

SEC Comment Letters — Including Industry Insights: *A Recap of Recent Trends*



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 eighth edition of *SEC Comment Letters — Including Industry Insights: A Recap of Recent Trends* 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 staff has continued to address virtually all topics discussed in our seventh edition, and it remains focused on the clarity of registrants' disclosures. Sections in the eighth edition have been updated to reflect newer comments on registrants' financial statements and other areas of their filings. In addition, the appendixes in the eighth edition offer further insights. For example, [Appendix A](#) gives a glimpse into the SEC staff's review and comment letter process. [Appendix B](#) discusses best practices for managing unresolved SEC comments, and [Appendix C](#) provides helpful tips on searching the SEC's EDGAR database for comment letters. In addition, [Appendix D](#) lists the titles (or links to titles) of the standards referred to in this publication, and [Appendix E](#) defines the abbreviations we used.

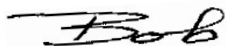
Our eighth edition captures developments on relevant financial reporting topics through the date of publication. The SEC and its staff will continue to provide registrants with information that is pertinent to their filings by means of rulemaking and written interpretive guidance as well as speeches 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 8–10, 2014, and will be discussed in an upcoming issue of our *Heads Up* newsletter.

We hope you find our eighth 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,



Bob Uhl
Accounting Standards and Communications



Christine Davine
SEC Services

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Executive Summary

In October 2014, a new chief accountant, James Schnurr, assumed leadership of the SEC's Office of the Chief Accountant (OCA). In early November, Mr. Schnurr gave a glimpse of his priorities and noted that the OCA would place heavy emphasis on monitoring the implementation of the FASB's and IASB's new converged revenue standard, which introduces a new contract-based model that is designed to replace all current revenue accounting literature. While the standard will not be effective until 2017, Mr. Schnurr noted that a significant number of implementation issues have been identified and that the OCA is considering what additional steps it may take. He also said that he would work with his staff to provide some clarity about whether and, if so, how, to incorporate IFRSs in the U.S. financial reporting system. So it is likely that we will hear more about these topics in the coming months.

Another priority, the aggressive pursuit of investor protections, has been the focus of the SEC's Division of Enforcement and Office of the Whistleblower. Recently, the SEC announced that in fiscal year 2014, the Division of Enforcement filed approximately 755 enforcement actions and levied penalties in excess of \$4 billion — both record highs. Further, in September 2014, the Office of the Whistleblower announced that it expected to award a whistleblower approximately \$30 million, the highest sum it has paid to date.

The Division of Corporation Finance (the "Division") has been equally busy undertaking its own priorities, devoting much of 2014 to fulfilling the SEC's mandated rulemaking activities under the Dodd-Frank and JOBS Acts. In December 2013, in a report provided under the JOBS Act, the Division's staff indicated that the SEC would commence a broad effort to modernize and streamline its rules and regulations (also called its "disclosure effectiveness project").¹ In addition, the Division's staff has remarked on how, in the absence of rule changes, registrants can improve their disclosure documents in the near term — most notably by focusing their disclosures on matters that are material and relevant to their operations, liquidity, and financial condition.²

Further, the Division continues to meet its responsibilities under the Sarbanes-Oxley Act to review registrants at least once every three years. MD&A is again the leading source of SEC staff comments, and the staff has encouraged registrants to "tell their story" in MD&A to allow investors to see the company "through the eyes of management." Comments often focus on enhancing the executive overview to provide an investor with a balanced summary of key drivers, challenges, and risks that affect the registrant's liquidity and results of operations. In results of operations, the staff has continued to focus on encouraging registrants to disclose known trends or uncertainties, quantify components of overall changes in financial statement line items, and enhance their analysis of the underlying factors that cause such changes.

In addition to MD&A, the SEC staff has commented on all sections of a registrant's filings, including the financial statements. Among the questions it frequently asks registrants are those related to:

- *Segment reporting* — This remains a perennial topic of SEC staff inquiry. Historically, the staff has asked registrants about the identification of the chief operating decision maker (CODM), the identification of operating segments, and the analysis supporting the aggregation of operating segments. While the prominence of these themes has continued over the past year, the SEC staff recently remarked that its views are evolving and that it will renew its focus on these topics. In particular, the staff (1) will continue to ask questions to obtain a better understanding of a registrant's management structure and whether that structure supports the person or group identified as the CODM and (2) is rethinking the importance placed on the information package provided to, and regularly reviewed by, the CODM (the "CODM package"). That is, it is likely that the staff will no longer regard the CODM package as the determinative factor supporting the identification of a registrant's operating segments but will treat the CODM package as one of many factors to be considered.

¹ For additional information, see Deloitte's August 26, 2014, *Heads Up*.

² The SEC staff has discussed this topic in various speeches over the past year. For more information about the staff's remarks, see Deloitte's October 16, 2014, March 20, 2014, and December 16, 2013, *Heads Up* newsletters.

- *Revenue recognition* — Comments continue to include those that address the completeness and consistency of disclosures about revenue recognition policies, accounting for multiple-element arrangements, and principal-versus-agent analysis (i.e., gross or net reporting).
- *Income taxes* — The SEC staff remains focused on (1) the valuation and sufficiency of deferred tax assets, (2) appropriate breakout (and descriptions of) adjustments in a registrant's rate reconciliation, and (3) disclosures about liquidity in MD&A when registrants assert that they have indefinitely reinvested foreign earnings.
- *Internal control over financial reporting (ICFR)* — The SEC staff has concentrated on a registrant's evaluation of the severity of deficiencies in ICFR when there are immaterial error corrections disclosed in the filing. The severity of a deficiency depends on whether there is a reasonable possibility that the deficiency could result in a material misstatement. Accordingly, the staff may question whether there is a material weakness in ICFR even though the actual magnitude of the error was not material in amount. In addition, the staff has asked registrants (1) how they assessed the effect of control deficiencies on other components of the COSO framework and (2) to disclose which COSO framework they used to evaluate their ICFR if they have not already made such disclosure.
- *Cash flow statement* — Like past SEC staff comments, recent ones have centered on the appropriate classification of items in the cash flow statement (i.e., the determination of whether particular items should be classified as operating, investing, or financing activities). The process and internal controls related to the preparation of this statement are likely to be topics of future comments given an increase in classification errors. At a recent conference, the SEC staff noted that the errors were generally not attributable to complex fact patterns and cautioned registrants to revisit their processes and related internal controls.

Industry-specific comments to registrants have also been substantial. For example, comments related to the oil and gas industry have focused on (1) understanding how registrants accounted for master limited partnerships, (2) the amount and classification of proved undeveloped reserves, and (3) separate disclosure of natural gas liquid reserves. Registrants in the technology and investment management industries have received comments on how they recognize revenue related to multiple-element arrangements and performance fees, respectively. The SEC staff has asked registrants in the banking industry about disclosures related to the credit quality of their assets, including the sufficiency of their loan loss allowances. Comments to registrants in the retail industry have centered on the need for separate disclosure and analysis of online sales in MD&A.

Financial Statement Accounting and Disclosure Topics

Business Combinations

Purchase Price Allocation

Example of an SEC Comment

Please expand the adjustment notes to disclose, in tabular form, how the purchase price was determined and allocated. . . . Please [also] expand the disclosure to show the allocation of the purchase price to the tangible and intangible assets acquired. Also, for each class of intangibles acquired disclose the related amortization period. Further, disclose the nature of the intangible assets acquired and the factors that make up the goodwill acquired in the [X] acquisition.

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 a finite or indefinite useful life; (2) the useful life of identified intangible assets determined to have a finite useful life; and (3) material revisions to the initial accounting for a business combination, including what significant assumptions have changed that support a revision to the value of intangible assets.

Contingent Consideration

Example of an SEC Comment

We note that you agreed to pay an additional \$[X] of contingent consideration for earn-out payments based upon performance and milestones. We further note that you determined the fair value of this contingent consideration to be \$[Y]. Please revise your filing to clearly explain how you determined the \$[Y] fair value for this contingent consideration. Disclose the significant assumptions and how the significant assumptions were determined.

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 identified 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

We note your disclosure that you recognized a bargain purchase gain that represents the excess of the fair value of the property and equipment over the amount used to determine the original purchase consideration. Tell us what consideration you gave to discussing the reasons why the transaction resulted in a gain. Refer to ASC 805-30-50-1.f.2. In this regard, further explain to us how the purchase price was determined and why you believe the consideration was acceptable to the seller. Describe the methodology and assumptions used in the valuation of the property and equipment. In addition, please tell us how you considered the guidance in ASC 805-30-25-2 through 25-4.

When a registrant recognizes a gain related to a bargain purchase, the SEC staff will typically comment on how the registrant determined and reassessed the purchase price allocation. A gain from a bargain purchase occurs when the acquisition-date fair value of the identifiable assets acquired and liabilities assumed is greater than the sum of the acquisition-date fair value of (1) the consideration transferred, (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.

Disclosures

Example of an SEC Comment

Please revise [your filing] to include all of the disclosures required by ASC 805-10-50 as applicable. For example, it does not appear that you disclosed the revenue and earnings of the combined entity for the comparable prior period as though the acquisition date for all business combination that occurred during [the year indicated] had occurred as of the beginning of the comparable prior annual period (supplemental pro forma information.)

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 related 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 provide pro forma financial information that complies with Regulation S-X, Article 11, in a registration statement, proxy statement, or Form 8-K. For additional information, see the [SEC Reporting](#) section.

The SEC staff has also asked registrants:

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



Consolidation

ASC 810 provides guidance on entities that are subject to consolidation under either the voting interest entity model or the VIE model. Recent SEC comments have focused primarily on the consolidation conclusions reached under the VIE model, including those related to (1) the determination of whether an entity is a VIE, (2) the determination of whether the reporting entity is the primary beneficiary of a VIE, and (3) VIEs in foreign jurisdictions.

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

Example of an SEC Comment

We note you consolidate the [partnership] and its subsidiaries. Please explain to us in detail your basis for consolidating these entities. If you are within the scope of the Variable Interest Subsections of ASC 810-10-15, please tell us in detail: (i) the basis for your conclusion that the [partnership], by design, is a variable interest entity based on the conditions in ASC 810-15-15-14; (ii) the basis for your conclusion that you have the power to direct the activities of the [partnership] that most significantly impact its economic performance and the obligation to absorb losses or the right to receive benefits that could potentially be significant to the [partnership] based on the provisions of ASC 810-10-25-38A through 25-38G; and (iii) your consideration of the disclosure requirements in ASC 810-10-50 related to variable interest entities.

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

VIEs in Foreign Jurisdictions

Examples of SEC Comments

- To provide balance and context, please disclose that the registrant is a holding company and clarify that your operational consolidated affiliated entity in the [People's Republic of China (PRC)] includes a variable interest entity holding the [Internet content provider (ICP)] license, material to your business operations and financial results. Disclose that it is through the contractual arrangements that you have effective control, which allows you to consolidate the financial results of the VIE in your financial statements. Disclose that, if your PRC VIE and its shareholders fail to perform their obligations under the contractual arrangements, you could be limited in your ability to enforce the contractual arrangements that give you effective control. Further, if you are unable to maintain effective control, you would not be able to continue to use the material ICP license to operate your business and that you are not eligible as a [foreign investment enterprise] to hold an ICP. Disclose the percentage of revenues in your consolidated financial statements that are derived from your use of the ICP held by the VIE.
- Please disclose all the terms of the various contractual agreements between [Entity A], the trustees, the [wholly foreign-owned enterprise], [Entity B] and [Entity C] such as duration, mutual consent provisions, validity and enforceability of the contracts and any revocability clause. Disclose how these terms convey to you through [Entity A] the power to control [Entity B] and [Entity C] and how the economics are flowing to you before the deconsolidation date. Include any provisions that might limit the ability to exercise power and or whether there are any restrictions on your contractual rights.

¹ 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.

The SEC staff also continues to focus on the consolidation conclusions for overseas VIE arrangements (particularly wholly foreign-owned entities used to invest in China). The SEC staff expects registrants to disclose the critical judgments they made about their involvement with overseas VIEs, such as the validity and enforceability of contracts with the parties involved and whether there are any restrictions on the registrants' contractual rights. Accordingly, the staff may ask registrants to disclose the terms of their significant contractual agreements (e.g., contract duration, mutual consent provisions, renewal rights, or revocability clauses) and how these terms enhance or limit the registrants' ability to exercise power over the foreign VIEs. Further, the staff has indicated that registrants should disclose details about such VIEs, such as their nature, purpose, size, and activities. The SEC staff has also pointed out that registrants' MD&A should (1) describe the economic effects of their involvement with a foreign VIE (e.g., whether material service fees under contractual arrangements are not being settled) and (2) allow investors to assess how registrants would be affected by their deconsolidation of foreign VIEs.² At the 2013 AICPA Conference, the SEC staff indicated that it would expect registrants to disclose risk factors related to these structures (e.g., the registrants may have only limited legal protection in China, or there may be restrictions on cash transfers from foreign VIEs).

These expectations overlap significantly with the disclosure requirements in ASC 810-10-50-2AA, under which reporting entities' audited financial statements must provide information about the following:

- a. The significant judgments and assumptions made by a reporting entity in determining whether it must do any of the following:
 1. Consolidate a [VIE.]
 2. Disclose information about its involvement in a VIE.
- b. The nature of restrictions on a consolidated VIE's assets and on the settlement of its liabilities reported by a reporting entity in its statement of financial position, including the carrying amounts of such assets and liabilities.
- c. The nature of, and changes in, the risks associated with a reporting entity's involvement with the VIE.
- d. How a reporting entity's involvement with the VIE affects the reporting entity's financial position, financial performance, and cash flows.

For additional information, see the [Disclosures About Risk](#) section.

Other Deloitte Resources

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

² Paragraph 2110.1 of the FRM clarifies that upon deconsolidation of a VIE, registrants should evaluate whether they need to file a Form 8-K for a significant disposition.

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 the following:

- 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 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

Example of an SEC Comment

For multiple matters you state that the impact of the final resolution on your results of operations in a particular reporting period is not known. It is not clear for these matters whether there is at least a reasonable possibility that a loss exceeding amounts already recognized may have been incurred. If so, please either disclose an estimate (or, if true, state that the estimate is immaterial in lieu of providing quantified amounts) of the additional loss or range of loss, or state that such an estimate cannot be made. Please refer to ASC 450-20-50.

If you conclude that you cannot estimate the reasonably possible additional loss or range of loss, please supplementally: (1) explain to us the procedures you undertake on a quarterly basis to attempt to develop a range of reasonably possible loss for disclosure and (2) for each material matter, what specific factors are causing the inability to estimate and when you expect those factors to be alleviated. 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.

You may provide your disclosures on an aggregated basis. Please show us in your supplemental response what the revisions in future filings will look like.

Many comments from the SEC staff have focused on comparing current-year disclosures with those in prior-year filings. If a registrant's filing includes disclosures related to a potential contingency, or if the 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 often asks about estimates of potential losses. Questions commonly include whether additional reasonably possible losses have been incurred since the initial disclosure, why the accrual amount for the current year is different from that reported in previous filings, and whether there are any changes in facts and circumstances that may affect the accrual amount. In addition, the SEC staff often 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 demonstrate that they at least attempted to estimate the loss or range of losses before concluding that an estimate could not be made. The staff has also indicated that in such cases, registrants should disclose the specific factors that limited their ability to reasonably estimate the loss and has asked about registrants' quarterly procedures related to such estimates. These factors should be specific to the loss contingency in question and could include representations that (1) claims do not specify an amount of damages, (2) there are a large number of plaintiffs, or (3) the case is in its early stages.

Further, the SEC staff may ask about (1) the basis of 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). See the [Management's Discussion and Analysis](#) section for additional information about early-warning disclosures.

Litigation Contingencies

Example of an SEC Comment

Although your disclosures . . . indicate that you do not believe you have material potential liability in connection with litigation proceedings, you also disclose that they "could have a material adverse effect." Consistent with ASC 450-20-50-4(b), please disclose the aggregate estimated loss or range of reasonably possible losses in excess of amounts accrued or state that such an estimate cannot be made. If an estimate of reasonably possible additional losses can be made and that amount, both for each individual matter and in the aggregate, is not material to your consolidated financial position, results of operations or cash flows, we will not object to a statement to that effect.

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

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."

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.



Restrictions

Example of an SEC Comment

We note you disclose that your Senior Notes and European Senior Notes include covenants that limit the Company's ability to cause its restricted subsidiaries to pay dividends or make other payments to the Company. Please tell us if the restricted net assets of the applicable restricted entities exceed 25% of consolidated net assets as of [the end of the most recently completed fiscal year]. If so please tell us how you have complied with the requirement to provide the disclosures required by Rule 4-08(e)(3)(i) and (ii) 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) may have 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

We note you refinanced your credit facility [on two occasions]. Please tell us how you considered ASC 470-50, Modifications and Extinguishment, for these transactions and provide us with your analysis to determine if the transactions were a modification or extinguishment.

The SEC staff's comments on this topic 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

Regarding your obtaining a limited waiver of the debt covenants subsequent to [the end of the fiscal quarter], pertaining to limitations on capital expenditures and the Debt Service Coverage (DSC) Ratio, please revise future filings to disclose the specific terms of the covenants, including the actual amounts for each period and the required amounts before and after any revisions or waivers. This will allow readers to understand how much cushion there is between the required and the actual ratios and amounts. Please show the specific computations used to arrive at the actual ratios with corresponding reconciliations to US GAAP amounts, if necessary. Your disclosure should also address the risks and potential consequences of not complying with your debt covenants.

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 the terms of the most severe covenants and how a registrant has complied with those covenants. 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.

For additional information on redeemable noncontrolling interests, see the [Noncontrolling Interests](#) section.

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. (See the [Initial Public Offerings](#) section for additional considerations for entities undergoing IPO transactions.) In addition, the SEC staff frequently asks registrants about the accounting for conversion features in convertible instruments, including convertible preferred securities. See the [Financial Instruments](#) section for considerations regarding embedded conversion features.



Discontinued Operations, Assets Held for Sale, and Restructuring Charges

Discontinued Operations and Assets Held for Sale

Examples of SEC Comments

- Please tell us and disclose the gain or loss recorded upon the sale of your ownership interest in [Component A].
- We note your disclosure that business operations to be divested include the revenues and operating expenses from the recently acquired [Component A] and [Component B] business, both of which were acquired during the year ended September 30, 2013, and which [Company A] intends to divest. Tell us what consideration you gave to classifying these operations as held for sale and presenting as discontinued operations in your financial statements for the year end September 30, 2013, in accordance with ASC 360-10-45-9 and ASC 205-20-45. As part of your response, tell us how you considered the provisions of ASC 350-20-40-4 and 5 in determining the carrying value of any goodwill to be included in the disposal group.

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 that 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, especially when the registrant has cash flows from, or continuing involvement with, the disposed-of operations.¹ In addition, 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 comments on long-lived-asset impairment testing and early-warning disclosures.

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

¹ Under ASC 205-20-45-1, when a component has been disposed of or is classified as held for sale, the results of the component’s operations must be reported in discontinued operations if (1) the “operations and cash flows of the component have been (or will be) eliminated from the ongoing operations of the entity as a result of the disposal transaction” and (2) the “entity will not have any significant continuing involvement in the operations of the component after the disposal transaction.”

² In accordance with ASC 205-20-45-3, 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

Please revise future filings to more fully disclose and discuss the specific nature of your restructuring activities and their impact and expected impact on future operations. In regard to your 2013 restructuring activities, please revise MD&A in future filings to address these activities and to disclose: the number and nature of the employees to be terminated; the actual number of employees terminated at the most recent balance sheet date; the nature of the other costs; the amount of any annual savings anticipated and when they are expected to be realized; and the amount of any savings actually achieved during the periods presented. Refer to SAB Topic [5.P]. Please show us your proposed revisions in your response.

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. In addition, under 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 that you have both Class A and Class B Common Stock outstanding. Tell us what consideration you have given to the two-class method for computing basic and diluted earnings per share for each class of your common stock. We refer you to ASC 260-10-45-60B(d). To the extent that earnings per share would not differ under the two-class method, please revise your disclosures in future filings to indicate as such.

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 has other participating securities) that are treated as one class in the calculation of EPS, the SEC staff often asks whether the registrant considered the two-class method in computing EPS under ASC 260-10-45-59A through 45-70.

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). Further, the staff 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).

Regarding the treatment of convertible instruments, 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 conversion rights. See the [Debt](#) and [Financial Instruments](#) sections for more information about conversion features.

The SEC staff has focused on understanding the terms of registrants' arrangements regarding (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 the 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 they are considered with regard to the EPS calculation.

EPS Disclosures

Example of an SEC Comment

Please revise [your footnote] to disclose the number of stock options, restricted shares and other securities that could potentially dilute your basic earnings per share in the future that were not included in the computation of diluted earnings per share for the periods presented because to do so would have been antidilutive for the periods presented. If there were no such securities outstanding during the periods presented, please state this in [your footnote]. Refer to the guidance outlined in ASC [260-10-50].



The SEC staff may also 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

The SEC staff continues to ask registrants about the sufficiency of disclosures for fair value measurements that rely on unobservable inputs and on the use of third-party pricing services.

Disclosures Related to Unobservable Inputs

Quantitative and Qualitative Information

Example of an SEC Comment

You disclose the range of significant unobservable inputs used in developing the fair value of your Level 3 positions. Given the wide range of the forward market price assumptions, please tell us your consideration of disclosing the weighted average of the forward market prices, similar to the illustration provided in ASC 820-10-55-103, and your basis for calculating the weighted average. Please also tell us what consideration was given to providing a narrative description of the sensitivity of the fair value measurement to changes in unobservable inputs. Please refer to ASC 820-10-50-2(bbb) and (g).

Although ASC 820 requires entities to disclose the significant unobservable inputs used in Level 3 fair value measurements, it contains no explicit guidance on the types of quantitative information an entity should disclose to meet such a requirement. However, the example in ASC 820-10-55-103 illustrates quantitative information an entity “might disclose” to meet the requirement under 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 SEC staff has suggested that a registrant could instead present qualitative information about the distribution of the range of values if a weighted average would not be meaningful. 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. For additional information about unobservable inputs used to determine fair value, see the [Investment Management](#) section.

Sensitivity of Level 3 Measurements

Example of an SEC Comment

[T]here is no information about the sensitivity of a fair value measurement of Level 3 assets to changes in unobservable inputs and any interrelationships between those unobservable inputs. See ASU 2011-04.

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.

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](#).

Use of Third-Party Pricing Services

Example of an SEC Comment

We note you use third party pricing services and broker quotes to price your securities. Please tell us and revise MD&A disclosures in future filings to address the following areas:

- The number of quotes or prices you generally obtain per instrument, and if you obtain multiple prices, how you determine the ultimate value you use within your financial statements.
- Whether and if so, how and why, you adjusted prices or quotes you obtained from pricing services and brokers.
- The extent to which the brokers or pricing services are gathering observable market information as opposed to using unobservable inputs and/or proprietary models in making valuation judgments and determinations.
- Whether the broker quotes are binding or non-binding
- Describe any procedures you perform to validate the prices you obtain to ensure the fair value determination and its categorization within the fair value hierarchy is consistent with Topic 820 of the Accounting Standards Codification.

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, and (3) calculation of beneficial conversion features (BCFs).

Embedded Derivatives in Hybrid Financial Instruments

Examples of SEC Comments

- We note . . . that the company has performed analysis of [convertible preferred stock] and concluded that the embedded conversion feature does not need to be bifurcated and separately accounted for as a derivative as the conversion option is clearly and closely related to the economic characteristics of common equity and in turn, the host contract. . . . Please provide your analysis of the evaluation of the economic characteristics, risks and terms of the conversion option and the host contract to support your conclusion that the host contract is more akin to an equity host.
- Certain corporate bonds carry a make whole call provision and a par call provision. Please expand your disclosures to discuss the key terms of each of these provisions and any impact of these provisions on your accounting for the corporate bonds. Please also tell us what consideration you gave to the accounting impact of these provisions, including your consideration of ASC 815 in regards to the make whole call provision.

