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On the Radar

SEC Comment Letter Considerations, Including Industry Insights

The global business landscape continues to evolve at a rapid pace. After years of increasing interest rates and inflation, these trends have begun to moderate, however, other factors such as geopolitical conflicts and concerns about the commercial real estate sector continue to affect markets worldwide. Among these persistent trends, the transformative potential of generative artificial intelligence (AI) is significantly influencing world markets.

The SEC continues to undertake rulemaking and provide registrants with proactive guidance as needed to respond to recent market developments while conducting ongoing reviews and oversight to protect investors. Under the leadership of Chair Gary Gensler, who took office in April 2021, the Commission has pursued a comprehensive rulemaking agenda embodying three key themes: efficiency and competition, integrity and disclosure, and resiliency of the markets. Over the past few years, the SEC has issued final rules on disclosure topics such as cybersecurity, "clawback" policies, climate-related disclosures, and special-purpose acquisition companies (SPACs).[1] At the same time, the SEC has been addressing other issues in the marketplace, including significant growth in crypto assets, the rise of generative AI, and concerns about the banking and commercial real estate sectors.

[1] A SPAC is a newly formed company that raises cash in an initial public offering (IPO) and uses that cash, the equity of the SPAC, or both to fund the acquisition of a private operating company.

To help the SEC meet its responsibilities under the Sarbanes-Oxley Act, the SEC's Division of Corporation Finance (the "Division") continues to selectively review documents filed by registrants under the Securities Act of 1933 and the Securities Exchange Act of 1934. Under the Division's filing review process, the Division performs some level of review of each registrant at least once every three years and may issue comments to such registrants. The analysis herein summarizes the comments the Division issued during its reviews of periodic filings of public companies.

Top 10 Topics in Reviews

The table below summarizes comment letter trends by topic in the 12-month period ended July 31, 2024 ("review year 2024" or the "current year").

Topic	Percentage of All Reviews	Rank	Change in Rank From Prior Year
MD&A	41%	1	—
Non-GAAP measures	38%	2	—
Segment reporting	16%	3	—
Revenue recognition	13%	4	—
Inventory and cost of sales	11%	5	↑ 4
Intangible assets and goodwill	10%	6	↑ 5
Internal control over financial reporting	8%	7	—
Fair value	8%	8	—
Acquisitions, mergers, and business combinations	8%	9	↓ (4)
Income taxes	6%	10	↑ 5

The topics that constitute the current year's top 10 list are largely consistent with the prior year's list. However, the topic of income taxes and that of intangible assets and goodwill have joined the top 10 list, while the topic of signatures, exhibits, and agreements and that of debt have dropped out of the top 10.[2] Comments on MD&A and non-GAAP measure disclosures continue to increase in number, and these topics are still the two most significant sources of SEC comments by a wide margin since the staff remains laser-focused on them. Given the SEC staff's focus on ensuring that disclosures provide decision-useful information from management's perspective, we expect the volume of comments on MD&A to remain high. We also observed an increased number of comments related to intangible assets and goodwill, which rose from 11th place in 2023 to 6th place in 2024 because of an increase in comments asking for expanded "early-warning" disclosures about potential impairments. In addition, income taxes moved up five spots to 10th place because of an increase in comments on tax-related disclosures required by ASC 740.

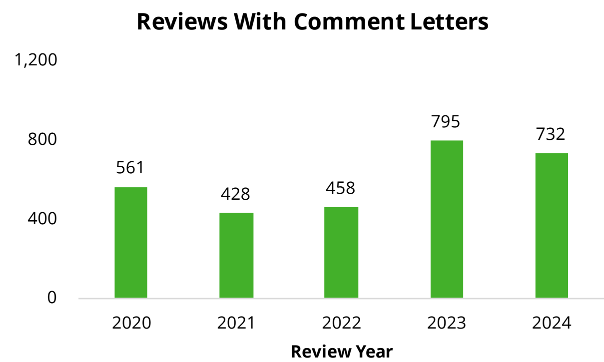
Further, although not identified as a separate top 10 topic, the impacts of higher interest rates, inflation, and supply-chain issues remained a source of SEC comments over the past year. Such comments have focused on disclosures related to the effects of these macroeconomic and geopolitical challenges on a registrant's (1) risk factors, (2) MD&A, (3) market risk disclosures, (4) early-warning disclosures about impairments, and (5) adjustments to non-GAAP measures. At a recent conference, the SEC staff has advised registrants that as inflation and interest rates moderate, its equally important to provide transparent, company-specific disclosures about such trends so that investors can understand how and when companies are affected by these changing macroeconomic factors.

