A Roadmap to SEC Comment Letter Considerations, Including Industry Insights
November 2020
Publications in Deloitte’s Roadmap Series

Business Combinations
Business Combinations — SEC Reporting Considerations
Carve-Out Transactions
Comparing IFRS Standards and U.S. GAAP
Consolidation — Identifying a Controlling Financial Interest
Contingencies, Loss Recoveries, and Guarantees
Contracts on an Entity’s Own Equity
Convertible Debt
Current Expected Credit Losses
Distinguishing Liabilities From Equity
Earnings per Share
Environmental Obligations and Asset Retirement Obligations
Equity Method Investments and Joint Ventures
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Fair Value Measurements and Disclosures (Including the Fair Value Option)
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Impairments and Disposals of Long-Lived Assets and Discontinued Operations
Income Taxes
Initial Public Offerings
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Preface

November 2020

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. Over the past year, the staff has continued to address most topics discussed in the 2019 edition of this publication and, in some cases, has also focused on additional topics. The current review year 2020\(^1\) coincided with several months of the coronavirus disease 2019 ("COVID-19") pandemic; however, as of the date of this publication, we have only started to see comments from the SEC staff on registrants’ disclosures related to the pandemic and its impacts. Early trends indicate that registrants’ MD&A and risk factor disclosures have been a main focus area related to the pandemic.

The 2020 edition of *A Roadmap to SEC Comment Letter Considerations, Including Industry Insights* offers perspective on such comment letter trends. In addition to extracts of letters and links to relevant related resources, it contains analysis of staff comments to help registrants understand trends and improve their financial statements and disclosures. You will also find (1) an update on some of the SEC’s strategic priorities, (2) a summary of comment letter trends related to the top 10 topics of frequent comment, and (3) analysis of other comment letter statistics.

Regarding procedural matters, *Appendix A* gives a glimpse into the SEC staff’s review and comment letter process, *Appendix B* discusses best practices for working with the SEC staff, and *Appendix C* provides helpful tips on searching the SEC’s EDGAR database for comment letters.

For a summary of key changes made to this Roadmap since publication of the 2019 edition, see *Appendix F*.

The 2020 edition captures developments on relevant financial reporting topics through November 6, 2020. 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 annual AICPA Conference on Current SEC and PCAOB Developments ("AICPA Conference") is a prime example.

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Subscribers to the Deloitte Accounting Research Tool (DART) may access any interim updates to this publication by selecting the Roadmap from the *Roadmap Series* page on DART. If a “Summary of Changes Since Issuance” displays, subscribers can view those changes by clicking the related links or by opening the “active” version of the Roadmap.

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\(^1\) The current review year 2020 is the 12-month period ended July 31, 2020.
Note that the Roadmap is not a substitute for the exercise of professional judgment, which is often essential to complying with the applicable accounting and disclosure requirements. It is also not a substitute for consulting with Deloitte professionals on complex transactions and SEC reporting matters.

We hope you find the 2020 edition — and other publications on DART — useful resources as you prepare your annual reports and plan for the upcoming year. In line with the SEC’s disclosure effectiveness initiative, we encourage you to consider materiality, relevance, and redundancy as you assess whether to provide additional disclosures or enhance existing ones.

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

Sincerely,

Deloitte & Touche LLP
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Chapter 1 — Before the Details: Trends and Priorities

1.1 Overview

Despite the global pandemic that rocked the world in 2020, the SEC remained fully operational under Chairman Jay Clayton’s leadership by quickly transitioning to a mandatory telework environment in early March. As the COVID-19 pandemic has evolved, the SEC has provided guidance and offered companies regulatory relief as well as emphasized the importance of timely, high-quality financial reporting in the current environment, issuing over 50 different statements, orders, and pieces of interpretive guidance. Notwithstanding the incremental workload caused by the pandemic, the SEC’s planned oversight, rulemaking, and enforcement work continues, and the following priorities may be helpful for registrants to consider as they start to prepare for the 2020 annual reporting cycle:

- **Investor protection** — In working to protect investors, the SEC is guided by five core principles: (1) focus on the retail investor, (2) hold individuals accountable, (3) keep pace with technological change, (4) impose remedies that most effectively further enforcement goals, and (5) continually assess the allocation of SEC resources. During fiscal year 2020, the Commission brought over 700 actions, many of which were accomplished in the telework environment. The SEC obtained over $4 billion in financial remedies and awarded to 39 individual whistleblowers approximately $175 million — significantly more than in any prior fiscal year.

- **Rulemaking and facilitating capital formation** — The SEC in recent years has been active in rulemaking, having issued a number of rule proposals and final rules, as well as Commission guidance intended to modernize and improve the disclosure regime for the benefit of both registrants and investors. This significant rulemaking activity continues to reflect the SEC’s efforts to facilitate capital formation by making initial public offerings (IPOs) more attractive while continuing to protect investors.

- **Disclosures about evolving risks** — The SEC has been devoting more attention to disclosures about evolving risks. As global markets evolve and information technology advances, the Commission continues to focus on registrants’ disclosures related to matters such as cybersecurity, Brexit, LIBOR transition, intellectual property (IP) and technology risks, and the effects of COVID-19. See Section 3.3.2 for additional information.

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1 For more information about the SEC’s rulemaking activity, see Deloitte’s August 28, 2018; March 25, 2019; February 10, 2020; March 10, 2020; March 19, 2020; June 2, 2020; September 3, 2020; and October 8, 2020, Heads Up newsletters.
• **Rule 3-13 financial statement waivers** — The SEC staff has historically placed a high priority on registrants’ requests to seek modifications to their financial reporting requirements under Regulation S-X, Rule 3-13, particularly when the requirements are burdensome but may not be material to the total mix of information available to investors. While many of the recent rulemaking activities (e.g., those that improve disclosures for business acquisitions) are intended to modernize the requirements and are expected to reduce the number of waivers granted, registrants may still seek modifications to their reporting requirements under Rule 3-13 as the SEC staff continues to entertain those requests. For further discussion, see Section B.2.

• **New and recent accounting standards** — The adoption of new and recent accounting standards, including the revenue, leasing, and credit losses standards, is critical to the financial reporting system given the pervasiveness of the changes. Therefore, the Commission continues to focus on the successful implementation of new accounting standards, including the accounting, disclosures, and related internal control over financial reporting (ICFR).

To help the SEC meet its responsibilities under the Sarbanes-Oxley Act, the SEC’s Division of Corporation Finance (the “Division”) continues to selectively review documents filed by registrants under the Securities Act of 1933 (the “Securities Act”) and the Securities Exchange Act of 1934 (the “Exchange Act”). Under the Division’s filing review process, the Division performs some level of review of each registrant at least once every three years (referred to as a “filing review”). However, many registrants are reviewed more frequently, and they may or may not receive a comment letter from the Division. During fiscal year 2020, the Division staff reviewed the filings of more than 3,500 reporting companies and the registration statements of more than 800 IPOs and initial registration statements.

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

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2 Unless noted otherwise, comment letter trend information in this publication:
- Was derived from data provided by Audit Analytics.
- Is related to reviews of Forms 10-K, 10-K/A, 10-Q, and 10-Q/A (which are referred to generally as “filings”).
- Is based on SEC uploads (i.e., comment letters that the SEC issued to registrants) and does not include registrant responses.
- Does not include the SEC’s “closing letter” communicating that its review is complete.
- Includes only information related to reviews that have been closed and subsequently posted to EDGAR. Accordingly, the statistics presented in the tables and charts below may be affected by reviews that are still ongoing or have recently been closed.
- Pertains to 12-month periods ended July 31 ("review years").
- May be different upon comparisons with the 2019 edition of this publication because additional 2019 reviews were closed and posted to EDGAR after that edition was issued.
## 1.2 Top 10 Topics in Reviews

The following table summarizes comment letter trends by topic in the 12-month periods ended July 31, 2020 ("review year 2020" or the "current year"), and July 31, 2019 ("review year 2019" or the "prior year").

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<thead>
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<th>Topic</th>
<th>Review Year 2020</th>
<th>Review Year 2019</th>
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<tr>
<td></td>
<td>Number of Reviews With a Comment on Topic</td>
<td>Percentage of All Reviews</td>
</tr>
<tr>
<td>MD&amp;A: Results of operations</td>
<td>100</td>
<td>20%</td>
</tr>
<tr>
<td>Critical accounting policies and estimates</td>
<td>29</td>
<td>6%</td>
</tr>
<tr>
<td>Liquidity</td>
<td>37</td>
<td>7%</td>
</tr>
<tr>
<td>Contractual obligations</td>
<td>7</td>
<td>1%</td>
</tr>
<tr>
<td>Non-GAAP measures</td>
<td>153</td>
<td>31%</td>
</tr>
<tr>
<td>Revenue recognition</td>
<td>105</td>
<td>21%</td>
</tr>
<tr>
<td>Segment reporting</td>
<td>72</td>
<td>14%</td>
</tr>
<tr>
<td>Signatures, exhibits, and agreements</td>
<td>51</td>
<td>10%</td>
</tr>
<tr>
<td>ICFR</td>
<td>41</td>
<td>8%</td>
</tr>
<tr>
<td>Fair value</td>
<td>38</td>
<td>8%</td>
</tr>
<tr>
<td>Contingencies</td>
<td>37</td>
<td>7%</td>
</tr>
<tr>
<td>Intangible assets and goodwill</td>
<td>35</td>
<td>7%</td>
</tr>
<tr>
<td>Inventory and cost of sales</td>
<td>34</td>
<td>7%</td>
</tr>
</tbody>
</table>

The topics that constitute this year's top 10 list remain largely consistent with last year's list. While non-GAAP measures was nudged out of the top spot by MD&A, the number of comments on non-GAAP measures remained high, making the topic a close second behind MD&A. The increase in MD&A comments is primarily attributable to the increase in comments on results of operations, which highlights the staff's continuing focus on greater transparency and specificity in disclosures about a registrant's operating results. The decline in the number of revenue recognition comments is not surprising in light of the fact that most registrants successfully adopted the new revenue standard (codified primarily in ASC 606) before or during review year 2019. In addition, we saw two new topics join the top 10 this year: (1) contingencies and (2) inventory and cost of sales.

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

4 The number of reviews with a comment in 2020 may be subject to change as more 2020 reviews with comment letters are posted to EDGAR.
The top 10 topics in reviews with comment letters issued in review year 2020 are as follows:

1. **MD&A** — The fact that MD&A remains a leading source of SEC staff comments reflects the staff's continuing sentiment that registrants should “tell their story” in MD&A to allow investors to see the company “through the eyes of management.” While the staff's comments have addressed various topics of MD&A, the comments 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) critical accounting estimates, and (4) contractual obligations. More recently, SEC staff comments on COVID-19 have focused on (1) the pandemic's impact on future operating results and future financial condition, (2) known trends or uncertainties related to COVID-19 that will have a material favorable or unfavorable impact on income from continuing operations, and (3) discussions of current liquidity and availability of financial resources.

2. **Non-GAAP measures** — Although the number of reviews with comments on this topic has continued to decline since its peak in 2017, non-GAAP measures remains one of the top topics in review year 2020. Since the SEC staff continues to monitor registrants' use of non-GAAP measures, registrants should be mindful of the key focus areas, which include (1) whether there is undue prominence of non-GAAP measures, (2) enhancing the disclosure related to the purpose and use of such measures, (3) identification and clear labeling of non-GAAP measures, (4) whether measures are appropriately characterized as liquidity or performance measures, (5) reconciliation requirements, (6) whether the nature of certain adjustments may be potentially misleading or could represent tailored accounting, and (7) the lack of presentation of the tax impact of non-GAAP adjustments.

3. **Revenue recognition** — Some notable themes identified in our review of comment letters related to the revenue standard are (1) disclosure of significant judgments exercised in applying the standard, (2) accounting for performance obligations, (3) capitalization of contract costs, (4) disaggregation of revenue, (5) contract balances, and (6) remaining performance obligations. The largest volume of revenue-related comments focused on the disclosure of significant judgments exercised in applying the standard. Comments on such significant judgments address an array of revenue issues, including (1) the identification of performance obligations, (2) the determination and allocation of the transaction price, and (3) the identification of a measure of progress. Broadly, the SEC staff cautioned against using boilerplate language in disclosures; rather, registrants should provide disclosures that faithfully depict their revenue recognition practices and related accounting policies in a tailored manner.

4. **Segment reporting** — Segment reporting continues to be a significant source of SEC comments in review year 2020. Like comments on segment reporting issued in previous years, recent ones have specifically addressed (1) the identification and aggregation of operating segments, (2) changes in reportable segments, (3) reporting considerations for entities with a single reportable segment, and (4) entity-wide disclosures regarding products, services, or both.

5. **Signatures, exhibits, and agreements** — The SEC has specific requirements related to certain signatures, exhibits, and agreements that must be filed with a registrant's financial statements. With respect to those rules, the SEC staff continues to issue comments related to (1) the form and content of a registrant's quarterly and annual certifications and (2) material contracts, including requests for them to be filed as exhibits.
6. **ICFR** — Comments on ICFR in the current year primarily focused on registrants’ (1) evaluation of the severity of control deficiencies, including those related to immaterial misstatements; (2) evaluation of deficiencies identified in COSO components other than control activities; (3) disclosures of material changes in ICFR, including the impact and remediation of material weaknesses; (4) conclusions that ICFR remains effective after a restatement; (5) disclosures about the framework used to evaluate ICFR; and (6) incomplete or missing ICFR evaluations.

7. **Fair value** — The staff continues to ask registrants about (1) valuation techniques and inputs used in fair value measurements (including disclosure requirements for recurring and nonrecurring fair value measurements) and (2) the use of third-party pricing services. In addition, the staff frequently comments on fair value estimates, including those related to revenue recognition, goodwill impairment, and share-based payments.

8. **Contingencies** — Although the accounting and disclosure framework for contingencies has been in place for many years, the staff has increased its focus on this topic. Comments on contingencies in the current year primarily focused on whether (1) disclosures provide specificity and quantification of amounts accrued, (2) estimates and disclosures for reasonably possible losses or ranges of possible losses were provided, and (3) disclosures related to loss contingencies have been evaluated and updated over time as facts and circumstances change.

9. **Intangible assets and goodwill** — The SEC staff continues to comment on (1) goodwill impairment disclosures, including early-warning disclosures and the specific events and circumstances that led to the charge in the period of impairment rather than general market factors; (2) asset groupings for goodwill impairment testing (i.e., the identification and composition of reporting units); and (3) whether or why an interim impairment test was performed and the results of any such interim impairment test. In addition, the SEC staff comments on intangible assets recognized in a business combination, including the useful lives of identified intangible assets and how the fair value of those intangible assets was determined.

10. **Inventory and cost of sales** — Comments on inventory in the current period have been primarily related to accounting policy disclosures regarding inventory valuation, and, in particular, adjustments related to excess and obsolete inventories. In addition, the SEC staff commonly asks registrants about their cost of sales and gross profit measures and requests disclosure of the types of expenses that are included in or excluded from such measures.

A number of the aforementioned trends are likely to continue in years to come given the consistency of topics seen year over year. While it is difficult to predict what new comment letter trends are on the horizon, we look to the Commission’s priorities to help us predict topics of focus in the coming year. In light of those priorities, we may see a continued focus on the accounting and disclosures under the new and recent accounting standards, with a focus on disclosures related to the application of the new credit losses standard. New SEC disclosure rules and interpretive guidance related to significant acquisition and dispositions, pro forma financial information, registered debt securities, human capital resources, and key performance indicators and metrics may result in increased focus and scrutiny from the staff. We also expect the staff to continue to monitor the effects of the COVID-19 pandemic and perhaps focus future comments on accounting and reporting related to the pandemic and the associated economic uncertainty. As noted in the following section, we have recently started to see public comments related to the pandemic, and we believe it is likely that the staff will continue to focus on this issue in the coming year.
1.3 Preliminary COVID-19 Comment Letter Trends

The current review year 2020 coincided with several months of the COVID-19 pandemic, which has affected virtually all industries and resulted in unprecedented challenges for businesses. As of the date of this publication, we have only started to see early comments from the SEC staff on registrants’ disclosures related to the pandemic and its impacts. We believe that this trend may have resulted from (1) the SEC staff’s retrospective review of filings (i.e., its review of historical financial results is performed only after they have been filed with the SEC) and the public release of comments on a delayed basis, as discussed elsewhere throughout this chapter, and (2) the staff’s proactive approach in issuing guidance on what its expectations are for registrants’ disclosures regarding the COVID-19 pandemic’s current and potential future impact on registrants. Specifically, in CF Disclosure Guidance (CFDG) Topic 9 (issued March 25, 2020) as well as CFDG Topic 9A (issued June 23, 2020), the SEC staff provided a series of illustrative questions for registrants to consider when developing disclosures related to the current and expected future impact of COVID-19. As a result, registrants have insight into what areas the staff may be focusing on and are able to proactively address those areas in their disclosures.

On the basis of the early comments that we have seen, it is clear that the SEC staff expects registrants to disclose material risks and uncertainties related to COVID-19. As mentioned above, the staff has focused its comments on registrants’ MD&A disclosures regarding the pandemic’s historical and future impact on the registrant’s financial condition, results of operations, and liquidity. In addition, the staff has commented on registrants’ risk factor disclosures regarding the known or reasonably likely effects of the pandemic and the types of risks presented by the outbreak. Thus far, the number of comments issued by the SEC staff related to the COVID-19 pandemic has been limited; however, we expect that MD&A and risk factor disclosures related to COVID-19 will be a focus for the staff going forward.


1.4 Reviews With Comment Letters and Number of Comment Letters Trending Downward

The following charts show, for each of the review years 2016 through 2020, (1) the number of reviews with comment letters and (2) the total number of SEC comment letters issued:

* The 2020 review information may be affected by reviews that are still ongoing or that will be made public after the release of this publication. Historically, the number of reviews with comment letters and the number of comment letters increased by approximately 16 percent and 14 percent, respectively, as more reviews with comment letters were posted to EDGAR following the release of this annual publication.
As the charts above illustrate, there has been a notable decline over the past five years in the number of reviews with comment letters and the number of comment letters issued. The SEC staff observed at the 2018 AICPA Conference that this trend demonstrates the effectiveness of the review process and improved financial reporting by registrants, which the staff suggested may have resulted from the following:

- **Registrants’ ability to view comments published on EDGAR and subsequently improve their reporting and disclosures** — Registrants have access to comment letters via EDGAR and thus have visibility into what the SEC staff focuses on when commenting on certain disclosures. To enhance that ability, law firms and accounting firms have issued publications (similar to this publication) that highlight comment letter trends and financial reporting best practices.

- **More frequent filing reviews** — While the Sarbanes-Oxley Act requires the SEC to review registrants at least once every three years, data indicate that the Division reviews some registrants more often. As a result, such registrants have a strong understanding of what the SEC staff is looking for in their filings and have been proactive in addressing issues accordingly.

- **More selective use of comments** — Given the SEC’s focus on its disclosure effectiveness initiative and the impact that comment letters may have on disclosures in registrants’ filings, the Division issues concise and tailored comments focused on key topics and material disclosures.

- **More active communication with the SEC** — The SEC staff may reach out to registrants by phone to facilitate timely closure of an ongoing SEC staff review (see Section B.1.1).

### 1.5 Comment Letters per Review and Days to Complete a Review

#### 1.5.1 Comment Letters per Review

The following chart shows, for each of the review years 2016 through 2020, the percentage breakdown of the number of comment letters per review:

*The 2020 review information may be affected by reviews that are still ongoing or that will be made public after the release of this publication. Historically, the percentage of reviews resolved with two or fewer comment letters did not significantly change as more reviews with comment letters were posted to EDGAR following the release of this annual publication.*
In review years 2016 through 2020, the average number of comment letters issued per review was approximately 1.4 letters per review. For the past five years, approximately 90 percent or more of all reviews were resolved after one or two comment letters. This consistent trend in the number of comment letters per review may be partly attributable to some of the reasons noted above for the overall decrease in reviews with comment letters and the number of comment letters (e.g., outreach to registrants by phone to facilitate timely closure of an ongoing SEC staff review).

1.5.2 Days to Complete a Review

The following chart presents, for each of the review years 2016 through 2020, the percentage breakdown of reviews by the number of days to complete a review:

<table>
<thead>
<tr>
<th>Review Year</th>
<th>121+ days</th>
<th>91-120 days</th>
<th>61-90 days</th>
<th>31-60 days</th>
<th>1-30 days</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016</td>
<td>8%</td>
<td>6%</td>
<td>11%</td>
<td>30%</td>
<td>45%</td>
</tr>
<tr>
<td>2017</td>
<td>7%</td>
<td>4%</td>
<td>9%</td>
<td>32%</td>
<td>48%</td>
</tr>
<tr>
<td>2018</td>
<td>7%</td>
<td>6%</td>
<td>10%</td>
<td>26%</td>
<td>51%</td>
</tr>
<tr>
<td>2019</td>
<td>7%</td>
<td>5%</td>
<td>12%</td>
<td>27%</td>
<td>49%</td>
</tr>
<tr>
<td>2020*</td>
<td>3%</td>
<td>7%</td>
<td>27%</td>
<td>60%</td>
<td>3%</td>
</tr>
</tbody>
</table>

* The 2020 review information may be affected by reviews that are still ongoing or that will be made public after the release of this publication. Historically, the percentage of reviews completed in fewer than 60 days decreased by an average of approximately 7 percent as more reviews with comment letters were posted to EDGAR following the release of this annual publication.

In the period from review year 2016 through review year 2020, it took approximately 46 days on average to complete a review. During that same period, an average of more than 75 percent of reviews were completed within 60 days; this trend has remained relatively consistent over the past five years.

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

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Note: The number of days to complete a review was calculated by determining the number of days between the initial comment letter date and the closing letter date.
1.6 Topics Addressed per Initial Comment Letter

The following chart illustrates the average number of topics discussed in an initial comment letter for review years 2016 through 2020:

While there had been a steady decline in the average number of topics discussed per initial comment letter since review year 2016, we saw the average remain relatively flat (from 2.1 in the prior year to 2.2 in the current year). The overall decline may be attributable to some of the reasons noted above for the overall decrease in the number of comment letters and reviews with comment letters (e.g., improved financial reporting by registrants, more selective use of comments).

1.7 Reviews by Filing Status and Revenue

1.7.1 Reviews by Filing Status

On June 28, 2018, the SEC issued a final rule that amended the definition of a “smaller reporting company” (SRC) to expand the number of companies that qualify for this classification and therefore able to take advantage of the scaled disclosure requirements that apply to such entities. The final rule became effective on September 10, 2018; consequently, certain registrants may qualify as (1) an SRC and a nonaccelerated filer, or (2) an SRC and an accelerated filer. On March 12, 2020, the SEC issued a final rule that amends the eligibility criteria for nonaccelerated filer status to include issuers that qualify as SRCs with annual revenues of less than $100 million and public float of less than $700 million. The final rule became effective on April 27, 2020, and it more closely, although not completely, aligns an issuer's filing status determination with the previously amended SRC definition.

Notwithstanding the recent changes in the filing status definitions, it is interesting to consider the filing status of registrants in the evaluation of comment letter trends and statistics. For example, large accelerated filers have consistently been subject to the most reviews with comment letters. That information, however, is more meaningful when considered in relation to the percentage of registrants within each filing status classification. For example, in review year 2020, large accelerated filers continue to be subject to a disproportionately higher number of reviews, whereas nonaccelerated filers are subject to disproportionately fewer reviews. More specifically, in review year 2020, accelerated and large accelerated filers were subject to over 70 percent of reviews with comment letters although they represented only about 50 percent of the Forms 10-K that were eligible for a filing review date.

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

1.7.2 Reviews by Revenue

Although a registrant’s filing status is generally determined on the basis of its public float, companies with larger public floats generally produce more revenue. As a result, it is no surprise that companies that generate more revenue have been party to a disproportionately higher number of reviews with comment letters than companies that generate less revenue. More specifically, in review years 2016 through 2020, on average, (1) registrants generating $1 billion or more of revenue were subject to approximately 48 percent of reviews with comment letters although they represented only about 24 percent of the Forms 10-K that were eligible for a filing review, and (2) registrants generating less than $500 million in revenue were subject to approximately 42 percent of reviews with comment letters although they represented approximately 68 percent of the Forms 10-K that were eligible for a filing review.

1.8 Top Five Topics in Reviews by Industry

The table below lists the top five topics addressed in comment letters, organized by various industries, for the current year. See Chapter 6 for further details on industry trends, by sector. The identified top five topics for each industry that are not specifically discussed in the corresponding industry sections of Chapter 6 are discussed more broadly in Chapters 2 and 3.

<table>
<thead>
<tr>
<th>Industry</th>
<th>Related SEC Comment Letter Roadmap Sections (by Industry Sector)</th>
<th>Top Five Topics</th>
</tr>
</thead>
<tbody>
<tr>
<td>Consumer</td>
<td>6.1.1 Retail, Wholesale, and Distribution</td>
<td>1. MD&amp;A</td>
</tr>
<tr>
<td></td>
<td>6.1.2 Transportation, Hospitality, and Services</td>
<td>2. Non-GAAP measures</td>
</tr>
<tr>
<td></td>
<td></td>
<td>3. Revenue recognition</td>
</tr>
<tr>
<td></td>
<td></td>
<td>4. Segment reporting</td>
</tr>
<tr>
<td></td>
<td></td>
<td>5. Inventory and cost of sales</td>
</tr>
<tr>
<td>Energy, resources, and industrials</td>
<td>6.2.1 Oil, Gas, and Chemicals</td>
<td>1. MD&amp;A</td>
</tr>
<tr>
<td></td>
<td>6.2.2 Power, Utilities, and Renewables</td>
<td>2. Non-GAAP measures</td>
</tr>
<tr>
<td></td>
<td></td>
<td>3. Revenue recognition</td>
</tr>
<tr>
<td></td>
<td></td>
<td>4. Segment reporting</td>
</tr>
<tr>
<td></td>
<td></td>
<td>5. Contingencies</td>
</tr>
</tbody>
</table>
(Table continued)

<table>
<thead>
<tr>
<th>Industry</th>
<th>Related SEC Comment Letter Roadmap Sections (by Industry Sector)</th>
<th>Top Five Topics</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial services — noninsurance</td>
<td>6.3.1 Banking and Capital Markets</td>
<td>1. Non-GAAP measures</td>
</tr>
<tr>
<td></td>
<td>6.3.2 Investment Management</td>
<td>2. MD&amp;A</td>
</tr>
<tr>
<td></td>
<td>6.3.3 Real Estate</td>
<td>3. Acquisitions, mergers, and business combinations</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Fair value (tie)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>5. Revenue recognition</td>
</tr>
<tr>
<td></td>
<td></td>
<td>ICFR (tie)</td>
</tr>
<tr>
<td>Life sciences</td>
<td>6.4 Life Sciences</td>
<td>1. Revenue recognition</td>
</tr>
<tr>
<td></td>
<td></td>
<td>2. Signatures, exhibits, or agreements</td>
</tr>
<tr>
<td></td>
<td></td>
<td>3. MD&amp;A</td>
</tr>
<tr>
<td></td>
<td></td>
<td>4. ICFR</td>
</tr>
<tr>
<td></td>
<td></td>
<td>5. Business overview</td>
</tr>
<tr>
<td>Technology, media, and telecommunications</td>
<td>6.5.2 Telecommunications</td>
<td>1. MD&amp;A</td>
</tr>
<tr>
<td></td>
<td></td>
<td>2. Non-GAAP measures</td>
</tr>
<tr>
<td></td>
<td></td>
<td>3. Revenue recognition</td>
</tr>
<tr>
<td></td>
<td></td>
<td>4. Segment reporting</td>
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<tr>
<td></td>
<td></td>
<td>5. Income taxes</td>
</tr>
</tbody>
</table>

**Other Deloitte Resources**

2.1 Business Combinations
The SEC staff’s comments about business combinations continue to focus on (1) the evaluation of whether a transaction should be accounted for as a business combination or an asset acquisition, (2) the identification of the accounting acquirer, (3) questions about the allocation of the consideration transferred to identified assets acquired and liabilities assumed, (4) accounting for any contingent consideration, and (5) required disclosures.

2.1.1 Business Combination Versus Asset Acquisition

<table>
<thead>
<tr>
<th>Example of an SEC Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td>You recorded the February and December [201X] acquisitions as asset acquisitions. Please tell us, for each acquisition, why you believe the acquisitions are not required to be recorded as an acquisition of a business pursuant to ASU 2017-01. In this [regard], please specifically address the following:</td>
</tr>
<tr>
<td>• As it appears you acquired both tangible and intangible assets in the February acquisitions and the December acquisition appears to relate to assets with significantly different risks, please confirm our understanding that the acquisitions did not meet the “practical screen” in ASC 805-10-55-5A through 55-5C as the term is used in ASC 805-10-55-5. Refer also to the example in ASC 805-10-55-68.</td>
</tr>
<tr>
<td>• Please address each of the criteria in ASC 805-10-55-5E in determining whether or not a substantive process was acquired, that together with the input acquired, significantly contribute to the ability to create outputs.</td>
</tr>
</tbody>
</table>

In January 2017, the FASB issued ASU 2017-01 to clarify the guidance in ASC 805-10 on evaluating whether a transaction should be accounted for as an acquisition of assets or of a business. The FASB issued the ASU in response to stakeholder feedback indicating that the previous definition of a business in ASC 805-10 was being applied too broadly and was difficult and costly to apply. The amendments to ASC 805-10 were intended to make the application of the guidance more consistent and cost-efficient and are expected to result in a reduction in the number of transactions identified as business acquisitions.

ASU 2017-01 introduces a screen for determining when a set of activities and assets is not a business. An entity uses the screen to assess whether substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or group of similar identifiable assets. In accordance with the ASU, if “substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or group of similar identifiable assets, the set is not considered a business.” If such a concentration is not found, the screen is not met, and entities must then apply a framework to determine whether the set is a business. Under the framework, a set is considered to be a business if it includes an input and a substantive process that together significantly contribute to the ability to create outputs.
The SEC staff has asked registrants to provide their analysis regarding their conclusion about whether an acquisition meets the definition of a business underASC 805-10. The correct determination of the nature of the acquisition is critical because there are significant differences between the accounting for a business combination and the accounting for an asset acquisition.

### 2.1.2 Determining the Accounting Acquirer

**Example of an SEC Comment**

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

The SEC staff may ask registrants for the analysis on how they determined the accounting acquirer when it is not clear which entity obtained control in accordance withASC 810.1 For example, the staff may ask registrants to explain how they considered the additional factors inASC 805-10-55-10 through 55-15 in determining the accounting acquirer if the relative ownership interests held by each party are close to 50 percent or if the entity identified as the acquirer obtained less than 50 percent of the ownership interests in the combined entity. Identification of the acquirer may require the exercise of considerable judgment, and a registrant’s response should include its consideration of all pertinent facts and circumstances as of the acquisition date. The staff may also ask similar questions regarding a probable business combination that is reflected in pro forma financial statements.

### 2.1.3 Assigning Amounts to Assets and Liabilities

**Examples of SEC Comments**

- You disclose . . . that you acquired the legal rights, permits, licenses and assets of [various entities]. However, it appears the purchase prices were allocated entirely to licenses. Please tell us why the purchase prices were not allocated to other assets and/or liabilities acquired.
- We note your acquisition of [Entity B] and Subsidiaries and your disclosure that it will expand your [product offering] in North America and allow you to diversify your business, leverage your distribution network and infrastructure and increase your market reach. Additionally, you stated the transaction is expected to provide synergies, enhancing your ability to better serve your combined customers’ needs for healthier products. Given the magnitude of the amount of goodwill recognized, please explain further the specific synergies you identified, relative magnitude of each, and consideration for including such discussion in your disclosures. Also, please explain to us in performing the purchase price allocation, how you evaluated the purchase for the existence of any other intangible assets.

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

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1 ASC 810 indicates that one entity controls another if it holds a “controlling financial interest.” In addition, ASC 810 prescribes criteria for determining which entity has obtained control.
The staff may also ask detailed questions about material revisions to the initial accounting for a business combination, including what significant assumptions have changed to support a revision to the value of acquired assets. For example, the staff may ask a registrant the reasons that led to the recognition of a significant amount of intangible assets during the measurement period if no amount, or only an insignificant amount, of intangible assets was recognized as part of the initial accounting for the business combination.

Further, if a registrant sold a recently acquired asset and recognized a significant gain on the sale, the staff may request information about how the registrant determined the fair value of that asset.

### 2.1.4 Contingent Consideration

**Example of an SEC Comment**

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

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

### 2.1.5 Disclosures

**Examples of SEC Comments**

- Please clarify for us why you were not able to provide the pro forma information for each of the . . . acquisitions pursuant to ASC 805-10-50-2.h.3 which is based on historical information prior to the acquisitions.
- The acquisitions of [Entity A] in [201X] represented approximately [A]% of total assets at June 30, [201X] and [Entity B] in [201Y] represented approximately [B]% of total assets at December 31, [201X]. You disclose each acquisition as a factor affecting the variance in results in the applicable periods affected without quantifying the impact of each. You disclose you did not present the pro forma results of the acquisitions because you believe they are not material to your results. Also, you did not disclose the revenue and earnings of each acquiree since the acquisition date included in your consolidated statement of earnings for the applicable periods. Please explain to us your analysis of ASC 805-10-50-2.h.1 and 3 in the preparation of your disclosures. Quantify for us the impact each acquisition had on your results for [201X] and through June 30, [201Y], as appropriate, as a variance factor and in regard to the amount of revenue and earnings included in the consolidated statement of earnings.
ASC 805-10-50-2(h) requires the following disclosures when comparative financial statements are presented, unless disclosure of such information is impracticable:

- “The amounts of revenue and earnings of the acquiree since the acquisition date included in the consolidated income statement for the reporting period.”
- The “revenue and earnings of the combined entity as though the business combination(s) that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period (supplemental pro forma information).”
- “The nature and amount of any material, nonrecurring pro forma adjustments directly attributable to the business combination(s) included in the reported pro forma revenue and earnings (supplemental pro forma information).”

If disclosure of any of the information required by ASC 805-10-50-2(h) is impracticable, the registrant must disclose that fact and why the otherwise required disclosure is impracticable.

The SEC staff has commented when a registrant fails to provide pro forma disclosures under ASC 805-10-50. The staff may also ask a registrant to clarify how it determined that disclosure of some or all of the information required by ASC 805-10-50-2(h) is impracticable since use of the impracticability exception is expected to be infrequent.

If certain criteria are met (e.g., if a significant business combination has occurred or is probable), registrants may also be required to (1) comply with Regulation S-X, Rule 3-05, and (2) provide pro forma financial information that complies with Regulation S-X, Article 11, in a registration statement, proxy statement, or Form 8-K. For additional information about significant business acquisitions, see Section 3.2.2.

In addition to inquiring about pro forma disclosures, the SEC staff has asked registrants:

- To indicate the item or items for which the measurement period is still open.
- To disclose the amount and the income statement classification of acquisition-related costs they incurred (e.g., due diligence fees, legal fees).
- Whether individually immaterial acquisitions are collectively material, in which case the registrants would be required to disclose certain information.
- Whether a transaction is considered to be an acquisition of an entity under common control.