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 purchased 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.

Classification of Warrants

Example of an SEC Comment

Tell us why equity classification for the warrants [is] appropriate and reference the authoritative literature you rely upon to support your accounting.

If certain criteria are met, warrants issued in connection with debt and equity offerings are accounted for on a separate basis (i.e., as a freestanding financial instrument²). 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, its classification as either debt or equity hinges 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,

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

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."

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.

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.

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 over 10% of total current liabilities are aggregated into other accrued expenses for each period presented. Please revise future filings to separately state any current liabilities that exceed 5% of total current liabilities, as applicable. Refer to Rule 5-02.20 of Regulation S-X.

Under Regulation S-X, Rule 5-02, 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. The SEC staff may ask a registrant to confirm whether the reported balances of other current assets and liabilities or other noncurrent assets and liabilities include any items in excess of 5 percent of total current assets and liabilities or total assets and liabilities, respectively. 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.

Current Versus Noncurrent Classification

Example of an SEC Comment

[T]ell us how you considered the guidance in ASC 210-10-45-4 as it appears that this receivable balance has been outstanding longer than one year.

Many of the SEC staff's comments have addressed registrants' classification of current and noncurrent assets and liabilities, including debt. When presenting a classified balance sheet, registrants should consider the guidance in ASC 210-10-45 and other applicable accounting literature to determine whether an item should be classified as current or noncurrent. The SEC staff may ask a registrant to explain an item's classification and presentation or to reclassify an asset or liability appropriately.

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.

Because the guidance on classification of income and expense items lacks specificity, classification is often established through practice and the SEC comment process. 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

We note from the disclosures that have been provided in Note 1 that the Company's revenues include revenues from both the provision of services and the sale of products. To the extent that your revenues from the sale of products [exceed] ten percent of your total revenues during the periods presented in your financial statements, please revise your consolidated statements of operations to provide separate disclosure of the revenues and related costs associated with revenues derived from sales of products and services. Refer to the guidance outlined in [Rule 5-03(b)(1)] of Regulation S-X.

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

Cost of Sales

Example of an SEC Comment

In future filings, please revise your footnote disclosures to clarify, if true, that you allocate a portion of your depreciation and amortization to cost of goods sold. If you do not allocate a portion to cost of goods sold, please tell us how you considered the guidance in SAB Topic 11.B, including depreciation and amortization not being positioned in your statement of operations in a manner which results in reporting a figure for income before depreciation like gross margin. Please provide us your proposed disclosures.

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, in particular whether distribution costs are included in cost of sales. It may ask registrants to disclose the line item in which such costs are recorded as well as whether their gross margins are comparable to those of other registrants. The SEC staff has also commented on registrants' allocation of 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 you recorded \$[X] as a gain on the sale of certain [assets] that were included in the previous . . . business segment, and have reflected the gain as non-operating income. Please explain why the gain is not included in operating income.

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 gains or 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

You classify dividends received by the parent company as cash inflows 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)). In the absence of specific facts and circumstances to the contrary, dividends should be presumed to be returns **on** investment and classified as cash inflows from operating activities. 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 September 2014 AICPA Banking 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 speculated that the errors may be occurring because registrants (1) are relying on manually used spreadsheets instead of automated processes to prepare their statements of cash flows and (2) are preparing their statements of cash flows late in the financial reporting process. Accordingly, the staff cautioned registrants to revisit their processes and internal controls associated with the preparation of their statements of cash flows. For information about SEC staff comments on how registrants' errors could affect their conclusions about DCP 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 intercompany investing activities and intercompany long-term financing activities are required to be presented gross, not net. . . . See ASC 230-10-45.

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, in certain instances financial statement users 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 more appropriate to report certain cash flows on a net basis rather than on a gross basis.

Comprehensive Income

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.

Presentation of Tax Effects

Example of an SEC Comment

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 220-10-45-17.

The SEC staff has also commented on ASC 220-10-45-12, which requires entities to “present the amount of income tax expense or benefit allocated to each component of other comprehensive income, including reclassification adjustments.” Entities must present such information each reporting period either on the face of the statement where the OCI is presented or in the footnotes.

Foreign Currency

Quantification of Foreign Currency Adjustments

Example of an SEC Comment

You indicate . . . that increases in the value of the U.S. dollar relative to other currencies may adversely affect your business, results of operations and financial condition. Please address the need to expand your segment discussions to address the impact that changes in the value of the U.S. dollar relative to other currencies had on segment sales and adjusted operating profit for each period presented.

The SEC staff's comments on quantitative disclosures related to foreign currency adjustments reflect its [guidance](#)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.

Disclosures About Venezuelan Operations

The SEC staff continues to focus on accounting and disclosure considerations related to the foreign currency exchange environment in Venezuela. Entities currently may be able to convert Venezuelan bolivar fuertes (BsF) to U.S. dollars at one of three legal exchange rates obtained via four exchange-rate mechanisms. Business operations in Venezuela may give rise to accounting questions about (1) which exchange rate is appropriate for remeasurement, (2) whether certain BsF-denominated monetary assets should be classified as noncurrent in a classified balance sheet, and (3) whether such operations should be deconsolidated or considered impaired. At the June 27, 2014, FASAC meeting, the SEC staff acknowledged that there is little guidance on which exchange rate an entity should use in a multiple-rate environment. The SEC staff advised registrants to disclose the exchange rates used and their thought processes in selecting the rate.

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

Accordingly, registrants should consider providing disclosure in the notes to the financial statements as well as in the Description of Business, Risk Factors, and MD&A sections of their SEC filings. The SEC staff has informally indicated that additional disclosures related to a registrant's Venezuelan operations may be warranted if such operations are material. It has also provided certain disclosure recommendations, which can be found in Deloitte's [Financial Reporting Alert 14-1](#).²



² 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 that during the second quarter of fiscal 2014, you forecasted a significant decline in revenue and operating revenue related to certain reporting units within your [X] reporting segment, which resulted in an interim evaluation of your goodwill for potential impairment. Tell us the percentage by which the fair value exceeded the carrying value for your [X] reporting segment at the time of your evaluation. Also, to the extent that you have determined the estimated fair value substantially exceeds the carrying value for your reporting units, please disclose this determination in future filings. Alternatively, if the estimated fair value for any of your reporting units is not substantially in excess of the carrying value and is potentially at risk of failing step one of your goodwill impairment analysis, please tell us and disclose the following in future filings:

- [T]he percentage by which the fair value of the reporting unit exceeded the carrying value as of the date of the most recent test;
- [D]iscuss the degree of uncertainty associated with the key assumptions; and
- [D]escribe the potential events and/or changes in circumstances that could reasonably be expected to negatively affect the key assumptions used in determining fair value.

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, Rule 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, even if it passed the test. Further, registrants should avoid attributing the 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

We have reviewed your analysis of whether the components have similar economic characteristics to aggregate each of your reporting units. Please provide the following for [each of your] reporting units:

- [T]he level of variation between the products and services offered by each of the component businesses within each [of the] reporting units[;]
- [A]dditional information as to the manner in which you operate each component business and the nature of the resources and services shared amongst the component businesses related to operational management, equipment and intellectual resources[;]
- [C]ontrast the shared activities discussed in response to the bullet above with the types of activities that are not shared among the components of each reporting unit;
- [E]xplain which of the qualitative factors you weighted most heavily in your analysis to conclude that the components should be aggregated; and
- [T]he financial information regularly reviewed by segment management to assess performance.

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 disclose 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.

Interim Impairment Tests

Example of an SEC Comment

You disclose that during the fourth quarter ended January 31, 2013, you concluded there were indicators of potential goodwill impairment. As a result, you updated your goodwill impairment as of January 31, 2013 and recorded a goodwill impairment charge of \$[X]. Please tell us how circumstances changed in the fourth quarter from the second quarter when you performed your annual impairment testing and the third quarter, and the factors that existed in the fourth quarter to trigger the impairment charge in the fourth quarter that did not exist or were not reasonably foreseen in the second and third quarters. Also, tell us your assessment of the circumstances that existed in the third quarter and your conclusion at that time with respect to the prospect that impairment charges may be forthcoming. Additionally, tell us the three reporting units for which the carrying values including goodwill exceeded their fair values and how much the carrying value exceeded the fair value for each.

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

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."](#)

Income Taxes

The SEC staff's comments about income taxes continue to focus on (1) disclosure of potential tax and liquidity ramifications related to the repatriation of foreign earnings, (2) valuation allowances, (3) rate reconciliation disclosures, and (4) unrecognized tax benefits. More recently, the staff has asked registrants to support situations in which their valuation allowances were reduced or reversed.

The staff continues to ask registrants to provide early-warning disclosures to help 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.

Repatriation of Foreign Earnings and Liquidity Ramifications

Example of an SEC Comment

We note . . . you hold . . . undistributed earnings in non-U.S. subsidiaries that you plan to reinvest outside the U.S. indefinitely. [P]lease tell us the amount of cash and equivalents and liquid investments held by your foreign subsidiaries . . . and quantify the amount that would not be available for use in the U.S. without incurring U.S. taxes. . . . Further, as we note . . . that the majority of your net long-lived assets are in the U.S., please discuss for us the impact on your liquidity and capital positions if cash and cash equivalents as well as liquid investments held by your foreign subsidiaries were not available for use in the U.S. Similarly, discuss the impact of income tax liabilities you would incur if you were to repatriate the cash and cash equivalents as well as liquid investments held by your foreign subsidiaries to the U.S.

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, it 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.

Disclosures in an MD&A liquidity analysis should include the following:

- 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 repatriated.
- If true, a statement that the company does not intend to repatriate those funds.

Valuation Allowances

Examples of SEC Comments

- Your disclosure indicates that it is generally difficult for positive evidence regarding projected future taxable income, exclusive of reversing taxable temporary differences, to outweigh objective negative evidence of recent financial reporting losses. Given your two years of recent losses, please tell us and revise future filings, including your next quarterly filing, to address the following:
 - [P]rovide a more robust discussion of the specific factors you considered in determining that no additional valuation allowance for deferred tax assets is necessary, including the reasons why you expect to return to profitability in FY 2014;
 - [D]isclose the amount of taxable income you are required to generate and the time period over which you are required to generate it to fully realize your deferred tax assets; and
 - [D]isclose the potential impact on your financial statements if you determine you will not return to profitability in FY 2014.
- We note your disclosure stating that after considering all available positive and negative evidence, you reversed \$[X] of the remaining valuation allowance on your [Country A] and [Country B] deferred tax assets . . . , as you determined that it was more likely than not that these benefits would be realized.

Given the impact of the reversal of the valuation allowance on your [net income], please provide draft disclosure to be included in future filings that expands discussion on the material positive and negative evidence you considered, along with how it was weighted, in determining that it is more likely than not that your deferred tax assets will be realized. Your response should provide a detailed analysis regarding how you determined [the] realization of the [Country B] deferred tax asset. Specifically address the positive and negative evidence considered for your [Country B] subsidiary Refer to the guidance in ASC 740-10-30-16 through 30-25.

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 the current economic environment 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 is less objectively verifiable. Likewise, a registrant's poor track record of accurately forecasting future results would also result in future profit projections that are less objectively verifiable. Thus, such evidence would carry less weight in a valuation allowance 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.

For example, at the 2013 AICPA Conference, the SEC staff discouraged registrants from providing "boilerplate disclosures" and instead recommended that they discuss registrant-specific factors (e.g., limitations on their ability to use net operating losses and foreign tax credits). The SEC staff also stated that it has asked registrants to disclose the effect of each source of taxable income on their ability to realize a DTA, including the relative magnitude of each source of taxable income. In addition, the staff recommended that registrants consider disclosing the material negative evidence they evaluated since such disclosure could provide investors with information about uncertainties related to a registrant's ability to recover a DTA.

Rate Reconciliation

Example of an SEC Comment

We note your effective tax rate . . . compared to the prior year effective tax rate decreased [X]% due to changes in the geographical mix of income, among other reasons. If changes in the geographical mix of income were a significant driver of the decrease in your effective tax rate, please explain to us and disclose the facts and circumstances leading to the changes in the geographical mix of income and whether you expect these changes to continue. In this regard, an overview of how your effective tax rate may be impacted by a mix of earnings among your domestic and foreign operations would appear useful to an investor. We refer you to Item 303(a)(3)(i) of Regulation S-K and Section III.B of SEC Release No. 33-8350.

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.

At the 2013 AICPA Conference, the SEC staff 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 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

Examples of SEC Comments

- You disclose . . . that the addition of unrecognized tax benefits . . . was primarily attributable to U.S. tax positions taken in the current year. Please explain in detail what these tax positions relate to by category and amount, including the facts and timing of the circumstances specific to these positions in the current year as compared to prior years. See FASB ASC 740-10-50.
- Reference is made to the discussion . . . regarding the [State A] audits of your tax returns and the related assessments. Please tell us your consideration of disclosing an estimate of the range of reasonably possible change in your unrecognized tax benefits or a statement that an estimate of the range cannot be made. Refer to ASC 740-10-50-15d.3. In addition, please tell us your consideration of expanding your critical accounting policy disclosure related to uncertain tax positions . . . to quantify the extent to which your estimate is sensitive to change.

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, it should be netted against the related DTA for the carryforward. Otherwise, a liability is recognized for the amount of the unrecognized tax benefit. 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 the following:

- 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

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



Leases

Nonperformance Provisions

Example of an SEC Comment

Please address the following regarding the classification of your leases:

- Please tell us whether your leases contain default covenants related to nonperformance. If so, please confirm all the conditions set forth in ASC 840-10-25-14 exist. Otherwise, confirm that you included the maximum amount that the lessee could be required to pay under the default covenant in your minimum lease payments for purposes of applying ASC 840-10-25-1(d);
- Please tell us whether your leases contain material adverse change clauses. If so, please tell us how this is determined and what potential remedies are available to you as the lessor;
- Please tell us if your leases contain cross-default provisions. If so, please tell us what consideration you gave to the potential impact of these provisions on your lease classification; and
- Please tell us if your leases include subjective default provisions. If so, please tell us whether there is any cap on potential remedies that would impact your lease classification.

Refer to ASC 840-10-25-41 through 25-69.

In recent years, the SEC staff has heightened its focus on registrants' accounting for nonperformance covenants contained in lease agreements. Examples of such covenants include material adverse change clauses, cross-default provisions, subjective default clauses, and change-in-control provisions. Nonperformance covenants do not affect lease classification if they meet all the conditions in ASC 840-10-25-14. However, if any one of those conditions is not met (e.g., if default is subjectively determined), the maximum amount the lessee is required to pay under the nonperformance covenant must be included as a minimum lease payment regardless of the probability of the occurrence of a default. The SEC staff has asked registrants whether any of their lease contracts contain such provisions and, if so, to explain how they considered the provisions in determining whether the lease was a capital or operating lease.

While registrants have used different methods to establish the amount to include from default provisions in the measurement of the lease liability, the SEC staff has indicated that there are only two acceptable ways for registrants to consider potential payments that may result from default when measuring the lease liability: (1) by using the probability of default as part of the measurement of the lease liability (with an ongoing reassessment of probability each reporting period) or (2) by recognizing the maximum amount payable under the default provision regardless of the probability of default.

Sale and Leaseback Transactions Involving Fixed-Price Renewal Options

The accounting for sale and leaseback transactions that involve fixed-price renewal options can be problematic. 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 may cause real estate to be precluded from sale accounting (i.e., 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 rent 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 adjusting the current base rents with an inflationary index. 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

Please tell us in greater detail the facts and circumstances regarding the corrections to prior year's income taxes and depreciation of properties. In your response, tell us how you complied with ASC 250-10-45-22 and SAB Topics 1M and 1N, and provide us with your materiality assessment. Please be detailed in your response.

Registrants perform materiality analyses to determine the impact of identified misstatements on their financial statements. 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 2¹ 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 (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, registrants should first decide whether an individual error is material by considering the affected financial statement line item and 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. 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. The SEC staff has observed that registrants' materiality assessments are often presented in a "checklist" fashion in which only the factors in SAB Topic 1.M are considered. Instead, the staff believes that a registrant should describe how the factors were 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

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.

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.

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. 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 (including immaterial restatements) may have on their previous conclusions about ICFR and DCP. As a result of such misstatement, 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 upon because of an error.

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.

Other Deloitte Resources

[December 11, 2012, *Heads Up*, “Highlights of the 2012 AICPA National Conference on Current SEC and PCAOB Developments.”](#)

Noncontrolling Interests

Examples of SEC Comments

- Please . . . explain the process by which you determine the allocation of net income (loss) to each of the predecessor, previous owners, and noncontrolling interest, and why the remainder of that allocation represents net income attributable to partners.
- We note that as part of your statement of changes in stockholders' equity, you have a column titled "Noncontrolling Interest." In light of the fact that you have both redeemable and non-redeemable noncontrolling interest, please revise this column to clearly identify this amount as non-redeemable noncontrolling interest. Also, please revise to present a column for redeemable noncontrolling interest which includes a roll-forward of this temporary equity amount but does not combine the total with permanent equity. See guidance in ASC 810-10-50-1A(c).

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 initial 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) requires equity instruments 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.

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."

For additional information about classification of redeemable securities, see the [Debt](#) and [Financial Instruments](#) sections.

Other-Than-Temporary Impairment of Investments in Securities

Registrants are required to evaluate investments in debt and equity securities for impairment in each reporting period. An investment in debt or equity securities is impaired when its fair value is less than its carrying value, but an impairment loss is not recognized in net income (or loss) unless the impairment is determined to be other-than-temporary.

A registrant must use significant judgment in determining whether an investment is other-than-temporarily impaired because no “bright lines” or “safe harbors” for this determination are established by either the SEC or U.S. GAAP. A registrant should therefore be prepared to support its conclusion that unrealized losses are temporary.

The improved performance of the equity markets over much of the past year has resulted in fewer SEC staff comments on OTTI of securities. However, market factors, such as increases in interest rates (which would cause debt securities to decrease in value), may lead the SEC staff to ask registrants how they determined whether their investments were other-than-temporarily impaired.

Investments in Debt and Equity Securities — Recoverability

Example of an SEC Comment

Considering the significant judgment required to determine if a security is other than temporarily impaired and the focus users of financial statements have placed on this area, we believe comprehensive and detailed disclosure is required [W]e note [from] your disclosure that: (1) the market for collateralized mortgage obligations was not active, (2) all of the securities are in mezzanine tranches and are currently rated less than investment grade . . . , and (3) you have determined that not all contractual cash flows will be received on collateralized debt obligations back[ed] by trust preferred securities. Yet we note that you have determined there was no other-than-temporary impairment in the periods presented. Please provide us your other-than-temporary-impairment analysis which clearly identifies the key factors you considered in your conclusion. Refer to ASC 320-10-35-33.

For debt securities, ASC 320-10-35 provides guidance on determining whether a credit loss has occurred. For example, ASC 320-10-35-33C specifies that a credit loss exists if the present value of cash flows that an entity expects to collect from the security is less than the security’s amortized cost basis. Further, ASC 320-10-35-33F requires entities to consider a number of factors in estimating whether a credit loss exists, including (1) the “length of time and the extent to which the fair value has been less than the amortized cost basis” and (2) “[a]ny changes to the rating of the security by a rating agency.” ASC 320-10-35 also includes guidance on assessing whether equity securities are impaired (see below for additional information). Consequently, the SEC staff frequently focuses on the duration and severity of losses when asking registrants about their conclusions related to whether securities with significant unrealized losses are other-than-temporarily impaired. As a result, the SEC staff has asked registrants to explain their basis for concluding that they have the intent and ability to hold debt and equity securities until recovery.

In addition, when credit losses on debt securities have not been recognized, the SEC staff may ask:

- Why unrealized losses of a longer duration are not indicative of credit losses.
- Whether the registrant continues to receive interest payments in a timely manner.
- How the registrant considered significant inputs, such as:
 - The performance indicators of the security’s underlying collateral (if any), including default rates, delinquency rates, and percentage of nonperforming assets.
 - Loan-to-collateral-value ratios.
 - Current levels of subordination.

- Geographic concentration.
 - Credit ratings.
- Whether the registrant's cash flow projections include expectations about a lack of receipt of future interest payments, principal payments, or both and, if so, the basis for this assumption.
- Whether a class of securities is considered investment-grade, including the amounts attributable to the securities that are considered below investment-grade.
- Whether there have been any changes to the rating of the security by a rating agency and, if so, when the changes occurred.
- Whether securities with unrealized losses are other-than-temporarily impaired when their credit spreads are significantly greater than credit spreads in the broader market.
- To what extent credit enhancement supports the registrant's judgment about unrealized losses.

For equity securities, registrants should consider the guidance in ASC 320-10-35 and SAB Topic 5.M to determine whether an impairment is other-than-temporary. Under SAB Topic 5.M, a registrant should consider the following factors, either individually or in combination with other factors, when evaluating an equity security for OTTI:

- Length of time and extent of impairment.
- Financial condition and near-term prospects of the issuer.
- Ability and intent to hold the security until recovery.

Registrants should avoid overreliance on bright lines. For example, depending on the facts and circumstances, a 75 percent decline in an equity security's fair value may be considered severe enough for an entity to recognize an OTTI even when the decline in fair value has been present for only three months.

OTTI Disclosures for Debt Securities

Because entities must use significant judgment to determine whether investments in securities are other-than-temporarily impaired, the SEC staff may ask registrants to provide qualitative and quantitative disclosures about the inputs and assumptions they used in discounted cash flow models to measure impairment losses and about the procedures they performed to determine whether a credit impairment exists. When bonds subsequently become other-than-temporarily impaired, the staff may ask the registrant to explain the facts and circumstances that led to the impairment and to disclose information about the potential for future impairment charges.

Timing of Recognition

The SEC staff may ask registrants to provide additional information about the facts and circumstances leading up to recognition of an OTTI, including their analysis supporting the recognition of the impairment in a given period rather than in an earlier period. In particular, the staff may ask what factors have changed since the last reporting period that triggered the recognition in the current period.

Pensions and Other Postretirement Benefits

The SEC staff continues to emphasize the 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

- We see the significance and variability of your pension expense, in part related to your policy to fully [recognize] actuarial gains and losses in the fourth quarter of each year. However, we note that the disclosure in MD&A appears to mostly address the basic accounting policy. Please help us better understand your disclosure by responding to the following:
 - Tell us where you provide basic accounting policy disclosure in [your footnote] or elsewhere in your audited financial statements.
 - While we note that you make a general statement that reasonably likely changes in assumptions may have a material impact on future earnings, please tell us how your critical accounting policy disclosure considers the guidance from Section V of Release 33-8350. The cited guidance, in part, provides that: “Since critical accounting estimates and assumptions are based on matters that are highly uncertain, a company should analyze their specific sensitivity to change, based on other outcomes that are reasonably likely to occur and would have a material effect. Companies should provide quantitative as well as qualitative disclosure when quantitative information is reasonably available and will provide material information for investors.”
- 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. Often the staff asks a registrant how its disclosures in the critical accounting estimates section of MD&A align with its accounting policy disclosures in the notes to the financial statements. The staff also requests more quantitative and qualitative information about the nature of the registrant’s assumptions. In particular, the staff has focused on the discount rate and the expected return on plan assets.

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

- Whether a corridor¹ 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.

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 reasons why the expected return has changed or is expected to change in the future.
- The effect of plan asset contributions during the period on profit or loss, when this effect is significant. The SEC staff has indicated that additional plan asset contributions reduce net pension costs even if actual asset returns are negative because the amount included in profit or loss is determined through the use of expected and not actual returns. Consequently, such information can provide an understanding of unusual or nonrecurring items or other significant fluctuations so that investors can ascertain the likelihood that past performance is indicative of future performance.

Liquidity and Capital Resources

Example of an SEC Comment

We note that you significantly increased your pension contributions for fiscal year 2013 above the minimum funding requirement and that you anticipate doing the same for fiscal year 2014. In future filings, please explain the factors that contributed to this cash management decision along with the impact to your consolidated financial statements.

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 plan's 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., an entity'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 indicate 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 value² 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 in 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.

Disclosures for 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.

