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SEC Comment Letters — Including Industry Insights
What “Edgar” Told Us

Ninth Edition
October 2015

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 ninth edition of *SEC Comment Letters — Including Industry Insights: What "Edgar" Told Us* 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.

Over the past year, the SEC staff has continued to address most topics discussed in our eighth edition, and it remains focused on the clarity of registrants' disclosures. This ninth edition reflects current SEC comments on registrants' financial statements and other aspects of their filings and includes the following appendixes: (1) Appendix A, which lists comment letter trends discussed in our eighth edition that no longer represent recent trends; (2) Appendix B, which gives a glimpse into the SEC staff's review and comment letter process; (3) Appendix C, which discusses best practices for managing unresolved SEC comments; (4) Appendix D, which provides helpful tips on searching the SEC's EDGAR database for comment letters; (5) Appendix E, which lists the titles (or links to titles) of the standards referred to in this publication; and (6) Appendix F, which defines the abbreviations we used.

Our ninth 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 9–11, 2015, and will be discussed in an upcoming issue of our *Heads Up* newsletter.

We hope you find our ninth edition of this publication — and other publications on US GAAP Plus — useful resources as you prepare your annual reports and plan for the upcoming year.

In keeping with recent SEC staff remarks about how registrants can make their disclosures more effective, 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,

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Executive Summary

As we approach the start of the 2015 annual reporting cycle, it seems natural to look back at the strategic priorities of the SEC over the past 12 months.

Since Mary Jo White took the helm of the SEC in April 2013 as its 31st chairman, the aggressive pursuit of investor protection has been a key focus of the Commission. The SEC recently announced that in its fiscal year ended September 2015, it filed 807 enforcement actions and obtained orders totaling approximately $4.2 billion in disgorgements and penalties. Further, as technology and business practices have continued to evolve, the SEC's Division of Enforcement has increased its focus on cybersecurity. For example, the SEC recently announced the settlement of a cybersecurity case against an investment adviser that had failed to establish the required cybersecurity policies and procedures before a breach.

Convergence of U.S. GAAP and IFRSs is another topic of interest for the SEC — particularly its Office of the Chief Accountant headed by James Schnurr, who continues to monitor this as well as the progress the FASB and the IASB are making in identifying and addressing implementation issues related to the new converged revenue standard. While the chief accountant seems generally pleased with the progress toward implementation that has been achieved to date, it appears from his remarks at the 2015 AICPA Banking Conference that he is focusing on the role of industry groups in the implementation process. Regarding whether and, if so, how to incorporate IFRSs in the U.S. financial reporting system, Mr. Schnurr has publicly stated that in the foreseeable future, continued collaboration between the boards seems to be the most realistic path forward.

The Division of Corporation Finance (the "Division") has been busy undertaking its own priorities over the past year. In the period leading up to the five-year anniversary of the Dodd-Frank Act, the Division continued to help the SEC fulfill its responsibilities under the Act's mandatory rulemaking provisions. For example, the SEC issued (1) a proposed rule[1] that would require disclosure of the relationship between executive compensation paid by a registrant and the registrant's financial performance ("pay versus performance") and (2) a proposed rule[2] that would require registrants to adopt clawback policies on executive compensation. The SEC also issued a final rule[3] on pay ratio disclosure that requires a registrant to disclose the ratio of the compensation of its CEO to the median compensation of its employees.

In addition, the Division facilitated the SEC's issuance of a concept release[4] in July 2015 that requested input on audit committee disclosure requirements with a focus on audit committees' oversight of independent auditors. The Division has also been working on the SEC's "disclosure effectiveness project,"[5] which began in earnest in December 2013 and resulted in the September 2015 issuance of a release[6] that requests public comment on the effectiveness of the financial disclosure requirements in Regulation S-X that apply to certain entities other than the registrant.[7]

Further, the Division continues to help the SEC meet its responsibilities under the Sarbanes-Oxley Act to review registrants at least once every three years. In this ninth edition of our publication, we, in turn, continue our tradition of highlighting trends in SEC staff comments by analyzing comments issued by the staff over the past year.

1 SEC Proposed Rule Release No. 34-74835, *Pay Versus Performance*.

2 SEC Proposed Rule Release No. 33-9861, *Listing Standards for Recovery of Erroneously Awarded Compensation*.

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

4 SEC Release No. 33-9862, *Possible Revisions to Audit Committee Disclosures*.

5 For additional information, see Deloitte's August 26, 2014, *Heads Up*.

6 SEC Release No. 33-9929, *Request for Comment on the Effectiveness of Financial Disclosures About Entities Other Than the Registrant*.

7 For additional information, see Deloitte's October 6, 2015, *Heads Up*.

The table below summarizes comment letter trends in the 12-month periods ended July 31, 2015, and July 31, 2014:[8]

	12 Months Ended July 31, 2015				12 Months Ended July 31, 2014		
Topic	**Number of 10-K and 10-Q Reviews With Comment Letters That Include a Comment on Topic**	**Percentage of All Comment Letter–Yielding 10-K and 10-Q Reviews That Include a Comment on Topic**	**Rank**	**Change in Rank From Prior Year**	**Number of 10-K and 10-Q Reviews With Comment Letters That Include a Comment on Topic**	**Percentage of All Comment Letter–Yielding 10-K and 10-Q Reviews That Include a Comment on Topic**	**Rank**
MD&A:[9]			1	—			1
• Results of operations	379	23%			516	23%	
• Liquidity issues	187	11%			336	15%	
• Critical accounting policies and estimates	147	9%			248	11%	
Fair value measurement and estimates	358	22%	2	—	544	25%	2
Revenue recognition	246	15%	3	↑ 1	318	14%	4
Non-GAAP measures	235	14%	4	↑ 2	277	13%	6
Signatures, exhibits, and agreements	205	12%	5	↓ 2	370	17%	3
Income taxes	184	11%	6	↓ 1	291	13%	5
Segment reporting	164	10%	7	↑ 3	219	10%	10
Acquisitions, mergers, and business combinations	162	10%	8	↓ 1	254	12%	7
Property, plant, and equipment; intangible assets; and goodwill	146	9%	9	↓ 1	244	11%	8
Debt, warrants, and equity securities	134	8%	10	↑ 1	218	10%	11

In the 12 months ended July 31, 2015, there was a sharp decline from the previous 12-month period in the number of registrants that received a comment letter as a result of the SEC staff's review of Form 10-K and Form 10-Q filings. That significant decline is reflected in the reduced number of Form 10-K and Form 10-Q reviews that yielded comment letters that include a comment related to one of the top 10 topics noted in the table above.

As the table indicates, MD&A is again the leading source of SEC staff comments, many of which reflect 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." In reviewing registrants' analysis and disclosure of results of operations, the staff has continued to focus on encouraging registrants to (1) disclose known trends or uncertainties, (2) quantify components of overall changes in financial statement line items, and (3) enhance their analysis of the underlying factors that cause such changes.

8 Comment letter trend information in the table was derived from data provided by Audit Analytics.

9 Statistics related to three MD&A subtopics are noted below.

Highlights of comment letters issued over the past year also include:

- *Fair value* — The SEC staff continues to ask registrants about (1) valuation techniques and inputs used to determine fair value, (2) sensitivity of Level 3 measurements, (3) categorization of assets and liabilities in the fair value hierarchy, and (4) the use of third-party pricing services.
- *Revenue recognition* — Although many preparers are focused on the forthcoming revenue recognition standard, application of the current standard continues to draw the staff's attention. Revenue recognition issues addressed in comment letters include (1) the completeness and consistency of disclosures about revenue recognition policies, (2) accounting for multiple-element arrangements, and (3) principal-versus-agent analysis (i.e., gross versus net reporting).
- *Non-GAAP financial measures and key metrics* — Staff comments on non-GAAP financial measures and key metrics have focused on asking registrants to (1) explain why such measures and metrics are useful to investors, (2) reconcile non-GAAP financial measures to the appropriate GAAP measures and avoid attaching "undue prominence" to the non-GAAP measures, and (3) explain how key metrics are calculated and describe how a key metric is related to current or future results of operations.
- *Income taxes* — The SEC staff remains focused on (1) the potential tax and liquidity ramifications related to the repatriation of foreign earnings, (2) valuation allowances, (3) rate reconciliation, and (4) unrecognized tax benefits.
- *Segment reporting* — The staff continues to ask registrants about (1) the identification of the chief operating decision maker (CODM); (2) the identification of operating segments; and (3) the analysis supporting the aggregation of operating segments, including consideration of qualitative factors (e.g., similar products and customers).
- *Business combinations* — M&A activity has remained high over the past couple of years, and so has the number of related SEC comments. Like past SEC staff comments on business combinations, recent ones have centered on (1) purchase price allocation, (2) contingent consideration, (3) bargain purchases, and (4) disclosures.

Many of the recent comment letter trends noted above and current industry-specific trends[10] are likely to continue in the coming year. In addition, while it is difficult to predict what new comment letter trends are on the horizon, history tells us that new trends are often prompted by events such as (1) the enactment of new rules and (2) changes in economic cycles and trends:

- *New rules* — Whether they are accounting- or reporting-related, new rules typically make for a comment letter–rich environment as registrants work through accounting and system implementation issues and familiarize themselves with the new requirements. Accordingly, since U.S. GAAP guidance on consolidation is once again in flux, an uptick in related comments is likely in the coming year.
- *Changes in economic cycles and trends* — As the economy fluctuates between periods of contraction and expansion and other economic trends develop on a global or regional basis, tension is placed on different accounting and reporting rules. Given the current state of play, we may see an increase in SEC staff comments related to (1) the release of loan allowances and DTAs (timing and amount) and (2) requests for additional disclosures when a registrant's results of operations are significantly affected by depressed commodity prices or hyperinflationary currencies.

[10] For a discussion of comment letter trends related to particular industries, see Industry-Specific Topics below.

Financial Statement Accounting and Disclosure Topics

Business Combinations

Purchase Price Allocation

Example of an SEC Comment

In regard to your preliminary purchase price allocation . . . , please provide further supporting disclosure for each purchase price adjustment to each tangible and intangible asset acquired and liability assumed. This disclosure should explain in greater detail what the adjustment represents and how the increase or decrease was determined, including a brief explanation of the factors and assumptions involved in the calculation. For example, please disclose and explain how you determined the increase in property, plant and equipment, franchises and customer relationships.

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. The staff also compares disclosures provided in press releases, the business section, and MD&A to the purchase price allocation in the financial statements. For example, the SEC staff may ask why a registrant did not recognize a customer-related intangible asset if it discloses in MD&A that it acquired customers in a business combination. In addition, the SEC 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) material revisions to the initial accounting for a business combination, including what significant assumptions have changed to support a revision to the value of intangible assets.

Contingent Consideration

Example of an SEC Comment

Please note that ASC 805-30-50-1(c) requires a description of contingent consideration arrangements in the financial statements including the basis for determining the amount of any payments. Also, disclosure of the changes in the range of outcomes and reasons for those changes is required to be disclosed in accordance with ASC 805-30-50-4. Given these disclosure requirements, please provide draft disclosure to be included in future filings to disclose both the nature and terms of the contingent consideration arrangement including the metrics which must be achieved for payments to occur, and the nature and timing of the changes in facts and circumstances that resulted in your reversal of the previously recorded expense for future incentive payments of $[X] during the fourth quarter of the fiscal year ended February 1, 2014. As part of your revised disclosure, please also explain why your determination that the financial metrics would not be achieved did not occur until the fourth quarter of your fiscal year ended February 1, 2014.

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 a retrospective 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 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.

Bargain Purchases

> **Example of an SEC Comment**
>
> Please fully explain to us how you determined the fair value of the property, plant and equipment you acquired from [Company A]. Please specifically address why the gain on bargain purchase you recognized was so significant relative to the purchase price. Please also address if you have performed any subsequent impairment analysis for the assets you acquired and, if applicable, tell us the significant assumptions you used.

When a registrant recognizes a gain related to a bargain purchase, the SEC staff will typically issue comments on how the registrant determined and reassessed the purchase price allocation. A gain from a bargain purchase occurs when the net of the acquisition-date 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,[1] (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. The SEC staff has asked registrants to (1) explain their 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.

Disclosures

> **Example of an SEC Comment**
>
> Please revise [the notes] to disclose the amounts of revenue and earnings of [Company A] and [Company B] since the acquisition date which have been included in the consolidated income statement for the reporting period in which the acquisitions occurred. Also, please revise to disclose the revenue and earnings of the combined entity for the current reporting period as though the acquisition date for all business combinations that occurred during the period had been as of the beginning of the annual reporting period. Comparable information for the prior annual period should also be presented as if these acquisitions had occurred at the beginning of the comparable prior annual reporting period. Refer to the disclosure requirements outlined in ASC 805-10-50-2(h).

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) states that the disclosure requirements for comparative financial statements are as follows:

> [F]or a calendar year-end entity, disclosures would be provided for a business combination that occurs in 20X2, as if it occurred on January 1, 20X1. Such disclosures would not be revised if 20X2 is presented for comparative purposes with the 20X3 financial statements (even if 20X2 is the earliest period presented).

In accordance with ASC 805-10-50, 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.

[1] Certain share-based payment awards are not measured at fair value.

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

September 30, 2015, *Heads Up*, "FASB Simplifies the Accounting for Measurement-Period Adjustments."

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).
- Presentation of assets and liabilities of consolidated VIEs.

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

Examples of SEC Comments

- Please provide us with your detailed analysis of the accounting model and the authoritative accounting guidance you considered in your conclusion to consolidate [the legal entity]. Tell us whether [the legal entity] is subject to the consolidation guidance related to variable interest entities and what consideration was given to the guidance in ASC 810-10-15-14(b)(1). If it is subject to this guidance, explain how you determined that you have the characteristics of a controlling financial interest per ASC 810-10-25-38A.
- You disclosed that at December 31, 2013, you consolidated an investment in [an] LLC where you were determined to be the primary beneficiary due to a related party affiliation. At June 30, 2014, you were no longer considered the primary beneficiary of this LLC and therefore deconsolidated this LLC in accordance with ASC 810. Please tell us how you determined that it was appropriate to deconsolidate this LLC. Please also tell us how you accounted for this deconsolidation and tell us whether you recognized a gain or loss in net income attributable to the parent. Refer to ASC 810-10-40.
- We note that during the year ended December 31, 2013 and the subsequent quarterly period ended March 31, 2014, amendments of existing operating agreements governing certain properties resulted in you gaining control of these properties. Please tell us and describe the pre-existing terms and the changes that were made to these operating agreements. In addition, please cite the specific authoritative guidance within [ASC 810] relied upon that resulted in the change from equity method to consolidation treatment.

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.[1] 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.[2] 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).

[1] The comment letter trends discussed in this section are applicable to consolidation analyses that do not qualify for the deferral under ASU 2010-10 and are subject to the consolidation guidance in ASC 810-10 as amended by ASU 2009-17.

[2] 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.

Presentation of Assets and Liabilities of Consolidated VIEs

Example of an SEC Comment

We note that you separately present the assets and liabilities held by variable interest entities on your balance sheet. In future filings, please recast your balance sheet to present the consolidated totals for each line item required by Rule 5-02 of Regulation S-X. Please note that you may state parenthetically after each line item the amount that relates to consolidated VIEs, or you may include a table following the consolidated balance sheets to present assets and liabilities of consolidated VIEs that have been included in the preceding balance sheet.

SEC staff comments have addressed the reporting entity's presentation of assets and liabilities of consolidated VIEs. When presenting assets, liabilities, and noncontrolling interests of a consolidated VIE, a reporting entity should present those items in the consolidated financial statements as if the basis for consolidating the VIE had been voting interests. ASC 810-10-45-25 requires a reporting entity to present on the face of the statement of financial position the (1) "[a]ssets of a consolidated [VIE] that can be used only to settle obligations of the consolidated VIE" and (2) "[l]iabilities of a consolidated VIE for which creditors (or beneficial interest holders) do not have recourse to the general credit of the primary beneficiary." A reporting entity must also satisfy the requirements related to (1) the elimination of intra-entity balances and transactions and (2) other matters discussed in ASC 810-10-45.

Other Deloitte Resources

- May 26, 2015, *Heads Up*, "FASB Amends Its Consolidation Model."
- December 15, 2014, *Heads Up*, "Highlights of the 2014 AICPA Conference on Current SEC and PCAOB Developments."

Contingencies

Because registrants' contingency disclosures have improved, the SEC staff has commented on this topic less frequently than in prior years. However, the staff continues to 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.
- 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

- We note [your assertion] that "given the uncertainty of litigation combined with the fact that such matters are each in their very preliminary stages[,]" you cannot provide the "range of potential losses." Please supplementally explain to us the procedures you undertake on a quarterly basis to attempt to develop a range of reasonably possible loss for disclosure and tell us the specific factors that are causing the inability to estimate a range for each material matter. We recognize that there are a number of uncertainties and potential outcomes associated with loss contingencies. Nonetheless, an effort should be made to develop estimates for purposes of disclosure, including determining which of the potential outcomes are reasonably possible and what the reasonably possible range of losses would be for those reasonably possible outcomes.

  Additionally, ASC 450 does not use the term "potential"; therefore, in future filings please provide disclosure relative to reasonably possible losses.

- You state that "At this time, no assessment can be made as to the likely outcome of these lawsuits or whether the outcome will be material to the Company." We do not believe that this disclosure meets the requirements of ASC 450-20-50-3 and 50-4. Please provide us proposed disclosure to be included in future periodic reports for all legal proceedings to include an estimate of the possible loss or range of loss or a statement that such an estimate cannot be made for loss contingencies that are at least reasonably possible but not accrued, either because it is not probable that a loss has been incurred or the amount of loss cannot be reasonably estimated.

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 specific 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.

Many comments from the SEC staff have focused on comparing current-year disclosures with those in prior-year filings. Staff questions commonly include (1) whether additional reasonably possible losses have been incurred since the initial disclosure of a reasonably possible loss, (2) why the accrual amount for the current year is different from that reported in previous filings, and (3) whether there are any changes in facts and circumstances that may affect the accrual amount. 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) 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

Example of an SEC Comment

We note your disclosure . . . regarding the [merger] litigation that the company believes the claims in the Illinois and Delaware actions are without merit. Your introductory disclosure regarding litigation . . . quantifies the accrued aggregate liability for pending legal matters, but does not address reasonably possible losses in excess of amounts accrued. If there is at least a reasonable possibility that a loss exceeding amounts already recognized may have been incurred, you must either disclose an estimate of the additional loss or range of loss that is reasonably possible, or state that such an estimate cannot be made. Such disclosure may be provided in the aggregate. Please tell us how your disclosures comply with paragraphs 50-3 through 50-5 of ASC 450-20-50 and SAB Topic [5.Y].

The SEC staff often asks registrants to expand their disclosures about litigation contingencies. If a registrant discloses that the impact of pending or threatened litigation is not expected to be material to its financial statements, the staff is likely to request that the registrant disclose the estimated loss or range of reasonably possible losses in excess of amounts accrued in accordance with ASC 450-20-50-4(b) and SAB Topic 5.Y.[1]

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.

[1] Specifically, the interpretive response to Question 2 of SAB Topic 5.Y indicates that "a statement that the contingency is not expected to be material does not satisfy the requirements of FASB ASC Topic 450 if there is at least a reasonable possibility that a loss exceeding amounts already recognized may have been incurred and the amount of that additional loss would be material to a decision to buy or sell the registrant's securities. In that case, the registrant must either (a) disclose the estimated additional loss, or range of loss, that is reasonably possible, or (b) state that such an estimate cannot be made."

Debt

Restrictions

Example of an SEC Comment

We note your disclosure . . . that credit facilities of certain subsidiaries include financial covenants. Please tell us whether these covenants and/or any other third party or regulatory restrictions on your subsidiaries or investments accounted for by the equity method restrict the ability to transfer funds to you in the form of loans, advances or cash dividends without consent. 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 as of the most recent balance sheet date 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.

When the transfer of assets (cash or other funds) to the parent company/registrant 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 disclosures 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.

Refinancing

Example of an SEC Comment

Please provide us your analysis under ASC 470-50-40 supporting your conclusion that the January 23, 2014 second amendment to the credit agreement was a modification and not an extinguishment.

The SEC staff's comments on refinancings have focused on registrants' (1) conclusions about whether debt refinancing transactions should be accounted for as debt extinguishments under ASC 470-50 and (2) disclosures about the significant components of the gains or losses recorded on a debt extinguishment and how registrants calculated the components.

Financial Covenant Disclosures

Example of an SEC Comment

We note you received a waiver from the Lender for non-compliance with a financial covenant and the lender modified various financial covenants relating to fiscal 2014. We further note your disclosure . . . that states the Credit Agreement requires maximum levels of cash usage and minimum levels of liquidity, as defined, and provides for increased liquidity levels if operating results are not achieved. It appears to us that your Credit Agreement is a material agreement, that the covenants are material terms of the Credit Agreement and that information about the covenants would be material to an investor's understanding of the Company's financial condition and liquidity. Please describe to us the nature of the waiver received from the Lender to cure non-compliance with the financial covenant. In addition, please provide us with draft disclosure of the following information to be included in future filings:

- The material terms of the debt covenants, including quantification of the amount or limit required for compliance with any financial covenants as compared to your actual results.
- The likelihood of failing a financial covenant or obtaining a waiver in the future.
- The actual or reasonably likely effects of compliance or non-compliance with the covenants on the Company's financial condition and liquidity.

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 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

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 either debt or 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

June 18, 2015, *Heads Up*, "FASB Simplifies Guidance on Presentation of Debt Issuance Costs."

Discontinued Operations, Assets Held for Sale, and Restructuring Charges

Discontinued Operations and Assets Held for Sale

Examples of SEC Comments

- We note the disclosure that as part of a strategic repositioning and refocusing of [Company A], a decision was made to sell [Facility A and Facility B] in 2013. In light of the fact that [Facility B has] not been sold as of December 31, 2014 and you expect a final determination for [Facility B] to occur in 2015, whereby [Company A] is currently weighing all of its disposal options, please tell us why [Company A] continues to believe that the fixed assets are appropriately classified as held for sale and the results of operations classified in discontinued operations as of December 31, 2014. Please tell us the specific considerations given to ASC 360-10-45-9 through ASC 360-10-45-11 in concluding that the assets continue to meet the held for sale criteria as of December 31, 2014.
- With reference to ASC 205-20-45-1, please tell us why your expected sale of [Component A] is not reflected as held for sale and discontinued operations. In this regard, we note . . . that you entered into a definitive agreement in December 2014 and the sale is expected to close in the first half of 2015 pending receipt of customary regulatory approvals. See also ASC 360-10-45-9.

The SEC staff continues to ask registrants whether the operations they have disposed of should be accounted for as discontinued operations. The staff may challenge whether the operations are a "component of an entity" under ASC 205-20. Specifically, it may ask whether the operations and cash flows "can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity."

Whether components qualify as discontinued operations must be carefully considered.[1] Further, the staff has 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 (i.e., classified as held for use and thus not recorded at net realizable value). 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.

The SEC staff has also asked registrants about why they did not disclose the gain or loss on a sale after disposition.[2]

[1] See ASC 205-20-45.

[2] Before its amendment by ASU 2014-08, ASC 205-20-45-3 provided that gains or losses on disposal transactions "shall be disclosed either on the face of the income statement or in the notes to financial statements."

Restructuring Charges

Example of an SEC Comment

In your February 24, 2015 earnings call, your CEO indicated that you implemented approximately $[X] in cost reduction actions, including [an X]% head count reduction to your global workforce. You disclose . . . that you implemented a number of cost reduction actions during the quarter, including the planned closure of a manufacturing facility in [Location A]. Please describe to us the nature and extent of any workforce reduction actions undertaken during the year ended December 31, 2014 and the quarter ended March 31, 2015 and tell us how you considered providing the disclosures required by ASC 420-10-50.

The SEC staff has inquired about corporate reorganizations and restructurings and registrants' disclosures about such activities. Comments primarily stem from workforce reductions and facility closures.
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 directed registrants to comply with the guidance in SAB Topic 5.P.4 on disclosures related to material restructuring activities.

Earnings per Share

Two-Class Method

Example of an SEC Comment

We note from your disclosure . . . that recipients of restricted stock receive all dividends with respect to the shares, whether or not the shares have vested. Please tell us whether you consider the restricted stock to be participating securities that would be included in your computation of earnings per share under the two-class method. Refer to ASC 260-10-45-61A.

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.

EPS Disclosures

Example of an SEC Comment

We note your diluted [EPS] reflect the potential reduction in EPS using the treasury stock method to reflect the impact of common stock equivalents if stock options, [stock appreciation rights,] and warrants were exercised. Related to your reconciliation of basic and diluted EPS computations . . . , please confirm that you will disaggregate the dilutive [effect] of these share based awards by the award type (e.g., options, warrants, etc.) in future filings similar to the illustration provided in ASC 260-10-55-51 and [55-52].

The SEC staff may comment on whether a registrant has met the requirements of ASC 260-10-50-1, under which an entity must disclose all of the following for each period in which an income statement is presented:

> a. A reconciliation of the numerators and the denominators of the basic and diluted per-share computations for income from continuing operations. . . .
>
> b. The effect that has been given to preferred dividends in arriving at income available to common stockholders in computing basic EPS.
>
> c. Securities . . . that could potentially dilute basic EPS in the future that were not included in the computation of diluted EPS because to do so would have been antidilutive for the period(s) presented.

In addition, the SEC staff may ask registrants to elaborate on their calculation of EPS by disclosing:

- How unvested shares, unvested share units, unvested restricted share units, and performance shares are treated in basic and diluted EPS.
- Whether unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (paid or unpaid) are treated as participating securities and factored into the calculation of EPS.
- The nature of incentive distribution rights.

Fair Value

Valuation Techniques and Inputs

Examples of SEC Comments

- [P]lease provide us, for each "class" of level 2 fixed maturity securities, the valuation technique(s) and inputs used in your fair value measurement. To the extent that you use more than one technique in a class, tell us:
  - [T]he extent to which you use each technique for the class;
  - [W]hat determines when each technique is used in the class; and
  - [T]he inputs for each technique in the class.
- Please tell us, and revise future filings, to include the disclosure requirements of ASC 820-10-50-2.bbb, specifically quantitative information about the significant unobservable inputs used in the fair value measurement for fair value measurements categorized within Level 3 of the fair value hierarchy for impaired loans and other real estate owned. Refer to ASC 820-10-55-103 for a proposed template for disclosing this information in future filings.

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.[1] 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.

Sensitivity of Level 3 Measurements

Example of an SEC Comment

You disclose the significant unobservable inputs used in developing the fair value of your warrants which are classified as a Level 3 measurement. Given that your warrants carried at fair value are a critical accounting policy, please revise your future filings to address the sensitivity disclosures required by ASC 820-10-50-2(g).

[1] 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*.

The SEC staff continues to comment when a registrant omits disclosures about the sensitivity of Level 3 measurements and may ask for disclosures about changes in significant unobservable inputs to be more granular and transparent. In addition, the staff has noted that it may be helpful for registrants to discuss the specific inputs that changed in the sensitivity analysis and the effect of changing those significant unobservable inputs.

Fair Value Hierarchy

Example of an SEC Comment

We note your disclosure . . . that you estimate the fair value of your "non-centrally cleared" interest rate swaps using inputs from counterparty and third-party pricing models to estimate the net present value of the future cash flows. We further note that these assets and liabilities are classified within Level 2 of the fair value hierarchy. Please provide us with additional details to support your Level 2 classification.

The SEC staff has asked registrants for additional information that supports their categorization of assets and liabilities in the fair value hierarchy. In addition, when assets or liabilities are transferred between levels in the fair value hierarchy, the staff has requested expanded disclosures to explain the amounts of any transfers, the reasons for those transfers, and the registrant's policy for determining when transfers between levels are deemed to have occurred.