Other Deloitte Resources

A Roadmap to Accounting for Business Combinations

2.2 Consolidation

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

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

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

Examples of SEC Comments

- We note from your prior response that you believe you should consolidate [the legal entity] under either the variable interest or voting interest models. Please tell us how you considered ASC 810-10-15-14 in determining whether [the legal entity] has the characteristics of a variable interest entity.

- Please describe to us the changes in the capital structure of [the legal entity] and in its contractual relationships with [you, as the reporting entity] that resulted in your conclusion that you are no longer its primary beneficiary and that you should deconsolidate [the legal entity]. Explain to us in appropriate detail how these specific changes support your conclusion that you are no longer the primary beneficiary of the variable interest entity. Refer to the guidance provided in ASC 810-10, including ASC 810-10-35-4.

- Please tell us how you concluded you are the primary beneficiary of [the VIEs] considering your disclosure that the power to direct the activities of the VIEs is shared. In addition, tell us why the general partners of the limited partnerships do not have standalone power given that they only need your consent over certain activities. Please refer to FASB ASC 810-10-25-38D.

- It appears that your conclusion for being the primary beneficiary of the subject entities is based upon your power arising from your capacity as a decision maker (“manager”). Please explain to us, in detail, your consideration of the guidance in ASC 810-10-55-37 to 37D and 55-38.

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. Given that the SEC staff continues to focus on consolidation conclusions under ASC 810-10, it often asks registrants to (1) explain their involvement with, and the structure of, VIEs; (2) provide detailed support for their conclusions about whether an entity is a VIE (including the consolidation model they ultimately used); (3) discuss the basis for their determination of whether they are the primary beneficiary of a VIE; and (4) discuss any events affecting their previous consolidation conclusion (e.g., events that result in deconsolidation).

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2 Registrants should consider whether consolidating a VIE meets the significance thresholds for reporting under Item 2.01 of Form 8-K and Regulation S-X, Rule 3-05. For additional information about Rule 3-05, see Section 3.2.2.
2.2.2 Required Disclosures for VIEs

Example of an SEC Comment

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

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

Other Deloitte Resources

A Roadmap to Consolidation — Identifying a Controlling Financial Interest

2.3 Contingencies

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

The staff frequently comments on:

- Lack of specificity regarding the nature of the matter.
- Lack of quantification of amounts accrued, if any, and possible loss or range of loss and/or disclosure about why such an estimate cannot be made.
- Insufficient detail about judgments and assumptions underlying significant accruals.
- 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 of 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.
### 2.3.1 Loss Contingencies

<table>
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<tr>
<th>Examples of SEC Comments</th>
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<tr>
<td>• With respect to the cyber-security incident and related assessments and litigation, please tell us your consideration of the requirement in ASC 450-20-50-4.b. to disclose an estimate of the possible loss or range of loss or to disclose that such an estimate cannot be made.</td>
</tr>
<tr>
<td>• We note your disclosure regarding the . . . claims that the litigation trust filed against you and certain of your current and former officers and directors relating to [Matter A]. . . . Please expand your disclosure to specify your estimate of reasonably possible loss or the range of reasonably possible loss pertaining to this matter. If you have not prepared an estimate and are unable to estimate such amount or range, you must include a statement that such an estimate cannot be made to comply with FASB ASC 450-20-50-3 and 4. If this is the case, disclose the amount of damages that are being sought and which have been quantified, and identify any aspects of the litigation for which the amount of damages claimed remain unspecified. Also revise your disclosure to conform to the terminology guidance in FASB ASC 450-20-50-1, or clarify your reserve reference.</td>
</tr>
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</table>

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

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

The SEC staff may also ask about (1) the basis for a registrant's accrual (e.g., factors supporting an accrual, such as trends in claims received and rejected), (2) the timing of a loss contingency's recognition, and (3) the disclosure of a loss contingency. In addition, when a material settlement is disclosed during the period, the staff may review prior-period disclosures to determine whether such disclosures were appropriate (i.e., whether the registrant should have provided early-warning disclosures about the possibility of incurring or settling a loss in future periods to help financial statement users understand these risks and how they could potentially affect the financial statements) or whether an accrual should have been recognized in a prior period. See Section 3.1 for additional information about early-warning disclosures.
2.3.2 Litigation Contingencies

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

Changing Lanes

On August 26, 2020, the SEC issued a final rule that amends Regulation S-K, Item 103. The final rule permits the use of hyperlinks or cross-references to disclosures about legal proceedings that were included elsewhere in the document provided that the hyperlink or cross-reference does not make reference from such financial statements to other areas outside of the financial statements (e.g., Item 103). The final rule also updates the disclosure threshold for environmental proceedings. Before the amendment, Instruction 5.C. to Item 103 required disclosure of environmental proceedings to which the government was a party if such a proceeding was expected to result in sanctions of $100,000 or more. The final rule increases the quantitative threshold to $300,000 but also permits the registrant to elect an alternative higher threshold if the registrant determines that such threshold is more reasonably designed to result in the disclosure of material environmental proceedings. If so, the alternative higher threshold is limited to the lesser of $1 million or 1 percent of its current assets on a consolidated basis. A registrant must disclose this alternative threshold in each annual and quarterly report.

2.3.3 Asset Retirement Obligations

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<th>Examples of SEC Comments</th>
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<tr>
<td>• Please tell us your consideration of recording asset retirement obligations in connection with the future removal of gasoline tanks from your gasoline stations. Refer to ASC 410.</td>
</tr>
<tr>
<td>• We note your disclosures . . . regarding the challenges faced by your nuclear generating stations and the resulting potential for early retirement or shutdown of the [Facility 1] and [Facility 2] nuclear units, as well as your disclosure that [Segment A] recorded an increase to its [asset retirement obligation (ARO)] liabilities primarily due to a higher assumed probability of early retirement of its nuclear units. Please tell us your consideration of providing additional critical accounting policy disclosure that allows for an assessment of the probability, magnitude and timing of future material charges associated with early retirement or shutdown of these units, along with a description of the specific events and/or changes in circumstances that could reasonably be expected to result in early retirement or shutdown. Refer to Section V of SEC Release 34-48960 and Item 303(a)(3)(ii), which requires a description of a known uncertainty.</td>
</tr>
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The SEC staff may ask about a registrant’s legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development, and normal operation of such assets. Accordingly, a registrant should carefully evaluate whether, as a result of assets capitalized as long-lived assets, there are AROs under ASC 410-20-15-2. Further, the staff may ask a registrant how it may be affected by changes to existing AROs. If a material impact is expected, the staff may ask the registrant to disclose the potential impact and the associated uncertainty.

Other Deloitte Resources

- A Roadmap to Accounting for Contingencies, Loss Recoveries, and Guarantees
- A Roadmap to Accounting for Environmental Obligations and Asset Retirement Obligations
2.4 Debt

2.4.1 Restrictions

Example of an SEC Comment

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

The SEC staff may comment on restrictions that limit a registrant's ability to pay dividends or transfer funds within a consolidated group. When the transfer of assets (cash or other funds) to the parent company/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 disclosure of such restrictions, an investor may presume that the registrant (at the parent or subsidiary level) has more discretion to transfer funds or pay cash dividends than is actually the case.

If Rule 4-08(e) applies, registrants must disclose in the notes to the financial statements a description of “the most significant restrictions 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 such disclosure would be considered material. Disclosures required under Rule 4-08(e)(3) consist of the following:

- 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; consequently, registrants must consider both rules to determine what is required. Given the materiality-based threshold for footnote disclosures under Rule 4-08(e), if Schedule I is required, footnote disclosures under Rule 4-08(e) may also be 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.

2.4.2 Financial Covenant Disclosures

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<th>Example of an SEC Comment</th>
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<tr>
<td>We note that [Company A] was in compliance with the terms of their financial covenants in the Credit Agreement and Purchase Agreement as of December 31, [201X] and June 30, [201Y]. You disclose that due to the low commodity price environment, it is possible that the total leverage ratio financial covenant may not be met at some point during [201Y] without further action. Please revise your disclosure to explain the reasonably likely impact of any breach on your financial condition or operating performance and identify any alternate sources of funding. Refer to Item 303(a)(1) of Regulation S-K and, for further guidance, section IV.C. of SEC Release No. 33-8350.</td>
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</table>

It is important for a registrant to consider providing disclosures about covenant compliance in MD&A to illustrate its financial condition and liquidity. These disclosures may include a discussion of (1) the terms of the most severe covenants and how the registrant has complied with those covenants, (2) waivers obtained from lenders and the likelihood of failing a covenant or obtaining a waiver in the future, and (3) the impact of noncompliance on the registrant's financial condition and liquidity. In addition, a registrant may present a table that compares its most material actual debt covenant ratios as of the latest balance sheet date with the minimum and maximum amounts permitted under debt agreements. Such transparent disclosures will enable investors to better understand the risk of future covenant noncompliance by the registrant.

For additional discussion on liquidity, see Section 3.1.3.

2.4.3 Classification as Debt or Equity

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

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(2) states, in part, that “ASR 268 requires preferred securities that are redeemable for cash or other assets to be classified outside of permanent equity if they are redeemable (1) at a fixed or determinable price on a fixed or determinable date, (2) at the option of the holder, or (3) upon the occurrence of an event that is not solely within the control of the issuer.” ASC 480-10-S99-3A also notes the SEC staff's belief that ASR 268 can be applied analogously to other redeemable instruments.

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

See Section 2.15 for more information about redeemable noncontrolling interests. See Section 2.8.1 for considerations related to embedded conversion features.

Other Deloitte Resources

A Roadmap to Distinguishing Liabilities From Equity

2.5 Discontinued Operations, Assets Held for Sale, and Restructuring Charges

2.5.1 Discontinued Operations and Assets Held for Sale

Under ASC 205-20, a disposal should be presented as a discontinued operation if it “represents a strategic shift that has (or will have) a major effect on an entity’s operations and financial results.” ASC 205-20 does not define the terms “strategic shift” or “major.” Therefore, the determination of whether a disposal qualifies for discontinued-operations reporting requires (1) an assessment of both qualitative and quantitative factors and (2) the use of judgment. Accordingly, the SEC staff has asked registrants to provide more information about how they concluded that a disposal either did or did not qualify for discontinued-operations presentation.

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

- The timeline of events leading to the sale.
- The company’s consideration of the factors used to determine whether assets qualify for classification as held for sale, especially, when assets have been classified as held for sale for an extended period or when assets are not classified as held for sale at the end of a reporting period but are sold shortly thereafter.

In addition, the SEC staff has commented when a registrant that presented income or loss from discontinued operations failed to provide disclosures about discontinued operations as required under ASC 205-20-50.

The SEC staff may ask questions about the timing of impairment testing when assets are classified as held for sale or are disposed of. For example, the staff may ask whether assets that the registrant...
expects to sell or dispose were tested for impairment in prior periods. See Sections 2.11 and 3.1 for further discussion of long-lived-asset impairment testing and early-warning disclosures, respectively.

2.5.2 Restructuring Charges

**Examples of SEC Comments**

- We note your disclosure that . . . you identified annual reductions in SG&A in the amount of $[X] to $[Y] million. Please also provide the footnote disclosures required by ASC 420-10-50 related to your restructuring activities.
- You incurred $[X] million of [restructuring] costs compared to your pre-tax income of $[Y] million for the [six-month period]. The only disclosures provided related to these costs appear to be that they were incurred to support the transformation of the . . . business. We also note that you exclude these costs from your determination of Adjusted EBITDA. Please provide the disclosures required by ASC 420-10-50 and SAB Topic 5.P.4 related to these [restructuring] costs. Please ensure your disclosures specifically address the nature of these costs including the transformation that you are referring to and whether you expect to incur additional costs related to this transformation.

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

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

**Other Deloitte Resources**

*A Roadmap to Impairments and Disposals of Long-Lived Assets and Discontinued Operations*

2.6 Earnings per Share

While SEC comments on EPS have focused on the calculation of EPS and related disclosures, more recent comments have also concentrated on the use of non-GAAP EPS measures. For additional considerations related to non-GAAP measures, see Section 3.4.

2.6.1 Two-Class Method

**Example of an SEC Comment**

You disclose . . . that the holders of your preferred stock are entitled to receive non-cumulative dividends in an amount equal to or greater than those declared to holders of common stock out of funds legally available if and only when declared by the Board of Directors. Disclose how you considered the two-class method under ASC 260-10 for your loss per share calculation purpose. Further tell us how you considered including the preferred stock in the table of potentially dilutive securities that were not included in the calculation of diluted net loss per share.
Under ASC 260-10-45-59A, the two-class method applies to the following securities:

a. Securities that may participate in dividends with common stocks according to a predetermined formula (for example, two for one) with, at times, an upper limit on the extent of participation (for example, up to, but not beyond, a specified amount per share)

b. A class of common stock with different dividend rates from those of another class of common stock but without prior or senior rights.

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

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

Further, the SEC staff expects that a registrant with two classes of common stock will present both basic and diluted EPS for each class regardless of whether either class has conversion rights. See Section 2.8.1 for more information about conversion features.

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

2.7 Fair Value

2.7.1 Valuation Techniques and Inputs

The SEC staff has requested more specific information from registrants related to valuation techniques and inputs used in fair value measurements. Registrants should consider how the fair value disclosure requirements of ASC 820-10-50 apply to their recurring and nonrecurring fair value measurements. More specifically, registrants should provide information about (1) the methods and techniques used to determine fair value and (2) the inputs to those models.3

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3 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.
Under ASC 820-10-50-2(bbb), entities are required to disclose quantitative information about the significant unobservable inputs used in Level 3 fair value measurements. Although this provision contains no explicit guidance on the types of quantitative information an entity should disclose, the example in ASC 820-10-55-103 illustrates quantitative information an entity “might disclose” to comply with 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 inferred 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.

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

**Changing Lanes**

In August 2018, the FASB issued ASU 2018-13, which changes the fair value measurement disclosure requirements of ASC 820. The amendments in the ASU add an incremental requirement for public entities to disclose (1) the range and weighted average used to develop significant unobservable inputs and (2) how the weighted average was calculated for fair value measurements categorized within Level 3 of the fair value hierarchy. However, entities may disclose other quantitative information in lieu of the weighted average if they determine that such information embodies a more reasonable and rational method of reflecting the distribution of significant unobservable inputs used to develop Level 3 fair value measurements. In these cases, entities are not required to disclose their reasons for omitting the weighted average.

ASU 2018-13 is effective for all entities for fiscal years beginning after December 15, 2019, including interim periods therein. Entities are permitted to early adopt any of the ASU’s amendments that remove or modify existing disclosure requirements.

### 2.7.2 Use of Third-Party Pricing Services

**Example of an SEC Comment**

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

The SEC staff continues to ask registrants to describe the procedures they perform to validate fair value measurements obtained from third-party pricing services. The staff has also asked registrants to clarify when and how often they use adjusted rather than unadjusted quoted market prices and to disclose why prices obtained from pricing services and securities dealers were adjusted. If multiple quotes were obtained, the SEC staff may request information about how the registrant determined the ultimate value used in the financial statements.
2.8 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 and (2) classification of financial instruments.

2.8.1 Embedded Derivatives in Hybrid Instruments

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<tr>
<td>• Please tell us in sufficient detail how you account for the €[X] million Dublin Convertible Preferred shareholder loans. In doing so, tell us how you analyzed the embedded conversion option and Stakeholder Warrants for derivatives and/or beneficial conversion features, how you account for the conversion option associated with dividends paid-in-kind, and where you classify the warrants on your balance sheet. Tell us the specific provisions of the conversion option and warrants, including the conversion price(s) of the loan principal, whether the warrants are legally detachable and separately exercisable, and how the “specified conversion price” of the warrants is determined.</td>
</tr>
<tr>
<td>• We note that the conversion price of most of the convertible debentures is denominated in Canadian dollars while the conversion price of the convertible debentures issued [in July 201X] is denominated in US dollars. As such, it appears the conversion feature embedded in the debentures issued in July [201X] is not indexed to your own stock and should be separated from the host contract and accounted for as a derivative pursuant to ASC 815. Please tell us how you accounted for the embedded conversion features and the basis in GAAP for your accounting.</td>
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</tbody>
</table>

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

2.8.2 Classification of Financial Instruments

<table>
<thead>
<tr>
<th>Example of an SEC Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td>You disclose that . . . you will be required to repurchase each share of [convertible preferred stock] that have not been converted into shares of common stock or automatically redeemed. Please tell us how you determined that your [convertible preferred stock] should be classified as mezzanine equity on your balance sheet and your consideration of the guidance in ASC 480-10-25-4.</td>
</tr>
</tbody>
</table>

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

2.9 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.

2.9.1 Balance Sheet Classification

2.9.1.1 Separate Presentation

Examples of SEC Comments

- Please tell us whether there are any items included in other current assets that exceed five percent of total current assets. If so, please state separately, in the balance sheets or in the notes thereto, any item in excess of five percent of total current assets. Refer to Rule 5-02.8 of Regulation S-X.

- Your accrued and other current liabilities [amount] represented [A]% and [B]% of total current liabilities as of December 31, [201Y] and [201X], respectively. Please separately disclose, either on your balance sheet or in a footnote, any item in excess of five percent of total current liabilities, or explain to us how you have complied with Rule 5-02.20 of Regulation S-X.

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

**Example of an SEC Comment**

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

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

2.9.2 Income Statement Classification

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

2.9.2.1 Separate Presentation of Revenues From Products and Services

**Examples of SEC Comments**

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

- Information in various parts of your filing indicates that you generate revenue from the sale of products and services. Given this, explain to us how you have considered separately disclosing on the face of your income statement net sales of tangible products and revenue from services, as well as cost of tangible goods sold and cost of services. See Rules 5-03.1 and 5-03.2 of Regulation S-X.

The SEC staff continues to comment when registrants omit certain captions required by Rule 5-03 from the face of their income statements. The staff has asked registrants to explain their consideration of Rule 5-03 and to revise their income statement presentation accordingly. For example, the 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.
2.9.2.2 Cost of Sales

Examples of SEC Comments

- Explain to us the specific cost items included in your income statement line items Cost of Goods Sold and Operating Expenses. To the extent that Cost of Goods Sold does not include all costs directly attributable to sales of products and revenue from services, other than as contemplated by SAB Topic 11.B, explain to us how your current presentation complies with the requirements of Rule 5-03.2 of Regulation S-X.

- We note you present cost of goods sold exclusive of depreciation expense and stock-based compensation expense along with the subtotal, gross profit. Please tell us how your presentation complies with the guidance in SAB Topic 11.B and Article 5-03 of Regulation S-X, since gross profit appears to represent a figure for income before depreciation.

The SEC staff often asks registrants to disclose the types of expenses that are included in or excluded from the cost-of-sales line item and to support their determination of the types of costs included in costs of goods sold in accordance with Regulation S-X, Rule 5-03(b)(2).

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

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

Under Rule 5-03, a subtotal line item for gross margin (or a similar measure, such as gross profit) is not required on the face of the income statement. However, if a registrant presents a subtotal for the measure, it should not exclude depreciation and amortization since such exclusion would result in the presentation of a “figure for income before depreciation.” Often, a registrant will not present a gross margin subtotal on the face of the income statement but will discuss such a measure in MD&A. In those circumstances, the SEC staff will ask registrants to disclose that the measures are non-GAAP financial measures and to consider the disclosure requirements in Regulation S-K, Item 10(e). Further, reporting cost of sales that excludes other expenses, such as stock compensation expense, is not permitted since this would be reporting a non-GAAP financial measure.

For additional discussion of non-GAAP measures, see Section 3.4.

2.9.2.3 Presentation of Operating Expenses

Examples of SEC Comments

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

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

### 2.9.2.4 Operating Versus Nonoperating Income

The SEC staff has commented on 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 the sale of long-lived assets (e.g., plant, property, and equipment that do not qualify as discontinued operations).
- Litigation settlements.
- Insurance proceeds.
- Restructuring charges.

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

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

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

2.9.3.1 Gross Versus Net Classification

**Examples of SEC Comments**

- Please revise the other assets and liabilities, net line item to present changes in other assets separately from other liabilities and further breakout any material components. Refer to ASC paragraphs 230-10-45-7 and 45-29.
- We note that you present the caption Investments in property and equipment, net. Please revise future filings to separately present the cash inflows and cash outflows for property and equipment on a gross basis as discussed in ASC 230-10-45-26.

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. Generally, cash payments should not be presented net of cash receipts in the statement of cash flows. However, ASC 230-10-45-7 through 45-9 state that although reporting gross cash receipts and gross cash payments provides more relevant information, financial statement users sometimes may not need gross reporting to understand certain activities. Further, the netting criteria in ASC 230-10-45-8 (turnover is quick, the amounts are large, and the maturities are short) must be met for an entity to present investing and financing activity on a net basis. Accordingly, the SEC staff may ask a registrant to revise the presentation or to explain (in accordance with ASC 230) why it is appropriate to report certain cash flows on a net basis rather than on a gross basis.

2.9.3.2 Category Classification

**Examples of SEC Comments**

- Please tell us your basis for classifying the capitalization of contract costs as an investing cash flow activity as opposed to an operating activity.
- We note that you present increases and decreases in book overdrafts as cash flows from financing activities. In this regard, please provide us with your basis for reporting changes in book overdrafts as cash flows from financing activities instead of cash flows from operating activities. Also, clarify whether the overdraft is with a bank.

ASC 230 requires entities to classify cash receipts and cash payments as operating, investing, or financing activities on the basis of the nature of the cash flow. Many of the SEC staff’s comments are related to understanding the classification or potential misclassification among these three cash flow categories.

**Changing Lanes**

In 2016, the FASB issued ASU 2016-15 and ASU 2016-18 to add and clarify guidance on the classification and presentation of certain items within the statement of cash flows. The ASUs became effective for public business entities for fiscal years beginning after December 15, 2017.

ASU 2016-15 addresses the diversity in practice associated with various cash flow issues and provides guidance on classification of (1) debt prepayments or debt extinguishment costs, (2) the settlement of zero-coupon bonds, (3) contingent consideration payments made after a business combination, (4) proceeds from the settlement of insurance claims, (5) proceeds from the settlement of corporate-owned life insurance policies, (6) distributions received from equity method investees, (7) beneficial interests in securitization transactions, and (8) separately identifiable cash flows (including guidance on the application of the predominance principle).
ASU 2016-18 clarifies and provides additional guidance on classification and presentation of restricted cash in the statement of cash flows. The key requirements of the new guidance are as follows:

- An entity should include in its cash and cash-equivalent balances those amounts that are deemed to be restricted cash and restricted cash equivalents.
- A reconciliation between the statement of financial position and the statement of cash flows must be disclosed when the statement of financial position includes more than one line item for cash, cash equivalents, restricted cash, and restricted cash equivalents.
- Changes in restricted cash and restricted cash equivalents that result from transfers between cash, cash equivalents, and restricted cash and restricted cash equivalents should not be presented as cash flow activities in the statement of cash flows.
- An entity that has a material balance of restricted cash and restricted cash equivalents must disclose information about the nature of the restrictions.

With the adoption of ASU 2016-15 and ASU 2016-18, the SEC staff will most likely continue to question the classification of various types of cash receipts and cash payments as well as a registrant's presentation and classification of restricted cash in the statement of cash flows.

### 2.9.3.3 Extended Vendor Payable Arrangements

<table>
<thead>
<tr>
<th>Example of an SEC Comment</th>
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<tbody>
<tr>
<td>We note your “Accounts Payable days” are [X] days as of [the fiscal year-end]. We further note your Accounts Payable days [have] increased substantially over the past ten years. . . . Please tell us if you are engaging in supply chain finance operations and mechanisms, such as reverse factoring or similar methods to increase your Accounts Payable days. Otherwise, please explain how you have been able to achieve such extended accounts payable terms with your suppliers.</td>
</tr>
</tbody>
</table>

The SEC staff has recently issued comments to registrants that use extended vendor payable arrangements involving the participation of a paying agent or other financial institution. Under such programs, the paying agent or financial institution may settle the payment obligation directly with the registrant's supplier, for a fee, earlier than the extended payment term. Because there is no explicit authoritative guidance on these arrangements, the SEC staff has challenged registrants' determinations of whether the payments under such programs (1) constitute trade payables, which would represent operating activities, or (2) are more akin to debt, which would represent financing activities. In addition, the staff has encouraged registrants to provide enhanced disclosures of their extended vendor payable arrangements, such as the following:

- A description of the program; the material and relevant terms of the program, including the risks along with the general benefits; amounts settled through the program; and impacts of the program on the registrant's payment terms to suppliers, days payable outstanding, working capital, liquidity, and capital resources.
- Amounts remaining in trade payables at year-end for which the registrant's supplier has elected early payment (i.e., the balance sheet impact).
In addition, in recent comment letters to registrants, the SEC staff has expressed interest in better understanding quantitative and qualitative characteristics of such arrangements, including:

- Analysis supporting classification of amounts settled under the arrangement as trade payables or bank financing, including classification and noncash disclosure considerations in accordance with ASC 230.
- The impact these arrangements have on an entity’s operating cash flows for all periods presented.
- The intraperiod variability in accounts payable balances attributed to the programs.
- Guarantees provided by subsidiaries, the parent, or both.
- Plans to further extend terms to suppliers.
- Factors that may limit an entity’s ability to continue using similar arrangements to further improve operating cash flows.
- Trends and uncertainties related to the extension of payment terms under the arrangements.

On the basis of our discussions with the SEC staff in the context of registrant preclearance processes, we understand that the staff expects an issuer to consider making the following qualitative and quantitative disclosures, if material, related to trade payable arrangements involving an intermediary:

- A description of the arrangement and why the registrant entered into the arrangement.
- A description of the benefits to the entity and to the entity’s suppliers.
- The amount that is eligible for factoring and the amount that has been factored (if known).
- Any risks the arrangement exposes the entity to and how those risks are mitigated.

In October 2019, the FASB received an agenda request related to these emerging issues.

### 2.9.4 Comprehensive Income — Disclosure

#### Examples of SEC Comments

- Please tell us what consideration you gave to disclosing the amount of income tax expense or benefit allocated to each component of other comprehensive income, including reclassification adjustments, in accordance with ASC 220-10-45-12.
- We note your convertible redeemable preferred shares of [Investment X] were redeemed during [the fiscal year]. Please clarify for us if you had any unrealized gains or losses that were recorded in accumulated other comprehensive income prior to the redemption. To the extent you had unrealized gains or losses, please tell us how you determined it was not necessary to reflect a reclassification of these unrealized gains or losses in the amounts reclassified from accumulated other comprehensive income column in your table . . . . Please refer to ASC 220-10.

The SEC staff has commented when registrants have not provided information required by ASC 220 about the amounts reclassified out of accumulated OCI. For example, the staff frequently reminds registrants to “present the amount of income tax expense or benefit allocated to each component of other comprehensive income, including reclassification adjustments,” for each reporting period either on the face of the statement where those items are presented or in the footnotes. Similarly, the staff reminds registrants to reclassify unrealized gains or losses from accumulated OCI to realized gains or losses in comprehensive income when an event that would trigger a reclassification adjustment occurs.
2.10 Foreign Currency

The SEC staff's comments on quantitative disclosures related to foreign currency adjustments reflect published staff views 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 SEC staff continues to closely monitor registrants' disclosures related to foreign currency, and it may comment when such disclosures do not comply with U.S. GAAP or SEC rules and regulations.

2.10.1 Determination of Functional Currency

<table>
<thead>
<tr>
<th>Examples of SEC Comments</th>
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</thead>
<tbody>
<tr>
<td>- You disclose that the U.S. dollar is your functional currency; however, we note that all of your current operations are outside of the U.S. Using the guidance in ASC 830-10-45 and ASC 830-10-55 please tell us how you determined your functional currency.</td>
</tr>
<tr>
<td>- Pursuant to ASC 830-10-45-2, please help us better understand how you determined that the U.S. dollar is the currency of the primary economic environment in which you operate and in which you primarily generate and expend cash. Please specifically address your consideration of ASC 830-10-55-3 through 55-5. We note that your disclosures . . . indicate that you have not generated any revenues in the U.S. and that all of your long-lived assets are located in [Country A].</td>
</tr>
</tbody>
</table>

Although ASC 830 states that an entity’s functional currency is “a matter of fact,” sometimes it may not be clear what the functional currency is if, for instance, “a foreign entity conducts significant amounts of business in two or more currencies.” An entity may need to use significant judgment in determining the functional currency, depending on the nature of the foreign entity being evaluated. When a registrant conducts business in more than one currency, the SEC staff often requests additional information regarding the judgments the registrant used in determining its functional currency, particularly in light of other potentially contradictory disclosures. In determining the appropriate functional currency, management should consider each of the following economic factors in ASC 830-10-55-5:

- Cash flow indicators.
- Sales price indicators.

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6 Division of Corporation Finance: Frequently Requested Accounting and Financial Reporting Interpretations and Guidance, Section II.J.
Chapter 2 — Financial Statement Accounting and Disclosure Topics

- Sales market indicators.
- Expense indicators.
- Financing indicators.
- Intra-entity transactions and arrangements indicators.

2.10.2 Change in Functional Currency

### Examples of SEC Comments

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<thead>
<tr>
<th>Examples of SEC Comments</th>
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<tbody>
<tr>
<td>- We note your disclosure that “[Company A's] functional currency changed to the United States dollar.” Please explain to us the facts and circumstances that resulted in the change in functional currency, including your consideration of each factor outlined in ASC 830-10-55-5.</td>
</tr>
<tr>
<td>- We note that as a result of the Acquisition, you reevaluated your functional currency accounting conclusions. Due primarily to your new legal entity organization structure, global cash management and raw material sourcing strategies, you determined that the functional currency of certain subsidiaries operating outside of the United States is the local currency of the respective subsidiaries. For the Predecessor period, your reporting currency was the U.S. dollar as [Company B] management determined that the U.S. dollar was the functional currency of [Company B's] legal entities and this functional currency was appropriate for [Company B's] organizational legal entity structure and the economic environment in which [Company B] operated during the period covered by the Predecessor consolidated and combined financial statements. With reference to ASC 830-10-45-3 through 45-6, please provide a thorough analysis that demonstrates the appropriateness of the functional currency of your subsidiaries in both the Successor and Predecessor periods.</td>
</tr>
</tbody>
</table>

Because changes in functional currency are expected to be infrequent, the SEC staff will often ask for additional information about the facts and circumstances that resulted in such reported changes. Acquisitions or reorganizations may be circumstances in which an entity is required to reevaluate its functional currency determination. The economic factors in ASC 830-10-55-5, which are used in the initial determination of an entity's functional currency, should be considered in the determination of whether there is a change in the entity's functional currency. The SEC staff may ask a registrant to explain its consideration of each factor when there has been a change in functional currency.

Regardless of the underlying reason for a change in functional currency, the SEC staff has indicated in published interpretations that although a registrant is not required to do so under ASC 830, it “should consider the need to disclose the nature and timing of the change, the actual and reasonably likely effects of the change, and economic facts and circumstances that led management to conclude that the change was appropriate.” In addition, the registrant should discuss in its MD&A the “effects of those underlying economic facts and circumstances on the registrant's business.” When registrants fail to do so, the staff may issue comments requesting additional disclosures about the underlying reason for the change and the associated effects.

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7 Division of Corporation Finance: Frequently Requested Accounting and Financial Reporting Interpretations and Guidance, Section I.D.
2.10.3 Translation Adjustments

<table>
<thead>
<tr>
<th>Examples of SEC Comments</th>
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<tbody>
<tr>
<td>• Please revise your accounting policy disclosure to address how you account for the translation adjustments that result from the process of translating your financial statements from the [functional currency] to the [reporting currency]. Please refer to the guidance in ASC 830-30-45. Also disclose the impact of translation adjustments and include an analysis of the changes in the accumulated amount of translation adjustments. Please refer to the guidance in paragraphs 830-30-45-12 and 830-30-50-1.</td>
</tr>
<tr>
<td>• We note that foreign currency translations adjustments materially impacted the change in comprehensive income from [year 1] to [year 2]. Please expand your discussion and analysis to provide a comprehensive discussion and analysis of the foreign currencies and transactions that led to the adjustments recognized.</td>
</tr>
</tbody>
</table>

In accordance with ASC 830-30-45-21, any adjustments that result from the translation of an entity's financial statements from its functional currency to the reporting currency should be recorded in OCI (i.e., such adjustments do not affect net income), and deferred taxes should be provided for the translation adjustments unless, as stated in ASC 740-30-25-17, “sufficient evidence shows that the subsidiary has invested or will invest the undistributed earnings indefinitely or that the earnings will be remitted in a tax-free liquidation.” Further, entities must disclose details of the changes in the cumulative translation adjustment. In accordance with ASC 830-30-45-18, this analysis can be presented (1) “[i]n a separate financial statement,” (2) “[i]n notes to financial statements,” or (3) “[a]s part of a statement of changes in equity.” Regardless of the format in which the analysis is provided, it must contain the items listed in ASC 830-30-45-20. If a registrant does not comply with this guidance, the SEC staff may ask the registrant to revise its disclosures accordingly.

2.10.4 Disclosures in MD&A, Including Risks and Uncertainties

<table>
<thead>
<tr>
<th>Examples of SEC Comments</th>
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<tbody>
<tr>
<td>• We note that foreign currency exchange rates materially impacted your consolidated statements of income and consolidated statements of comprehensive income. Please expand your disclosure to provide the disclosures required by Item 305 of Regulation S-K, including a discussion of the specific foreign currency rate exposures that represent the primary risk of loss.</td>
</tr>
<tr>
<td>• We note your risk factor . . . related to the value of the currencies in countries where you operate against the U.S. dollar and its effect on your financial results reported in U.S. dollar terms. As such, fluctuations in foreign exchange rates could affect your financial results reported in U.S. dollar terms without giving effect to any underlying change in your business or results of operations. Please fully expand your discussion of results of operations to separately quantify for each period presented the amount of the change in revenues and expenses that is due to foreign currency translations.</td>
</tr>
<tr>
<td>• We note your disclosure throughout the document referencing foreign subsidiaries and foreign operations. Your accounting policies do not appear to address your accounting for foreign currency matters. In future filings, please provide the disclosures required by FASB ASC 830.</td>
</tr>
</tbody>
</table>

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 in relation 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.

Other Deloitte Resources
A Roadmap to Foreign Currency Transactions and Translations

2.11 Impairments of Goodwill and Other Long-Lived Assets

2.11.1 Goodwill

2.11.1.1 MD&A Disclosures

Examples of SEC Comments

- We note that quantitative assessments were performed for [certain of your] reporting units. Please provide information for investors to assess the probability of future goodwill impairment charges. For example, please disclose whether [certain of your] reporting units are at risk of failing step one of the impairment test or that the fair value of each of the reporting units is substantially in excess of carrying value and are not at risk of failing step one. If a reporting unit is at risk of failing step one, you should disclose:
  - the percentage by which fair value exceeded carrying value at the date of the most recent step one test;
  - the amount of goodwill allocated to the reporting unit;
  - a more detailed description of the methods and key assumptions used and how the key assumptions were determined;
  - a discussion of the degree of uncertainty associated with the assumptions; and
  - a description of potential events and/or changes in circumstances that could reasonably be expected to negatively affect the key assumptions.