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.

Other Deloitte Resources

- [Financial Reporting Alert 13-3, "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 and in Market-Related Value of Plan Assets."](#)

Revenue Recognition

Revenue Recognition Disclosures

Examples of SEC Comments

- We note your current revenue recognition disclosures. Confirm to us, if true, that you only recognize revenue if a sales transaction meets each of the criteria outlined at SAB Topic 13(A)(1). In that regard, in future filings please disclose whether there is persuasive evidence of an arrangement, the sales price is fixed or determinable, and management believes collectability is reasonably assured.
- We note that your business overview . . . separately discusses the nature of your regulated terminal operations, electricity transmission, regulated distribution, rail operations, port operations, toll road operations and energy transmission and distribution operations. Based on your consistent use of these categories to describe your business throughout your filing, it is unclear to us why disclosing revenues from each of those categories . . . would not be useful to investors. We note, for example, that your transport and energy platform consists of four separable lines of business in four different geographic regions: rail operations in Australia, port terminals in Europe, toll road operations in Chile, and natural gas transmission primarily in the U.S.

In addition to requesting general policy information, the SEC staff often asks registrants to clearly state whether 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 collectability is “reasonably assured” and whether the sales price the registrant is charging 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 by comparing the disclosures with the revenue streams described in the business section, in MD&A, and on the registrant’s Web site. At the 2013 AICPA Conference, the SEC staff indicated that 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.

Sales Returns

Example of an SEC Comment

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.

Multiple-Element Arrangements

Examples of SEC Comments

- Tell us your consideration of disclosing whether the significant deliverables in your arrangements qualify as separate units of accounting, and the reasons that they do not qualify as separate units of accounting, if applicable. In addition, your disclosures should discuss the significant factors, inputs, assumptions and methods used to determine the selling price (whether vendor-specific objective evidence, third-party evidence, or estimated selling price) of the significant deliverables. We refer you to the guidance in ASC 605-25-50-2.
- Explain how you concluded that the set-up services have no stand-alone value upon completion. Your policy states that revenue recognition begins upon delivery. Indicate whether the delivery is the result of the set-up services. It appears from your response that the set-up services require a significant amount of time and effort to complete. Indicate how the fee for these services compares to the entire contract value and whether this fee varies by contract or customer.

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 supplemental information, and sometimes requests additional disclosures, about multiple-element arrangements, including the following:

- 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 recently focused on registrants' accounting for set-up or installation services for products sold to customers, particularly when consideration for these services is paid at the inception of the arrangement or as the services are provided. The staff has asked registrants to explain whether such services have stand-alone value and how they determined the period over which the consideration for these services is recognized.

Principal-Agent Considerations

Example of an SEC Comment

Your revenue recognition policy continues to reiterate the overall revenue recognition requirements under U.S. GAAP. However, your disclosures should specifically address your policy for recognizing revenue in accordance with U.S. GAAP. For example, you should discuss how your current revenue recognition methodology complies with the Principal-Agent Considerations discussed in ASC Topic 605-45. In particular, tell us how you considered this literature in determining whether to report revenue gross as a principal or net as an agent.

The SEC staff often inquires into principal-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 providing 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

- Please tell us . . . the percentage of revenue recognized using the percentage-of-completion method, using the completed-contract method, for [services], and for direct sales not provided in conjunction with the performance of construction contracts. . . . With respect to customer contracts, please revise future filings to disclose:
 - [T]he amount of contract losses recorded during each period presented and the current status of material loss contracts, as well as the current status of any contracts for which material losses are reasonably possible;
 - [T]he impact of material changes in contract estimates during each period presented; and
 - [T]he impact of contract penalties, claims, change orders and/or settlements during each period presented, if material.
- It appears \$[X] of operating income in 2013 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 frequently asks registrants to clarify their treatment of these contracts under ASC 605-35. For instance, the staff may ask a registrant to provide the following information:

- How the registrant developed its estimate of total contract costs and how those costs are directly related to contract performance.
- How the registrant treats precontract and early-stage contract costs, which should normally be expensed.
- A description of the nature, status, amounts, and types of change orders and claims that occurred during the periods presented and how the registrant accounted for them.
- 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).
- An analysis of a registrant's historical accuracy of making estimates and the likelihood of changes in those estimates in the future.
- The amount of contract losses recorded during each period presented.
- If there were changes in estimates during the period (e.g., the estimate of percentage complete or amount of profit recognized on claims), disclosures (under ASC 250-10-50-4) about the effect of the change in estimate in the financial statements.
- For transactions that recognize revenue 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 that use that method to enhance their disclosures 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.

Industry-Specific Considerations

See the [Industry-Specific Topics](#) section for industry-specific revenue considerations.

Other Deloitte Resources

- May 28, 2014, *Heads Up*, "Boards Issue Guidance on Revenue From Contracts With Customers."
- December 16, 2013, *Heads Up*, "Highlights of the 2013 AICPA Conference on Current SEC and PCAOB Developments."

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

Example of an SEC Comment

We note from the disclosures provided in MD&A and in [a footnote] to the financial statements that you have not provided any disclosure as to how any recently issued accounting pronouncements may impact [your] financial statements in future periods. In future filings, please revise MD&A and the notes to the financial statements to discuss how any recently issued accounting standards or pronouncements may impact your financial statements. Refer to the guidance outlined in SAB Topic [11.M].

SAB Topic 11.M (SAB 74) indicates that a registrant should disclose the effects of recently issued ASUs and SABs that are not yet effective “unless the impact on [the registrant’s] financial position and results of operations is not expected to be material” (footnote omitted). These disclosures are meant to help financial statement users assess the effect that new standards will have once adopted. SAB 74 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 74, 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. However, 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 74 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) the interaction of operating segments and goodwill impairment testing, and (5) disclosure of 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 centered on (1) the identification of the chief operating decision maker (CODM), (2) how the company identifies operating segments and supports its process for identifying them, (3) the quantitative and qualitative factors used to support the aggregation of operating segments, and (4) how the registrant has considered whether previous decisions about the identification and aggregation of operating segments remain appropriate (i.e., how it has continued to assess such conclusions in light of changes in its management or operations).

Examples of SEC Comments

- We understand that you have identified your CEO as your CODM, although you acknowledge that he “ . . . leads the Company with a supporting senior leadership team [(SLT)] that assists in providing input and driving the performance of the Company.” You further clarify by stating that “the CEO utilizes inputs from the SLT to evaluate performance.” Please describe the nature and form of this input. Additionally, explain the extent to which the input pertains to your [brands], and includes any combination of operating metrics, budgets or targets, related to sales, costs or market share.
- We note the discussion of your major markets . . . and the breakout of net sales by market application in Management’s Discussion and Analysis Please tell us how you determined that you only have two [reportable] segments, [A] and [B], under FASB ASC 280-10-50. Your response should address the following:
 - Describe the contents of the information you provide to your chief operating decision maker.
 - Explain your disclosure that the segmentation reflects the go-to-market strategies for various products and markets.
- It appears to us that you aggregate four operating segments into your [X] reportable segment. Please demonstrate to us how you determined aggregation is appropriate and complies with ASC 280-10-50-11. We note we previously commented on this issue We also note since that time the number of your operating segments has increased Please ensure your assessment provides a specific and comprehensive discussion of the similar economic characteristics of each operating segment during each period presented.

Although ASC 280 has been effective for many years, segment reporting is still a frequent SEC comment letter topic. The staff often challenges registrants’ conclusions about identification of operating segments, identification of the entity’s CODM, and aggregation of operating segments into reportable segments. 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 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 importance of the CODM package in supporting a registrant's segment reporting. At the September 2014 AICPA Banking Conference, the SEC staff noted that while its views on how it should assess information in a registrant's CODM package are evolving, it may have overemphasized the importance of the CODM package. The staff indicated that rather than viewing the CODM package as the determinative factor in identifying operating segments, it would 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 would automatically nullify other information (i.e., information that might suggest different operating segments). Registrants should expect that the staff will review other publicly available information for consistency with the registrant's segment disclosures, such as the information in 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.

At the AICPA Banking Conference, the SEC staff noted that it would place 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. Accordingly, the staff indicated that it would also focus on understanding management's structure (e.g., through organization charts or other information) in supporting the person (or group) identified as the CODM.

In addition, ASC 280-10-50-11 allows entities to 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. Further, many registrants have complex business models and organizational and reporting structures. Such complexities often make it difficult for registrants to determine the basis for economic similarity when aggregating operating segments. As a result, the SEC staff may ask a registrant to provide an analysis of how it determined that its aggregation of operating segments complies with ASC 280-10.

Consequently, 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. In addition, the staff may 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 the future.

For additional information, see Deloitte’s [Financial Reporting Alert 14-3, “Segment Reporting.”](#)

Changes in Reportable Segments

Example of an SEC Comment

We note your disclosure . . . that you began including your . . . services within your [A] segment on July 1, 2013. Please tell us whether you have restated prior segment financial information pursuant to ASC 280-10-50-34. Please quantify for us total assets of the transferred operations and the related impact they had on your statements of income, including revenues and net economic earnings, for all periods presented in your filing.

ASC 280-10-50-34 and 50-35 require public entities to recast information from prior periods for consistency with current reportable segments. 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 either include the revised financial statements in the registration or proxy statement or recast them 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

Please explain to us how you considered ASC 280-10-50-40 in your determination that product line disclosures are not required. For example, we note from your business disclosures and your website that you appear to sell products across multiple product categories.

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

As discussed in the [Impairments of Goodwill and Other Long-Lived Assets](#) section, 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 be incorrectly testing goodwill for impairment (i.e., at the wrong level).

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 16, 2013, *Heads Up*, "Highlights of the 2013 AICPA Conference on Current SEC and PCAOB Developments."](#)
- [December 11, 2012, *Heads Up*, "Highlights of the 2012 AICPA National 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 whether award holders are entitled to dividends or dividend equivalents.
- The number of options that are expected to vest and the assumptions used in developing those expectations.
- The registrant’s valuation method, including significant assumptions used (e.g., volatility).

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 to commenting on the types of share-based payment transactions discussed above, 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 staff comments on registrants’ proxy statements.

Share-Based Payment Awards Issued by Privately Held Companies

Example of an SEC Comment

Please tell us about each significant factor contributing to the difference between the estimated IPO Price and the fair value of your shares since the September 2013 grant and any subsequent grants through the date of your response. In your response, please tell us about significant intervening events and reasons for changes in assumptions, as well as the weighting of expected outcomes and selection of valuation techniques employed.

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 (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.

While the SEC staff has 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 recently updated its FRM to indicate that registrants should significantly reduce such disclosures. Specifically, the staff revised Section 9520 of the FRM 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.

Financial Statement Presentation

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

Other Deloitte Resources

- [April 28, 2014, *Heads Up*, “MD&A Disclosures About ‘Cheap Stock’ in IPO Transactions.”](#)
- [March 20, 2014, *Heads Up*, “Highlights of the ‘SEC Speaks in 2014’ Conference.”](#)



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 and that well over half of all MD&A-related comments are about the results of operations section. Consequently, the SEC staff's comments have addressed most topics of MD&A¹ but 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, and (4) obligations subject to uncertainties.

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 recommend² 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.

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

We note that you do not quantify the impact of the various factors that affected your revenues from period to period. For example, . . . you state that the sales . . . were negatively impacted by the exit of [certain product lines] and lower sales in your . . . product lines prior to being sold, but you do not quantify the impact. Similarly, you state . . . that gross profit . . . increased in 2013 primarily due to favorable raw material costs, but do not indicate either the change in raw material costs or the impact of this change. These are just examples. In future filings please quantify the effects of such factors and also discuss whether you believe these factors are the result of a trend, and, if so, whether you expect it to continue and how it may impact your financial condition and results of operations. See Item 303 of Regulation S-K and SEC Release No. 33-8350.

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 also suggested that in addition to discussing how volume and product mix affect a registrant's results of operations, the registrant should consider explaining other potential influences, such as pricing changes, acquisitions, new contracts, inflation, and foreign exchange rates.

The SEC staff also encourages 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](#), [Retail and Distribution](#), and [Technology](#) sections for additional information.

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.

- Present changes in a tabular format (e.g., a table that summarizes disaggregated cost of sales components by reportable segment).

The SEC staff has also asked registrants to separately discuss the impact of online sales on their results of operations. See the [Retail and Distribution](#) section for additional information.

Liquidity and Capital Resources

Example of an SEC Comment

In future filings, please provide a more informative analysis and discussion of changes in operating cash flows, including changes in working capital components, for each period presented. In doing so, please explain the underlying reasons for and implications of material changes between periods to provide investors with an understanding of trends and variability in cash flows. Please ensure your discussion and analysis is not merely a recitation of changes evident from the financial statements. Refer to Item 303(a) 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.³ In addition, the SEC staff has indicated that MD&A disclosures should take into account how the following factors, among others, affect a registrant's liquidity:

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

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

- Significant debt instruments, guarantees, and covenants. See the [Debt](#) section for more information about financial covenant disclosures in MD&A.
- Effects on liquidity of material cash balances that are held. For additional information, see the [Income Taxes](#) section.

³ At the 2011 AICPA Conference, the SEC staff highlighted the need for registrants to include appropriate narratives regarding liquidity and capital resources.

Critical Accounting Policies

Example of an SEC Comment

Your discussion of goodwill . . . substantially duplicates the footnote disclosure. Please revise this section to provide an analysis of your goodwill accounting policies and the significant underlying estimates that supplements, but does not duplicate, the description of accounting policies in the notes to the financial statements and provides greater insight into the quality and variability of information regarding your impairment test of goodwill.

The critical accounting policies section of MD&A is intended to highlight only those financial statement items that require significant management estimates and judgment. 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 the methods and 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.

The economy and volatility in the financial markets may also affect a registrant's defined benefit plans and related disclosures. For example, the SEC staff has indicated that registrants may need to expand disclosures in MD&A about key assumptions, pension asset investment strategies, changes to pension plan assets, and consideration of statutory minimum funding requirements. For additional information, see the [Pensions and Other Postretirement Benefits](#) section.

In addition to pension accounting, SEC staff comments to registrants have frequently focused on the management estimates used in the valuation of long-lived assets, income taxes (including DTAs and uncertain tax positions), and fair value estimates. See the [Impairments of Goodwill and Other Long-Lived Assets](#), [Income Taxes](#), and [Fair Value](#) sections for more information.

Tabular Disclosure of Contractual Obligations

Examples of SEC Comments

- Please expand footnote 1 [in your contractual obligations table] to disclose the components of “Other Liabilities” that were excluded from the Contractual Obligations table and the reasons why as stated in your response.
- 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 continues to comment on the contractual obligations table and the associated notes and disclosures. Such comments typically focus on (1) a registrant’s omission of material obligations, such as interest payments on debt, pension obligations, and uncertain tax position liabilities, and (2) omission of disclosures about the terms of obligations, such as purchase obligations. See the [Income Taxes](#) section for more information about ASC 740-10 liabilities.

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

Off-Balance-Sheet Arrangements

Example of an SEC Comment

Please revise to include a separately-captioned section within MD&A discussing your off-balance sheet arrangements as required by Item 303(a)(4) of Regulation S-K.

The SEC staff continues to focus on the requirement that registrants include a discussion of off-balance-sheet arrangements in a separately captioned section in MD&A⁶ and has encouraged registrants to focus on the following themes in their disclosures about such arrangements:

- Any material difficulties that off-balance-sheet entities are experiencing (including asset write-downs or credit downgrades) and the effect on the registrant.
- Detailed disclosure of support the registrant has provided, or is obligated to provide, to off-balance-sheet entities (including obligations to provide liquidity).
- The potential effect on debt covenants, capital ratios, credit ratings, or dividends, should the registrant consolidate or incur losses associated with the entities.

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

⁵ To the extent that the obligations cannot be quantified, the SEC staff expects registrants to disclose information that investors and users need to understand the nature and extent of the registrant’s obligations. As indicated in paragraph 9240.7 of the 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.”

⁶ A reason for the staff’s focus on off-balance-sheet arrangements is noted in paragraph 9230.2 of the FRM, which states that the disclosure requirements related to such arrangements “are intended to elicit disclosure about why the registrant engages in the off-balance sheet arrangement, the magnitude and importance of the arrangement and the circumstances that would cause the registrant to recognize material liabilities or losses related to the arrangement.”

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 give investors insight into when charges may be incurred in the future; whether a charge is related to contingencies, restructuring activities, goodwill or other long-lived asset impairments, or the settlement of uncertain tax positions; when revenue growth or profit margins may not be sustainable because of underlying economic conditions; or when the registrant will be unable to comply with debt covenants. Such disclosures give investors insight into the underlying conditions and risks that the company faces before a material charge or decline in performance is reported.

Other Deloitte Resources

- December 16, 2013, *Heads Up*, “Highlights of the 2013 AICPA Conference on Current SEC and PCAOB Developments.”
- December 11, 2012, *Heads Up*, “Highlights of the 2012 AICPA National Conference on Current SEC and PCAOB Developments.”
- December 14, 2011, *Heads Up*, “Highlights of the 2011 AICPA National Conference on Current SEC and PCAOB Developments.”



SEC Reporting

SEC authoritative literature includes a number of requirements 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.

At the 2013 AICPA Conference, the SEC staff noted that there may be situations in which registrants seek relief from complying with certain SEC reporting rules and regulations (see below for a discussion of many of those provisions). For example, a registrant may seek relief from complying with Regulation S-X, Rule 3-05, under which the registrant must provide financial statements of an acquired business if the required significance test yielded a result that the registrant believes is unusual or anomalous. With this in mind, the staff acknowledged that relief may be warranted in some cases and that registrants may seek to obtain a waiver from CF-OCA. The SEC staff provided best practices for registrants to consider when seeking reporting relief.

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. Under ASU 2013-12, the definition of a public business entity (PBE) includes entities that are "required by the [SEC] to file or furnish financial statements, or does file or furnish financial statements (including voluntary filers), with the SEC (including other entities whose financial statements or financial information are required to be or are included in a filing)." 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 provide to us your significance calculations for [the acquisition of Company A] under the asset, investment and income tests as prescribed by Rule 3-05 of Regulation S-X and tell us your basis for not providing financial statements under Rule 3-05 for this acquisition.
- [C]onfirm that for each business acquired, or to be acquired, you have acquired substantially all of the target's key operating assets. Provide your analysis of why presenting full financial statements under Rule 3-05 of Regulation S-X is appropriate as you are not acquiring certain assets and assuming certain liabilities.

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) under Rule 3-05 in a Form 8-K, registration, 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 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. The definition of a business for SEC reporting purposes under Regulation S-X, Article 11, is not the same as the definition under ASC 805 for U.S. GAAP purposes.
- Did not perform the significance calculations correctly. Some of the most common mistakes are misapplications of the income test, such as excluding unusual gains or losses from the test.
- Did 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.
- Did 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 and 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 demonstrate to us that audited financial statements pursuant to Rule 3-09 of Regulation S-X were not required for any of your unconsolidated investees Provide all calculations and assumptions as applicable.

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. 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 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 investee significant for the first time.

- 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 is materially restricted, limited, or in need of 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 and 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.

As noted above, 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.

All of the exceptions under Rule 3-10 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

Please revise your disclosure in future filings to clarify that all of the guarantor subsidiaries and the issuer are 100% owned by the parent as defined in [Rule] 3-10(h)(1) of Regulation S-X, if correct. In this regard, we note your reference to the guarantor subsidiaries as "wholly-owned", which has a different meaning than 100% owned. Please also refer to [Rule] 1-02(aa) of Regulation S-X for guidance.

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. In addition, 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).

Full and Unconditional Guarantees and Release Provisions

Example of an SEC Comment

You disclosed that . . . all guarantees are full and unconditional, subject to certain customary release provisions set forth in the applicable Indenture. Please provide us with a specific and comprehensive discussion regarding how you considered these release provisions in determining that the guarantees are “full and unconditional” and in your reliance on Rule 3-10 of Regulation S-X.

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.

Condensed Consolidating Financial Information

Example of an SEC Comment

We note positive operating cash flows recorded for either the Parent or Guarantor in each period presented. It is unclear how the Parent was able to generate substantial positive operating cash flows . . . given the absence of any revenue transactions in the fiscal years presented and the lack of dividends from subsidiaries during [those fiscal years]. . . . Please advise and provide us a reconciliation of operating cash flows from net income using the indirect method for the Parent, Guarantor subsidiary and the Non-Guarantor subsidiaries for each period presented.

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 in 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. GAAP¹ (e.g., intercompany receivables should be shown as an asset and not as a negative liability).

¹ One exception is that investments in subsidiaries should be presented under the equity method of accounting. See Rule 3-10(i)(5).

- The classifications in the condensed consolidated statement of cash flows should also comply with U.S. GAAP.
- A total for comprehensive income should be presented in either a single continuous statement or two separate but consecutive statements.²

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.” ASC 230 distinguishes between returns **on** investment, which should be classified as inflows from operating activities (see ASC 230-10-45-16(b)), and returns **of** investment, which should be classified as inflows from investing activities (see 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.

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 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 net book value or purchase price (whichever is greater) of the subsidiary 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 audited in accordance with the standards of the PCAOB for the most recent fiscal year and unaudited interim financial statements 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).

² Separately, 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.

Issuers of Securities That Collateralize Registered Securities (Rule 3-16)

Example of an SEC Comment

Please advise whether the collateral includes the securities of any of the guarantors and, if so, whether such securities constitute a “substantial portion” of the collateral for the [notes] as defined in Rule 3-16 of Regulation S-X. In addition, . . . please advise how you intend to monitor any future obligation to provide financial statements pursuant to Rule 3-16.

Regulation S-X, Rule 3-16, requires a registrant to file full audited financial statements for each of the registrant’s affiliates whose securities constitute a “substantial portion of the collateral” for any class of securities registered or being registered. This requirement may apply when the capital stock of some or all of the registrant’s subsidiaries are pledged as collateral for a debt instrument. The registrant must provide these financial statements in its Forms 10-K and certain registration statements.

Registrants often look at the tests under Rules 3-10 and 3-16 as one test or related tests. However, they should be aware that these tests are performed separately and that the results must be assessed individually.

Rule 3-16 includes its own specific test (the “substantial portion of the collateral” test) and “bright-line” requirements. Unlike Rule 3-10, Rule 3-16 does not permit condensed consolidating financial information in lieu of full financial statements. Therefore, Rule 3-16 requires full audited financial statements of each affiliate whose securities constitute a substantial portion of the collateral of a security.

For additional SEC staff interpretations of Rule 3-16, see Section 2600 of the FRM.

Pro Forma Financial Information (Article 11)

Example of an SEC Comment

[T]ell us how you determined that these . . . expenses are (i) directly attributable to the transaction, (ii) not expected to have a continuing impact, and (iii) factually supportable. Refer to Rule 11-02(b)(6) of Regulation S-X.

Pro forma information is required under Regulation S-X, Article 11, when (1) it is material to an understanding of a significant consummated or probable transaction, such as a business combination; (2) a transaction is subject to a shareholder vote; or (3) other conditions outlined in Article 11 are met. Pro forma financial information under Article 11 may be required in a registration or proxy statement or a Form 8-K but 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 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 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 “onetime”).³ 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.

³ The SEC staff has expanded on its view of what would constitute continuing impact. See the [highlights](#) of the June 2012 CAQ SEC Regulations Committee joint meeting 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.” 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. See the [Initial Public Offerings](#) section for more information.

Section 3300 of the FRM summarizes special problems and issues that are often associated with pro forma financial information.

SEC Reporting Considerations for Material Changes That Require Retrospective Application

After the registrant has issued its annual financial statements, an event may occur that requires it to make a material retrospective change (e.g., the initial adoption of certain accounting pronouncements, a segment change, or the classification of a component as a discontinued operation). If the registrant files a new registration statement after it has filed interim financial statements that report the material retrospective change, it generally must file updated financial statements and other financial information (e.g., MD&A, selected financial data) to reflect the retrospective adjustments for periods before adoption of the change. These filings are typically made on Form 8-K. The SEC staff has allowed limited exceptions to this requirement for certain retrospective changes (see Section 13500 of the FRM for information regarding retrospective presentation of stock splits). In addition, there are different considerations for (1) currently effective registration statements (see Regulation S-K, Item 512(a)), (2) registration statements on Form S-8 (see the note to Section 13100 of the FRM), and (3) retrospective changes to provisional amounts recorded for business combinations (see Section 13600 of the FRM).