Use of Third-Party Pricing Services

Example of an SEC Comment

We note that you use third-party pricing services to determine the fair value of your investments in [available-for-sale] securities. Please revise your future filings to disclose if you adjust prices obtained from pricing services and if so, the underlying reason for the adjustment and methods used to determine the adjustment. Please also revise to describe the procedures you perform to validate the valuations received from such third-party pricing services. Please refer to ASC 820-10-50-2(bbb) for further guidance.

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 instruments,[1] (2) classification of warrants on a company's own stock, and (3) identification and calculation of beneficial conversion features (BCFs).

Embedded Derivatives in Hybrid Financial Instruments

Examples of SEC Comments

- It appears the exchangeable senior notes issued in August 2014 contain redemption features. Provide us your analysis that supports your conclusion that none of the redemption features are required to be bifurcated in accordance with ASC 815-15. Specifically address whether the debt involves a substantial discount in accordance with ASC 815-15-25-40 through [25-43].
- We note your disclosure that the 1.25% Notes contain an embedded cash conversion option and that you have determined that this option is a derivative financial instrument that is required to be separated from the notes. Please provide us with the details of your analysis in determining that this conversion option should be accounted for separately as a derivative and refer to the specific accounting literature you relied on.

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 (e.g., a put option embedded in a company's preferred stock) 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. After 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 Warrants on a Company's Own Stock

Example of an SEC Comment

Please tell us why the warrants you sold in this transaction are properly classified in equity and reference for us the authoritative literature you relied upon to support your accounting. In your response, specifically tell us how the strike price of these warrants can be adjusted and why these adjustments do not trigger derivative accounting.

[1] The ASC Master Glossary defines a hybrid instrument as a "contract that embodies both an embedded derivative and a host contract."

If certain criteria are met, warrants issued in connection with debt and equity offerings are accounted for on a separate basis (i.e., as freestanding financial instruments[2]). Under U.S. GAAP, an issuer of a stock purchase warrant is required to first determine whether the warrant should be classified as a liability under ASC 480. If the warrant is not classified as a liability under ASC 480, liability classification may still result under ASC 815. Specifically, the warrant's classification as either a liability or equity may hinge on whether the instrument meets the definition of a derivative and qualifies for any scope exceptions under ASC 815-10-15. When a warrant is accounted for as a freestanding financial instrument, the manner in which offering proceeds are allocated to the issued instrument and to the warrant depends on whether the warrant is classified as an equity instrument or as a liability instrument. Consequently, the SEC staff has asked registrants to explain the basis for their determination of how warrants should be classified, including the application of relevant accounting literature.

Identification and Calculation of BCFs

Examples of SEC Comments

- Please submit the analyses you performed in determining whether these classes of preferred shares contain [BCFs].
- Please tell us how you calculated the [BCF] you recorded in connection with the issuance of [convertible shares]. Further, please provide to us your accounting analysis which supports recognizing the BCF as a non-cash distribution that is recognized ratably from the issuance date through the conversion date in equity.

The SEC staff frequently comments on the recognition and calculation of BCFs. ASC 470-20 requires the issuer of a convertible security to measure the amount of any embedded BCF at the intrinsic value of the embedded conversion option, which is computed on the basis of the effective conversion price (i.e., the issuer computes the intrinsic value of the embedded conversion option by multiplying (1) the amount by which the fair value of the common stock or other securities into which the security is convertible exceeds the effective conversion price by (2) the number of shares into which the security is convertible). Accordingly, registrants can expect the SEC staff to ask how they calculated the value of a BCF that was recorded in connection with the issuance of a hybrid financial instrument. In addition, the SEC staff frequently asks registrants to provide the accounting analysis that supports the BCF calculation.

[2] The ASC Master Glossary defines a freestanding financial instrument as a financial instrument that either (1) "is entered into separately and apart from any of the entity's other financial instruments or equity transactions" or (2) "is entered into in conjunction with some other transaction and is legally detachable and separately exercisable."

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

> **Example of an SEC Comment**
>
> We note that "Other accrued expenses" comprises more than 13% of total current liabilities as of November 30, 2014. Please tell us what consideration you gave to separately presenting any individual items within this category that were in excess of 5% of total current liabilities pursuant to Regulation S-X Rule 5-02(20).

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**
>
> Please refer to Rule 5-02 of Regulation S-X and tell us how you considered presenting or disclosing restricted cash associated with the company's participation in programs administrated by the Department of Education and Department of Defense.

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 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. For example, the SEC staff has asked registrants to explain why they have excluded certain line items required by Rule 5-03 from the face of their income statements. In addition, the SEC staff has reminded registrants that when alternative classifications are permissible, they should disclose their policies and apply them consistently in accordance with ASC 235-10.

Separate Presentation

> **Example of an SEC Comment**
>
> To the extent that Other expenses remains material to the income statement, please consider disaggregating its components on the face of the statement or in a note to the financial statements.

Among the requirements of Rule 5-03 is separate presentation of certain material (1) other operating costs and expenses and (2) other general expenses. The SEC staff frequently comments when registrants present material amounts in "other expenses" (or similarly phrased line items) and, in certain instances, 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.

Further, the SEC staff has focused on the distinction between product and service revenue. Under 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. Accordingly, registrants that combined the presentation of product and service revenue when such revenue met the separate presentation threshold have received SEC staff comments directing them to revise their consolidated statement of operations.

Cost of Sales

> **Example of an SEC Comment**
>
> We note that you present a subtotal for gross profit on your consolidated statements of income and that this profit measure reflects revenues less the cost of food and retail merchandise sold, which you label as "Cost of goods sold." We note that costs of goods sold does not reflect certain costs of goods and services such as labor, benefits, rent, depreciation, and amortization, among others. Please tell us the basis for your determination of the types of costs included in cost of goods sold and your consideration of S-X Rule 5-03.2, S-K Item 302, and SAB Topic 11.B.

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. For example, the SEC staff has issued comments to registrants that did not 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.

Most of the SEC staff's comments on this matter have stemmed from registrants' lack of awareness or incorrect application of the guidance in SAB Topic 11.B, particularly their inappropriate reporting of an amount for gross profit before depreciation and amortization.

Operating Versus Nonoperating Income

> **Example of an SEC Comment**
>
> We note that you classified the net gain of $[X] from the sale of your microphone product line within non-operating income. We also note that the microphone product line was not considered to be a component of the company. Please tell us why you classified the amount as non-operating income and not within operating income. Include a discussion of your consideration of FASB ASC 360-10-45-5.

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).
- Noncontrolling interest in income of consolidated subsidiaries.

Cash Flow Statement Classification

Category Classification

> **Example of an SEC Comment**
>
> We note you classified dividends received from your banking subsidiary of $[X] in 2014, $[X] in 2013, and $[X] in 2012 as cash flows from investing activities. Please tell us why you classified these cash inflows to the parent company as investing cash flows as opposed to operating cash flows. Please refer to ASC 230-10-45-16(b) for specific guidance on how to classify dividends received on a statement of cash flows.

Many of the SEC staff's comments are related to misclassification among the three cash flow categories: operating, investing, and financing. ASC 230 distinguishes between returns **of** investment, which should be classified as inflows from investing activities (see ASC 230-10-45-12(b)), and returns **on** investment, which should be classified as inflows from operating activities (see ASC 230-10-45-16(b)). Under ASC 230-10-45-16(b), cash inflows from operating activities include "[c]ash receipts from returns on loans, other debt instruments of other entities, and equity securities — interest and dividends."

At the 2014 AICPA Conference, the SEC staff noted that it has observed an increased number of classification errors in registrants' statements of cash flows. Further, such errors are generally not attributable to complex fact patterns. The SEC staff identified various actions that registrants could take when preparing the statement of cash flows to potentially reduce the likelihood of errors, including:

- Evaluating the completeness and accuracy of the information collected for preparation of the statement.
- Standardizing and automating required reports and other information.
- Separately considering the effect of nonrecurring transactions in the statement.
- Preparing the statement earlier to allow for adequate review.
- Selecting employees that have the appropriate expertise to prepare the statement of cash flows and providing them with sufficient training on the accounting requirements related to the statement.
- Incorporating risk assessment and monitoring controls in addition to control activities.

For information about SEC staff comments on how registrants' errors could affect their conclusions about DC&P and ICFR, see the Disclosure Controls and Procedures and Internal Control Over Financial Reporting sections.

Net Versus Gross Presentation

Example of an SEC Comment

Please note that borrowings and payments on your revolving credit facility should be recorded on a gross basis in the statement of cash flows unless the original maturity of the borrowings is three months or less. Refer to ASC 230-10-45-9 and advise us why the borrowings and payments were not reflected on a gross basis.

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

Examples of SEC Comments

- Please tell us your consideration of disclosing in the notes to the financial statements the gross changes, along with the related tax expense or benefit, of each classification of other comprehensive income. Refer to ASC 220-10-45-12 and [ASC] 220-10-45-17.
- Please provide the disclosures required by ASU 2013-02 related to amounts reclassified out of accumulated other comprehensive income or tell us why this authoritative literature does not apply to you.

Entities are required to report components of comprehensive income in either (1) a continuous statement of comprehensive income or (2) two separate but consecutive statements.

The SEC staff has commented when registrants have not provided information required by ASC 220 (ASU 2013-02) 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.

Foreign Currency

Quantification of Foreign Currency Adjustments

Example of an SEC Comment

Throughout MD&A, you indicate that results were negatively impacted by the effects of foreign currency translation. Please expand your discussion to quantify the impact of foreign currency translation on each segment, where applicable. Please also discuss any trends related to foreign currency currently impacting your results of operations and indicate whether they are expected to continue (i.e. whether currency has strengthened or weakened from period to period).

The SEC staff's comments on quantitative disclosures related to foreign currency adjustments reflect published staff views[1] 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.

Accounting and Disclosure Considerations Related to Venezuelan Operations

The SEC staff continues to focus on accounting and disclosure considerations related to the foreign currency exchange environment in Venezuela. Business operations in Venezuela may give rise to accounting questions about (1) which exchange rate is appropriate for remeasurement and (2) whether such operations should be deconsolidated or considered impaired. For additional accounting and disclosure considerations related to the foreign currency exchange environment in Venezuela, see (1) the October 2, 2015, Deloitte Accounting Journal entry and (2) Deloitte's Financial Reporting Alerts 15-1,[2] 14-5,[3] and 14-1.[4]

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

2 Financial Reporting Alert 15-1, "Foreign Currency Exchange Accounting Implications of Recent Government Actions in Venezuela."

3 Financial Reporting Alert 14-5, "Consolidation and Disclosure Considerations Related to Venezuelan Operations."

4 Financial Reporting Alert 14-1, "Foreign Currency Exchange Accounting Implications of Recent Government Actions in Venezuela."

Impairments of Goodwill and Other Long-Lived Assets

Goodwill

Disclosures

Example of an SEC Comment

We note your disclosure . . . that the fair value of [Reporting Unit A] substantially exceeded the related carrying value as of your annual assessment in the fourth quarter of fiscal 2014. We also note that operating income of [Reporting Unit A] declined [X]%, from $[X] million to $[X] million, during fiscal year 2014 primarily as a result of a decrease in gross margin rates and increases in buying, distribution and occupancy costs and depreciation expense. Please provide the following:

- [T]he percentage by which [Reporting Unit A]´s fair value exceeded its carrying value as of June 26, 2014;
- [A]n explanation of how the decline in operating income that occurred during fiscal year 2014 was considered in your goodwill impairment analysis. Please specifically address the fact that the lower gross margin rate was mainly attributable to higher promotional markdowns, which resulted from increased promotional activity required to sell through seasonal merchandise; and
- [W]hether you believe the continued decline in [Reporting Unit A]'s operating income through the quarter ending October 25, 2014 puts it at risk for potential impairment of its related goodwill as of October 25, 2014.

Section 9510 of the FRM 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 SEC 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. 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.

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

Please revise [your critical accounting policy discussion of goodwill and other intangible assets as follows]:

- Clarify the number of reporting units identified for impairment testing and how they were determined (e.g., operating segments or components) and how goodwill is assigned to reporting units;
- If you aggregate more than one component into a single reporting unit, provide the specific facts and circumstances supporting a conclusion that aggregation is appropriate;
- Clarify whether the optional qualitative assessment was performed for any reporting units;
- Please disclose whether or not your reporting units' fair value is substantially in excess of [their carrying value]. To the extent that any of your reporting units have estimated fair values that are not substantially in excess of the carrying value and to the extent that goodwill for these reporting units, in the aggregate or individually, if impaired, could materially impact your operating results, please provide the following disclosures for each of these reporting units:
    - Identify the reporting unit;
    - The percentage by which fair value exceeds the carrying value as of the most recent step-one test;
    - The amount of goodwill;
    - A description of the assumptions that drive the estimated fair value;
    - A discussion of the uncertainty associated with the key assumptions; and
    - A discussion of any potential events and/or circumstances that could have a negative effect on the estimated fair value.

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; (4) whether and, if so, how the registrant aggregated reporting units to perform goodwill impairment testing; and (5) how the fair value of the reporting units was determined. For additional information about the identification and aggregation of operating segments, see the Segment Reporting section.

Interim Impairment Tests

Example of an SEC Comment

We note your goodwill impairment charge of $[X] recorded in the fourth quarter of 2014 as a result of your annual goodwill impairment test. Please tell us whether you performed an interim goodwill test as a result of a triggering event described in ASC 350-20-35-3C. If an interim impairment test was performed, please tell us the triggering event that caused the evaluation, the results of the impairment test and the percentage that fair value exceeded carrying value for each of your reporting units. If no interim impairment test was completed, please confirm that there were no triggering events described in ASC 350-20-35-3C and explain in detail why each factor did not trigger an interim impairment test. Please be specific when explaining the factor in ASC 350-20-35-3C(d). Refer to 350-20-35-30.

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 SEC 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 in the second quarter 2014 earnings conference call you stated that you plan to close [X] stores with a majority of the closures occurring in the fourth quarter of 2014. In light of the planned closures, please tell us if you have tested the related long-lived assets for impairment and reviewed their depreciation estimates, as of August 2, 2014. See ASC 360-10-35-21 and 35-22. If so tell us the outcome of your evaluations. If you have not [recorded an impairment] or revised depreciation estimates for these assets, please tell us your accounting basis for not doing so. We have reviewed your policy for impairment testing; however, it does not appear to address long-lived assets associated with planned store closings.

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 SEC 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.

Other Deloitte Resources

- March 20, 2014, *Heads Up*, "Highlights of the 'SEC Speaks in 2014' Conference."
- December 16, 2013, *Heads Up*, "Highlights of the 2013 AICPA Conference on Current SEC and PCAOB Developments."
- May 2012, *Qualitative Goodwill Impairment Assessment — A Roadmap to Applying the Guidance in ASU 2011-08*.

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) rate reconciliation, and (4) unrecognized tax benefits.

Further, the 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. For additional information about early-warning disclosures, see the Management's Discussion and Analysis section.

At the 2014 AICPA Conference, 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

Example of an SEC Comment

You disclose that during fiscal 2014, 2013 and 2012, you provided for U.S. and non-U.S. income and withholding taxes in the amount of $[X], $[X] and $[X], respectively, on earnings that were or are intended to be repatriated. You further indicate that, in general, the remaining earnings of your subsidiaries are considered to be permanently reinvested and that you have approximately $[X] of undistributed earnings that are considered to be permanently reinvested. Please quantify the amounts repatriated for each period presented and tell us the facts and circumstances for repatriating your subsidiaries earnings. Substantiate how your assertion that the remaining portion will be permanently reinvested meets the indefinite reinvestment criteria in ASC 740-30-25. In this regard, since you did or intend to repatriate earnings in each of the periods presented and indicated the related tax amounts for each of those periods, please tell us why your assertion that it is not practicable to determine the cumulative amount of tax liability that would arise if these earnings were remitted is reasonable.

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 deferred tax liability (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 during 2014, you released $[X] of the valuation allowance that existed at the beginning of the year. We further note that you considered your income from operations and reduction in interest expense as a result of refinancings as positive evidence supporting this release. Given that you have three years of cumulative losses from pre-tax income, please help us better understand how you determined it was appropriate to release the valuation allowance during 2014. Your response should tell us how you weighted all of the positive and negative evidence, including your consideration of the extent to which it can be objectively verified, in reaching the conclusion to reverse the valuation allowance. Refer to paragraphs 30-21 through 30-23 of ASC 740-10-30.
- Given your recurring losses before income taxes, please disclose in future filings the nature of the deferred tax assets that have not been offset by a valuation allowance and how you determined they would be realized. Please also disclose the following:
  - The nature of the positive and negative evidence you considered, how that evidence was weighted, and how that evidence led you to determine it was not appropriate to record a valuation allowance on the remaining deferred tax assets;
  - The amount of any pre-tax income you need to generate to realize the deferred tax assets;
  - The anticipated future trends included in any projections of future taxable income; and
  - State, if true, that the deferred tax liabilities you are relying on in your assessment of the realizability of your deferred tax assets will reverse in the same period and jurisdiction and are of the same character as the temporary differences giving rise to the deferred tax assets.

ASC 740-10-30-5(e) requires entities to reduce deferred tax assets (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.

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 SEC 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.

Rate Reconciliation

Examples of SEC Comments

- We note your tax benefit from non-U.S. net earnings as depicted in the tax reconciliation table. Please discuss and disclose in your MD&A the identities of specific jurisdictions that materially affect your effective tax rate (currently, [X]%), the tax rates and incentives in those specific jurisdictions, earnings within those jurisdictions and information about the effects of such foreign jurisdictions (e.g., magnitude, mix), including but not limited to [Country A], on the current and future effective tax rate.
- We note the foreign tax rate differential is significantly lower than the federal statutory rate in the income tax rate reconciliation. In light of the significantly lower impact of taxes imposed on foreign earnings to your operating results, in future filings please explain in MD&A the relationship between foreign pre-tax income and the foreign effective tax rate in greater detail. We refer you to Section III.B of SEC Release 33-8350. Please provide us with your proposed revised disclosure.

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.

Unrecognized Tax Benefits

Example of an SEC Comment

We note [an $X] increase in unrecognized tax benefits related to additions for prior year tax positions. Please describe for us in greater detail the significant components of this increase in unrecognized tax benefits. Please also describe whether this increase relates to the tax audit by the [Country A] tax authorities . . . . In this regard, please tell us how you have concluded that no other major jurisdictions outside the U.S. are required to be disclosed under FASB ASC 740-10-50-15(e).

Under ASC 740-10-25-6, entities cannot recognize a tax benefit related to a tax position unless it is "more likely than not" that tax authorities will sustain the tax position solely on technical merits. The tax benefit recognized is measured as the largest amount of the tax benefit that is more than 50 percent likely to be realized. The difference between a tax position taken or expected to be taken in a tax return and the benefit recognized and measured under ASC 740-10 is referred to as an "unrecognized tax benefit." Generally, if the unrecognized tax benefit would be settled by offsetting it with an available loss or tax credit carryforward in the same jurisdiction, it should be netted against the related DTA. Otherwise, the amount of the unrecognized tax benefit is presented as a liability in the statement of financial position. The SEC staff has commented when registrants omit disclosures required under ASC 740-10-50-15 and 50-15A about unrecognized tax benefits, which include a tabular reconciliation of such benefits.

In addition, the SEC staff may ask registrants about their conclusions regarding disclosures about reasonably possible changes in unrecognized tax benefits. Because the guidance on the acceptable level of aggregation of information for these disclosures is not prescriptive and permits judgment, the SEC staff evaluates a registrant's level of disclosure on a case-by-case basis.

Examples of what registrants should disclose under ASC 740-10-50-15(d) include:

- Information related to scheduled expiration of the tax position's statute of limitations. A registrant should disclose this information if (1) the statute of limitations is scheduled to expire within 12 months of the financial statement's date and (2) management believes it is reasonably possible that the statute's expiration will cause the total amounts of unrecognized tax benefits to significantly increase or decrease.
- Significant unrecognized tax benefits for tax positions that the registrant believes will be effectively settled within 12 months in accordance with ASC 740-10-25-9.

Other Deloitte Resources

January 2015, *A Roadmap to Accounting for Income Taxes*.

Leases

Lease Classification

Examples of SEC Comments

- We note your disclosure that during fiscal 2014 you entered into [X] agreements covered under a master lease agreement to lease back the equipment. Please provide us with your analysis of the guidance in ASC 840-10-25-1 supporting your classification of these as operating leases, including your consideration of the renewal option and transfer of ownership at the end of the lease term.
- [T]ell us how you determine that the exercise of a bargain renewal option is reasonably assured, including whether you consider historical experience in determining such exercises. Further, quantify for us the number of leases in your portfolio that have bargain renewal options. In your response, tell us the accounting literature relied upon and the basis for your conclusions.

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 further explain their considerations of the lease classification criteria. Many of the comments have focused on criteria (a) and (b) of ASC 840-10-25-1, which are related to transfer of ownership by the end of the lease term and bargain purchase options, respectively. 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. Determining whether a purchase option is a bargain requires judgment (e.g., determining whether the exercise price is sufficiently lower than the expected fair value of the asset at the date of exercise to make exercise of the option reasonably assured), and there are no bright lines in this regard. 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.

Sale-and-Leaseback Transactions Involving Fixed-Price Renewal Options

In the past, the SEC staff has commented on how registrants 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 (in which case, the real estate would remain on the seller's books and be treated as a financing arrangement). 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 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 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.

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 2[1] 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 (1) the effectiveness of their ICFR and DC&P and (2) other reporting requirements, such as the need to file a Form 8-K. 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. Then, 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.[2]

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

[1] 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."

[2] The SEC commented on this topic at the 2011 AICPA Conference. See Deloitte's December 14, 2011, *Heads Up* for additional information.

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 is relevant to its investors and financial statement users.[3] 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.[4]

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 as well as what analysts cover 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 adjusted or "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,[5] a quantitatively material GAAP error does not become immaterial simply because of the presentation of non-GAAP measures.[6] Further, there may be circumstances in which an error that is otherwise immaterial to the GAAP financial statements — when taken as a whole and 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.[7]

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 interim period, should no longer be relied on because of an error.

3 In an October 2010 joint webcast with the CAQ, the SEC staff provided its views about registrants' materiality assessments.

4 The SEC staff discussed qualitative and quantitative factors at the 2012 AICPA Conference. For more information, see Deloitte's December 11, 2012, *Heads Up*.

5 At the 2007 and 2008 AICPA conferences, the SEC staff addressed these topics. For more information, see Deloitte's December 20, 2007, and December 18, 2008, *Heads Up* newsletters.

6 At the 2010 AICPA Conference, the staff expressed its views on this topic. See Deloitte's December 16, 2010, *Heads Up* on the conference.

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

Noncontrolling Interests

Examples of SEC Comments

- We note the reconciliation of net income (loss) to net loss attributable to [your stockholders] on your consolidated statements of income (loss). Please tell us the basis for the attributing amounts to the parent and the non-controlling interests and tell us how amounts are calculated as it relates to your non-controlling interests, such as net (income) loss attributable to non-controlling interests on the consolidated statements of income (loss).
- We note that your non-controlling interests of the [consolidated entities include] both redeemable non-controlling interests reported outside of the permanent capital section (when investors have the right to redeem their interest) and equity attributable to non-controlling interests of [the consolidated entities] reported inside the permanent capital section (when investors do not have the right to redeem their interests). In the interest of transparency, please revise throughout your filing to label your redeemable non-controlling interests as redeemable non-controlling interests of [the consolidated entities].

SEC staff comments related to noncontrolling interests (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."[1]

For additional information about classification of redeemable securities, see the Debt section.

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

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 rather than duplicating the accounting policy disclosures in the financial statement footnotes. 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 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. 34-48960. 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.
- Please tell us how you determined the discount rates used in the measurement of plan obligations at the most recent balance sheet date and why you believe the discount rates are reasonable based on the expected dates and amounts of cash outflows associated with retiree pension benefits.

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.

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

- Whether a corridor[1] 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 yields results that are materially different from the results yielded 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.

[1] 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."

- 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.

Liquidity and Capital Resources

Example of an SEC Comment

We note . . . that you had changes in both your discount rate and mortality assumptions during 2014 that have significantly affected your benefit obligations and related funding status. Particularly, your unfunded obligations have increased by approximately $[X] since 2013. 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 December 31, 2014 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.

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 value[2] 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."[3] 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.

Mortality Assumption

Example of an SEC Comment

We understand that the Society of Actuaries developed an update[d] set of mortality assumptions presented in its RP-2014 Mortality Tables Report issued in October 2014. We also understand that the RP-2014 mortality tables represent the most current and complete benchmarks of U.S. private pension plan mortality experience. Please tell us what consideration you gave to changing the mortality table used to calculate the present value of pension and postretirement plan liabilities. If you did not adopt the new mortality assumptions, please tell us the mortality table used to calculate the present value of pension and postretirement plan liabilities and why you believe the mortality rate assumptions [reflect] the best estimate of expected mortality rates for your participant population. If you adopted the RP-2014 mortality tables, please tell us the impact on pension and postretirement plan liabilities.

The SEC believes that the RP-2014 mortality tables released by the Society of Actuaries (SOA) in October 2014 should not be disregarded in the development of the best estimate[4] of mortality since entities have historically used the data issued by the SOA. Further, since a change in the mortality assumption may have a significant effect on the entity's result of operations, registrants should consider the requirement in ASC 715-20-50-1(r) to disclose an "explanation of any significant change in the benefit obligation or plan assets not otherwise apparent in the other disclosures required by [ASC 715-20]." In addition to footnote disclosures, registrants should consider the need to highlight in MD&A the effects of a change in the mortality assumption.[5]

[2] 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).

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

[4] Under ASC 715-20 and ASC 715-60, each assumption should represent the "best estimate" for that assumption as of the current measurement date.

[5] For more information, see Deloitte's December 15, 2014, *Heads Up* on the 2014 AICPA Conference.

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 disclosure for the U.S. and non-U.S. plans.

Other Deloitte Resources

- Financial Reporting Alert 15-3, "Employers' Accounting for Defined Benefit Plans — Alternatives for Applying Discount Rates to Measure Benefit Cost."
- August 14, 2015, *Heads Up*, "FASB Issues ASU on Employee Benefit Plan Accounting."
- Financial Reporting Alert 14-4, "Financial Reporting Considerations Related to Pension and Other Postretirement Benefits."
- Financial Reporting Alert 11-2, "Pension Accounting Considerations Related to Changes in Amortization Policy for Gains and Losses in the Market-Related Value of Plan Assets."

Revenue Recognition

Revenue Recognition Disclosures

Examples of SEC Comments

- We see that your revenue recognition policy cites the four general criteria from SAB Topic 13. Please tell us how you apply the criteria from your disclosure in determining the appropriate timing of revenue recognition. For instance, describe what you consider to be pervasive evidence of an arrangement, tell us when title and risk of loss transfer to your customers, and describe the factors you consider in concluding that the price is fixed and determinable and that collection is reasonably assured.
- Please tell us and revise to clarify how your revenue recognition policy addresses each type of revenue discussed . . . . In this regard, [you describe] data analytics, subscriptions and data-driven intervention platform services but your revenue recognition policy [in your financial statements] describes data analytics and data-driven intervention platforms and multiple element arrangements. Clarify how each of the revenue components . . . is accounted for [in your financial statements], the nature of the services being subscribed for and which product and service offerings are subject to software accounting under ASC 985-605.

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.[1]

[1] The SEC staff discussed its expectations related to the completeness and consistency of revenue policy footnotes at the 2013 AICPA Conference.

Sales Returns

Examples of SEC Comments

- Please tell us whether your wholesale customers have the right to return goods and, if so, confirm to us that you record an estimate for anticipated returns when sales are recorded. Also confirm to us that you will revise your revenue recognition disclosure in future filings to clarify your wholesale customers' return rights and your policy for estimating returns on wholesale sales; and provide us with your draft disclosure in your response letter.
- We note your statement that the sales return reserve represents the gross profit effect of sales returns. Please explain to us in more detail how you determine and record your sales return reserve. It is unclear to us if you are reducing sales for the gross profit of expected returns or if you are reducing sales and cost of sales to reflect estimated returns. Please refer to ASC 605-15-45-1.