- We note you recorded a goodwill impairment charge in [Reporting Unit A] of $[X] million in the fourth quarter of [fiscal year 2]. Please more fully explain to us the specific facts and circumstances that resulted in an impairment charge during the fourth quarter of [fiscal year 2] and address the following:
  - Explain any changes to this reportable segment and reporting unit, including the allocation of goodwill, that resulted from the Merger and the related reallocation of goodwill;
  - Tell us if you performed any interim impairment tests between your [fiscal year 1] and [fiscal year 2] annual impairment tests and explain why or why not;
  - Tell us the differences between the significant assumptions and estimates you used to determine the estimated fair values of this reporting unit in your [fiscal year 2] and [fiscal year 1] annual impairment tests; and
  - Explain when the changed circumstances related to this reporting unit occurred and tell us what, if any, cautionary disclosures regarding a potential material goodwill impairment charge related to this reporting unit you provided prior to your [fiscal year 2] Form 10-K.
Section 9510 of the SEC Division of Corporation Finance’s Financial Reporting Manual (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 staff has commented on a registrant’s compliance with the disclosure requirements of Regulation S-K, Item 303(a)(3)(ii), to discuss a known uncertainty — specifically, to disclose the potential for a material impairment charge — in light of potential impairment triggers (i.e., whether the registrant should have provided early-warning disclosures about the possibility of an impairment charge in future periods to help financial statement users understand these risks and how they could potentially affect the financial statements). The staff has noted that it may use these disclosures to assess whether a registrant’s goodwill impairment analysis is reasonable or whether the registrant should have performed an interim goodwill impairment analysis. See Section 3.1 for additional information about early-warning disclosures.

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

Changing Lanes

In January 2017, the FASB issued ASU 2017-04, which simplifies the accounting for goodwill impairments by eliminating step 2 from the goodwill impairment test. Instead, if “the carrying amount of a reporting unit exceeds its fair value, an impairment loss shall be recognized in an amount equal to that excess, limited to the total amount of goodwill allocated to that reporting unit.”

For public business entities (PBEs) that are SEC filers, ASU 2017-04 is effective for annual and any interim impairment tests for periods beginning after December 15, 2019. PBEs that are not SEC filers should apply the new guidance to annual and any interim impairment tests for periods beginning after December 15, 2020. For all other entities, the ASU is effective for annual and any interim impairment tests for periods beginning after December 15, 2021. Early adoption was allowed for all entities as of January 1, 2017, for annual and any interim impairment tests occurring on or after January 1, 2017.

2.11.1.2 Reporting Units

Example of an SEC Comment

Your disclosures . . . indicate that you determined you had two operating segments and correspondingly two reporting units . . . . Your Form 8-K . . . indicates that . . . you now have four operating divisions . . . . Please disclose the impact of these recent organizational changes on your determination of operating segments and reportable segments pursuant to ASC 280 as well as the impact on your determination of reporting units for purposes of goodwill impairment testing pursuant to ASC 350-20.
The SEC staff has commented on identification of reporting units for goodwill impairment testing, especially when changes appear to have been made to a registrant's reporting structure (e.g., as the result of a reorganization, an acquisition, or a change in management). Given the interaction between the guidance on reporting units in ASC 350-20 and the guidance on operating segments in ASC 280, the staff may also ask questions to better understand (1) how the reporting units were identified; (2) how many reporting units were identified; (3) how the reporting units align with the registrant's segment reporting; and (4) whether and, if so, how the registrant aggregated reporting units to perform goodwill impairment testing. For additional discussion about the identification and aggregation of operating segments, see Sections 2.19.1 and 2.19.2, respectively.

2.11.1.3 Interim Impairment Tests

Example of an SEC Comment

We note that you performed an interim testing of impairment of [Intangible Asset A] due to the continuing challenging business conditions in certain markets as of the end of the third quarter . . . . Please tell us if you performed an interim testing of impairment of goodwill . . . due to these same market conditions and tell us if you determined the estimated fair value of your reporting units substantially exceeded their carrying value and the percentage by which the fair value of the reporting unit exceeded the carrying value as of the date of most recent test. If an interim impairment test of goodwill was not performed, please explain why you believe one was not required given your operating environment and market conditions.

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. If a registrant performs an interim impairment test, it should consider disclosing (1) that it performed the test, (2) the event that triggered the test, and (3) the test result regardless of whether goodwill was determined to be impaired. 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 the last annual impairment test. The staff may also request an explanation of how the impairment had not been reasonably foreseen during management's prior-period assessments. Specifically, the staff may question why management did not identify an impairment during a previous quarter.

2.11.2 Other Long-Lived Assets

Example of an SEC Comment

Based on your disclosure, it does not appear you recorded any store level long-lived asset impairments in fiscal [201X] or through the third quarter of fiscal [201Y]. Further, you state in your disclosure, “For store level long-lived assets, expected cash flows are determined based on management's estimate of future sales, merchandise margin rates and expenses over the remaining expected terms of the leases.” In this regard, we note the comments made by management in the third quarter [201Y] earnings call that would imply that certain stores are cash flow negative. Additionally, we note declining sales and gross profit margins for the fiscal year ended [201X], and the 13 and 39 weeks ended December 1, [201X]. With reference to ASC 360-10-35-21, please clarify whether or not you tested any store level long lived assets for recoverability during the 39 weeks ended December 1, [201X]. If not, please provide support for your conclusion that impairment testing was unnecessary. If you tested these assets for impairment, please refer to the guidance in ASC 360-10-35-29 through 33, and provide us with the summary results of your testing, including the underlying material assumptions you relied on in determining the estimates of future cash flows.
In its comments on impairments of long-lived assets, the SEC staff may ask a registrant that has recorded, or is at risk of recording, impairment charges to disclose, or inform the staff about, the following:

- The adequacy and frequency of the registrant’s asset impairment tests, including the date of its most recent test.
- The factors or indicators (or both) used by management to evaluate whether the carrying value of other long-lived assets may not be recoverable.
- The methods and assumptions used in impairment tests, including how assumptions compare to recent operating performance, the amount of uncertainty associated with the assumptions, and the sensitivity of the estimate of fair value of the assets to changes in the assumptions.
- The registrant’s conclusions regarding its asset groupings.
- 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. A registrant may be also be required to disclose in MD&A risks and uncertainties associated with the recoverability of assets in the periods before an impairment charge is recorded. For example, even if an impairment charge is not required, a reassessment of the useful life over which depreciation or amortization is being recognized may be appropriate.

In addition, the SEC staff may ask why no impairment was recorded when the staff observes adverse economic conditions (e.g., decrease in net cash flow).

The SEC staff may also ask about the sale of assets that resulted in significant gains or losses. Under ASC 360-10-45-5, a “gain or loss recognized . . . on the sale of a long-lived asset (disposal group) that is not a discontinued operation shall be included in income from continuing operations before income taxes in the income statement of a business entity. If a subtotal such as income from operations is presented, it shall include the amounts of those gains or losses.” The staff may ask a registrant about the classification of gains or losses on the disposal of long-lived assets if not clearly disclosed.

**Other Deloitte Resources**

- February 1, 2017, *Heads Up*, “FASB Eliminates Step 2 From the Goodwill Impairment Test”
- *A Roadmap to Accounting for Business Combinations*
2.12 Income Taxes

Overall, the themes of SEC staff comments on financial reporting and disclosures related to income taxes have remained relatively consistent year over year. For example, the SEC staff has continued to issue comments to registrants on the following:

- Valuation allowances (see Section 2.12.1).
- Disclosures related to the income tax rate (see Section 2.12.2).
- Tax effects of significant or unusual transactions that occurred during the period (see Section 2.12.3).
- Noncompliance with disclosure requirements (e.g., omission of required disclosures) (see Section 2.12.4).

The SEC staff continues to request early-warning disclosures to help financial statement users understand key estimates and assumptions that registrants made in recording items related to income taxes and how changes to those estimates and assumptions could potentially affect the financial statements in the future. The SEC staff also continues to issue comments on non-GAAP measures with a particular focus on the income tax impact of the adjustments made to the GAAP measures. For additional information about early-warning disclosures and non-GAAP measures, see Sections 3.1 and 3.4, respectively.

Historically, the SEC staff has stated that boilerplate language should be avoided with respect to income tax disclosures within MD&A and the financial statements, and that approaches more conducive to effective disclosure would include:

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

<table>
<thead>
<tr>
<th>Examples of SEC Comments</th>
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</table>
| • We note that you released $X million of your tax valuation allowance in [the fiscal year], on the basis of management's reassessment of the amount of U.S. deferred tax assets that are more likely than not to be realized. We also note your disclosure that management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Please provide us, and revise your disclosures here or in critical accounting policies in MD&A to provide, a more specific and comprehensive analysis of your assessment of the realizability of your deferred tax assets as of [the fiscal year-end]. Your analysis should include, but not be necessarily limited to, the following:
| o Clarify your disclosure that you achieved twelve quarters of cumulative pretax income in the U.S. in light of the tabular disclosures . . . ;
| o Clarify if the deferred tax liabilities you are relying on reverse in the same period and jurisdiction and are of the same character as the temporary differences that gave rise to the deferred tax assets;
| o Quantify the projected taxable income and the time periods over which it will be required to be generated for you to fully utilize your deferred tax assets;
| o Describe the nature of any tax planning strategies, including any uncertainties, risks, and assumptions associated with those strategies;
| o Discuss all the positive and negative evidence you considered and how such evidence was weighted; and
| o Discuss any other significant estimates and assumptions used in your analysis.
| Please refer to ASC 740-10-30-16 through 30-25, ASC 740-10-55-39 through 55-48, and ASC 740-10-55-120 through 55-123 for guidance.
| • Please consider expanding your disclosure to provide a more comprehensive discussion and analysis of the specific positive and negative evidence you considered in determining the realizability of the material components of your deferred tax assets. In this regard, we note the Company is in a cumulative three year net loss position at the [fiscal year-end]. Please tell us how you concluded that no significant valuation allowance was needed.
| • We note your disclosure that due to cumulative previous losses incurred by the Company, the Company is unable to conclude it is more likely than not to realize its deferred tax asset in excess of the deferred tax liability and accordingly, the Company has recorded a full valuation allowance as of [the end of fiscal year 1] and [the end of the second quarter of fiscal year 2]. We also note you have recorded net income for [fiscal year 1] and [the first two quarters of fiscal year 2]. Please ensure you consider all available evidence, both positive and negative, to determine whether, based on the weight of that evidence, a valuation allowance for deferred tax assets is needed. Refer to ASC 740-10-30-16 through 30-25 for guidance. Additionally, please revise future filings to discuss the factors that impact your estimates and judgment regarding the realizability of your deferred tax asset and the measurement of your valuation allowance. Refer to ASC 740-10-50-21 for guidance.

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 30-25 provide additional guidance. In light of this guidance, the SEC staff has commented when registrants’ filings indicate that no valuation allowance has been recorded, when it seems that the valuation allowance recorded is insufficient, or when a valuation allowance has been recorded but there is evidence to suggest that an allowance is not needed. More recently, the staff has asked registrants about reversals of, or other changes in, their valuation allowance, particularly when registrants reverse only a portion of their valuation allowance.
The SEC 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 SEC staff has noted that registrants should bear in mind that the goal of the assessment is to determine whether sufficient positive evidence outweighs existing negative evidence. The staff has emphasized the importance of evidence that is objectively verifiable and has noted that such evidence carries more weight than evidence that is not. In addition, registrants should (1) assess the sustainability of profits in jurisdictions in which an entity was previously in a cumulative loss position and (2) consider their track record of accurately forecasting future financial results. Doubts about the sustainability of profitability in a period of economic uncertainty may give rise to evidence that would carry less weight in a valuation allowance assessment. Similarly, a registrant’s poor track record of accurately forecasting future results would result in future profit projections that may be very uncertain and should carry less weight in the overall assessment.

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

<table>
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<tr>
<th>Examples of SEC Comments</th>
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<tbody>
<tr>
<td>• We note that there have been significant changes in your effective tax rate in recent periods. Specifically, the effective rate was [A]% for [year 1], [B]% for [year 2], and [C]% for the [first through third quarters of year 3]. There appear to be multiple factors contributing to these fluctuations which include foreign losses in [Country X] with no tax benefits, tax benefits on the repatriation of foreign earnings, additional tax expense related to an underaccrual and tax expense on a settlement with [foreign] tax authorities. Please address the following:</td>
</tr>
<tr>
<td>◦ In your discussion of the effective tax rate, please quantify the extent to which each significant factor contributed to the fluctuation in the effective tax rate from period to period;</td>
</tr>
<tr>
<td>◦ Please help us better understand the nature of the additional expense recorded related to the underaccrual of tax expense and in a settlement with [foreign] authorities, including what periods the underaccrual and settlement relate to and the extent to which these factors impact the effective tax rate; and</td>
</tr>
<tr>
<td>◦ Please help us better understand why you are generating tax benefits rather than incurring tax expense on the repatriation of foreign earnings pursuant to ASC 740.</td>
</tr>
<tr>
<td>• Please provide us with a breakdown of the tax differential and non-deductible expense line items included in the effective tax rate reconciliation and tell us what consideration you gave to Rule 4-08(h)(2) of Regulation S-X to provide a further quantitative breakdown of such amounts. Also, considering the significant changes in the effective tax rate, please tell us what consideration you gave to providing an expanded discussion of the factors that impacted your tax provision. In this regard, we note the disclosures . . . only address the impact for the change in the valuation allowance and not the changes in the line items noted herein. Refer to Item 5.D of Form 20-F and Section III.D of SEC Release No. 33-6835.</td>
</tr>
<tr>
<td>• We note from your tax rate reconciliation . . . that foreign income taxed at lower rates significantly impacted your effective tax rates in each of the reported periods. Please revise future filings to provide greater insight into the nature of this reconciling item, including the primary taxing jurisdictions where your foreign earnings are derived and the relevant statutory rates in those jurisdictions. Disclose any incentivized tax rates you have been granted and briefly describe the factual circumstances of any tax holidays, the per share effects of the tax holiday, and the date upon which any special tax status terminates. Refer to ASC 740-10-50-12 and SAB Topic 11.C.</td>
</tr>
<tr>
<td>• Please tell us each of the individual components of the [X]% and [Y]% benefits in your “other, net” reconciling item in your rate reconciliations for [year 2] and [year 1], respectively.</td>
</tr>
<tr>
<td>• Revise your discussions of income taxes in this note and in MD&amp;A in future filings to disclose the estimated annual effective tax rate used in computing your year-to-date provision for income taxes. Refer to ASC 740-270-25 and ASC 740-270-50.</td>
</tr>
<tr>
<td>• Please disclose a reconciliation using percentages or dollar amounts of the reported amount of income tax expense attributable to continuing operations for the year to the amount of income tax expense that would result from applying domestic federal statutory tax rates. Refer to ASC 740-10-50-12.</td>
</tr>
</tbody>
</table>
Registrants often pay income taxes in multiple jurisdictions other than the domestic federal jurisdiction (e.g., domestic state and local jurisdictions, foreign federal and foreign local or provincial jurisdictions), and the applicable income tax rates vary in each jurisdiction and therefore affect the registrant’s effective tax rate. Further, tax laws often differ from financial accounting standards; therefore, permanent differences can arise between pretax income for financial reporting purposes and taxable income. Although such differences are not uncommon, the SEC staff often requests that registrants provide greater transparency into the underlying reasons for differences between the federal statutory rate and the registrant’s effective tax rate. The staff may also request additional details about events that gave rise to a significant change in a registrant’s effective tax rate as compared with prior periods.

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

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

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

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

Further, in past speeches, the SEC staff has remarked that registrants (1) continue to use boilerplate language in the tax rate reconciliation that does not describe the components shown and (2) would provide more meaningful information to investors if they explain why certain events that affected the effective tax rate occurred and how those events will affect the tax rate going forward. The staff has also noted that when the “foreign rate differential” and other components of the tax rate reconciliation are not easily understood or transparent, registrants might consider preparing the tax rate reconciliation on a disaggregated basis (e.g., by country) in a tabular format.
2.12.3 Transaction-Specific Disclosures

<table>
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<th>Examples of SEC Comments</th>
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<tr>
<td>• You disclose that the $[X]$ million intangible asset recorded as of [the end of the first quarter] includes $[X]$ million of costs capitalized to record an offset to a deferred tax liability related to the exercise of your option to acquire an exclusive license from [Entity Y] related to patent rights and know-how to develop and commercialize compounds and products for [Item Z]. You also disclose . . . that this deferred tax liability was created when [Y] sold its license and know-how to you for stock in a transaction under Section 351 of the Internal Revenue Code (Section 351 transaction) which treats the acquisition of the license and know-how as a tax-free exchange. Please provide us with a detailed analysis explaining how you determined that this transaction met the requirements to be considered a tax-free exchange under Section 351. In this regard, it would appear that under Section 351 an exchange would be considered tax free if (a) the property was exchanged solely for stock of the company and (b) immediately after the exchange the transferor controlled the company via 80% or more ownership of voting stock. Based on your beneficial ownership table on . . . your Form S-1 filed [one month after the end of the second quarter], it appears that [Y] owns only [X]% of your outstanding shares.</td>
</tr>
<tr>
<td>• We note that in the third quarter . . . , you released approximately $[X]$ million of valuation allowance related to the [Country A] deferred tax assets you acquired in connection with your purchase of [Entity M]. We also understand that you finalized your purchase price allocation as of [the end of the third quarter]. Please tell us the facts and circumstances that led to the release of your valuation allowance and your consideration of ASC 805-740-45-2 in determining whether to record the change in valuation allowance to income tax expense or as an adjustment to goodwill during the measurement period.</td>
</tr>
<tr>
<td>• Please describe the nature of the foreign tax restructuring in [year 1] that gave rise to the $[X]$ million in deferred tax assets and revise your disclosures to describe the restructuring. Also, confirm whether these are the same deferred tax assets of your [foreign] subsidiary . . . that would give rise to an income tax benefit in excess of $[Y]$ million if the valuation allowance were released. If they are the same, revise your disclosures to clarify.</td>
</tr>
<tr>
<td>• You disclose that the deferred tax liability associated with the in-process research and development intangible asset from your acquisition of [Company A] is not considered positive evidence of future income in part because it is an indefinite-lived intangible asset. Please tell us why you did not record some income tax benefit outside acquisition accounting under ASC 805-740-30-3 associated with any net operating loss generated in [year 1]. In this regard, we note that net operating losses since the enactment of the Tax Cuts and Jobs Act do not expire. In your response, tell us the amount of net operating loss generated in [year 1].</td>
</tr>
<tr>
<td>• You disclose . . . that your effective tax rate in [year 2] includes tax benefits from taxable losses arising from Hurricanes Irma, Harvey and Maria. Please tell us how the tax benefits from these catastrophes impact your effective tax rate in [year 2] and reference for us the authoritative literature you rely upon to support your position. In this regard, it appears that these events contributed to pre-tax income in [year 2] being less than that in [year 1], but it also appears that any differences between tax deductions taken on your return in [year 2] and your GAAP loss reserves associated with these catastrophes would be temporary differences that do not impact your overall effective tax rate.</td>
</tr>
</tbody>
</table>

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

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

2.12.4 Noncompliance With Disclosure Requirements

<table>
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<th>Examples of SEC Comments</th>
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<tr>
<td>• Please tell us and revise to disclose the components of income (loss) before income tax expense (benefit) as either domestic or foreign, if material. See Rule 4-08(h) of Regulation S-X.</td>
</tr>
<tr>
<td>• Please tell us your consideration for disclosing the cumulative amount of undistributed foreign earnings that are considered indefinitely reinvested in accordance with ASC 740-30-50-2 in light of your disclosure that you intend to indefinitely reinvest your undistributed foreign earnings.</td>
</tr>
<tr>
<td>• We note that the line item “other impact of foreign operations” in your effective tax rate reconciliation has grown significantly. To the extent any of the items in this amount exceed the 5% disclosure threshold in Rule 4-08(h)(2) of Regulation S-X, please revise to disclose these amounts separately.</td>
</tr>
<tr>
<td>• Tell us your consideration for disclosing those items that account for more than 1.05 percentage points of your effective tax rate in [year 2] and 1.75 percentage points in [year 1] as stipulated in Rule 4-08(h)(2) of Regulation S-X.</td>
</tr>
<tr>
<td>• We note the reversal of $[X] million of your tax reserves primarily due to the settlement of an audit of your fiscal [year 1] through [year 3] federal corporate income tax returns. We also note your disclosure in prior filings that in [year 10], a preliminary understanding was reached with the IRS regarding the contested issues for the audit and post-audit years. Please tell us and disclose in more detail the reason for the significant change in amounts from the preliminary understanding to the final settlement.</td>
</tr>
<tr>
<td>• We note that you are currently litigating a tax matter with the [foreign] tax authority. Considering the potential significance, please tell us why you have not included a discussion of this matter in your financial statement footnotes disclosures or revise accordingly. We refer you to ASC 740-10-50-15(d).</td>
</tr>
</tbody>
</table>

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

• Omission of required disclosures (e.g., components of income [loss] before income tax expense [benefit] as either domestic or foreign).
• Limited or missing description of the income tax effects of any of the following:
  ◦ An accounting change or error, including amounts and classification within the financial statements.
  ◦ The adoption of an accounting standard.
  ◦ Tax elections, tax receivable agreements, and tax holidays.
  ◦ Unrecognized tax benefits (UTBs) when it is reasonably possible that the total amounts of UTBs will significantly increase or decrease within 12 months of the reporting date.
• Use of inappropriate non-GAAP measures related to income taxes.
2.12A Inventory

Example of an SEC Comment

We note your reference to excess and obsolete inventory reserves here and the rollforward analysis in your Schedule II disclosures. Please clarify for us whether you maintain an inventory valuation allowance through which subsequent recoveries are recorded, and if so, explain how that is consistent with the guidance noted in SAB Topic 5.BB and ASC 330-10-35-14. Otherwise, revise your disclosures regarding inventory reserves in future filings.

The SEC staff may ask registrants to clarify their accounting policy disclosures regarding excess and obsolete inventory adjustments, particularly when terms such as “reserve” or “valuation allowance” are used when making such disclosures. ASC 330-10-35-14 states that if a product’s cost is written down below its cost at the end of a fiscal period, this reduced amount will be the carrying amount or new “cost” of the product for all subsequent periods. Therefore, adjustments for excess and obsolete inventory are not considered “reserves” but rather permanent impairments of inventory. Consequently, registrants who use terms such as “reserve” or “valuation allowance” may be asked by the SEC staff to revise their disclosures.

2.13 Leases

In 2019, the new leasing standard (the guidance in ASU 2016-02, as amended, which is codified in ASC 842) was adopted by most SEC registrants. Consequently, the focus of the SEC staff’s comments on leasing transactions is shifting from registrants’ accounting under the legacy leasing standard (codified in ASC 840) to their application of the new leasing standard. While the number of comment letters related to the adoption of ASC 842 has increased over the past year, we have not yet seen a significant number of comment letters related to leasing transactions under ASC 842, and we believe that the SEC staff is still in the early stages of its review process. Although it is currently unclear what trends may result from staff comments on the application of ASC 842, the sections below discuss preliminary comment letter trends and other observations related to the application of the new leasing standard.

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8 ASU 2020-05 delayed the effective date of ASU 2016-02 for nonpublic companies and certain public not-for-profit (NFP) entities. The effective date for public NFP entities that qualify for the deferral under ASC 842-10-65-1(a) is annual periods beginning after December 15, 2019, and interim periods therein. The effective date for all other public companies remains unchanged.
The sections below also discuss comments issued in previous years on the application of ASC 840 since certain registrants may elect to defer adoption of ASC 842 in light of the revised effective dates allowed for certain entities under ASU 2020-05. While we did not observe any new comments related to ASC 840 in the current year, we believe that the themes discussed in Section 2.13.2, which were identified in prior years, remain applicable to entities that are still accounting for lease arrangements in accordance with that standard.

2.13.1 Application of the New Leasing Standard (ASC 842)

In addition to introducing a more principles-based accounting model, ASC 842 contains many new and modified quantitative and qualitative disclosure requirements, which significantly increase the amount of information disclosed about leasing activities and related transactions. Although relatively few SEC staff comments on the application of ASC 842 have been issued thus far, some observations in comments related to its application have emerged. For example, registrants have received comments on (1) how ASC 842 is being applied in certain arrangements, (2) the discount rate used to calculate the amount of the lease liability and corresponding right-of-use (ROU) asset, (3) the nature and treatment of variable lease payments that depend (or do not depend) on an index or rate, and (4) required ASC 840 disclosures in prior periods when the registrant has elected not to recast its comparative periods in the period of adoption when transitioning to ASC 842 (the “Comparatives Under 840 Option”). Other topics addressed in SEC staff comments on ASC 842 include, but are not limited to, the nature of expenses treated as initial direct costs, impairment considerations for ROU assets, and transition-related disclosures.

Given the low, albeit increasing, volume of SEC staff comments related to ASC 842 that have been issued thus far, registrants should continue monitoring staff comments to identify any new comments or trends related to the new leasing standard that may emerge in the future.

See Deloitte’s *A Roadmap to Applying the New Leasing Standard* for more information about ASC 842.

2.13.1.1 Accounting for Arrangements Under ASC 842

<table>
<thead>
<tr>
<th>Example of an SEC Comment</th>
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</thead>
<tbody>
<tr>
<td>We note that . . . you entered into a non-cancellable lease for an office building with an estimated construction cost of $[X] million. Please explain to us how you account for this project and lease agreement under ASC 842. See guidance in ASC 842-40-55-3 through 55-5.</td>
</tr>
</tbody>
</table>

The SEC staff has asked registrants to explain how they account for certain arrangements under ASC 842. As required by ASC 842-20-50-1, a lessee should ensure that it has appropriately disclosed qualitative information about its leases, including significant judgments used in the application of ASC 842. The information that a lessee discloses about the nature of its leases should be consistent with the disclosure objective of ASC 842 and generally is qualitative (e.g., the extent to which terms or conditions exist and a description of those terms or conditions). Registrants should ensure that their disclosures sufficiently describe how arrangements are accounted for in accordance with ASC 842, particularly when individual transactions are significant.

Further, as noted in ASC 842-20-50-2, a lessee should consider the appropriate level of disclosure aggregation or disaggregation so that it avoids “including a large amount of insignificant detail or . . . aggregating items that have different characteristics.”
2.13.1.2 Discount Rate

**Example of an SEC Comment**

We note from your disclosure . . . that the weighted-average discount rate used for finance leases is [X]% and the weighted-average discount rate used for operating leases is [Y]%. Please provide us with additional details regarding how you determined or calculated the weighted-average discount rates for each class of your leases.

The SEC staff has asked registrants to explain and revise their disclosure about the determination of the discount rate used to measure the lease liability and ROU assets recorded in accordance with ASC 842. Specifically, ASC 842-20-50-3(c)(3) states that the information a lessee is required to disclose about significant assumptions and judgments it made in applying the requirements of ASC 842 may include the “determination of the discount rate for the lease (as described in paragraphs 842-20-30-2 through 30-4).”

It is important for a lessee to consider disclosing information about the significant assumptions and judgments it used to determine its discount rate(s). For example, a lessee may need to disclose information regarding its determination of the incremental borrowing rate, such as collateral assumptions, the term used, and the economic environment in which the lease is denominated. To the extent that a portfolio approach is used to determine discount rates, a lessee should consider disclosing information about the composition of the portfolios.

In addition, since ASC 842-20-50-4(g)(4) requires lessees to disclose the weighted-average discount rate for both operating and finance leases, a lessee should consider whether the discount rate it used for some of its leases is significantly different from the discount rate it used for other leases and is therefore affecting the weighted-average calculation disclosed. In these situations, a lessee may want to consider providing additional disclosure of the discount rates that are affecting the lessee’s disclosed weighted-average rate. Further, a lessee with multiple asset classes of leases should consider providing additional disclosures on how the weighted-average discount rate was determined for each asset class, including any significant assumptions or judgments used in that calculation.

2.13.1.3 Variable Lease Payments That Depend (or Do Not Depend) on an Index or Rate

**Example of an SEC Comment**

We note your disclosure that you have certain lease agreements structured with a fixed base rent adjusted periodically for inflation or changes in fair market value of the underlying real estate. Please provide us with additional details regarding the terms of the rent adjustments including the basis for determining the adjustments. Please also tell us how you are accounting for leases structured with these adjustments both at the commencement of the lease and subsequently. Specifically address whether any of these lease agreements include variable lease payments that depend on an index or a rate.

The SEC staff has asked registrants to explain their treatment of variable lease payments that depend (or do not depend) on an index or rate. Comments received thus far have focused on the registrant’s initial estimates used in the calculation of lease payments that depend on an index or rate to comply with ASC 842-10-30-5(b), as well as subsequent accounting for these payments throughout the term of the lease agreement. Comments have also focused on the nature and terms of payments that are not initially measured by using the index or rate and are excluded from the measurement of the lease liability and ROU asset at commencement (i.e., variable payments that do not depend on an index or rate). Accordingly, it is important for registrants to adequately disclose the nature and accounting treatment of its different types of variable payments associated with its lease agreements.
In addition, the SEC staff has asked registrants to revise their disclosures in accordance with ASC 842-20-50-4 when they have not appropriately disclosed variable lease cost as a component of total lease cost.⁹

2.13.1.4 **Required Legacy ASC 840 Disclosures When Registrants Have Adopted ASC 842 by Electing the Comparatives Under 840 Option**

<table>
<thead>
<tr>
<th>Example of an SEC Comment</th>
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<tbody>
<tr>
<td>In future filings, please provide the required ASC 840 disclosures for all periods that continue to be reported in accordance with ASC 840 or explain why such disclosures are not required. Reference is made to ASC 842-10-65-1(jj).</td>
</tr>
</tbody>
</table>

The SEC staff has asked registrants that have elected to apply the Comparatives Under 840 Option available under ASC 842-10-65-1(jj) to provide ASC 840 disclosures for all periods in which they continue to report balances in accordance with ASC 840. Accordingly, registrants that have historically made relevant ASC 840 disclosures should carry forward those disclosures (to the extent that the ASC 842 disclosures are not repetitious) to help users of their financial statements understand lease balances presented in the financial statements under the legacy leasing standard.

2.13.2 **Application of the Legacy Leasing Standard (ASC 840)**

The SEC staff’s comments to registrants applying the legacy leasing guidance in ASC 840 historically have focused on (1) lease classification and (2) the evaluation of sale-and-leaseback transactions.

2.13.2.1 **Lease Classification**

The SEC staff has asked registrants to explain their considerations of the lease classification criteria in ASC 840-10-25-1. If a lease transfers title to the lessee by the end of the lease term or shortly thereafter for no additional consideration or for nominal consideration, the lease would be classified by the lessee as a capital lease. Further, if the lease contains a bargain purchase option, it also would be classified by the lessee as a capital lease. Consequently, it is important to disclose how the registrant determined that a bargain purchase option is reasonably assured or, in turn, how the registrant determined that it has not met the bargain purchase option criteria.

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

2.13.2.2 **Sale-and-Leaseback Transactions**

The SEC staff has also commented on how registrants evaluated whether a transaction qualifies for sale-and-leaseback accounting in accordance with ASC 840-40. Certain forms of continuing involvement may preclude a real estate transfer from qualifying for sale accounting (in which case, the real estate would remain on the seller’s books and be treated as a financing arrangement with the receipt of proceeds recognized as a financing obligation). Renewal options, residual value guarantees, nonrecourse financing, and provision of collateral on behalf of the buyer-lessee are some of the prohibited forms of continuing involvement that would preclude sale-and-leaseback accounting. Accordingly, the staff has inquired about registrants’ considerations and assumptions that support sale-and-leaseback accounting and has asked registrants to provide the required disclosures in the footnotes to the financial statements.

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⁹ While the comments on required disclosures have focused on the perspective of the lessee, similar disclosure requirements exist for lessors under ASC 842-30-50-5. Thus, these comments are equally applicable to lessors.
2.14 Materiality

Example of an SEC Comment

We note your disclosure that you made certain adjustments to fiscal [201X] earnings to correct errors attributable to prior years which you believe are both quantitatively and qualitatively immaterial to the current period and previously reported periods, including quarterly periods. . . . In order to assist us in understanding your disclosure, please provide us with the following additional information:

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

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

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

SAB Topic 1.M indicates that a “matter is ‘material’ if there is a substantial likelihood that a reasonable person would consider it important.” The definition of materiality is based on FASB Concepts Statement 2\(^{10}\) and on legal precedent in interpretations of the federal securities laws. The SEC staff has noted that in Supreme Court cases, the Court has followed precedent regarding materiality — namely, that the materiality requirement is met when there is a “substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information made available.”

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

To understand registrants’ materiality assessments and conclusions, the SEC staff frequently asks registrants about the nature of an error, the quantitative and qualitative factors that registrants considered, and an error’s impact on their conclusions about the effectiveness of their ICFR and DC&P. The SEC staff often challenges registrants’ conclusions that errors are immaterial; for example, the staff has asked about (1) whether the method used to correct an error was appropriate, (2) whether restatement disclosures were appropriately presented, and (3) whether an Item 4.02 Form 8-K was required to indicate nonreliance on previously issued financial statements.

\(^{10}\) 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.”
Accordingly, a registrant should first decide whether an individual error is material by considering (1) the effect of the misstatement on subtotals and totals in the financial statements and (2) the financial statements as a whole — keeping in mind what metrics are most important to the users of the financial statements. Then, 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 material to the users of the financial statements. In reaching this conclusion, the registrant should consider individual line items, subtotals and totals in the financial statements, and the financial statements as a whole. The SEC staff has cautioned registrants to avoid bright-line rules or litmus tests and “not to succumb” to rules of thumb or percentage thresholds when determining materiality because no one factor can be viewed as determinative.

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

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

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

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

The SEC staff has also observed that certain registrants have argued that a quantitatively large error in the GAAP financial statements is immaterial when it has a quantitatively small impact on non-GAAP metrics. While the staff has indicated that it may be appropriate for a registrant to look at metrics other than those that are GAAP-based in determining whether the financial statements taken as a whole are materially misstated, the SEC staff will most likely focus on the GAAP metrics unless a registrant can demonstrate why other metrics are more important to its investors. In addition, the SEC staff has acknowledged that while it is possible for quantitatively small errors to be material and for quantitatively large errors to be immaterial, a quantitatively material GAAP error does not become immaterial simply
because of the presentation of non-GAAP measures. Further, there may be circumstances in which an error that is otherwise immaterial to the GAAP financial statements — when taken as a whole and 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.¹¹

In addition to inquiring about a registrant’s materiality analysis under SAB Topics 1.M and 1.N, the SEC staff often asks questions about the errors themselves. Registrants should consider the impact that misstatements (and immaterial restatements) may have on their previous conclusions about ICFR and DC&P. As a result of such misstatements, the SEC staff may question whether a material weakness existed at the time of the initial assessment. For additional considerations, see Sections 3.5 and 3.6.

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 a Form 8-K when it has concluded that previously issued financial statements, covering either an annual or an interim period, should no longer be relied on because of an error.