Topic 13 of the FRM provides additional information about the effects of retrospective changes on financial statements required in registration statements.

Audit Report Requirements

Examples of SEC Comments

- Please provide a dated audit report reflecting the city and state where issued as required by Rule 2-02(a) of Regulation S-X.
- We note that your auditor’s report refers to “the auditing standards” of the PCAOB rather than to “the standards” of the PCAOB as is required by the PCAOB’s Auditing Standard No. 1. Please explain why the report includes the qualifier “auditing”; and if the reason is a typographical error, please amend the filing to include a corrected audit report.

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.⁴
- 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.

The SEC staff will generally ask the registrant to amend its filing or provide a revised audit report if its Report of the Independent Registered Public Accounting Firm is not in compliance with the technical requirements of Regulation S-X, Rule 2-02(a), or Regulation S-T, Rule 302.

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.

Other Deloitte Resources

- [December 16, 2013, *Heads Up*, "Highlights of the 2013 AICPA Conference on Current SEC and PCAOB Developments."](#)
- [December 11, 2012, *Heads Up*, "Highlights of the 2012 AICPA National Conference on Current SEC and PCAOB Developments."](#)

⁴ In February 2011, the CAQ issued [Alert 2011-04](#) to remind auditors about (1) the requirement under Regulation S-X, Rule 2-02(a), for registrants to include signed audit reports in EDGAR filings and (2) the additional requirements related to typed "signatures" in electronic submissions.

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

Please ensure that your risk factors fully describe the material risks faced by you and explain specifically how such risks are related to your business.

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. 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. The staff also reminds registrants that the title of each risk factor should adequately describe the related risk.

Cybersecurity

Example of an SEC Comment

We note your disclosure that an unauthorized party was able to gain access to your computer network "in a prior fiscal year." So that an investor is better able to understand the materiality of this cybersecurity incident, please revise your disclosure to identify when the cyber incident occurred and describe any material costs or consequences to you as a result of the incident. Please also further describe your cyber security insurance policy, including any material limits on coverage.

The SEC staff has noted the increasingly frequent occurrence of cyber incidents, 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 cyber incidents that occur and to provide the appropriate level of disclosure about such incidents in their filings.

At the "SEC Speaks in 2014" Conference, the SEC staff acknowledged that no SEC rules explicitly require registrants to disclose cybersecurity-related matters in their filings. However, registrants were reminded that the SEC's Division of Corporation Finance has issued [CFDG Topic 2](#), which provides interpretive guidance 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 cyber incidents may constitute material known trends and uncertainties that a registrant 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 other remarks at the conference, the SEC staff clarified its expectations regarding the nature and extent of a registrant's cybersecurity disclosures. It noted that a registrant should avoid boilerplate cybersecurity disclosures and instead should include such information as (1) the aspects of the business that are subject to risks, (2) updates for new information, and (3) cost estimates, if possible and material. The staff reminded registrants that they should not state that there is a risk of a cybersecurity breach after the occurrence of an actual cyber-attack; rather, such registrants should disclose that they have experienced security breaches or cyber-attacks. However, the staff indicated that it would not expect disclosures to be so detailed that they constitute a "roadmap" that would further expose a registrant to cyber-attack. In addition, the staff acknowledged that limited disclosures may be justified in certain situations (e.g., when the registrant is working with law enforcement officials after a cybersecurity breach).

Accordingly, the SEC staff may monitor information outside a registrant's filings and ask why certain cyber incidents are not disclosed. Further, a registrant may be asked to confirm that it has disclosed the occurrence of material cyber incidents in its filings.

Issuers Based in China

At the 2013 AICPA Conference, the SEC staff discussed risk factor disclosures that issuers with substantial operations based in China should consider making (although the same considerations could apply to issuers with operations in other jurisdictions). See the [Consolidation](#) section for additional information.

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

Non-GAAP Financial Measures

Example of an SEC Comment

Given your disclosure stating that you utilize your non-GAAP measure [to determine the amount of cash available for distribution to your limited partners,] please explain why you have not reconciled this non-GAAP liquidity measure to operating cash flow as the most directly comparable GAAP measure, rather than net income, to comply with Item 10(e)(1)(i)(B) of Regulation S-K.

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.

The SEC staff has continued to comment on non-GAAP financial measures, primarily focusing 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). 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 Generally Accepted Accounting Principles (GAAP);
- (B) A reconciliation (by schedule or other clearly understandable method), which shall be quantitative for historical non-GAAP [financial] 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 [otherwise] disclosed.

The SEC staff has commented 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 is typically net income (loss) for a performance measure and cash flows from operating activities for a liquidity measure.

The SEC staff focuses on consistency in communications with investors. It may ask a registrant about inconsistencies between (1) the measures identified as key metrics 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 metrics 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

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

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.

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. Further, 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.

See the [Materiality](#) and [Real Estate](#) sections for additional information about non-GAAP financial measures.

Nonrecurring, Infrequent, and Unusual Items

Example of an SEC Comment

We note your reconciliation of adjusted net earnings from continuing operations contains an adjustment for acquisition amortization . . . Further, we note that you are providing this non-GAAP measure because it helps your investors understand the effect of nonrecurring items on your reported results. Explain to us why the acquisition adjustment item should not be considered a recurring item. In this regard, we note this adjustment was made for the past three fiscal years in your reconciliation. . . . Please revise your disclosure so that you do not indicate that these items are nonrecurring, infrequent or unusual. We refer you to Item 10(e)(1)(ii)(B) of Regulation S-K.

The SEC staff often comments when adjustments to non-GAAP measures are labeled as nonrecurring, infrequent, or unusual. [Question 102.03 of the C&DIs related to non-GAAP financial measures](#) clarifies the guidance in Regulation S-K, Item 10(e), which 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.” Specifically, Question 102.03 indicates 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.

Undue Prominence of a Non-GAAP Financial Measure

Example of an SEC Comment

Your disclosures include a full non-GAAP income statement, which appears to be provided for the purposes of reconciling non-GAAP measures to the most directly comparable GAAP measures. We believe this may cause undue prominence to the non-GAAP information. Please confirm for us that you will revise your disclosures in future filings such that a full non-GAAP income statement is not included and your reconciliations are disclosed in a different format. We refer you to question 102.10 in the Division of Corporation Finance’s Compliance and Disclosure Interpretations at <http://www.sec.gov/divisions/corpfin/guidance/nongAAPinterp.htm>.

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 instead of applying the guidance in [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 Item 10(e)(1)(i).

C&DIs Related to Non-GAAP Financial Measures

The SEC's C&DIs related to non-GAAP financial measures give registrants greater flexibility to disclose such metrics in filings with the Commission. The topics covered in the C&DIs include disclosure of non-GAAP financial measures in business combination transactions; interpretive issues related to the non-GAAP liquidity and performance measure prohibitions in Item 10(e) (including issues related to EBIT, EBITDA, and segment performance measures); and compliance issues related to the release of quarterly and annual financial information under Item 2.02 of Form 8-K.

In addition to the C&DIs, SEC resources on non-GAAP measures include Regulation S-K, Item 10(e); Regulation G; and Topic 8 of the FRM.

Other Deloitte Resources

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



Disclosure Controls and Procedures

In their quarterly discussions of disclosure controls and procedures (DCP),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 DCP or omit certain language in reaching conclusions about the effectiveness of their DCP. In these situations, the staff frequently requires registrants to confirm that their DCP are effective in the current year and to revise their disclosures in future filings.

Inappropriate Conclusion About DCP

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 DCP 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.”

In addition, the SEC staff has also commented when registrants refer to the level of assurance of the design of their DCP. 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 DCP are, in fact, effective at the “reasonable assurance” level.

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

Incomplete Definition of DCP

Example of an SEC Comment

We note that you disclose a partial definition of disclosure controls and procedures. When you include a definition of disclosure controls and procedures, the entire definition in Exchange Act Rules 13a-15(e) or 15d-15(e) is required. Alternatively, you can simply reference the Rule 13a-15(e) without including the definition. Please revise your disclosure in future annual and quarterly reports accordingly.

Registrants are not required to define DCP in their conclusion. However, if they choose to define the term, they must use the entire definition in Rule 13a-15(e) or Rule 15d-15(e).

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

Example of an SEC Comment

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 Internal Controls over Financial Reporting (“ICFR”) are an integral part of Disclosure Controls and Procedures (“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.

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.

Paragraph 4310.9 of the FRM states, “Because of the substantial overlap between ICFR and DCP, if management concludes that ICFR is ineffective, it must also consider the impact of the material weakness on its conclusions related to DCP.” If a registrant concludes that its DCP 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 DCP.

The SEC staff has also asked about management’s conclusion that DCP were effective when a registrant did not file periodic reports in a timely manner. A registrant should design DCP to ensure that information it must disclose 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 DCP Were Effective If No Changes to ICFR Were Disclosed

Example of an SEC Comment

In light of the fact that your Form 10-K discloses that management determined that both disclosure controls and procedures and internal controls over financial reporting were not effective due to certain disclosed material weaknesses, please explain to us why you believe that it is appropriate to conclude that disclosure controls and procedures are effective for the quarterly periods subsequent to your most recent year-end. In this regard, we also note from your disclosure in your Form 10-Qs that there have been no changes in internal controls in the applicable quarterly periods. Please advise or revise to change your disclosure in your Form 10-Qs accordingly.

If a registrant concludes that its DCP were effective after a period in which the DCP 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 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 Further, 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 this year, and this focus is evidenced by two recent charges. In the first case, the SEC's Division of Enforcement brought an [enforcement action](#) against the CEO and 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 the second case, an [enforcement action](#) was brought against a corporation for FCPA violations, including internal control violations of the Exchange Act, with the chief of the Division of Enforcement's FCPA Unit noting that "[w]hen a company makes the strategic decision to sell its products overseas, it must ensure that the right internal controls are in place and operating."

Evaluation of Severity of Control Deficiencies

Example of an SEC Comment

We note that you have concluded that no significant deficiencies or material weaknesses (arising from either your consolidation policies or revenue recognition policies or a combination of both) existed as of December 31, 2012 and December 31, 2013. Tell us whether you identified the existence of any control deficiencies as of either of those dates in relation to consolidation or revenue recognition that did not rise to the level of a significant deficiency or material weakness. If so, explain what they are and discuss how you assessed their severity. [Emphasis omitted]

When registrants identify numerous control deficiencies but do not report a material weakness, the SEC staff issues comments to understand how they evaluated the severity of the deficiencies in aggregate. The SEC staff has reiterated that the existence of a material weakness does not depend on the actual magnitude of the error in a restatement but instead depends on whether there is a reasonable possibility that a material misstatement could occur and not be detected or prevented by the registrant's ICFR.⁵ In the interpretive release discussed above, the SEC stated that management needs to consider "whether each deficiency, individually or in combination, is a material weakness as of the end of the fiscal year . . . even though such deficiencies may be individually less severe than a material weakness"; in addition, the SEC noted an increased likelihood of misstatement when there are "[m]ultiple control deficiencies that affect the same financial statement amount or disclosure." At the 2013 AICPA Conference, Brian Croteau, 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."

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."

⁵ The SEC staff discussed this issue at the 2010 AICPA Conference. See Deloitte's December 16, 2010, [Heads Up](#) for more information.

Evaluation of Control Deficiencies Related to Immaterial Misstatements

Example of an SEC Comment

We note that during the second quarter of 2013, you identified an immaterial cumulative error We also note that you have corrected three separate financial statement item errors during the year ending December 31, 2013 which you have determined as immaterial to your previously reported amounts contained in your interim and annual reports. Please provide to us the following:

- a) The amount(s) and a full description of the nature of the error . . . ;
- b) [A]n explanation of factors considered by management in determining that the effect of the \$[X] or [Y]% reduction to depreciation and depletion expense and [Z]% benefit to pre-tax loss in the second quarter was not material to results of operations for the second quarter of 2013 or to any of the prior periods affected by this error;
- c) [Y]our criteria or policy for assessing an error as material. Please provide an explanation of the quantitative and qualitative factors considered by management in its conclusion that all three errors were not material to your financial statements for the year ended December 31, 2013 or any of the prior periods affected by these errors; and
- d) [A]n explanation of how you considered the identification and correction of these errors in your evaluation of disclosure controls and procedures and internal controls over financial reporting as of the end of each related period, i.e., December 31, 2011, 2012, and 2013. In addition, tell us if the identification and correction of errors resulted in any changes to your internal controls that have materially affected, or [are] reasonably likely to affect materially, your internal control over financial reporting as of December 31, 2013.

At the 2014 AICPA Banking Conference, the SEC staff indicated that it will question how registrants have considered and evaluated the severity of deficiencies in ICFR related to immaterial misstatements that were corrected by immaterial restatements.⁶ 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 result in a misstatement, and the evaluation of the severity warrants consideration of risk factors including, but not limited to, the potential future consequences of the deficiency. Accordingly, it is possible that an immaterial restatement represents a material weakness in ICFR even though the actual magnitude of the 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.

Evaluation of Deficiencies Identified in the Other COSO Components

Example of an SEC Comment

In light of the multiple significant deficiencies involving multiple accounts and processes, please explain the extent to which you considered whether deficiencies existed in other components of the Committee of Sponsoring Organizations of the Treadway Commission Internal Control Framework (COSO), such as the control environment, information and communication, risk assessment, and monitoring. To the extent any deficiencies existed in these components, please tell us how you evaluated the severity of these deficiencies along with the existing significant deficiencies and other control deficiencies.

⁶ 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.

The SEC staff has questioned whether deficiencies in control activities may also be indicative of related deficiencies in the control environment, information and communication, risk assessment, and/or monitoring components of ICFR. 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.

Disclosure of Material Changes in ICFR

Example of an SEC Comment

Please disclose whether there has been any change in your internal control over financial reporting that occurred during the last fiscal quarter that has materially affected, or is reasonably likely to materially affect, your internal control over financial reporting. Refer to paragraph (c) of Item 308 of Regulation S-K.

The SEC staff has commented when a registrant has not explicitly and clearly asserted whether there has been a change in ICFR in the last fiscal quarter that had or could have a material effect on its ICFR, as required by Regulation S-K, Item 308(c). Registrants should state clearly whether there were changes in ICFR for the quarter and, if so, should disclose the nature of the changes. The staff has stressed that registrants should avoid “boilerplate” disclosure that there have been no material changes affecting ICFR in a period, particularly when identifiable events such as layoffs, changes in outsourcing arrangements, or changes in accounting policies exist.⁷

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.⁸

At the 2013 AICPA Conference, the SEC staff stated that in reviewing registrant filings, it 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

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 internal controls over financial reporting (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.

⁷ This issue was discussed by the staff of the SEC’s Division of Corporation Finance in a speech at the Forums on Auditing in the Small Business Environment hosted by the PCAOB in December 2012.

⁸ The SEC staff discussed remediation of material weaknesses and related disclosure considerations at the 2010 AICPA Conference. See footnote 5.

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.⁹

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 that they should consider other financial statement line items that may also be affected.¹⁰

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.¹¹

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

We note . . . that you continue to believe your internal controls over financial reporting and disclosure controls and procedures are effective despite this error in your financial statements. Given the significance of the error, we believe you should revise the conclusion in your fiscal 2013 10-K to state that your internal controls over financial reporting and disclosure controls and procedures were not effective. If you have since remediated the weaknesses in controls, you may disclose the remediations in your fiscal 2014 10-K.

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 DCP) are effective after restating their financial statements. As a result, registrants can expect questions from the staff about the effectiveness of their ICFR after a restatement has occurred. In addition, since most elements of ICFR are subsumed within the definition of DCP and it is therefore typically difficult for a registrant to conclude that its DCP 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 DCP are effective. At the 2013 AICPA Conference, Mr. Croteau discussed a registrant's responsibility to maintain effective DCP 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 DCP 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.

⁹ For additional information, see Deloitte's December 18, 2008, [Heads Up](#) on the 2008 AICPA Conference. Also, see Deloitte's December 16, 2010, [Heads Up](#) on the 2010 AICPA Conference.

¹⁰ This issue was discussed at the December 2012 Forums on Auditing in the Small Business Environment. See footnote 7.

¹¹ This issue was discussed at the 2008 AICPA Conference. See footnote 9.

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.

Domestic Companies With a Majority of Operations Outside the United States

Example of an SEC Comment

We note that you conduct substantially all of your operations outside of the United States. In order to enhance our understanding of how you prepare your financial statements and assess your internal control over financial reporting, we ask that you provide us with information that will help us understand more about the background of the people who are primarily responsible for preparing and supervising the preparation of your financial statements and evaluating the effectiveness of your internal control over financial reporting and their knowledge of U.S. GAAP and SEC rules and regulations. Do not identify people by name, but for each person, please tell us:

- What role he or she takes in preparing your financial statements and evaluating the effectiveness of your internal control;
- What relevant education and ongoing training he or she has had relating to U.S. GAAP;
- The nature of his or her contractual or other relationship to you;
- Whether he or she holds and maintains any professional designations such as Certified Public Accountant (U.S.) or Certified Management Accountant; and
- About his or her professional experience, including experience in preparing and/or auditing financial statements prepared in accordance with U.S. GAAP and evaluating effectiveness of internal control over financial reporting.

The SEC staff is interested in understanding the credentials of the individuals preparing U.S. GAAP financial statements for domestic registrants with a substantial amount of their operations in foreign countries and has continued to focus on registrants' assertions that the internal controls of a foreign operation are effective. In evaluating assertions of U.S. GAAP expertise, the SEC staff attempts to ensure that management of the foreign operation has the appropriate knowledge and capability to prepare financial statements in accordance with U.S. GAAP, which may be demonstrated through:

- Education and ongoing training in U.S. GAAP.
- Professional qualifications such as a U.S. CPA license.
- Professional experience either as an auditor or a preparer of U.S. GAAP financial statements.

The SEC staff has mentioned that viewing the Internet and attending one-off conferences would not qualify as persuasive evidence of appropriate U.S. GAAP expertise. The staff has noted that its ultimate goal is to reduce material weaknesses by ensuring that registrants possess sufficient expertise and capabilities.¹² In addition, the staff has observed that it may ask registrants about their relationship with an outside consultant and about the consultant's qualifications if there is any doubt about the consultant's U.S. GAAP expertise.¹³

¹² This issue was discussed at the 2011 AICPA Conference. For additional information, see Deloitte's December 14, 2011, [Heads Up](#).

¹³ This issue was discussed at the December 2012 Forums on Auditing in the Small Business Environment. See footnote 7.

In addition, the SEC staff has reminded registrants that when a majority of their subsidiaries' operations are outside the United States, management should assess the U.S. GAAP competence and knowledge of those preparing U.S. financial information overseas for ICFR implications.¹⁴

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 introduces 17 new principles that explicitly articulate and describe the components of internal control. 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. 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.¹⁵ As a result, a registrant may be asked to advise the SEC staff of the framework used in the current year and to revise the disclosures in current and future filings. While COSO has indicated that it will consider the 1992 framework superseded by December 15, 2014, the SEC has not issued a formal statement concerning the transition and implementation of the revised framework for purposes of Section 404 of the Sarbanes-Oxley Act. However, the staff has stated that it will monitor the transition of issuers to the revised framework and evaluate the need for further actions by the SEC in the future. Registrants are encouraged to closely monitor this issue and any further statements by the SEC in planning any potential transition to the revised framework.¹⁶

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."¹⁷

¹⁴ This issue was discussed at the 2010 AICPA Conference. See footnote 5.

¹⁵ The SEC staff discussed this issue in a speech at the 2008 AICPA Conference. See footnote 9.

¹⁶ For additional information, see Deloitte's June 10, 2013, [Heads Up](#) on the revised COSO framework.

¹⁷ For additional information, see the [highlights](#) of the September 2013 CAQ SEC Regulations Committee joint meeting with the SEC staff.

Disclosure of the Date of an ICFR Evaluation

Example of an SEC Comment

Please note that pursuant to Item 308(a)(3) of Regulation S-K, management's conclusion on its assessment of the effectiveness of internal control over financial reporting is required as of the end of the most recent fiscal year. [P]lease revise the disclosure to state, if true, that as of March 31, 2013, management concluded that your internal control over financing reporting was not effective. [Emphasis omitted]

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 when they have either failed to indicate a date for their ICFR evaluation or included a date other than the end of their most recent fiscal year in their filing. Registrants should ensure that the appropriate date of their ICFR evaluation is prominently displayed in any filing with the SEC.

Other Deloitte Resources

- [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, continues to be a topic of SEC staff focus. Many of the staff's comments are related to disclosures about (1) how performance is assessed, including the use of performance targets and benchmarking; (2) CD&A, including compensation table disclosures; and (3) related-party transactions.

Determining Compensation — Assessment of Performance

Performance Targets

Examples of SEC Comments

- Please revise this section to provide a more detailed explanation and analysis of specific factors that are considered in setting compensation for each of the named executive officers. For example, disclose the specific financial, operational and strategic objectives, in addition to personal achievement targets and/or goals established for each of the named executive officers. In that regard, we note you state . . . that the compensation committee reviews and approves corporate goals and objectives. Similarly, for each named executive officer, discuss the aspects of his individual performance, prior experience and level of responsibility that factored into the total compensation he received during the last year. See Item 402(b)(2) of Regulation S-K.
- Based on your disclosure, it is unclear how the compensation committee used the pre-established performance goals and evaluated individual performance to determine the actual amount that was paid to the NEOs in 2013. Please supplementally explain how each of the annual incentive bonuses for fiscal 2013 [was] determined for each named executive officer and include similar disclosure in future filings. Please also clearly state if the compensation committee established any individual performance goals for the NEOs.

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 NEOs in its CD&A. The discussion should include the objectives of the compensation program, what the compensation program is designed to reward, the elements of the compensation, the registrant's reasons for paying each element, how each element is calculated (including any formula used), and 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

It appears that total compensation levels for named executive officers were benchmarked at the [X] percentile of the benchmark compensation levels. However, your disclosure stating that “industry compensation survey data” represented [X]%, [Y]% and [Z]% of benchmark total compensation for certain officers is unclear. Please revise to clarify this statement.

A registrant may use benchmarks for total compensation or a material element of compensation (e.g., the registrant compared its executive compensation to that of a peer group in the same industry or used 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.

Compensation Discussion and Analysis

The SEC staff continues to focus on CD&A, particularly the summary compensation table, because it gives investors important information about a registrant’s compensation policies and decisions.

Examples of SEC Comments

- [W]e note that your “NEOs are compensated through a combination of equity grants, carried interest and incentive fees . . .” and that Messrs. [X] and [Y] received incentive fees in fiscal 2013. Please explain why these compensation awards are not included in the compensation table.
- We note that you have disclosed in the “Bonus” column rather than the “Non-Equity Incentive Plan Compensation” column amounts earned pursuant to your annual bonus program Please advise regarding your basis for disclosing these amounts in the “Bonus” column. For guidance, refer to Question 119.02 of the Regulation S-K Compliance and Disclosure Interpretations.

The SEC staff often asks about inconsistencies between the amounts disclosed in the financial statements and the amounts disclosed in the summary compensation table. Regulation S-K, Item 402(c), requires that for each NEO, registrants include tabular disclosures specifying the NEO’s name and principal position, the fiscal year covered, the base salary earned, the bonus earned, the stock/option awards, nonequity incentive plan compensation, the change in pension value and nonqualified deferred compensation earnings, all other compensation, and the total amount of compensation. Both the cash portion and the noncash portion of salary and bonus must be disclosed.

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

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 SEC 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 valuing share-based compensation, which the registrant can accomplish 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 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 disclose related-party transactions that affect the financial statements and, when material, to separately present amounts on the face of the balance sheet, income statement, or statement of cash flows. 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 discuss your policies and procedures for the approval of related party transactions, as required by Item 404(b) of Regulation S-K, in future filings.