The SEC staff continues to comment on registrants' failure to separately present or disclose information about their sales returns, particularly when other information in a registrant's filing or in other public communications suggests that sales returns may be material. In addition, the SEC staff will comment if it appears that a registrant has accounted for sales returns as a reduction in revenue on the basis of the gross profit of the related transactions instead of as a reduction in both sales and cost of sales as required by ASC 605-15. Comments on these topics are particularly prevalent in the retail industry.

Multiple-Element Arrangements

Examples of SEC Comments

- We note that you have multiple-element arrangements. . . . In future filings please disclose the following as required by FASB ASC 605-25-50-1:
    - o Disclose the significant deliverables within the arrangement including your maintenance and service agreements or tell us why the maintenance and service agreements are not part of the arrangements;
    - o Disclose the general timing of delivery or performance of services for the deliverables in the arrangement;
    - o Discuss the significant factors, inputs, assumptions, and methods used to determine selling price for the significant deliverables; and
    - o Disclose whether the significant deliverables in the arrangement qualify as separate units of accounting, and the reasons that they do not qualify as separate units of accounting, if applicable.

  Please provide us with your proposed disclosure.
- Your disclosure . . . indicates that some of the revenue from non-refundable upfront fees is recognized over the estimated customer life . . . . If any of the non-refundable upfront fees are recognized over the estimated customer life, please tell us whether the non-refundable upfront fees have standalone values and are considered separate units of account and tell us your basis for recognizing the revenue over the estimated customer life. If you do not have non-refundable upfront fees that are recognized over the estimated customer life, please remove the reference from your disclosure in future filings.

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.

The SEC staff has also focused on registrants' accounting for up-front fees. It has asked registrants to explain whether such fees are related to specific performance obligations and how they determined the period over which the up-front fees are recognized.

Principal-Versus-Agent Considerations

Example of an SEC Comment

We note your disclosure . . . that you act as a billing and collection agent for many nominees. We specifically note that you collect the fees and remit to nominees any difference between the fees that the nominees are entitled to collect and the amount that the nominees have agreed to pay you for your services. Please tell us how you recognize revenues from these transactions and how you considered including disclosures in your revenue recognition accounting policies explaining whether you record such revenues gross as a principal or net as an agent. Please refer to ASC 605-45.

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 records revenue at the gross amount billed to a customer) or as an agent (and records revenue at the net amount retained). The staff has asked registrants to explain how they determined gross or net reporting to be appropriate for certain revenue transactions under ASC 605-45. In addition, the SEC staff may request detailed information about the rights and obligations of the parties involved in a registrant's revenue transactions. 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 recorded 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

- For the long-term [Product X] manufacturing contracts you enter into, please tell us the following:
  - The nature and terms of these contracts;
  - The amount of revenue recognized for each period presented related to these contracts; and
  - Expand your disclosure to include the method of measuring the extent of progress toward completion for your percentage of completion contracts in accordance with ASC 605-35-50-2.
- It appears $[X] of operating income . . . resulted from a change in estimates underlying your percentage-of-completion accounting on long-term contracts. [P]lease provide a discussion of the underlying reasons for the significant changes in estimates, including quantified information where available and useful for an investor's understanding of contract performance, the impact on operations, and the potential impact on future operations.

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) and which method was 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.

Other Deloitte Resources

- February 2015, *Revenue From Contracts With Customers — A Roadmap to Applying the Guidance in ASU 2014-09*.
- December 2011, *Software Revenue Recognition — A Roadmap to Applying ASC 985-605*.
- July 2010, *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

Please revise to include a discussion of the potential effects that recently issued accounting standards will have on your financial statements when adopted in a future period. Refer to SAB Topic 11.M. For example, please revise to disclose the potential effect of ASU No. 2014-09, Revenue from Contracts with Customers.

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 are meant to help financial statement users assess the effect that new standards will have once adopted. Disclosure is not required when a registrant will adopt a new accounting standard that will not affect the reported results (i.e., when only enhanced disclosures would be required by the new accounting standard).

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 does not expect the disclosures to include a "laundry list" of new standards that registrants state will have no material effect on their financial statements; only those ASUs that are expected to have a material impact should be described in the financial statements. Further, the staff expects disclosures about the potential effects of a new standard to be increasingly clear and precise as the standard's effective date approaches.

Accordingly, the SEC staff has commented on the following items related to SAB Topic 11.M disclosures:

- Failure to provide the required disclosures.
- Inadequate discussion of the accounting changes and how they will be adopted (i.e., whether retrospectively or prospectively and what periods will be affected).
- Disclosures about prospective accounting standards that are exactly the same in both the notes to the financial statements and MD&A. For example, registrants may consider the effect of adoption on their operations, financial condition, or liquidity in future periods and provide related disclosures in their MD&A. Disclosures in the financial statements should focus on whether the historical financial information will change (e.g., as a result of the retrospective application of the standard).

Segment Reporting

Segment reporting remains a perennial topic of SEC staff comments. Like those issued in previous years, recent SEC staff comments have specifically addressed (1) the identification and aggregation of operating segments, (2) changes in reportable segments, (3) product and service revenue by segment, (4) operating segments and goodwill impairment, and (5) information about geographic areas.

Identification and Aggregation of Operating Segments

In asking registrants about the identification and aggregation of their operating segments, the SEC staff's comments have focused on (1) the identification of the chief operating decision maker (CODM), (2) how registrants identify operating segments and support their process for identifying them, (3) the quantitative and qualitative factors used to support the aggregation of operating segments, and (4) how registrants have considered whether their previous conclusions about the identification and aggregation of operating segments remain appropriate (i.e., how they have continued to assess such conclusions in light of changes in their management or operations).

Example of an SEC Comment

We note that your [CODM] is provided an income statement overview by business unit and that your CODM holds team meetings with your functional leaders and segment managers for [Segment A] and [Segment B]. In order to assist us with our evaluation of how you considered the guidance in FASB ASC 280, please address the following comments:

- Please provide to us the names of your business units and a summary of how these business units are structured. Discuss who manages the business units and describe their role with the company.
- Please describe to us the nature of interactions between the CODM and the business unit managers.
- Clarify for us the role of the segment managers and describe how the segment managers interact with the business unit managers and the CODM.
- Describe to us how the business unit manager's responsibilities differ from the segment manager's responsibilities.
- Clarify the roles and responsibilities of the functional leaders within the company and if they are different from the business unit managers and segment managers.
- Provide to us more information about your budgeting process. Within your discussion, describe who is involved with each level of review and approval during the budgeting process. Also discuss who is responsible for assessing actual performance versus budgeted performance. Clarify who is responsible for discussing any excesses or shortfalls and who is involved in these discussions and to what level of detail.
- Please explain to us if there are situations where the [Segment A] or [Segment B] managers are responsible for any elements of the business units. Within your response discuss if each business unit is aligned solely under one segment manager or if certain business units report to both segment managers.

ASC 280 prescribes the "management approach" for the presentation of segments in a public entity's financial statements. The objective of the management approach is to allow financial statement users to (1) see through the eyes of management the entity's performance, (2) assess the entity's prospects for future cash flows, and (3) make more informed judgments about the entity as a whole. It is presumed that investors would prefer disaggregated information. Consequently, operating segments should not be aggregated unless providing more detailed information would not enhance an investor's understanding of the entity.

Determining an entity's operating segments is the first step in the assessment of what segment information needs to be reported in the entity's financial statements. An operating segment is a component of the business (1) that engages in business activities from which it may earn revenues and incur expenses, (2) whose operating results are regularly reviewed by the public entity's CODM, and (3) that has discrete financial information available. When challenging a registrant's conclusion about its operating segments, the SEC staff has historically placed a great deal of weight on the information regularly provided to, and reviewed by, the CODM (i.e., the CODM package). The SEC staff would frequently request copies of the CODM package to determine whether the information in the CODM package supports how operating segments are identified and aggregated.

However, technology advancements in registrants' financial reporting systems allow the CODM to easily access additional information that may not be reflected in the CODM package. These advancements have led the SEC staff to revisit its views on the relative importance of the CODM package to the segment identification analysis. At the September 2014 AICPA Banking Conference and December 2014 AICPA Conference, the SEC staff noted that while it may have previously emphasized the importance of using the information in a registrant's CODM package to identify operating segments, the staff's views on how it should weight information in a registrant's CODM package have evolved. The staff indicated that instead of viewing the CODM package as the determinative factor in the identification of operating segments, it would now treat the CODM package as only one of many factors to be considered. Similarly, the staff noted that it would not view the CODM package as a safe harbor for registrants. In other words, the staff would not be supportive of an assertion that information in the CODM package automatically nullifies other information (i.e., information that might suggest different operating segments). Other factors that may be considered in the identification of operating segments include (1) a registrant's organizational chart, (2) a registrant's overall management structure, (3) the basis on which budgets and forecasts are prepared, and (4) the basis on which executive compensation is determined. A registrant should 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.

As used in ASC 280, the term "chief operating decision maker" identifies a function, not an individual in the company who has the specific title. The CODM determines the allocation of resources and assesses the performance of the operating segments. While the CODM is usually an individual, sometimes the function is performed by a group.

Accordingly, at the September 2014 AICPA Banking Conference and December 2014 AICPA Conference, the SEC staff further noted that it has placed a renewed emphasis on the determination of a registrant's CODM. The staff remarked that although most registrants identify their CEO as the CODM, questions from the staff sometimes engender a change in the registrant's conclusion about its CODM's identity, which in turn affects the registrant's determination of operating segments. In light of this, the staff encouraged registrants to reassess their determination of the CODM and, when doing so, to focus on understanding management's structure (e.g., through organizational charts or other information).

Under ASC 280-10-50-11, entities may aggregate operating segments into reportable segments if the operating segments exhibit (1) similar economic characteristics (e.g., similar historical and expected future performance, such as through similar long-term average gross margins) and (2) other similar characteristics, including:

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 280-10 does not define the term "similar" or provide much guidance on the aggregation criteria, and the determination of whether two or more operating segments are similar depends on the individual facts and circumstances and is subject to a high degree of 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 280-10. In the assessment of whether operating segments may be aggregated, determining the basis for economic similarity is particularly difficult for registrants that have complex models and organization and reporting structures. Accordingly, the SEC staff may ask registrants that have aggregated segments how they satisfied the quantitative requirements of ASC 280-10 and may further comment when the economic measures of a registrant's aggregated operating segments have not converged over time despite the registrant's previous assertion that it expected such measures to become more similar. In addition, the SEC staff has emphasized that registrants should also focus on the qualitative factors in ASC 280 (e.g., similar products and customers) when assessing whether operating segments are similar for aggregation purposes. Further, at the 2014 AICPA Conference, the SEC staff noted that registrants should consider whether aggregation is consistent with the objective and basic principles of ASC 280.

Changes in Reportable Segments

Example of an SEC Comment

In your Form 8-K filed July 9, 2014, you indicate your board of directors approved your new organizational design at its meeting on June 19, 2014. Please explain why you waited until the first quarter of fiscal 2015 to reevaluate the impact of the Organizational Redesign restructuring program on the determination of your operating segments and reporting units. Please explain why the reclassification of [Brand X] from [Operating Segment A] to [Operating Segment B] was not reflected in your financial statements as of June 30, 2014. Please refer to ASC 280-10-50-34.

Registrants should continually monitor any changes in facts and circumstances that may affect the identification or aggregation of operating segments. Examples of 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 FRM 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. See the SEC Reporting section for more information.

Product and Service Revenue by Segment

Example of an SEC Comment

We note . . . that you offer a number of different products and in your earnings release you also discuss and quantify sales for different products. Please explain to us your consideration of the guidance in FASB ASC 280-10-50-40 with respect to revenues for each product.

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.

Operating Segments and Goodwill Impairment

Registrants should 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 unit and, as a result, improperly test goodwill for impairment. See the Impairments of Goodwill and Other Long-Lived Assets section for additional information.

Information About Geographic Areas

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

Other Deloitte Resources

- December 15, 2014, *Heads Up*, "Highlights of the 2014 AICPA Conference on Current SEC and PCAOB Developments."
- Financial Reporting Alert 14-3, "Segment Reporting."
- December 16, 2013, *Heads Up*, "Highlights of the 2013 AICPA Conference on Current SEC and PCAOB Developments."

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 [for determining] the fair value of the equity instruments granted."
- The "cash flow effects [of] 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 FRM, 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 FRM in 2014 to indicate that registrants should significantly reduce such disclosures. Specifically, Section 9520 of the FRM 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 FRM 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.

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 FRM (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 — The Simplified Method

Examples of SEC Comments

- We . . . note your disclosure does not explain the reasons why you use the simplified method to determine the expected term for your stock options. Please revise your disclosure to include the reasons why the simplified method was used.
- We note your disclosure that you use the simplified method to estimate the expected term of your stock options. Considering the extent of exercise activity since your initial public offering, please explain to us why you continue to believe that it is appropriate to use the simplified method rather than using historical information.

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 method[1] 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.

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.

Other Deloitte Resources

- June 12, 2015, *Heads Up*, "FASB Issues Proposed ASU to Simplify the Accounting for Share-Based Payments."
- April 2015, *A Roadmap to Accounting for Share-Based Payment Awards*.
- April 28, 2014, *Heads Up*, "MD&A Disclosures About 'Cheap Stock' in IPO Transactions."

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

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. The SEC staff continues to indicate that MD&A is the leading source of SEC staff comments, many of which are about 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, and (5) early-warning disclosures.

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.

Example of an SEC Comment

Please revise this section in future filings to include, if material, substantive disclosure on prospective developments and strategies that may affect your company. Your current disclosure . . . contains a list of factors that broadly affect your segments, but there is no disclosure addressing management's views about the trends and uncertainties that you reasonably expect will have a material impact on your operations. We note that . . . management expressed expectations for a number of items including oil prices, global macroeconomic conditions, raw materials, currency fluctuations and end market demand for each of your segments. In the future, to the extent material, please enhance your discussion of any particular trends, events or uncertainties that you expect may have a material impact on your operations. Please see Section III.B.3 of SEC Release 33-8350 and Item 303(a)(3)(ii) of Regulation S-K.

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.

For example, at the Practising Law Institute's "SEC Speaks in 2015" Conference, the SEC staff stressed the importance for a registrant to disclose in MD&A the effects of the decline in the price of crude oil, gas, and other commodities (e.g., iron, copper) if the decline materially affects, or is expected to affect, the registrant's operations. In addition, the staff noted that the mining and oil and gas industries may be particularly affected by such a price decline. Further, registrants with foreign operations in regions

[1] See paragraphs 9110.1 and 9110.2 of the FRM for the SEC staff's interpretive views about the objectives of a registrant's MD&A.

[2] See the SEC's interpretive release for additional information.

experiencing economic struggles (e.g., Greece, Puerto Rico) or that are otherwise exposed to material business or financial risks resulting from recent economic events should discuss in their MD&A any material trends, risks, and uncertainties related to their operations.[3]

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

> **Example of an SEC Comment**
>
> You state that you believe you will have sufficient capital to fund your operations for the next twelve months. Please discuss the company's capital needs over that period, what the capital will be used for, and what sources of capital and liquidity management believes it has access to. Please refer to Item 303(a)(1) of Regulation S-K and Item 303(a)(2)(i) of Regulation S-K.

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.

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.[4] 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.
- Intraperiod debt levels.
- Restrictions on cash flows between the registrant (i.e., the parent) and its subsidiaries.[5]
- 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.[6]
- Effects on liquidity of material cash balances that are held.[7]

[3] For additional information, see Deloitte's Financial Reporting Alert 15-2, "Financial Reporting Implications Related to Regions Experiencing Economic Struggles."

[4] At the 2011 AICPA Conference, the SEC staff highlighted the need for registrants to include appropriate narratives regarding liquidity and capital resources. See Deloitte's December 14, 2011, *Heads Up* for additional information.

[5] See the Debt section for more information.

[6] See footnote 5.

[7] See the Income Taxes section for more information.

Critical Accounting Estimates

> **Example of an SEC Comment**
>
> Please note that the accounting policy notes in the financial statements should generally describe the method you use to apply an accounting principle; whereas the discussion in Management's Discussion and Analysis of Financial Condition and Results of Operations should present your analysis of the uncertainties involved in applying a principle at a given time or the variability that is reasonably likely to result from its application over time. In future filings please include an analysis, to the extent material, of factors such as how you arrived at critical estimates, how accurate the estimate/assumption has been in the past, how much the estimate/assumption has changed in the past, and whether the estimate/assumption is reasonably likely to change in the future. In addition, your disclosure should address sensitivity of the estimate/assumption to change based on other outcomes that are reasonably likely to occur and would have a material effect. Please refer to the Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations, Release No[.] 34-48960.

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.

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

Examples of SEC Comments

- With respect to your purchase obligations, we note the discussion of the types of purchase obligations [is] not included in the table in the paragraph following the table. Please tell us how you considered the definition of purchase obligations in Item 303(a)(5)(ii)(D) of Regulation S-K.
- We note . . . that you have long-term raw material and power supply contracts. Please tell us why you do not report these long-term contracts in your contractual obligations table under Item 303(a)(5) of Regulations S-K. In addition, tell us why amounts due under your revolving credit agreement are also excluded from the table. Please provide revised tabular disclosure of your contractual obligations to be included in future filings which includes these obligations or tell us how your current presentation complies with Item 303(a)(5) of Regulation S-K.

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.[8] 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.[9]

Early-Warning Disclosures

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.

8 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.

9 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 FRM, 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."

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. 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 rules and regulations. 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. The SEC staff has provided best practices for registrants to consider when seeking reporting relief.

Further, on September 25, 2015, the SEC announced that it is seeking 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.[1] SEC Chairman Mary Jo White indicated that the request for comment, which is part of the SEC's disclosure effectiveness initiative, "is an important step in [the SEC's] review of the disclosure requirements" and "will help [the SEC] evaluate potential changes to Regulation S-X that would benefit both investors and companies."

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)." 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.

Significant Business Acquisitions (Rule 3-05)

Examples of SEC Comments

- Please tell us how you determined that it was not necessary to provide audited financial statements of [Company A] in accordance with Rule 3-05 of Regulation S-X. Please provide us with your [significance] calculations pursuant to Rule 3-05(b)(2) and Rule 1-02(w) 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.

[1] For more information about the SEC's request for comment, see Deloitte's October 6, 2015, *Heads Up*.

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.
- 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 FRM.

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

Example of an SEC Comment

Please tell us why you have not presented the summarized financial data under Rule 4-08(g) of Regulation S-X for your equity method investments for the years presented. Additionally, please provide us with your significance test with respect to income before continuing operations before income taxes to determine whether the financial statements of [Company A] are required under Rule 3-09 of Regulation S-X. Please refer to Rule 1-02(w)(3) of Regulation S-X.

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, such as a change in accounting principle or classification of a component as a discontinued operation. See paragraph 2410.8 of the FRM.

For additional SEC staff interpretations of Rules 4-08(g) and 3-09, see Section 2400 of the FRM.

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/registrant 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 FRM.

Definition of 100 Percent Owned

> **Example of an SEC Comment**
>
> It is not clear that you have provided all of the disclosures required by Rule 3-10(i)(8) to (11) of Regulation S-X. For example, pursuant to Rule 1-02(aa) of Regulation S-X, wholly-owned is not equal to 100% owned.

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).[1]

Full and Unconditional Guarantees and Release Provisions

> **Example of an SEC Comment**
>
> Your disclosure indicates that the subsidiary guarantees are full and unconditional. We note that the related indenture agreements contain certain release provisions. For example, . . . there are provisions under which the guarantees shall automatically terminate or the subsidiary guarantor shall be released and discharged from all obligations. Please tell us what consideration you gave to disclosing such release provisions to the full and unconditional guarantees in order to more accurately describe the qualifications to the subsidiary guarantors.

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 FRM 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 FRM 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 FRM'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.

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

Condensed Consolidating Financial Information

Examples of SEC Comments

- [T]ell us your consideration of the need to include a separate column for the condensed consolidating financial information of the subsidiary issuer(s). Refer to Rule 3-10 (b)–(f) of Regulation S-X.
- Please tell us the consideration you gave to presenting the material components of investing and financing activities in your condensed consolidating statements of cash flows. Refer to Rule 3-10(i)(1) and Rule 10-01(a)(4) of Regulation S-X.

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.
- The information should be presented in accordance with U.S. GAAP[2] (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.[3]

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 230-10-45-16(b) and ASC 230-10-45-12(b), 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. For more information about the SEC staff's comments regarding cash flow statement classification, see the Financial Statement Classification, Including Other Comprehensive Income section.

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

3 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 FRM for additional information.

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 financial statements in registration statements but not in periodic reports filed under the Exchange Act (e.g., Forms 10-K and 10-Q).

Pro Forma Financial Information (Article 11)

Examples of SEC Comments

- [P]lease explain the adjustments for the acceleration of certain profits interests awards from [Company A] as a result of the offering. Tell us why these adjustments are considered factually supportable, directly attributable to the transaction, and expected to have a continuing impact on the statement of operations. Refer to Rule 11-02(b)(6) of Regulation S-X.
- We note the terms and form of future earn-out payments . . . have not been finalized. . . . As a range of terms are under consideration, you should provide additional pro forma presentations which give effect to the range of possible results, consistent with the guidance in Rule 11-02(b)(8) of Regulation S-X. This information should fully address the anticipated impact upon future results of operations, earnings per share, and ownership percentages.

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").[4] 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.

[4] 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.

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."[5] 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.

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 FRM summarizes issues that are often associated with pro forma financial information.

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

Disclosures About Risk

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

Risk Factors

Example of an SEC Comment

Some of your risk factors appear to combine separate risk factors under one heading. Please review each risk factor heading to ensure it clearly conveys a separate, detailed risk to investors regarding your company, industry or security.

In recent years, the SEC staff has emphasized that registrants should present tailored risk factors in their filings and avoid using boilerplate language. In an April 11, 2014, speech[1] highlighting the SEC staff's "disclosure effectiveness" initiative, a staff member indicated that "risk factors could be written better — less generic and more tailored — and they should explain how the risks would affect the company if they came to pass."

Accordingly, the SEC staff routinely asks registrants to replace boilerplate risk disclosures with a discussion of the risks that specifically affect the registrant and their possible impact on the registrant's business. 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 that you may have been subject to [distributed denial of service] attacks in the past. 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. For additional guidance, consider our 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.

Currently, there are no SEC rules that explicitly require registrants to disclose cybersecurity-related matters in their filings. Therefore, some registrants' cybersecurity disclosures have been viewed as generic and uninformative. However CFDG Topic 2 provides SEC staff 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).

[1] Keith Higgins, director, Division of Corporation Finance, "Disclosure Effectiveness: Remarks Before the American Bar Association Business Law Section Spring Meeting," April 11, 2014.

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

- October 16, 2014, *Heads Up*, "SEC Staff Suggests Ingredients for Effective Disclosures."
- August 26, 2014, *Heads Up*, "The Road to Effective Disclosures."
- April 8, 2014, *Heads Up*, "Highlights of the SEC's Cybersecurity Roundtable."
- March 20, 2014, *Heads Up*, "Highlights of the 'SEC Speaks in 2014' Conference."

Non-GAAP Financial Measures and Key Metrics

Example of an SEC Comment

We note your presentation of the line item "net revenue" here and in the financial statement table within MD&A, which you describe on page 22 of MD&A as revenue minus transportation costs. As you appear to generally be the primary obligor for generally recognizing gross revenues under ASC Topic 605-45-45 and you report gross revenue in your audited financial statements, presenting "net revenue" appears to be a non-GAAP measure under Item 10(e) of Regulation S-K for which a tabular presentation reconciling net revenue to the most directly comparable GAAP measure would be necessary. As such, please revise the tables in Selected Financial Data and MD&A to disclose that the line item net revenue represents a non-GAAP measure. In a footnote to the tables, please describe how this measure is calculated and further, how it is used by management and how it should be used by an investor. Please revise in future filings.

SEC Rule 33-8176 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 EBITDA or adjusted EBITDA, adjusted revenues, free cash flows, core earnings, funds from operations, and measures presented on a constant-currency basis.

Regulation S-K, Item 10(e)(1)(i), states that for financial measures used in documents that are filed with the SEC, the following information should accompany a registrant's disclosure of non-GAAP financial measures:

(A) A presentation, with equal or greater prominence, of the most directly comparable financial measure or measures calculated and presented in accordance with [GAAP];

(B) A reconciliation (by schedule or other clearly understandable method), which shall be quantitative for historical non-GAAP measures presented, and quantitative, to the extent available without unreasonable efforts, for forward-looking information, of the differences between the non-GAAP financial measure disclosed or released with the most directly comparable financial measure or measures calculated and presented in accordance with GAAP . . . ;

(C) A statement disclosing the reasons why the registrant's management believes that presentation of the non-GAAP financial measure provides useful information to investors regarding the registrant's financial condition and results of operations; and

(D) To the extent material, a statement disclosing the additional purposes, if any, for which the registrant's management uses the non-GAAP financial measure that are not disclosed pursuant to [subparagraph (C) above].

At the 2013 AICPA Conference, the SEC staff noted that it continues to focus on disclosures of non-GAAP measures and particularly on whether registrants have (1) clearly labeled and described non-GAAP measures and adjustments (e.g., titles should not be confusingly similar to those of GAAP financial measures), (2) used appropriate conventional accounting terminology, and (3) provided context for their presentation.

Further, the SEC staff has indicated that a registrant should not present non-GAAP measures if they are misleading — regardless of whether the registrant intends to use them in or outside a filing. In addition, the staff has indicated that the following items should not be excluded from non-GAAP financial measures:

- Expenses that are necessary to run the business, such as traditional recurring cash operating expenses.
- The largest expenses that are necessary to generate the registrant's revenues.

The staff has also indicated that registrants should not eliminate recurring cash charges from a profit measure in a misleading way. When the staff believes that a registrant's presentation of a non-GAAP measure is misleading, it may take action in addition to issuing a comment, which could include bringing an enforcement action against the registrant.

In addition, the staff often comments when adjustments to non-GAAP measures are labeled as nonrecurring, infrequent, or unusual. Regulation S-K, Item 10(e), prohibits registrants from adjusting a non-GAAP financial performance measure "to eliminate or smooth items identified as non-recurring, infrequent or unusual, when the nature of the charge or gain is such that it is reasonably likely to recur within two years or there was a similar charge or gain within the prior two years." Question 102.03 of the C&DIs related to non-GAAP financial measures clarifies that guidance by indicating that a charge or gain may be included as an adjustment as long as it is not inappropriately labeled or described as nonrecurring, infrequent, or unusual.

Liquidity Versus Performance Measures

Example of an SEC Comment

We note that you reconcile your non-GAAP measure, Adjusted EBITDA, to net income attributable to [Company A]. Because you adjust this measure for changes in deferred revenue and course expenses, effectively reflecting cash disbursements and receipts as opposed to earned revenues and incurred expenses, it appears to be a measure of liquidity as opposed to performance. Therefore, we believe the most directly comparable GAAP measure is cash provided by operating activities rather than net income. Please advise or revise accordingly.

The SEC staff has continued to comment when a non-GAAP financial measure is not reconciled to the appropriate GAAP measure as determined on the basis of whether the purpose of the non-GAAP measure is to assess the registrant's performance or its liquidity. For example, the staff has indicated that the most directly comparable GAAP measure for reconciling EBITDA and adjusted EBITDA is typically net income (loss) for a performance measure and cash flows from operating activities for a liquidity measure.