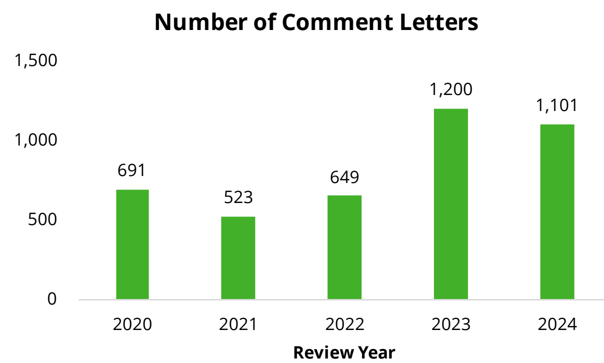
[2] The number of reviews with comment letters in review year 2024 may be subject to change as more comment letters from review year 2024 are posted to EDGAR.

A number of the aforementioned trends are likely to continue in years to come since comment letter topics have been largely consistent year over year. 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. The SEC staff has spoken extensively about disclosures related to AI, and we expect the staff to comment on such disclosures in future reviews. Given that the staff often focuses on compliance with new reporting requirements, we expect to see comments on new disclosures required under U.S. GAAP about supplier finance programs and segment reporting, as well as comments on new cybersecurity disclosures required under SEC regulations. In addition, we expect the SEC staff to continue monitoring the impacts of interest rates, inflation, geopolitical conflicts, and concerns about the commercial real estate market, and perhaps focus future comments on accounting and reporting related to these matters. These events, coupled with the staff's focus on ensuring that MD&A provides useful information to investors, mean that comments on MD&A are likely to remain elevated.

Long-Term Review Trends

The charts below show, for each of the review years 2020 through 2024, (1) the number of reviews with comment letters and (2) the total number of SEC comment letters issued.





As the charts above illustrate, while there was a notable decline in the number of reviews with comment letters and the number of comment letters issued on Forms 10-K and 10-Q from the beginning of review year 2020 through the end of review year 2021, the trend started to reverse in review year 2022, with a substantial increase in review year 2023. While down slightly from the prior year in both reviews with comment letters (an 8 percent decrease from the prior year) and the overall number of comment letters (an 8 percent decrease from the prior year), the volume of reviews and comment letters in review year 2024 represents an increase of more than 50 percent over the average seen from the beginning of review year 2020 through the end of review year 2022. We expect comment letter activity to remain elevated for the following reasons:

- *Increase in the number of public companies* — Throughout calendar years 2020 and 2021, the volume of traditional IPOs and SPAC transactions reached record levels, with more than 800 companies going public during this time frame. Consequently, there was an increase in the number of Forms 10-K filed by public companies, which are subject to recurring SEC staff review. With more public companies subject to review, we expect a higher level of comment letter activity than in past years.
- *Use of comments to elicit expanded disclosures related to emerging issues* — Over the past several years, the global economy has been affected by a variety of emerging market events. This trend shows no signs of stopping, especially with the transformational impacts of AI affecting business worldwide. The SEC staff often issues comments on the impacts of emerging market events to request expanded disclosures aimed at providing decision-useful information and greater transparency to investors.

Although the number of reviews with comment letters remains elevated, the vast majority of reviews conducted by the SEC do not result in a comment letter. In the SEC's fiscal year ended September 30, 2023, the SEC staff reviewed approximately 3,300 companies as part of the annual review process. However, only about 25 percent of the reviews of those companies resulted in a comment letter.

Priorities on the Horizon

Broader SEC priorities often influence comment letter trends. As registrants start to prepare for the 2024 annual reporting cycle, they may find it helpful to consider the following SEC priorities:

Investor protection	The SEC continues to focus on the investor protection pillar of its three-part mission — through the ongoing reviews described above as well as robust enforcement and examination activities. Enforcement actions, which have continued at historic levels, yielded $5 billion in judgments and orders in the SEC's fiscal year ended September 30, 2023.
AI	While advances in technology and finance are providing greater access to the U.S. markets and spurring innovation and competition within those markets, the Commission is focused on ensuring that it can achieve its core public goals with appropriate protections for everyday investors. To that end, the SEC issued a proposed rule on July 26, 2023, to address conflicts of interest related to AI and is investigating how the use of various AI models in the financial markets could affect market stability. Many registrants have included disclosures about AI in their SEC filings. These disclosures have largely focused on (1) AI regulation such as the EU Artificial Intelligence Act; (2) increased cybersecurity threats fueled by AI; and (3) market competition, innovation, and disruption from AI. Speaking about such disclosures at an event in February 2024, SEC Chair Gary Gensler cautioned registrants to avoid "AI washing" (i.e., making unfounded AI-related claims). He emphasized that "[c]laims about prospects should have a reasonable basis" and that disclosures about a company's use of AI should be accurate, complete, and balanced with the related risks. He also stated that companies may need to "define for investors what they mean when referring to AI" (e.g., machine learning, algorithms, generative AI). The SEC staff has warned that AI is one of its areas of focus.

(Table continued)

Recent rulemaking	Key final rules issued by the SEC that recently took effect address the following topics: • *Cybersecurity disclosures* — Under the SEC's July 26, 2023, final rule, a registrant is required to report the following: ◦ *Material cybersecurity incidents* — Within four business days after a registrant determines that any cybersecurity incidents material to it occurred, the registrant must file a Form 8-K to disclose those incidents under newly added Item 1.05, "Material Cybersecurity Incidents." ◦ *Annual cybersecurity disclosures* — The final rule adds Item 1C, "Cybersecurity," to Form 10-K. Under the final rule, registrants are required to provide disclosures in Item 1C that pertain to (1) cybersecurity risk management and strategy, including a comprehensive disclosure of the processes, if any, for assessing, identifying, and managing material risks from cybersecurity threats; (2) "management's role in assessing and managing material risks from cybersecurity threats"; and (3) "the board of directors' oversight of cybersecurity risks." See Deloitte's July 30, 2023 (updated December 19, 2023), *Heads Up* for more information. • *SPACs* — Under the SEC's January 24, 2024, final rule, the financial statement reporting requirements applicable to SPAC merger transactions are aligned more closely with the requirements for a traditional IPO. In addition, the final rule requires enhanced disclosures and provides additional investor protections related to SPAC IPOs and de-SPAC transactions. See Deloitte's February 6, 2024, *Heads Up* for more information. • *"Clawback" policies* — The SEC's October 26, 2022, final rule mandates that issuers must "claw back" excess compensation awarded on the basis of financial results that are later restated because of material noncompliance with financial reporting requirements. The final rule requires an issuer to (1) disclose its recovery policy in an exhibit to its annual report and (2) include new checkboxes on the cover page of its annual report to indicate whether the financial statements "reflect correction of an error to previously issued financial statements and whether [such] corrections are restatements that required a recovery analysis." For more information, see Deloitte's November 14, 2022, and December 10, 2023, *Heads Up* newsletters.
Climate-related disclosures	On March 6, 2024, the SEC issued a final rule requiring registrants to provide climate-related disclosures in their annual reports and registration statements. However, on April 4, 2024, the SEC issued a stay on the final rule pending judicial review. See Deloitte's March 6, 2024 (updated April 8, 2024), *Heads Up* for an executive summary of the final rule and Deloitte's March 15, 2024 (updated April 8, 2024), *Heads Up* for a comprehensive analysis of the final rule. Regardless of the stay, the Division has increased its focus on climate-related disclosures under existing SEC rules and regulations. On September 22, 2021, the Division publicly released a "Dear Issuer" letter on the topic, which outlines samples of the types of comments the Division may issue to public companies about climate-change disclosures and refers to considerations described in the SEC's 2010 interpretive release. Thus far, the SEC staff has issued such comments to more than 85 companies over the past three years.

(Table continued)

Commercial real estate	The current macroeconomic environment has created ongoing challenges and uncertainty as many commercial real estate entities have encountered increased costs of capital and tightening lending standards while also dealing with higher levels of maturing debt; reductions in the volume of real estate transactions; and evolving real estate demands and preferences related to the way people work, live, and shop. The SEC staff has encouraged companies with investments in commercial real estate to provide more disaggregated disclosure about such investments. It has also encouraged real estate entities to provide transparent disclosure about liquidity, lease renewals, and broader portfolio issues.

For a comprehensive discussion of comment letter trends affecting SEC filers, see Deloitte's Roadmap *SEC Comment Letter Considerations, Including Industry Insights*.

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