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

For all transactions involving indebtedness, please revise to disclose the amount of principal paid during the periods for which disclosure is provided. Refer to Item 404(a)(5) of Regulation S-K.

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

- [December 2013, Center for Corporate Governance, *Hot Topics: The 2014 Boardroom Agenda*.](#)
- [October 2013, Center for Corporate Governance, *Hot Topics: CEO Pay Ratio Disclosure: What Would It Take to Implement the SEC Proposal?*](#)



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.
- 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, and (3) the elections they made under Title I of the JOBS Act.

EGC Status and Elections

Example of an SEC Comment

Since you appear to qualify as an "emerging growth company," as defined in the Jumpstart Our Business Startups Act, please:

- Disclose that you are an emerging growth company;
- Describe how and when a company may lose emerging growth company status;
- Briefly describe the various exemptions that are available to you, such as exemptions 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)(1), provide a risk factor explaining that this election allows you to delay the adoption of [those standards until they] apply to private companies. Please state in your risk factor [and in your critical accounting policy disclosures] that, as a result of this election, your financial statements may not be comparable to companies that comply with public company effective dates.

Filing Status

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 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 financial 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 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

Scope

Because a main 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.

Reduced Financial and Proxy Reporting Requirements

Example of an SEC Comment

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. Further, 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. In addition, certain JOBS Act provisions for scaled disclosures may interact with other SEC rules (e.g., other entities' financial statements may be required under Regulation S-X, Rules 3-05 and 3-09). 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.

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. In addition, the JOBS Act exempts EGCs from certain proxy provisions of the Dodd-Frank Act.

Requests for Written Communications

Example of an SEC Comment

Please supplementally provide us with copies 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. Similarly, please supplementally provide us with any research reports about you that are published or distributed in reliance upon Section 2(a)(3) of the Securities Act 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 your officer certification is not in the exact form as set forth in Item 601(b)(31)(i) of Regulation S-K. Your certifications include inappropriate modifications, such as the following:

- [O]mitting reference to establishing and maintaining internal controls over financial reporting in paragraph 4 introductory language; and
- [O]mitting [subparagraph 4(b)] related to the design of internal controls over financial reporting;

Please file an amended Form 10-K [and similarly file an amended Form 10-Q] to provide officer certifications consistent with the language that is set forth exactly as provided for by Item 601(b)(31).

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 Regulation S-K, Item 601(b)(31). The staff routinely notes that inclusion of a registrant's certifying officer's title 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 in amendments to periodic reports.

Use of Experts and Consents

Examples of SEC Comments

- It appears that you attribute information to third parties in the registration statement. If any of these reports or publications 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.
- Please file an updated consent from your independent registered public accounting firm.

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 asbestos liability.
- An independent actuary, about the estimation of workers’ compensation liability.
- Petroleum engineers, about the evaluation of oil and gas reserves. See the [Oil and Gas](#) section.
- 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.

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 (Securities 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 periodic reports 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 their independent registered public accounting firm. However, on the basis of informal discussions with the SEC staff and C&DIs issued by the staff, it appears that the key to assessing whether 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.

That is, if the registrant essentially “outsourced” the services to the third-party expert and management takes no responsibility for the ultimate statements or conclusion noted in the registration statement, management must obtain the consent of the third-party provider to be named an expert under the Securities Act. The SEC staff indicated that it would evaluate 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 or in their reports. The staff has emphasized that an expert’s consent should not contain any language that limits the use of the consent to the registrant or suggests that there is a limit on potential investor reliance.

Material Contracts

Example of an SEC Comment

We note that although you have filed as an exhibit your [X] Agreement with [Company Y], you have not filed your distribution agreement with that company. Please provide your analysis as to why filing of the distribution agreement is not required or file the agreement as an exhibit. Refer to Item 601(b)(10)(ii)(A) of Regulation S-K.

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.

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 Regulation S-K, Item 601.
- Explain why they have not filed the agreements.

The SEC staff also comments when registrants omit certain material agreements. 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

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).

- 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.

The SEC staff has also issued a number of [C&DIs related to Regulation S-K, Item 601](#), to address the various circumstances in which a registrant may be required to file agreements as exhibits. Registrants are encouraged to consult these and, in particular, the C&DIs in [Sections 146 and 246](#).

Backlog Disclosures

Examples of SEC Comments

- Please revise future filings to provide the following additional disclosures regarding your backlog:
 - Discuss how backlog is calculated, including what it includes and excludes;
 - Discuss any changes in the methodology used to determine backlog during each period, if material and applicable;
 - To allow better insight into changes in backlog from period to period, provide a roll-forward of backlog. The roll-forward should include beginning and ending balances, new contracts, cancellations, amounts recognized in revenue, and any other major categories relevant to your business.
- We note your disclosure of unbilled deferred revenue backlog for existing subscription agreements. Please tell us how you considered disclosing the amount of backlog not reasonably expected to be filled within the current fiscal year consistent with the requirements in 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 backlog information is a non-GAAP financial measure, 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

- Cuba, 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 Cuba, Sudan and Syria, whether through subsidiaries, affiliates, partners, customers, joint ventures or other direct or indirect arrangements. Your response should describe any services, products, information or technology you have provided to Cuba, 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 controlled by their governments.
- Please discuss the materiality of any contacts with Cuba, Sudan and Syria described in response to the foregoing comment, 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. Your materiality analysis should address the potential impact of the investor sentiment evidenced by such actions directed toward companies that have operations associated with Cuba, Sudan and Syria.

The U.S. Department of State has designated four countries as state sponsors of terrorism — Cuba, Iran, Sudan, and Syria. These countries are subject to U.S. economic sanctions and export controls. Registrants that do business in these countries are required to disclose material operations conducted in them and any agreements, commercial arrangements, or other contracts with the countries' respective governments or with entities controlled by such governments.¹ 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 contracts (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. See the [Materiality](#) section for additional information about materiality considerations. 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.²

¹ 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]

² Further, the [Iran Threat Reduction and Syria Human Rights Act of 2012](#) requires registrants to include certain disclosures related to sanctionable activities in all quarterly and annual reports. 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.¹ 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,² 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

We note that you have not included XBRL tagged financials as exhibits to your registration statement. Rather, you make reference to the XBRL information in your annual report on Form 10-K for the fiscal year ended December 31, 2013. Please include electronically tagged Interactive Data Files with your next amendment.

¹ The staff used the term "smaller filers" to refer to U.S. GAAP filers that are not large accelerated filers.

² *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.”

Other Deloitte Resources

- July 8, 2014, *Deloitte Accounting Journal*, “SEC 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.”



Initial Public Offerings

An IPO is most commonly thought of as the initial sale of equity 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. 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 nearly always reviews the related registration statement. The staff's review is typically comprehensive, covering reporting, accounting, and legal issues. In addition, comments about reporting topics often include:

- 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).

For more information on these topics, see the [SEC Reporting](#) section. Other SEC staff comments on IPOs have addressed 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](#), [Revenue Recognition](#), and [Share-Based Payments](#) 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. The SEC staff often comments when registrants do not include the required financial statements in the registration statement.

Recently Organized Registrant

Example of an SEC Comment

Tell us why you have not included an audited balance sheet for the registrant as of a point within 135 days of filing your registration statement as would ordinarily be required under Rule 3-01 of Regulation S-X.

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.

Age of Financial Statements

Example of an SEC Comment

Please consider the financial statement updating requirements set forth in Rule 3-12 of Regulation S-X.

A registrant's financial statements must meet the "age of financial statements" requirements as of every filing date as well as when the registration statement is declared effective. The age of financial statements generally refers to the specific annual and interim periods for which financial statements are required in a filing. Regulation S-X, Rule 3-12, provides guidance on such periods and on when the financial statements become stale (i.e., should be updated).

Predecessor Financial Statements

Examples of SEC Comments

- We note from your website [your relationship with Company A]. Please describe your relationship with [Company A] and provide us with your analysis addressing whether [Company A] represents a predecessor for which financial statement information should be provided.
- 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 that are required by Regulation S-X.

Carve-Out Financial Statements

Examples of SEC Comments

- Please note that the historical income statements of a registrant should reflect all of its costs of doing business. We note your disclosure [that the parent company] is responsible for the payment of your operating expenses, legal and accounting expenses related to the merger. Please tell us how you account for uncompensated services rendered by [the parent company]. Refer to SAB Topic 1.B.1.
- We note from your disclosures . . . that the predecessor financial statements represent the combination of carve out financial statements for the [assets] that [Company A] intends to transfer to [Company B] prior to the offering. Please explain to us in more detail how you determined these combined carve out financial statements were the most appropriate financial statements to present as the predecessor.

“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 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.

In many cases, 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 and related assets and liabilities 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 the 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. As stated in the [highlights](#) of the September 23, 2014, CAQ SEC Regulations Committee joint meeting with the SEC staff, the staff (1) acknowledged that “identifying the predecessor entity in many transactions requires careful analysis of all relevant facts and circumstances,” (2) “noted that current guidance in the FRM, GAAP and various SABs did not contemplate the level of complexity encountered in recent transactions,” and (3) “encourages companies to pre-clear these transactions.”

¹ A spin-off is a type of divestiture in which an independent company is created through the sale or distribution of new shares of a portion of a parent’s operations.

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., forward spin or reverse spin) 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) the application of pushdown accounting and 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 June 2013 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 will 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 include EPS (under ASC 260-10-15-2 and 15-3); segment reporting (under ASC 280-10-15-3 and ASC 280-10-20); and pensions and other postretirement benefits, such as defined benefit plans (under ASC 715-20-20). See the [Earnings per Share](#), [Pensions and Other Postretirement Benefits](#), and [Segment Reporting](#) sections for additional reporting considerations related to these topics.

In addition, the transition provisions related to the adoption of a new accounting pronouncement may differ depending on how a public entity is defined in ASC topics. Some guidance is effective for public entities before it is effective for nonpublic entities. Since registrants must follow public-entity guidance for all periods presented in the IPO financial statements, a nonpublic entity may be required to retrospectively change its adoption date 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. Because such a company would be considered a PBE, it would not be permitted to adopt PCC accounting alternatives. Accordingly, 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

- As required by Rule 4-08(k) of Regulation S-X, please identify and state the amounts of your related party transactions on the face of the consolidated balance sheets, income statements, and/or statements of cash flows.
- You disclose that you are in the process of redeeming \$[X] of your redeemable [preference shares]. Please clarify whether you are redeeming these shares for common stock or for cash. Please also tell us whether you were required to redeem these shares or if you had the sole option to redeem the preferred shares. Tell us how you considered Rules [5-02.27 and 5-02.28] of Regulation S-X in determining the classification of your redeemable preferred stock as of [period end].
- We note that “under certain circumstances, including a change in control . . .” the company is obligated to purchase common stock from shareholders at fair market value. Please tell us why these shares should not be presented outside of permanent equity pursuant to the guidance in [ASC 480-10-S99-3A]. Your response should be detailed and specific and should consider circumstances and examples such as those described in [ASC 480-10-S99-3A.7–9].

In an IPO, the registrant’s financial statements should comply with the applicable requirements of Regulation S-X, and SABs, for each period presented in the financial statements. Because such requirements and guidance are new to the registrant, 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 guidance 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 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).
- Pushdown accounting to reflect a change in basis because of an acquisition (ASU 2014-17).⁶

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

⁶ In November 2014, the FASB issued ASU 2014-17, which gives an acquired entity the option of applying pushdown accounting in its stand-alone financial statements upon the occurrence of a change-in-control event. The guidance is effective immediately. Also, in connection with the FASB’s issuance of ASU 2014-17, the SEC has rescinded SAB Topic 5.J, which historically has conveyed the SEC staff’s views on the application of pushdown accounting for SEC registrants. See the November 18, 2014, [Deloitte Accounting Journal](#) entry for additional information.

Distributions to Owners

Examples of SEC Comments

- [W]e note that prior to the closing of this offering [the Company] intends to make additional cash distributions of approximately \$[X] to the [owners of the Company] to enable them to meet their estimated income tax obligations for the period We also note that the board . . . has authorized an \$[X] distribution to its members in the third quarter In this regard, we assume that you will reflect the distribution accrual (but not giving effect to the offering proceeds) in the pro forma balance sheet [alongside] the historical balance sheet in the filing.
- We . . . assume that the pro forma per share data will give effect to the number of shares whose proceeds would be necessary to pay the dividend (but only the amount that exceeds current year's earnings). The number of shares to be added to the denominator for purposes of pro forma per share data should not exceed the total number of shares to be issued in the offering. Also note that a dividend declared in the latest year would be deemed to be in contemplation of the offering with the intention of repayment out of offering proceeds to the extent that the dividend exceeded earnings during the previous twelve months.

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 accrued 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 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 Balance Sheet

Example of an SEC Comment

Please revise to present a pro forma balance sheet giving effect to the redemption of the [preferred stock], excluding effects of the offering proceeds, alongside of the most recent historical balance sheet. Please also include disclosure in the notes to financial statements that describes the pro forma presentation.

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.

Pro Forma EPS

Example of an SEC Comment

We note that your convertible preferred stock will convert to [X] shares of common stock upon the closing of this offering. Revise to present unaudited pro forma basic and diluted EPS for the latest year giving effect to the conversion.

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.

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 finalized.

In accordance with Regulation S-X, Rule 2-02, and various 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 so as 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), the SEC staff has accepted the filing of a “draft report” in the form in which it will be expressed at effectiveness. 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

- You have not disclosed a net tangible book value per share before the planned offering that is consistent with historical amounts shown in your consolidated balance sheet at December 31, 2013. Please explain to us your basis for concluding that this presentation of dilution per share to new investors conforms to guidance in Item 506 of Regulation S-K.
- Please explain to us why you are excluding from your calculation of dilution the impact of the [X] million shares to be issued upon fulfillment of the [restricted stock unit] liquidity event condition.

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 24, 2013, *Deloitte Accounting Journal*, “FASB Defines a Public Business Entity.”

Foreign Private Issuers Using IFRSs

Currently, about 500 foreign private issuers (FPIs) reporting under IFRSs are registered with the SEC. 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 financial statement topics refer to the IFRS "equivalent" of U.S. GAAP).

In addition to nearly all of the topics that have been identified as comment trends applicable to domestic filers, SEC staff comments to FPIs ask about (1) the presentation of financial statements; (2) accounting for expenditures related to the exploration for, and evaluation of, mineral resources (i.e., under IFRS 6); (3) references to the use of IFRSs as issued by the IASB; and (4) going-concern language in PCAOB audit reports. These topics are discussed below.

Presentation of Financial Statements

Examples of SEC Comments

- Since you present costs and expenses by function, please provide additional information about the expenses by nature in accordance with paragraph 104 of IAS 1.
- Please consider revising future filings to present additional line items on the face of the statement of income for total operating income and total operating expense. Refer to paragraph 85 of IAS 1.
- Please address what consideration was given to Basis for Conclusions paragraph 56 of IAS 1 in determining that . . . it was appropriate to exclude the costs included in other expenses, net line item from your determination of operating income.

The SEC staff's comments have often focused on missing disclosures about the nature of expenses when issuers 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. In addition, the staff has asked issuers 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 IAS 1.104, 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 IAS 1.105, 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. IAS 1.IG6 illustrates income statements that are presented by nature and by function.

IAS 1.82 and IAS 1.82A 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 (i.e., operating income) or a similar line item should refer to IAS 1.BC56, 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, IAS 1.85 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].
- You indicate that you do not use free cash flow as a liquidity measure. In light of this, please further explain in your disclosures the reasons why you believe the presentation of this non-GAAP measure provides useful information to investors. Refer to Item 10(e)(1)(i)(C) of Regulation S-K.

The SEC staff has often requested more information about the issuer’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. In addition, the SEC staff’s recent comments to issuers in the mining industry have focused on non-GAAP financial measures, particularly on whether (1) those measures have been clearly labeled and described as non-GAAP measures and (2) the issuer’s disclosures demonstrate the purpose of the measures and their usefulness to investors. See the [Non-GAAP Financial Measures](#) and [Mining](#) sections for further discussion.

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, IFRS 6.5(b) 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 issuers 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.

Going-Concern Language in PCAOB Audit Reports

Example of an SEC Comment

As noted in the Audit Report and consistent with Instruction 2 to Item 8.A.2 of Form 20-F, the audit was conducted in accordance with the standards of the Public Company Accounting Oversight Board in the United States (PCAOB). As such, the audit opinion should comply with the PCAOB standard regarding going concern uncertainties. As previously requested, amend your filing to include a report that uses the term “substantial doubt.” Refer to AU 341.12. Also refer to the related discussion at the International Practices Task Force meeting on November 22, 2011.

The SEC staff continues to request that issuers amend their going concern language in their PCAOB audit reports to include unconditional statement of “substantial doubt.”

Paragraph 4230.1(c) of the FRM emphasizes the importance of the phrase “substantial doubt” by stating that “[g]oing concern opinions that do not use the words ‘substantial doubt’ when referencing a going concern matter do not comply with PCAOB standards/U.S. GAAS.”

Further, AU Section 341.12 states that the “auditor’s conclusion about the entity’s ability to continue as a going concern should be expressed through the use of the phrase ‘**substantial doubt** about its (the entity’s) ability to continue as a going concern’ [or similar wording that includes the terms substantial doubt *and* going concern]” (emphasis added). In addition, Footnote 5 to AU 341.13 states that “the auditor should not use conditional language in expressing a conclusion concerning the existence of substantial doubt about the entity’s ability to continue as a going concern. [One example] of inappropriate wording in the explanatory paragraph would be, ‘If the Company continues to suffer recurring losses from operations and continues to have a net capital deficiency, there **may** be substantial doubt about its ability to continue as a going concern’ ” (emphasis added).



Consumer and Industrial Products

Retail and Distribution

The SEC staff's comments to registrants in the retail and distribution industry have focused on topics such as the results of operations section in MD&A (including disclosures about metrics and online sales) and the revenue-recognition implications of customer loyalty programs.

In addition, registrants in this industry typically have multiple distribution channels (e.g., stores, catalogs, the Internet), customer segments, geographic locations, and store concepts and brands. Consequently, the SEC staff frequently asks registrants about the identification and aggregation of their operating segments, particularly when they disclose only one reportable segment. See the [Segment Reporting](#) section for additional information.

MD&A — Results of Operations

Examples of SEC Comments

- [Y]ou indicate that comparable store metrics are calculated on an annual basis, including relocations, using all stores open at least one year. In future filings, please provide the following:
 - Please revise your disclosures to clarify how your comparable store metrics take into account stores closed during the period; and
 - Please also disclose the percentage of your net sales that are online sales and state whether these online sales are included or excluded from comparable store metrics. If online sales are included in comparable store metrics, please address the extent to which online sales impacted the increase or decrease in comparable store sales from period to period in your MD&A.
- Fiscal years that contain 53 weeks should generally include a quantified analysis of the impact of the extra week on the comparability of your results.
- 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.

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. For example, a registrant that has a 53-week fiscal year should quantify how inclusion of the extra week in its analysis affects comparability with previous years' results. Recently, the staff has also asked registrants to clarify whether online sales are included in the calculation of same-store sales and, if so, to quantify their effect.

At the 2013 AICPA Conference, the SEC staff observed that registrants sometimes do not provide enough information about how online sales affect their strategies and financial results. It noted that registrants need to assess the materiality of Internet sales and provide MD&A disclosures about these sales if warranted. Specifically, it indicated that when a registrant's online sales are significant, the staff may ask the registrant 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.

Many registrants in the retail and distribution industry separately use non-GAAP financial measures (e.g., EBITDA) to communicate results. Consequently, the SEC staff may challenge their related disclosures. See the [Non-GAAP Financial Measures](#) section for additional information.

For other considerations, including SEC staff views on the use of appropriate metrics that help registrants "tell their story," see the [Management's Discussion and Analysis](#) section.

Revenue Recognition — Customer Loyalty Programs

Examples of SEC Comments

- Please explain to us and expand your disclosure to clarify how you account for the points at the time of award and when the points are redeemed. Also please disclose whether the points expire or have a specific term.
- [T]ell us how the cash-back feature of [your cobranded credit cards is] recognized, measured and classified in your financial statements.

The SEC staff may ask registrants to clarify the key terms and related accounting for customer loyalty programs and cobranded credit card arrangements. In such cases, the staff often seeks to understand the registrant's income statement classification analysis under ASC 605-50 and its consideration of other factors for recognizing and measuring such incentives.

Transportation, Travel, Hospitality, and Leisure

The SEC staff's comments to registrants in the TTHL industry have focused on capital expenditure disclosures, long-lived asset impairments, and VIEs.

Capital Expenditures

Examples of SEC Comments

- Please expand your disclosure to include additional analysis of your capital expenditures by breaking down total capital expenditures between new development (as applicable), routine capital expenditures and other capital expenditures by year. The total of these expenditures should reconcile to the cash flow statement. In addition, please expand your narrative discussion of fluctuations from year to year to discuss any known trends or expectations for the future.
- Please revise your disclosure related to capital expenditures in future filings to discuss significant variances or trends in your expenditures, and in your response to us, please tell us the reason for the decrease in enhancements to existing properties from \$[X] during 2011 to \$[Y] during 2012 to \$[Z] during 2013.

The SEC staff often asks TTHL registrants to clarify their capital expenditure activities by disclosing in MD&A information such as:

- The reasons for overall fluctuations in capital expenditures from year to year.
- Capital expenditures on a disaggregated basis (e.g., new development, renovations) in tabular form for each year presented to facilitate investor analysis of trends and enhance comparability. If it is not readily apparent, the SEC staff also may ask registrants whether (and how) total capital expenditures presented in MD&A reconcile to total capital expenditures in the cash flow statement.
- To the extent material, the methods used to allocate and capitalize soft costs (e.g., payroll) and a discussion of fluctuations in soft costs for the periods presented. Similarly, the SEC staff may ask TTHL registrants to clarify in the notes to the financial statements (1) the types and amounts of soft costs capitalized for each period presented and (2) the registrants' accounting policies regarding the capitalization of soft costs. Determining the types and amounts of soft costs to be capitalized frequently requires judgment, and such determinations may vary depending on whether the associated asset is considered inventory, a long-lived asset, or a leased asset.

Long-Lived Assets

Example of an SEC Comment

We [note that you] believe the market value of each of the vessels equals or exceeds its carrying value. In order to provide investors with additional information as to trends that could potentially impact your future results of operations, please revise future filings to include a comparative analysis of how the carrying values of your vessels compare to the fair market value of such vessels as of each balance sheet date presented in your financial statements. Also, please consider revising this table to include the date of acquisition, purchase price and carrying value at the balance sheet date for each of your vessels.

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. Consequently, the staff may ask such registrants to discuss more thoroughly the factors and conditions that would lead them to record an impairment loss.

In addition, 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.

Further, the SEC staff may ask for more robust disclosures about the sensitivity of assumptions used in the test for impairment, 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).

VIE Arrangements

Example of an SEC Comment

You have disclosed that your subsidiary has been granted the exclusive right to manage, operate and control [Entity A]. Please elaborate upon the notion of control and provide your analysis under ASC 810-10, including the specific rights held by you and [other] parties. Tell us how you have determined that you should consolidate this entity.

TTHL registrants may enter into arrangements that create variable interests (e.g., interests related to real estate investments, property management ventures, or investments in utilities that supply energy to property developments) that must be assessed in a consolidation analysis. The SEC staff often inquires 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 status. The staff has asked registrants to discuss how they evaluated changes in circumstances to determine whether consolidation was warranted and may request revised and expanded disclosures that more thoroughly explain the nature of the arrangements and the registrant's evaluation of any changes in circumstances.

For more information, see the [Consolidation](#) section.

Other Deloitte Resources

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

Energy and Resources

Oil and Gas

The SEC staff's comments to registrants in the oil and gas industry continue to focus on (1) master limited partnerships (MLPs); (2) oil and gas reserves; (3) disclosures about drilling activities, wells and acreage data, and delivery commitments; and (4) non-GAAP financial measures.