Relevance and Consistency of Non-GAAP Measures

Examples of SEC Comments

- We note your disclosure of the non-GAAP measures free cash flow, EBIT, and ongoing EPS. Furthermore, your disclosure states that "the presentation of non-GAAP financial measures is intended to supplement investor's understanding of our operating performance." It appears your disclosures are overly general and therefore, not consistent with the objective of Item 10(e)(1)(i) of Regulation S-K. Please revise to include disclosure concerning the reasons why the management believes that presentation of the non-GAAP financial measure provides useful information to investors in accordance with Instruction 2 to Item 2.02 of Form 8-K and Item 10(e)(1)(i) of Regulation S-K.
- While three of the factors disclosed in the press release and the Form 10-Q are the same, there are two factors disclosed in the press release that were not included in the Form 10-Q and one factor in the Form 10-Q that was not included in the press release. Please help us understand why there appears to be an inconsistency between the press release and the Form 10-Q.

The SEC staff has continued to comment on the extent of a registrant's disclosures and whether the disclosures demonstrate the purpose of the measures (i.e., how management uses them and their usefulness to investors).

Further, the SEC staff focuses on consistency in communications with investors. It may ask a registrant about inconsistencies between (1) the non-GAAP measures identified in information disclosed outside the registrant's SEC filings, such as on its Web site and in its press releases, earnings calls, and analyst presentations, and (2) the non-GAAP measures in the registrant's SEC filings. The SEC staff has noted that it does not require registrants to use non-GAAP measures in their filings. However, the staff may comment if a registrant discusses non-GAAP financial measures in other communications to investors but such discussion is omitted from, or contradicts, the information in the registrant's filings. In addition, if a non-GAAP measure is the focal point in all of a registrant's outside communications but is not included in filed documents, the SEC staff may ask why.[1]

Undue Prominence of a Non-GAAP Financial Measure

Example of an SEC Comment

We note that you present full non-GAAP income statements for the three months ended December 31, 2014 and 2013. We believe that the presentation of a full non-GAAP income statement attaches undue prominence to the non-GAAP information, results in the creation of many additional non-GAAP measures, and may give the impression that the non-GAAP income statement represents a comprehensive basis of accounting. Please confirm to us that you will revise your presentation to provide relevant information to investors without providing full non-GAAP income statements in future filings. For additional guidance, please refer to [Question 102.10 of the C&DIs related to non-GAAP financial measures].

The SEC staff will comment when a registrant presents its non-GAAP financial measures more prominently than its GAAP measures in terms of the order of presentation or the degree of emphasis. A registrant may receive a comment if its discussion of non-GAAP financial measures is significantly longer than its discussion of the corresponding GAAP financial measures, or if it uses a full non-GAAP income statement format that is generally not appropriate under Question 102.10 of the C&DIs related to non-GAAP financial measures. In recent comments, the SEC staff has indicated that as a substitute for presenting a full non-GAAP income statement, registrants may consider presenting only individual non-GAAP measures (e.g., line items) as long as each measure is used in a manner consistent with Regulation S-K, Item 10(e)(1)(i).

Key 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 unique financial or operating metrics (e.g., same-store sales, average rental rates, number of online users, room night stays, catalogs mailed) to illustrate the size and growth of its business. In public remarks, the SEC staff has stated that (1) metrics may differ from non-GAAP measures and (2) it is generally not referring to non-GAAP measures when discussing metrics.

At the "SEC Speaks in 2015" Conference, the SEC staff discussed metrics used in registrants' IPO registration statements and periodic filings. The 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

[1] The SEC staff discussed this topic at the 2010 AICPA Conference. See Deloitte's December 16, 2010, *Heads Up* for additional information.

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.

A registrant must use judgment in determining whether to include metrics in its filings. The staff noted at the "SEC Speaks in 2015" Conference that registrants should ask themselves the following questions in making this determination:

- Is the metric integral to the 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)?

Disclosure Controls and Procedures

In discussions of disclosure controls and procedures (DC&P)[1] registrants must use language that conforms to the requirements in Rule 13a-15(e) or Rule 15d-15(e) of the Exchange Act.[2] 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.

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

Examples of SEC Comments

- We note your Chief Executive Officer and Chief Financial Officer concluded that your disclosure controls and procedures as of June 30, 2014 were effective; however, you did not include the definition of disclosure controls and procedures or refer to such definition as stated in the Exchange Act Rules. Please confirm to us, if true, that your officers concluded your disclosure controls and procedures are effective as of June 30, 2014, to ensure that the information required to be disclosed by the company in reports that it files under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Commission´s rules and forms and also to ensure that information required to be disclosed in the reports that you file or submit under the Exchange Act is accumulated and communicated to management, as appropriate, to allow timely decisions regarding required disclosure. Further, in future filings, revise your disclosures to include the full definition of disclosure controls and procedures or clearly indicate that the evaluation was made with respect to disclosure controls and procedures as defined in Rule 13a-15(e) and 15d-15(e) of the Exchange Act. We refer you to Item 307 of Regulation S-K.
- The disclosure . . . that management concluded that your [DC&P] were effective [as of] December 31, 2013 is not consistent with your risk factor [regarding which] you disclose that management concluded that your DC&P were not effective due to the existence of certain material weaknesses.

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

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

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

- We note your disclosure of a material weakness related to the failure to maintain qualified accounting personnel. Your disclosure describes certain remediation efforts and states that you expect remediation to continue. Given [that ICFR is] an integral part of [DC&P], please tell us how you came to the conclusion that your material weakness related to ICFR did not impact your conclusion on the effectiveness of your DC&P or amend to revise your conclusion on the effectiveness of your DC&P.
- [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 as of June 30, 2014 and revise your disclosure as appropriate.

Paragraph 4310.9 of the FRM 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 the registrant to 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 concluded your disclosure controls and procedures were effective as of September 30, 2014. In forming this conclusion, please tell us how you considered the following: (a) the three material weaknesses you had as of December 31, 2013, (b) your internal control over financial reporting was not effective as of December 31, 2013, (c) your disclosure controls and procedures were not effective as of December 31, 2013, March 31, 2014 and June 30, 2014 and (d) you disclosed in each of your Forms 10-Q filed during 2014 that no material changes in your internal control over reporting had occurred. Please also tell us the factors you considered to support management's conclusion that your disclosure controls and procedures were effective as of September 30, 2014. Please revise your disclosures regarding changes in your internal control over financial reporting and corrections of material weaknesses, as appropriate. Otherwise, please amend your Form 10-Q for the period ended September 30, 2014 to disclose, if true, your disclosure controls and procedures were not effective as of September 30, 2014.

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,[1] a registrant must annually provide management's report on ICFR and, if applicable, the attestation report of the registrant's registered public accounting firm.[2] These reports are not required in registration statements or Form 11-K.[3] 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.[4] In addition, the JOBS Act amended Section 404(b) of the Sarbanes-Oxley Act by exempting emerging growth companies (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 regarding management's assessment of ICFR, particularly the guidance on the evaluation of control deficiencies. The OCA has stated that internal control reporting is a focus in its reviews and enforcement actions, and this focus is evidenced 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 Foreign Corrupt Practices Act (FCPA) violations, including internal control 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.
- Please address the following in relation to [the error you identified]:
    - Provide further information to help us understand how you considered the identification and correction of the error in your evaluation of [ICFR] as of December 31, 2013 and whether control deficiencies existed due to the error. To the extent that you determined there were control deficiencies due to the error, describe the deficiencies and how you evaluated the severity of each identified.
    - In addition, describe the evaluation performed on whether there was a reasonable possibility that your controls would have failed to prevent or detect a material misstatement associated with other related aspects of the consolidation process.
    - Last, tell us if the identification and correction resulted in changes to your internal controls and if so, describe those changes and the timing.

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

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

2 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.

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

4 However, paragraph 4310.6 of the FRM 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."

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, deputy chief accountant in the OCA, stated that he remains convinced that "at least some of the PCAOB's inspection findings related to the audits of internal control over financial reporting are likely indicators of similar problems with management's evaluations of ICFR, and thus potentially [are] also indicative of risk for unidentified material weaknesses." He also 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."

Mr. Croteau reiterated these points at the 2014 AICPA Conference, where he stated that he "continue[s] to question whether material weaknesses are being properly identified, evaluated, and disclosed." He also stated that the "efforts throughout the SEC pertaining to the ICFR requirements are ongoing, coordinated, and increasingly integrated into [the SEC's] routine consultation, disclosure review and enforcement efforts," thus indicating that ICFR will remain a focus of the SEC staff.

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.[5] 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.[6] 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.

[5] An immaterial restatement is a restatement of previously issued financial statements for the correction of a misstatement that is either of the following:

- Not material to the prior period being changed but would be material to the current period if corrected in the current period.
- Not material to any periods being presented.

[6] 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

Examples of SEC Comments

- 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 Kevin Stout, senior associate chief accountant in the OCA, 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

[Y]our disclosure indicates that there were no significant changes in your internal control over financial reporting during the last quarterly period covered by this report. This seems to contradict your statement that the signing of the acquisition agreement with [Company A] and the change in management, both of which occurred in November 2013, represent steps to cure deficiencies in your internal control over financial reporting. Please clarify.

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.

Consequently, the staff expects to see increased disclosures regarding changes in ICFR, specifically those related to remediation of material weaknesses. For example, the SEC 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.[7]

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 (discussed below). 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.

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 controls over financial reporting during the 2014 and 2013 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.

[7] 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*.

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.

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.[8]

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 recently 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.

Conclusion That ICFR Remains Effective After a Restatement

Example of an SEC Comment

Please tell us what consideration was given to management's assessment at December 31, 2013 and at dates before then during 2011, 2012 and 2013 of the effectiveness of disclosure controls and procedures and internal control over financial reporting in light of the restatement discussed in [your notes]. Explain why you believe both disclosure controls and procedures and internal controls over financial reporting were effective at those dates in light of the errors and why no modifications to the disclosures contained in management's report, including any material changes made to ICFR, were required.

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 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.

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

Registrants should consider paragraphs 4310.16 and 4310.17 of the FRM regarding the restatement of financial statements:

> 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

Please revise future filings to clarify which version, 1992 or 2013, of the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control — Integrated Framework* you utilized when performing your assessment of internal control over financial reporting.

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.[9] At the 2013 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 FRM. Because the COSO framework was updated in 2013 and provides for a transition period before the original framework is superseded, registrants should disclose whether they applied the 2013 framework or the original 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.

The SEC staff has also noted that "the longer issuers continue to use the 1992 framework, the more likely they are to receive questions from the staff about whether the issuer's use of the 1992 framework satisfies the SEC's requirement to use a suitable, recognized framework."[10]

[9] For additional information, see Deloitte's June 10, 2013, *Heads Up* on the revised COSO framework.

[10] For additional information, see the highlights of the September 2013 CAQ SEC Regulations Committee joint meeting with the SEC staff.

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.
- We note that management's report does not provide all the required information. Specifically, it does not define management's responsibility for establishing and maintaining adequate internal control over financial reporting, nor does it identify the framework used by management to evaluate the effectiveness of internal control over financial reporting at December 31, 2013.

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 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 about how performance is assessed, including the use of performance targets and benchmarking; (2) disclosures in CD&A, including compensation table disclosures; and (3) disclosures about related-party transactions.

Further, the SEC continues to expand executive compensation and other proxy disclosure requirements through its rulemaking under the Dodd-Frank Act. See Other Deloitte Resources below for additional considerations.

Determining Compensation — Assessment of Performance

Performance Targets

> **Example of an SEC Comment**
>
> We note disclosure that the maximum bonus opportunities were set between [X]% and [Y]% of base salary for each of your named executive officers. In future filings, please clearly disclose the threshold, target and maximum bonus opportunities as a percentage of salary for each of your named executive officers. Please also disclose all previously established performance goals (such as company operating income), the actual level of achievement, and how you calculated the performance based bonus award for each named executive officer. [P]lease provide us supplementally with draft disclosure showing how you will present this information in future filings. Refer to Items 402(b)(1)(v) and (2)(v) of Regulation S-K.

The SEC staff frequently asks registrants that use performance targets to disclose them and provide information about their use.[1] Under Regulation S-K, Item 402(b), a registrant is required to discuss any compensation awarded to named executive officers (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. Item 402(b) also requires discussion of whether and, if so, how the results of shareholder advisory votes on executive compensation may affect the registrant's decisions and policies related to executive compensation.

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 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.
- Indicate whether the compensation committee or others had discretion or additional qualitative input when determining the final amount of compensation awarded, and the factors that affected the determination.

[1] 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.

Benchmarking

> **Example of an SEC Comment**
>
> In future filings, please disclose the component companies used for benchmarking the compensation of your named executive officers. See Item 402(b)(2)(xiv) of Regulation S-K. We also note that target total annual compensation was within the [X] percentile. In future filings, please revise to disclose where actual total annual compensation fell for your named executive officers in relation to the benchmarked parameters.

A registrant may use benchmarks for total compensation or a material element of compensation (e.g., the registrant compares its executive compensation to that of a peer group in the same industry or uses compensation surveys to determine compensation levels). When it does, the registrant must identify (1) the benchmark for each NEO and (2) the components of compensation used and the entities that constitute the benchmark group.[2]

If benchmarks are used, the SEC staff may request that registrants disclose:

- All elements of compensation that are subject to benchmarking.
- The impact of the benchmarking on compensation decisions.
- Additional details about how they used the comparison information, including whether they had discretion regarding when and how to use it as well as the nature and extent of such discretion.
- Where payments fell with respect to the benchmark for each NEO.
- The degree to which their compensation committees consider entities in the benchmark group to be comparable to the registrants themselves.

The staff has also asked for explanations when actual compensation fell outside the targeted range.

Disclosures in CD&A

> **Examples of SEC Comments**
>
> - You disclose that the amounts of the 2014 cash incentives are included in the Bonus column. If the bonus was granted under a plan providing for compensation intended to serve as incentive for performance to occur over a specified period of time, then the bonus should be disclosed under the "Non-Equity Incentive Compensation Plan" column. Amounts earned under the plan as adjusted for the exercise of negative discretion would still be reportable in the Non-Equity Incentive Plan Compensation column. Please explain to us why the payments under the 2014 Annual Incentive Plan awards are being disclosed in the "Bonus" column, and to the extent necessary revise your future filing accordingly. For guidance, please refer to Question 119.02 of Regulation S-K Compliance and Disclosure Interpretations.
> - We note disclosure that Mr. [A] has received fees related to his services on the company's board . . . for a total aggregate of $[X]. Please tell us where these fees have been disclosed in the summary compensation table, and in future filing, identify them through the use of footnote disclosure to the extent applicable. Please see instruction 3 to Item 402(c) of Regulation S-K.

The SEC staff continues to focus on CD&A disclosures, particularly those in the summary compensation table, 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 and the amounts disclosed in the summary compensation table.

[2] See Regulation S-K, Item 402(b)(2)(xiv), for additional information.

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 disclosed.

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 CD&A, 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), also requires disclosure of the aggregate grant-date fair value and aggregate number of stock awards as of the fiscal year-end for each director.

Related-Party Transactions

Regulation S-K, Item 404(a), requires disclosure of transactions that the registrant participated in, or will participate in, with related parties in which the "amount involved exceeds $120,000, and [the related party] had or will have a direct or indirect material interest." ASC 850 does not establish a quantitative threshold but requires disclosure in the financial statements when the information "would make a difference in decision making." In addition, Regulation S-X, Rule 4-08(k), requires registrants to (1) disclose related-party transactions that affect the financial statements and (2) separately present the amounts of such related-party transactions on the face of the balance sheet, income statement, or statement of cash flows when those amounts are material. Types of related-party transactions that the SEC staff often comments about include sales and loans involving related parties.

As part of identifying related-party transactions, registrants should consider consulting with legal counsel and reviewing the instructions to Item 404(a) to better understand the definition of a "related person" and the types of transactions they need to disclose.

Policies and Procedures

Example of an SEC Comment

Please tell us your Committees' policies and procedures for the review, approval, or ratification of covered transactions. Please see Item 404(b) of Regulation S-K.

The SEC staff may request that the registrant provide a complete discussion of the policies and procedures related to the review, approval, or ratification of transactions with related persons, as required by Regulation S-K, Item 404(b). Registrants often disclose the existence, or a general summary, of such policies and procedures but exclude material features such as the types of transactions covered by the policies and procedures, the standards to be applied to the transactions, and the persons or group of persons responsible for applying the policies and procedures.

Transactions Involving Indebtedness

Example of an SEC Comment

Please provide the disclosure required by Item 404(a)(5) of Regulation S-K. In addition, please update the balance of the related party debt as of the most recent financial statements.

The SEC staff also often asks registrants to improve their disclosures about related-party transactions involving indebtedness. Item 404(a) indicates that registrants should disclose the major terms of related-party indebtedness (e.g., the amounts involved, the largest principal amount outstanding during the period and as of the latest practicable date, the principal and interest payments during the period, the interest rate, and the interest-payable amount).

Other Deloitte Resources

- September 10, 2015, *Heads Up*, "SEC Issues Final Rule on Pay Ratio Disclosure."
- August 5, 2015, *Heads Up*, "SEC Proposes Rule on 'Clawback' Policies."
- May 29, 2015, *Heads Up*, "SEC Proposed Rule on Pay Versus Performance."

Emerging Growth Companies

An emerging growth company (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 may elect to defer the adoption of new accounting standards until they become effective for private companies (i.e., nonissuers).
- EGCs are exempt from the requirement to obtain an attestation report on ICFR from their auditor.

In addition, an EGC may submit registration statements to the SEC for confidential reviews. Under the JOBS Act, an EGC would be required to make publicly available (at least 21 days before its "road show") any documents that were submitted to the SEC staff for confidential review. Accordingly, the SEC staff's comment letters to the EGC (and the EGC's responses) must be filed on EDGAR.

The staff in the SEC's Division of Corporation Finance 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 FRM.

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.

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;[1] and 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 allowed to adopt new or revised accounting standards on the basis of effective dates applicable to private companies (i.e., nonissuers) 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.

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 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).[2]

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.[3] Consequently, the 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.

1 For example, the EGC's total gross revenues do not exceed $1 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).

2 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.

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

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.

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

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.

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**
>
> We note that the prospectus includes market and industry data derived from publications, surveys, and reports, including from [Entities A, B, C, D, E, F, and G]. If any of these publications, surveys, or reports were commissioned by you for use in connection with the registration statement, please file consents of such third parties pursuant to Rule 436 of the Securities Act as exhibits to your registration statement or tell us why you believe you are not required to do so.

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.[1]

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

You state that you rely on the uninterrupted operation of your data centers. Yet it appears that you do not plan to file as exhibits any agreements with the third parties that host your network operating centers. To the extent you have entered into agreements with respect to your network operating centers, please revise the Business section to discuss the material terms of your material agreements. In addition, explain to us how you determined that the agreements need not be filed as exhibits pursuant to Item 601(b)(10) of Regulation S-K. Alternatively, file the agreements as exhibits to the registration statement.

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.[2]
- 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.

1 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.

2 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

- Please tell us how and when the "order process" that you mention was changed and how that will affect age outs. Also, please (1) clarify this issue in future filings where you mention the order process change, [and] (2) tell us about any other changes to the method that you used to determine the dollar amount of reported backlog during the last three fiscal years, the extent to which the change affected backlog, and where you describe those changes in your filings.
- To the extent material, please disclose the amount of backlog related to uncompleted contracts for which you have recorded a provision for estimated losses. Please also disclose the amount of backlog not reasonably expected to be filled within the current fiscal year, and seasonal or other material aspects of backlog. Refer to Item 101(c)(1)(viii) of Regulation S-K.

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." Because companies may compute backlog information differently, the SEC staff has requested expanded disclosures about it, including (1) the methods used (or changes in methods used) to determine backlog and (2) changes in backlog resulting 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

- You state . . . that [Company X] accounted for 10% of your sales in 2014. [Company X's] wholly-owned subsidiaries . . . both provide contact information on their respective websites for their respective [businesses] in each of [Sudan and] Syria. [Sudan and] Syria are designated by the Department of State as state sponsors of terrorism, and are subject to U.S. economic sanctions and export controls. Please describe to us the nature and extent of your past, current, and anticipated contacts with . . . Sudan and Syria, if any, whether through subsidiaries, affiliates, distributors, partners, customers, joint ventures or other direct or indirect arrangements. You should describe any services, products, information, or technology you have provided to [Sudan or] Syria, directly or indirectly, and any agreements, commercial 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 associated revenues, assets, and liabilities 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. Department of State has designated three countries as state sponsors of terrorism — Iran, Sudan, and Syria. These countries are subject to U.S. economic sanctions and export controls. Generally, registrants that do business in these countries are required to disclose material operations conducted in them (whether through subsidiaries, affiliates, distributors, 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.[3] 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.[4]

[3] In 2007, the SEC issued a concept release that 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]

[4] Further, the Iran Threat Reduction and Syria Human Rights Act of 2012 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 non-accelerated filer. Please revise to comply with the requirements of Section 405 of Regulation S-T and the EDGAR Filer Manual.

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.[5] 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.

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,[6] 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.

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

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

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. For example, under the SEC's recently proposed rule on pay-versus-performance disclosures, which would implement Section 953(a) of the Dodd-Frank Act, registrants would be required to provide such disclosures "in tagged data format using [XBRL]."[7]

Other Deloitte Resources

- 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."

Audit Report Requirements

Example of an SEC Comment

Please amend your filing to include an audit opinion which encompasses all of the financial statements included in your filing. In this regard, we note that your audit opinion refers to " . . . the related consolidated statements of operations, comprehensive loss, changes in stockholders' equity and cash flows for the year then ended." However, you have included more than one year of financial statements. We note the same terminology was used in the concluding paragraph of the audit opinion. Additionally, please ensure that your independent auditor properly references the city and state where the audit report was issued. Please refer to Rule 2-02 (a) of Regulation S-X. We remind you to also include currently dated certifications that refer to the amended form.

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

[7] For additional information about the SEC's proposed rule, see Deloitte's May 29, 2015, *Heads Up*.

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 FRM for additional information regarding certain PCAOB requirements in various SEC filings.

Selected Quarterly Financial Data

Example of an SEC Comment

We note in your disclosure that you describe the effects of certain significant items on an aggregate basis for each respective year. Please revise to clearly disclose how such unusual or infrequently occurring items are material to the results of each quarter. Please 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) extraordinary, 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 statement[8] 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.

[8] That is, a registration statement filed after the IPO.


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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 emerging growth company (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.

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 amend your filing to provide financial statements for [Company A] and its predecessor that comply with Rule 3-12 of Regulation S-X at the date the registration statement becomes effective.

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).

Recently Organized Registrant

> **Example of an SEC Comment**
>
> Please provide audited financial statements of the registrant (i.e. the current subsidiary that will become [Company X]) and [the existing entity] 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 FRM 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**
>
> Please tell us what factors you considered, and why you concluded, [Company A] represents your predecessor. In your response, please tell us how you are actually succeeding to substantially all of the business of [Company A], and what impact control of [Company A] has upon your ability to succeed to the business. We may have further comment.

Section 1170 of the FRM 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.

Trends related to predecessor financial statements in put-together transactions were considered at the March 2015 CAQ SEC Regulations Committee joint meeting with the SEC staff. The meeting highlights published by the CAQ state:

> The Committee and staff also discussed how registrants should evaluate who the predecessor is in put-together transactions where multiple entities that are roughly the same size are acquired by a [new entity ("Newco")] in a business combination in which Newco is the accounting acquirer. In this situation, the staff noted that it may not be readily apparent which entity or entities should be treated as the predecessor. The [s]taff also noted that the fact patterns it has seen have been unique, and in certain circumstances registrants have concluded that there is 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**
>
> You disclose that the combined financial statements may not include all of the actual expenses that would have been incurred had [the new entity] been a [stand-alone] company during the periods presented and that actual costs would have been different. Please disclose your estimate as to what the expenses would have been on a stand-alone basis for [the new entity], that is, the cost that would have been incurred if [the new entity] had operated as an unaffiliated entity for all years reported when such basis produces materially different results. Please refer to Question 2 of 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 spinnor and spinnee) may not be wholly determinative of the SEC's reporting requirements. Further, at the March 2015 CAQ SEC Regulations Committee joint meeting with the SEC staff, the staff discussed financial reporting differences that can arise depending on the legal form of the transaction.

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 prefiling 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.

In addition, the SEC staff discussed at the 2014 AICPA Conference the recent prevalence of IPO transactions that contemplate the formation of a master limited partnership. Examples include situations in which assets that function as internal services have been contributed by the sponsor but operations

[1] ASC 505-60-20 defines a spin-off as the "transfer of assets that constitute a business by an entity (the spinnor) 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 spinnor."

have not had historical revenue streams. Registrants need to carefully analyze the facts and circumstances to determine what historical financial statements to include. Again, the staff encouraged registrants to submit a prefiling letter to help resolve these unique and complex issues.

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 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.

For additional considerations related to carve-out transactions, see Deloitte's publication *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 disclosures required under U.S. GAAP and Regulation S-X.[2] 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.[3]

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.[4] 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. Examples of accounting principles and disclosures that apply to public entities but not nonpublic entities include EPS (under ASC 260-10-15-2 and 15-3); segment reporting (under ASC 280-10-15-3 and ASC 280-10-20); 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 715-20-20).

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.[5]

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 EGCs are allowed to adopt new or revised financial accounting standards on the basis of effective dates applicable to private companies (i.e., nonissuers) "if such standards apply to companies that are not issuers." See the Emerging Growth Companies section for additional information.

3 See paragraph 4110.5 of the FRM for additional information.

4 See footnote 2.

5 See footnote 2.

SEC Rules and Regulations

Examples of SEC Comments

- Please revise future filings to disclose the amount of income (loss) before income tax expense attributable to domestic or foreign operations. Refer to Rule 4-08(h) of Regulation S-X.
- Please revise to provide separate disclosure in your consolidated statements of operations of the license fee expense paid to [Company A], a company affiliated with one of your principal shareholders, during all periods presented. Refer to the guidance outlined in Rule 4-08(k) of Regulation S-X.

In an IPO, the registrant's financial statements should 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; Income Taxes; and SEC Reporting sections.

Distributions to Owners

Example of an SEC Comment

We note that you plan to distribute all of the proceeds from the offering of common units and a portion of the proceeds from your new credit facility to [Entity A] upon closing of the offering. Please explain to us what consideration you gave to providing a pro forma balance sheet alongside your latest historical balance sheet reflecting the distribution. Additionally, please tell us what consideration you gave to providing pro forma per unit data for the latest year and interim period within your historical financial statements to the extent that the distribution exceeds the current year's earnings. . . . We refer you to SAB Topic [1.B.3].

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 FRM 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 FRM 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

Examples of SEC Comments

- 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.
- We note your use of net proceeds from this offering includes the repayment of outstanding balances under your credit facility. Please revise your pro forma net loss per share information to address the effect of the proceeds intended to be used for debt repayment. In this regard, you should disclose the effects of the interest expense adjustment and the number of shares issued in this offering whose proceeds will be used to repay the credit facility. Please ensure that the footnotes to your pro forma disclosures clearly support the calculations of both the numerator and denominator used in computing pro forma net loss per share. We refer you to SAB Topic 3.A by analogy and Rule 11-01(a)(8) and Rule 11-02(b)(7) of Regulation S-X.

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 FRM 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 FRM 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.