2.15 Noncontrolling Interests

<table>
<thead>
<tr>
<th>Examples of SEC Comments</th>
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<tbody>
<tr>
<td>• [T]ell us how you attribute interests in [Company A] to noncontrolling interest.</td>
</tr>
<tr>
<td>• Please provide us with a detailed analysis of the balance sheet classification of the noncontrolling interest associated with the mandatory open offer . . . . Address how you considered the guidance in ASC 810-10-45-17, ASC 480-10-30-1, and ASC 480-10-55-54. Also tell us what consideration you gave to the classification guidance in ASC 480-10-S99-3A.</td>
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</table>

SEC staff comments related to noncontrolling interests have focused on the allocation of net income (loss) to the noncontrolling interest holder and the parent. Accordingly, a registrant may be asked to provide the SEC staff with detailed information about how the registrant determined the allocation, particularly when the allocation is disproportionate to the noncontrolling interest holder’s investment.

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

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

Thus, the SEC staff has indicated that “registrants with redeemable noncontrolling interests, redeemable preferred stock or other redeemable equity classified outside permanent equity should not include these items in any total or subtotal caption titled ‘total equity.’” Further, changing “the caption in the statement of changes in shareholders’ equity [from] ‘total equity’ to ‘total’ does not make the inclusion of redeemable equity acceptable.”¹²

¹¹ In its October 2010 joint webcast with the CAQ, the SEC staff also discussed non-GAAP financial measures in the context of materiality.
¹² Quoted text is from the highlights of the June 2009 CAQ SEC Regulations Committee joint meeting with the SEC staff.
For additional information about classification of redeemable securities, see Section 2.4.3.

Other Deloitte Resources
A Roadmap to Accounting for Noncontrolling Interests

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

2.16.1 Critical Accounting Estimates

Examples of SEC Comments

- In future filings, please provide a more robust discussion of your critical accounting policies and estimates to focus on the assumptions and uncertainties that underlie your critical accounting estimates. Please quantify, where material, and provide an analysis of the impact of critical accounting estimates on your financial position and results of operations for the periods presented. In addition, please include a qualitative and quantitative analysis of the sensitivity of reported results to changes in your assumptions, judgments, and estimates, including the likelihood of obtaining materially different results if different assumptions are applied. For example, if reasonably likely changes in the discount rate or long-term rate of return used in accounting for your pension and other post-retirement benefit plans would have a material effect on your financial condition or results of operations, the impact that could result given the range of reasonable outcomes should be disclosed and quantified. Please refer to SEC Release No. 33-8350. In your response, please show us what your disclosure would have looked like if these changes were made in your most recently filed Form 10-K.

- You determine your discount rate based on a review of published financial data and discussions with your actuary regarding rates of return on high-quality, fixed-income investments currently available and expected to be available during the period to maturity of your pension and postretirement plan obligations. We note that there was minimal change in the discount rate used to determine the net periodic benefit obligations at [the end of fiscal year 1] and [the end of fiscal year 2] for your pension benefits. . . . Similarly there was no change in the weighted average discount rate assumption used to determine net periodic benefit cost for [fiscal years 1 and 2]. We also note that [an X%] increase in your discount rate based on the sensitivity analysis provided . . . could cause [an $X million] decrease in pension expense compared to pre-tax income of [$Y million] recorded during [fiscal year 2]. In this regard, please help us better understand how you arrived at the appropriate discount rate to use each period in accounting for your pension plans pursuant to ASC 715.

Because of factors such as the low-interest-rate environment, optionality in U.S. GAAP accounting methods, and significant assumptions used in benefit obligation valuation, the SEC staff has continued to ask registrants about assumptions related to their pension and other postretirement benefit plans. For example, the staff has requested more quantitative and qualitative information about the nature of registrants’ assumptions. In particular, the staff has focused on the discount rate and the expected return on plan assets. Further, the staff has asked registrants how their disclosures in the critical accounting estimates section of MD&A align with their accounting policy disclosures in the notes to the financial statements. The staff expects registrants to provide robust disclosures of their critical accounting policies and estimates in MD&A, as opposed to merely duplicating documentation from the accounting policy disclosures in the financial statement footnotes.
In addition, the SEC staff has indicated that it may be appropriate for a registrant to disclose the following:

- Whether a corridor\(^1\) is used to amortize the actuarial gains and losses and, if so, how the corridor is determined and the period for amortization of the actuarial gains and losses in excess of the corridor.
- A sensitivity analysis estimating the impact of a change in expected returns on income. This estimate should be based on a reasonable range of likely outcomes.
- How the registrant calculates historical returns to develop its expected rate of return assumption. If use of the arithmetic mean to calculate the historical returns produces results that are materially different from the results produced when the geometric mean is used to perform this calculation, it may be appropriate for the registrant to disclose both calculations.
- The reasons why the expected return has changed or is expected to change in the future.
- The effect of plan asset contributions during the period on profit or loss, when this effect is significant. The SEC staff has indicated that additional plan asset contributions reduce net pension costs even if actual asset returns are negative because the amount included in profit or loss is determined through the use of expected, as opposed to 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.

### 2.16.2 Alternatives to Applying Discount Rates for Defined Benefit Plans

#### Example of an SEC Comment

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

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

The amounts of service cost, interest cost, and actuarial gains and losses recognized under the spot rate approach would generally differ from those recognized under the single weighted-average discount rate approach. For example, in an upward-sloping yield curve environment, the spot rate approach would generally result in lower interest cost and higher actuarial loss (or lower actuarial gain) than the single weighted-average discount rate approach. An entity measures the interest cost by applying duration-specific spot rates to the year-by-year projected benefit payments.

\(^1\) 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.”
weighted-average discount rate approach. Because the measurement of the benefit obligation as of each measurement date under the single weighted-average discount rate approach is the same as that under the spot rate approach, any change in the service cost or interest cost component would result in a different expected benefit obligation, which — compared with the remeasured benefit obligation (as of the next measurement date) — would give rise to an additional actuarial gain or loss so that the beginning-of-the-year benefit obligation is reconciled to the end-of-the-year benefit obligation. This actuarial gain or loss would be included with the other gains or losses and would then be recognized in net income in accordance with the entity's accounting policy for recognizing actuarial gains and losses in earnings (i.e., either immediate recognition or some other acceptable method of amortization under ASC 715). Accordingly, a change to the spot rate approach for measuring service cost and interest cost and the resulting differences in service cost, interest cost, and actuarial gains and losses could materially affect an entity's financial statements as well as a registrant's non-GAAP financial performance disclosures (to the extent that those items are reflected in non-GAAP measures). The SEC staff has indicated that it would not object if entities that use a yield curve approach (rather than bond matching or another method) to measure their defined benefit obligation change from the single weighted-average discount rate approach to a spot rate approach for measurement of interest cost. The staff has further indicated that it would not object to accounting for that change in approach as a change in estimate in such circumstances.

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

- ASC 250-10-50-4, which requires disclosure of the material effect of changes in accounting estimates on income statement and earnings-per-share measurements.
- ASC 715-20-50-1(k) and (r), as supplemented by ASC 715-30-35-45, which require disclosure of (1) the discount rates used for the benefit obligation and net periodic benefit cost as well as (2) an explanation for any significant change in the benefit plan obligation not otherwise apparent in the other required disclosures of ASC 715.

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

Further, the staff discussed the transparency of required non-GAAP disclosures under Regulation G. The staff highlighted that it expects registrants to disclose any significant impact of a change in the approach used to measure net periodic benefit cost on any non-GAAP measures. Specifically, registrants should explain how the change in approach affects components of net periodic benefit cost and actuarial gains and losses in the current period and on a prospective basis to the extent that those items are reflected in non-GAAP measures. For more information, see Section 3.4.

In accordance with these guidelines from the SEC staff, registrants should consider quantifying and disclosing the impact of a change to the spot rate approach in the year the change in estimate is recognized. Specifically, a registrant should consider disclosing the difference between service cost, interest cost, and actuarial gains and losses under the current approach (e.g., spot rate approach) and those under the prior approach (i.e., aggregated approach). Because ASC 715 requires disclosure of weighted-average discount rates used to determine the benefit obligation and net periodic benefit cost,
a registrant should consider that the weighted-average rate used to determine the benefit obligation is likely to be different from the weighted-average rates associated with service cost and interest cost components under the spot rate approach. In thinking about the financial statement disclosure requirements related to assumptions under ASC 715 as well as disclosures by registrants regarding critical accounting policies under Section II.J of the SEC’s Current Accounting and Disclosure Issues in the Division of Corporation Finance (updated November 30, 2006), registrants should consider disclosing a narrative description of how discount rates were determined along with the approach for how such discount rates have been applied to measure service cost and interest cost components.

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

### 2.16.3 Liquidity and Capital Resources

**Example of an SEC Comment**

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

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

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

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

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

The disclosures required by ASC 715 for fair value measurements of 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 Section 2.7. A registrant also should disclose whether the fair value or calculated value\textsuperscript{15} 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.

2.16.5 Immediate Recognition of Gains and Losses

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

Once an entity adopts a policy of immediately recognizing gains and losses, changing to a less preferable method (i.e., a subsequent change to a method that results in slower amortization) would be difficult to support. When entities adopt a policy of immediately recognizing actuarial gains and losses as a component of net periodic pension cost, they often present non-GAAP financial measures that “remove the actual gain or loss from the performance measure and include an expected long-term rate of return.”\textsuperscript{16}

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 for adjustments related to actuarial gains and losses is not provided.

2.16.6 Disclosures Related to Non-U.S. Plans

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

\textsuperscript{15}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).

\textsuperscript{16}For more information, see the highlights of the June 2012 CAQ SEC Regulations Committee joint meeting with the SEC staff.
2.17 Revenue Recognition

Early adopters of the new revenue standard (codified primarily in ASC 606) began to receive comments from the SEC staff in mid-2017. With most calendar-year-end public companies filing under the new revenue standard in the first quarter of 2018, the SEC staff's comments on revenue recognition have shifted to the application of the new revenue standard.

In addition to introducing a more principles-based accounting model, ASC 606 contains many new and modified quantitative and qualitative disclosure requirements, which significantly increase the amount of information disclosed about revenue activities and related transactions. While the standard is still relatively new, some themes in SEC staff comments related to its application have emerged. For example, registrants have received SEC staff comments on (1) significant judgments, (2) performance obligations, (3) contract costs, (4) disaggregation of revenue, (5) contract balances, and (6) remaining performance obligations. Those themes are discussed below.

2.17.1 Significant Judgments

ASC 606-10-50-17 through 50-20 require entities to provide disclosures about the significant judgments they made in applying the new revenue standard. The SEC staff has issued comments to registrants on their disclosures about such significant judgments and the appropriateness of conclusions they reached as a result of applying those significant judgments. The significant judgments on which the staff has commented can generally be classified into four broad categories: (1) identification of performance obligations, (2) determination of the transaction price, (3) allocation of the transaction price, and (4) identification of a measure of progress. These types of significant judgments are discussed below.
2.17.1.1 Identification of Performance Obligations

Examples of SEC Comments

- You state your subscription performance obligations consist of licenses, [postcontract customer support], and rights to continued delivery of unspecified upgrades, major releases and patches. Please provide us with your analysis as to how you determined it was appropriate to combine these promises into one performance obligation, with reference to ASC 606-10-25-19 through 25-21.

- We note your disclosure regarding three performance obligations under your franchise agreements. It appears that you have concluded that these items are not distinct and therefore are not separate performance obligations given your conclusion that they are highly interrelated. Please revise your disclosure to clarify your conclusions. Reference 606-10-25-22.

- For contracts that require the use of certain equipment in order to receive service, please tell us the significant judgements used in determining if equipment should be considered a separate performance obligation. Please refer to ASC 606-10-25-19 through 25-22.

- Please provide us the following information regarding your contracts that include a perpetual license and hosting services and revise your disclosures as appropriate:
  - Clarify for us whether you have determined if the perpetual license and the hosting service are one combined performance obligation and provide us with your analysis. Reference ASC 606-10-25-21.
  - If the perpetual license and the hosting service are one combined performance obligation, tell us the period of time over which you are recognizing revenue for the combined performance obligation. If this period is longer than your initial hosting period, please explain the basis for this determination.
  - Tell us if you have identified the material right as a separate performance obligation. If you have combined the material right with the perpetual license and hosting service, please tell us how you made this determination. Reference ASC 606-10-55-42.
  - Tell us the period of time over which you are recognizing revenue for your material right. If this period begins prior to the time the additional hosting services are provided or when the material right expires, please explain to us the basis for this determination. Reference ASC 606-10-55-42.

The SEC staff has stated\(^\text{17}\) that it believes it is important for companies to provide clear and transparent disclosures regarding the identification of performance obligations and that companies are likely to receive comments from the staff if a disclosure related to such identification is unclear or appears to conflict with the guidance. In a manner consistent with this statement, many of the staff’s comments on significant judgments have raised issues related to the identification of performance obligations. These comments have included requests for additional disclosure of the significant judgments made in the identification of performance obligations and often question the appropriateness of the identified performance obligations. For example, in at least one case, the staff questioned whether maintenance, support, and warranty services represented a single performance obligation. In addition, the staff has focused on contracts with promises to provide multiple goods and services to a customer and has questioned the conclusion of whether such goods and services are distinct performance obligations under ASC 606-10-25-19 through 25-22. Further, the staff has requested additional information from registrants to understand how they determined whether an option for additional goods or services was a material right.

\(^{17}\) Remarks were made at the 2018 AICPA Conference.
2.17.1.2 Determination of the Transaction Price

Examples of SEC Comments

- We note your disclosure that your solar power system sales include performance guarantees that represent a form of variable consideration and are recognized as adjustments to revenue. Please help us better understand your accounting for these potential bonus payments and/or liquidated damages. In this regard, based on your disclosure, it is unclear to us whether these amounts are included as part of your estimate of your transaction price at the outset of the arrangement and then reassessed at the end of each reporting period. Refer to ASC 606-10-32-5 through 32-10 and ASC 606-10-32-14.

- You state that you do not offer refunds, rebates, credits or other forms of variable consideration; however, you also indicate that the transaction price includes estimates of variable consideration. Please clarify the nature of the variable consideration included in your contracts. Refer to ASC 606-10-32-5 through 32-7 and ASC 606-10-50-20.

- You disclose . . . that every . . . Certified listing carries a 30-day return policy. Please tell us how you have considered this return policy in determining the transaction price in these arrangements. Refer to ASC 606-10-32-5 through 32-9.

- Please provide us with your analysis regarding payments made to partners. Describe in detail the nature of these payments and further clarify when payments are classified as marketing expenses and when payments are recognized as a reduction in revenue. Refer to ASC 606-10-32-25 and 26.

- We note certain advertising contracts have guarantees of audience member views. Please clarify if these guarantees are treated as variable consideration in determining your transaction price. Refer to ASC 606-10-32-5 and 606-10-50-20.

- We note you constrain estimates of variable consideration. Please explain to us the judgments used in assessing whether an estimate of variable consideration is constrained. In this regard, describe to us the factors that resulted in the constraint of variable consideration and how the constraint will be resolved. In addition, tell us how you considered ASC 606-10-50-17 and 50-20 related to disclosures of significant judgments used in determining the transaction price.

- In your Product Revenue disclosure . . . , you indicate that you estimate variable consideration using the most likely method. Please tell us why it is appropriate to apply this method rather than the expected value method. See ASC 606-10-32-8. In addition, tell us where you have made the disclosure specified in ASC 606-10-50-12b or your consideration for providing this disclosure.

Another topic of significant judgment under the new revenue standard is the determination of the transaction price. As a result, the SEC staff has focused on disclosures about how such a determination is made, particularly those related to variable consideration. The staff has questioned registrants on multiple types of variable consideration and requested additional information about how, and to what extent, such consideration has been included in the transaction price. Further, the staff has questioned whether variable consideration was constrained and, if so, the significant judgments that went into the determination of the constraint and when the constraint will be removed.

2.17.1.2.1 Sales- or Usage-Based Royalty Exception for Licenses of Intellectual Property

Example of an SEC Comment

Tell us if you believe these arrangements contain a functional license of intellectual property and if this is the predominant item to which royalties relate.
ASC 606-10-55-65 and 55-65A provide an exception to the inclusion of certain sales- or usage-based royalties in the determination of the transaction price, stating that revenue from a sales- or usage-based royalty related to a license of IP should be recognized at the later of when (1) the “subsequent sale or usage occurs” or (2) the “performance obligation to which some or all of the sales-based or usage-based royalty has been allocated has been satisfied (or partially satisfied),” provided that the license of IP is “the predominant item to which the royalty relates.” The SEC staff has questioned the application of ASC 606-10-55-65 to certain sales- or usage-based royalty arrangements in which the license of IP is combined with other goods and services and whether, in such arrangements, the license of IP is “the predominant item to which the royalty relates.”

### 2.17.1.3 Allocation of the Transaction Price

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<th>Examples of SEC Comments</th>
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<tr>
<td>• We note . . . that your contracts satisfy the allocation requirements in ASC 606-10-32-40. In future filings, please expand your disclosure of the nature of your performance obligation to clarify that your performance obligation is a series and how you allocate variable consideration to each distinct service in the series.</td>
</tr>
<tr>
<td>• Please tell us why the standalone selling price of software is typically estimated using the residual approach and how you met one of the criteria in ASC 606-10-32-34(c). To the extent you have determined the selling price for your software is highly variable; please provide a comprehensive, quantitative discussion of such variability to support your conclusions.</td>
</tr>
<tr>
<td>• We note the minimum and maximum amounts; however, it is unclear to us how you considered transactions within this range. Please provide us with more details of your analysis. In this regard, please tell us whether a significant number of transactions fell within a smaller portion of this range. Reference ASC 606-10-32-34(c).</td>
</tr>
<tr>
<td>• Please disclose the methods, inputs and assumptions used to allocate the transaction service fee charged to the car dealer to the identified performance obligations. Refer to ASC 606-10-50-20c.</td>
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</table>

SEC staff comments on significant judgments have also addressed the allocation of the transaction price. The staff has asked registrants to expand their disclosures about the significant judgments they have made, including the “methods, inputs, and assumptions” inherent in the allocation process. For example, the staff has requested that registrants enhance their disclosures to clarify (1) that a performance obligation represents a series and (2) the method used to allocate consideration to each distinct good or service in the series. In addition, the staff has questioned how registrants determined the stand-alone selling price of a good or service, including the application of the residual approach as well as how the registrants considered a range of transactions in determining the stand-alone selling price.

### 2.17.1.4 Identification of a Measure of Progress

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<th>Examples of SEC Comments</th>
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<tr>
<td>• [F]or those contracts that do meet the over time recognition criteria please tell us and disclose the nature of the input method you will use to recognize revenue as you produce the specified units. Also, disclose why this method provides a faithful depiction of the transfer of the goods. See ASC 606-10-50-18.</td>
</tr>
<tr>
<td>• Revise future filings to disclose why for performance obligations that you satisfy over time the method used provides a faithful depiction of the transfer of goods or services. Refer to ASC 606-10-50-18.</td>
</tr>
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</table>
For performance obligations satisfied over time, the SEC staff has reminded registrants to satisfy the requirements of ASC 606-10-50-18 to disclose (1) the “methods used to recognize revenue” and (2) an “explanation of why the methods used provide a faithful depiction of the transfer of goods or services.”

2.17.2 Performance Obligations

In addition to the comments discussed above related to the significant judgments inherent in the identification of performance obligations, the SEC staff has issued comments on certain disclosure requirements (under ASC 606-10-50-12) related to the identified performance obligations.

ASC 606-10-50-12 requires entities to disclose information about their performance obligations in contracts with customers. The SEC staff’s comments to registrants on disclosures required under ASC 606-10-50-12 can be categorized at a high level into four primary areas of focus: (1) timing of revenue recognition; (2) significant payment terms; (3) significant financing components; and (4) the nature of goods and services, including principal-versus-agent considerations. These topics are discussed in the sections below.

2.17.2.1 Timing of Revenue Recognition

<table>
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<th>Examples of SEC Comments</th>
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<tr>
<td>• For sales made through your indirect distribution channels, please clarify whether the performance obligation of providing software licenses is satisfied upon shipment or when the software is made available for download, to your indirect distribution partners or to the end user. Tell us how you considered the guidance in ASC 606-10-25-30 and ASC 606-10-55-58C in determining the point in time at which you recognize revenue and disclose any significant judgements made in evaluating when control is transferred. Refer to ASC 606-10-50-19.</td>
</tr>
<tr>
<td>• We note your disclosure that revenue for [original equipment manufacturer (OEM)] serial production contracts requiring customization is generally recognized at a point in time. Please explain to us why you believe these contracts do not meet the criteria for over time recognition, specifically the criteria that they have no alternative use and you have enforceable right of payment. See guidance at ASC 606-10-25-27.</td>
</tr>
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</table>

One of the key considerations related to the timing of revenue recognition under the new revenue standard is whether a performance obligation is satisfied at a point in time or over time. For instance, in a scenario in which a registrant is constructing an asset for a customer by using the customer’s specifications, the SEC staff has questioned how the registrant considered the criteria in ASC 606-10-25-27 through 25-29 in determining whether revenue should be recognized at a point in time or over time. Further, the staff has issued comments related to the identification of the appropriate point in time at which to recognize revenue.

2.17.2.2 Significant Payment Terms

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<th>Examples of SEC Comments</th>
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<tbody>
<tr>
<td>• Revise to disclose significant payment terms for sales of mileage credits to credit card companies, hotels, and car rental agencies pursuant to ASC 606-10-50-12(b).</td>
</tr>
<tr>
<td>• Please tell us how you considered and complied with the disclosures requirement outlined in ASC 606-10-50-12(b) with respect to significant payment terms.</td>
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</tbody>
</table>
ASC 606-10-50-12(b) requires an entity to disclose the “significant payment terms (for example, when payment typically is due, whether the contract has a significant financing component, whether the consideration amount is variable, and whether the estimate of variable consideration is typically constrained . . . ).” As a result, the SEC staff has requested that registrants disclose significant payment terms such as those described in ASC 606-10-50-12(b).

### 2.17.2.3 Significant Financing Components

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<th>Examples of SEC Comments</th>
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<tr>
<td>• Given that the majority of your revenue is generated from long-term contracts, please provide us with your analysis on if they contain a significant financing component. If a material portion of your contracts contain a significant financing component, please revise to disclose this information pursuant to ASC 606-10-50-12(b). If you relied upon the practical expedient based pursuant to ASC 606-10-32-18, disclose this pursuant to ASC 606-10-50-22 and confirm the timing between progress payments and transfer of control and payment was not expected to exceed one year.</td>
</tr>
<tr>
<td>• Your . . . contracts do not include a significant financing component because the primary [purpose] of your invoicing terms is to provide customers with simplified and predictable ways of purchasing your products and services, not to receive financing. You disclose your . . . contracts entitle you to receive advance payment at the beginning of the contract but you do not typically consider this to be a significant financing component. Please explain to us how you determined that the payment terms of your contracts do not contain a significant financing component under ASC 606-10-32-15 through 32-18. Address how you concluded that the difference between the promised amount of consideration and the cash selling price is proportional to the reasons for that difference.</td>
</tr>
</tbody>
</table>

ASC 606-10-50-12(b) requires an entity to disclose “whether the contract has a significant financing component.” Consequently, the SEC staff has issued comments requesting that registrants clarify how they reached the conclusion that their contracts did not include a significant financing component, as well as requesting future disclosure if a registrant elected the practical expedient in ASC 606-10-32-18 that permits an entity not to recognize a significant financing component if the time between the transfer of a good or service and payment is one year or less.

### 2.17.2.4 Nature of Goods or Services, Including Principal-Versus-Agent Considerations

<table>
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<th>Examples of SEC Comments</th>
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<tr>
<td>• We note from . . . your . . . Form 10-K (Competition) that you provide transportation services to third-party logistics providers that determine both the mode of transportation and the carrier. Please tell us the nature of these arrangements in further detail and explain to us whether you are the principal or agent pursuant to ASC 606-10-55-36 through 55-39. Further, to the extent these arrangements are material, disclose whether you present revenues earned from third-party logistics providers on a gross or net basis pursuant to ASC 606-10-50-12(c).</td>
</tr>
<tr>
<td>• We note your description of various goods and services related to your cruise offerings, which may include round-trip airfare and pre-cruise hotel packages. Provide us with your analysis regarding how you determined gross reporting for pre-cruise and post-cruise services was appropriate pursuant to ASC 606-10-55-36 through 39. Please specifically address how you considered the definition of control and how you are directing any third party providers.</td>
</tr>
</tbody>
</table>
**Examples of SEC Comments (continued)**

- Your disclosure indicates that transaction fees collected from your customers are recognized as revenue on a gross basis because you are the principal in respect of processing payments. Please describe the services provided by each party involved in the payment processing transaction and tell us how you determined you control each service before it is transferred to the customer. Reference ASC 606-10-55-36 through 40.

- We note your disclosure that when more than one party is involved in providing services to a customer, you generally act as the principal and report revenue on a gross basis. Please tell us which arrangements involve third parties and tell us how you determined you control each service before it is transferred to the customer. In addition, we note your disclosure . . . regarding agent commissions. Please help us understand the nature of these agent services. Reference ASC 606-10-55-36 through 40.

- Please explain to us the process by which interchange fees are earned and explain [your] role in the payment processing system. Tell us whether a portion of the interchange fee received by the company is remitted to a third party. If so, tell us whether revenue from these fees is presented net or gross of the amounts remitted to the third party and explain how you arrived at that determination.

For each identified performance obligation, registrants are required by ASC 606-10-50-12(c) to disclose the “nature of the goods or services that the entity has promised to transfer, highlighting any performance obligations to arrange for another party to transfer goods or services (that is, if the entity is acting as an agent).” The SEC staff has often referred to ASC 606-10-50-12 when commenting that the registrant should provide greater detail of the nature of the goods or services that the registrant has promised to transfer. Further, the staff has asked registrants to clarify whether they are presenting revenue on a gross or net basis and to explain how the conclusion to report revenue on a gross or net basis was reached. There are many significant judgments that registrants have to make in reaching a conclusion about whether they are principals or agents. As a result, the staff has stated that registrants should be mindful of the requirement in ASC 606-10-50-17 to “disclose the judgments, and changes in the judgments, made in applying the guidance in this Topic that significantly affect the determination of the amount and timing of revenue from contracts with customers.”

### 2.17.3 Contract Costs

**Examples of SEC Comments**

- Please revise to disclose the method by which you amortize the initial commission costs over the five-year period of benefit. Refer to ASC 340-40-50-2.

- It appears that a portion of your sales commissions is expensed upon delivery of the software license and a portion related to services is deferred. If so, please revise to clarify how your amortization expense reflects the transfer of the license and services to your customer. Refer to ASC 340-40-35-1 and 340-40-50-2(b).

- Please tell us, and revise to clarify if appropriate, whether additional sales commissions are paid upon contract renewal and, if so, whether such amounts are commensurate with the initial commissions. Please also disclose how commissions paid for renewals are considered in your five year period of benefit for the initial commission. Finally, please disclose the period of time over which you amortize commission costs related to contract renewals. Refer to ASC 340-40-35-1 and 340-40-50-2(b).

- You disclose that deferred commissions paid upon the acquisition of an initial contract and any subsequent renewals are amortized over an estimated period of benefit based upon the weighted-average term of contracts and related product and service delivery periods. Please explain further what you mean by the “weighted average term of contracts and related product and service delivery periods.” In addition, please clarify how you are accounting for commissions paid on renewals. Refer to ASC 340-40-50-2.
Under the new revenue standard and in accordance with ASC 340-40, entities capitalize certain costs associated with obtaining or fulfilling a revenue contract. ASC 340-40-50-1 through 50-3 require disclosures about such costs. Consequently, the SEC staff has asked registrants to provide additional disclosures about their capitalization of contract costs and the related period of amortization. Specifically, the SEC staff has requested additional disclosure about (1) the method being used to amortize the capitalized costs and (2) how the selected amortization period correlates with the period of benefit. Further, when additional commissions are paid upon renewal, the staff has questioned (1) whether such commissions are commensurate with the initial commissions and (2) how such renewals are considered in the amortization period.

### 2.17.4 Disaggregation of Revenue

#### Examples of SEC Comments

- We note your presentation of disaggregated revenue by major source . . . . With respect to the disclosure requirements of ASC 606-10-50-5, please tell us how you considered the guidance in paragraphs ASC 606-10-55-89 through 55-91 in selecting the appropriate categories to use to disaggregate revenue.

- You present “vehicles, parts, and accessories” as a major source of revenue. Please explain to us why the aggregation of revenue from “parts and accessories” with revenue from “vehicles” is appropriate pursuant to ASC 606-10-50-5. We note from your disclosures that parts and accessories appear to be subject to return from customers, whereas this does not appear to be the case for vehicles. It also appears these categories may have other different characteristics, such as type of good, pricing and dollar magnitude of contribution to margins.

- We note you provide other information outside your financial statements regarding the nature, amount, timing, and uncertainty of revenue and cash flows arising from your contracts with customers, including but not limited to:
  - Monthly sales reports which include unit sales by brand, by vehicle type, and between retail and fleet sales. These reports also include a discussion of underlying trends for key vehicles and some information on transaction prices.
  - A Strategic Update . . . which includes a discussion of plans to shift allocation of capital from cars to SUVs and trucks and to expand electric vehicles revenue opportunities.
  - An earnings call . . . which includes a discussion of the strong performance of commercial vehicles as well as consumers moving away from passenger cars and into utilities and trucks and your increasing investments in these areas as a result.

Given the information cited above, it appears other information about your automotive segment’s revenue (beyond geographical information) is used by the company and users of your financial statements to evaluate your financial performance or to make resource allocation decisions. In this regard, please tell us how you considered the presentation and use of such information pursuant to ASC 606-10-55-90(c) when determining the appropriate disaggregated revenue categories that depict how the nature, amount, timing and uncertainty of cash flows are affected by economic factors and in the context of meeting the overall disclosure objective of ASC 606-10-50-1.

- Please tell us what consideration you gave to disaggregating revenue by type of customer and timing of revenue recognition. Refer to ASC 606-10-55-91c and f.

ASC 606-10-50-5 requires disaggregation of “revenue recognized from contracts with customers into categories that depict how the nature, amount, timing, and uncertainty of revenue and cash flows are affected by economic factors.” ASC 606-10-55-91 states that categories that may be appropriate for an entity’s disclosures in the financial statements include (1) “[t]ype of good or service,” (2) “[g]eographical region,” (3) “[m]arket or type of customer,” (4) “[t]ype of contract,” (5) “[c]ontract duration,” (6) “[t]iming of transfer of goods or services,” and (7) “[s]ales channels.”
The SEC staff has issued comments to registrants asking them to clarify how they determined the categories in which to present disaggregated revenue information. It has reminded registrants that when assessing which categories are appropriate, they should consider information disclosed outside of the financial statements, such as in earnings calls and investor presentations. Further, the SEC staff has questioned whether a registrant’s selected categories are appropriate given the registrant’s business model and whether the categories depict how revenue and cash flows are affected by economic factors.

2.17.5 Contract Balances

**Examples of SEC Comments**

- Tell us your significant payment terms and how the timing of satisfaction of performance obligations relates to the timing of payment and the effect on the contract asset and liability balances. Disclose the information required by ASC 606-10-50-9 and 50-12(b) in future filings.
- You disclose that there are circumstances where customer incentives issued may exceed the reduction of revenue recorded over the contract term, and result in a recorded contract asset. Please provide examples of the types of incentives that would drive the generation of these contract assets and describe how those incentives would exceed the reduction of revenue over the contract term.
- Refer to ASC 606-10-50-8 through 15. Please tell us how you have considered shipments in transit at period-end as contract liabilities and remaining performance obligations. In this regard, if you recognize revenue in both segments based on time based metrics as stated in [your] note, it would appear that a portion of revenue for all in-transit shipments would qualify as remaining performance obligations and contract assets/liabilities.

ASC 606-10-50-8 through 50-10 require an entity to disclose (1) the “opening and closing balances of receivables, contract assets, and contract liabilities from contracts with customers, if not otherwise separately disclosed”; (2) “[r]evenue recognized in the reporting period that was included in the contract liability balance at the beginning of the period”; (3) an explanation of (a) “how the timing of satisfaction of [the entity’s] performance obligations [is related] to the typical timing of payment” and (b) “the effect that those factors have on the contract asset and the contract liability balances”; and (4) “an explanation of the significant changes in the contract asset and the contract liability balances during the reporting period” (including qualitative and quantitative information). The SEC staff has issued comments to registrants asking them to include additional information in their disclosures about how contract balances are derived.

2.17.6 Remaining Performance Obligations

**Examples of SEC Comments**

- Please tell us how you considered the requirements in ASC 606-10-50-13 to 50-15 to disclose information about remaining performance obligations or application of optional exemptions. In that regard, we note that in your Form 10-K . . . you state that you sell product to your largest customer, representing [X]% of total sales for the year, under a long-term contract. You further state that for your other customers you typically sell to them under contracts with one to two year terms.
- Please tell us and disclose the transaction price allocated to the performance obligations that are unsatisfied . . . and explain when you expect to recognize such amount. Refer to ASC 606-10-50-13. This would appear to include amounts referred to as Other Backlog as provided in the Form 8-K furnished . . . . If you are applying the practical expedient in 606-10-50-14 please tell us and disclose. Refer to 606-10-50-15.
Chapter 2 — Financial Statement Accounting and Disclosure Topics

ASC 606-10-50-13 through 50-15 require entities to provide information about the transaction price allocated to the remaining performance obligations. As a result, the SEC staff has asked registrants how they satisfied the disclosure requirements of ASC 606-10-50-13 through 50-15. For example, the staff has asked registrants how they complied with the guidance in ASC 606-10-50-13(b) that requires an entity to disclose when it expects to recognize amounts recorded as deferred revenue.

Other Deloitte Resources

A Roadmap to Applying the New Revenue Recognition Standard


July 11, 2018, Heads Up, “ASC 606 Is Here — How Do Your Revenue Disclosures Stack Up?”

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

Examples of SEC Comments

- We note the disclosures . . . relating to the impact of CECL and the discussion of the quantitative build to the allowance disclosed by your CFO at the conference . . . but were unable to locate this information in your Form 10-K . . . . Please revise to include this information in future filings . . . , consistent with SAB Topic 11.M.
- You state that you expect the impact of adoption of Topic 842 to be material to total assets and liabilities on the consolidated balance sheets. Please quantify the impact of adoption to the extent that you have determined such amounts. If you cannot reasonably estimate the impact of adoption, please revise to provide more specific qualitative disclosures of the potential impact that this standard will have on your financial statements when adopted. Also describe the status of your process to implement the new standard and the significant implementation matters yet to be addressed. Refer to ASC 250-10-S99-6 and SAB Topic 11.M.

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

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

- A brief description of the new standard, the date that adoption is required and the date that the registrant plans to adopt, if earlier.
- A discussion of the methods of adoption allowed by the standard and the method expected to be utilized by the registrant, if determined.
- A discussion of the impact that adoption of the standard is expected to have on the financial statements of the registrant, unless not known or reasonably estimable. In that case, a statement to that effect may be made.
- Disclosure of the potential impact of other significant matters that the registrant believes might result from the adoption of the standard (such as technical violations of debt covenant agreements, planned or intended changes in business practices . . . ).
The SEC staff has been reminding registrants about best practices to apply in the periods leading up to the adoption of ASU 2016-02 (the “new leasing standard,” which is codified in ASC 842) and ASU 2016-13 (the “new credit losses standard,” which is codified in ASC 326). The staff's comments reiterate themes it has addressed over the past three years that have focused on disclosures related to implementation activities.