MLP Considerations

Distributable Cash Flow and Maintenance Capital Expenditures

Examples of SEC Comments

- [You state] that Distributable Cash Flow provides investors with an approximation of Available Cash, as defined in your partnership agreement, prior to the establishment of any cash reserves. Please provide us with a comparison of the calculations of Available Cash and Distributable Cash Flow (e.g., tell us how capital expenditures are determined in calculating Available Cash). With your response, please tell us about the extent to which Distributable Cash Flow is considered by management and the board of directors in determining actual cash distributions. . . . As part of your response, explain how you evaluate, and how you believe investors should consider any excess or shortfall of Distributable Cash Flow over actual cash distributions for any given period.
- We note that a significant component of your distributable cash flow calculation is maintenance capital expenditures, which reduce the cash flow available for distribution to your unitholders. Since we understand that the definition of this term may vary within the industry, please tell us your definition of maintenance capital expenditures. Specifically, please clarify what you are maintaining: a specific level of net assets, throughput, capacity, profitability, etc. Since we understand that the definition of this term may vary, please also tell us how you considered clarifying this matter to your investors.

The partnership agreements of MLPs typically define distributable cash flow and often call for a distinction between capital expenditures associated with maintenance and those associated with 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 industry registrants may focus on:

- Providing greater clarity about how distributable cash flow is calculated.
- How maintenance capital expenditures is defined and how it affects distributable cash flow.
- Describing the relationship between the calculated amount of distributable cash flow and actual distributions.
- Understanding liquidity ramifications related to requirements to distribute cash.
- Compliance with S-K Item 10(e) related to non-GAAP financial measures, including (1) how distributable cash flow is used by management and (2) the registrant's reconciliation of the non-GAAP measure to the appropriate GAAP measure (e.g., why distributable cash flow as a cash measure is reconciled to a profit measure, such as net income, instead of to operating cash flows).

EPU Considerations

MLPs are common structures used in the energy and real estate industries. Frequently, MLPs have differing classes of ownership units, such as general partner (GP) units, limited partner (LP) units, and incentive distribution rights, that participate in earnings on the basis of the contractual rights stipulated in the partnership agreement; therefore, in such cases, MLPs must apply the two-class method in ASC 260 to determine earnings per unit (EPU). MLPs also commonly engage in dropdown transactions, in which the GP of the MLP transfers assets to the MLP in exchange for a greater partnership interest in the MLP or cash (or both).

ASC 260 does not address how the MLP's presentation of historical EPU would be affected by a dropdown transaction that (1) occurs after the MLP's initial formation and (2) is accounted for as a reorganization of entities under common control. As a result, two common approaches have developed, as noted in a [memorandum](#) prepared for the EITF's deliberations on this issue at its September 2014 meeting:

- Restate historical EPU "by allocating the net income (loss) of the transferred business prior to the date of the dropdown transaction to the GP, LPs, and [other participating interest] holders."
- Allocate "the net income (loss) of the transferred business prior to the date of the dropdown transaction entirely to the GP." The memorandum indicates that "[u]nder this alternative, there is no retrospective adjustment to previously reported EPU."

Consequently, the SEC staff has asked registrants about the basis for their EPU calculations in dropdown transactions. To address the diversity in practice, the FASB issued a proposed ASU in October 2014 under which an MLP would perform the allocation by using the second approach described above. As a result, there would be no adjustment to historical EPU reported for LP units.

Oil and Gas Reserves

PUD Reserves

Example of an SEC Comment

You disclose that a significant percentage of your net undeveloped acreage will expire over the next three years. Please tell us the extent to which you have assigned any proved undeveloped reserves . . . to locations which are currently scheduled to be drilled after lease expiration. If your undeveloped reserves include any such locations, [tell] us the steps you will take regarding an extension of your legal right to these leases; otherwise, please remove these undeveloped reserves as proved reserves in your next filing.

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."

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

Separate Disclosure of NGL Reserves

Example of an SEC Comment

We note you disclose proved reserves of crude oil, condensate and natural gas liquids (NGLs) as a single aggregated quantity in the tables The staff considers NGLs 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 disclosures to separately present, on a disaggregated basis, your NGL reserve quantities.

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 of changes in proved reserve quantities to include an explanation of significant changes that occurred during the periods presented. Refer to FASB ASC 932-235-50-5.
- Please expand your disclosure of the changes in net quantities of proved reserves to include appropriate explanations of significant changes relating to extensions and discoveries, other additions and revisions of previous estimates, for each of the reporting periods shown, to comply with FASB ASC Topic 932-235-50-5.

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; to address negatively revised estimates attributable to performance separately from those attributable to price reductions; to explain significant changes in extensions and discoveries; and to disclose prices used in the calculation of standardized measures. Further, the SEC staff may (1) ask industry registrants whether abandoned assets have been included in the standardized measure and, if so, to provide information about them and (2) refer registrants to guidance in a [sample letter](#) provided by the Division of Corporation Finance.

Reserve Reports

Example of an SEC Comment

Please file a third party report that complies with the requirements of Item 1202(a)(8) of Regulation S-K: (i) The purpose for which the report was prepared and for whom it was prepared; (ii) The date on which the report was completed; (iv) The data and procedures used, including the percentage of the registrant's total reserves reviewed in connection with the preparation of the report, and; (x) The signature of the third party. Include the third party's responsible person's technical qualifications as required by Item 1202(a)(7) of Regulation S-K.

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 Regulation S-K, Item 1202(a)(8)(iv), to disclose the "assumptions, data, methods, and

procedures used, including the percentage of the registrant's total reserves reviewed in connection with the preparation of the report, and a statement that such assumptions, data, methods, and procedures are appropriate for the purpose served by the report."

Drilling Activities, Wells, Acreage, and Delivery Commitments

Examples of SEC Comments

- Please revise or otherwise expand your disclosure to present the total gross and net productive wells expressed separately for oil and gas as of a reasonable current date or as of the end of the current fiscal year pursuant to the disclosure requirements under Item 1208(a) of Regulation S-K.
- Please expand the disclosure of your present activities, such as the number of wells in the process of being drilled, completed or shut in awaiting infrastructure, to provide this information as of March 31, 2014. Please refer to the disclosure requirements in Item 1206 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, 1205, 1206, 1207, and 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.

Non-GAAP Financial Measures

Registrants in the oil and gas industry commonly use derivative instruments to hedge their exposure to commodity price risk. However, registrants may elect not to apply hedge accounting for such derivative transactions. Accordingly, any mark-to-market adjustments are recorded in registrants' earnings (i.e., unrealized gains and losses are recorded in profit and loss in registrants' income statements). In addition, some registrants may present non-GAAP financial measures, such as adjusted EBITDA, as well as adjustments (in the required reconciliation to the most directly comparable GAAP measure) for the effects of such derivative transactions (e.g., excluding net unrealized gains/losses), which the SEC has indicated may not be in accordance with U.S. GAAP. As a result, the SEC staff has asked registrants to present two separate reconciling items within the non-GAAP reconciliation for (1) total net gains or losses in accordance with U.S. GAAP (i.e., total net realized and unrealized gains/losses) and (2) net cash receipts or payments for derivatives settled during the period (i.e., net realized gains/losses). See the [Non-GAAP Financial Measures](#) section for more information related to non-GAAP measures.

Power and Utilities

The SEC staff's comments to registrants in the power and utilities industry have continued to focus on (1) accounting for the impact of rate making; (2) regulatory disallowance of property, plant, and equipment; (3) identification of possible phase-in plans; and (4) parent and subsidiary dividend restrictions.

In addition, the staff continues to question whether registrants in the power and utilities industry have complied with requirements under ASC 450 to disclose their range of loss in connection with litigation and other contingencies and with segment reporting requirements under ASC 280. See the [Contingencies](#) and [Segment Reporting](#) sections for more information.

Because many utilities have both regulated and nonregulated businesses, the SEC staff has asked industry registrants to discuss their analysis for determining whether to separately disclose revenues and costs of revenues related to their nonregulated businesses. For additional information see the [Financial Statement Classification, Including Other Comprehensive Income](#) section.

Master limited partnerships (MLPs) are common structures used in the energy industry. See the [Oil and Gas](#) section for additional considerations related to MLPs.

Accounting for the Impact of Rate Making

Example of an of SEC Comment

You disclose that \$[X] of regulatory assets [was] not earning a rate of return as of September 30, 2013. You subsequently disclose that a portion of the regulatory asset related to pensions and other postemployment benefits relating to the unfunded differences between the projected benefit obligation and plan assets also does not earn a rate of return, but do not disclose an amount. Please revise to disclose the total amount of regulatory assets for which you do not earn a rate of return. Refer to ASC 980-340-50-1.

The SEC staff continues to ask rate-regulated utilities to disclose (1) how their current regulated rates are designed to recover their specific costs of providing service; (2) the nature of all of their material regulatory assets and liabilities; (3) the anticipated recovery period of their regulatory assets, or the anticipated refund period of their regulatory liabilities; (4) whether a particular regulatory asset is earning a rate of return; and (5) their accounting policies for revenues subject to refund. In addition, the SEC staff may request supplemental explanations or separate detailed analysis and evidence that support the registrant's recognition of regulatory assets.

Regulatory Disallowance of Property, Plant, and Equipment

Example of an of SEC Comment

It is our understanding that you continued to recognize [certain] capital costs related to your recently completed administrative and operations buildings as of June 30, 2013. If our understanding is correct, please tell us the specific facts and circumstances you considered in continuing to recognize said capital costs after the draft decision was issued, and your consideration of ASC 980-360-35-12. Please also tell us what events you believe would trigger derecognition of said capital assets.

Recently, various public utility registrants have received comments from the SEC staff about how they applied ASC 980-360-35, which provides guidance on an entity's subsequent measurement and recognition of property, plant, and equipment. Registrants have been asked to explain considerations related to their derecognition of property, plant, and equipment in light of recent regulatory orders by state public utility commissions that limit a public utility entity's cost recovery. Also, given the increasing costs of capital projects and cost caps imposed by regulatory authorities at the time of approving large new capital projects, the SEC staff has requested disclosure regarding the estimated costs of capital projects and detail of the costs that could change during construction. SAB Topic 10.E states that "disallowed costs for recently completed plants [should] be charged to expense when the disallowance becomes probable and can be reasonably estimated."

Registrants can refer to the example in ASC 980-360-55-18 for assistance in applying the guidance on accounting for the disallowance of plant cost resulting from a cost cap.

Identification of Possible Phase-In Plans

Example of an of SEC Comment

Please supplementally explain the history of the regulatory asset relating to depreciation including why a portion of depreciation for financial reporting purposes was deferred. Tell us over what period it arose and the identity of the plant(s) to which it relates . . . including whether any plant(s) were recently completed. Tell us when you started amortizing this regulatory asset.

Since many regulators wish to keep rates down in 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 new plant addition 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 three criteria outlined in ASC 980-360-20. Rate-making methods that can result in a phase-in plan include those under which:

- Rates for a new facility are levelized.
- Rates are based on the levelized lease payments under a capital lease (or power purchase agreement that meets the definition of a lease).
- A percentage of an overall rate increase that has been approved is deferred and included in rates in later years.
- The depreciation expense of a major new plant is deferred and included in rates in later years.

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 cost of service in the current proceeding, those costs may not qualify as a regulatory asset under U.S. GAAP unless an exception applies, regardless of the probability that the incurred costs will be recovered in future rates.

Dividend Restrictions

The financial flexibility of registrants in the power and utilities industry and the nature of their relationships with affiliated parties, including the parent company, may be constrained by regulation. Subsidiaries often enter into financing agreements that may restrict (1) the 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 with affiliates. The inability of a subsidiary to transfer assets to the parent company could, in turn, restrict the parent company's ability to pay a dividend to its shareholders. In addition, holders of significant noncontrolling interests in a subsidiary may influence the subsidiary's operations.

Various public utility registrants have received comments from the SEC staff about their compliance with Regulation S-X, Rules 4-08(e) and 5-04. The staff has questioned whether such registrants adequately considered the Federal Power Act as well as Federal Energy Regulatory Commission rules, state rules and regulations, and other regulations that restrict transfers of assets. In addition, the staff has asked public utility registrants whether, in the absence of regulatory restrictions, they have considered other limitations (e.g., debt agreement covenants), which 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 power and utilities 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 in accordance with Rule 5-04. A registrant must determine whether it needs to comply with Rule 4-08(e) independently of Rule 5-04 because 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.



Mining

Example of an SEC Comment

We note you present the non-GAAP measures of total cash costs per ounce of gold produced for fiscal years ended 2011 through 2013 on a mine-by-mine basis, computed after deducting by-product metal revenues. We understand your desire to convey the notion that sales of by-products offset part of your costs. However, to supplement your existing disclosure, please provide draft disclosure of the following information to be included in future filings:

- A measure presenting cash costs per ounce of gold produced before adjusting for by-product metal revenues;
- Transparent line item captions, i.e., cash costs per ounce of gold produced before by-product metal revenue and cash costs per ounce of gold produced net of by-product metal revenues;
- Description of the reasons why certain metals are considered by-products if the amount of by-product credits is material.

Recent SEC staff comments to registrants in the mining industry have focused on the registrants' use of non-GAAP financial measures. One such measure, which is often used in this industry, is total cash cost per ounce for the principal mineral the company produces. In their disclosures about the production of that mineral, registrants may identify by-products that generate revenue. The SEC staff has noted that registrants sometimes calculate the non-GAAP measure by netting the revenue earned from the by-products with the production cost of the principal mineral. This may result in a non-GAAP measure that is low compared with the gross production cost, or even negative, which could be confusing to investors.

At the 2013 AICPA Conference, the SEC staff emphasized that at a minimum, it expects full disclosure of what the non-GAAP measure represents and clear labeling of the measure to highlight that the cash costs per ounce have been reduced by the by-product revenues. To provide additional transparency, registrants may use a "with or without" measure that adjusts for the by-product revenues. The SEC staff also indicated that it may challenge the appropriateness of using the measure when by-product revenues materially affect the cost measure. The staff further emphasized that in cases involving multiple by-products, registrants should present any related revenues separately when material and reconcile such amounts to the total by-product revenue included in the non-GAAP measure.

In addition, recent SEC staff comments have asked registrants in the mining industry to (1) revise the titles of their non-GAAP measures throughout their filings to clarify that the measures are net of by-product credits, (2) disclose why management believes that presenting a cost measure net of revenue is useful to investors, and (3) explain why management considers other metals to be by-products when sales of such metals are significant.

See the [Non-GAAP Financial Measures](#) section for more information about non-GAAP measures.

Other Deloitte Resources

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

Financial Services

Banking and Securities

The SEC staff's comments to registrants in the banking industry continue to focus on the estimation of allowances for loan losses, loan modifications, and TDRs. In addition, the SEC staff periodically asks registrants in the securities industry to provide more information about PCI and other acquired loans as well as quantitative and qualitative disclosures about market risk and VaR.

Allowance for Loan Losses

Qualitative and Quantitative Factors Used in Evaluating the Allowance for Loan Losses

Examples of SEC Comments

- [D]escribe in detail the qualitative or quantitative factors you track and consider in your allowance methodology and specifically discuss how those factors are able to track and incorporate the current loss trends in order to ensure your allowance is appropriately capturing all incurred losses.
- Please revise future periodic filings to provide a more robust and detailed discussion of how you determine this allowance for loan loss. Your disclosure should discuss, as appropriate, but not be limited to:
 - a. how you group loans with similar characteristics (e.g. geography, past-due status, internal risk ratings, etc.);
 - b. how forecasted probable losses are determined (e.g. historical loss rates adjusted for environmental factors, migration analysis, etc.);
 - c. the key qualitative factors you considered and the impact on forecasted probable losses;
 - d. the time frames over which you evaluate loss experience; and
 - e. the interplay between the forecasted probable losses and the loss confirmation period.
- [You disclose] that you decreased the portion of your allowance for loan and lease losses (ALLL) related to qualitative and environmental factors to reflect improving credit quality trends and stabilizing economic conditions in some of your markets. Please revise your disclosure in future filings to address the following:
 - o Clarify whether the reduction in the ALLL in each portfolio segment was driven solely by the portion related to qualitative and environmental factors . . . In this regard, please also clarify whether more recent periods are more heavily weighted when determining historical loss rates.
 - o Enhance your disclosure within MD&A to discuss the drivers of such reductions in each component of your ALLL in a more granular level of detail. . . . Please also ensure that your disclosure addresses both positive and negative credit quality trends and how they were impacted [by] the level of your ALLL.

Estimating the allowance for losses is an inherently subjective process that requires registrants to consider both quantitative and qualitative factors related to the loan loss reserve as well as the tendency of the reserve to change. Registrants have been asked to expand their disclosures about how they determine each element of the allowance for loan losses, including how they derive general and unallocated components.

Specifically, the SEC staff may ask registrants to disclose:

- How they group loans with similar characteristics to evaluate loan collectibility (such as loan type, past-due status, sector, and risk).
- How they determine loss rates (e.g., on the basis of historical loss rates that are adjusted for environmental factors or migration analysis), and what factors they consider when establishing appropriate time frames for the evaluation of loss experience.

- Qualitative factors (e.g., industry, geographical, economic, and political) that have affected loss rates or other loss measurements.
- How they consider housing price depreciation and homeowners' loss of equity in collateral when determining the allowance for loan losses related to residential mortgages and other loans collectively evaluated for impairment.
- The basis for assumptions used about housing price depreciation.
- How increases and decreases in expected cash flows on covered loans affect FDIC indemnification assets and allowance for loan losses, and how these changes are recognized in the income statement.
- How they consider write-downs recognized on real estate inventory transactions in determining the appropriate level of allowance for loan losses (both individually assessed and collectively assessed) for other loans with similar collateral.
- Where in the income statement they charge negative differences between carrying amounts of a loan and the fair value less costs to sell.
- Why certain types of loans have lower nonaccrual and charge-off statistics than others.

In addition, in light of improved economic conditions that have enabled banking institutions to reduce their allowances for loan losses, the SEC staff has asked registrants in the banking industry to provide expanded disclosures in MD&A about the factors that led to reductions in those allowances.

Further, SEC staff comments to registrants in the banking industry commonly cite the guidance in ASC 310-10-S99-4 and Chapter 9 of the AICPA's [Audit and Accounting Guide](#) for depository and lending institutions. The SEC staff's interpretive guidance in ASC 310-10-S99-4 states that when registrants change their method for determining the allowance for loan losses, the staff would normally expect them to maintain "documentation that describes and supports the changes." Accordingly, the SEC staff in such cases continues to request the following disclosures:

- The nature of, and reason for, the modification.
- The specific change(s) made.
- Why the change is necessary.
- Why the change is expected to result in a more appropriate allowance.
- The impact of the change on the level of the allowance for loan losses.

Credit Quality

Example of an SEC Comment

Please tell us and revise future filings to fully explain how you analyze how changes in the credit quality of your loan portfolio are considered when you determine the amount of your provision for loan loss recorded during the period and the amount of the allowance for loan losses at period end. For example, provide an analysis of each component of your allowance for loan losses (general, specific, unallocated, etc.) detailing how you determined that each component was directionally consistent with the underlying credit quality of the applicable loan portfolio.

To better understand the credit quality of a banking industry registrant's loan portfolio, the SEC staff has requested additional information (and enhanced discussions) about (1) changes in credit quality indicators, such as loan-to-value ratios and FICO scores, and (2) the impact of seasonality on the allowance for loan losses. In addition, if the credit quality of a registrant's loans changes significantly, the SEC staff expects the registrant to discuss (1) the components of the registrant's allowance for loan losses for each period and (2) how the effects of the change in credit quality are reflected in the financial statements. Registrants should also disclose other relevant information that clearly explains the reasons for the change in credit quality during the period (e.g., significant charge-offs recorded as a direct result of a regulatory examination) and how they measured the components of their allowance for loan losses.

The SEC staff may also comment if it appears that disclosures about credit quality in the notes to the financial statements are inconsistent with those in other parts of the registrant's filing or in other publicly available information (e.g., a press release or earnings call).

Collateral Appraisals

Example of an SEC Comment

Discuss how frequently you obtain appraisals for the underlying collateral for both loan origination and loan impairment analysis and the type of appraisal obtained (e.g., in-person full appraisals, drive-by appraisals or automated valuation models . . .). If the type of appraisal differs by loan product or value, discuss those differences.

To understand how registrants determine their allowance for loan losses, the SEC staff often asks them to disclose how frequently they obtain updated appraisals for impaired collateral-dependent loans and to describe the types of adjustments that are made to appraised values.

Disclosures About Credit Quality Under ASC 310-10

Example of an SEC Comment

Please revise future filings to disclose 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, acquired with deteriorated credit quality) for each loan portfolio segment. Refer to ASC 310-10-50-11B(g) and (h) and the example disclosure in ASC 310-10-55-7 for guidance.

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. The FASB's objective in requiring enhanced disclosures is to give financial statement users a better understanding of (1) the nature of an entity's credit risk associated with its financing receivables, (2) how the entity assessed that risk in estimating its allowance for credit losses, and (3) changes in the allowance and why they were made.

Specifically, 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.

PCI and Other Acquired Loans

Examples of SEC Comments

- Please revise, in future filings, to provide a loan summary table that addresses the loans by category that are self-originated and that have been acquired (both PCI and non-PCI loans) for each period presented.
- Please revise, in future filings, to also provide a rollforward of the activity in the allowance for loan losses for non-PCI loans for each of the periods presented. This will provide the reader with an enhanced understanding of the performance of the non-PCI loans given the continued significant growth of these types of loans.

The SEC staff has asked registrants whose loan portfolios have grown significantly as a result of acquired rather than self-originated loans to provide more granular disclosures about loan balances and corresponding loan loss allowances for (1) self-originated loans and (2) acquired loans (both PCI and non-PCI).

Loan Modifications and TDRs

Examples of SEC Comments

- We note your disclosure that you have created a number of loan modification programs to help borrowers stay in their homes and operate their businesses. You also state that in some of these cases, the restructure or loan modification fits the definition of a [TDR] as defined by current accounting guidance. Please tell us and revise future filings to provide a brief summary of your various loan modification programs, disclose the amount of loans modified that are not considered TDR's, disaggregated by loan portfolio segment, and explain how you determined the modifications did not meet the definition of a TDR pursuant to ASC 310-40-15-5.
- We note that corporate renegotiated loans and consumer renegotiated loans . . . declined year over year despite the increase in consumer U.S. mortgage loans . . . Please tell us how much of the decline in renegotiated loans is due to loan sales, payments, charge-offs, removal from renegotiated/TDR loan status, or other factors, and confirm that you will revise your disclosure in future filings to separately address material trends in your renegotiated loans including any material offsetting amounts.

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 the following:

- 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.

- 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 the following:

- 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 company'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.



Quantitative and Qualitative Disclosures About Market Risk and VaR

Example of an SEC Comment

We note that you use a [VaR] methodology to measure the market risk inherent in your trading activities. Please revise your future filings to provide the following additional disclosures:

- [S]pecify the confidence level and time horizon used in your VaR model;
- [D]isclose your average, high and low VaR by type of risk (e.g., interest rate, equity, energy, foreign exchange, etc.) for each period presented; and
- [Q]uantify the number of times that actual trading losses exceeded VaR during the periods presented. Refer to Regulation S-K Item 305.

The SEC has periodically asked registrants in the banking and securities industries to provide more information on quantitative and qualitative disclosures about market risk and VaR. In addition, the SEC staff may ask broker-dealer 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.

Insurance

In many of its comments to registrants in the insurance industry, the SEC staff has continued to focus on (1) transactions with captive subsidiaries; (2) reinsurance receivables; (3) assumptions used in establishing reserves and loss adjustment expense; (4) deferred acquisition costs; and (5) various other considerations, including those related to statutory disclosures, disclosures about dividend restrictions, 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.