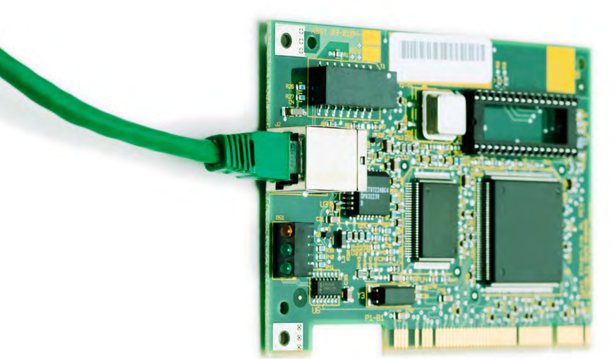
Further, SEC staff comments have noted that to the extent that proceeds of an offering are used for the repayment of outstanding borrowings, registrants should include the impact of such repayments in their pro forma EPS amounts by (1) increasing the denominator by the number of shares necessary to repay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

Draft Audit Reports

Example of an SEC Comment

We note that your reverse stock split will be effective immediately prior to completion of the offering. This reverse split should be retrospectively reflected in the financial statements, selected financial data and elsewhere throughout the filing. If the transaction prevents the auditor from expressing an opinion on the financial statements at the time of filing, we will not object to the filing of a "draft report" in the form that it will be expressed at effectiveness. In this case, the draft report should be accompanied by a signed preface of the auditor stating that it expects to be in a position to issue the report in the form presented at effectiveness. No registration statement can be declared effective until the preface is removed and the accountant's report [is] finalized.

In accordance with Regulation S-X, Rule 2-02, and interpretive guidance (e.g., Section 4710 of the FRM), 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 to prevent 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

Examples of SEC Comments

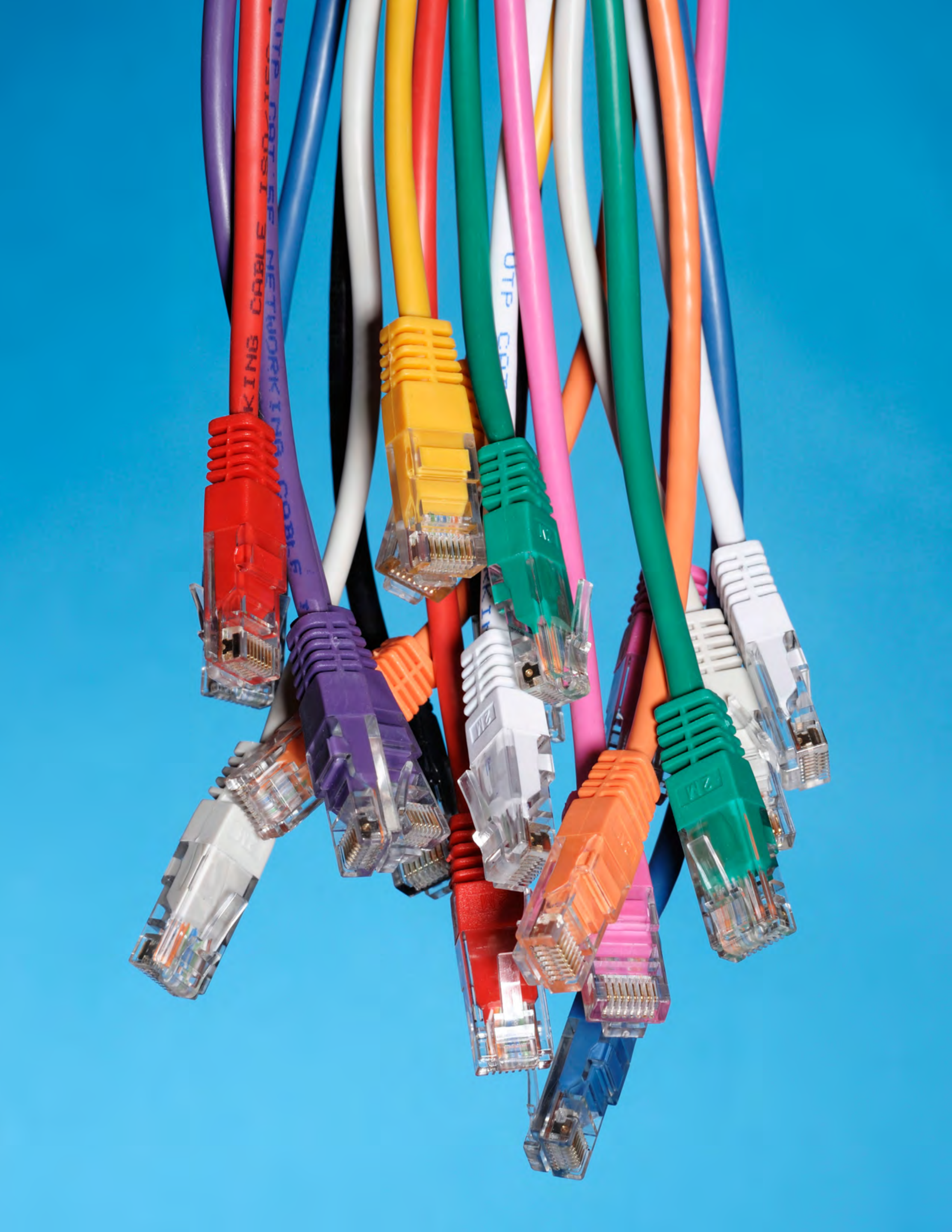
- Please tell us why you are including noncontrolling interest in your calculation of historical net tangible book value for purposes of assessing dilution to shareholders that invest at the time of your IPO.
- We note that you removed the measure of net tangible book value from your disclosure in addition to removing your measure of net tangible liabilities. Please revise your disclosures to present the net tangible book value measures required by Item 506 of Regulation S-K, or tell us why you believe these disclosures are no longer applicable.

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 FRM 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.

Other Deloitte Resources

- December 15, 2014, *Heads Up*, "Highlights of the 2014 AICPA Conference on Current SEC and PCAOB Developments."
- December 24, 2013, *Deloitte Accounting Journal*, "FASB Defines a Public Business Entity."



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 that are discussed in other sections of this publication (albeit staff comments to FPIs on financial statement topics refer to IFRSs). In addition, FPIs have received staff comments about (1) the presentation of financial statements (i.e., under IAS 1); (2) accounting for expenditures related to the exploration for, and evaluation of, mineral resources (i.e., under IFRS 6); (3) their consolidation analysis and disclosures (e.g., under IFRS 10); and (4) references to the use of IFRSs as issued by the IASB.

Presentation of Financial Statements

Examples of SEC Comments

- Please confirm that you have disclosed all material expenditures by nature as required under paragraph 104 of IAS 1 or revise your disclosure to quantify these expenditures.
- We note . . . that you view the loss of settlement as [being] unrelated to your operations because the settlement was based on an allegation of infringement and no finding of infringement was ever made by a court of proper jurisdiction. We would expect that it is normal operational activity for companies to defend their patents used in operations against claims of infringement, whether litigated or settled. Since the patents involved are used by your operations, we continue to believe that the associated settlement costs are representative of activities that would normally be regarded as operating. Refer to BC 56 of IAS 1.

The SEC staff's comments have often focused on missing disclosures about the nature of expenses when FPIs used a functional presentation of expenses in the statement of profit or loss and OCI. The staff has also commented on the exclusion of certain expenses from 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.

Under IAS 1, an entity can present expenses either by nature or by function. According to paragraph 104 of IAS 1, an entity that presents expenses by function must provide additional disclosures about the "nature of expenses, including depreciation and amortisation expense and employee benefits expense." As explained in paragraph 105 of IAS 1, this is "because information on the nature of expenses is useful in predicting future cash flows." The use of the term "including" in IAS 1 implies that additional disclosures about the nature of expenses may not be limited to depreciation, amortization, and employee benefit expenses. Rather entities should disclose other expenses by nature if such information may be useful in predicting future cash flows. An entity that uses a functional format should ensure that all additional disclosures are included in the footnotes and should consider including them in a single footnote for greater transparency. Paragraph IG6 of IAS 1 illustrates income statements that are presented by nature and by function.

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, in part, 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."

Further, 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." 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.

Exploration for, and Evaluation of, Mineral Resources

Examples of SEC Comments

- We note . . . that you rely on IFRS 6 guidance in capitalizing exploration expenditures. We also note . . . that capitalized exploration costs are classified as mine development assets and you are relying on the guidance in IAS 16. To help us better understand your accounting policy for capitalizing exploration expenditures, please address the following items:
  - Tell us why you consider it appropriate to classify the capitalized exploration costs as mine development assets under IFRS 6 paragraphs 10 and 25.
  - Tell us how you reclassify the capitalized exploration costs when the technical feasibility and commercial viability of extracting a mineral resource are demonstrable under the guidance in IFRS 6 paragraph 17 if the related capitalized exploration costs have been recorded as mine development assets.
  - Tell us the amount of exploration costs capitalized by mine at [Mine A and Mine B].
- We note your disclosure that you capitalize exploration and evaluation costs as intangible assets and reclassify these costs to mining properties when intended production levels are achieved. Please provide us a detailed discussion of how your accounting policy complies with IFRS 6, particularly paragraph 17. Additionally, please tell us how you define intended production levels being achieved.

The SEC staff has often requested more information about an FPI's accounting policy related to the types of expenditures that the issuer recognizes as exploration and evaluation assets, including whether such policy complies with IFRS 6.

IFRS 6 requires an entity to develop an accounting policy that specifies the types of expenditures it recognizes as exploration and evaluation assets and to apply that policy consistently — particularly because IFRS 6 does not require entities to capitalize exploration and evaluation expenditures. In addition, when specified conditions are met, IFRS 6 permits entities to continue applying the accounting policies they used to account for exploration and evaluation expenditures before adopting IFRS 6.

Under IFRS 6, an entity's assessment of which expenditures would qualify as exploration and evaluation assets is determined on the basis of how closely the expenditures are associated with finding specific mineral resources. IFRS 6 provides a nonexhaustive list of expenditures that an entity might consider including in the initial measurement of its exploration and evaluation assets. Such expenditures include those related to:

- Acquisition of rights to explore minerals.
- Topographical, geological, geochemical, and geophysical studies.
- Exploratory drilling.
- Trenching.
- Sampling.
- Activities related to evaluating the technical feasibility and commercial viability of extracting a mineral resource.

However, in accordance with IFRS 6, entities should not recognize expenditures related to the development of mineral resources as exploration and evaluation assets; instead, entities are required to apply the *Conceptual Framework for Financial Reporting* and IAS 38 to determine an appropriate accounting policy for such amounts. Further, although the term "development" is not defined, paragraph 5(b) of IFRS 6 indicates that the development phase begins "after the technical feasibility and commercial viability of extracting a mineral resource are demonstrable."

References to the Use of IFRSs as Issued by the IASB

Example of an SEC Comment

Please amend your filing to include an audit opinion that refers to and opines on International Financial Reporting Standards as issued by the International Accounting Standards Board or include a reconciliation to US GAAP. Refer to Item 17(c) of Form 20-F.

The SEC staff has requested that FPIs amend their Form 20-F when they have not asserted, and the audit report has not stated, that the financial statements were prepared in accordance with "IFRSs as issued by the IASB."

As stated in paragraph 6310.2 of the FRM and similarly indicated in Item 17 of Form 20-F, the issuer's "accounting policy footnote must state compliance with [IFRSs] as issued by the IASB and the auditor's report must opine on compliance with [IFRSs] as issued by the IASB." An issuer that does not prepare its financial statements in accordance with IFRSs as issued by the IASB is required to reconcile its financial statements to U.S. GAAP. The SEC staff has reiterated that FPIs need to provide a statement of compliance with "IFRSs as issued by the IASB" to be eligible to omit the U.S. GAAP reconciliation.

Consolidations

Examples of SEC Comments

- We note that upon adoption of IFRS 10, you deconsolidated five companies because you determined you are not exposed to variable returns although you have power over the relevant activities. [F]or [Entity A] and [Entity B], your ownership percentage is 100.00% and 92.64%, respectively. Tell us and revise your future filings to disclose the significant judgments and assumptions made in your determination that you are not exposed to variable returns for these entities even though you have substantially all voting rights.
- We note that your adoption of IFRS 11 resulted in accounting for several entities under the equity method instead of the proportional consolidation method you used prior to the adoption of IFRS 11. Please tell us in sufficient detail how you determined these joint arrangements qualified as joint ventures as opposed to joint operations. Ensure your analysis discusses the structure and form of the arrangements and the involved parties' rights and obligations arising from the arrangements.

FPIs have received SEC staff comments about their IFRS 10 conclusions, including whether they have (1) power over the relevant activities of an investee, (2) exposure or rights to the variable returns of an investee, and (3) the ability to affect an investee's variable returns through their power over the investee.

In addition, FPIs have been asked to provide disclosures required by IFRS 12 related to (1) their interests in other entities and (2) the significant judgments and assumptions they made in determining that they have control, joint control, or significant influence over another entity.

Further, the SEC staff has inquired about how a registrant determined whether joint arrangements qualified as joint ventures rather than joint operations.

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

Examples of SEC Comments

- [P]lease expand your discussion of how the trend towards mobile and multi-channel shopping will affect both your liquidity and capital resources expenditures moving forward.
- Since it appears that your online business has a significant impact on your results, please provide a quantified discussion of your online business as part of providing investors with a view of the company through the eyes of management. . . . In making this disclosure, please disclose the revenues and profitability of your online channel for each period presented and provide a comprehensive discussion and analysis of the performance and known trends related to your online operations.
- While we recognize that situations such as placing an online order while standing in a store make it difficult to present pure store and online sales amounts, we assume that if management separately tracks the sales from stores and online you are using a reasonable allocation methodology to make those figures meaningful to you, and we believe that your investors would benefit from you sharing this information along with your allocation methodology.
- We note your eCommerce sales are included within your same store sales calculation. Tell us your basis for inclusion of online sales in your same store sales calculation and explain to us what consideration you gave to also disclosing same store sales excluding eCommerce sales. In explaining your basis, please tell us and disclose whether the prices, margins or types of products ordered online differ materially from products available at your brick and mortar stores.

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, in a manner consistent with SEC staff remarks at the 2013 AICPA Conference, the SEC staff continues to ask registrants with significant online sales to separately discuss (1) the impact of such sales on the results of operations, including changes in overall gross margin, and (2) any trends affecting online sales. Incrementally, retailers have received comments requesting expanded disclosure of the impact that online sales have on year-to-year sales metrics, such as same-store sales. 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

- We note that delivery sales are recognized at the time of shipment rather than upon delivery to and acceptance by the customer. Please explain why this policy is appropriate referencing authoritative literature.
- Please tell us how you account for your customer loyalty program and your consideration of disclosing your accounting policy specifically as it relates to the program.
- 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.

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.

Sales Returns and Allowances

Example of an SEC Comment

Please tell us your consideration of disclosing your accounting policy for sales returns and allowances and your consideration of including the activity in Schedule II as prescribed by Rule 12-09 of Regulation S-X in accordance with Rule 5-04 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 accounting and disclosures, (2) impairment of long-lived assets, and (3) VIEs.

Revenue Recognition

Examples of SEC Comments

- We note from your revenue recognition critical accounting policy that at the majority of your private clubs, members are expected to pay an initiation fee or deposit upon acceptance as a member to the club for which revenue related to the initiation fee is recognized over the expected life of an active membership. . . . In this regard, please tell us and revise your critical accounting policies to disclose the expected lives or range of expected lives of active memberships for purposes of recognizing revenue associated with initiation fees and deposits for each of the periods presented in your financial statements. Your revised discussion should address attrition rates and how they are used in determining the expected lives of active memberships.
- We refer to the September 2013 modifications to your [Entity A] agreement that have changed the way you record [travel program miles] sold. We note your disclosure that you allocate the consideration received from selling miles to all deliverables based on their relative standalone sales price and you disclose your method for determining your best estimate of selling prices. Please clarify for us, and revise to disclose the timing when revenue is recognized for each deliverable and the classification of the revenue in the statements of operations.
- Given your acquisition of [Entity A] during 2013 and a portion of [A's] revenues being derived from membership fees, please revise your revenue recognition policy to disclose how you recognize membership fees, the period over which such revenue is recognized and how you account for any deferred revenue and the classification of such on your balance sheet.

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:

- Any estimates used in the determination of deferred or recognized revenue. For example, the SEC staff may ask for additional disclosure about (1) estimation processes used to determine timing of recognition (e.g., how breakage estimates for loyalty programs were determined) or (2) estimates associated with determining selling prices for contracts with multiple-elements. The SEC staff may also ask THL registrants to disclose amounts recorded in revenue that are based on such estimates.
- The specific inputs and assumptions used to calculate estimates for revenues recognized over time. The SEC staff may ask THL registrants to clarify in their critical accounting policies (1) the significant inputs and assumptions used to determine estimates and (2) the values of the inputs and assumptions used to determine the estimates for the periods reported (e.g., customer attrition rates used to determine average membership life).

In addition, THL registrants have received SEC staff comments asking them to (1) disclose the percentage of revenue derived from key customers mentioned in the registrants' respective SEC filings and (2) provide the staff with quantitative and qualitative information related to any contracts or agreements with countries designated by the U.S. government as state sponsors of terrorism (see the Disclosures Regarding State Sponsors of Terrorism section for more information).

Long-Lived Assets

> **Example of an SEC Comment**
>
> Please consider expanding the Critical Accounting Policies section of MD&A to include a table summarizing your owned vessels that details by vessel, the date of acquisition, purchase price and carrying value at the balance sheet date. Also, please identify within this table any vessels whose estimated market values are less than their carrying values. In this regard, for those vessels whose estimated market value is below their carrying value, please add disclosure below the table of the aggregate market value and aggregate book value of such vessels. This additional disclosure will provide investors with an indication of the estimated magnitude of the potential aggregate impairment charge related to these vessels, if you decided to sell all of such vessels. Also, the disclosure accompanying the table should discuss the related accounting treatment of your vessels, and describe the circumstances under which you would be required to record an impairment loss for those vessels with a carrying value in excess of their estimated fair market values.

The SEC staff has encouraged shipping company registrants to provide tabular disclosures in the critical accounting policies section of MD&A that include information about assets at the individual-vessel level, especially if asset values are depressed. Further, the SEC staff has asked such registrants to disclose, on a comparative basis, the aggregate amount by which their vessels' carrying value exceeds the vessels' aggregate basic charter-free market value (or valuation for covenant compliance purposes). This disclosure is intended to highlight the potential for impairment, the trend in vessel values, and how that trend could affect future results of operations.

In addition, the SEC staff may ask shipping company registrants to discuss more thoroughly (1) the factors and conditions that would lead them to recognize an impairment loss and (2) the sources or events that are driving the change in fair value for recorded impairment charges at the individual-vessel level.

The SEC staff may also ask for more robust disclosures about the sensitivity of assumptions used in the impairment test, particularly those used in the selection of historical average charter rates. Accordingly, registrants are encouraged to consider disclosing the margins by which estimated future undiscounted cash flows would exceed each vessel's carrying value if management were to use various historical trailing averages (e.g., those based on one-year, three-year, and five-year periods).

VIEs

> **Example of an SEC Comment**
>
> Please tell us more specifically how you determined that it was appropriate to not consolidate the variable interest [entity] which you manage, but do not consolidate. Please refer to the specific guidance starting at ASC 810-10-25-20 and compare and contrast to your [c]onsolidated VIEs.

THL registrants may enter into arrangements that result in their holding variable interests (e.g., interests related to real estate investments, property management ventures, or investments in utilities that supply energy to property developments). Since holders of variable interests are required to perform a consolidation analysis, the SEC staff often inquires, or requests additional disclosures, about (1) the specific terms of such arrangements, (2) the initial determination and evaluation of the primary beneficiary under ASC 810-10, and (3) changes in circumstances (e.g., development plans) that could affect the primary beneficiary analysis. In addition, the SEC staff has asked THL registrants to clarify why a consolidated VIE's assets (or liabilities) are not separately presented on the face of the primary beneficiary's statement of financial position if the consolidated VIE's assets can only be used to settle obligations of the consolidated VIE (or the consolidated VIE's liabilities do not provide creditors with recourse to the general credit of its primary beneficiary).

For more information, see the Consolidation 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 master limited partnerships (MLPs); (2) oil and gas reserves; (3) disclosures about drilling activities, wells and acreage data, and delivery commitments; (4) income statement classification; and (5) declines in oil and gas prices.

Distributable Cash Flow and Maintenance Capital Expenditures for MLPs

Example of an SEC Comment

Please tell us and disclose whether you incurred any capital expenditures that had an element of both maintenance capital expenditures and expansion capital expenditures. If so, please revise your disclosure to quantify the portion allocated to expansion capital expenditures for each of the periods presented. In your response, please show us what your disclosure would have looked like had such disclosures been provided in your current Form 10-K.

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

- You state that "at June 30, 2014, none of our proved undeveloped reserves, which are all at [Location A], have remained undeveloped for five years from the date of initial recognition and disclosure as proved undeveloped reserves." Please disclose the extent to which these proved undeveloped reserves are not expected to be converted from undeveloped to developed status within five years since your initial disclosure of these reserves. If any of your proved undeveloped reserves will take more than five years to develop since initial disclosure, you should disclose the specific circumstances to comply with Item 1203(d) of Regulation S-K.
- We note that your inventory of proved undeveloped drilling locations included four wells that had been recognized as proved reserves for five years or longer. Please quantify the reserves related to these wells, describe the specific circumstances that justified the continued recordation of these reserves, and outline your progress in drilling these four wells. Refer to Rule 4-10(a)(31) of Regulation S-X.

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 Question131.04 of the C&DIs of the oil and gas rules for the definition of proved undeveloped (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).

In addition, at the 2014 AICPA Conference, the SEC staff reminded registrants in the oil and gas industry to consider the recent declines in oil and gas prices and the related potential impact on exploration, development, and production levels. See Declines in Oil and Gas Prices below for more information.

Separate Disclosure of NGL Reserves

Example of an SEC Comment

We note your disclosure of "wet" natural gas reserves including NGLs in the presentation of your proved and probable reserves as of June 30, 2013. If your reserves as of June 30, 2013 represent a combination of two separate sales products, please revise your disclosure to provide separate disclosure by product type. In this regard, the staff considers natural gas liquids to be a separate product type under Item 1202(a)(4) of Regulation S-K. Therefore, NGL reserves, if material, should be presented as separate quantities for disclosure under Item 1202(a)(2) of Regulation S-K. Please revise your disclosure or tell us why a revision is not necessary.

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

- Please revise your disclosure to include an explanation of significant changes in reserve quantities as discussed in FASB ASC 932-235-50-10.
- Despite the decrease in [PUDs] from [X thousand barrels of oil equivalent (MBoe)] at December 31, 2013 to [X] MBoe at December 31, 2014, we note that future development costs used to calculate the standardized measure of discounted future net cash flows increased from approximately $[X] to approximately $[X]. Please tell us whether you expect the PUDs recorded as of December 31, 2014 to require greater expenditure for development to proved developed status than PUDs converted in prior periods.

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 SEC's Division of Corporation Finance on the required disclosures.

Reserve Reports

Example of an SEC Comment

The discussion of methods employed in the estimation of reserves provided in the Appendix to the reserves report lists four methods customarily employed in the estimation of reserves. While this appears to be a comprehensive list of the methods available to the evaluator, Item 1202(a)(8)(iv) of Regulation S-K requires that the disclosure should address the methods and procedures used in connection with the preparation of the estimates specific to the report. Please obtain and file an amended report to revise the discussion, if necessary, to list only those methods and/or combinations of methods actually used to estimate the reserves contained in the report.

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

- [P]lease revise your disclosure to provide additional information regarding the minimum remaining terms of leases and concessions. As currently presented, your disclosure only provides information on acreage expirations for the three fiscal years following the periods covered by your Form 10-K. Refer to Item 1208(b) of Regulation S-K.
- Please expand the disclosure of your production to present the total annual quantities, by final product sold, for each of the periods presented to comply with the requirements in Item 1204(a) of Regulation S-K.

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

Example of an SEC Comment

We note your disclosure . . . indicating that in certain instances you take title to the natural gas, NGLs or crude oil that you gather, store, or transport for your customers. We further note the disclosure in your revenue recognition footnote . . . that you recognize revenues for services and products. Please tell us how much revenue you have recognized, for each financial period presented, related to the sales of tangible product for which you have taken title and the amount of revenue related to services. Also tell us how you determined you were not required to separately disclose net sales of tangible products and revenues from services to comply with Rule 5-03(b)(1) of Regulation S-X and to separately disclose the related costs and expenses to comply with Rule 5-03(b)(2).

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.

Declines in Oil and Gas Prices

Example of an SEC Comment

You indicate that a continued low price environment could cause a "significant revision" in the carrying value of oil and gas properties in future periods. Section III.B.3. of SEC Release No. 33-8350 provides guidance regarding quantitative disclosure of reasonably likely effects of material trends and uncertainties. Please revise to provide more extensive discussion, including, where reasonably practicable, quantification of the impact of current commodity prices on the carrying value of your oil and gas properties. Your revised disclosure should also quantify the impact of potential scenarios deemed reasonably likely to occur on your estimated reserve volumes.

At the 2014 AICPA Conference, the SEC staff reminded registrants in the oil and gas industry to consider the recent declines in oil and gas prices and that such changes may:

- Represent a known trend or uncertainty that should be discussed in MD&A.
- Represent a risk that should be discussed in risk factor disclosures.
- Affect the determination of estimated proved reserves.

The SEC staff has noted that one of the most important elements necessary to gaining an understanding of a company's performance, and the extent to which reported financial information is indicative of future results, is the discussion and analysis of known trends and uncertainties. Section III.B.3 of SEC Release No. 33-8350 calls for the quantification of material effects of known material trends and uncertainties and states that "material forward-looking information regarding known material trends and uncertainties is required to be disclosed as part of the required discussion of those matters and the analysis of their effects." Given the nature of the oil and gas industry, significant changes to commodity prices could affect the overall operations of the company. In particular, a significant decline in commodity prices could have a material impact on the carrying value of an exploration and production company's oil and gas properties and may be an early-warning sign of impairment. Accordingly, registrants in the oil and gas industry should quantify, to the extent possible, the impact of commodity prices on their (1) future development and capital programs and (2) oil and gas properties, including reserves. For more information, see Deloitte's January 2015 *Oil & Gas Spotlight*. Registrants should also consider their risk factor disclosures, including quantitative disclosures about the potential impact of the recent changes in commodity prices on their reserves, and whether those disclosures adequately address the risks arising from the uncertainty associated with the price changes. See PUD Reserves above.

Other Deloitte Resources

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

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. Specifically, the staff has concentrated on (1) dividend restrictions; (2) accounting for the impact of rate making; (3) regulatory disallowance of property, plant, and equipment; and (4) identification of possible phase-in plans.

The SEC staff has also issued comments related to whether registrants in the P&U industry have complied with requirements under ASC 450 to disclose their range of loss in connection with litigation and other contingencies. Further, the staff has asked such registrants to explain the considerations they gave to separately disclosing the revenues and costs of revenues related to nonregulated businesses in light of Regulation S-X, Rule 5-03(b)(1) and (2). For additional considerations related to these topics, refer to the Contingencies and Financial Statement Classification, Including Other Comprehensive Income sections.

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 as of September 30, 2014 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] during the fiscal year ended December 31, 2014 . . . . 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

Example of an SEC Comment

We note from your Form 8-K filed on March 9, 2015 that [Utility Commission A] voted to disallow recovery of costs related to [Capital Project A] and that you expect to record a charge of approximately $[X] during the first quarter of 2015. Considering the recovery disallowance recommendations of [Intervenor A] and [Intervenor B] during 2014 along with the February 2015 [administrative law judge] recovery disallowance proposal, please tell us in more detail why no charges were recorded during fiscal 2014 related to the [Capital Project A] prudence investigation.

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.

Identification of Possible Phase-In Plans

Example of an SEC Comment

Please explain to us in detail why the method of recognition of allowable costs in rates associated with bare steel and cast iron replacement activities of [Subsidiary A] and [Subsidiary B], the capital infrastructure program of [Subsidiary A,] and [the replacement of] bare steel and cast iron pipelines and other infrastructure by [Subsidiary C] are not considered phase-in plans as defined in ASC 980-340-20.