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

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

Since the 2016 Announcement, the SEC staff has continued to emphasize the importance of providing these transition disclosures for new standards, which now include ASU 2017-12 (the “new derivatives and hedging standard,” which is codified in ASC 815) and ASU 2018-12 (the “new long-duration insurance contracts standard,” which is codified in ASC 944). The staff has also explained that it would expect these disclosures to become more informative to the financial statement users as a company's required adoption dates come closer.

While most registrants have adopted the new leasing standard and the new derivatives and hedging standard, EGCs that have elected to use the non-PBE effective date of ASC 842 and ASC 815 have not yet adopted those standards. Further, some registrants have not yet adopted the new credit losses standard and the new long-duration insurance contracts standard. Registrants should focus on providing appropriate disclosures in the periods leading up to their adoption of the new standards.

Other Deloitte Resources

- June 3, 2020, Heads Up, “FASB Defers Effective Dates of Revenue and Leasing Standards for Certain Entities”
- November 19, 2019, Heads Up, “FASB Changes Some Effective Dates for Certain New Accounting Standards”
- A Roadmap to Applying the New Leasing Standard
- August 2018, Insurance Spotlight, “FASB Makes Targeted Improvements to the Accounting for Certain Long-Duration Insurance Contracts”

2.19 Segment Reporting

Segment reporting remains a perennial topic of SEC staff comments. Like those issued in previous years, recent staff comments have specifically addressed (1) the identification of operating segments, (2) the aggregation of operating segments, (3) changes in reportable segments, (4) reporting considerations for entities with a single reportable segment, and (5) entity-wide disclosures.

Segments as defined by ASC 280 provide a basis for an SEC registrant's required disclosures in the business and MD&A sections of the registrant's filing. Accordingly, registrants should also be mindful of the SEC's guidance on non-GAAP measures applicable to the financial information presented in their filings. Financial measures that a registrant must disclose under U.S. GAAP are not considered non-GAAP measures under the SEC's guidance. The most common examples of such measures are related to segment financial information such as revenue, profit or loss, and total assets for each reportable segment. However, a registrant should ensure that reported amounts are consistent with the measures required to be reported under ASC 280. Any aggregation of individual segment amounts or other segment information voluntarily provided would be within the scope of the SEC's guidance on non-GAAP measures. For additional considerations, see Section 3.4.

2.19.1 Identification of Operating Segments

<table>
<thead>
<tr>
<th>Examples of SEC Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Please more fully explain to us how you determined your new operating segments, including how you integrated the business components of [Acquiree A], how segment management was realigned, how you identified your chief operating decision maker (CODM), and what information is used by management to allocate resources and assess performance.</td>
</tr>
<tr>
<td>• [It] appears that you maintain discrete financial information for your two reporting units . . . . We also note from your website that you have executive management, e.g. presidents, for both your . . . business units. Please refer to ASC 280-10-50 and provide us with the following information with respect to your organization and business units:</td>
</tr>
<tr>
<td>◦ Describe the company's internal management reporting process, including organization and reporting structure and provide us with an organizational chart;</td>
</tr>
<tr>
<td>◦ Identify the company's chief operating decision maker or makers (“CODM”) and describe the basis for this determination;</td>
</tr>
<tr>
<td>◦ Identify the individuals that [report] directly to the CODM;</td>
</tr>
<tr>
<td>◦ Identify each of the business units, the business unit managers and describe their responsibilities;</td>
</tr>
<tr>
<td>◦ Describe how budgets are developed and resources are allocated throughout your organization;</td>
</tr>
<tr>
<td>◦ Describe the level of detail communicated to the CODM when actual results differ from budgets and annual operating targets, and who is involved in meetings with the CODM to discuss budget/target-to-actual variances;</td>
</tr>
<tr>
<td>◦ Describe how performance of the business units is evaluated;</td>
</tr>
<tr>
<td>◦ Describe how performance of the business unit managers is evaluated, including consideration of bonuses;</td>
</tr>
<tr>
<td>◦ Tell us how often the CODM meets with his direct reports, the financial information he reviews to prepare for those meetings, the financial information discussed in those meetings, and who attends; and</td>
</tr>
<tr>
<td>◦ Describe the nature of the financial information regularly reviewed by your CODM to make decisions about allocating resources and assessing performance. As part of your response, please describe the financial information that the CODM reviews for each of the business units.</td>
</tr>
</tbody>
</table>
ASC 280 prescribes the “management approach” for the identification of segments in a public entity's financial statements. The objective of the management approach is to allow financial statement users to (1) see the entity's performance through the eyes of management, (2) assess the entity's prospects for future cash flows, and (3) make more informed judgments about the entity's performance. Accordingly, the SEC staff will consider a number of factors when evaluating a registrant's identification of operating segments, including (1) what financial information is regularly reviewed by the CODM (i.e., the “CODM package”) and board of directors, (2) a registrant's organizational chart and overall management structure, (3) the basis on which budgets and forecasts are prepared and reviewed, and (4) the basis on which executive compensation is determined. A registrant should also expect that the staff will review other publicly available information for consistency with the registrant's segment disclosures; such information may include the forepart of Form 10-K (i.e., the business section and MD&A), the registrant’s Web site, analysts’ reports, and press releases.

Registrants should also be aware that incorrect identification of operating segments can affect goodwill impairment testing. Goodwill is tested at the reporting-unit level in accordance with ASC 350-20, and reporting units are identified as either operating segments or one level below. If a registrant has not correctly identified its operating segments, it could incorrectly identify its reporting units and, as a result, improperly test goodwill for impairment. See Section 2.11.1.2 for additional information.

### 2.19.2 Aggregation of Operating Segments

<table>
<thead>
<tr>
<th>Examples of SEC Comments</th>
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</thead>
<tbody>
<tr>
<td>• We note that you have two operating segments, [Service Line A] and [Service Line B], and that you have determined that these two operating segments can be aggregated into a single reportable segment. Please compare and contrast your operating segments relative to the areas listed in ASC 280-10-50-11 through e. Regarding any differences among your operating segments, tell us why you determined that disaggregation was not warranted. As part of your response, please provide us with your historical and projected revenues, operating margin and measure of segment profitability.</td>
</tr>
<tr>
<td>• Please tell us whether the three businesses in [Reportable Segment A] ([Business 1, Business 2, and Business 3]) are operating segments aggregated into one reportable segment. In this regard, [some of] your disclosures . . . reference the criteria in ASC 280-10-50-11. However, [another] disclosure . . . indicates that the newly created [Reportable Segment A] is also an operating segment. If the three businesses are individual operating segments, please provide us with your detailed analysis of the aggregation requirements in ASC 280-10-50-11.</td>
</tr>
<tr>
<td>• Given that you continue to engage in the activities that had constituted your Midstream and marketing segment, noting the revenues and costs related to midstream services and your sales and purchases of oil, tell us how you concluded that your exploration and production activities, along with your midstream and marketing activities, now represent a single operating segment, as defined in FASB ASC 280-10-50-1.</td>
</tr>
</tbody>
</table>

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

a. The nature of the products and services  
b. The nature of the production processes  
c. The type or class of customer for their products and services  
d. The methods used to distribute their products or provide their services  
e. If applicable, the nature of the regulatory environment, for example, banking, insurance, or public utilities.
ASC 280 does not define the term “similar” or provide extensive guidance on the aggregation criteria. Therefore, determination of whether two or more operating segments are similar depends on facts and circumstances and is subject to judgment. As a result, the SEC staff may ask a registrant to provide an analysis on how it determined that its aggregation of operating segments complies with both the quantitative and qualitative requirements of ASC 280.

In the assessment of whether operating segments may be aggregated, determining the basis for economic similarity is particularly difficult for registrants that have complex business models and reporting structures. Accordingly, the SEC staff may ask registrants that have aggregated segments how they satisfied the quantitative requirements of ASC 280 and may request historical and projected financial information by operating segment. Further, the staff continues to challenge a registrant’s conclusion that operating segments should be aggregated when the registrant reports profit measures for a level below the reportable segment.

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

### 2.19.3 Changes in Reportable Segments

#### Examples of SEC Comments

- We note that effective [the beginning of fiscal year 2], the results of [Business Unit A have] been included within your former [Segment A] instead of your former [Segment B]. We note from your disclosure [in] your Form 10-K for [fiscal year 1] that you determined you had eight reporting units in [fiscal year 1]. Please tell us and disclose in future filings:
  - The reason for this change;
  - How the change impacts your determination of your reporting units for purposes of goodwill impairment testing pursuant to ASC 350-20; and
  - How the change impacts your determination of operating segments as well as your aggregation of operating segments in determining your reportable segments. Please also provide the disclosures required by ASC 280-10-50-21.

- We note your disclosure that, subsequent to the spin-off of [Entity A], you have only one reportable segment. [Y]ou previously disclosed that you had two operating segments. Please tell us and revise your future filings to clarify if you continue to have two operating segments that you have now aggregated into a single reportable segment. Please refer to ASC 280-10- 50-21(a). Please also revise your critical accounting policy disclosures . . . to describe any changes in your definition of goodwill reporting units after [A’s] spin-off and the reasons for those changes. Please refer to Item 303(b) of Regulation S-K and Section V of SEC Release 33-8350.

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

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

In addition, a change in identified operating segments may also result in a change to a registrant’s reporting units for goodwill impairment testing purposes. See Section 2.11.1.2 for additional information.

2.19.4 Reporting Considerations for Entities With a Single Reportable Segment

Example of an SEC Comment

We note that you provide segment operating income (loss); however, you only report one operating segment. The objective of requiring disclosures about segments of a public entity is to provide information about the different types of business activities in which a public entity engages and the different economic environments in which it operates. The footnote does not disclose different types of business activities in which the Company engages, but rather includes a measure for the same set of operations that is presented in the consolidated financial statements. Please explain to us how the presentation of a segment measure for an entity with one single operating segment complies with the objective of ASC 280-10-10.

As a related matter, it appears that your presentation of segment operating income (loss) is a non-GAAP measure. In this regard, please tell us how you considered the prohibition against presenting a non-GAAP financial measure in the footnotes to the financial statements. Refer to Item 10(e)(ii)(C) of Regulation S-K.

An entity with one reportable segment should not disclose in the notes to its financial statements financial information whose measurement basis differs from the one used in its consolidated financial statements, even if the measures are reviewed by the CODM or their disclosure is argued to be beneficial to readers (e.g., EBITDA for the entity as a whole or for portions of the entity). Specifically, the SEC staff has challenged single segment entities on their inclusion in the notes to their financial statements of measures whose measurement basis differs from the one used in their consolidated financial statements as being inconsistent with the objective of ASC 280. Further, as noted by the staff at the 2016 AICPA Conference, the presentation of such measures outside of the financial statements (e.g., in MD&A) would be within the scope of the SEC’s guidance on non-GAAP measures since the disclosure is not required by U.S. GAAP. See Section 3.4 for additional discussion of non-GAAP measures.

2.19.5 Entity-Wide Disclosures

Examples of SEC Comments

- Please provide entity-wide disclosure with respect to your revenues from external customers for each product or service or each group of similar products or services. Refer to ASC 280-10-50-40.
- [P]lease provide the entity-wide information required by ASC 280-10-50-38 to 42 or tell us why you believe the disclosure[s] are not required. In this regard, we note that you derive revenues from [Country A, Country B, and Country C].

ASC 280 also requires disclosure of revenue by product or service on an entity-wide basis. Therefore, registrants should remember to identify the “[t]ypes of products and services from which each reportable segment derives its revenues” and to report the total “revenues from external customers for each product and service or each group of similar products and services” in accordance with ASC.
Chapter 2 — Financial Statement Accounting and Disclosure Topics

280-10-50-21 and ASC 280-10-50-40, respectively. The SEC staff has objected to overly broad views of what constitute “similar” products and services.

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

Other Deloitte Resources
A Roadmap to Segment Reporting

2.20 Share-Based Payment Awards

2.20.1 Disclosures

Examples of SEC Comments

- 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.
- Please tell us your consideration of disclosing the weighted-average grant-date fair value of equity options granted during the years presented. Refer to ASC 718-10-50-2d.1.
- ASC 718-10-50 requires disclosure of “As of the latest balance sheet date presented, the total compensation cost related to nonvested awards not yet recognized and the weighted-average period over which it is expected to be recognized.” Please direct us to or provide us this information and tell us your consideration of disclosing this information.

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

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

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

- The nature of, and reason for, a modification in the share-based payment award's terms and how the registrant accounted for that modification.
- The terms and conditions of awards, including vesting conditions and whether grantees are entitled to dividends or dividend equivalents.
- The number of awards that are expected to vest and the assumptions that were used to determine that number.
• The registrant’s valuation method, including significant assumptions used (e.g., volatility, expected term, dividend yield).
• The “weighted-average grant-date fair value” of equity instruments granted during the year.
• The “total intrinsic value of options exercised” during the periods presented.
• The “total compensation cost related to nonvested awards not yet recognized and the weighted-average period over which it is expected to be recognized.”

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

In addition, the SEC staff may ask 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 Section 3.7 for more information about SEC staff comments on registrants’ proxy statements.

2.20.2 Share-Based Payment Awards Issued by Nonpublic Entities

2.20.2.1 Cheap Stock

Examples of SEC Comments

- Please tell us the estimated IPO price range. To the extent there is a significant difference between the estimated grant-date fair value of your common stock during the past twelve months and the estimated IPO price, please discuss for us each significant factor contributing to the difference.
- Please disclose the dates and fair values for the third-party valuations of your common stock during the periods presented. Clarify the estimated common stock price at the time of the . . . options issuance and explain to us how it relates to the share price in the . . . convertible preferred stock financing. Once you have an estimated offering price or range, please explain to us the reasons for any differences between the recent valuations of your common stock leading up to the IPO and the estimated offering price. This information will help facilitate our review of your accounting for equity issuances including stock compensation and beneficial conversion features.

Calculating share-based compensation for nonpublic entities 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 often focuses on “cheap stock” issues in connection with a nonpublic entity’s preparation for an IPO. The staff is interested in the rationale for any difference between the fair value measurements of the underlying common stock of share-based payment awards and the anticipated IPO price. In addition, the staff will challenge valuations that are significantly lower than prices paid by investors to acquire similar stock. If the differences cannot be reconciled, a nonpublic entity may be required to record a cheap-stock charge. Since share-based payments are often a compensation tool to attract and retain employees or nonemployees, a cheap-stock charge could be material and, in some cases, lead to a restatement of the financial statements.

An entity preparing for an IPO should 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

19 “Cheap stock” refers to issuances of equity securities before an IPO in which the value of the shares is below the IPO price.
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.

The SEC staff has frequently inquired about a registrant’s pre-IPO valuations. Specifically, during the registration statement process, the SEC staff may ask an entity to (1) reconcile its recent fair values with the anticipated IPO price, (2) describe its valuation methods, (3) justify its significant valuation assumptions, (4) outline significant intervening events, and (5) discuss the weight it gives to stock sale transactions. We encourage entities planning an IPO in the foreseeable future to use the AICPA’s Accounting and Valuation Guide Valuation of Privately-Held-Company Equity Securities Issued as Compensation (the “AICPA Valuation Guide,” which is commonly referred to as the “Cheap Stock Guide”) and to consult with their valuation specialists. Further, they should ensure that their pre-IPO valuations are appropriate and that they are prepared to respond to questions the SEC may have during the registration statement process.

In addition, the AICPA Valuation Guide highlights differences between pre-IPO and post-IPO valuations. One significant difference is that the valuation of nonpublic-entity securities often includes a discount for lack of marketability (DLOM). The DLOM can be determined by using several valuation techniques, as described in the AICPA Valuation Guide, and is significantly affected by the underlying volatility of the stock and the period the stock is illiquid.

The SEC staff had historically asked registrants to expand the disclosures in their critical accounting estimates to add information about the valuation methods and assumptions used for share-based compensation in an IPO. In 2014, however, the staff updated Section 9520 of the FRM to indicate that registrants should significantly reduce, in the critical accounting estimates section of MD&A, their disclosures about share-based compensation and the valuation of pre-IPO common stock. Nevertheless, paragraph 9520.2 of the FRM notes that the SEC staff may continue to request that companies “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; they 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 discussed the types of detailed disclosures it had observed in IPO registration statements that had prompted the updates to Section 9520 of the FRM. The staff indicated that despite the volume of share-based compensation information included in IPO filings, disclosures of such information were typically incomplete because registrants did not discuss all assumptions related to their common-stock valuations. Further, disclosures about registrants’ pre-IPO common-stock valuations were not relevant after an IPO and were generally removed from their periodic filings after the IPO. The staff expressed the view that in addition to reducing the volume of information, streamlined share-based compensation disclosures make reporting more meaningful. The staff also indicated that by eliminating unnecessary information, registrants could reduce “down to one paragraph” many of their prior disclosures.

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20 The AICPA Valuation Guide provides best-practice guidance for valuing the equity securities of nonpublic entities. It discusses, among other topics, possible methods of allocating enterprise value to underlying securities, enterprise- and industry-specific attributes that should be considered in the determination of fair value, best practices for supporting fair value, and recommended disclosures for a registration statement.
At the conference, the SEC staff also provided insights into how registrants would be expected to apply the guidance in paragraph 9520.1 of the FRM (and thereby reduce the share-based compensation disclosures in their IPO registration statements):

- 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 that a discounted cash flow method was used and involved cash flow projections that were 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 but 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 entity goes public because it will then rely on the market price to determine the fair value of its common stock.

We encourage entities planning an IPO in the foreseeable future to use the AICPA Valuation Guide and to consult with their valuation specialists. Further, they should ensure that their pre-IPO valuations are appropriate and that they are prepared to respond to questions the SEC staff may have during the registration statement process.

For further discussion of SEC staff comments related to IPOs, see Chapter 4.

2.20.2.2 Purchases of Shares From Employees

Examples of SEC Comments

- Please tell us whether you repurchased any common stock, stock options or restricted stock units from employees. If so, tell us, and revise to disclose, if material, how you considered the guidance in ASC 718-20-35-7. Also, tell us how you considered the price paid per share for repurchases in your determination of the fair value of your stock on the date of grant for your stock based compensation.

- Reference is made to the . . . stock sales by employees or former employees. Please explain the business reason(s) that existing investors would pay in excess of fair value for employee shares and whether employees continued to be employed post-sale. . . . Please also explain how you determined fair market value. If based on a valuation model, please explain why the model is a better indication of fair value than the share sale between existing investors and employees. Please also provide any price information on contemporaneous sales of stock to unrelated third parties.

To give their employees liquidity (or for other reasons), entities may sometimes repurchase vested common stock from them. In some cases, the price paid for the shares exceeds their fair value at the time of the transaction, and the excess would generally be recognized as additional compensation cost in accordance with ASC 718-20-35-7. In addition, an entity's practice of repurchasing shares, or an arrangement that permits repurchase, could affect the classification of share-based payment awards.
On occasion, investors (such as private equity or venture capital investors) intending to increase their stake in an emerging nonpublic entity may undertake transactions with other shareholders in connection with or separately from a recent financing round. These transactions may include the purchase of shares of common or preferred stock by investors from the founders of the nonpublic entity or other individuals who are also considered employees. Because the transactions are between employees of the nonpublic entity and existing shareholders and are related to the transfer of outstanding shares, the nonpublic entity may not be directly involved in them (although it may be indirectly involved by facilitating the exchange or not exercising a right of first refusal). Sometimes, if there is sufficient evidence that a transaction is an arm’s-length fair value transaction, it may be necessary to treat the transaction as a data point in the estimation of the fair-value-based measurement of share-based payment awards. Other times, particularly when a transaction involves founders or a few select key employees, it may be difficult to demonstrate that the transaction is not compensatory. If the price paid for the shares exceeds their fair value at the time of the transaction, it is likely that the nonpublic entity will be required to recognize compensation cost for the excess, even if the entity is not directly involved in the transaction. It is important for a nonpublic entity to recognize that transactions such as these may be subject to the guidance in ASC 718 because the investors are considered holders of an economic interest in the entity.

In all situations, the determination of whether a transaction should be accounted for under ASC 718 should be based on an entity’s specific facts and circumstances.

2.20.2.3 Profits Interests

Example of an SEC Comment

Please provide an analysis supporting your accounting treatment for the Class B equity units in [Company A] under which you record compensation expense at the time distributions [were] made to Class B holders but not at grant date. In your response, describe the terms of the Class B equity units and refer to specific accounting guidance on which you relied.

Nonpublic entities (often limited partnerships or limited liability companies) may grant special classes of equity, frequently referred to as “profits interests.” In many cases, a waterfall calculation is used to determine the payout to the different classes of shares or units. While arrangements vary, the waterfall calculation often is performed to allocate distributions and proceeds to the profits interests only after specified amounts (e.g., multiple of invested capital) or specified returns (e.g., internal rate of return on invested capital) are first allocated to the other classes of equity. In certain cases, distributions on and realization of value from profits interests are expected only from the proceeds from a liquidity event such as a sale or IPO of the entity, provided that the sale or IPO exceeds a target hurdle rate.

While the legal and economic form of these awards can vary, they should be accounted for on the basis of their substance. If an award has the characteristics of an equity interest, it represents a substantive class of equity and should be accounted for under ASC 718; however, an award that is, in substance, a performance bonus or a profit-sharing arrangement would be accounted for as such in accordance with other U.S. GAAP (e.g., typically ASC 710 and ASC 450 for employee arrangements).
2.20.3 Significant Assumptions

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

As noted above, the SEC staff’s comments have focused on significant assumptions used in a registrant’s valuation of share-based payment awards, such as volatility, expected term, and dividend yield. For example, there have been a number of comments related to the use of the “simplified method” to calculate the expected term of employee share options. Under ASC 718, the expected term of an option is a key factor for measuring the option’s fair-value-based amount and the related compensation cost. Question 6 of SAB Topic 14.D.2 discusses the simplified method\(^\text{21}\) of estimating the expected term of “plain-vanilla” share options and permits a registrant to use the simplified method under certain circumstances if the registrant “concludes that its historical share option exercise experience does not provide a reasonable basis upon which to estimate expected term.” The SEC staff’s comments have focused on a registrant’s use of the simplified method, and in certain instances, registrants were asked to explain why they believe that their historical share option experience does not provide a reasonable basis for estimating the expected term.

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

The estimated volatility of an option is also a key factor for measuring the option’s fair-value-based amount and the related compensation cost because in an option pricing model, the option’s value is based on potential share returns over the option’s term. If an entity is newly public or nonpublic, it may have limited historical data and no other traded financial instruments from which to estimate expected volatility. In such cases, as discussed in Question 6 of SAB Topic 14.D.1, it may be appropriate for the entity to base its estimate of expected volatility on the historical, expected, or implied volatility of comparable entities.

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

\(^{21}\) Question 6 states that under the simplified method, the “expected term = ((vesting term + original contractual term) / 2).”
and use sufficient information in determining whether taking historical volatility, implied volatility or a combination of both into account will result in the best estimate of expected volatility.”

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

### 2.20.4 Financial Statement Presentation

<table>
<thead>
<tr>
<th>Example of an SEC Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Please tell us how your presentation of a separate line item for stock-based compensation complies with SAB Topic 14F.</td>
</tr>
</tbody>
</table>

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

### Other Deloitte Resources

- **A Roadmap to Accounting for Share-Based Payment Awards**
  - November 13, 2019, *Heads Up*, “FASB Clarifies the Accounting for Share-Based Payments Issued as Sales Incentives to Customers”
  - June 21, 2018, *Heads Up*, “FASB Simplifies the Accounting for Share-Based Payment Arrangements With Nonemployees”
  - May 11, 2017, *Heads Up*, “FASB Amends the Scope of Modification Accounting for Share-Based Payment Arrangements”
  - April 21, 2016, *Heads Up*, “FASB Simplifies the Accounting for Share-Based Payments”
Chapter 3 — SEC Disclosure Topics

3.1 Management’s Discussion and Analysis
Regulation S-K, Item 303, provides guidance on the information a registrant should consider providing in its discussion of financial condition and results of operations in MD&A. MD&A is one of the leading sources of SEC staff comments, many of which focus on the results of operations section. While the SEC staff’s comments have addressed various topics of MD&A, they have continued to focus on greater transparency in registrants’ disclosures about (1) material trends and uncertainties that affect results of operations, (2) liquidity and capital resources, (3) estimates in critical accounting policies, and (4) contractual obligations. In addition, the SEC staff’s comments have focused on the effects of the COVID-19 pandemic on items (1) through (4).

Changing Lanes
On January 30, 2020, the SEC issued a proposed rule that would amend certain aspects of Regulation S-K, Item 303. Key amendments in the proposed rule would:

• Concisely state the objective of MD&A.
• Codify the requirements in SEC Interpretive Release No. 33-8350 (the “December 2003 interpretive release”) related to capital resources and critical accounting estimates.
• Require the disclosure of any known events that are reasonably likely to cause a material change in the relationship between costs and revenue.
• Require a registrant to (1) discuss factors that led to material changes from period to period in net sales or revenues and (2) disclose the underlying reasons for those material changes in quantitative and qualitative terms.
• Eliminate (1) the inflation and price changes discussion from the results of operations (unless the discussion is material), (2) the separately captioned off-balance-sheet-arrangements section, and (3) the contractual obligation table.
• Enable a registrant to disclose comparisons of its results of operations for the most recently completed fiscal quarter to its results of operations for either (1) the corresponding fiscal quarter of the prior year (as currently required) or (2) the immediately preceding fiscal quarter.

See Deloitte’s February 10, 2020, Heads Up for more information about the proposed rule.

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 (1) when charges may be incurred in the future, including possible charges related to contingencies, restructuring activities, impairment of goodwill or other long-lived assets, or the settlement of uncertain tax positions; (2) when

1 See paragraphs 9110.1 and 9110.2 of the FRM for the SEC staff’s interpretive views on the objectives of a registrant’s MD&A.
revenue growth or profit margins may not be sustainable because of underlying economic conditions; or (3) when the registrant will be unable to comply with debt covenants. Accordingly, such disclosures may alert investors to the underlying conditions and risks that the company faces before a material charge or decline in performance is reported. See Sections 2.3.1, 2.11.1.1, and 6.3.3.6 for more information.

The SEC staff has frequently reminded registrants that it is also looking for improvement in disclosures that help the reader understand the company's big-picture tax situation and the trends and uncertainties associated with changes in income tax. See Section 2.12 for more information.

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

3.1.1 Omitting Discussion of the Earliest Year From MD&A

On March 20, 2019, in a bid to improve the readability of filed documents and simplify registrants’ compliance efforts while ensuring that all material information is provided to investors, the SEC issued a final rule that revises certain disclosure requirements in Regulation S-K. Most of the final rule’s provisions became fully effective on May 2, 2019. Under the final rule, registrants that present three years of audited financial statements are permitted to omit discussion of the earliest year if such discussion was already included in any of the registrants’ prior EDGAR filings that required such information. Registrants electing to omit discussion of the earliest year must disclose, in the current filing, the location of such discussion in the prior filing. In addition, a registrant may use judgment in determining what type of presentation would most clearly communicate results and trends to investors. For example, in certain circumstances, a narrative discussion about specific periods on a stand-alone basis may be more meaningful than period-to-period comparisons. Registrants should consider the total mix of available information, including the impact of any recastable events (e.g., a discontinued operation or other retrospective accounting change) on the prior-period MD&A when determining whether to omit discussion of the earliest year and the most appropriate form of presentation. If a registrant concludes that it is necessary to discuss operations related to the earliest period presented, the registrant may limit the discussion to the information that has changed or has been determined to be significant to its operations or financial condition. For more information about the final rule, see Deloitte’s March 25, 2019, Heads Up.

In January 2020, the SEC staff issued three new C&DIs related to the application of this accommodation. C&DI Questions 110.02 and 110.04 address the wording that is required to incorporate by reference the omitted discussion into a filing and registration statement, respectively. C&DI Question 110.03 states that a registrant is not permitted to omit discussion of the earliest year (i.e., discussion of the earliest year must either be included in the current disclosure or expressly incorporated into the current disclosure by reference) if such information is “necessary to an understanding of [the registrant’s] financial condition, changes in financial condition and results of operations.” The minutes of the June 25, 2019, CAQ SEC Regulations Committee joint meeting with the SEC staff indicate that in the staff’s view, circumstances in which a registrant should consider whether discussion of the earliest year is necessary to such an understanding include those involving retrospective changes to the financial statements, such as corrections of errors and changes in accounting principle.

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2 See the SEC’s December 2003 interpretive release for additional information.
3.1.2 Results of Operations

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

### Examples of SEC Comments

- Please revise your disclosures to comply with Item 303 of Regulation S-K. In doing so, please be sure to describe the reasons for significant changes in revenues, expenses, cash flows and financial position. It is not sufficient to merely recite the information that is available on the face of the financial statements without describing the events, transactions and economic changes that materially affected the reported amounts.

- We note that direct operating expenses increased significantly and in a higher proportion as compared to the percentage increase in revenue for each of your segments and on a consolidated basis. Please revise your disclosures in future filings to separately discuss direct operating expenses and to quantify and discuss factors responsible for changes pursuant to Item 303 of Regulation S-K. As part of your revised disclosure for direct operating expenses and for your existing expense discussion, please quantify each material component when a change is attributed to more than one factor. For example, you state that certain increases were “primarily” attributed to one factor, or “partially offset” by another [factor], or you cite several other factors responsible for the change. In your response, please provide us with an example of the disclosure to be included in future filings. Refer to 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 suggested that in addition to discussing how volume and product mix affect their results of operations, registrants should consider explaining other potential influences, such as pricing changes, acquisitions, new contracts, inflation, and foreign exchange rates.

The SEC staff has also encouraged registrants to:

- Use appropriate metrics to help them “tell their story” — including those that may be common to their industry (e.g., same-store sales, average subscribers). However, the SEC staff distinguishes such metrics from non-GAAP measures that are adjusted GAAP measures. See Section 3.4.9 for additional information.

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

<table>
<thead>
<tr>
<th>Examples of SEC Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>• In future filings, including your quarterly reports, please revise to disclose whether you believe you have sufficient cash and other types of liquidity available to fund operations and meet your obligations on both a long-term and short-term basis. We would consider long-term to be greater than twelve months.</td>
</tr>
<tr>
<td>• Your discussion of operating cash flows appears to be a recitation of changes disclosed on the consolidated statement of cash flows. Please revise and expand this discussion to include the primary drivers of, and other material factors necessary to understand, the company’s cash flows from operating activities. Refer to section IV.B of SEC Release 33-8350.</td>
</tr>
<tr>
<td>• [Please] revise the MD&amp;A in your Form 10-Q to address your capital needs for the next twelve months, the material uncertainties surrounding your liquidity, and the impact that those uncertainties could have on your business. Refer to Item 303 of Regulation S-K.</td>
</tr>
</tbody>
</table>

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. 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.
- Intragroup debt levels.
- Restrictions on cash flows between the registrant (i.e., the parent) and its subsidiaries. See Section 2.4.1 for more information.
- The impact of liquidity on debt covenants and ratios.

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

- Significant debt instruments, guarantees, and related covenants. See Section 2.4.2 for more information.
- Effects on liquidity of material cash balances that are held.

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3 Refer to Section 9210 of the FRM.
3.1.4 Critical Accounting Estimates

<table>
<thead>
<tr>
<th>Example of an SEC Comment</th>
</tr>
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<tbody>
<tr>
<td>We note that you acquired significant property and equipment, patents and additional licenses and commenced operations during the six months ended June 30, [201X] and it appears that estimates and assumptions involved in the application of GAAP for the period may have a material impact on reported financial condition and operating performance. As such, please tell us your consideration of providing disclosure about those critical accounting estimates when the nature of the estimates is material due to the level of subjectivity and judgment necessary to account for highly uncertain matters or susceptibility of such matters to change and the impact of the estimates and assumptions on financial condition or operating performance is material. Please refer to Commission Guidance Regarding Management’s Discussion and Analysis of Financial Condition and Results of Operations, SEC Release No. 34-48960.</td>
</tr>
</tbody>
</table>

The critical accounting policies section of MD&A is intended to highlight only those financial statement items that require significant management estimates and judgment. When reviewing the section, the SEC staff has frequently focused on the estimates that management used in valuations (e.g., estimates used in the valuation of (1) pension assets; (2) impairment of long-lived assets; (3) income taxes, including DTAs and uncertain tax positions; and (4) fair value determinations). Registrants should not simply copy their accounting policy disclosures from the footnotes to the financial statements. Instead, the SEC staff expects discussion and analysis of material uncertainties associated with assumptions underlying each critical accounting estimate.

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

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

In addition, registrants should consider providing greater insight into the quality and variability of information regarding financial condition and operating performance by including an analysis of the sensitivity of estimates to changes on the basis of outcomes that are reasonably likely to occur and that would have a material effect. The sensitivity analysis should be quantitative if it is reasonable for registrants to obtain such information.

For more information, see Sections 2.11.1.1 and 2.16.1.

3.1.5 Tabular Disclosure of Contractual Obligations

<table>
<thead>
<tr>
<th>Example of an SEC Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td>It does not appear that you have included interest payments in your contractual obligations table. Please confirm that you will disclose the amount of interest related to your debt in future filings. Please refer to footnote 46 in our Release 33-8350.</td>
</tr>
</tbody>
</table>
Chapter 3 — SEC Disclosure Topics

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

Some registrants have questioned how obligations subject to uncertainties about timing or amount should be presented in the table of contractual obligations. The SEC staff has noted that registrants should consider their circumstances and use judgment in determining whether to include such information in the table or the footnotes to the table. 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.

The SEC staff has indicated that “it [does] not expect a change in the lease accounting model to change historical practice that the cash outflows in the contractual obligations table would be consistent with U.S. GAAP disclosures (i.e., disclosures under ASC 840 or ASC 842, when adopted).”

3.1.6 COVID-19 and Impact on MD&A

Examples of SEC Comments

- On your first quarter earnings call, you indicate that you currently anticipate second quarter revenue to be down as much as 50% to 60% with approximately 80% of your global business having been closed since April 1, 2020. Revise your future periodic filings to disclose known trends and uncertainties related to COVID-19. For example, disclose how you expect COVID-19 to impact your future operating results and near-and-long-term financial condition and how that compares to the current period. See Item 303 of Regulation S-K, SEC Release No. 33-8350, and CF Disclosure Guidance Topic No. 9.

- We note that given the uncertainty of the impacts of COVID-19, you are monitoring your ability to comply with debt covenants in future periods and are in discussions with certain counterparties to your debt obligations. In future filings, please expand your disclosures to include the significant debt covenants and the particular companies affected.

The COVID-19 pandemic has caused registrants to experience conditions often associated with a general economic downturn, including, but not limited to, financial market volatility and erosion of market value, deteriorating credit, liquidity concerns, further increases in government intervention, increasing unemployment, broad declines in consumer discretionary spending, increasing inventory levels, reductions in production because of decreased demand and supply constraints, layoffs and furloughs, and other restructuring activities.

