3-14, "Special Instructions for Real Estate Operations to Be Acquired"

Rule 3-16, "Financial Statements of Affiliates Whose Securities Collateralize an Issue Registered or Being Registered"

Rule 4-08, "General Notes to Financial Statements"

Rule 4-10, "Financial Accounting and Reporting for Oil and Gas Producing Activities Pursuant to the Federal Securities Laws and the Energy Policy and Conservation Act of 1975"

Article 5, "Commercial and Industrial Companies"

Rule 5-02, "Balance Sheets"

Rule 5-03, "Income Statements"

Rule 5-04, "What Schedules Are to Be Filed"

Article 8, “Financial Statements of Smaller Reporting Companies”

Rule 8-02, “Annual Financial Statements”

Article 10, “Interim Financial Statements”

Article 11, “Pro Forma Financial Information”

Rule 11-02, “Preparation Requirements”

Article 12, “Form and Content of Schedules”

Rule 12-04, “Condensed Financial Information of Registrant”

Rule 12-09, “Valuation and Qualifying Accounts”

SEC SAB Topics

SAB Topic 1.B, “Allocation of Expenses and Related Disclosure in Financial Statements of Subsidiaries, Divisions or Lesser Business Components of Another Entity”

SAB Topic 1.M, “Materiality” (SAB 99)

SAB Topic 1.N, “Considering the Effects of Prior Year Misstatements When Quantifying Misstatements in Current Year Financial Statements” (SAB 108)

SAB Topic 5.P, “Restructuring Charges”

SAB Topic 5.Y, “Accounting and Disclosures Relating to Loss Contingencies”

SAB Topic 6.K, “Accounting Series Release 302 — Separate Financial Statements Required by Regulation S-X”

SAB Topic 11.B, “Depreciation and Depletion Excluded From Cost of Sales”

SAB Topic 11.C, “Tax Holidays”

SAB Topic 11.M, “Disclosure of the Impact That Recently Issued Accounting Standards Will Have on the Financial Statements of the Registrant When Adopted in a Future Period” (SAB 74)

SAB Topic 13, “Revenue Recognition” (SAB 101 and SAB 104)

SAB Topic 13.B, “Disclosures”

SAB Topic 14, “Share-Based Payment”

SAB Topic 14.D, “Certain Assumptions Used in Valuation Methods”

SAB Topic 14.F, “Classification of Compensation Expense Associated with Share-Based Payment Arrangements”

SEC Accounting and Auditing Enforcement Release (AAER)

AAER No. 3490, *In the Matter of JPMorgan Chase & Co., Respondent*

Securities Act of 1933 Rules

Rule 405, “Definitions of Terms”

Rule 436, “Consents Required in Special Cases”

Securities Exchange Act of 1934 Rules

Rule 13a-15, "Controls and Procedures"

Rule 15d-15, "Controls and Procedures"

International Standards

IAS 36, *Impairment of Assets*

IAS 1 (Revised 2007), *Presentation of Financial Statements*

Appendix E — Abbreviations

Abbreviation	Description	Abbreviation	Description
AICPA	American Institute of Certified Public Accountants	DC&P	disclosure controls and procedures
AICPA Banking Conference	AICPA National Conference on Banks and Savings Institutions	DD&A	depreciation, depletion, and amortization
AICPA Conference	AICPA Conference on Current SEC and PCAOB Developments	DTA	deferred tax asset
ASC	FASB Accounting Standards Codification	DTL	deferred tax liability
ASR	SEC Accounting Series Release	EBIT	earnings before interest and taxes
ASU	FASB Accounting Standards Update	EBITDA	earnings before interest, taxes, depreciation, and amortization
AUM	assets under management	EBITDAR	earnings before interest, taxes, depreciation, amortization and rent/restructuring
BC	Basis for Conclusions	EDGAR	SEC's Electronic Data Gathering, Analysis, and Retrieval system
Boe	barrels of oil equivalent	EGC	emerging growth company
C&DI	SEC Compliance and Disclosure Interpretation	EPS	earnings per share
CAQ	Center for Audit Quality	ERP	enterprise resource planning system
CD&A	Compensation Discussion and Analysis	ETR	effective tax rate
CEO	chief executive officer	FASB	Financial Accounting Standards Board
CF-OCA	SEC's Division of Corporation Finance, Office of the Chief Accountant	FAQs	frequently asked questions
CFDG	Corporation Finance Disclosure Guidance	FCPA	Foreign Corrupt Practices Act
CFO	chief financial officer	FFO	funds from operations
CIK	central index key	FPI	foreign private issuer
CODM	chief operating decision maker	GAAP	generally accepted accounting principles
COSO	Committee of Sponsoring Organizations of the Treadway Commission	IAS	International Accounting Standard
		ICFR	internal control over financial reporting
		IFRS	International Financial Reporting Standard

Appendix E — Abbreviations

Abbreviation	Description	Abbreviation	Description
IPO	initial public offering	PBE	public business entity
KPI	key performance indicator	PCAOB	Public Company Accounting Oversight Board
M&A	mergers and acquisitions	PCC	Private Company Council
MBoe	thousand barrels of oil equivalent	PCS	postcontract customer support
MBS	mortgage-backed security	PUD	proved undeveloped
MD&A	Management's Discussion and Analysis	R&D	research and development
MLP	master limited partnership	ROIC	return on invested capital
NAREIT	National Association of Real Estate Investment Trusts	SAB	SEC Staff Accounting Bulletin
NCI	noncontrolling interest	SEC	Securities and Exchange Commission
NEO	named executive officer	SG&A	selling, general, and administrative expense
NGL	natural gas liquid	SIC	standard industrial classification
NOI	net operating income	THL	travel, hospitality, and leisure
OCA	SEC Office of the Chief Accountant	TPE	third-party evidence
OCI	other comprehensive income	VIE	variable interest entity
OCIE	SEC's Office of Compliance Inspections and Examinations	VSOE	vendor-specific objective evidence
P&U	power and utilities	XBRL	eXtensible Business Reporting Language

The following is a list of short references for the Acts mentioned in this publication:

Abbreviation	Act
Dodd-Frank Act	Dodd-Frank Wall Street Reform and Consumer Protection Act
Exchange Act	Securities Exchange Act of 1934
FCPA	Foreign Corrupt Practices Act
JOBS Act	Jumpstart Our Business Startups Act
Sarbanes-Oxley Act	Sarbanes-Oxley Act of 2002
Securities Act	Securities Act of 1933