To lessen the impact of a rate increase as part of a current rate proceeding, a regulator may decide to defer costs associated with a major new plant addition. A deferral of any costs associated with a major, newly completed plant could be a phase-in plan. In accordance with ASC 980-340-25-2, cost deferrals are not permitted for phase-in plans. To qualify as a phase-in plan, a method for recognizing allowable costs must meet the three criteria outlined in ASC 980-340-20.

If a major, newly completed plant is being included in rates for the first time and the regulator provides for a deferral of any costs associated with the new plant for inclusion in future rates rather than as part of the cost of service in the current proceeding, those costs may not qualify as regulatory assets under U.S. GAAP regardless of whether the incurred costs are probable of recovery in future rates unless an exception applies.

Mining

Examples of SEC Comments

- We note you have combined your proven and probable reserve categories which is contrary to the explicit guidance of Industry Guide 7, which provides that reserves may be combined as "proven and probable" only if proven and probable reserves cannot be readily segregated. Your filing does not state that your proven and probable reserves cannot be differentiated or segregated with an explanation. Please modify your filing and segregate your proven reserves from your probable reserves in the appropriate reserve tables or provide a statement that this is not possible with the appropriate explanation.
- We note you refer to [Properties A and B] as development stage properties . . . . The terms development and production have very specific meanings within Industry Guide 7 (see www.sec.gov/about/forms/industryguides.pdf). These words/terms reference the development stage when preparing reserves for production, and the production stage when companies are engaged in commercial-scale, profit-oriented extraction of minerals. Since you do not disclose any reserves for these properties, as defined by Guide 7, please remove the terms develop, development or production throughout your document, and replace this terminology, as needed, with the terms such as explore or exploration.
- We note your disclosure of proven and probable reserves for [Mine A]. Please forward to our engineer, as supplemental information and not as part of your filing, your technical report or the information that establishes the legal, technical and economic feasibility of the materials designated as reserves, as required by paragraph (c) of Industry Guide 7. This information should include:
  - Acreage breakdown by owned, leased or other.
  - Maps showing property, mine permit and reserve boundaries; including recent and historic production areas.
  - Drill-hole maps showing drill intercepts.
  - Justifications for the drill hole spacing used at various classification levels.
  - General cross-sections that indicate the relationship between seams, geology, and topography.
  - A detailed description of your procedures for estimating reserves.
  - The specific criteria used to estimate reserves.
  - An indication of how many years are left in your longest-term mining plan for each reserve area.
  - Site specific economic justification for the criteria you used to estimate reserves.
  - Mining plans or feasibility studies, including production schedules, cost estimates and cash flow projections.
  - Third party reviews of your reserves that were developed within the last three years.
  - Any other information needed to establish legal, technical and economic feasibility.

The SEC staff often comments when a registrant has not separately disclosed proven and probable reserves in accordance with paragraph (a) of SEC Industry Guide 7. Under paragraph (b) of Guide 7, such reserves may be combined if "the difference in degree of assurance between the two classes of reserves cannot be readily defined."

Registrants should also ensure that they are appropriately using the terms "exploration stage," "development stage," and "production stage." These terms are explicitly defined in Section (a) of Guide 7.

Further, paragraph (c) of Guide 7 outlines the supplemental information that registrants should disclose "[i]f an estimate of proven (measured) or probable (indicated) reserves is set forth in the [technical] report." Such information includes (1) "maps drawn to scale showing any mine workings and the outlines of the reserve blocks involved together with the pertinent sample-assay thereon," (2) "all pertinent drill data and related maps," and (3) "the calculations whereby the basic sample-assay or drill data were translated into the estimates made [of] the grade and tonnage of reserves in each block and in the complete reserve estimate." Accordingly, the SEC staff may ask for supplemental information for proven and probable reserves. For example, the staff may ask registrants to furnish the technical report or the information that establishes the legal, technical, and economic feasibility of the materials designated as reserves.

Financial Services

Banking and Securities

The SEC staff's comments to registrants in the banking industry have moderated over the past couple of years; however, they continue to focus on (1) the estimation of allowances for loan losses, (2) disclosures about credit quality, (3) acquired loans, and (4) loan modifications and TDRs.

Further, registrants in the securities industry have received SEC staff comments requesting enhanced disclosures about (1) market risk and VaR, (2) asset management and administration fees, (3) order flow revenues and disclosures about license agreements, and (4) the impact of regulatory reporting errors on ICFR.

Allowance for Loan Losses — Collateral Appraisals

Example of an SEC Comment

Please revise your future filings to disclose whether your policy for obtaining appraisals for properties outside of [Country A] is consistent with your policies disclosed here for properties inside [Country A]. If not, disclose the similar policies for obtaining appraisals for properties outside of [Country A]. Additionally, please revise future filings to disclose whether your collateral valuations for construction or development projects that are in process contemplate collateral values "as is" or "as complete/developed."

To understand how registrants determine their allowance for loan losses, the SEC staff often requests disclosures about (1) their appraisal policies, including differences in those policies for various jurisdictions; (2) how frequently they obtain updated appraisals for impaired collateral-dependent loans; and (3) the types of adjustments made to appraised values, if any.

Disclosures About Credit Quality Under ASC 310-10

Example of an SEC Comment

[Please revise future filings to:]

1. [D]isclose the allowance for loan losses rollforward by portfolio segment. Refer to ASC 310-10-50-11B.c for guidance and provide us your planned disclosure in your response.
2. [D]isclose both the balance of your allowance for loan losses and your recorded investment in financing receivables by impairment method (e.g. collectively evaluated, individually evaluated) for each loan portfolio segment. Refer to ASC 310-10-50-11B(g) and (h), ASC 310-10-50-11C, and the example disclosure in ASC 310-10-55-7 for guidance and provide us your planned disclosure in your response.
3. [I]nclude all of the disclosure requirements of ASC 310-10-50-14A through [50-20] related to impaired loans and provide us your planned disclosure in your response.
4. [I]nclude all of the disclosure requirements of ASC 310-10-50-28 through [50-30] related to credit quality information and provide us your planned disclosure in your response.
5. [I]nclude the disclosure requirements of ASC 310-10-50-7(b) and [ASC] 310-10-50-7A regarding past due loans. Refer to ASC 310-10-55-9 for guidance and provide us your planned disclosure in your response.

The SEC staff continues to focus on the disclosures prescribed by ASC 310-10, particularly the granularity of those disclosures. ASC 310-10 requires entities to enhance and disaggregate their disclosures about the credit quality of their financing receivables and their allowance for credit losses.

Specifically, as indicated in ASU 2010-20, ASC 310-10 requires disclosure of the following information about credit exposure and reserving methodology on the basis of disaggregated portfolio segments and classes of financing receivables:

1. Credit quality indicators of financing receivables at the end of the reporting period by class of financing receivables
2. The aging of past due financing receivables at the end of the reporting period by class of financing receivables
3. The nature and extent of troubled debt restructurings that occurred during the period by class of financing receivables and their effect on the allowance for credit losses
4. The nature and extent of financing receivables modified as troubled debt restructurings within the previous 12 months that defaulted during the reporting period by class of financing receivables and their effect on the allowance for credit losses
5. Significant purchases and sales of financing receivables during the reporting period disaggregated by portfolio segment.

Acquired Loans

Example of an SEC Comment

[R]evise your future filings [as follows]:

- [P]lease enhance the relevant sections of your MD&A disclosures to disaggregate your allowance for credit losses and related asset quality disclosures[,] differentiating between your acquired loan portfolio for all periods presented and your originated loan portfolio. . . .
- [D]isclose how changes in the credit quality of your originated loan portfolio are reflected in the amount of your provision for loan loss[es] recorded during the period and the amount of the allowance for loan losses at period end . . . . Your analysis should quantify each loan portfolio component of your allowance for loan losses (ASC 310-10, ASC 450-20) and explain how incremental credit quality changes are reflected.

The SEC staff has requested disclosures that clearly distinguish between the registrant's originated loans and its acquired loans (both PCI and non-PCI) to enable financial statement users to understand the key characteristics of each portfolio and the related impact on the determination of the allowance for credit losses.

Loan Modifications and TDRs

Example of an SEC Comment

Please revise your disclosure in future filings to provide [information about your forbearance program as follows]:

- Clarify whether you have any limits on the number of times a borrower may request a modification of the terms of [its] loan. If not, please discuss how you consider multiple modifications in determining whether a loan has been renegotiated or refinanced.
- [S]eparately disclose the balance of loans that have received multiple modifications [and the balance of loans] that have received only one modification.
- [R]evise future filings to discuss how you consider the level of loans needing more than one modification as well as the level of re-defaults of refinanced or renegotiated loans when determining the appropriate level of allowance for loan losses. If you believe this disclosure is no longer meaningful, please tell us why.

The SEC staff continues to request enhanced disclosures about loan restructurings. The staff has also inquired about whether such restructurings should be accounted for as TDRs and therefore should be included in the registrant's risk element disclosures required by SEC Industry Guide 3.

The SEC staff has suggested that registrants consider disclosing:

- How modifications affect the timing of the recording of the allowance for loan losses.
- A description of the key features of the registrant's loan modification programs, including whether the programs are government- or company-sponsored and whether they are short- or long-term.
- How frequently loans are modified and remodified.
- More granular and quantitative information about the levels of loan modifications and remodifications.
- Quantification of the types of concessions made (e.g., rate reductions, payment extensions, forgiveness of principal, forbearance) and discussion of success with the different types of concessions.
- The accounting policy for restructured loans, including how and when a restructured loan is determined to be nonaccrual or accrual (i.e., noninterest accruing or interest accruing); the factors the registrant considered in determining whether the loan should accrue interest; the anticipated period and number of borrower payments for a restructured loan to return to accrual status; and whether any loan loss allowance has been recorded or any portion of the loan has been charged off.
- Confirmation of whether loan restructurings should be classified as TDRs under ASC 310-40 and, if so, separate disclosure of the loans in the nonperforming assets table under SEC Industry Guide 3, Item III(C)(1).
- TDRs by loan type, classified separately as accrual or nonaccrual.

In addition, if there are material changes in TDRs, the SEC staff may ask about such changes and request additional disclosures, including a rollforward detailing loan sales, payments, charge-offs, and loans that have been removed from TDR status.

Further, when a material amount of a registrant's loan modifications is not accounted for as TDRs, the SEC staff often requests disclosures that explain:

- Triggers and factors the registrant considered to identify loans to modify and to support its conclusion that modifications are not TDRs.
- Key features of the modification programs, including a description of the significant terms modified and the typical length of each modified term.
- Success rates of the modification programs.
- The amount of the loans modified in each period presented.
- Whether the modified loans are included in the registrant's impairment analysis of the general reserve (ASC 450-20) or individual reserve (ASC 310-10) and, if included in the general reserve analysis, whether a materially different amount would have resulted if the loans had been included in the individual reserve analysis.

In evaluating whether a loan modification represents a TDR, a registrant must use judgment to determine whether (1) the debtor (i.e., the borrower) is experiencing financial difficulty and (2) the lender has granted a concession to the borrower.

ASC 310-40 outlines considerations for determining whether a borrower is experiencing financial difficulties (e.g., debtor default, debtor bankruptcy, and concerns about the borrower's ability to continue as a going concern). Further, it clarifies that a borrower not currently in default could be experiencing financial difficulties if default is probable in the foreseeable future.

Disclosures About Market Risk and VaR

Example of an SEC Comment

We note that you made significant changes to your regulatory VaR and stressed-VaR models in 2013. We also observe . . . that certain significant variances in VaR measures from June 30, 2013 to September 30, 2013 were the result of changes made to your VaR models (i.e. you replaced relative or percentage changes in interest rate risk factors with absolute changes). Finally, we note that you have omitted comparative information for 2012 because of the changes made to your VaR models. Please explain to us and revise your future filings to address the following:

- Disclose comparative information for prior periods under the current model or additionally provide current and comparative information under the previous model until all reported periods are presented under the current model. Refer to Item 305(a)(1)(iii)(4)(ii) of Regulation S-K which requires the disclosure of both the old and new methods for the purposes of comparability.
- Explain to us your basis for making the changes to your VaR models (i.e. explain how this change has made your model more precise). Include in your explanation a description of any other changes made to your model and indicate which changes were the result of regulatory guidance.

The SEC continues to ask registrants in the banking and securities industries to provide enhanced quantitative and qualitative disclosures about market risk and VaR. In addition, the SEC staff may ask registrants to:

- Quantify the amount of the investment positions excluded from the VaR measure.
- Explain whether the VaR measure includes the market risk associated with securities sold but not yet purchased.
- Include comparative disclosures for the prior year, along with a discussion describing the reasons for material quantitative changes in market risk.
- Explain the reason for the length of the historical observation period used to calculate VaR-based measures.
- Identify whether VaR-based measures are based on regulatory or internal risk management parameters and include a description of the parameters used.
- Revise future filings to present information under a stressed-VaR scenario or to explain why this information would not be meaningful.

Asset Management and Administration Fees

Example of an SEC Comment

We note that a significant amount of your asset management and administration fees are generated from [your] money market funds, equity and bond funds, and [Mutual Fund A] (i.e. mutual fund service fees). In an effort to enhance your disclosure and provide greater transparency to investors, please revise your future filings to address the following:

- Provide a separate roll-forward of your assets under management and administration (AUM&A) for each asset class (as noted above). Your roll-forward should include, but not be limited to, gross in-flows and gross out-flows, market appreciation (depreciation), and the effects of foreign currency translations for each period provided.
- Disclose the average AUM&A for each asset class for each period provided. In addition, consider expanding your client metrics . . . to provide your average client assets.
- Provide an analysis (preferably in tabular format) comparing your weighted average fee rate charged (e.g. by basis points) for the aforementioned asset classes.
- Provide a discussion here, and elsewhere within your MD&A as necessary, of any significant trends experienced in AUM&A (e.g. new client assets or redemptions, significant changes between asset classes attributable to specific or general economic factors, etc.).

The SEC staff has asked registrants in the banking and securities industries to enhance their disclosure about asset management and administration fees to provide greater transparency to investors. Specifically, the staff has asked registrants to include (1) a separate rollforward of AUM for each asset class, and (2) the rollforwards that reflect gross inflows, gross outflows, and market appreciation (depreciation) separately from effects of foreign currency translations for each period. In addition, the SEC staff may ask registrants to present the net return on AUM for each period presented to give investors a better understanding of AUM performance.

Order Flow Revenues and Disclosures About License Agreements

Examples of SEC Comments

- It appears that order flow revenues have been a significant component of your "Other Revenue" line item in each of last three fiscal years. However, your disclosure does not indicate the amount of order flow payments or the amount of the change, year over year. We note that payments made to brokers by market venues were subject to a significant amount of public, press, regulatory and congressional scrutiny. Also, we note that on your website you provide customers with disclosure about the revenue per share you receive from various market venues. In order for investors to better understand the impact of order flow payments and any changes to the arrangements, please revise your disclosure in future filings to disclose the amounts of revenue generated from order flow in each period. Please discuss the major components of order flow revenues. Please also discuss the reasons for any material changes in order flow revenues, such as whether an increase was a result of a higher trade volume or a change in the fee structure paid by the market venues.
- We note from your disclosure . . . that licensing agreements in place with [Entities A, B, and C] expire in 2017, 2015 and 2015, respectively. Please tell us and, in future filings, consider discussing the impact that the expiration of these licenses could have on your business, to the extent that they are material individually or in the aggregate. In addition, in future filings, consider disclosing the expiration date of your license agreement with [Entity D] and include it in the discussion suggested above to the extent that [the license agreement] will expire in the near term.

Although other revenues and expenses may not typically be thought of as items that require additional disclosure, the SEC staff has asked registrants in the securities industry to identify significant components of other revenue and expense items that may be of interest, or may be material, to users.

Impact of Regulatory Reporting Errors on ICFR

Example of an SEC Comment

We note your disclosure that you applied an incorrect adjustment . . . , resulting in an overstatement of your historical regulatory capital ratios included in prior SEC filings and other regulatory reports. Additionally, . . . you filed an 8-K disclosing that a third party was engaged to perform certain procedures . . . , and that this review resulted in adjustments to your regulatory capital ratios . . . . Lastly, . . . a spokesperson for the company noted that you made an error in calculating the volume data you sent to FINRA regarding the equity volume transacted on your alternative trading system. In light of these errors noted in your SEC and other regulatory reporting, please provide us with the following additional information:

- Tell us whether the identification of the regulatory capital ratio error and subsequent adjustments are indicative of the existence of one or more material weaknesses in [ICFR], and, if so, whether any such material weaknesses also would have existed as of December 31, 2013;
- To the extent you identified significant deficiencies in your original assessment of ICFR as of December 31, 2013, tell us the nature of each, including the impacted component(s) of the [COSO] Internal Control Integrated Framework, and how you evaluated their severity individually and in the aggregate, including in aggregation with any deficiencies identified upon discovery of the above regulatory capital ratio errors, if applicable; and
- Upon discovery of the error related to alternative trading system volume in your regulatory reporting to FINRA, tell us the extent to which there may be common root causes to the errors in your regulatory capital ratio reporting that are relevant to the evaluation of the nature and severity of any deficiencies in ICFR (especially the control environment, risk assessment, or monitoring components of COSO).

Registrants should be aware that regulatory disclosures are a critical part of the financial statements and that the SEC staff asks issuers to determine how deficiencies in regulatory reporting affect ICFR.

Other Considerations

The SEC staff has asked registrants to explain, and disclose in future filings, (1) whether they have evaluated the impact of a decline in the market and (2) how their brokerage revenues and investment holdings would be affected.

For more information, see the Management's Discussion and Analysis section.

Insurance

In many of its comments to registrants in the insurance industry, the SEC staff has continued to focus on (1) reserves and loss adjustment expense; (2) disclosures related to the current interest rate environment; and (3) various other considerations, including those related to statutory disclosures, disclosures about dividend restrictions, captive subsidiaries, and investments and financial instruments.

In addition to the insurance-related matters (discussed below), the SEC staff's comments to registrants in the insurance industry have focused on goodwill and income taxes. See the Impairments of Goodwill and Other Long-Lived Assets and Income Taxes sections for more information.

Reserves and Loss Adjustment Expense

Example of an SEC Comment

Please tell us the variations in loss and loss adjustment expenses for the appropriate periods that relate to prior year loss reserve development and provide proposed revised disclosure to be included in future periodic reports that discusses the amount and underlying causes of prior year loss development.

The SEC staff has asked registrants to discuss in the critical accounting policy section of their MD&A the drivers of change to their loss reserve, including assumptions that have changed and assumptions that are reasonably likely to change. In addition, the SEC staff continues to ask registrants to (1) explain the key methods and assumptions they used in deriving their loss adjustment expense and related reserves and (2) provide current disclosures that comply with the requirements of SEC Industry Guide 6.

Interest Rate Environment

Example of an SEC Comment

You state that the current low interest rate environment has meant that you have invested or reinvested cash flows at substantially lower yields than your existing portfolio yield, while your ability to reduce credited rates has been limited by contractual minimums. Please provide us proposed disclosure to be included, in MD&A, in future periodic reports that discloses the expected effects of this known trend or uncertainty on your future financial position, results of operations and cash flows. To the extent that information about cash flows you expect to have to reinvest at lower rates due to potential maturities or calls of your investments, or [information about] cash flows that you are committed to pay due to products with guaranteed features[,] is necessary to understand these effects, please include information such as the amount of maturing or callable investments and their weighted average yields and the amount of products with guaranteed features and their rates in your proposed disclosure.

Depending on the interest rate environment, the SEC staff may comment on effective interest rates and ask registrants to expand their disclosures about the expected effects of the interest rate environment and the impact of those effects on future financial information (e.g., financial position, results of operations, and cash flows).

Other Considerations

Statutory Disclosures and Disclosures About Dividend Restrictions

SEC staff comments to registrants in the insurance industry continue to focus on compliance with existing disclosure requirements about statutory capital, surplus, and dividend restrictions under ASC 944-505-50 and Regulation S-X, Rule 4-08(e). When registrants have used in their annual audited financial statements labels such as "Unaudited," "Approximate," or "Preliminary" to describe their statutory capital and surplus, the staff will remind them that these disclosures are required to be audited. Further, the staff has asked registrants to enhance disclosures on minimum capital and surplus requirements for both domestic and foreign subsidiaries.

The SEC staff has also asked registrants in the insurance industry about their compliance with Regulation S-X, Rules 4-08(e) and 7-05(c),[1] when there appear to be restrictions on the payment of dividends. In addition, registrants in the industry have been asked to provide additional information about the considerations underlying their determination of why they did not need to disclose information required under Rules 4-08(e) and 7-05(c). Further, the staff has reminded registrants that in applying Rule 4-08(e), they must consider foreign insurance operations and nonregulated subsidiaries in addition to U.S. domestic subsidiaries. See the Debt section for additional information.

Captive Subsidiaries

Many insurance entities have captive subsidiaries, which insure specific risks for the parent entity and its affiliates. These captive subsidiaries allow entities to manage their own risks and provide many advantages, including capital management benefits. The SEC staff has continued to request expanded disclosures about transactions between registrants in the insurance industry and their captive subsidiaries, such as the nature, purpose, and number of those transactions. Further, it has requested enhanced disclosures about the impact of captive subsidiaries on registrants' financial statements and about the risks and uncertainties associated with those subsidiaries.

Investments and Financial Instruments

Given the significance of investment portfolios to most registrants in the insurance industry, the SEC staff may ask such registrants about their investments and financial instruments and whether related disclosures portray their financial position accurately. Accordingly, the staff may concentrate on conclusions reached by management about the credit quality of investments and may ask registrants to summarize the procedures they performed (and other support they obtained) to make such determinations.

The SEC staff may also question registrants' disclosures about key drivers that affected their net derivative results. When there has been significant volatility in results for multiple periods, registrants may be asked to enhance their disclosures about the drivers of net derivative gains and losses.

[1] Rule 7-05(c) requires registrants in the insurance industry to file Schedule II if the rule's conditions are met. These conditions are identical to those under Regulation S-X, Rule 5-04, that govern whether a commercial company must file Schedule I. See the Debt section for information about Rule 5-04.

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) risk oversight, (3) consolidation, and (4) commitments and contingencies. The staff has also commented on quantitative and qualitative disclosures about market risk. For more information about risk factors, see the Disclosures About Risk section.

In addition, the SEC's Office of Compliance Inspections and Examinations (OCIE) highlighted the examination priorities of the SEC's 2015 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) protecting retail investors and investors saving for retirement, (2) assessing market-wide risks, and (3) using data analytics to identify signals of potential illegal activity. For more information about these priorities, see the OCIE's 2015 National Exam Program.

Fair Value Measurement

> **Example of an SEC Comment**
>
> We note that you use valuations provided by third party pricing services as the basis for your fair value measurements for several different types of financial instruments. Please revise your future filings to disclose the procedures you perform to validate the valuations received from such third party pricing services.

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. 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 net asset value per share 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[2]). 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.

Risk Oversight

> **Example of an SEC Comment**
>
> Please expand your risk management discussion to describe in more detail the various tools you use to monitor risk. You should address:
>
> - Whether you have identified triggering events that require reports/communications to the committee;
> - Whether you have a Chief Risk Officer and this person's role in the risk management process; and
> - Potential challenges your organization faces in managing risk.

An Exchange Act registrant is required to disclose its board's risk management policies and procedures under Regulation S-K, Item 407(h). The SEC staff may ask an investment adviser in the investment management industry to elaborate on its board's risk management oversight of investment vehicles and to disclose additional information about the risk management responsibilities of board committees (e.g., the audit and compliance committees).

[2] For SEC staff remarks about the use of third-party pricing services to measure fair value, see Deloitte's December 14, 2011, *Heads Up*.

Consolidation

Example of an SEC Comment

We note your consolidation policy related to variable interest entities ("VIEs"). Please revise your future filings to address the following:

- Expand your disclosure to discuss how you assess your rights in determining if you have the power to direct the activities of the VIE that most significantly impact the [VIE's] economic performance.
- In your discussion of VIEs evaluated for consolidation that are not money market funds or investment companies you state that "when determining whether the Company stands to absorb the majority of a VIE's expected losses or receive a majority of [the] VIE's expected returns, if the Company determines it has control over the activities that most significantly impact the economic performance of the VIE and it will absorb a majority of the VIE's expected variability, [the Company] will consolidate the [VIE."] Explain how your disclosure here is consistent with the guidance in ASC 810-10-25-38.
- In your discussion of [VIEs] that will be consolidated when you have both the power to direct the activities of the VIE that most significantly impact the VIE's economic performance and the obligation to absorb losses or right to receive benefits that could potentially be significant to the VIE, clarify how the calculation of variability, based on an analysis of projected probability-weighted cash flows based on the design of a particular VIE, complies with the guidance in ASC 810-10-25-38A(b) in determining whether losses and benefits could potentially be significant to the VIE.
- Expand the examples of entities assessed for consolidation under the different frameworks described in your policy discussion . . . to increase transparency as to the basis for entities consolidated (e.g. [collateralized debt obligations], pooled investment vehicles, etc.).

Because VIEs are common in the investment management industry, the SEC staff continues to comment on management's conclusions regarding the consolidation or deconsolidation of VIEs and asks investment advisers to clarify why certain vehicles have been consolidated and others have not. The SEC staff frequently questions (1) the consolidation model applied to specific investments, (2) the qualitative and quantitative assessments used to determine the primary beneficiary, and (3) the related disclosures. For more information, see the Consolidation section.

Commitments and Contingencies

Example of an SEC Comment

In future financial statements, please include a line item for "Commitments and Contingencies," along with a reference directing the reader to the related footnote in the Company's Notes to Financial Statements . . . . See Regulation S-X Rule 6-04.15.

Business development companies have received SEC staff comments related to their financial statements. Recently, the SEC staff has focused on the requirements of Regulation S-X, Rule 6-04.15, and has asked business development companies to include a line item on the balance sheet for commitments and contingencies along with a reference to the related footnote.

Real Estate

The SEC staff's comments to registrants in the real estate industry have focused on topics 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) leasing activities; (3) capitalization of real estate development, construction, and leasing costs; (4) non-GAAP financial measures; (5) liquidity considerations associated with distributions; and (6) consolidation.

In addition, in industries other than real estate, the SEC staff has observed a higher frequency of REIT transactions (e.g., conversions, spin-offs, and carve-outs) involving nontraditional real estate assets such as cell towers, data centers, and billboards. REITs holding nontraditional real estate assets have received staff comments suggesting that they should strive to comply with the spirit of the disclosure requirements prescribed for REITs that hold traditional real estate assets (e.g., requirements related to Schedule III,[3] portfolio occupancy, effective rents, material tenant concentrations, category and physical location of the assets, significant lease types, and lease expiration dates). REITs holding traditional real estate assets that provided insufficient disclosures have also received comments from the staff.

Real Estate Acquisitions

Examples of SEC Comments

- Please provide us with the results of the significance tests for your 2013 and 2014 acquisitions in accordance with Rule 3-14 of Regulation S-X. For each property acquisition where Rule 3-14 financial statements are required, please tell us where you have filed these financial statements.
- Please tell us and disclose your policy for determining whether the acquisition of real estate is a business or asset purchase and the result of that determination on how [you] record the cost of the transaction.

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 (see the SEC Reporting section for additional information about Rule 3-05). 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.

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.

[3] Under Regulation S-X, Rule 5-04, certain real estate companies are required to file a Schedule III that presents supplemental information about real estate investments and accumulated depreciation on a property-by-property basis in the manner prescribed by Regulation S-X, Rule 12-28.

Leasing Activities

Triple Net Leases

Examples of SEC Comments

- It appears that [Entity X] is a significant lessee of properties under a long-term triple-net lease. Please tell us how you determined it was not necessary to provide audited financial statements of [Entity X].
- We note that you have presented within . . . [Forms 8-K] summary financial information for [Entity X], [Entity Y] and [Entity Z], along with disclosure as to where audited financial statements could be located on the internet for these companies. Please tell us how you have complied with the applicable rules to provide financial statements of significant asset concentrations as these financial statements have not been filed pursuant to the Exchange Act.