In addition to discussing the impact of the COVID-19 pandemic on historical results, the SEC expects registrants to clearly disclose how material risks and uncertainties related to COVID-19 are affecting their financial condition, results of operations, or liquidity. As a result, most registrants will need to disclose the impact of COVID-19 in various sections of their SEC filings, including MD&A. In CFDG Topic 9 (issued March 25, 2020) and CFDG Topic 9A (issued June 23, 2020), the SEC staff provides a series of questions for registrants to consider when developing disclosures related to the current and expected future impact of COVID-19.

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

5 To the extent that the obligations cannot be quantified, the SEC staff expects registrants to disclose information that investors and users need to understand the nature and extent of the registrant’s obligations. As indicated in paragraph 9240.7 of the 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 Quoted text is from the highlights of the September 24, 2019, CAQ SEC Regulations Committee joint meeting with the SEC staff.
SEC staff comments on COVID-19 have focused on (1) the pandemic’s impact on future operating results and future financial condition, (2) known trends or uncertainties related to COVID-19 that will have a material favorable or unfavorable impact on income from continuing operations, and (3) discussions of current liquidity and availability of financial resources.

### 3.2 SEC Reporting

SEC authoritative literature includes a number of requirements in Regulation S-X that govern the form and content of a registrant’s financial statements and other information that must be included in filings with the SEC, including financial statements and financial information of other entities. The SEC staff often comments on these requirements, and they have been the subject of discussion at a variety of forums, including the annual AICPA Conference, various industry conferences, and joint meetings of the SEC staff and the CAQ SEC Regulations Committee. However, there may be situations in which registrants seek relief from complying with certain SEC reporting requirements. With this in mind, the SEC staff has acknowledged that relief may be warranted in some cases and that registrants may seek to obtain a waiver from the SEC Division of Corporation Finance, Office of the Chief Accountant (CF-OCA). At the 2018 AICPA Conference, the SEC staff continued to encourage registrants to consider using Regulation S-X, Rule 3-13, to seek modifications to their financial reporting requirements when the application of Regulation S-X results in a requirement to provide more information than the registrant believes is necessary to reasonably inform investors in light of the total mix of information available. For additional guidance on Rule 3-13 waivers and prefiling letter requests, see Appendix B.

The SEC has issued a number of final rules that incorporate stakeholders’ feedback on its 2015 request for public comment on the effectiveness of financial disclosure requirements in Regulation S-X, including those related to the form and content of financial disclosures about (1) guarantors and issuers of guaranteed securities and (2) acquired businesses and the accompanying pro forma financial information.

On March 2, 2020, the SEC issued a final rule that amends various financial disclosure requirements for guarantors and issuers of guaranteed securities under Regulation S-X, Rules 3-10 and 3-16; see Section 3.2.5 for more information. Further, on May 20, 2020, the SEC issued a final rule that amends the financial statement requirements for acquisitions and dispositions of businesses, including real estate operations, and related pro forma financial information under Regulation S-X, Rules 3-05 and 3-14 and Article 11. The amendments in this final rule also affect the application of certain reporting requirements for equity method investees under Regulation S-X, Rule 3-09. See Sections 3.2.2, 3.2.3, and 3.2.6 for additional information.

### 3.2.1 Private-Company Accounting Alternatives

As noted above and discussed further below, there are instances in which a registrant must provide the financial statements of other entities in its registration statements or periodic filings. Among the entities that meet the definition of a PBE under ASU 2013-12 are those that are “required by the [SEC] to file or furnish financial statements, or [do] file or furnish financial statements (including voluntary filers), with the SEC (including other entities whose financial statements or financial information are required to be or are included in a filing).” Therefore, other entities that may not be SEC filers but whose financial statements are provided under Regulation S-X, Rules 3-05 and 3-09, or whose summarized financial information is provided under Regulation S-X, Rule 4-08(g), for example, generally meet the definition of a PBE. Such other entities that meet the definition of a PBE are not permitted to adopt private-company accounting alternatives. Accordingly, the effects of any previously elected private-company accounting

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7 For more information about the 2018 AICPA Conference, see Deloitte’s December 16, 2018, Heads Up.

8 For more information about the SEC’s request for comment, see Deloitte’s October 6, 2015, Heads Up.
alternatives would have to be eliminated from the historical financial statements of an entity whose financial statements are included in the SEC filing of a registrant.

In July 2017, the SEC staff announced that it would not object to elections by certain PBEs to use the non-PBE effective dates for the sole purpose of adopting the FASB's new standards on revenue (ASC 606) and leases (ASC 842). Although the SEC staff's announcement has provided considerable and welcome relief to registrants preparing to adopt ASC 606 and ASC 842, it is purposely narrow in scope and should not be applied by analogy to the adoption-date assessment for any other standard. However, at the FASB's July 17, 2019, meeting, the Board tentatively decided to change the manner in which it staggers effective dates for major standards and to amend the effective dates in some of its recently issued or amended major ASUs to give implementation relief to certain types of entities. As discussed in the July 17, 2019, meeting handout, the “Board learned that although large [PBEs] may encounter difficulties in transitioning to a new standard, the challenges are magnified for smaller PBEs and nonpublic business entities.”

In November 2019, the FASB issued ASU 2019-10, which introduced a “two-bucket” framework that the Board has begun implementing to determine the effective dates for certain future major accounting standards. Under the FASB’s new framework, the buckets are defined as follows:

- **Bucket 1** — All PBEs that are SEC filers (as defined in U.S. GAAP), excluding SRCs (as defined by the SEC).
- **Bucket 2** — All other entities, including SRCs, other PBEs that are not SEC filers, private companies, not-for-profit organizations, and employee benefit plans.

The FASB decided that for future major accounting standards, the effective date for entities in Bucket 2 would be at least two years after the effective date for entities in Bucket 1.


### 3.2.2 Significant Business Acquisitions (Regulation S-X, Rule 3-05)

<table>
<thead>
<tr>
<th>Examples of SEC Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>- We note that you consummated the [Company A] acquisition . . . but to date you have not filed audited financial statements of the acquired business or pro forma information relating to the acquisition. Please provide us with your calculations of the significance tests outlined in Rule 1-02(w) of Regulation S-X that you used in applying the requirements of Rule 3-05 and Article 11 of Regulation S-X.</td>
</tr>
<tr>
<td>- The company filed a Form 8-K . . . indicating that it intends to file by amendment the historical financial statements of [Company A], and pro formas reflecting the acquisition, not later than 71 calendar days after the date the Form 8-K was required to be filed. Your registration statement may not be declared effective before the financial statements meeting the requirements of Rule 3-05 of Regulation S-X are provided, if the transaction exceeds the 50% significance level. Please provide us with a reasonably detailed presentation of your significance level computations.</td>
</tr>
<tr>
<td>- [Please] tell us the amount of income from continuing operations before taxes, extraordinary items and cumulative effect of a change in accounting principle of [Company A] for the year ended December 31, [201X], used to measure the significance of the acquired business under Rule 3-05 of Regulation S-X.</td>
</tr>
</tbody>
</table>
When a registrant consummates, or it is probable that a registrant will consummate, a significant business acquisition, the SEC staff may require the registrant to file certain financial statements for the acquired or to be acquired business (acquiree) in accordance with Regulation S-X, Rule 3-05, in a Form 8-K, registration statement, or proxy statement. The following factors govern whether, and for what period, financial statements for the acquiree are required:

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

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

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

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

On May 20, 2020, the SEC issued a final rule that amends the financial statement requirements for acquisitions and dispositions of businesses, including real estate operations, and related pro forma financial information under Regulation S-X, Rules 3-05 and 3-14 and Article 11. In addition, the final rule includes amendments to financial disclosures specific to SRCs and investment companies. The amendments are intended to improve the information investors receive regarding acquired or disposed businesses, reduce complexity and costs of preparing the required disclosures, and facilitate timely access to capital.

Key amendments in the final rule will:

- Change the investment test to use the aggregate worldwide market value of common equity of the registrant when available.
- Change the income test to use the lower measure of significance based on (1) income from continuing operations before taxes or (2) revenue.
• Reduce required acquiree annual financial statement periods to a maximum of the two most recent fiscal years.
• Result in fewer circumstances in which acquiree financial statements would be required for an IPO.
• Modify the disclosure requirements for individually insignificant acquirees.
• Permit the use of abbreviated financial statements for an acquiree in certain circumstances without a request for SEC staff permission.
• Allow the use of, or reconciliation to, IFRS Standards in certain circumstances.
• Amend the pro forma financial information disclosures to require adjustments and certain disclosures for (1) transaction accounting adjustments and (2) autonomous entity adjustments when a registrant was previously part of another entity.
• Permit a registrant to present, in the explanatory notes to the pro forma financial information, “Management's Adjustments” (e.g., synergies or dis-synergies for which there is a reasonable basis) if certain conditions are met.
• Align certain requirements for a real estate acquiree with those in Rule 3-05.
• Raise the significance threshold for reporting dispositions of a business from 10 percent to 20 percent to conform the threshold with that of a significant acquisition.
• Make other changes specific to SRCs and investment companies.

Despite these changes, many elements of Rule 3-05 were retained under the amendments in the final rule. For example, although the amendments modify two of the significance tests, the final rule retains the use of bright-line significance thresholds. In addition, the final rule retains the current definition of a business for SEC reporting purposes (see Section 1.3.1 of Deloitte's A Roadmap to SEC Reporting Considerations for Business Combinations for a discussion of the definition of a business). Further, some of the amendments codify current SEC staff practice or interpretation and thus may not result in a significant change in practice. Also, although the final rule may reduce the financial statement requirements under Rule 3-05 (e.g., by eliminating a third year of acquiree financial statements), it does not apply to (1) target companies included in a proxy statement or registration statement on Form S-4 or (2) a company that is considered the predecessor of a registrant.

The final rule will become effective at the beginning of the registrant's fiscal year that starts after December 31, 2020 (e.g., the mandatory compliance date would be January 1, 2021, for calendar-year-end companies). However, voluntary compliance is permitted before the effective date as long as the final rule is applied in its entirety as of the date of such early compliance.

See Deloitte's June 2, 2020, Heads Up for more information about the final rule.

9 See paragraph 1170.1 of the FRM.
3.2.3 Investments in Equity Method Investees (Regulation S-X, Rules 4-08(g) and 3-09)

**Examples of SEC Comments**

- Please tell us how you complied with Rule 3-09 and Rule 4-08(g) of Regulation S-X. In this regard, please provide us with your significance test calculations pursuant to Rule 3-09 and Rule 4-08(g) of Regulation S-X.
- Please demonstrate how the denominator used in your significance calculation complies with Rule 3-09 of Regulation S-X. Please note that the denominator should begin with the amount identified in Rule 5-03(b)10 of Regulation S-X, which is a figure that excludes equity in earnings of unconsolidated affiliates. The Rule 5-03(b)10 figure should be adjusted to include your equity in the pre-tax earnings of unconsolidated affiliates, exclusive of amounts attributable to any noncontrolling interests of the investees, and exclude the portion of your pre-tax income attributable to any noncontrolling interests in your subsidiaries. Please recalculate the denominator used in your [Company A] significance test or clarify how the $[X] million figure you used in your calculation was appropriate.

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

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

On May 20, 2020, as discussed in Section 3.2.2, the SEC issued a final rule that amends the financial statement requirements for acquisitions and dispositions of businesses. This final rule includes certain amendments to the significance tests set forth in Regulation S-X, Rule 1-02(w). The final rule retains the existing investment test (i.e., use of total assets) used to evaluate equity method investments for significance in accordance with Rule 3-09 or Rule 4-08(g). However, registrants will be required to apply the final rule’s amended income test, including the revenue component, when evaluating equity method investments for significance in accordance with Rule 3-09 or Rule 4-08(g). See Deloitte’s June 2, 2020, Heads Up for more information about the final rule.

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

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

For additional guidance, see Deloitte’s A Roadmap to SEC Reporting Considerations for Equity Method Investees.
3.2.4 Restrictions on Dividends (Regulation S-X, Rules 4-08(e), 5-04, and 12-04)

Registrants must consider the requirements of Regulation S-X, Rules 1-02(dd), 4-08(e), 5-04, and 12-04, when the transfer of assets (cash or other funds) to the parent company/registrant from its subsidiary (or subsidiaries) or equity method investee (1) is materially restricted, (2) is limited, or (3) requires a third party's approval.

For additional discussion, see Section 2.4.1.

3.2.5 Guarantors of Registered Securities (Regulation S-X, Rule 3-10)

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

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

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

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

For additional SEC staff interpretations of Rule 3-10, see Section 2500 of the FRM.

On March 2, 2020, the SEC issued a final rule that amends certain disclosure requirements related to registered debt securities under Regulation S-X, Rules 3-10 and 3-16. With respect to the disclosure requirements related to issuers and guarantors of guaranteed debt securities or issuers of registered securities whose affiliates collateralize those securities, the final rule:

- Replaces the previous requirement under Rule 3-10 to provide condensed consolidating financial information in the registrant's financial statements with a requirement to provide alternative financial disclosures (which include summarized financial information of the parent and any issuers and guarantors, as well as other qualitative disclosure) in either the registrant's MD&A or its financial statements.
- Simplifies the requirements in Rule 3-10 that currently must be met for a parent company to qualify for exceptions allowing it to provide alternative disclosures rather than full audited financial statements (e.g., by replacing the requirement that a subsidiary issuer or guarantor be 100 percent owned with a requirement that it be consolidated in the parent company's financial statements).
• Eliminates the current requirement in Rule 3-10(g) to provide preacquisition financial statements for recently acquired subsidiary issuers and guarantors. However, in certain circumstances, an issuer is required to provide preacquisition summarized financial information.
• Replaces the current requirement in Rule 3-16 to provide separate financial statements for an affiliate that collateralizes a substantial portion of a security with a requirement to provide summarized financial information and other narrative disclosures.
• Reduces the periods for which summarized financial information is required to the most recent (1) annual period and (2) year-to-date interim period.
• Relocates the alternative disclosures requirements in Rule 3-10 to new Rule 13-01 in SEC Regulation S-X.
• Adds to Regulation S-X a new rule, Rule 13-02, which is applicable to collateralized securities.

The final rule applies to annual reports on Form 10-K or Form 20-F for fiscal years ending after January 4, 2021, quarterly reports on Form 10-Q for quarterly periods ending after January 4, 2021, and Securities Act registration statements first filed on or after January 4, 2021. However, registrants may voluntarily comply with the final rule before January 4, 2021.

See Deloitte’s March 10, 2020, Heads Up for further details.

3.2.6 Pro Forma Financial Information (Regulation S-X, Article 11)

Examples of SEC Comments

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

Pro forma information is required under Regulation S-X, Article 11, when (1) it is material to an understanding of a significant consummated or probable transaction, such as a business combination; (2) a transaction is subject to a shareholder vote; or (3) other conditions outlined in Article 11 are met. Pro forma financial information under Article 11 may be required in a registration statement, proxy statement, or Form 8-K, but it is not required in a Form 10-K or 10-Q. Although Article 11 pro forma financial statements are not required in a registrant’s Form 10-K or 10-Q, a registrant must separately evaluate the need for supplemental pro forma disclosures under ASC 805 (related to business combinations) in its financial statements included in a Form 10-K or 10-Q. See Section 2.1.5 for more information about supplemental pro forma disclosures that are required under U.S. GAAP.
Registrants should generally present Article 11 pro forma financial statements in columnar form with separate columns for historical financial information, pro forma adjustments, and pro forma results. In limited circumstances, registrants may present narrative disclosures in lieu of pro forma financial statements. Further, Article 11 requires pro forma balance sheet adjustments to reflect events that are (1) factually supportable and (2) directly attributable to the transaction. In addition, pro forma income statement adjustments must have a “continuing impact” on the registrant’s operations (i.e., they are not “one time”). The SEC staff continues to comment on certain form and content matters, such as when a registrant fails to clearly explain each financial statement adjustment or does not clearly demonstrate how the above requirements are met.

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

For companies undertaking 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. For additional reporting considerations related to IPOs, see Chapter 4.

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

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

On May 20, 2020, as discussed in Sections 3.2.2 and 3.2.3, the SEC issued a final rule that amends the financial statement requirements for acquisitions and dispositions of businesses, including real estate operations, and related pro forma financial information under Regulation S-X, Rules 3-05 and 3-14 and Article 11. Key amendments to Article 11 in the final rule will:

- Amend the pro forma financial information disclosures to require adjustments and certain disclosures for (1) transaction accounting adjustments and (2) autonomous entity adjustments when a registrant was previously part of another entity.
- Permit a registrant to present, in the explanatory notes to the pro forma financial information, “Management’s Adjustments” (e.g., synergies or dis-synergies for which there is a reasonable basis) if certain conditions are met.

See Deloitte’s June 2, 2020, Heads Up for more information about the final rule.

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10 The SEC staff has expanded on its view of what would constitute continuing impact. See the highlights of the June 2012 and March 2013 CAQ SEC Regulations Committee joint meetings with the SEC staff for additional information.
11 Quoted text is from the highlights of the March 2012 CAQ SEC Regulations Committee joint meeting with the SEC staff.
3.3 Disclosures About Risk

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

3.3.1 Risk Factors

Examples of SEC Comments

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

Regulation S-K, Item 105, requires registrants to provide “a discussion of the most significant factors that make an investment in the registrant or offering speculative or risky.” Certain indicators of risk may be present in the footnotes to the financial statements, in MD&A, or elsewhere in investor presentations or other periodic filings. The SEC staff commonly requests that registrants include new or more detailed risk factors specific to matters identified elsewhere in the filing. Registrants should be diligent in ensuring that risk factors are comprehensive and are related to their particular circumstances.

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

On March 20, 2019, the SEC issued a final rule that revises certain disclosure requirements of Regulation S-K. The final rule was issued in response to recommendations in the SEC staff's 2016 Report on Modernization and Simplification of Regulation S-K. Most of the final rule's provisions, including those related to the disclosure of risk factors, became effective on May 2, 2019. Previously, Regulation S-K provided examples of specific factors that a company could consider when disclosing risk. Although the risk disclosure requirements of Regulation S-K before the effective date of the final rule were intended to be principles-based, the examples of risk factors led certain registrants to disclose information that was generic or not specific to their circumstances. The final rule eliminates the examples from the disclosure requirements and encourages registrants to revisit their risk assessment and disclose their most significant risk factors.

Changing Lanes

On August 26, 2020, the SEC issued a final rule that further amends Regulation S-K to address the historically “lengthy and generic nature” of disclosures currently provided by many registrants related to risk factors. Specifically, the final rule:

- Requires registrants with more than 15 pages of disclosures in the Risk Factors section to provide a summary of such factors. The summary must be no more than two pages and consist of “a series of concise, bulleted or numbered statements summarizing the principal factors.”
• Replaces the requirement for registrants to disclose the “most significant” risk factors with one to disclose the “material” risk factors.
• Requires registrants to (1) organize risk factors under relevant headings and (2) disclose any risk factors that generally apply to an investment in securities at the end of the risk factor section under a separate caption.

3.3.2 Disclosures Related to Complex and Evolving Risks

The SEC has identified certain complex and evolving market risks and encouraged registrants to evaluate their disclosures of such risks when the risks may be material to investors. In remarks about evolving market risks delivered at the Practising Law Institute’s 18th Annual Institute on Securities Regulation in Europe, SEC Division of Corporation Finance (the “Division”) Director William Hinman emphasized that the SEC’s principles-based disclosure requirements related to risk factors and MD&A “should result in disclosure that keeps pace with emerging issues.” Emerging risks that have been a recent focus of the SEC include, but are not limited to, (1) cybersecurity, (2) the United Kingdom’s exit from the European Union (“Brexit”), and (3) the transition away from the London Interbank Offered Rate (LIBOR). The SEC continues to monitor public-company disclosures on these topics.

At the December 2019 AICPA Conference, the Division staff noted the need for registrants to make transparent disclosures related to the emerging risks listed above and other world events that pose risks. Chief of the Division’s Office of Trade and Services Mara Ransom emphasized that if registrants expect the impacts of these evolving risks to be material, they should consider disclosures to address:

• How management assesses the risks.
• What management is doing to mitigate and manage the risks.
• What the board’s role is in risk oversight.

While the SEC staff’s remarks above predate the COVID-19 pandemic, registrants may still find these concepts relevant to the risks associated with the pandemic. Many registrants may already provide disclosures about general risk related to issues such as potential natural disasters or pandemics. They should consider updating such disclosures to (1) clarify that the risk is no longer hypothetical and (2) provide more specificity about the actual and evolving potential future impact of the pandemic. For more information, see Deloitte’s Financial Reporting Alert, “Financial Reporting Considerations Related to COVID-19 and an Economic Downturn.”

3.3.2.1 Cybersecurity

**Examples of SEC Comments**

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

- In this risk factor you discuss the potential impact of operational risks. Have you suffered any significant losses or other damages as a result of operational risks, or has your controls testing indicated that you have a significant deficiency? Please revise to provide a description of any cyber incidents that you have experienced that are individually, or in the aggregate, material, including a description of the costs and other consequences and to provide the investor with an idea of the likelihood that a risk may impact your results and the potential impact on your assets and earnings. Refer to CF Disclosure Guidance: Topic No. 2.

The SEC staff has noted the increasingly frequent occurrence of cyberincidents, which may cause registrants to incur significant remediation and other costs for (1) direct damages (both real and reputational), (2) the impact on their customers, and (3) increased protection from future cybersecurity attacks. To help combat these threats, the SEC announced on September 25, 2017, the formation of a Cyber Unit within the Commission’s Division of Enforcement to target cyber-related misconduct.

In addition, on February 21, 2018, the SEC issued interpretive guidance (the “release”) in response to the pervasive increase in digital technology as well as the severity and frequency of cybersecurity threats and incidents. The release largely refreshes existing SEC staff guidance related to cybersecurity, such as CFDG Topic 2. Like the existing staff guidance on cybersecurity, the release does not establish any new disclosure obligations; rather, it presents the SEC’s views on how the Commission’s existing rules should be interpreted in connection with cybersecurity threats and incidents. However, the release does address topics not discussed in previously issued SEC releases, such as (1) disclosures about a corporate board’s risk oversight, (2) insider trading policies, and (3) Regulation FD and selective disclosure.

The release indicates that under existing SEC requirements, registrants may need to consider disclosures in various sections of an SEC filing, including risk factors, legal proceedings, MD&A, and the financial statements. For example, cybersecurity risks and cyberincidents may constitute material known trends and uncertainties that registrants should consider disclosing in MD&A in accordance with Regulation S-K, Item 303(a)(3)(ii).

In cybersecurity disclosures, registrants should avoid using boilerplate language and instead should include information such as (1) the aspects of the business that are subject to cybersecurity risks, (2) updates for new information, and (3) cost estimates, if possible and material.

Further, on October 16, 2018, the SEC issued an investigative report reminding registrants of the requirement to have controls in place that address the potential for misappropriation of assets caused by business e-mail compromises, a type of cyber-related fraud in which spoofed e-mails from fake executives or fake vendors are sent to employees of a registrant with requests for payments. Such e-mails often appear to come from a high-ranking executive or appear to be time-sensitive, and the investigative report highlights a number of instances in which an employee transferred funds to a cybercriminal in response to this type of e-mail. Once funds are transferred, they can be very difficult to
recover. The investigative report highlights the importance of reassessing controls in light of emerging risks, including risks arising from cyber-related fraud.

At the December 2018 AICPA Conference, Mr. Hinman highlighted the importance of:

- DC&P to address cyberincidents related to the identification and escalation of a breach at the appropriate levels within an organization, which would include ensuring that all relevant parties, including a company's IT and financial reporting functions, are involved in assessing the potential effect of the breach and related disclosure requirements.
- Insider trading policies that take into account cyber risks and align with escalation procedures for significant cyberincidents.
- Disclosures that describe the role of the board of directors in cyber risk oversight when cyber risk is material.

During a panel session on SEC comment letter trends at the same conference, the SEC staff noted that it will be reviewing cybersecurity disclosures and encouraged registrants to continually reassess these disclosures given the evolving nature of cyber risk. For example, it may not be sufficient for a company that has experienced a material cybersecurity breach to continue to simply disclose that there is a risk that a breach could occur. In addition, the staff reminded registrants that the staff reads the news too, noting that if a significant cyberincident is reported by the news media, the staff may contact a registrant to better understand the registrant's plans for disclosure of the incident.

Given the increased emphasis on cybersecurity, the SEC staff is expected to continue focusing on cybersecurity disclosures. For more information, see Deloitte's February 23, 2018, and October 30, 2018, Heads Up newsletters.

### 3.3.2.2 Brexit

**Example of an SEC Comment**

> Considering your operations in the United Kingdom (“U.K.”) as well as the U.K. pension plan, please tell us what consideration was given to including risk factor disclosure for Brexit.

Upon ratification of Brexit in January 2020, the United Kingdom entered into a transition period to negotiate the terms of its future relationship with the European Union. Although many aspects of the parties' current relationship may remain the same after the transition period, which is expected to run until January 1, 2021, the results of their material negotiations on issues such as trade, tariffs, and law enforcement are uncertain. Therefore, we believe that the considerations discussed below, which were applicable during the events leading up to Brexit, will remain relevant until those uncertainties are resolved.

Before Brexit, SEC Chairman Jay Clayton broadly observed that until recently, the financial and business risks of Brexit were either not well understood or underestimated. He further noted that the effects of uncertainty related to Brexit were already observable; for example, some entities adopted a more risk-averse approach to their hiring and business investment decisions as the United Kingdom approached potential withdrawal deadlines.
Mr. Clayton also commented on the wide-ranging nature of Brexit disclosures. For example, the SEC has observed that while some registrants have provided granular disclosures describing entity-specific implications of Brexit, other registrants have disclosed Brexit as a general risk. In a related speech, Mr. Clayton indicated that he has directed the SEC staff to focus on registrants’ disclosures about Brexit and Brexit’s effects on market utilities and infrastructure.

Given the uncertain and evolving outcome of Brexit negotiations, businesses have not been able to take a “wait and see” approach. Rather, they have had to plan for a variety of outcomes. Registrants are encouraged to ensure that (1) their disclosures give investors sufficient information about both the potential implications of Brexit and the registrants’ planning and preparation for the transition and (2) they use materiality as a basis for determining the appropriate disclosure level.

Topics that registrants may consider when evaluating the potential risks and related disclosures associated with Brexit may include (1) new laws and regulations, (2) supply chain disruption, (3) impacts on revenue due to tariffs or other costs that may affect demand for a company’s products, (4) foreign currency risk, (5) impacts on existing contractual arrangements, (6) potential asset impairments, and (7) restructuring costs.

### 3.3.2.3 Transition Away From LIBOR

<table>
<thead>
<tr>
<th>Examples of SEC Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>• We note . . . that the interest on a significant portion of your long-term debt is indexed to LIBOR. In light of UK regulators’ decision to abandon the LIBOR benchmark by the end of 2021, please disclose whether the underlying agreements reference an alternative benchmark. Please address whether you may be required to refinance sooner as a result.</td>
</tr>
<tr>
<td>• Please supplement the disclosure in the “Risk Factors” section of the Registration Statement with respect to the possible elimination of LIBOR.</td>
</tr>
</tbody>
</table>

The use of LIBOR is pervasive in today’s markets as a benchmark or reference rate in contracts such as derivatives (e.g., interest rate swaps), corporate and consumer loans and mortgages, and corporate and municipal bonds. The United Kingdom’s Financial Conduct Authority is set to phase out LIBOR by the end of 2021. To prepare for the possible discontinuation of LIBOR, certain jurisdictions in which the use of LIBOR is prevalent have formed working groups to develop possible successor alternative reference rates (ARRs). In the United States, the Alternative Reference Rates Committee (ARRC) has designated the Secured Overnight Financing Rate (SOFR) as the recommended alternative rate for U.S. dollar–based LIBOR.

The LIBOR transition could have a pervasive impact on the financial markets and significantly affect market participants’ systems, operations, and financial reporting. All entities should gauge their potential exposure to LIBOR, identify potential risks associated with the LIBOR transition, and determine whether action is necessary to mitigate those risks. In particular, entities should assess whether existing contracts that refer to LIBOR and are expected to extend beyond 2021 have effective fallback language so that the entities have sufficient time to take corrective action if necessary. Also, market participants should consider the impending LIBOR transition when they negotiate the terms of new contracts and ensure that such contracts either refer to ARRs or incorporate sufficient fallback language if LIBOR is used.

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Chapter 3 — SEC Disclosure Topics

On July 12, 2019, the SEC staff issued a statement (the “Statement”) that:

- Discusses how the transition from LIBOR may significantly affect financial markets and market participants (including public companies, investment companies and advisers, and broker-dealers).
- Lists questions and considerations for market participants related to new or existing contracts and other business risks.

The Statement does not establish any new disclosure obligations; rather, it presents the SEC staff's views on how the SEC’s existing rules should be interpreted in connection with the transition from LIBOR. When evaluating the potential impact of future benchmark rate changes, registrants are encouraged to consider the effect that the changes could have on cost of credit and the value of assets as well as the financial impact of contractual fallback provisions. SEC registrants also need to be mindful of their disclosure obligations under SEC rules and regulations and ensure that their disclosures are transparent and timely. Further, if there are material changes to systems or controls, registrants may need to consider disclosing such information. Given the evolving nature of this transition, registrants should also update their disclosures as material new information becomes available. For more information about the Statement, see Deloitte's August 6, 2019, Heads Up.

The FASB also considered the accounting implications of this expected change, as well as transition relief. In March 2020, the Board concluded its reference rate reform project and issued ASU 2020-04. For more information about the FASB’s reference rate reform, see Deloitte’s March 23, 2020, Heads Up.

3.4 Non-GAAP Financial Measures and Key Metrics

The SEC's January 22, 2003, final rule on the conditions for use of non-GAAP financial information defines a non-GAAP financial measure as a “numerical measure of a registrant's historical or future financial performance, financial position or cash flows” that includes amounts that are not part of the most directly comparable GAAP measure or excludes amounts that are part of the most directly comparable GAAP measure. Common non-GAAP financial measures include operating income that excludes one or more expense items, adjusted revenues, adjusted net income, EBITDA or adjusted EBITDA, free cash flows, core earnings, net debt, funds from operations, and measures presented on a constant-currency basis.

Many registrants assert that non-GAAP measures are meaningful and provide valuable insight into the information that management considers important in running the business. Registrants may believe that GAAP numbers do not provide a full picture of their business or their results of operations and liquidity unless supplemented with non-GAAP measures that they believe are useful. While the SEC staff allows registrants to use non-GAAP measures “to tell their story,” registrants must apply the appropriate SEC guidance and provide required disclosures.

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

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

In addition, the SEC has issued (1) C&DI that clarify the guidance on non-GAAP measures and (2) SEC Interpretive Release No. 33-10751 (the “January 2020 interpretive release”), which provides guidance on the disclosure and use of key performance indicators (KPIs) and metrics.

3.4.1 Disclosure Requirements Applicable to Domestic Registrants

The following table summarizes the disclosure requirements that apply to domestic\textsuperscript{14} registrants under the Rules:

<table>
<thead>
<tr>
<th>Disclosure Requirements</th>
<th>All Disclosure of Non-GAAP Financial Measures (Regulation G\textsuperscript{15,16})</th>
<th>SEC Filings (Item 10(e) of Regulation S-K\textsuperscript{17,18})</th>
<th>Press Releases Furnished to the SEC (Item 2.02 of Form 8-K\textsuperscript{19})</th>
</tr>
</thead>
<tbody>
<tr>
<td>Presentation of the most directly comparable GAAP financial measure</td>
<td>X</td>
<td></td>
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<tr>
<td>Presentation, with equal or greater prominence, of the most directly comparable GAAP financial measure</td>
<td></td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Quantitative reconciliation of the non-GAAP financial measure to the most directly comparable GAAP financial measure</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Statement disclosing the reasons why management believes the non-GAAP financial measure provides useful information to investors</td>
<td></td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>To the extent material, a statement disclosing the additional purposes for which management uses the non-GAAP financial measure</td>
<td></td>
<td>X</td>
<td>X</td>
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</table>

In May 2016, in response to increasing concerns regarding the increased use and prominence of non-GAAP measures, the nature of the adjustments, and the increasingly large difference between the amounts reported for GAAP and non-GAAP measures, the SEC issued new and updated C&DI to provide additional guidance on what it expects from registrants when they use non-GAAP measures. The SEC staff noted its expectation that the updated C&DI would promote changes in the use of non-GAAP measures, particularly related to the undue prominence placed on such measures and to the presentation of potentially misleading measures, as well as compliance with other presentation and disclosure requirements. Since the issuance of the updated C&DI, non-GAAP measures have remained among the leading topics of focus in SEC comments despite improvements in registrants’ disclosures.

\textsuperscript{14} For guidance on foreign private issuers, see Regulation G, Regulation S-K, Item 10(e); Section 106 of the C&DI; and Section 8140 of the FRM.

\textsuperscript{15} Regulation G applies whenever a registrant, or person acting on its behalf, publicly discloses or releases material information that includes a non-GAAP financial measure, whether that information is furnished to, or filed with, the SEC.

\textsuperscript{16} In certain situations, Regulation G and Item 10(e) do not apply. For example, they do not apply to non-GAAP measures related to a proposed business combination or measures required to be disclosed by a governmental authority.

\textsuperscript{17} Item 10(e) applies to all SEC filings that include non-GAAP financial measures.

\textsuperscript{18} See footnote 15.

\textsuperscript{19} Form 8-K, Item 2.02, requires registrants to furnish to the SEC all releases or announcements disclosing material nonpublic financial information about completed annual or quarterly fiscal periods, regardless of whether the release or announcement includes disclosure of a non-GAAP financial measure.
SEC comments have continued to cover a wide range of matters related to non-GAAP measures. Although there has been a decline in the number of comments related to prominence of non-GAAP measures, that topic has remained a focus of the staff. Comments have also focused on enhancing the disclosure related to the purpose and use of such measures, reconciliation requirements, and clear labeling. In addition, the SEC has questioned the nature of certain adjustments that may be potentially misleading, such as those that use individually tailored accounting principles. Deloitte’s *A Roadmap to Non-GAAP Financial Measures and Metrics* provides further guidance on each of these topics of SEC focus, which are also discussed further below.

3.4.2 Undue Prominence

**Examples of SEC Comments**

- We note that in your executive summary you focus on key non-GAAP financial measures and not GAAP financial measures which may be inconsistent with the updated Compliance and Disclosure Interpretations issued on May 17, 2016 (specifically Question 102.10). We also note issues related to prominence within your earnings release. . . . Please review this guidance when preparing your next earnings release.

- We note that your reconciliation of EBITDA starts with the non-GAAP measure and reconciles to the GAAP measure (net income). In future filings please revise your presentation to start with the GAAP measure so that the GAAP measure is presented with equal or greater prominence. This comment also applies to any non-GAAP measures presented in an earnings release. Refer to Question 102.10 of the Compliance and Disclosure Interpretations.