Captive Subsidiaries

Example of an SEC Comment

Please provide us the following information regarding your use of [Company A], your special purpose financial captive insurance company:

- The nature and the business purpose of transactions with [Company A] and, if applicable, other captives. Explain how you reinsure with [Company A] including whether, and if so, to what extent, [Company A] assumes reinsurance from third parties to whom you ceded policies.
- The amount of [Company A's] obligations and the nature and amount of assets and guarantees that secure the captives' obligations, apart from the line of credit with [Company B] Tell us the nature and amount of the [the holding company's] assets, guarantees, letters of credit or promises securing [Company A's] obligations.
- The effects in your GAAP consolidated financial statements of transacting with [Company A] directly and, if applicable, indirectly through third parties.
- Your consideration of disclosing the risks of employing your captives strategy.
- Any uncertainties associated with the continued use of this strategy and the expected effects on your financial position and results of operations if you discontinue this strategy.

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 also 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.

Reinsurance Receivables

Example of an SEC Comment

Given the magnitude of your reinsurance recoverable assets in relation to your equity, please provide us proposed revised disclosure to be included in future periodic reports that specifically indicates how you manage your associated credit risk. In your disclosure, at a minimum, please include the following concepts provided in your response to [a previous comment]:

The criteria you use to qualify new reinsurers;

- How you monitor the financial strength ratings of existing reinsurers; and
- The amount of collateral you hold against these recoverable assets and how you have accounted for this collateral, including where it is classified on your balance sheet.

In addition to information about investments and financial instruments, the SEC staff has asked registrants about their disclosures related to the credit quality of financing receivables and allowances for credit losses associated with insurance-specific balances, such as reinsurance receivables (also known as “reinsurance recoverables”). The staff has also asked registrants to disclose how they manage credit risk related to those receivables.

Reserves and Loss Adjustment Expense

Examples of SEC Comments

- We refer to your disclosure . . . noting the updates to your loss development triangles based on the higher than expected reported losses, changes in loss development factors and other actuarial assumptions. Please tell us for each significant line of business and assumption the nature and extent of a) new events that occurred or b) additional experience/information obtained in the second quarter that led to the change in estimates of prior year unfavorable development of \$[X] which resulted in an additional reserve of \$[Y] recorded in the second quarter of 2013 and \$[Z] recorded in the third quarter of 2013. Ensure your explanation clarifies the timing of the change in estimate such as why recognition occurred in the period that it did and why recognition in earlier periods was not required.
- Please identify and describe those key assumptions included in your underlying actuarial methodologies that materially affect the estimate of the reserve for loss and loss adjustment expenses. From your disclosures in the risk factors section it appears that the number of claims expected to be paid (frequency) and the average cost per claim (severity) are considered to be the key assumptions that materially affect your losses and loss adjustment reserve. When applicable, for each of your key assumptions quantify and explain what caused them to change from the assumptions used in the immediately preceding period.

The SEC staff continues to ask registrants to explain the key methods and assumptions used in deriving their loss adjustment expense and related reserves and to provide current disclosures that comply with the requirements of [SEC Industry Guide 6](#). In addition, the staff has asked registrants to discuss the drivers of the estimate’s change, including assumptions that have changed and assumptions that are reasonably likely to change, in the critical accounting policy section of their MD&A. Further, the SEC staff may comment on reserve disclosures related to catastrophes. See the [Management’s Discussion and Analysis](#) section for more information about comments related to critical accounting policies.

Deferred Acquisition Costs

Examples of SEC Comments

- Please provide us revised disclosure to be included in future periodic reports that addresses the following requirements of ASC 944-30-50-1:
 - Please revise your policy disclosure to clarify that the nature of acquisition costs capitalized relates only to the costs associated with successful efforts;
 - Disclose the amount of acquisition cost amortized for the period; and
 - Clarify whether the policy acquisition expenses line-item on your statements of operations and comprehensive income includes expenses that are not capitalized and amortized.
- Please confirm that the ceding commission income you reflect as revenue in your statements of income includes reimbursement for the recovery of acquisition costs on the ceded premiums. If so, please tell us why you did not reflect that portion of your ceding commissions as a reduction of your deferred acquisition costs as required by ASC 944-30-35-64 and tell us for each period provided in your filing the portion of your ceding commission income that relates to the recovery of acquisition costs.

The SEC staff has asked registrants in the insurance industry to (1) provide disclosures about the composition of their deferred acquisition costs (and enhance their related accounting policy disclosures) and (2) discuss omitted disclosures when it appears that such disclosures may be material. Further, the staff has asked such registrants about the presentation in the statement of comprehensive income of ceding commission income that is essentially a recovery of acquisition costs.

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.

In addition, the SEC staff has 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. The staff has asked registrants to add information about the considerations underlying their determination of why they did not need to disclose information required under Regulation S-X, Rules 4-08(e) and 7-05(c). Also, 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.

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.

Further, 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).

See the [Fair Value](#), [Financial Instruments](#), and [Other-Than-Temporary Impairment of Investments in Securities](#) sections for more information.

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 registrants in the investment management industry have continued to focus on topics such as fair value measurement, revenue recognition, risk oversight, and consolidation. The staff has also commented on executive compensation, quantitative and qualitative disclosures about market risk, and share-based payments. For more information on these topics, see the [Disclosures About Risk](#), [Executive Compensation and Other Proxy Disclosures](#), and [Share-Based Payments](#) sections.

In addition, in a June 2014 [speech](#), Norm Champ, director of the SEC's Division of Investment Management (the "Division"), highlighted the examination priorities of the SEC's 2014 National Exam Program for investment advisers and investment companies, which include issues such as conflicts of interest and fund marketing and performance. Mr. Champ noted that under this program, the SEC staff "will continue to examine a significant percentage of the advisers who have been registered with the [SEC] for more than three years, but have not yet been examined by the National Exam Program." Another focus of the Division has been to continue the practice of issuing IM Guidance Updates¹ that summarize the Division's views regarding various disclosures and other regulatory and compliance matters.

Fair Value Measurements

Example of an SEC Comment

We note your disclosure that the valuations for corporate private equity and real estate investments may be derived by reference to observable valuation measures adjusted by management for differences between the investment and the referenced comparables, and in some instances by reference to option pricing models or other similar methods. Please revise your disclosure to discuss the type of adjustments and the factors and information you consider when determining the appropriate adjustment to make to the observable valuation measures of your corporate private equity and real estate investments. Also explain the situations when the fair value determination would be made by reference to option pricing models or other similar methods.

The SEC staff continues to focus on fair value measurement and related disclosures in comments to registrants in the investment management industry. In particular, the SEC staff will frequently ask registrants 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 registrant's net asset value per share does not represent fair value. Further, the SEC staff has asked registrants to disclose additional information about the procedures they use to validate values obtained from external sources (e.g., broker quotes). In addition, the SEC staff has often asked registrants 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.

¹ See, for example, the Division of Investment Management's Guidance Update Nos. 2014-07, "Private Funds and the Application of the Custody Rule to Special Purpose Vehicles and Escrows," and 2014-08, "Guidance Regarding Mutual Fund Enhanced Disclosure."

Revenue Recognition

Examples of SEC Comments

- We note your disclosure that investment management fees are recognized as earned over the period in which services are rendered and are generally determined based on a percentage of [assets under management (AUM)]. We also note your disclosures . . . regarding your sales and distribution fees including those paid by Rule [12b-1] plans where you pay substantially all of the fees to the financial advisers and other intermediaries. Please expand your revenue recognition policy in future filings to address the following:
 - Disclose how frequently these fees are calculated and paid, and identify the basis for the AUM in the calculation. For example, tell us whether the fee is based on a percentage of average daily or monthly AUM. In your response clarify any differences between investment management fees earned under contractual arrangements with your [sponsored investment products] versus the sub-advised products.
 - Tell us whether any portion of your investment management fee on sub-advised products is paid to another party, and if so, explain whether the fees are reported on a gross or net basis.
- Tell us the typical contractual terms of your consolidated funds with incentive income arrangements. For example, clarify whether there are typically hurdle rates or lock-up periods, and describe the typical type of waterfalls for the incentive income distributions for these funds.
- We note you present your assets under management (AUM) by investment objective and the average mix of AUM for the last three fiscal years We also note your discussion . . . for fluctuations in operating revenues and expenses that are driven by the mix or average of certain investment objective AUM. In an effort to provide more transparent disclosures regarding trends in revenue and expenses, please disclose your average AUM by investment objective.

The SEC staff guidance in EITF D-96 (codified in ASC 605-20-S99) provides two alternatives for recognizing performance-based management fees and requires disclosure of the accounting policy used with regard to these arrangements. Disclosure should also include (1) whether the company has recorded any revenue that is at risk as a result of future performance contingencies, (2) the nature of contracts giving rise to the contingencies, and, if material, (3) the amount of such revenues recorded. The SEC staff has asked registrants to discuss their revenue recognition policy disclosures and has also inquired about their contract terms, including (1) whether carried interest and incentive fees are based on a fixed percentage and (2) whether there are any hurdle rates or lock-up periods. In addition, registrants have been asked whether they report transaction and/or placement fees on a gross or net basis and to explain how they made that reporting determination. Further, registrants have been requested to provide more transparent disclosures about trends in revenue and expenses by disclosing average AUM by investment objective, which could include a sensitivity analysis that demonstrates the impact that changes in the fair value of managed assets could have on results of operations (e.g., revenues and net income).

Risk Oversight

Example of an SEC Comment

You disclose that each segment runs its own risk management process. Please describe your policies and procedures related to the reporting of risks from each segment to your Board of Directors, your Manager, your Managing Partners and other entities/individuals with risk management responsibilities.

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 a registrant 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 (such as the audit and compliance committees).

Consolidation

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 registrants 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.

Real Estate

The SEC staff's comments to registrants in the real estate industry have focused on topics such as whether real estate acquisitions represent acquisitions of businesses, assets, or real estate operations; leasing activities; capitalization of real estate development, construction, and leasing costs; non-GAAP financial measures; liquidity considerations associated with distributions; consolidation; and impairments.

In addition, the SEC staff typically expects registrants that qualify as a REIT to file Schedule III,¹ which requires them to present supplemental information about real estate investments and accumulated depreciation. Registrants that recently converted to a REIT but did not file Schedule III may receive comments from the SEC staff.

Master limited partnerships (MLPs) are common structures used in the real estate industry. See the [Oil and Gas](#) section for additional considerations related to MLPs.

Real Estate Acquisitions

Examples of SEC Comments

- Please provide us with an analysis of the acquisitions you have made in the past three years, and whether or not those acquisitions were treated as asset acquisitions or business combinations. For each of these transactions, tell us whether properties were purchased vacant, partially leased, fully leased or whether you entered into a lease in conjunction with the purchase, and what impact this had on your accounting. For the transactions accounted [for] as asset acquisitions, please tell us if you allocate any value to in-place leases, and tell us the amount of transaction costs you have capitalized.
- We note that your [acquisition] was significant and you filed [Regulation S-X, Rule] 3-14 financial statements Please tell us the extent of [your acquisition's operations that are] other than leasing real estate (i.e. property management or development) and how this factored into your determination that [Rule] 3-14 financial statements are more appropriate than [Regulation S-X, Rule] 3-05 financial statements.

¹ The schedule is required for certain real estate companies in accordance with Regulation S-X, Rule 12-28.

Regulation S-X, Rule 3-05, requires a registrant to provide full financial statements 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. 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, 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, the SEC staff has asked registrants with material acquisitions to elaborate on their process for determining whether the acquired assets, including acquired real estate (e.g., single-family homes) that is subject to a lease, qualify as a business or an asset acquisition under U.S. GAAP. To help entities make this determination, ASC 805-10-25-1 links to the Master Glossary's definition of a business. ASC 805-10-55-4 through 55-9 also contain guidance on what constitutes a business. 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.

Leasing Activities

Triple Net Leases

Example of an SEC Comment

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].

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, an investor may be interested in (or may need) the lessee's financial statements or other financial information when (1) a registrant leases (under triple net leases) one or more properties to a single lessee or tenant and (2) "such properties represent a 'significant' portion of the registrant's assets." That is, such lease arrangements with a single lessee or tenant may represent a significant concentration of risk that an investor would need to evaluate.

Further, Section 2340 notes that a registrant should provide full audited financial statements of the lessee (or guarantor) — for the periods required by Regulation S-X, Rules 3-01 and 3-02 — when the asset concentration exceeds 20 percent of the registrant's assets as of its most recent balance sheet. Accordingly, when an industry registrant enters into a triple net lease transaction, the SEC staff may ask it to provide additional information about whether a triple net lease is significant, particularly when it appears to the staff that such a lease may be significant but the registrant has not included the lessee's or tenant's financial statements.

Disclosures About Rental Performance

Examples of SEC Comments

- We note your disclosure regarding your weighted average net rental rates. In future Exchange Act periodic reports, please provide an explanation of whether these amounts are net of leasing costs, including free rent. In addition, please include a comparison of both rents on new leases to rents on expiring leases and rents on renewals and expansions to rents on expiring leases.
- Please provide additional information regarding the fluctuations in your rental income amounts. Specifically, please expand your disclosures to quantify the amount increased as a result of increased rental rates on renewed leases, including the average percentage increase and the amount of the increase associated with new leases signed during the period.

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 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

- We note your disclosure related to upcoming capital expenditures for the coming months. In future filings please include additional analysis of your capital expenditures that have occurred by breaking down total capital expenditures between new development, redevelopment/renovations and other capital expenditures by year. The total of these expenditures should reconcile to the cash flow statement. In addition please provide a narrative discussion for fluctuations from year to year and expectations for the future.
- [P]lease include the amount of soft costs (i.e., payroll costs, interest expense, etc.) capitalized for each year that are included in the table of capital expenditures below the table.

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 highlight expenditures related to acquisitions, new development, redevelopment, and improvements to existing properties.

Non-GAAP Financial Measures

Examples of SEC Comments

- We note your use of funds from operations (FFO) and net operating income (NOI) in your press release. Please explain to us whether you consider these metrics to be key performance indicators. To the extent that you do consider FFO and NOI to be key performance indicators, tell us why you have not included a discussion of these metrics in your MD&A.
- We note your disclosure of operating statistics for your same store property portfolio . . . In future Exchange Act periodic reports, please expand your analysis in the MD&A section to address any material period to period changes in same-store performance, including the relative impact of occupancy and rental rate changes, or advise.

The SEC staff has commented 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 filings of most REITs include FFO as defined by 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.² In circumstances in which these key performance measures are provided in other communications to investors, the SEC staff may ask registrants why these non-GAAP financial measures were not disclosed in their periodic reports (e.g., Forms 10-K and 10-Q).

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 in rental revenue and expenses clarifies the impacts of same-store and non-same-store results and the impacts of changes in rental rates and occupancy. To improve transparency, disclosures of "same-store NOI" should be accompanied by an explanation of how the same-store pool is determined and should highlight any changes in the pool from the prior reporting period.

Recently, the staff has also requested further information and disclosure about backlog for those real estate companies involved in engineering and construction, such as home builders.

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

Liquidity and Capital Resources — Distributions

Examples of SEC Comments

- In your tabular disclosure, please show the percentage of your distributions that were covered/funded by your cash flow from operations for each period presented.
- Please disclose your cumulative earnings or FFO since inception as compared to your cumulative distributions.

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 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

² See Questions 102.01 through 102.03 of the C&DIs on non-GAAP financial measures for additional information about FFO and NAREIT.

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.

Consolidation

Example of an SEC Comment

We note that you have a [70-plus percent] interest in [a] joint venture and that you have determined that the joint venture is a variable interest entity. It appears that you have determined that you are not the primary beneficiary because you do not have the power to direct the activities that most significantly impact the VIE's economic performance. Please tell us which activities most significantly impact the VIE's economic performance and tell us what happens if a vote on a significant matter is deadlocked. In addition please tell us if either party is required to consent to any significant activity of the entity or [whether there are] any contractual clauses that determine how to break a deadlock. For reference see ASC 810-10-25.

The SEC staff continues to focus on registrants' involvement with VIEs and joint ventures and has inquired about consolidation assessments.

The staff also routinely asks for additional information and disclosures about non-VIE joint ventures, particularly when a registrant that has a majority ownership interest uses the equity method of accounting or when the qualitative disclosures about such arrangements are not robust. Disclosures about these arrangements should include a discussion of the governance provisions that led the registrant to conclude that it does not exercise control over the joint venture.

See the [Consolidation](#) section for further discussion.

Impairments

Example of an SEC Comment

We note that due to changes in cash flow estimates and hold periods, you have recognized [an] impairment charge on real estate held for investment. Please tell us and revise future periodic filings to include a description of the impaired real estate and the facts and circumstances leading to the impairment To the extent these facts and circumstances are different for each real estate holding, please discuss separately. Reference is made to paragraph 360-10-50-2 of the Financial Accounting Standards Codification. In addition, your MD&A disclosure should also be expanded to discuss these changes, potential variability from period to period, and to the extent any of these changes are attributable to an area of concentration risk.

The SEC staff has frequently asked registrants in the real estate industry to enhance their disclosures about (1) the timing of impairments, (2) the need for MD&A disclosures that warn of potential future impairments, (3) the inputs used in asset recoverability tests, and (4) the valuation techniques used to develop nonrecurring measurements of fair value. Comments on impairment issued to such registrants are consistent with those discussed in the [Fair Value](#) and [Impairments of Goodwill and Other Long-Lived Assets](#) sections.

Health Sciences

Life Sciences

The SEC staff's comments to registrants in the life sciences industry have focused on topics such as revenue recognition, MD&A disclosures, business combinations, contingencies, and segment disclosures.

Revenue Recognition

Collaborative Arrangements

Examples of SEC Comments

- [P]lease identify for us each significant accounting element in the arrangement, the character of each element (revenue vs. expense reimbursement), the units of accounting (i.e., which elements are separate vs. combined), and the accounting basis for the units of accounting (e.g., ASC 605-25).
- In order to help us understand more fully how your collaborative arrangements impact your financial statements for each period presented, please provide us a table showing 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 to third-parties. Please provide separate tables for this information for each of your significant collaborative arrangements and in the aggregate for all of your collaborative arrangements (i.e. the significant arrangements and all other arrangements).

Collaborative arrangements are common for 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 overall effect of collaborative arrangements on the financial statements. For example, 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 such tables, the staff may also ask that the registrant separately present amounts attributable to transactions with other participants and third parties that are presented net in a financial statement line item.
- The factors leading to the registrant's conclusion that a collaborative arrangement is (or is not) within the scope of ASC 808. For example, if an arrangement involving the manufacture of a drug to be sold to third parties began after the drug was FDA-approved for sale, the SEC staff may seek to understand the basis for the registrant's conclusion that it entered into a collaborative arrangement (since the parties' agreement did not include initial research activities).
- 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 process for identifying, and allocating consideration to, such activities.

- 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. 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 staff may also 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

Examples of SEC Comments

- Regarding your development, license and supply agreement with [Entity A], please disclose the amount of the upfront payment received and how you accounted for the agreement. In addition disclose each substantive milestone and the related contingent consideration. Refer to ASC 605-28-50-2b.
- Please expand your disclosure . . . to disclose the factors that management considered in determining whether the milestone or milestones are substantive as required by ASC 605-28-50-2d. This comment also applies to your disclosure of new agreements in the interim financial statements.

The SEC staff often comments on disclosures about milestone recognition under ASC 605-28. When such disclosures apply, the staff will review 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](#) section.

Multiple-Element Arrangements

Examples of SEC Comments

- Please confirm that all of the disclosures required by ASC 605-25-50-2 have been made. For example, please assure that the performance-, cancellation-, termination-, and refund-type provisions of your [revenue] agreement have been disclosed. Clarify the reasons why your significant deliverables under the agreement do not qualify as separate units of accounting.
- Please revise your disclosure to state the reason why the license does not qualify for a separate unit of accounting. Refer to ASC 605-25-50-2f. Additionally, please clarify whether the initial supply of the compound of the license product represents a separate unit of accounting.

The SEC staff often asks registrants in the life sciences industry to expand or clarify their disclosures about multiple-element arrangements. 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 such description is complete (i.e., that all material terms are disclosed), 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.

Branded Pharmaceutical Drug Annual Fee

In July 2014, the IRS issued final regulations that indicate that an entity's obligation to pay its portion of the branded pharmaceutical drug (BPD) annual fee (under the Patient Protection and Affordable Care Act and the Health Care and Education Affordability Reconciliation Act of 2010) in any given calendar year is not triggered by the first qualifying sale in that calendar year but instead by the qualifying sales in the previous year. This accounting treatment differs from that previously prescribed in ASC 720-50 and will apply to financial reporting periods that include the July 28, 2014, effective date of the final IRS regulations. Accordingly, registrants should consider disclosing information about (1) the change in recognition of the BPD fee resulting from the final IRS regulations, (2) the impact of the catch-up adjustment recorded in the period, and (3) how the BPD fee will be accounted for prospectively. For additional information see Deloitte's October 13, 2014, [Financial Reporting Alert 14-2](#).

MD&A Disclosures

R&D Expenses

Example of an SEC Comment

You state that you have made, and expect to continue to make, substantial investments in research and development to expand your product portfolio and grow your business. . . . Please provide us with the following information and revise your disclosures as appropriate:

- For your key research and development projects, please tell us the following:
 - The nature, objective, and current status of the project;
 - The costs incurred during each period presented and to date;
 - The nature of efforts and steps necessary to complete the project;
 - The risks and uncertainties associated with completing development;
 - The extent and nature of additional resources that need to be obtained if current liquidity is not expected to be sufficient to complete the project; and
 - Whether a future milestone such as completion of a development phase, date of filing [a new drug application (NDA)] with a regulatory agency, or approval from a regulatory agency can be reliably determined.
- For the remainder of projects not considered individually significant, tell us the composition of the total R&D expense for each period presented. This can take a variety of forms but is mainly driven by how many projects are managed and how they are reported within the organization. We believe disclosure of R&D by your divisional structure would be informative. Also distinguishing between discovery, preclinical and clinical development categories and further by late stage such as phase III development categories along with providing the number of projects in each category helps provide information necessary to understand the pipeline and trends by division. To the extent that management has information available by therapeutic class, we believe that further enhances the understanding of R&D expense and trends.
- If based on a known event, trend, demand, commitment or uncertainty, future R&D expense or the mix of R&D expense is reasonably likely to differ from current trends, please tell us the reasons for and the amount of the expected change.
- For projects that you disclose are in the late stage of development such as phase III, unless management believes that the expected effect on results of operations or financial position from the project when completed will be insignificant, please tell us the following about each project, even if the R&D expenses incurred on the project [have] not been material, in order to provide insight into expected effects on future operations, financial position or liquidity. Please include:
 - A description of the nature and its indication;
 - The phase the project is in at the end of the reporting period and the month and year it entered that phase;
 - Significant patents associated with the project and their expiration dates as well as other information about the exclusivity period related to the project;

Example of an SEC Comment (continued)

- o Significant developments of the project during the period such as significant milestones, filing for regulatory approval, approval and other responses from regulatory agencies; suspension or termination and their reasons;
- o Future expected milestones such as completion of a development phase, date of filing an NDA with a regulatory agency, or approval from a regulatory agency if it can be reliably determined. If the extent and timing of these future events cannot be reliably determined, please tell us the facts and circumstances that prevent their determination.

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 sections 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.

Patents

Examples of SEC Comments

- [Please] include proposed disclosure about the type of protection offered by the patent covering [Formulation A] that expires in 2016. Please additionally disclose what effects such expiration could have on sales of [Product X], and what specific steps you plan to take to mitigate this loss of patent protection in your Management's Discussion and Analysis section. You should also provide proposed disclosure to this effect to be included [in] your risk factors section.
- Please expand your disclosure to provide the type of patent coverage (e.g., method of use, composition of matter) and the expiration date (or, if a patent application, the date filed).

The SEC staff has also regularly commented on life sciences registrants' disclosure of patents, particularly on patent exclusivity of their products 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 and jurisdiction of a registrant's patents.

Liquidity

Example of an SEC Comment

[P]lease disclose the amount of cash and investments that are currently held by your foreign subsidiaries that are considered permanently reinvested and its expected effect on your liquidity and capital resources. Refer to Item 303(a)(1) of Regulation S-K and Section IV of SEC Release 33-8350.