In a triple net lease, a lessee is typically required to pay costs that are normally associated with ownership, such as property taxes, insurance, utilities, and maintenance costs. In accordance with Section 2340 of the FRM, a registrant that leases, under triple net leases, one or more properties to a single lessee may need to provide full audited financial statements of the lessee (or guarantor) for the periods required by Regulation S-X, Rules 3-01 and 3-02, if a determination was made that the properties represent a "significant" portion of the registrant's assets (i.e., more than 20 percent of the registrant's assets as of its most recent balance sheet date). Section 2340 further states that if the lessee is a public company subject to the periodic reporting obligations of the Exchange Act, a registrant that would otherwise be required to provide such full audited financial statements may instead include in its filing a statement that refers investors to a publicly available Web site containing financial statements the lessee filed with the SEC. Accordingly, when a registrant enters into a triple net lease and its filing does not include or refer to a lessee's financial statements, the SEC staff may request information related to the significance test performed to determine whether there is significant asset concentration. Similarly, the SEC staff will inquire about significant asset concentration when a registrant acquires a property that is subject to a triple net lease.

Disclosures About Rental Performance

Examples of SEC Comments

- In future Exchange Act periodic reports, please provide more detailed leasing statistics, including the amount of space available at the start of the period, the amount of lease expirations, the amount of new leases, the amount of renewals and the amount of vacant space at the end of the period. Additionally, please provide more detailed disclosure regarding tenant improvement costs and leasing commission costs for new leases.
- In future Exchange Act periodic reports, please include a discussion that compares new leases and renewed leases on previously leased properties to prior rents received. Such amounts should be adjusted for any tenant concessions provided, such as free rent.

Over the past few years, as rental rates in many markets have fluctuated, the SEC staff has commented about registrants' disclosures in MD&A of lease rollover trends, including changes in rental rates on lease renewals and new leases in the reporting period. For space expected to be re-leased over the next 12 months, the staff has commented on the difference between existing rents and current market rents to better understand registrants' current and future performance trends.

The SEC staff has also requested information about activity related to new and expiring leases and lease renewals during the reporting period, including:

- Square feet leased.
- Average rents.
- Per-square-foot costs associated with leasing (e.g., leasing commissions, tenant allowances, and tenant improvements).

See the Leases section for additional staff comments on leasing transactions.

Capitalization of Real Estate Development, Construction, and Leasing Costs

Examples of SEC Comments

- [C]onsider including in future filings a breakdown of your capital expenditures by type (new development, redevelopment/renovation, tenant improvements/allowances, CAM, etc.) and by period presented.
- In future filings, please expand your disclosure to clearly describe your capitalization policy as it relates to construction/development costs including interest, salaries and G&A, real estate taxes and any other significant amounts that are capitalized during the pre-acquisition phase and the construction phase including a discussion of when the capitalization period ends.

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.

Non-GAAP Financial Measures

Examples of SEC Comments

- In future Exchange Act periodic reports, in order to illustrate for investors your internal earnings growth, please disclose period to period same store net operating income. Additionally, please disclose how you determine the properties that fall within the “same store” pool, including also a discussion of any properties that were excluded from the pool that were owned in all periods compared, and how you determined which revenues and expenses to include in determining NOI. For example, please explain if you include items such as tenant improvement and leasing commissions, ground rent, lease termination fees and marketing costs.
- In arriving at Funds from operations, you start with Net income available to common stockholders. As a result, it appears Funds from operations is actually Funds from operations attributable to just common stockholders instead of all equity stockholders. In future periodic filings please re-title “Funds from operations” to the more appropriate “Funds from operations attributable to common stockholders.”

The SEC staff has continued to comment on inconsistencies between (1) the key performance measures identified in press releases, earnings calls, and analyst presentations and (2) the non-GAAP financial measures disclosed in registrants’ SEC filings. Although the SEC filings of most REITs include FFO as defined by the National Association of Real Estate Investment Trusts (NAREIT), REIT communications to shareholders and analysts may use other performance measures, such as modified FFO, adjusted FFO, core FFO, EBITDA, NOI, or core earnings.[4] When these key performance measures are provided in other communications to investors, the SEC staff may ask registrants why such non-GAAP financial measures were not disclosed in their periodic reports (e.g., Forms 10-K and 10-Q).

In addition, the staff has recently issued comments on FFO disclosures that are inconsistent with NAREIT's definition of FFO. Many of these comments have specifically asked the registrant to confirm whether its FFO calculation is in accordance with NAREIT's definition of FFO and have focused on whether FFO is reported gross or net of noncontrolling interest adjustments. In situations in which the FFO calculation appears to consider noncontrolling interest adjustments and is simply labeled "FFO," the staff has asked registrants to update the labeling of the total to reflect "FFO attributable to common stockholders" or "FFO attributable to the company."

The SEC staff has also focused on non-GAAP performance metrics used in MD&A. The staff has requested clarification of how registrants define NOI to determine whether any additional property operating costs should be included. The SEC staff will often question whether the MD&A disclosure of period-to-period changes clarifies the impacts of same-property and non-same-property results, particularly when the discussion does not address the drivers of changes in the operating results (e.g., occupancy, rental rates) besides changes in the number of properties. To improve transparency, disclosures of "same-property NOI" should (1) be accompanied by a clear explanation of how the same-property pool is defined and determined and (2) highlight any changes in the pool from the prior reporting period, including the number of properties that were added to and removed from such metrics in any given year.

Over the past couple of years, the SEC staff has also requested additional information and disclosure about backlog from (1) real estate companies involved in engineering and construction and (2) home builders.

See the Backlog Disclosures, Management's Discussion and Analysis, and Non-GAAP Financial Measures and Key Metrics sections for additional information.

Liquidity and Capital Resources — Distributions

Example of an SEC Comment

In future Exchange Act periodic reports, please provide separate disclosure showing cash coverage and earnings coverage of distributions for the last fiscal year . . . . Highlight the relationship between total distributions paid, and cash flow from operations showing the source of any shortfall. In addition, show the relationship of the total distributions paid and earnings, net income or FFO. To the extent there is a shortfall in either cash flow from operations coverage or FFO . . . coverage, please specify the percentage coverage in a risk factor related to dividend coverage.

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.

See the Management's Discussion and Analysis section for further discussion about liquidity and capital resources.

[4] See Questions 102.01 through 102.03 of the C&DIs on non-GAAP financial measures for additional information about FFO and NAREIT.

Consolidation

> **Example of an SEC Comment**
>
> Please clarify how you determined that you do not have a controlling interest in either of [your] joint ventures. Your disclosure . . . suggests that you are the managing member in each of the joint ventures and as such there would be a presumption of control by analogy to ASC 970-810-25-3.

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 further discussion about VIEs.

Health Sciences

Life Sciences

The SEC staff's comments to registrants in the life sciences industry have focused on topics such as (1) revenue recognition, (2) disclosures related to risk factors, (3) MD&A disclosures, (4) business combinations, and (5) commitments and contingencies.

Revenue Recognition

Collaborative Arrangements

Examples of SEC Comments

- In order to help us understand more fully how your collaborative arrangements impact your financial statements for each period presented, please provide us, in table format, the amounts . . . by year and by line item included in your statements of operations attributable to transactions arising from collaborative arrangements between you and the other participants and third-parties. Please provide separate tables for each of your "significant" collaborative arrangements and for all of your collaborative arrangements in the aggregate (i.e. the "significant" arrangements and all other arrangements). Present separately amounts with other participants and third-parties that are netted in a financial statement line item.
- You indicate that collaborative activities may include research and development, marketing and selling (including promotional activities and physician detailing), manufacturing, and distribution. Tell us your accounting policies regarding separation and allocation for your collaborative arrangements.
- Although you disclose your accounting policies for income you generate as a result of collaboration agreements under "revenue recognition" . . . , tell us your accounting recognition for other aspects of these arrangements and where these policies are disclosed.

Collaborative arrangements are common among biotech and pharmaceutical companies. ASC 808-10 provides guidance on the income statement presentation, classification, and disclosures related to collaborative arrangements but "does not address recognition or measurement matters related to collaborative arrangements, for example, determining the appropriate units of accounting, the appropriate recognition requirements for a given unit of accounting, or when the recognition criteria are met." As a result, the SEC staff often asks registrants in the industry about the nature of, and accounting for, their collaborative arrangements and has continued to probe them 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. Collaborative arrangements within the scope of ASC 808 are based on the premise that each party to the agreement assumes a proportionate share of risks and, therefore, a vendor-customer relationship does not exist. Even if the registrant concludes that it is a party to a collaborative agreement, however, there may be circumstances in which certain elements of the agreement represent activities that are similar to those in a vendor-customer relationship. Accordingly, the SEC staff seeks to understand the registrant's accounting policies regarding separation (i.e., unit of accounting) and allocation (i.e., when multiple units exist) for collaborative arrangements.

In addition, since collaborative arrangements often include up-front payments, royalty or profit-share payments, and expense reimbursements, the SEC staff has requested supplemental explanation of the registrant's determination and disclosure of (1) the separation, allocation, recognition, and classification principles that were used to account for payments between collaboration partners and (2) the factors that led the registrant to conclude that it is the principal (or agent) in transactions with third parties.

The SEC staff also has requested enhanced disclosures about registrants' collaborative agreements, including the overall effect of collaborative arrangements on the financial statements. Staff requests for such disclosures have focused on clearly describing the material terms of a collaborative arrangement, such as (1) each party's rights and obligations under the arrangement, (2) potential payments, (3) the existence of royalty provisions, and (4) duration and termination provisions. Further, the SEC staff has asked that registrants prepare a tabular summary to provide the staff with a composite disclosure of the financial statement impact of all collaborative arrangements. For all periods presented, the staff may request a separate table for each significant collaborative arrangement and a table for all collaborative arrangements in the aggregate; in addition, the staff may request separate presentation in such tables of amounts attributable to transactions with other participants and third parties that are presented net in a financial statement line item.

Further, the staff may ask registrants to file a material collaborative arrangement as an exhibit to their filing in accordance with Regulation S-K, Item 601(b)(10). For more discussion, see the Material Contracts section.

Milestones

Example of an SEC Comment

Your disclosure . . . lists the awarding of a license as an example of an appropriate milestone for revenue recognition. Please provide us with a detailed explanation of your basis for previously recognizing this revenue, including the specific milestones previously reached that made recognition of the revenue on the affected contracts appropriate. Also, please clarify your ongoing revenue recognition policy in terms of when it is appropriate to recognize revenue prior to obtain[ing] a license.

The SEC staff has continued to comment on disclosures related to the milestone method of revenue recognition under ASC 605-28. When such disclosures apply, the staff will review the registrant's filings to determine whether they contain the following disclosures outlined in ASC 605-28-50-2:

a. A description of the overall arrangement

b. A description of each milestone and related contingent consideration

c. A determination of whether each milestone is considered substantive

d. The factors that the entity considered in determining whether the milestone or milestones are substantive

e. The amount of consideration recognized during the period for the milestone or milestones.

Registrants in the industry will often make adjustments for milestones when determining non-GAAP income. For a discussion of adjustments made by registrants when determining their non-GAAP measures, see the Non-GAAP Financial Measures and Key Metrics section.

Multiple-Element Arrangements

> **Example of an SEC Comment**
>
> You disclose that you recognize revenue from the licensing of product rights and the performance of research or selling activities over the periods earned. Please tell us the amounts of each of these streams of [revenue] you recognized in each of the last three years and address the following:
>
> - Tell us your consideration for disclosing each revenue stream separately under Item 5-03.1 of Regulation S-X;
> - Tell us your consideration for disclosing the terms of any material arrangements under which these revenues are earned; and
> - To the extent these streams are material, provide us proposed revised policy disclosure to be provided in future periodic reports that clarifies how you recognize these revenues "over the periods earned."

The SEC staff often asks registrants in the life sciences industry to expand or clarify their disclosures about multiple-element arrangements, particularly those involving licenses of product rights and other deliverables. Registrants could improve their required disclosures about the nature and terms of such arrangements by (1) separating the description of the obligations and rights from the discussion of how they were accounted for, (2) ensuring that the description is complete (i.e., that all material terms are disclosed for each revenue stream), and (3) precisely describing the rights conveyed by the license.

In addition, the staff has reminded registrants that they should explicitly identify each deliverable in the arrangement and explain why it represents (or does not represent) a separate unit of accounting. The staff has also suggested that registrants could improve their disclosures about the relative selling price method of allocating arrangement consideration by (1) quantifying the total arrangement consideration to be allocated, (2) identifying the amount of consideration allocated to each unit of accounting, and (3) explaining how the estimated selling price for each unit was determined (including the significant assumptions used). For more information about multiple-element arrangements and other revenue-related considerations, see the Revenue Recognition section.

Risk Factors

> **Example of an SEC Comment**
>
> You disclose your plan to initially conduct further clinical trials in Europe and that you intend to put off any clinical trials in the United State until 2015. Accordingly, please also discuss here any risks to your product development and domestic commercialization strategy from conducting trials outside of the United States. For example, you should address the possibility that the FDA may not accept the results of such trials and how such lack of acceptance could impact the regulatory approval process.

The SEC staff recently issued several comments on risk factors related to product development. More specifically, when registrants have used boilerplate language for risk factor disclosures, the staff has commented that risk factor disclosures should focus on providing additional detail specifically related to the registrant and the risks associated with the registrant's product development. In addition, the staff has asked registrants to explain how they would be affected by such risks if those risks came to pass.

MD&A Disclosures

R&D Expenses

Example of an SEC Comment

Please revise your disclosure to disclose the costs incurred during each period presented and to date for each of your research and development projects. If you do not maintain any research and development costs by project, disclose that fact and explain why you do not maintain and evaluate research and development costs by project and provide other quantitative or qualitative disclosure that indicates the amount of your resources being used on each of your projects.

The SEC staff has asked registrants in the life sciences industry to expand their disclosures about internal R&D expenses and estimated future expenses beyond those required under ASC 730-10. In addition to disclosing the types of activities and elements included in R&D expenses and the amount of R&D expenses incurred during each reporting period, registrants may be asked to revise their MD&A (and Business section) to include information about each major R&D project. If registrants do not maintain information about R&D costs by project or program, they may be asked to explain why.

Registrants must carefully consider whether their R&D projects are significant enough to warrant disclosure and whether the timing of the costs associated with the projects can be reasonably estimated. Registrants involved in late-stage clinical trials should consider expanding their disclosures about such projects to reflect the uncertainty of ultimate regulatory approval and commercial success.

The SEC staff may also ask a registrant to include, in its contractual obligations table in MD&A, commitments to make payments for R&D contractual relationships. See the Management's Discussion and Analysis section for more information about the contractual obligations table.

Revenue Adjustments

Examples of SEC Comments

- We believe that your disclosure related to estimates of items that reduce revenues such as product returns, chargebacks, rebates and other sales deductions could be improved. . . . [P]lease provide us a revised table to be included in future periodic reports that presents the following:
  - Current provision related to sales made in current period,
  - Current provision related to sales made in prior periods,
  - Actual returns or credits in current period related to sales made in current period, and
  - Actual returns or credits in current period related to sales made in prior periods[.]
- [P]lease provide us disclosure to be provided in future periodic reports that discusses the amount of and reason for fluctuations for each type of reduction of revenue (i.e. product returns, chargebacks, rebates and other sales deductions) including the effect that changes in your estimates of these items had on your sales and operations.

The SEC staff has asked registrants to expand their MD&A disclosure related to the reductions in revenue incurred as a result of product returns, chargebacks, rebates, and other revenue adjustments. Enhancement requests have focused on (1) describing in tabular format the period-over-period fluctuations that occurred and (2) disclosures describing the reasons for changes, such as changes in pricing strategies or changes in contracts. Further, the SEC staff has asked registrants to clarify the period to which their recorded provisions or processed credits apply.

Patents

Examples of SEC Comments

- We note your disclosure regarding your patent portfolio which you have provided in bullet point format . . . . Please revise your disclosure regarding your patents and patent applications to provide the following information:
    - Please specify which of your patents and [patent] applications are owned and which are licensed. For the patents and patent applications which are licensed, please specify from whom they are licensed;
    - Please disclose in which jurisdictions your patents have been granted and which jurisdictions your patent applications are currently pending. In this regard we note that you provide this information in some of your bullet points but not in others; and
    - Please provide the expected expiration dates if your pending patent applications are approved. Please provide this information separately from the expiration dates of your approved patents where applicable.
- Please tell us, and disclose in future filings, when the patents . . . expire. In this regard, please tell us which patents, if any, expired and will expire in the near future that are resulting in or are likely to result in material competition from generic products; include in your response the portion of your revenue and income derived from those patents.

The SEC staff has regularly commented on life sciences registrants' disclosure of patents, particularly on patent exclusivity of their products in U.S. and foreign jurisdictions and the impact of such exclusivity on revenues and overall operations. Patent expiration and challenges can affect not only a registrant's current-period earnings but also its future operations and liquidity, particularly if the patents are for core products. Registrants should consider Regulation S-K, Items 101 and 503(c), respectively, for guidance on (1) disclosing patent information in the Business section of their periodic filings and (2) discussing patent expiration and challenges as possible risk factors in their annual reports. In addition, the SEC staff has requested information on the subject matter, type of patent coverage (e.g., method of use, composition of matter), and jurisdiction of a registrant's patents.

Liquidity

Examples of SEC Comments

- We note your disclosure that a significant amount of your earnings occur outside the U.S., and that non-U.S. subsidiaries hold funds that are indefinitely reinvested there and that are available for use by your non-U.S. operations. However, it appears from your disclosure . . . that you intend to borrow these funds from your non-U.S. subsidiaries.
- You disclose that during fiscal 2014, 2013 and 2012, you provided for U.S. and non-U.S. income and withholding taxes in the amount of $[X], $[X] and $[X], respectively, on earnings that were or are intended to be repatriated. You further indicate that, in general, the remaining earnings of your subsidiaries are considered to be permanently reinvested and that you have approximately $[X] of undistributed earnings that are considered to be permanently reinvested. Please quantify the amounts repatriated for each period presented and tell us the facts and circumstances for repatriating your subsidiaries earnings.

Life sciences companies typically have manufacturing and distribution sites, as well as holding company subsidiaries, domiciled in countries with favorable tax rates. If a life sciences registrant discloses that it will reinvest undistributed earnings of its foreign subsidiaries indefinitely, 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. See the Income Taxes section for additional information.

Business Combinations

> **Example of an SEC Comment**
>
> You state that you acquired no significant processes in your . . . acquisition of all of the outstanding shares of [Company A]. Please provide your analysis supporting this conclusion and that this was not an acquisition of a business. Refer to ASC 805-10-55-4 through [55-9].

In recent years, the life sciences industry 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. For example, whereas an entity would capitalize acquired IPR&D and recognize the fair value of contingent consideration and goodwill in a business combination, it would expense acquired IPR&D and not recognize contingent consideration and goodwill in an asset acquisition. Consequently, when acquisitions occur, it is important to determine whether what is being acquired meets the definition of a business under ASC 805. Accordingly, the SEC staff often issues comments related to whether the acquired set meets the definition of a business and further inquires about the basis for the registrant's conclusion.

In addition, in business combinations involving the acquisition of intangible assets, acquirers must determine the useful life of each intangible asset acquired. Because the intangible assets acquired are typically the patent rights to a product or potential product, most life sciences companies begin their analysis by considering the patent life of the underlying product. However, useful life could be affected by other factors, such as the risk of competition from branded or generic products before the company's patent expires or a high barrier to market entry even after the company's patent expires. Therefore, the SEC staff has asked registrants to provide additional analysis that explains the basis for their conclusions about the useful lives of acquired intangible assets.

For additional accounting and reporting considerations related to acquisitions, see the Business Combinations section.

Commitments and Contingencies

Example of an SEC Comment

Please summarize for us your potential milestone and royalty payments related to your collaborations and explain why these potential payments are excluded from the Contractual Obligations and Commitments table. Refer to Item 303(a)(5) of Regulation S-X.

Pharmaceutical and medical device companies often enter into licensing arrangements that include up-front payments and royalty or profit-share payments contingent on the occurrence of certain future events linked to the success of the asset in development. The SEC staff often comments on life sciences registrants' disclosures about these commitments and contingencies associated with payments due to licensors of intellectual property. Registrants can improve such disclosures by disclosing the nature, timing, and amount of contingent milestone and royalty payments, including the factors that trigger payment. For additional accounting and disclosure considerations related to contingencies, see the Contingencies section.

Other Deloitte Resources

March 2015, *Life Sciences: Accounting and Financial Reporting Update — Including Interpretive Guidance*.

Health Plans

The SEC staff's recent comments to health plan registrants have focused mainly on (1) accounting for risk adjustment, reinsurance, and risk corridor programs (the "three Rs") and (2) statutory disclosures. Like other registrants, health plan registrants have also continued to receive comments related to MD&A, contingencies, goodwill impairment, and revenue recognition. For more information on these topics, see the Management's Discussion and Analysis, Contingencies, Impairments of Goodwill and Other Long-Lived Assets, and Revenue Recognition sections.

In addition, because health plan registrants are primarily engaged in offering health care insurance products, SEC staff comments to registrants in the insurance industry may also apply to health plans. For more information, see the Insurance section.

Accounting for the Three Rs

Example of an SEC Comment

Please provide us with your accounting policy for the risk corridor, reinsurance and risk adjustment ("three Rs") that you reference . . . . Please also tell us the amounts you have recorded for each item as well as for the reinsurance fee assessment.

The Patient Protection and Affordable Care Act (PPACA) provided for the establishment of three premium stabilization programs. Commonly referred to as the three Rs, these programs became effective on January 1, 2014, and consist of the following:

- *Risk adjustment program* — This program is designed to enable health insurers to price and offer policies to individuals and small groups without regard to the health status of individual policyholders or group members. It is the only permanent program among the three Rs.
- *Reinsurance program* — Designed as a temporary measure for the 2014–2016 calendar years, the reinsurance program aims to mitigate the effects of a potential increase in the number of large claims filed by policyholders in the individual health care insurance market.

- *Risk corridor program* — Like the reinsurance program, the risk corridor program was designed to be a temporary measure for the 2014–2016 calendar years. Its purpose is to help protect health care insurers from variability in the individual and small group markets by limiting gains and losses. The program applies only to qualified health plans established under the PPACA in the individual and small-group markets.

Similar risk adjustment provisions may also exist in registrants' insurance plan contracts that are not subject to the PPACA.

The SEC staff has asked health plan registrants about their accounting policies and recorded amounts related to the three Rs as well as the method they used to determine such amounts.

Statutory Disclosures

Example of an SEC Comment

Please provide us disclosure to be included in future periodic reports of the restricted net assets for your subsidiaries as of the balance sheet date or otherwise provide disclosure that complies with the objective in Rule 4-08(e)(3)(ii) of Regulation S-X such as disclosing the amount available from these subsidiaries. In this regard, you indicate that dividends received from your regulated subsidiaries are a source of liquidity.

Regulation S-X, Rule 4-08(e)(3), requires footnote disclosure in the consolidated financial statements about the nature and amount of significant third-party restrictions on the ability of subsidiaries to transfer funds to the registrant if restricted net assets of consolidated subsidiaries and equity method investees exceed 25 percent of consolidated net assets. The SEC staff has commented when disclosures required under ASC 944-505 (e.g., disclosures about statutory requirements related to minimum capital standards and certain restricted accounts or assets that may limit payment of dividends) and Rule 4-08(e) are incomplete or missing. In addition, the SEC staff has reminded health plan registrants that disclosures under ASC 944-505 should not be labeled as unaudited. For more information, see the Debt and Insurance sections.

Technology and Telecommunications

Technology

Over the past year, the technology industry has seen a continued high volume of initial public offering (IPO) filings in both domestic and foreign markets. As the amount of capital available to the technology industry rises, business models in various sectors of the industry keep evolving, leading to a need for more robust and transparent disclosures about (1) how companies in those sectors earn revenue and (2) the related critical accounting policies and estimates. Accordingly, when the SEC staff reviews IPO and annual financial report filings, it continues to focus largely on matters related to revenue recognition, including (1) accounting policies and disclosures regarding multiple-element arrangements, (2) gross versus net reporting, and (3) accounting for nonrefundable up-front fees. In addition, the staff has focused on registrants' use of key metrics in MD&A. See the Revenue Recognition section for more information about SEC staff comments on revenue-related topics.

In addition, SEC staff comments to registrants in the technology industry, like those received by registrants in other industries, have concentrated on disclosures about contingencies, income taxes, segment determination, and share-based compensation. See the Contingencies, Income Taxes, Segment Reporting, and Share-Based Payments sections for additional information about such comments.

Revenue Recognition — Multiple-Element Arrangements

Accounting Policies and Disclosures Regarding Multiple-Element Arrangements

Examples of SEC Comments

- Please explain to us how you apply FASB ASC 605-25-30, which requires arrangement consideration to be allocated based on the relative selling price to all deliverables in your multiple element arrangements. Please identify each unit of accounting and discuss how you determine the selling price for each deliverable under FASB ASC 605-25-30-2. Please also include clarifying disclosure in future filings.
- We note your disclosure that implementation services that are delivered prior to the customer being able to use the platform do not have stand-alone value and are recognized over the longer of the life of the subscription or the expected life of the customer relationship. Please explain your basis for concluding that these services do not have [stand-alone] value and tell us how you considered ASC 605-25-25-5(a). In this regard, we note that you disclose that these services can be provided by the Company, third-party service providers or distributors.
- Disclose how you are allocating the arrangement fee to each element or deliverable identified in an arrangement. Further, describe how you account for [one or more arrangements] with a customer that [contain] software-related and non-software related elements, if any. We refer you to ASC 985-605-15-4A.

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 vendor-specific objective evidence (VSOE) if available, third-party evidence (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.

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.

For multiple-element arrangements that include tangible products containing software, the staff may ask registrants to clarify the accounting guidance they applied and how they determined whether a tangible product's software components and nonsoftware components function together to deliver its essential functionality (and are therefore outside the scope of the guidance in ASC 985-605). Accordingly, registrants should (1) carefully consider all facts when determining the appropriate accounting guidance to apply to arrangements that involve tangible products containing software and (2) clearly and adequately disclose the guidance they applied to such arrangements.

Disclosures About VSOE

> **Example of an SEC Comment**
>
> You indicate that you have established VSOE for consulting days, training and software support, except for software support bundled with time-based licenses, based on separate stand-alone sales of these elements. Please describe in greater detail the methodology for establishing VSOE for these arrangements, including the volume and range of [stand-alone] sales used to establish VSOE. We refer you to ASC 985-605-25.

Establishing VSOE of fair value can 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., postcontract customer support (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 periodically asks registrants that have multiple-element arrangements within the scope of ASC 985-605 — many of which are undergoing IPOs — to expand their disclosures about how they determined VSOE. The additional information may include:

- The percentage of customers that renew at contractually stated rates for PCS and how the rates are substantive when contractually stated renewal rates are used to establish VSOE.
- An explanation of how the registrant determined VSOE if it does not use stated renewal rates or a bell-curve analysis of stand-alone sales to establish VSOE.
- A description of the process used to evaluate the various factors that affect VSOE.
- A quantitative description of the volume and range of stand-alone sales used to establish VSOE and how the registrant accounts for contracts whose sales volume falls outside that range.
- A description of how VSOE is determined when different levels of renewable rates exist.
- An explanation of why the registrant believes that it cannot determine VSOE for its undelivered elements if it accounts for software arrangement elements ratably because they are not separated.
- An explanation of why the registrant could not determine VSOE in prior years and, in cases in which VSOE is first established or is reestablished, what changes arose in the current year.

Revenue Recognition — Gross Versus Net Reporting

Under ASC 605-45, an entity should report revenue on a gross basis when it is acting as the principal of the transaction and on a net basis when acting as an agent to the transaction; applying this guidance often requires careful consideration and judgment. Although ASC 605-45 refers to eight indicators of gross reporting, the SEC staff has placed a higher emphasis on (1) which party is the primary obligor to the transaction and (2) which party has general inventory risk.