- We note you present full GAAP to Non-GAAP Adjusted Statements of Earnings . . . . Please note that the presentation of a full non-GAAP income statement may place undue prominence to the non-GAAP information and may give the impression that the non-GAAP income statement represents a comprehensive basis of accounting. Please confirm to us that you will not present non-GAAP consolidated income statements in future filings. Please refer to Item 10(e)(1)(i) of Regulation S-K and Question 102.10 of the Compliance and Disclosure Interpretations. . . . As an alternative, you may present a non-GAAP performance measure reconciled to the most comparable measure calculated in accordance with GAAP.

- We note that you provide tabular disclosures of Adjusted Segment EBIT by segment without providing more prominent tabular disclosures of the most directly comparable GAAP measures, Segment EBIT by segment. We also note that you do not provide reconciliations of Adjusted Segment EBIT by segment to the most directly comparable GAAP measures. Please refer to Item 10(e)(1)(i) of Regulation S-K and Question 102.10 of the updated C&DI related to Non-GAAP Financial Measures and revise your disclosures accordingly. In addition, please clearly identify each segment measure under “Total Segment EBIT, adjusted” in the table as “Adjusted Segment EBIT.”

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

- If GAAP and non-GAAP measures are presented in a particular section of a document, the GAAP measures should be presented before the non-GAAP measures. For example, if a registrant wants to use certain non-GAAP measures in its discussion of results of operations, it should discuss the GAAP results before the non-GAAP measures.

- In public forums and in SEC comment letters, the SEC staff has clearly indicated that when a registrant reconciles a non-GAAP measure to the most comparable GAAP measure, it should start with the GAAP measure.
• The registrant should not present the non-GAAP measure in more detail or emphasize it more than it does the comparable GAAP measure. For example, use of terms such as “exceptional” or “record” in a discussion of the non-GAAP measure would place undue emphasis on that measure if such terms were not used to describe the comparable GAAP measure.

• The disclosures related to the purpose and use of non-GAAP measures should not state or imply that the non-GAAP measures are superior to, provide better information about, or more accurately represent the results of operations than GAAP measures.

• Certain presentations that give undue prominence to non-GAAP information, such as a full non-GAAP income statement, are prohibited.

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

3.4.3 Disclosures About Purpose and Use

Example of an SEC Comment

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

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

3.4.4 Identification and Clear Labeling

Examples of SEC Comments

• [I]n your summary table of non-GAAP results, you label the items using the same name as your GAAP measures while in your discussion of the non-GAAP measures you refer to the non-GAAP measures with different titles, such as non-GAAP gross profit. In future filings when disclosing non-GAAP financial measures, please revise your presentation to use titles consistently and to use titles or descriptions for your non-GAAP financial measures that are not the same as, or confusingly similar to, titles or descriptions used for GAAP financial measures. Refer to Item 10(e)(1)(ii)(E) of Regulation S-K.
Examples of SEC Comments (continued)

- Within your discussion of modified net operating income, we note you have indicated that some of your adjustments are non-recurring. Given the nature of these adjustments, it is not clear why they are non-recurring. Please clarify and/or revise to remove the reference to non-recurring from your disclosure. Reference is made to Question 102.03 of the Division's Compliance and Disclosure Interpretations for Non-GAAP Financial Measures.

- Gross margins appear to represent a non-GAAP financial measure. Please tell us why you believe that gross margin is presented in accordance with GAAP. If gross margin is a non-GAAP financial measure, please provide a reconciliation of the differences between the non-GAAP financial measure with the most directly comparable financial measure calculated and presented in accordance with GAAP and the other disclosures required by Item 10(e) of Regulation S-K. Also, the use of titles or descriptions of non-GAAP financial measures should not be the same as, or confusingly similar to, titles or descriptions used for GAAP financial measures. Please refer to Item 10(e) of Regulation S-K. Please revise the title of this non-GAAP financial measure in future filings.

- We note that gross margin excludes depreciation and amortization. As such, it appears gross margin represents a non-GAAP financial measure. If so, please provide the disclosures required by Item 10(e)(i) of Regulation S-K. If not, please explain to us why you do not believe gross margin is a non-GAAP financial measure.

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

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

For example, a registrant should not:

- Use GAAP titles such as “gross margin” or “operating income” for amounts presented that exclude costs that would generally be included in these totals under GAAP or Regulation S-X, Article 5. If such costs are excluded, the label attached to the amount should clearly indicate that (1) the measure represents a non-GAAP measure, (2) such amounts are adjusted (e.g., “adjusted operating earnings” if a registrant excludes restructuring charges from its non-GAAP “operating earnings” measure), and (3) the measure complies with Regulation G and Regulation S-K, Item 10(e).

- Label a measure “pro forma” if the measure was not calculated in a manner consistent with the concepts in Regulation S-X, Article 11, or in ASC 805.

In addition, some registrants do not present a gross margin subtotal on the face of the income statement; however, they may present outside the financial statements a non-GAAP margin for which the most comparable GAAP measure could be considered gross profit. This practice has been observed in the public utility and oil and gas industries (e.g., refining margin), but it is not limited to those sectors. The measure may also be labeled “non-GAAP contribution margin” or “adjusted gross margin.” The SEC staff expects such registrants to (1) disclose that these measures are non-GAAP financial measures and (2) consider the disclosure requirements in Item 10(e). Further, the SEC staff has reminded registrants that non-GAAP measures should be presented in a balanced manner and reconciled to the most comparable GAAP measure. If a registrant does not present a gross margin subtotal on the face of the income statement but concludes that gross margin is the most comparable measure, the registrant should consider calculating and presenting a “fully loaded” GAAP measure of gross margin as the starting point in the non-GAAP reconciliation.
Further, as discussed in C&DI Question 102.03, if management concludes that an adjustment to a non-GAAP performance measure is appropriate but that the adjustment is reasonably likely to recur within two years or there was a similar charge in the past two years, it may adjust the non-GAAP performance measure (subject to Regulation G and the other requirements in Regulation S-K, Item 10(e)) but may not describe the adjustment as “nonrecurring,” “infrequent,” or “unusual” because the adjustment does not meet the specified criteria.

### 3.4.5 Liquidity Versus Performance Measures

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<tr>
<th>Examples of SEC Comments</th>
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<tr>
<td>• We continue to question whether your disclosure of non-GAAP diluted EPS is consistent with C&amp;DI 102.05. In particular, you point out that the reconciling items from GAAP net income to non-GAAP net income will not require cash settlement. By adjusting your net income to exclude only non-cash items, it appears that you are attempting to present a cash-based earnings measure. Furthermore, we note that for the periods presented in . . . earnings releases, your non-GAAP net income was within [X]% of your cash provided by operating activities in your Statements of Cash Flows for the same periods. In light of the above, please explain how you determined that your non-GAAP net income measure could not be used as a liquidity measure. Alternatively, please remove non-GAAP diluted EPS from your future earnings releases.</td>
</tr>
<tr>
<td>• It appears that you are presenting non-GAAP adjusted net loss and net loss per share as liquidity measures based on your statement that these measures remove the impact of stock-based compensation due to your emphasis on cash burn and, more specifically, cash used in operations. As such, please revise to provide a reconciliation of adjusted net loss to the most directly comparable GAAP measure for a liquidity measure (i.e., cash flows from operations). In addition, please note that non-GAAP liquidity measures that measure cash generated must not be presented on a per share basis. Whether per share data is prohibited depends on whether the non-GAAP measure can be used as a liquidity measure, even if management presents it solely as a performance measure. Refer to Question 102.05 of the updated Non-GAAP Compliance and Disclosure Interpretation.</td>
</tr>
<tr>
<td>• We note that you present Adjusted OIBDA as a measure of segment performance and that you also present it on a consolidated basis . . . . Please reconcile consolidated Adjusted OIBDA to the most directly comparable GAAP measure. Refer to Item 10(e)(1)(x)(B) of Regulation S-K. In this regard, you disclose both that operating income is the most directly comparable GAAP financial measure and that Adjusted OIBDA provides a meaningful representation of operating cash flows. If considered both a performance and a liquidity measure, consolidated Adjusted [OIBDA] should be reconciled to both net income and operating cash flows, respectively. Refer to Question 102.06 of the Non-GAAP Financial Measures C&amp;DI’s. Please advise and revise, as appropriate.</td>
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</table>

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

Registrants should consider whether the classification of a non-GAAP measure as a performance measure is appropriate if the non-GAAP measure is, in substance, a liquidity measure. The SEC staff may focus on the substance of the non-GAAP financial measure and not on management's characterization, and it may challenge a measure designated as a performance measure that appears to be more like a liquidity measure. The context of the non-GAAP disclosure may be an important consideration.
Depending in part on the size and nature of the adjustments to the corresponding GAAP measure, a registrant may need to use judgment in assessing whether a non-GAAP performance measure can be used as a liquidity measure. The SEC staff may comment if, for example:

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

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

### 3.4.6 Reconciliation

**Examples of SEC Comments**

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

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

### 3.4.7 Nature of Adjustments

**Examples of SEC Comments**

- Please explain to us why it is appropriate to remove restructuring, integration and deal costs, termination of certain supply and distribution agreements costs and legal settlement and legal proceedings, investigations and inquiries costs from your adjusted non-GAAP income measure when they appear to be normal, recurring operating expenses that will be settled in cash. See CDI 100.01. In your response, please tell us the significant components of each of the expenses for each of the last three years and the latest interim periods with comparable amounts.
Examples of SEC Comments (continued)

- We note your computations of non-GAAP measures Adjusted Operating Earnings, Adjusted Net Income and Adjusted EPS exclude acquisition related intangible assets amortization. Please tell us how you determined the adjustments to exclude the amortization of certain acquired intangible assets do not substitute individually-tailored income or expense recognition methods for those of GAAP. Refer to Question 100.04 of the Non-GAAP Financial Measures Compliance and Disclosure Interpretations.

- We note your disclosure . . . that EBITDAR is useful in evaluating your operating performance compared to your competitors. This measure eliminates . . . rent, which is a normal, recurring cash operating expense necessary to operate your business. Therefore, please revise this disclosure here and elsewhere within your registration statement to indicate this measure is solely used as a valuation metric and to add disclosure emphasizing the limitations of its use, including that it should not be viewed as a measure of overall performance. Please refer to Question 100.01 of our Compliance & Disclosure Interpretations for Non-GAAP Financial Measures dated April 4, 2018.

- We note, regarding the non-GAAP measure identified as adjusted EBITDAR, you disclose that it is a commonly used measure to compare the enterprise value of different companies. . . . You further disclose it is “a financial valuation measure” and it is “not displayed as a performance measure”. It is unclear why it is appropriate or useful to investors to present comparative valuation measures. . . . Please refer to Rule 100(b) of Regulation G and Item 10(e)(1)(C) of Regulation S-K, and revise your disclosures accordingly.

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

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

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

For example, if a registrant has recurring restructuring charges or frequent routine business acquisitions (i.e., the registrant is a “serial” restructurer or acquirer), the SEC staff may ask about the facts and circumstances supporting an adjustment for what may appear to be a recurring cost. Depending on its specific circumstances, the registrant may be able to support why such an adjustment is appropriate. However, the registrant may wish to consider whether enhancements to its disclosures about the nature and purpose of the adjustment or resulting non-GAAP measure would help clarify the intent of the measure or its use by management and investors.
Chapter 3 — SEC Disclosure Topics

The SEC staff has also asked certain registrants about their presentation of EBITDAR and adjusted EBITDAR because the deduction for rent could be viewed as eliminating a normal, recurring cash operating expense from a non-GAAP performance measure. In recent SEC comment correspondence, the staff has indicated that non-GAAP presentations of EBITDAR and adjusted EBITDAR should not be characterized as performance measures. However, in some circumstances, the staff may not object to disclosure of the measures if they are characterized as financial valuation measures. Further, if EBITDAR is presented as a financial valuation measure, the SEC staff may object to such presentation for all comparative periods because it may indicate that the measure is also a performance measure. Accordingly, the SEC staff may request that the measure be presented only for the most recent period.

Question 100.04 of the C&DI on non-GAAP measures notes that a registrant is prohibited from presenting non-GAAP performance measures that substitute individually tailored revenue recognition and measurement methods for those of GAAP. Although the example in the C&DI focuses on revenue recognition, the guidance indicates that individually tailored accounting principles may also be prohibited when they are applied to other financial statement line items to create a non-GAAP measure. While the SEC staff will comment when it observes an individually tailored revenue recognition method in a non-GAAP measure, an increasing number of comments have been issued on individually tailored measures other than revenue. For example, the SEC staff has commented on measures that (1) use pro rata consolidation, (2) remove the impact of purchase accounting (“fair value”) adjustments for acquired loans from the GAAP measure, (3) adjust for only the portion of amortization associated with acquired intangible assets, and (4) assume changes to an entity's capital structure.

After a registrant responds in writing to the original comment, the SEC staff may reach out to the registrant and request a phone call to discuss the presentation of a non-GAAP measure that uses individually tailored accounting principles or certain other non-GAAP presentations. As a result of the registrant’s discussion with the staff, the registrant may either (1) make prospective changes to the presentation of the non-GAAP measure to modify or eliminate certain adjustments or (2) provide additional disclosure regarding the use and limitations of the measure.

### 3.4.8 Income Tax Effects

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<th>Examples of SEC Comments</th>
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<tr>
<td>• We note that you separately adjust for the change in U.S. Tax Law in your non-GAAP reconciliations but appear to show all other adjustments net of tax. Please present the income tax effects of your non-GAAP adjustments as a separate adjustment and explain how you calculated the income tax effects related to these adjustments in your next earnings release. Refer to Question 102.11 of the Non-GAAP Compliance and Disclosure Interpretations.</td>
</tr>
<tr>
<td>• We note that you adjust the income tax provision to reflect the expected cash taxes to be paid in your calculation of Non-GAAP adjusted net income. Your income tax adjustment is inconsistent with Question 102.11 of the updated Non-GAAP Compliance and Disclosure Interpretations issued on May 17, 2016. Please revise the tax adjustment in future filings to reflect the current and deferred tax expense commensurate with the non-GAAP measure of profitability.</td>
</tr>
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</table>

20 For additional examples of individually tailored accounting principles, see Section 4.3.3 of Deloitte’s A Roadmap to Non-GAAP Financial Measures and Metrics.
In certain circumstances, a registrant may reflect a non-GAAP measure after taxes and therefore show the tax adjustments when reconciling a non-GAAP measure to the appropriate GAAP measure. A registrant should present its reconciling adjustments gross of tax and should disclose how the tax adjustments were determined. If other tax adjustments are included in the reconciliation, such as the removal of discrete tax adjustments, a registrant should separately disclose the income tax effects of the non-GAAP adjustments from other adjustments. The SEC staff frequently reminds registrants (1) to revise their disclosures and tabular presentations to separately present the income tax impact of their non-GAAP adjustments, (2) to disclose how the tax impact of the non-GAAP adjustments was calculated, and (3) that the tax adjustments should reflect current and deferred tax expense commensurate with the non-GAAP measure of profitability.

3.4.9 Certain Financial or Operating Metrics

Examples of SEC Comments

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

- We note in your earnings calls that you discuss net revenue per client . . . and inventory turnover. If these metrics are used by management to manage the business, and promote an understanding of the company’s operating performance, they should be identified as key performance indicators and discussed pursuant to Instruction 1 of paragraph 303(a) or Regulation S-K and Section III.B.1 of SEC Release No. 33-8350. Please tell us your consideration of disclosing these metrics, or other key performance indicators used.

In the SEC's January 2020 interpretive release, the SEC indicated that a registrant should consider the need to disclose KPIs or metrics that it uses to manage its business in MD&A because this information may be material to investors and necessary in the evaluation of the company's performance. While such disclosures may be required in MD&A, it may also be appropriate for registrants to disclose KPIs or metrics in other areas outside the financial statements, such as the business section or press releases.

The types of metrics a registrant uses may vary widely among industries. For example, the same-store sales metric is used frequently in the retail and restaurant industries, subscriber numbers are often used by cable and streaming companies, and occupancy and revenue per available room are performance metrics used throughout the hospitality industry. Such measures are not provided on the face of the financial statements or in the notes thereto, and they are not necessarily derived from any underlying financial statement amounts. While such customized metrics are generally not considered non-GAAP measures, a registrant should provide certain disclosures about them, many of which are similar to those the registrant would provide for non-GAAP measures.
While the SEC staff has provided its views on metric disclosures in various speeches, the January 2020 interpretive release formalizes the SEC’s guidance on disclosures about KPIs and metrics. Accordingly, a registrant should (1) clearly define the metrics used and how they are calculated; (2) describe any key estimates, assumptions, and limitations (e.g., whether the metric is a “hard” amount or an estimate); (3) present a metric within a balanced discussion; and (4) clearly describe how a metric is related to current or future strategy and results of operations. A registrant should also disclose how management uses the metrics and why they are important to investors. The SEC emphasized in the January 2020 interpretive release that when assessing whether to include metrics in its disclosures, a registrant should consider its existing MD&A requirements. It noted that a company’s narrative should permit “investors to see [the] company ‘through the eyes of management,’ so these metrics should not deviate materially from metrics used to manage operations or make strategic decisions.”

For more information about metrics, see Deloitte’s *A Roadmap to Non-GAAP Financial Measures and Metrics*.

### 3.5 Disclosure Controls and Procedures

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

#### 3.5.1 Inappropriate Conclusion About DC&P

<table>
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<tr>
<th>Examples of SEC Comments</th>
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<tr>
<td>• 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.</td>
</tr>
<tr>
<td>• Please amend your disclosure to clarify whether management concluded that disclosure controls and procedures were effective or ineffective as of [the fiscal year-end]. Your current disclosure indicates that they were both not effective and determined to be effective upon “re-evaluation.”</td>
</tr>
</tbody>
</table>

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

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

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

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21 Under Part I, Item 4, of Form 10-Q and Part II, Item 9A, of Form 10-K.
22 As required by Regulation S-K, Item 307.
### 3.5.2 Incomplete, Inconsistent, or Inaccurate Information in Disclosure About DC&P

#### Examples of SEC Comments

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

- Please tell us how you considered your disclosure controls and procedures to be effective . . . despite identifying that you did not maintain effective internal control over financial reporting due to a material weakness in your controls related to [Topic X].

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

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

#### Examples of SEC Comments

- Please tell us how you were able to conclude that your disclosure controls and procedures were effective in light of the material weaknesses that existed as of [the fiscal year-end] and considering your conclusion in subsequently filed Form 10-Qs that your disclosure controls and procedures were not effective due to these same material weaknesses. Refer to Item 307 of Regulation S-K.

- [P]lease consider whether management's failure to perform or complete its report on internal control over financial reporting impacts its conclusions regarding the effectiveness of your disclosure controls and procedures . . . and revise your disclosure as appropriate.

Paragraph 4310.9 of the FRM states, in part, “Because of the substantial overlap between ICFR and [DC&P], if management concludes that ICFR is ineffective, it must also consider the impact of the material weakness on its conclusions related to [DC&P].” If a registrant concludes that its DC&P are effective when a material weakness exists, the SEC staff often asks for information on the factors the registrant considered in reaching such a conclusion. In addition, when a registrant is required to file amended periodic reports containing restated financial statements, the SEC staff generally asks the registrant to reconsider its conclusions about the effectiveness of its DC&P.
The SEC staff has also asked about management’s conclusion that DC&P were effective when a registrant did not file periodic reports in a timely manner. A registrant should design DC&P to ensure that information disclosed in its reports filed or submitted under the Exchange Act is recorded, processed, summarized, and reported within the periods specified in the SEC's rules. If the registrant does not report such information within these periods, the staff may request that the registrant supply additional information to support management’s conclusion.

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

#### Example of an SEC Comment

You state that your disclosure controls and procedures were effective as of [the end of the second quarter of fiscal year 2]. Given that your disclosure controls and procedures appear to have been ineffective as of [the end of fiscal year 1], please tell us what changed from [the end of fiscal year 1] to [the end of the second quarter of fiscal year 2] that allowed you to reach a different conclusion about the effectiveness of your disclosure controls and procedures as of [the end of the second quarter of fiscal year 2].

If a registrant concludes that its DC&P were effective after a period in which the DC&P had been deemed ineffective, the SEC staff may ask the registrant to explain the basis for its conclusion. The 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.

### 3.6 Internal Control Over Financial Reporting

In addition to disclosing material changes in ICFR on a quarterly basis, a registrant must annually provide management’s report on ICFR and, if applicable, the attestation report of the registrant’s registered public accounting firm. These reports are not required in registration statements or Form 11-K. Further, newly public companies generally do not need to provide management’s report on ICFR in the first Form 10-K that they file after their initial public registration statement is declared effective; however, they are required to include a statement regarding the transition period established for them if management’s report is not included. In addition, the Jumpstart Our Business Startups (JOBS) Act amended Section 404(b) of the Sarbanes-Oxley Act by exempting EGCs from the requirement to obtain an attestation report on ICFR for as long as such entities retain their EGC status. See Section 3.8 for considerations related to EGCs.

Entities should be mindful of the SEC’s June 20, 2007, interpretive release regarding management’s assessment of ICFR, particularly the guidance on the evaluation of control deficiencies. The SEC staff has stated that internal control reporting is a focus in its reviews and enforcement actions, and this focus is demonstrated by past SEC cases.

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23 See footnote 21.
24 The requirement to provide 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.
25 Form 11-K is used to file the annual reports for employee stock purchase, savings, and similar plans.
26 However, paragraph 4310.6 of the FRM states, in part, “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.”
27 As required by Instruction 1 to Regulation S-K, Item 308.
3.6.1 Evaluation of Severity of Control Deficiencies

Examples of SEC Comments

- Please describe in detail your evaluation of the severity of the key control deficiency. Refer to the guidance for evaluation of control deficiencies beginning on p. 34 of SEC Release No. 33-8810 “Commission Guidance Regarding Management’s Report on Internal Control Over Financial Reporting Under Section 13(a) or 15(d) of the Securities Exchange Act of 1934.” Include in your analysis a description of the maximum potential amount or total of transactions exposed to the deficiency and how that determination was made.

- We note that you identified a misstatement in the accounting for certain partnership interests . . . , which resulted in a reduction to Retained Deficit of $[X] million, an increase in Additional Paid-In Capital of $[Y] million and a decrease in Redeemable Non-Controlling Interests of $[Z] million. We also note that you concluded the misstatement to be inmaterial to the prior periods and revised the historical consolidated financial information within this Form 10-Q. Please describe the nature of the error, how it was identified and how the error impacted your conclusion on the effectiveness of the Company’s disclosure controls and procedures (“DC&P”) and internal control over financial reporting (“ICFR”). In this regard, please note that a material weakness as defined in Rule 1-02(a) of Regulation S-X is not limited to the existence of a material financial statement misstatement but rather considers whether there is a reasonable possibility that a material misstatement of the annual or interim financial statements will not be prevented or detected on a timely basis.

Registrants whose responses to SEC staff comments disclosed the identification of numerous control deficiencies without reporting a material weakness have received follow-up comments asking them to explain how they evaluated the severity of the deficiencies in the aggregate. The SEC staff has reiterated that the existence of a material weakness does not depend on the actual magnitude of an error (or whether an error existed) but instead depends on whether there was a reasonable possibility that a material misstatement could have occurred without being detected or prevented by the registrant’s ICFR. In the interpretive release discussed above, the SEC stated that (1) 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” and (2) “multiple control deficiencies that affect the same financial statement amount or disclosure increase the likelihood of misstatement.”

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

ICFR was also a key topic at the 2016 AICPA Conference. The SEC staff stated at the conference that although companies’ identification of material weaknesses is improving, improvement is still needed with respect to the timing of identifying deficiencies and the evaluation of their severity, noting that this continues to be a focus of the SEC.

At the 2018 AICPA Conference, the SEC staff stated that “[o]n certain occasions, [the] OCA has objected to management’s conclusions regarding whether identified control deficiencies constituted a material

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28 See the December 9, 2015, speech delivered by Brian Croteau, then deputy chief accountant in the SEC’s Office of the Chief Accountant (OCA), at the 2015 AICPA Conference.
weakness.” For example, in certain instances, “management’s analysis . . . did not fully evaluate the type or magnitude of misstatements that were reasonably possible due to the identified control deficiency.”

### 3.6.2 Evaluation of Control Deficiencies Related to Immaterial Misstatements

<table>
<thead>
<tr>
<th>Example of an SEC Comment</th>
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<tbody>
<tr>
<td>We note that you concluded that the errors related to deferred tax assets were immaterial to the previously reported amounts contained in your periodic reports. Please tell us the following concerning these errors:</td>
</tr>
<tr>
<td>• Explain to us in greater detail the nature of the errors and how they were determined and remediated;</td>
</tr>
<tr>
<td>• Tell us if there was any impact on the evaluation of your disclosure controls and procedures and your conclusion on Internal Control over Financial Reporting; and</td>
</tr>
<tr>
<td>• Provide us with your SAB 99 materiality analysis beginning with the initial time period in which the errors were detected, addressing how you concluded that these errors were immaterial to the previously reported amounts contained in your periodic reports.</td>
</tr>
</tbody>
</table>

At the September 2014 AICPA National Conference on Banks & Savings Institutions, the SEC staff indicated that it will continue to question how registrants have considered and evaluated the severity of deficiencies in ICFR related to immaterial misstatements that were corrected by immaterial restatements. The staff reminded registrants that the severity of a deficiency does not depend on whether a misstatement actually has occurred; rather, it depends on whether there is a reasonable possibility that the deficiency could have resulted in a misstatement. The evaluation of the severity warrants consideration of risk factors including, but not limited to, the potential future consequences of the deficiency. Accordingly, it is possible that an immaterial restatement represents a material weakness in ICFR even though the actual magnitude of an error was not material. The SEC’s June 20, 2007, interpretive release states, in part:

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.

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29 See the December 10, 2018, speech delivered by Tom Collens, then professional accounting fellow in the OCA, at the 2018 AICPA Conference.

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

31 In a December 8, 2014, speech delivered at the December 2014 AICPA Conference, then OCA Senior Associate Chief Accountant Kevin Stout stated that “[c]onsidering the nature of the deficiency is an important next step in determining the magnitude of the potential misstatement.” This evaluation should include consideration of both (1) the nature and current number of transactions affected by the deficiency and (2) the expected amount or volume of transactions that may be affected in the future.
3.6.3 Evaluation of Deficiencies Identified in the Other COSO Components

<table>
<thead>
<tr>
<th>Example of an SEC Comment</th>
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<tbody>
<tr>
<td>We continue to question your evaluation of the deficiencies in ICFR and your determination that it was not reasonably possible that a material misstatement of your financial statements would not be prevented or detected on a timely basis as a result of certain control deficiencies. In this regard, please address the following:</td>
</tr>
<tr>
<td>- Tell us how you considered the various errors identified at your corporate location and across multiple geographic regions, some of which were the result of control deficiencies, including significant deficiencies, in different components of the COSO Framework, in evaluating the effectiveness of the control environment component of COSO, especially as it relates to the factor regarding competence (i.e., knowledge, skills, training, and experience of the relevant employees).</td>
</tr>
<tr>
<td>- For the significant deficiencies you identified in the risk assessment, monitoring, and information and communication components, tell us why the severity of each is limited to the specific, individual process-level errors you describe in your response and how you determined that the reasonably possible potential error for each is limited to the various errors identified. For example, how was it determined that the significant deficiency in the risk assessment component related to “not having the appropriate resources” is limited to only being manifested through an immaterial error in a specific type of revenue transaction?</td>
</tr>
<tr>
<td>- Tell us how you concluded that the significant deficiency resulting in the embedded derivative error is appropriately classified within the information and communication component, as opposed to the failure to identify the relevant clauses in the contracts resulting from, for example, a lack of appropriate employee technical skill (control environment), an improper risk assessment of the types of activities that could lead to embedded derivatives, or the ineffective monitoring of the regional accounting team by the corporate accounting team.</td>
</tr>
</tbody>
</table>

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

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

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

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32 See the December 8, 2014, speech delivered by then OCA Senior Associate Chief Accountant Kevin Stout at the 2014 AICPA Conference.
3.6.4 Disclosure of Material Changes in ICFR

<table>
<thead>
<tr>
<th>Examples of SEC Comments</th>
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<tbody>
<tr>
<td>• You disclose that you substantially completed the implementation of your new Enterprise Resource Planning System (&quot;ERP&quot;) by the end of [the fiscal year] and the implementation of this System has affected and will continue to affect your internal controls over financial reporting. We remind you that if your ERP implementation results in any material changes to internal controls over financial reporting, you should provide disclosures required by Item 308(c) of Regulation S-K.</td>
</tr>
<tr>
<td>• We note your disclosure . . . concerning the changes that are continually being made to your controls in light of the restatement announced in [fiscal year 1]. Given the nature of the items outlined in the remediation plan, including the uniform internal control policy implementation, new team members, internal audit, and enhanced compliance practices, please tell us how you concluded that there have been no changes in your internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, your internal control over financial reporting as of [the end of fiscal year 1], [the end of the first quarter of fiscal year 2], and [the end of the second quarter of fiscal year 2]. As part of your response, please tell us whether you expect to report any changes in your future periodic reports.</td>
</tr>
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</table>

The SEC staff has commented when a registrant has not explicitly and clearly asserted whether there has been a change in ICFR in the last fiscal quarter that had or could have a material effect on its ICFR, as required by Regulation S-K, Item 308(c). Registrants should state clearly whether there were changes in ICFR for the quarter and, if so, should disclose the nature of the changes. The staff has stressed that registrants should avoid “boilerplate” disclosure that there have been no material changes affecting ICFR in a period, particularly when there have been identifiable events such as layoffs, changes in outsourcing arrangements, or changes in accounting policies. In his December 5, 2016, keynote address at the 2016 AICPA Conference, then SEC Chief Accountant Wesley Bricker noted that updating and maintaining internal controls will be particularly important as companies implement new accounting standards. It will be important for management to evaluate whether changes to internal controls in response to the adoption of a new accounting standard should be disclosed as a material change in ICFR.

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

**Example of an SEC Comment**

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

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

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

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

At the 2018 AICPA Conference, the SEC staff reiterated that the goal of management’s material weakness disclosure is not only to highlight the existence of a material weakness, but also “to allow for investors to understand the cause of the control deficiency and assess its potential impact on the company’s financial reporting.”34 The staff noted that although the OCA has observed improvements in registrants’ disclosures of material weaknesses, “more could be done to make these disclosures more informative to investors.” To help registrants determine whether a disclosure about a material weakness would provide an investor with the most meaningful information, the staff suggested that they consider the following questions:

- “Does the disclosure allow an investor to understand what went wrong in the control that resulted in a material weakness?”
- “Is it sufficiently clear from the disclosure what the impact of each material weakness is on the company’s financial statements? For example, is the material weakness pervasive or isolated to specific accounts or disclosures?”
- “Are management’s plans to remediate the material weakness sufficiently clear? For example, does [the] disclosure of the remediation plans provide sufficient detail [to allow] an investor [to] understand what management’s plans are and how the remediation plans would address the identified material weakness?”

33 This issue was discussed at the Forums on Auditing in the Small Business Environment hosted by the PCAOB in December 2012.
34 See the December 10, 2018, speech delivered by Emily Fitts, then professional accounting fellow in the OCA, at the 2018 AICPA Conference.
In certain instances, the SEC staff has observed that questions about the validity and completeness of management’s disclosures regarding material weaknesses have arisen as a result of management’s discussion of its remediation plans. Sometimes the remediation plans are broader than the material weakness identified, potentially indicating that the actual material weakness is more pervasive than the material weakness disclosed or that there may be another material weakness that was not identified and disclosed. In providing disclosures about remediation plans, registrants should therefore consider the root cause of a material weakness and whether it highlights a more pervasive material weakness in their ICFR or deficiencies in other controls.

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

3.6.6 Conclusion That ICFR Remains Effective After a Restatement

Example of an SEC Comment

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

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

Registrants should consider paragraphs 4310.16 and 4310.17 of the FRM regarding the restatement of financial statements, which state, in part:

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

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<tr>
<th>Examples of SEC Comments</th>
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<tbody>
<tr>
<td>• We note that management has conducted an evaluation of the effectiveness of your internal control over financial reporting as of [the fiscal year-end] based on the “Internal Control-Integrated Framework” issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Please tell us and revise future filings to disclose whether you applied the 1992 or 2013 COSO framework in your assessment. Reference is made to Item 308(a)(2) of Regulation S-K.</td>
</tr>
<tr>
<td>• Management's report on internal control over financial reporting still does not identify the relevant framework that was used to evaluate your internal controls over financial reporting. Please revise to indicate the relevant framework that was used to evaluate your internal controls over financial reporting.</td>
</tr>
</tbody>
</table>

The COSO framework is one of the most widely applied frameworks that registrants use to evaluate the effectiveness of their ICFR. On May 14, 2013, COSO released an updated version of its Internal Control — Integrated Framework to reflect the significant changes in business and operational environments that have occurred since the original framework was introduced in 1992. Although the components of internal control under the framework remain unchanged, the update introduced 17 new principles that explicitly articulate and describe the components of internal control. Registrants must disclose the internal control framework they applied in assessing the effectiveness of their ICFR in accordance with paragraph 4310.7 of the FRM. COSO's transition guidance stated that the 1992 framework would be available until December 15, 2014, after which COSO would consider the 1992 framework to be superseded by the 2013 framework. However, because COSO is not a standard setter or a regulator, registrants may view the adoption of the 2013 framework as optional. Accordingly, when issuers have disclosed their use of the 1992 framework after the December 15, 2014, transition date, the SEC staff has questioned why they continue to use the 1992 framework.

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

3.6.8 Incomplete or Missing ICFR Evaluation

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<th>Examples of SEC Comments</th>
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<tbody>
<tr>
<td>• [Y]ou did not include your conclusion regarding the effectiveness of your internal control over financial reporting. Please confirm to us that you intended to state . . . that your internal control over financial report is not effective, if correct, and confirm that you will include your conclusions for your assessments of the effectiveness of your disclosure controls and procedures and internal control over financial reporting in all future Forms 10-K.</td>
</tr>
<tr>
<td>• Please revise this report in future [Forms 10-K] to include all the statements required by Item 308(a)(1) of Regulation S-K, including a statement of management's responsibility for establishing and maintaining adequate internal control over financial reporting.</td>
</tr>
<tr>
<td>• We note that your management report does not include a statement that your registered public accounting firm issued an attestation report. Refer to Item 308(a)(4) of Regulation S-K and revise future filings as necessary.</td>
</tr>
</tbody>
</table>

35 For additional information, see Deloitte’s June 10, 2013, Heads Up on the revised COSO framework.
Chapter 3 — SEC Disclosure Topics

Regulation S-K, Item 308(a)(3), requires registrants to assess and conclude on the effectiveness of their ICFR as of the end of their most recent fiscal year. In several instances, the SEC staff has issued comments to registrants that omitted a conclusion or provided one that did not contain all of the required information. The staff has also issued comments to registrants that failed to indicate a date for their ICFR evaluation or included in their filing a date other than the end of their most recent fiscal year. Registrants should ensure that the appropriate date of their ICFR evaluation is prominently displayed in any filing with the SEC. In addition, the SEC staff has issued comments to registrants that did not comply with Regulation S-K, Item 308(a)(4), which requires a registrant to include in management’s report a statement that the registered public accounting firm that audited the registrant’s financial statements issued an attestation report on the registrant’s ICFR.