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 the 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

As [Product X] was an approved product when you licensed it, please provide us with an analysis supporting your conclusion that the license of [Product X] was an asset acquisition and not a business combination. Please refer to [ASC] 805-10-55-4 to 9.

Since business combinations in the life sciences industry are typically complex and individually unique, the SEC staff frequently comments on registrants' disclosures about them. For example, the staff has asked registrants about their evaluation of whether a certain transaction constitutes a business combination under ASC 805. In addition, the staff has asked registrants how they determined the useful life of their intangible assets. 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 registrant's patent expires or a high barrier to market entry even after the registrant's patent expires. Therefore, the staff has asked registrants to provide additional analysis that explains the basis for their conclusions about their intangible assets' useful life. For additional accounting and reporting considerations related to acquisitions, see the [Business Combinations](#) section.

Contingencies

Examples of SEC Comments

- Please further clarify your policy in which you record "at least the minimum estimated liability related to those claims where a range of loss has been established," given the requirements of paragraph 450-20-30-1 of the FASB Accounting Standards Codification.
- We note the accruals for product liability contingencies involve a large number of small individual claims of a similar type. Please tell us your consideration of providing a roll forward within MD&A of the outstanding claims including the number of claims pending at each balance sheet date, the number of claims filed each period presented, the number of claims dismissed, settled, or otherwise resolved for each period, and/or including the average settlement amount per claim as discussed in Question 3 to SAB Topic [5.Y].

The SEC staff often comments on life sciences registrants' disclosures about legal contingencies. Pharmaceutical and medical device companies alike must often defend against various claims related to their products, including potentially both product liability and patent infringement claims. In addition, further legal exposure may arise from an entity's potential noncompliance with applicable government regulations (e.g., FDA and FCPA). The SEC staff commonly asks registrants in the industry to explain (1) how their accounting and reporting for a loss contingency complies with the recognition, measurement, and disclosure requirements in ASC 450 and (2) their consideration of the disclosure requirements in SAB Topic 5.Y. Also, the SEC staff often asks such registrants to quantify, in the risk factors section, the amount of product liability coverage they maintain. For additional accounting and disclosure considerations related to contingencies, see the [Contingencies](#) section.

Segment Disclosures

Example of an SEC Comment

We note your disclosure with respect to Medicare. Please tell us how you considered FASB ASC 280-10-50-42 which states that you should consider a group of entities under common control as a single customer (for example, the federal government). This comment also applies to your interim information.

Many life sciences companies have a diverse portfolio of products that are sold throughout the world. The SEC staff may question how a registrant's segment disclosures comply with the requirements in ASC 280 regarding disclosures that are disaggregated by products and services, geography, or major customer. The staff, for example, routinely reminds registrants of the requirement to disclose revenue information pertaining to groups of similar products and services, and it objects to an overly broad definition of "similar." For additional discussion of segment disclosure requirements, see the [Segment Reporting](#) section.

Health Plans

The SEC staff's recent comments to health plan registrants have focused mainly on (1) the provision for adverse deviation and (2) statutory disclosures. Like other registrants, health plan registrants have also continued to receive comments related to contingencies, goodwill impairment, and revenue recognition. For more information on these topics, see the [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.

Provision for Adverse Deviation

Example of an SEC Comment

You state . . . that for the three and six months ended June 30, 2013, there were no material reserve developments related to prior years. You state in [your Form 8-K] that you had a favorable development of \$[X] for the six months ended June 30, 2013. Please provide proposed disclosure to be included in your next [Form] 10-Q to clarify the reserve development relating to prior years and the reasons for the development. You state in [your Form 8-K] that the majority of the adjustments to reserves relate to variables and uncertainties associated with actuarial assumptions. Please clarify in the proposed disclosure what assumptions changed, why the assumptions changed and how it affected your reserve.

For most health plans, the provision for adverse deviation represents a significant estimate involving assumptions that are often highly subjective and that are, or could be, material to the plan's financial condition or operating performance. Accordingly, the SEC staff expects registrants to disclose information that would allow users to clearly understand (1) what the provision for adverse deviation represents, (2) how this reserve is established, and (3) the amount of the provision and changes in the provision for each period presented. The staff also asks registrants how the provision complies with the requirements of ASC 944-40-25.

Statutory Disclosures

Example of an SEC Comment

Although you disclose that your regulated subsidiaries currently exceed the minimum capital requirements, please provide us proposed disclosure to be included in future filings that states the amount of statutory capital and surplus necessary to satisfy regulatory requirements if significant in relation to actual statutory capital and surplus, as required under ASC 944-505-50-1b. If not significant, please clarify in the disclosure.

Specifically, the SEC staff has commented when registrants' disclosures required by Regulation S-X, Rule 4-08(e), and 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) are incomplete or missing. In addition, the SEC staff reminds registrants that such ASC 944-905 disclosures should not be labeled unaudited. For more information, see the [Debt](#) and [Insurance](#) sections.



Technology, Media, and Telecommunications

Technology

In 2014, SEC registrants in the technology industry have seen an increase in SEC staff comments. This increase is partly attributable to the continued strength of the markets, which have prompted more IPOs, but it has also resulted from the complexity of, and significant judgments necessary to apply, the accounting guidance on topics such as revenue recognition. As it did in the prior year, the SEC staff continues to focus on software and nonsoftware multiple-element arrangements. More recently, it has also focused on registrants' considerations related to gross versus net revenue reporting, accounting for nonrefundable up-front fees, and disclosures about 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

Multiple-Element Arrangement Accounting Policies and Disclosures

Examples of SEC Comments

- We note that for multiple element arrangements that include non-software elements, you allocate revenue to all deliverables based on their relative selling prices. Please tell us how you determine the selling price of the deliverables in your multiple deliverable arrangements including the significant factors, inputs, assumptions and methods used to determine the selling price. Please also tell us what consideration was given to disclosing this information. Refer to ASC 605-25-30-2 and ASC 605-25-50-2(e).
- Please tell us what consideration was given to the application of the provisions of ASC 985-605-15-3 to determine whether your software element is essential to the functionality of your hardware. In this regard, please explain whether the hardware has substantive functionality without the software such that a customer could reasonably be expected to purchase the hardware without the software.

Under ASC 605-25, consideration in a multiple-element arrangement must be allocated to the deliverables on the basis of their relative selling price. To determine the selling price of each deliverable, entities apply a hierarchy that requires them to use VSOE if available, TPE if VSOE is not available, or their best estimate of the selling price if neither VSOE nor TPE is available. The SEC staff focuses on how technology registrants allocate consideration to elements in such arrangements and may request additional information about the factors, inputs, and assumptions used to determine the selling price of each element.

In addition, 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 components 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 the software components and nonsoftware components of the tangible product function together to deliver the tangible product's essential functionality (and are therefore outside the scope of the guidance in ASC 985-605). Accordingly, registrants should carefully consider all facts when determining the appropriate accounting guidance to apply to arrangements that involve tangible products containing software and should clearly and adequately disclose the guidance they applied to such arrangements.

Disclosures About VSOE

Example of an SEC Comment

We note that, for multiple element arrangements that contain software products and related services, you allocate the total arrangement consideration to all deliverables based on VSOE of fair value. Please describe for us, in detail, your methodology for establishing VSOE for each of the elements in your multiple element arrangements. For example, if VSOE of your subscription services is based on stated renewal rates please provide the range of renewal rates and tell us what percentage of your customers actually renew at such rates. Alternatively, if VSOE is based on stand-alone sales, then provide the volume and range of stand-alone sales used to establish VSOE. Also, please tell us what consideration was given to disclosing the significant factors, inputs, and assumptions used to determine VSOE. Refer to ASC 605-25-50-2(e).

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., 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 continues to focus on this topic and frequently 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 references 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.

SaaS and Online Gaming

Examples of SEC Comments

- You indicate that in certain instances, your partners are considered the primary obligors for providing subscription services and at other times you are considered the primary obligor. Please tell us how the criteria of ASC 605-45 regarding principal-agent considerations [were] considered in your analysis.
- [Y]ou indicate that for all your types of games, you are able to release game updates and special editions through [your network]. In addition, we note . . . that your cloud-based server and network infrastructure enable you to deliver games and that you routinely deliver massive amounts of content to millions of users across your platform. In light of these disclosures, please clarify your statement that developers are responsible for providing the game product desired by the game players used in your evaluation of principal agent considerations.

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

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,”¹ “ad exchanges,”² and “supply-side platforms.”³

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 ad exchange 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 the 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).

¹ Ad networks or demand-side platforms are companies that interact closely with an advertiser to develop the strategy and scope of an advertising campaign and use their technologies to take control of executing such a campaign.

² Ad exchanges are companies that provide an auction process (generally in a real-time bidding (RTB) environment) and partner with various parties representing advertisers and publishers that participate in the RTB auction.

³ Supply-side platforms are companies that interact closely with a publisher to develop an optimal strategy for making advertising space available to bring about the greatest monetary return on such advertising space.

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 revenue from non-refundable upfront fees is deferred and recognized over the term of the related arrangement or the estimated customer life. Please tell us whether the non-refundable upfront fees have standalone values and are considered separate units of account. Refer to ASC 605-25-25-5(a). Also, please tell us how you determine whether the fees are recognized over the arrangement term versus over the estimated customer life.

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 fees. 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 fees are 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 in your earnings calls you discuss the weighted average duration of new contracts signed in the quarter. Please tell us what consideration was given to disclosing this metric in MD&A. Also, tell us whether the weighted average duration of new contracts signed is a key performance indicator for your business. Refer to Section III.B.1 of SEC Release 33-8350.
- We note your response [that] the number of your end customers is [not] a key metric used by management to evaluate your business. Please explain why you believe the number of your end customers is not a key metric in spite of the prominence you provide such figures [in] your prospectus.

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 profitability 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).

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 telecommunications registrants to expand or clarify their disclosures about revenue recognition. Customer arrangements in the industry often involve multiple deliverables. Accordingly, the disclosure requirements under ASC 605-25 are intended to help financial statement users understand the nature of each deliverable, how it is valued, and how revenue is recognized.

In addition, 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 industry continues to evolve, telecommunications registrants 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 telecommunications registrants 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, given the complexity of accounting for contracts that contain multiple deliverables, the staff may also request a registrant's analysis of whether it is a principal or an agent in a transaction.

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 have made significant success-based capital investments, which include building out fiber to new wireless towers and replacing copper facilities with fiber facilities to wireless towers that you already serve. Tell us how you evaluated the remaining economic life of copper facilities that you already serve and the impact on depreciation expense in subsequent periods.

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 values of significant types of assets and the methods used to estimate the assets' useful life. For additional information, see the [Impairments of Goodwill and Other Long-Lived Assets](#) section.

Appendix A: SEC Staff Review Process

The SEC's Division of Corporation Finance (the "Division") selectively reviews filings made under the Securities Act and the Exchange Act. 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 12 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 reviewing the disclosure from a potential investor's perspective and asking questions that an investor might ask when reading the document." The section also addresses how to respond to staff comments and close a filing review.
- *The reconsideration process* — This section emphasizes that "staff members, at all levels, are available to discuss disclosure and financial statement presentation matters with a company and its legal, accounting, and other advisors." In addressing a registrant's potential request for the SEC staff to reconsider a staff member's comment or view on a registrant's response, the staff emphasizes that registrants do not have to "follow a formal protocol." However, the staff explains where registrants should start and the steps involved in the normal course of the reconsideration process. The staff also specifies contact information for each office for both accounting and financial disclosure matters and legal and textual disclosure matters.

Registrants may involve the SEC's Office of the Chief Accountant (OCA) during any stage of the review process. Unlike the Division's role, which is to address matters related to the age, form, and content of registrants' financial statements that are required to be filed, the OCA's role is to address questions concerning a registrant's application of GAAP. [Guidance](#) on consulting with the OCA is available on the SEC's Web site.

A registrant that receives an SEC comment letter should generally respond within the time frame indicated in the letter. See [Appendix B](#) for more information about responding to SEC comment letters. The registrant should continue to respond to any requests for more information until it receives a letter from the Division stating that the Division has no further comments. A registrant that does not receive a completion letter within a reasonable amount of time after submitting a response letter should call its SEC staff reviewer (named in the letter) to ask about the status of the review. If the review is complete, the registrant should request a completion letter.

To increase the transparency of the Division's review process, comment letters are made public, via the SEC's Web site, no more than 20 days after the review is completed. See [Appendix C](#) 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 B: 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:

- 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.
- 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, the registrant should contact its SEC staff reviewer quickly for clarification so that it can provide an appropriate response.
- 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.



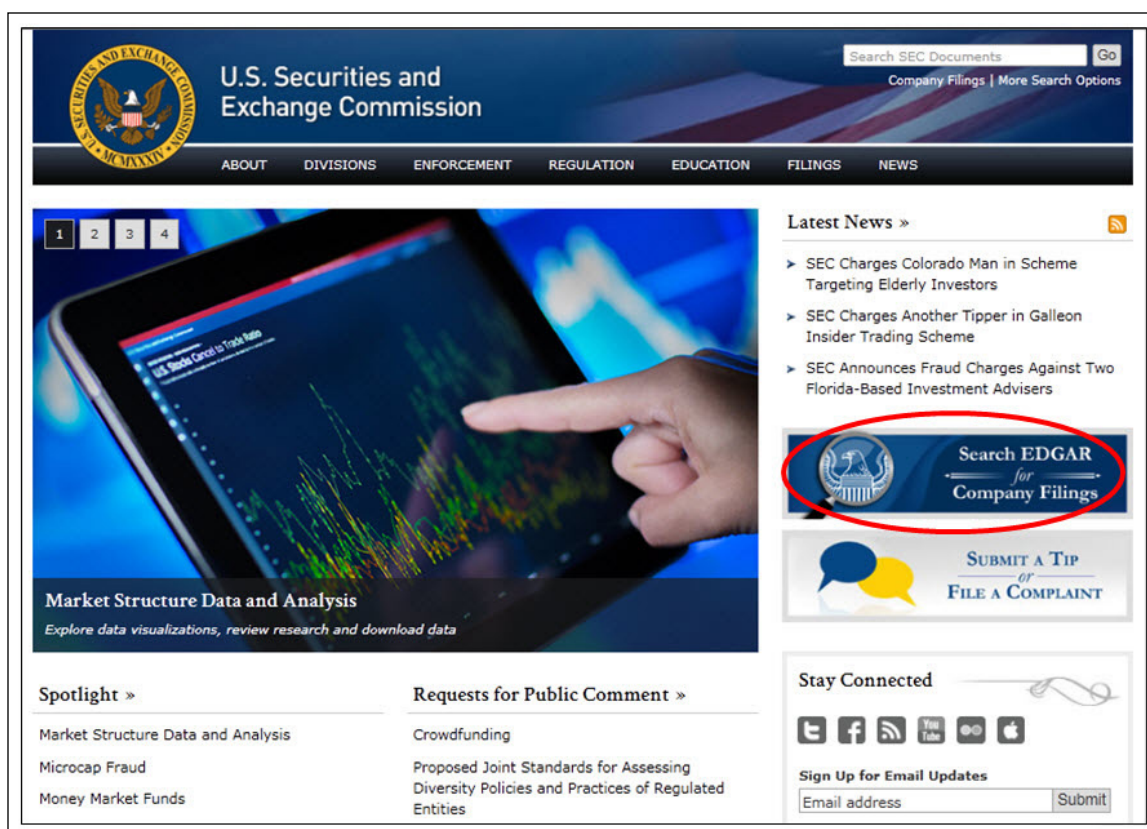
Appendix C: Tips for Searching the SEC's Database for Comment Letters

The SEC adds comment letters (and responses from registrants) to its EDGAR database no earlier than 20 days after its review of a filing is complete. Registrants can refer to such comments as part of their financial statement review process and to improve their own accounting and overall disclosure.

Although the SEC has recently 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 | Company Filings” page:

U.S. Securities and Exchange Commission

Search SEC Documents Go

Company Filings | More Search Options

ABOUT DIVISIONS ENFORCEMENT REGULATION EDUCATION FILINGS NEWS

EDGAR Search Tools

Latest Filings

Company Filings

Mutual Funds

Variable Insurance Products

Daily Filings by Type

Boolean Archive Search

Full Text (Past 4 Years)

CIK Lookup

Confidential Treatment Orders

Effectiveness Notices

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Company Name Search

More Options ▶

Fast Search ?

Ticker or CIK Search

Ticker symbol or CIK is the fastest way to find company filings.

Guides

How to Research Public Companies

Learn how to quickly research a company's operations and financial information with EDGAR search tools.

Filing Types

Learn which filing types contain earnings announcements, executive compensation, SEC correspondence and more.

Search Tools

CIK Lookup Tool

Look up the central index key (CIK) of an EDGAR filer. Searching by CIK is the most accurate way to view filings.

Save Your Search

Want to get updates on new filings? Learn how to save your search by subscribing to EDGAR RSS feeds.

Home > Filings > Search for Company Filings

Site Map | Accessibility | Contracts | Privacy | Inspector General | Agency Financial Report | Careers | Contact

FOIA | No FEAR Act & EEO Data | Open Government | Plain Writing | Links | Investor.gov | USA.gov

On the “Full-Text Search” page, select “Advanced Search Page”:

Home | FAQ

U.S. Securities and Exchange Commission

Full-Text Search

This page allows you to search the full text of EDGAR filings from the last four years. The full text of a filing includes all data in the filing as well as all attachments to the filing. To find the information you need and make your search easy and enjoyable, please visit our [FAQ](#) page. We are still developing this feature, and we plan to enhance it based on user feedback. Please email your comments and suggestions for improvement to textsearch@sec.gov.

Note: Occasionally, some recent filings are not available through the EDGAR Full-Text Search.

Search For Text: Search Reset

Advanced Search Page

This brings up the following form:

The screenshot shows the U.S. Securities and Exchange Commission's Full-Text Search interface. At the top left is the SEC logo, and at the top right are links for "Home" and "FAQ". The page title is "U.S. Securities and Exchange Commission". Below this is the "Full-Text Search" heading. A paragraph explains that the page allows searching the full text of EDGAR filings from the last four years, including all data and attachments. It also mentions a plan to enhance the search based on user feedback and provides an email address: textsearch@sec.gov. A note states that occasionally, some recent filings are not available through the EDGAR Full-Text Search.

The search form includes the following fields and options:

- Search For Text:** A text input field with a "Basic Search Page" link to its right.
- In Form Type:** A dropdown menu currently set to "All Forms".
- Results Per Page:** A dropdown menu currently set to "10".
- Sort By:** A dropdown menu currently set to "Date (Latest First)".
- Use Stemming:** A checkbox that is checked.
- For:** Radio buttons for "Company Name:", "Central Index Key (CIK):", and "Standard Industrial Classification:". The "Standard Industrial Classification:" option is selected, and a dropdown menu shows "All SICs".
- Between These Dates:** Two date input fields labeled "Start Date:" and "End Date:", both with a "mm/dd/yyyy" format and a calendar icon.
- Search and Reset:** Two buttons at the bottom right of the 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., investments AND temporary). 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., investments AND “temporary decline”).

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

Example	
08/13/2013	SC 13G/A for CAPITALSOURCE INC
COMPANY NAME(s) - [CAPITALSOURCE INC (CIK - 1241199 / SIC - 6022) WELLS FARGO COMPANY MN (CIK - 72971 / SIC - 6021)]	
UNITED STATES SECURITIES AND EXCHANGE COMMISSION Washington, D.C. 20549 SCHEDULE 13G Under the Securities	

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 who 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:

Home | [FAQ](#)

U.S. Securities and Exchange Commission

Full-Text Search

This page allows you to search the full text of EDGAR filings from the last four years. The full text of a filing includes all data in the filing as well as all attachments to the filing. To find the information you need and make your search easy and enjoyable, please visit our [FAQ](#) page. We are still developing this feature, and we plan to enhance it based on user feedback. Please email your comments and suggestions for improvement to textsearch@sec.gov.

Note: Occasionally, some recent filings are not available through the EDGAR Full-Text Search.

Search For Text: [Basic Search Page](#)

In Form Type: **Results Per Page:**

Sort By: **Use Stemming:** ☒

For ☐ Company Name:

Or ☐ Central Index Key (CIK):

Or ☐ Standard Industrial Classification:

Between These Dates:

Start Date: End Date:

Appendix D: Glossary of Standards and Other Literature

The standards and literature below were cited or linked to in this publication.

AICPA Audit and Accounting Guide

Depository and Lending Institutions

Valuation of Privately Held Company Equity Securities Issued as Compensation ["Cheap Stock Guide"]

AICPA Accounting and Valuation Guide

Valuation of Privately-Held-Company Equity Securities Issued as Compensation

CAQ Alerts

Alert No. 2012-16, "Reference to the Standards of the PCAOB in Auditors' Reports"

Alert No. 2011-04, "SEC Staff Reminds Auditors of Requirement to Sign EDGAR Audit Reports"

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](#).

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

Regulation S-K

Securities Act Rules

SEC Division of Corporation Finance Disclosure Guidance

Topic 2, "Cybersecurity"

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 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"

SEC Interpretive Release

33-8350, *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 G

SEC Regulation S-K

Item 10, "General"

Item 101, "Description of Business"

Item 103, "Legal Proceedings"

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 512, "Undertakings"

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 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 11-02, "Preparation Requirements"
Article 12, "Form and Content of Schedules"
Rule 12-04, "Condensed Financial Information of Registrant"
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 5.J, "New Basis of Accounting Required in Certain Circumstances"
SAB Topic 5.M, "Other Than Temporary Impairment of Certain Investments in Equity 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 10.E, "Classification of Charges for Abandonments and Disallowances"
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.F, "Classification of Compensation Expense Associated With Share-Based Payment Arrangements"

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 E: Abbreviations

Abbreviation	Description
AICPA	American Institute of Certified Public Accountants
AICPA Banking Conference	AICPA National Conference on Banks and Savings Institutions
AICPA Conference	The annual AICPA Conference on Current SEC and PCAOB Developments
ALLL	allowance for loan and lease losses
ASC	FASB Accounting Standards Codification
ASR	SEC Accounting Series Release
ASU	FASB Accounting Standards Update
AU	PCAOB Interim Auditing Standard
AUM	asset under management
BCF	beneficial conversion feature
BPD	branded pharmaceutical drug
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
CPA	certified public accountant
DCP	disclosure controls and procedures
DTA	deferred tax asset
DTL	deferred tax liability

Abbreviation	Description
EBIT	earnings before interest and taxes
EBITDA	earnings before interest, taxes, depreciation, and amortization
EDGAR	SEC's Electronic Data Gathering, Analysis, and Retrieval system
EGC	emerging growth company
EITF	Emerging Issues Task Force
EPS	earnings per share
EPU	earnings per unit
FASAC	Financial Accounting Standards Advisory Council
FASB	Financial Accounting Standards Board
FAQs	frequently asked questions
FCPA	Foreign Corrupt Practices Act
FDA	Food and Drug Administration
FDIC	Federal Deposit Insurance Corporation
FFO	funds from operations
FICO	Fair Issac Corporation
FPI	foreign private issuer
FRM	SEC Financial Reporting Manual
GAAP	generally accepted accounting principles
GAAS	generally accepted auditing standards
GP	general partner
IASB	International Accounting Standards Board
ICFR	internal control over financial reporting
ICP	Internet content provider
IFRS	International Financial Reporting Standard
IPO	initial public offering
IRS	Internal Revenue Service

Abbreviation	Description
LP	limited partner
MD&A	Management's Discussion and Analysis
MLP	master limited partnership
NAREIT	National Association of Real Estate Investment Trusts
NCI	noncontrolling interest
NDA	new drug application
NEO	named executive officer
NGL	natural gas liquid
NOI	net operating income
OCA	SEC's Office of the Chief Accountant
OCI	other comprehensive income
OTTI	other-than-temporary impairment
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
TDR	troubled debt restructuring

Abbreviation	Description
TTHL	transportation, 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
JOBS Act	Jumpstart Our Business Startups Act
Sarbanes-Oxley Act	Sarbanes-Oxley Act of 2002
Securities Act	Securities Act of 1933

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