Determining the principal in an online transaction is challenging for technology companies, particularly those engaging in transactions related to software as a service (SaaS), online gaming, or online advertising, since there is no tangible product (and, in some instances, transactions are executed almost instantaneously). Because these types of arrangements have become more prevalent, they are topics of increased SEC staff focus.

At the 2014 AICPA Conference, the SEC staff discussed challenges related to determining whether an entity is a principal or an agent under ASC 605-45 when the guidance is applied to emerging business models, such as digital advertising. The staff observed that this analysis should generally begin with the identification of a "deliverable" in the transaction and the party ultimately responsible for its fulfillment. In this regard, the staff may scrutinize the deliverable identified by a registrant and consider all available information (e.g., MD&A, Web sites, marketing materials, contractual arrangements) in evaluating the reasonableness of this determination. Further, the staff noted that the deliverable that is ultimately identified for ASC 605-45 application purposes should be consistent with the deliverable that is subsequently evaluated for revenue recognition purposes.

In its discussion of principal-versus-agent considerations at the 2014 AICPA Conference, the SEC staff also indicated that it is likely to focus on a registrant's assessment of the primary obligor and general inventory risk indicators under ASC 605-45. If the identity of the primary obligor is unclear, the staff may focus its analysis on other factors, such as general inventory risk and latitude in establishing pricing. The staff also noted that latitude in establishing pricing should be evaluated in the context of any "economic constraints" in accordance with ASC 605-45.

SaaS and Online Gaming

Example of an SEC Comment

We note . . . that you believe the second type of arrangement is not within the scope of ASC 605-45. Please clarify whether the partner's customer will enter into any agreement or licensing rights with you to have the right to access your software. Indicate whether the partner's customer will seek remedy from your partner or you. That is, tell us whom the partner's customer will consider responsible for the acceptability and fulfillment of the services. Describe how any marketing materials or other representations made in executing these arrangements describe your role. Your response should address how you considered that you are hosting and providing the services that the customers want.

SaaS and online gaming companies often use operator or reseller partners to target new markets. Questions arise about which party is the primary obligor (i.e., the party responsible for providing the product or service desired by the customer). The SEC staff has challenged the conclusions of various SaaS and online gaming companies (and their resellers) about the appropriateness of gross or net reporting for their transactions and has asked such registrants to provide additional analysis with an emphasis on the factors outlined in ASC 605-45-45. The staff may also request additional disclosures about the nature of these transactions and the role of each of the parties.

Online Advertising

> **Example of an SEC Comment**
>
> We note that you recognize advertising revenue from customers that are advertising networks on a net basis, while advertising revenues earned directly from advertisers are recognized on a gross basis. Also we note your agreements with [Company X] and [Company Y] executed in September and October 2013, respectively. With the agreements you have apparently transferred the primary responsibility to fill substantially all website advertising inventory to [X] and mobile advertising inventory to [Y]. Further both [X] and [Y] will pay for all advertising requests regardless of their ability to fill the inventory. In light of the arrangements, please explain how you have considered whether your website and mobile advertising revenue should be recognized on a gross or net basis under ASC 605-45-45.

Like other forms of advertising, online advertising often involves at least three parties:

- An owner/operator of the online content (a "publisher") that provides the online space or search engine results in which advertising content may be placed.
- A party (an "advertiser") that desires to place the advertising content.
- A third-party service provider (e.g., an "advertising agency").

In addition, there are many companies that offer various technologies and solutions to help advertisers and publishers in what is commonly referred to as the "ad tech" industry. These include "ad networks" or "demand-side platforms," "ad exchanges," and "supply-side platforms."

A registrant that has entered into an online advertising arrangement needs to evaluate the terms of the arrangement and the responsibilities of each of the parties to the agreement to determine whether it should report revenues on a gross or net basis. As a result, the SEC staff may review the contractual terms and marketing materials related to the transaction to determine the nature of the deliverable and the party ultimately responsible for fulfillment. For example, it may be challenging for an advertising agency to conclude that it is the primary obligor (and therefore the principal) if it cannot demonstrate that it is responsible for displaying the advertising content but instead appears to be acting as an agent by matching advertisers with publishers. On the other hand — to understand whether, for example, a demand-side platform is the principal — the SEC staff often seeks to understand contractual terms (among other factors) to determine whether there are sufficient economic and fulfillment risks analogous to inventory risk. Accordingly, the SEC staff may review the contractual agreements with advertisers to understand whether the demand-side platform provided a firm commitment to deliver a certain amount of advertising space at fixed pricing by means of contractual insertion orders (a common contractual form used in the online advertising industry).

Because of the complexity and judgments associated with determining whether to record revenues on a gross or net basis, technology registrants should (1) thoroughly document the basis for their conclusions and (2) consider whether additional disclosures would be appropriate for investors.

Revenue Recognition — Accounting for Nonrefundable Up-Front Fees

Example of an SEC Comment

We note that your [Segment X] business recognizes nonrefundable setup fees as services are performed. Please tell us whether the setup fees have standalone value. Refer to ASC 605-25-25-5(a). If they do not have standalone value, please tell us how you determined that recognition of revenue as services are performed is appropriate. Refer to footnote 39 of SAB Topic [13.A.3(f)].

SAB Topic 13.A.3(f) provides guidance on the accounting for nonrefundable up-front fees. In the technology industry, up-front fees often exist in hosting or SaaS arrangements. These fees, which are typically charged together with a subscription fee for the hosting or SaaS services, cover items such as training, connection services, data migration, and other implementation services. Entities entering into such arrangements are generally required to determine whether the activities associated with the up-front fees and those related to the ongoing hosting or SaaS services are separate units of accounting in a multiple-element arrangement under ASC 605-25. To make this determination, entities must assess whether the activities associated with the up-front fees have stand-alone value and can therefore be regarded as a separate unit of accounting. In assessing stand-alone value, entities need to consider whether such activities are sold separately by any vendor or whether the customer can resell any products or services received.

When the activities associated with an up-front fee and the hosting or SaaS services are treated as a single unit of accounting under ASC 605-25, registrants apply the guidance in SAB Topic 13.A.3(f) to determine an appropriate accounting policy for recognizing revenue related to the up-front fee. Under that guidance, "[u]nless the up-front fee is in exchange for products delivered or services performed that represent the culmination of a separate earnings process," revenue is typically deferred and recognized over the period in which the up-front fee is earned, which may extend beyond the initial contract term.

Footnote 39 of SAB Topic 13.A.3(f) states that the "revenue recognition period should extend beyond the initial contractual period if the relationship with the customer is expected to extend beyond the initial term and the customer continues to benefit from the payment of the up-front fee." The SEC staff has asked registrants about their accounting policies for recognizing revenue in these circumstances. Specifically, it has focused on the period during which registrants recognize revenue for up-front fees, particularly when revenue is recognized either immediately or over the initial contract period despite indications that the relationship with the customer may extend beyond that period.

Disclosures About Key Metrics in MD&A

Examples of SEC Comments

- We note . . . that you expect to significantly increase your subscription base and the annual value per subscription, which you state will ultimately drive billings growth. Considering your transition to cloud based and flexible licenses in fiscal 2014, tell us how you considered providing quantification of your subscription base and annual value per subscription as key metrics in analyzing revenues. We refer you to . . . Section III.B.1 of SEC Release 33-8350.
- We note you provide information regarding the cumulative number of customers that have made at least one purchase since inception of your business and that you believe this metric helps you understand the activity rate of your subscribers. Please explain further why you believe this information is meaningful to your investors and how this metric relates to your results of operations. For example, based on your description, it appears the cumulative number of customers is a metric that is always going to increase and does not factor in currently active or inactive customers. Similar concerns apply to your metric regarding the cumulative number of repeat customers. Please advise.

Technology registrants often use metrics to convey information to their investors. Because there are various types of registrants in the industry (i.e., offering a broad range of products and services), there is diversity in metrics discussed in registrants' earnings calls, registration statements, and periodic filings. 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 key performance indicators. 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 Release No. 33-8350 and Regulation S-K, Item 303(a)(3)(iii). In addition, registrants that have not already done so are asked to provide disclosures in MD&A to discuss why the metrics were chosen, how they are used, and any inherent limitations in the metrics selected.

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 profitably may not be clear. Registrants should review their metrics to ensure that the metrics portray a balanced discussion and remain relevant. If that is not the case, registrants should consider removing metrics (or replacing them with new ones).

Other Deloitte Resources

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

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

- While your disclosure addresses the basic revenue recognition criteria related to product sales, it is not clear when delivery typically occurs and when the related revenues are typically recognized. . . . Please tell us what consideration was given to disclosing the general timing of delivery or performance of service and the general timing of revenue recognition for product sales. Please refer to ASC 605-25-50-2.
- Tell us and explain why [Product A shipments] were not recognized as revenues. It is unclear from the Critical Accounting and Estimates section of the MD&A what revenue recognition criteria were not met. In addition, tell us in detail the nature of your sell-through to end users and how you are accounting for such sales.

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. Such offerings can have significant revenue recognition implications. New offerings also may trigger a requirement for registrants in the industry to provide financial statement disclosures not previously considered significant. These could include disclosures about financing receivables for which registrants may not have historical information to appropriately predict an allowance for credit losses, credit quality indicators, and potential guarantee liabilities that arise from the various handset-purchase options. 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 [201X] and [201Y] 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.

The SEC staff continues to 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 inquires 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: Topic "Graveyard"

This appendix is a "graveyard" of comment letter topics discussed in our publication's eighth edition that no longer represent recent trends. Although such topics are not discussed in the current edition, we realize that they remain relevant to a registrant that may receive SEC staff comments regarding them and to any preparer who is interested in understanding topics on which the SEC staff has historically focused. Accordingly, this appendix links topic headings from last year's SEC comment letter book that do not appear elsewhere in the current edition. For information about a previously discussed topic, click one of the topic heading links below (also available on our US GAAP Plus Web site at http://www.iasplus.com/en-us/tag-types/united-states) and you will be directed to the corresponding section or subsection of the eighth edition. Linked titles of past comment letter book editions are also provided below.

Links to Prior-Year Topic Headings Not Included in This Year's Sections

Financial Statement Accounting and Disclosure Topics

Consolidation — VIEs in Foreign Jurisdictions

Financial Statement Classification, Including Other Comprehensive Income — Current Versus Noncurrent [Balance Sheet] Classification

Leases — Nonperformance Provisions

Other-Than-Temporary Impairment of Investments in Securities

Share-Based Payments — Financial Statement Presentation

SEC Disclosure Topics

Management's Discussion and Analysis — Off-Balance-Sheet Arrangements

SEC Reporting:

- Issuers of Securities That Collateralize Registered Securities ([Regulation S-X,] Rule 3-16).
- SEC Reporting Considerations for Material Changes That Require Retrospective Application.

Disclosures About Risk — Issuers Based in China

Internal Control Over Financial Reporting — Domestic Companies With a Majority of Operations Outside the United States

Foreign Private Issuers

Foreign Private Issuers Using IFRSs — Going-Concern Language in PCAOB Audit Reports

Industry-Specific Topics

Consumer and Industrial Products

Transportation, Travel, Hospitality, and Leisure — Capital Expenditures

Financial Services

Insurance:

- Reinsurance Receivables.
- Deferred Acquisition Costs.

Investment Management — Revenue Recognition

Real Estate — Impairments

Health Sciences

Life Sciences — Branded Pharmaceutical Drug Annual Fee

Health Plans — Provision For Adverse Deviation

Past Editions of Deloitte's SEC Comment Letter Publication

SEC Comment Letters on Domestic Registrants — A Closer Look (First Edition)

SEC Comment Letters on Domestic Registrants —A Closer Look (Second Edition)

SEC Comment Letters on Domestic Registrants — A Closer Look (Third Edition)

SEC Comment Letters — Including Industry Insights: A Snapshot of Current Themes (Fourth Edition)

SEC Comment Letters — Including Industry Insights: Improving Transparency (Fifth Edition)

SEC Comment Letters — Including Industry Insights: Highlighting Risks (Sixth Edition)

SEC Comment Letters — Including Industry Insights: Constructing Clear Disclosures (Seventh Edition)

SEC Comment Letters — Including Industry Insights: A Recap of Recent Trends (Eighth Edition)

Appendix B: 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. In January 2009, the SEC staff issued 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 C 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.

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 D for tips on searching the SEC's comment letter database.

[1] An overview of the legal, regulatory, and capital markets offices is also available on the SEC's Web site.

Appendix C: Best Practices for 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.
- 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.

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.

[1] The SEC staff discussed this topic at the 2012 AICPA Conference. Refer to Deloitte's December 11, 2012, *Heads Up* for more information.

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.

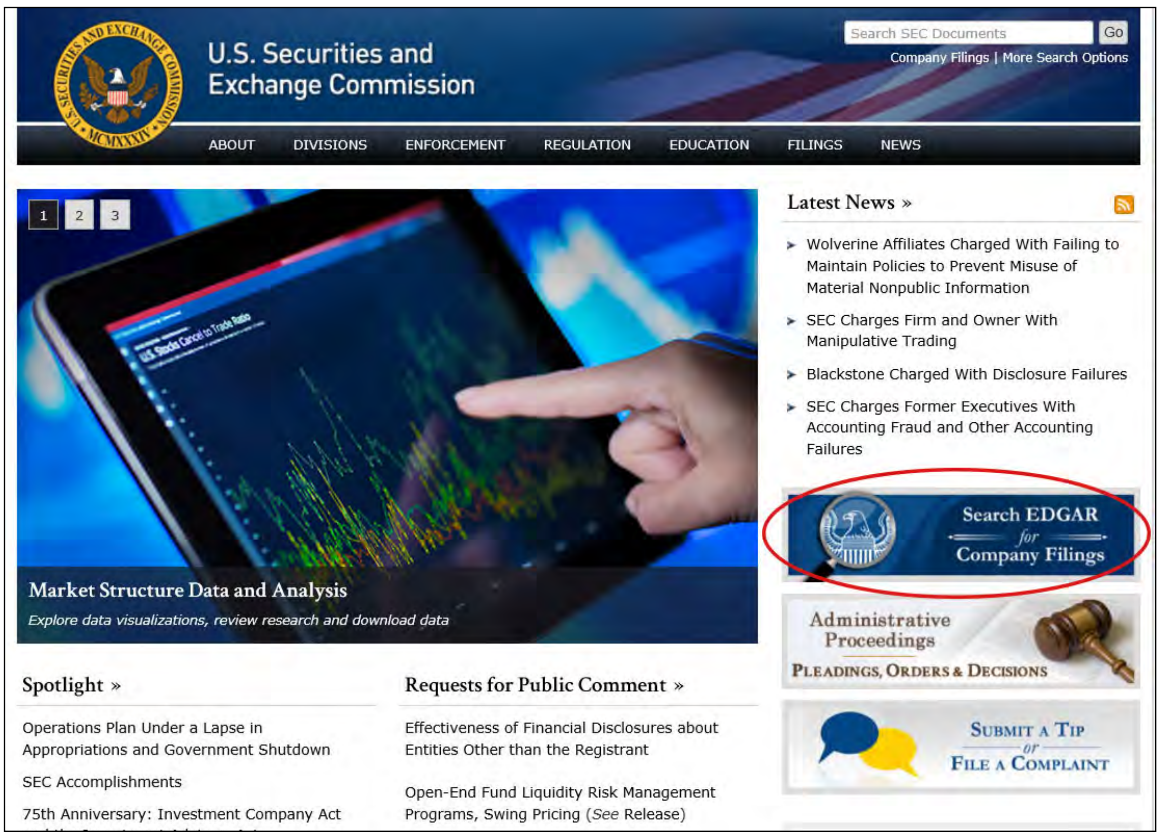
Appendix D: Tips for Searching the SEC's Database for Comment Letters

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.

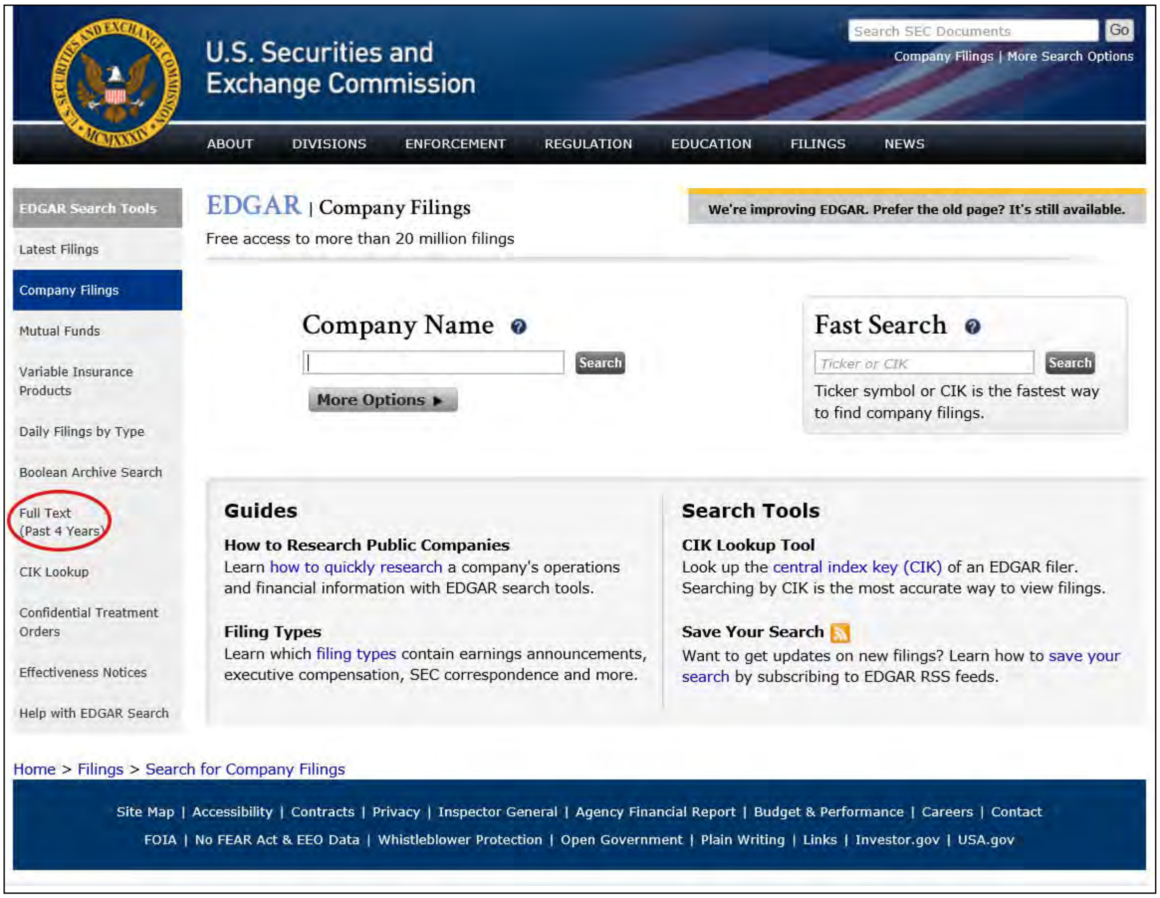
Although the SEC has updated the EDGAR search engine to simplify searches of corporate filings, users may still wish to use the "full-text" search feature to find the text of specific comment letters posted within the last four years and to generally narrow their search results. The process of performing a full-text search is discussed below.

Full-Text Searching

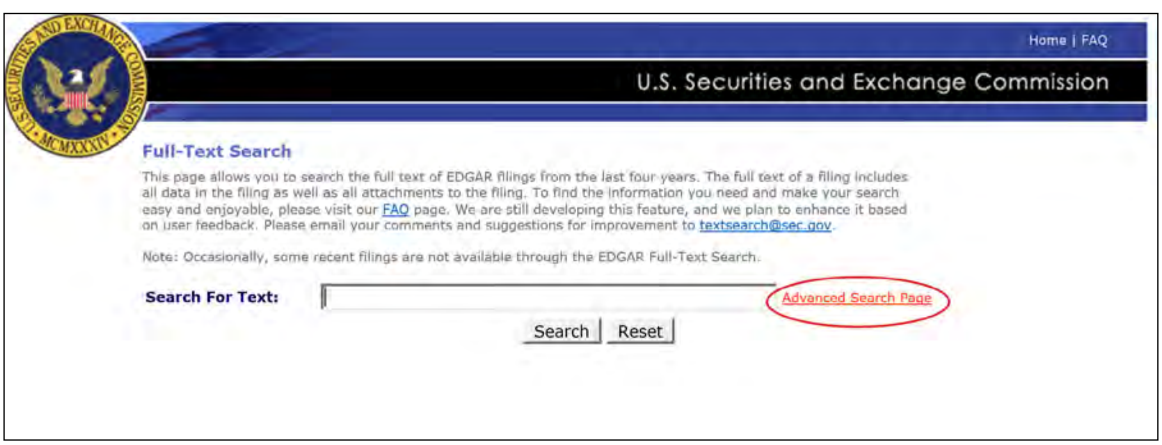
To perform a full-text search, first go to the SEC's home page (www.sec.gov) and click the "Search EDGAR for Company Filings" image:



Then, click the “Full Text” link in the left sidebar on the “EDGAR l 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 only locate 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.

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:

Example

10/09/2015 S-3 for PACIFIC MERCANTILE BANCORP

COMPANY NAME(s) - [**PACIFIC MERCANTILE BANCORP (CIK - 1109546 /SIC - 6021)**]

As filed with the Securities and Exchange Commission on October 9, 2015 Registration No. 333- UNITED STATES SECURITIES AND EXCHANGE COMMISSION Washington, D.C. 20549 FORM S-3 REGISTRATION

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.

[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] A 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.

Additional Information

For more information about full-text searching, click the FAQ link on in the search form:

Appendix E: 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 ASC References

For titles of *FASB Accounting Standards Codification* references, see Deloitte's "Titles of Topics and Subtopics in the *FASB Accounting Standards Codification*."

FASB — Other Literature

See the FASB's Web site for titles of:

- Accounting Standards Updates.
- Pre-Codification literature (Statements, Staff Positions, EITF Issues, and Topics).
- Concepts Statements.

International Standards

See Deloitte Touche Tohmatsu's IAS Plus Web site for the titles of citations to:

- International Financial Reporting Standards (IFRSs).
- International Accounting Standards (IASs).
- Other pronouncements.

PCAOB Auditing Standards

See the Standards page on the PCAOB's Web site for titles of its auditing standards.

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

Non-GAAP Financial Measures

Oil and Gas Rules

Regulation S-K

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 FRM

Topic 1, "Registrant's Financial Statements"

Topic 2, "Other Financial Statements Required"

Topic 3, "Pro Forma Financial Information"

Topic 4, "Independent Accountants' Involvement"

Topic 6, "Foreign Private Issuers & Foreign Businesses"

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 Rule

33-8176, *Conditions for Use of Non-GAAP Financial Measures*

SEC Industry Guides

Guide 3, "Statistical Disclosure by Bank Holding Companies"

Guide 6, "Disclosures Concerning Unpaid Claims and Claim Adjustment Expenses of Property-Casualty Insurance Underwriters"

Guide 7, "Description of Property by Issuers Engaged or to Be Engaged in Significant Mining Operations"

SEC Interpretive Release

33-8350 (34-48960), *Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations*

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*

SEC Regulation S-K

Item 10, "General"

Item 101, "Description of Business"

Item 103, "Legal Proceedings"

Item 302, "Supplementary Financial Information"

Item 303, "Management's Discussion and Analysis of Financial Condition and Results of Operations"

Item 305, "Quantitative and Qualitative Disclosures About Market Risk"

Item 307, "Disclosure Controls and Procedures"

Item 308, "Internal Control Over Financial Reporting"

Item 402, "Executive Compensation"

Item 404, "Transactions With Related Persons, Promoters and Certain Control Persons"

Item 407, "Corporate Governance"

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"

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 3-14, "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"

Rule 6-04, "Balance Sheets"

Rule 7-05, "What Schedules Are to Be Filed"

Article 8, "Financial Statements of Smaller Reporting Companies"

Article 10, "Interim Financial Statements"

Article 11, "Pro Forma Financial Information"

Rule 11-01, "Presentation Requirements"

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"

Rule 12-28, "Real Estate and Accumulated Depreciation"

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 3.A, "Convertible Securities"

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.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.A, "Selected Revenue Recognition Issues"

SAB Topic 14, "Share-Based Payment"

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, "Issuer's Disclosure Controls and Procedures Related to Preparation of Required Reports"

Rule 15d-15, "Controls and Procedures"

Appendix F: Abbreviations

Abbreviation	Description
AICPA	American Institute of Certified Public Accountants
AICPA Banking Conference	AICPA National Conference on Banks and Savings Institutions
AICPA Conference	AICPA Conference on Current SEC and PCAOB Developments
ASC	FASB Accounting Standards Codification
ASR	SEC Accounting Series Release
ASU	FASB Accounting Standards Update
AUM	assets under management
AUM&A	assets under management and administration
BC	Basis for Conclusions
BCF	beneficial conversion feature
CAM	common area maintenance
CAQ	Center for Audit Quality
C&DI	SEC Compliance and Disclosure Interpretation
CD&A	Compensation Discussion and Analysis
CEO	chief executive officer
CF-OCA	SEC's Division of Corporation Finance, Office of the Chief Accountant
CFDG	Corporation Finance Disclosure Guidance
CFO	chief financial officer
CIK	central index key
CODM	chief operating decision maker
COSO	Committee of Sponsoring Organizations of the Treadway Commission
DC&P	disclosure controls and procedures
DTA	deferred tax asset
DTL	deferred tax liability
EBIT	earnings before interest and taxes

Abbreviation	Description
EBITDA	earnings before interest, taxes, depreciation, and amortization
EDGAR	SEC's Electronic Data Gathering, Analysis, and Retrieval system
EGC	emerging growth company
EPS	earnings per share
FASB	Financial Accounting Standards Board
FAQs	frequently asked questions
FDA	Food and Drug Administration
FFO	funds from operations
FINRA	Financial Industry Regulatory Authority
FPI	foreign private issuer
FRM	SEC Financial Reporting Manual
G&A	general and administrative expense
GAAP	generally accepted accounting principles
IAS	International Accounting Standard
IASB	International Accounting Standards Board
ICFR	internal control over financial reporting
IFRS	International Financial Reporting Standard
IPO	initial public offering
IPR&D	in-process research and development
LLC	limited liability company
M&A	mergers and acquisitions
MBoe	thousand barrels of oil equivalent
MD&A	Management's Discussion and Analysis
MLP	master limited partnership
NAREIT	National Association of Real Estate Investment Trusts
NCI	noncontrolling interest

Abbreviation	Description
NEO	named executive officer
NGL	natural gas liquid
NOI	net operating income
OCA	SEC's Office of the Chief Accountant
OCI	other comprehensive income
OCIE	SEC's Office of Compliance Inspections and Examinations
P&U	power and utilities
PBE	public business entity
PCAOB	Public Company Accounting Oversight Board
PCC	Private Company Council
PCI	purchased credit-impaired
PCS	postcontract customer support
PUD	proved undeveloped
R&D	research and development
REIT	real estate investment trust
SaaS	software as a service
SAB	SEC Staff Accounting Bulletin
SEC	Securities and Exchange Commission
SG&A	selling, general, and administrative expense
SIC	standard industrial classification
SOA	Society of Actuaries
TDR	troubled debt restructuring
THL	travel, hospitality, and leisure
TPE	third-party evidence
VaR	value at risk
VIE	variable interest entity
VSOE	vendor-specific objective evidence
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
PPACA	Patient Protection and Affordable Care Act
Sarbanes-Oxley Act	Sarbanes-Oxley Act of 2002
Securities Act	Securities Act of 1933