Other Deloitte Resources

December 15, 2019, Heads Up, “Highlights of the 2019 AICPA Conference on Current SEC and PCAOB Developments”

December 16, 2018, Heads Up, “Highlights of the 2018 AICPA Conference on Current SEC and PCAOB Developments”


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


3.7 Executive Compensation and Other Proxy Disclosures

Proxy disclosure, particularly executive compensation, has been a topic of focus in SEC staff comments to registrants, including those issued to smaller reporting companies (SRCs). Many of the staff’s comments are related to (1) disclosures in Compensation Discussion and Analysis (CD&A), including disclosures about how performance is assessed and the use of performance targets; (2) executive compensation table disclosures; and (3) requests to include employment agreements as exhibits to certain filings.

Further, the SEC continues to evaluate executive compensation and other proxy disclosure requirements through its rulemaking. On August 5, 2015, the Commission issued a final rule that requires a public company to disclose the ratio of the median of the annual total compensation of all employees to the annual total compensation of the CEO (the “pay ratio rule”). In the five years since the release of the final rule, stakeholders have raised concerns about its implementation. In response to those concerns and to clarify the final rule as well as revise some of the interpretations that the SEC issued on October 16, 2016, the SEC issued interpretive guidance on pay ratio disclosure, a revised set of C&DIs on the final rule, and staff guidance on the calculation of pay ratio disclosure on September 21, 2017. The pay ratio rule became effective for disclosures required for the first full fiscal year beginning on or after January 1, 2017. See Deloitte’s October 17, 2017, Heads Up for more information on the pay ratio rule.

36 SRCs and EGCs may refer to Regulation S-K, Item 402(m)-(r) for scaled executive compensation disclosure requirements applicable to such filers.

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

#### Examples of SEC Comments

- We note that . . . you disclose your company-wide net income targets and named executive officer base salary target percentages associated with threshold, target and high-end levels for net income. However, . . . you cite net sales and return on average assets as additional formula-based factors used to determine payment amounts under the management incentive plan. In these cases, you have not disclosed any target or formula relating to these factors. You also have not disclosed the actual amount of net income, net sales or return on assets used to determine the amount of the payments. [I]n future filings, please disclose all of the company-wide targets and formulas that form the basis of incentive compensation payments, as well as the actual amount of each related measure of company performance, so that it is clear how the Compensation Committee determined the specific amounts of incentive compensation paid to each named executive officer. In your response, please show us what your disclosure would have looked like for [the fiscal year]. In addition to your narrative explanation, please consider providing an illustrative example.

- [W]e note your disclosure . . . that the . . . award of performance units to Mr. [A] “represent[s] the right to receive a cash payment equal to $[X] multiplied by certain performance factors.” Please expand your disclosure to identify the performance factors upon which the award of performance units is to be based. We note the related disclosure you include in the Form 8-K that you filed . . . . Also discuss how difficult it will be for Mr. [A] or how likely it will be for the company to achieve the target levels or other factors.

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

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

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

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

**Examples of SEC Comments**

- You disclose that you did not increase base salaries in [the fiscal year] due to the Company’s financial performance, but your Summary Compensation Table shows salary increases for all named executive officers. Please tell us the reason for this discrepancy, and in future filings, please explain any changes in your base salaries.

- It appears that the amounts which you have disclosed in the “Bonus” column of this summary compensation table should have been disclosed under the “Non-Equity Incentive Compensation Plan” column because the amounts reflect the performance of your executives under your non-equity incentive plan, as defined in Item 402(a)(6)(iii) of Regulation S-K. If, in the exercise of discretion, an amount is paid over and above the amounts earned by meeting the performance measure in the non-equity incentive plan, that amount should be reported in the “Bonus” column. It appears that Mr. [B]’s discretionary bonus increase in the amount of $[X] should have been disclosed in the Bonus column. Please explain to us why the payments under the annual incentive bonus awards are being disclosed in the “Bonus” column. For guidance refer to Question 119.02 of Regulation S-K Compliance and Disclosure Interpretations. Please ensure that in future filings you disclose payments under your annual incentive bonus as earned under a non-equity incentive plan and provide appropriate disclosure in your Grant of Plan-Based Awards Table.

- In [a footnote] to your summary compensation table . . . , you state that the amounts for [the CEO] for [201X] and [201Y] reflect “the aggregate grant date fair value for certain performance units granted in December [201X] and [201Y] that are valued based on a performance factor that is tied to certain operational performance metrics.” Given that the non-equity plan compensation represented [A]% and [B]% of [the CEO]’s [201X] and [201Y] total compensation, respectively, please expand [the footnote] to quantify the grant date fair values for both [201X] and [201Y].

- Please update your executive compensation table for the fiscal year ended December 31, [201X], your most recently completed fiscal year. We note that your executive compensation table still references it is dated as of September 30, [201X].

The SEC staff has focused on executive compensation tables because they give investors important information about a registrant’s compensation policies and decisions. Frequently, the staff has asked registrants to (1) explain why the amounts disclosed in the financial statements or other filings are inconsistent with the amounts disclosed in the summary compensation table for NEOs and (2) provide more recent information in the executive compensation table.

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

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

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

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<tr>
<th>Examples of SEC Comments</th>
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<tbody>
<tr>
<td>• We note your disclosure in this section that you amended and restated the letter agreements with each of your executive officers. Please file such amended and restated agreements as exhibits or tell us why you believe that you are not required to file such agreements pursuant to Item 601(b)(10) of Regulation S-K.</td>
</tr>
<tr>
<td>• Please file the employment agreements for the individuals who will serve as the executive officers of [Company X].</td>
</tr>
<tr>
<td>• To the extent any of your executive compensation plans or agreements are completed prior to the closing of your spin-off, please file them as exhibits pursuant to Item 601(b)(10) of Regulation S-K.</td>
</tr>
<tr>
<td>• Please revise to describe the material terms of each letter separately as it appears the terms of the letters were not the same for each officer. For instance, we note that Dr. [A] received a stock bonus of [B]% of [Company X's] ordinary shares in connection with his appointment letter.</td>
</tr>
</tbody>
</table>

The SEC staff has asked registrants to file new or updated employment agreements required under Regulation S-K, Item 601, as exhibits to certain filings when (1) there are new NEOs for an existing company or a newly formed company (e.g., for a spin-off) or (2) there are amended and restated compensation agreements for current NEOs. In addition, the staff frequently asks registrants to disclose the material terms of executive agreements.

### 3.8 Emerging Growth Companies

An emerging growth company (EGC) is a category of issuer that was established in 2012 under the JOBS Act and was granted additional accommodations in 2015 under the FAST Act to encourage public offerings by small and developing companies. A private company undertaking an IPO will generally qualify as an EGC if it (1) has total annual gross revenues of less than $1.07 billion during its most recently completed fiscal year and (2) has not issued more than $1 billion of nonconvertible debt over the past three years. Once a company completes its IPO, it must meet additional criteria to retain EGC status. The regulatory and reporting requirements for EGCs are less stringent than those for other types of issuers. For example, EGCs:

- Need only two years of audited financial statements in an IPO of common equity.\(^{39}\)
- Are not required to present selected financial data for periods before the first year of financial statements presented in the IPO.
- Are not required to adopt new accounting standards as of the effective dates for public entities.
- May omit financial information (including certain annual and interim periods) from their draft and publicly filed IPO registration statements if that financial information is related to periods not reasonably expected to be required at the time of the offering.\(^{40}\)
- Are exempt from the requirement to obtain an attestation report on ICFR from their auditor.
- Are eligible for reduced executive compensation disclosures.
- May submit a draft IPO registration statement to the SEC for confidential review.

\(^{39}\) This accommodation is limited to an IPO of common equity. As the SEC clarifies in paragraph 10220.1 of the FRM, an entity will generally need to include three years of audited financial statements when entering into an IPO of debt securities or filing an Exchange Act registration statement, such as a Form 10, to register securities.

\(^{40}\) On August 17, 2017, the SEC Division of Corporation Finance updated Question 1 of its C&DI on the FAST Act and added a corresponding C&DI (Question 101.04) to the C&DI on Securities Act forms to clarify the interim financial information that may be omitted from a draft registration statement submitted by an EGC. For additional information, see Deloitte’s July 11, 2017, Heads Up (updated August 24, 2017).
EGCs are not required to apply the above accommodations and may choose to provide some scaled disclosures but not others. However, if an EGC has elected to opt out of the extended transition period for complying with new or revised accounting standards, this election is irrevocable. Therefore, the registrant, its advisers, and the underwriters should consider which EGC accommodations to use early in the IPO process. The SEC expects EGCs to disclose, in their IPO registration statements, their EGC status and to address related topics, such as the exemptions available to them, risks related to the use of those exemptions, and how and when they may lose EGC status.

If an EGC elects to submit its IPO registration statement to the SEC on a confidential basis, the submission and related comment letters and responses will not immediately be posted on EDGAR. However, a “public” filing of the IPO registration statement must be made at least 15 days before the EGC’s “road show,” after which any confidential draft registration statements, along with related comment letters and responses, will also be publicly released by the SEC staff on EDGAR.

Unless the SEC deems otherwise in specific cases, EGCs are also exempt from any future PCAOB rules that may require (1) rotation of independent registered public accounting firms or (2) supplements to the auditor’s report, such as communications regarding critical audit matters, that are required for certain other issuers.

Certain scaled disclosure provisions that apply to EGCs are also related to other SEC rules. For example, the accommodations listed above can typically also be applied to the requirement to include any other entity’s financial statements required under Regulation S-X, Rules 3-05 and 3-09.

After going public, a registrant will retain its EGC status until the earliest of:

- The last day of the fiscal year in which its total annual gross revenues exceed $1.07 billion.
- The date on which it has issued more than $1 billion in nonconvertible debt securities during the previous three years.
- The date on which it becomes a large accelerated filer (which is an annual assessment performed on the last day of the fiscal year).
- The last day of the fiscal year after the fifth anniversary of the date of the first sale of common equity securities under an effective Securities Act registration statement for an EGC.

The staff in the Division of Corporation Finance (the “Division”) has issued FAQs on numerous aspects of the JOBS Act, many of which are related to qualifying for EGC status and the filing requirements for EGCs. In addition, the SEC staff has incorporated EGC-related guidance in Topic 10 of the FRM.

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

### Examples of SEC Comments

- You state that you are an “emerging growth company” as defined in the Jumpstart Our Business Startups Act. Please revise your prospectus to address the following:
  - 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 403(b) of the Sarbanes-Oxley Act of 2002 and Section 14(a) and (b) of the Securities Act of 1934; and
  - State your election under Section 107 (b) of the JOBS Act. If you elect to use the extended transition period for complying with new or revised accounting standards, state that as a result of this election, your financial statements may not be comparable to companies that comply with public company effective dates. If you have elected to opt out of the extended transition period, include a statement that the election is irrevocable.
- Given your stated intention to take advantage of the extended transition period provided in Section 7(a) (2)(B) of the Securities Act, please disclose the date on which you will adopt the standard(s) disclosed, assuming you will remain an EGC at such time. Refer to Question 14 of the Jumpstart Our Business Startups Act Frequently Asked Questions.

3.8.1.1 Filing Status

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

3.8.1.2 Extended Transition Period to Adopt New or Revised Accounting Standards

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

At the 2018 AICPA Conference, then Division Deputy Chief Accountant Lindsay McCord (who became the Division’s chief accountant on August 5, 2020) addressed transition requirements related to the adoption of new accounting standards for EGCs that elect to take advantage of the extended transition provisions and defer adoption of a new or revised accounting standard by using private company adoption dates. In her remarks, she discussed examples of registrants that qualify as EGCs and later lose their EGC status. For more information, see Deloitte's December 16, 2018, *Heads Up*.

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41 For example, the EGC’s total gross revenues do not exceed $1.07 billion in any year 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).
At the 2019 AICPA Conference, Ms. McCord addressed transition requirements related to the adoption of the new credit loss standard (the guidance in ASU 2016-13, as amended, which is codified in ASC 326) for EGCs. She clarified that ASU 2019-09 and ASU 2019-10 do not benefit non-SRC registrants that are EGCs that plan to adopt a new standard by using Bucket 2 adoption dates (of the “two-bucket” framework\(^\text{42}\) that is based on the FASB’s definition of an SEC filer\(^\text{43}\)) but subsequently lose their EGC status. For further discussion, including illustrative examples that reflect our understanding of the requirements, see Deloitte’s December 15, 2019, *Heads Up*.

### 3.8.1.3 *Section 404(b) Exemption*

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

### 3.8.2 Other Considerations

#### 3.8.2.1 Requests for Written Communications

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<th>Example of an SEC Comment</th>
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<tr>
<td>Provide us copies of all written communications as defined in Rule 405 under the Securities Act that you or anyone authorized 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, provide us 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.</td>
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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

* A Roadmap to Initial Public Offerings

\(^{42}\) See Section 3.2.1 for an explanation of the two-bucket framework.

\(^{43}\) For the definition of an SEC filer in the ASC master glossary, see Appendix A of Deloitte’s November 19, 2019, *Heads Up*. 
3.9 Other SEC Reporting Matters

3.9.1 Certifications

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

- Please amend your filing to provide new certifications filed as Exhibits [A] and [B] to conform exactly to that provided in Item 601(b)(31) of Regulation S-K as it relates to internal controls over financial reporting (ICFR). In this regard, the introductory sentence in paragraph 4 should refer to ICFR as defined in the Exchange Act and certification 4(b) should discuss your obligations related to ICFR. Similarly, please amend the 10-Qs for the quarterly periods ended March 31, [201X] and June 30, [201X].

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 Regulation S-K C&DIs states:

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

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

Registrants must include certifications when they are filing amendments to periodic reports. See Question 161.01 of the Exchange Act Rules C&DIs for guidance on what paragraphs can be excluded from certifications filed with amendments to periodic reports.
3.9.2 Use of Experts and Consents

**Examples of SEC Comments**

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

- We note that you have engaged third parties to provide independent validations of the inputs and assumptions you use and to evaluate the reasonableness of the advisor's [net asset value] calculations. Please tell us what consideration you have given to identifying the third parties as experts and filing their consents. Please refer to Section 7(a) and Rule 436 of the Securities Act.

- The report date referenced in the consent of the independent registered public accounting firm included as exhibit [X] is inconsistent with the report date of the report of the independent registered public accounting firm . . . included [in] your registration statement. Please revise so that these report dates are consistent.

In their registration statements under the Securities Act (e.g., Forms S-1, S-3, and S-4) and periodic reports under the Exchange Act (e.g., Forms 10-K and 10-Q), registrants sometimes refer to an “independent valuation firm” or other third party. The SEC staff has asked such registrants whether management or the board relied on a third-party expert and will sometimes infer reliance on a third-party expert even when the registrants do not refer to one. Examples of third-party experts that registrants commonly consider or rely on include the following:

- Valuation firms, about:
  - The valuation of a registrant’s common and preferred stock in an IPO.
  - The fair value determination of goodwill and assets acquired and liabilities assumed in a business combination.
  - The determination of goodwill impairment.
  - The determination of an environmental liability.

- An independent actuary, about the estimation of workers' compensation liability.

- Petroleum engineers, about the evaluation of oil and gas reserves.

- Pricing services or brokers that provide information used to determine the fair values of financial assets or liabilities. See Section 2.7.2 for additional considerations.

- Counsel providing legal opinions.

- Tax specialists providing tax opinions.

The SEC staff has stated that in registration statements or periodic reports, registrants generally are not required to refer to an independent valuation firm or other expert. If a registrant does not refer to the expert in its filing, it 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.

In addition, the SEC has historically issued comments asking registrants to amend experts' language or consents to (1) fix typographical errors, (2) provide updated consents when amended registration statements are filed, (3) include proper dates or titles of referenced financial statements, (4) include the proper date or title of the consent issued by the independent registered public accounting firm, and (5) include the signature of the independent registered public accounting firm in a consent.
3.9.2.1 Periodic Reports (Exchange Act)
Independent registered public accounting firms are not required to consent to the inclusion of their audit or review reports in periodic reports filed in accordance with the Exchange Act (e.g., Forms 10-K or 10-Q). However, the guidance below on registration statements should be applied if the registrant (1) refers to an independent valuation firm or other expert in a periodic report and attributes statements in the report to the expert and (2) incorporates that periodic report by reference into a registration statement.

3.9.2.2 Registration Statements (Securities Act)
Historically, when a registrant has referred to third-party experts in a registration statement, the SEC staff has asked the registrant to provide the experts’ consents, including those from the registrant’s independent registered public accounting firm. However, C&DIs issued by the staff appear to indicate that the key to assessing whether a consent will be required is determining the degree to which management takes responsibility for statements related to work performed by a third-party expert that are included in or incorporated into the registration statement. The staff typically evaluates the totality of the disclosure provided when determining whether management is taking responsibility for the conclusion.

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

3.9.3 Material Contracts

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<th>Example of an SEC Comment</th>
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<tr>
<td>We note your disclosure in the risk factors . . . and also your later disclosure in the MD&amp;A section regarding the significance of your recurring arrangements with [certain customers]. Please file the respective master service agreement for each customer in accordance with Item 601(b)(10) of Regulation S-K, or tell us why you believe you are not required to file the agreements. Further, please disclose the material terms of the agreements, and discuss any material adverse impact on your operations if either agreement were to be terminated.</td>
</tr>
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Regulation S-K, Item 601, requires registrants to file certain material contracts as exhibits if, during the reporting period, such contracts (1) become effective or (2) are executed, amended, or modified. For example, Item 601(b)(10) requires a registrant to file:

- Every material contract that is “not made in the ordinary course of business.”
- Any material contract “made in the ordinary course of business”:
  - With certain parties, such as directors, officers, promoters, voting trustees, certain security holders, or underwriters, other than contracts involving only the purchase or sale of current assets at a price that equals a determinable market price.
  - On which the registrant’s business substantially depends.

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44 Consents are not required in registration statements on Form 10 since such registration statements are filed in accordance with the Exchange Act. Similarly, consents are not required in proxy statements.

45 Registrants may look to Question 233.02 of the Securities Act Rules C&DIs that were issued by the SEC staff in November 2008 but should be aware that other consent-related Securities Act Rules C&DIs may apply to their specific circumstances and that they should therefore review such C&DIs periodically.
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.\(^4^6\)

- 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.

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

- File the material agreements in their entirety, including schedules and related exhibits, as exhibits to Form 10-K or 10-Q or separately on Form 8-K in accordance with Item 601.

- Explain why they have not filed the agreements.

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

\(^{46}\) 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).
3.9.4 Backlog Disclosures

Examples of SEC Comments

- We note your disclosure . . . that the majority of your revenue is derived from contracts that generally have terms of three to five years. Please tell us the consideration given to disclosing the amount of firm backlog as of [each of the past two fiscal year-ends], along with the portion not reasonably expected to be filled within the current fiscal year. We refer you to Item 101(c)(1)(viii) of Regulation S-K.

- Please more fully explain to us the specific facts and circumstances that resulted in you modifying your backlog policy in the second quarter . . . for long term contracts associated with the [Country A] government’s privately financed initiatives or projects. Please explain to us how you estimate the total value of work to be performed and clarify whether that amount is equal to or greater than the amount clients are required to pay you. Also, based on your inclusion of your share of work to be performed by unconsolidated joint ventures in your backlog, please revise future filings to quantify the amount of backlog to be executed within one year that will be recognized as revenue and the amount that will be recorded by your unconsolidated joint ventures.

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

Changing Lanes

On August 26, 2020, the SEC issued a final rule that modernizes the disclosure requirements in Regulation S-K, Item 101, “Description of Business”; Item 103, “Legal Proceedings”; and Item 105, “Risk Factors.”

Item 101(c) previously listed 12 items (including backlog) that, if material, must be included in the registrant’s disclosures. The final rule provides a revised “non-exclusive list” of disclosure topics, including information about “[r]evenue-generating activities, products and/or services, and any dependence on revenue-generating activities, key products, services, product families, or customers.” Disclosure is required if the topics are “material to an understanding of the registrant’s business taken as a whole.” While backlog is no longer explicitly identified, in accordance with the principles-based approach outlined in the final rule, registrants should consider whether backlog disclosures are material.

See Deloitte’s September 3, 2020, Heads Up for further information.
3.9.5 Disclosures Regarding State Sponsors of Terrorism

### Examples of SEC Comments

- [Y]ou identify [Company A] as one of your customers. [Company A] is reported to have sold products into Sudan and Syria. Sudan and Syria are designated as state sponsors of terrorism by the State Department and are subject to U.S. economic sanctions and export controls. You do not include disclosure in the Form 10-K about contacts with Sudan and Syria. Please describe to us the nature and extent of any past, current and anticipated contacts with Sudan and Syria, whether through subsidiaries, distributors, resellers, customers or other direct or indirect arrangements. You should describe any products, technology or services you have provided into Sudan or Syria, directly or indirectly, and any agreements, arrangements or other contacts you have had with the governments of those countries or entities they control.

- Please discuss the materiality of any contacts with Sudan and Syria you describe in response to the comment above, and whether [those] contacts constitute a material investment risk for your security holders. You should address materiality in quantitative terms, including the approximate dollar amounts of any revenues, assets and liabilities associated with Sudan and Syria for the last three fiscal years and the subsequent interim period. Also, address materiality in terms of qualitative factors that a reasonable investor would deem important in making an investment decision, including the potential impact of corporate activities upon a company’s reputation and share value. Various state and municipal governments, universities and other investors have proposed or adopted divestment or similar initiatives regarding investment in companies that do business with U.S.-designated state sponsors of terrorism. You should address the potential impact of the investor sentiment evidenced by such actions directed toward companies that have operations associated with Sudan and Syria.

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

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47 In 2007, the SEC issued Concept Release No. 33-8860, which requested input on certain matters related to state sponsors of 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).

48 Further, the Iran Threat Reduction and Syria Human Rights Act of 2012 (the “Act”) requires registrants to include certain disclosures about sanctionable activities with those countries in all quarterly and annual reports. There is no materiality threshold for such reporting; therefore, a registrant may be required to disclose immaterial transactions meeting the criteria specified in the Act. For implementation guidance, see Questions 147.01 through 147.07 of the Exchange Act Sections C&DIs.
3.9.6 Interactive Data — eXtensible Business Reporting Language

3.9.6.1 SEC Staff's Review and Observations

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<thead>
<tr>
<th>Examples of SEC Comments</th>
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<tbody>
<tr>
<td>• 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.</td>
</tr>
<tr>
<td>• The XBRL Document and Entity Identification Information rendered as part of your filing appears to contain a number of data element errors, including but not limited to, your classification as a nonaccelerated filer. Please revise to comply with the requirements of Section 405 of Regulation S-T and the EDGAR Filer Manual.</td>
</tr>
<tr>
<td>• Please amend your quarterly report to include the interactive data exhibits required by Item 601(b)(101) of Regulation S-K.</td>
</tr>
</tbody>
</table>

The SEC staff continues to monitor registrants’ interactive data file (i.e., eXtensible Business Reporting Language (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. See Deloitte's April 20, 2020, Heads Up, which further discusses recent developments in XBRL reporting.

On June 28, 2018, the SEC issued a final rule that requires registrants to use the Inline XBRL (iXBRL) format in their submissions of operating company financial statement information and fund risk/return summary information. The final rule became effective on September 17, 2018. To give certain registrants enough time to prepare for adoption, the final rule phases in the requirements on the basis of filer category. Compliance is required with the first Form 10-Q filed after the applicable compliance date. The compliance dates are as follows:

• Large accelerated filers that prepare their financial statements in accordance with U.S. GAAP are required to comply beginning with fiscal periods ending on or after June 15, 2019.
• Accelerated filers that prepare such financial statements must comply beginning with fiscal periods ending on or after June 15, 2020.
• All other operating company filers (including foreign private issuers that prepare their financial statements in accordance with IFRS Standards) that are required to submit interactive data files must comply beginning with fiscal periods ending on or after June 15, 2021.

See Deloitte's July 3, 2018, Heads Up, which (1) summarizes the final rule and related financial reporting implications and (2) highlights some key considerations regarding the final rule's implementation.
On March 20, 2019, the SEC issued a final rule that revises certain disclosure requirements in Regulation S-K. In accordance with the final rule, iXBRL tagging will be required for additional information, such as the jurisdiction of incorporation and exchange on which the securities are registered, on the cover page of certain forms filed under the Exchange Act, including Forms 8-K, 10-K, 10-Q, 20-F, and 40-F. These additional requirements are effective at the same time the registrant implements iXBRL. See Deloitte’s March 25, 2019, Heads Up for further information.

3.9.6.2 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, 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.

3.9.6.3 Interactive Data Requirements in Other Filings

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

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 registration 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 Commission and that have been revised pursuant to applicable accounting standards to reflect the effects of certain subsequent events, including a discontinued operation, a change in reportable segments or a change in accounting principle.”

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

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Sample Letter Sent to Public Companies Regarding XBRL Requirement to Include Calculation Relationships.
3.9.7 Audit Report Requirements

<table>
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<tr>
<th>Examples of SEC Comments</th>
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<tbody>
<tr>
<td>• We note the reference to the report of other auditors dated June [X], [201X] for the financial statements as of March 31, [201X]. Please amend your filing to include the audit report for the March 31, [201X] financial statements. Refer to the requirements of Rule 2-02 and 8-02 of Regulation S-X.</td>
</tr>
<tr>
<td>• Please have your [auditors] revise their audit report to comply with PCAOB AS 3101, The Auditor’s Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion. Refer to SEC Release 34-81916.</td>
</tr>
<tr>
<td>• Please revise to indicate the related notes to the consolidated financial statements were also audited. Refer to AS 3101.08d.</td>
</tr>
</tbody>
</table>

The SEC staff has commented when a registrant does not comply with (1) Regulation S-X, Rule 2-02, and (2) PCAOB Auditing Standard 3101, as amended. For example, the staff has commented when a registrant:

• Includes a report from its auditor that does not appropriately identify the financial statements, including the related notes and any related schedules, covered by the audit report.

• Includes a report from its auditor for a fiscal year ending on or after December 15, 2017, that does not comply with PCAOB Auditing Standard 3101, as amended.

• Includes an auditor's report that does not indicate that the auditor conducted its audits in accordance with (1) PCAOB standards for issuers or (2) U.S. generally accepted auditing standards for nonissuers (with certain exceptions, as noted in paragraph 4210.4 of the FRM).

• Does not include the report of the other auditor when its principal auditor makes reference to the work of the other auditor in the principal auditor's report on either the financial statements or ICFR.

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

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

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50 As originally approved by the SEC, PCAOB Auditing Standard 3101 became effective in accordance with SEC Release No. 34-81916 for audits of fiscal years ending on or after December 15, 2017.
3.9.8 Selected Quarterly Financial Data

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<th>Example of an SEC Comment</th>
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<tbody>
<tr>
<td>During both fiscal years presented, the quarterly data shows significant fluctuation in the operating results between the quarters. Please revise your disclosure to discuss the nature of any unusual or infrequently occurring items that impacted your quarterly results of operations between the periods presented. Refer to Item 302(a)(3) of Regulation S-K.</td>
</tr>
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</table>

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

Quarterly financial data do not need to be provided in an IPO registration statement because the entity’s securities are not yet registered; however, quarterly financial data are frequently included voluntarily, often at the request of underwriters. A new registrant will be required to furnish such data in its first Form 10-K and may also need to do so in a secondary or follow-on offering initiated before the filing of the first Form 10-K. Many companies therefore voluntarily provide such information in the IPO registration statement.

Changing Lanes

On January 30, 2020, the SEC issued a proposed rule that would modernize and simplify MD&A and certain financial disclosure requirements in SEC Regulation S-K. Specifically, the proposal would, among other changes, eliminate Regulation S-K, Item 302, “Supplementary Financial Information.”

Chapter 4 — Initial Public Offerings

4.1 Overview

An IPO commonly occurs as the initial sale of equity or debt securities to the public by a private company that registers its securities on Form S-1. However, there are other situations in which debt or equity securities can be initially registered with the SEC, such as transactions involving (1) the exchange of private debt securities for debt securities registered on a Form S-4, (2) the registration of shares that are used to pay for the acquisition of a target on a Form S-4 in a merger, (3) the registration of currently outstanding equity securities (e.g., in secondary offerings), and (4) the distribution of shares in a spin-off transaction performed by a public company (typically on a Form 10).

Once submitted to or filed with the SEC, an IPO registration statement is processed and reviewed by the staff of the SEC's Division of Corporation Finance. A company can generally expect the staff to complete its initial review and furnish the first set of comments within 30 calendar days. The company would then respond to each of the SEC's comments and reflect requested edits, as well as any other updates, in an amended IPO registration statement, which the SEC will also review. After the initial filing, the SEC's review time can vary significantly but typically is within two weeks. A company can expect several rounds of comment letters with follow-up questions on responses to original comments as well as additional comments on new information included in the registration statement. For additional information about the IPO registration statement process, see Deloitte's A Roadmap to Initial Public Offerings.

The SEC staff's review of the initial registration statement is typically comprehensive, covering reporting, accounting, and legal issues. In addition, the SEC staff's comments often focus on the following reporting topics (most of which are further discussed in Section 3.2):

- Registrant financial statement issues, including predecessor reporting (Regulation S-X, Rule 3-01).
- 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).
- Restrictions on dividends (Regulation S-X, Rules 4-08(e), 5-04, and 12-04).
- Pro forma financial statements (Regulation S-X, Article 11).

It is also common for the SEC staff to comment on IPO registration statements to address accounting and disclosure topics such as (1) complex equity instruments; (2) share-based compensation, including equity securities issued as compensation in periods before an IPO (commonly referred to as “cheap stock” considerations); (3) revenue recognition; and (4) the registrant's relevant significant accounting policies. For more information, see Sections 2.4, 2.17, and 2.20. In addition, the SEC staff comments on certain issues that are more specific to IPO registration statements; such issues are discussed in this chapter.
Throughout 2020, the SEC began commenting on disclosures related to the impact of the COVID-19 pandemic, including those for registrants undertaking IPOs. Many of the comments seek expanded disclosure on the actual and expected impact of the pandemic on operations, liquidity, capital resources, and going concern, as well as government assistance or relief programs in which the registrant may be participating. The SEC’s Division of Corporation Finance issued CFDG Topic 9 and Topic 9A to provide guidance for registrants to consider in evaluating their disclosures related to the pandemic. For further information, see Deloitte’s Financial Reporting Alert, “Financial Reporting Considerations Related to COVID-19 and an Economic Downturn.”

### 4.2 Registrant Financial Statements

A company undergoing an IPO is required to present its financial statements, footnotes, and schedules for certain annual and interim periods in its registration statement. Regulation S-X, Rules 3-01 through 3-04, describe the general financial statement requirements for the registrant and its predecessors. Registrants must determine which financial statements to include in their initial registration statement on the basis of their individual facts and circumstances and must continue to update the financial statements throughout the registration process to provide current financial information.

#### 4.2.1 Age of Financial Statements

<table>
<thead>
<tr>
<th>Example of an SEC Comment</th>
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<tbody>
<tr>
<td>Please revise to include updated interim financial statements or confirm that you do not intend to publicly file your registration statement without including audited financial statements as of [the most recently completed year-end]. Please refer to Rule 3-12 of Regulation S-X and Securities Act Forms C&amp;DI 101.04 for guidance.</td>
</tr>
</tbody>
</table>

A registrant’s financial statements must meet the “age of financial statements” and “staleness” requirements as of every filing date as well as when the registration statement is declared effective. The age of financial statements generally refers to the specific annual and interim periods for which financial statements are required in a filing. Regulation S-X, Rule 3-12, provides guidance on such periods and on when the financial statements become stale (i.e., should be updated). As a result of accommodations provided by the FAST Act, a company that confidentially submits a draft registration statement may omit certain interim and annual periods from such submission if the company reasonably believes that those periods will not be presented in its public filing (for non-EGCs) or at the time of the contemplated offering (for EGCs); however, upon the first public filing or at the time of the contemplated offering for non-EGCs and EGCs, respectively, the appropriate interim and annual financial information would need to be included.

#### 4.2.2 Recently Organized Registrant

<table>
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<tr>
<th>Example of an SEC Comment</th>
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<tbody>
<tr>
<td>We note your disclosure . . . that [Company A] was formed for the purpose of becoming the stock holding company and currently holds minimal assets and has not conducted any business. However, we do not believe this provides a sufficient basis to omit the audited financial statements of the registrant. Please provide audited financial statements of the registrant [A] as required by Rule 3-01(a) of Regulation S-X, or tell us why you believe such financial statements are not required.</td>
</tr>
</tbody>
</table>
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 balance sheet of the recently organized registrant may need to be included 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. For more information, see Section 4.2.1 of this Roadmap and Section 2.1.1 of Deloitte's A Roadmap to Initial Public Offerings.

### 4.2.3 Predecessor Financial Statements

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<th>Example of an SEC Comment</th>
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We note that your historical results of operations for [the fiscal year] do not include the results of [Entity A] prior to [its] acquisition . . . . Based on the significance of [A] prior to the acquisition, it appears that [A] is a predecessor to the registrant. Please expand the disclosure in Selected Financial Data to provide predecessor financial information, pro forma financial information using the guidance in Article 11 of Regulation S-X and expand the notes to the Selected Consolidated Financial Data to include sufficient detail of [A’s] historical results of operations to facilitate comparison of the periods presented. Also revise the presentation in MD&A and elsewhere in the document.

Depending on the nature of the registrant and the registrant's operations, it may be important to consider whether any predecessor financial information needs to be reflected in the registration statement. 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 typically be presented as of and for all periods required by Regulation S-X, with no lapse in audited periods, so that the investor is given a complete picture of the registrant and any relevant reporting history.

In addition, the SEC staff has indicated that it has noticed an increase in put-together transactions in which a new company (i.e., a “newco”) is formed to acquire multiple entities. In such transactions, some of the entities are acquired before the IPO, in conjunction with the IPO, or by using the proceeds of the IPO. This has led to questions about how to identify the predecessor and the appropriate financial statements to include in an IPO registration statement. The staff believes that instances in which there is no predecessor would generally be rare (unless the registrant is a start-up business), even if the newco is substantive and was deemed the accounting acquirer. The staff has highlighted a number of factors for registrants to consider in determining the predecessor, including, but not limited to, (1) the order in which the entities are acquired, (2) the size of the entities, (3) the fair value of the entities, and (4) the historical and ongoing management structure. The staff also encourages registrants to evaluate their determination of predecessors in light of how management intends to discuss its business in the IPO registration statement as well as whether financial information in its subsequent Forms 10-K would provide sufficient information to investors. The staff has indicated that no one item is determinative on its own and that there could also be more than one predecessor. At the 2019 AICPA Conference, the SEC staff emphasized the importance of identifying any predecessors early in the IPO process and encouraged consultation with the OCA. Registrants were reminded that identifying predecessors

1 If a business is not identified as a predecessor, it would generally be evaluated under SEC Regulation S-X, Rule 3-05. Therefore, in an IPO registration statement, the financial statements of nonpredecessor entities may be provided under Rule 3-05. However, for subsequent Forms 10-K, only the financial statements of the registrant and its predecessor(s) would be required.
requires striking a balance between providing the history of the business and providing information on
the specific operations in which the IPO investor is investing.

### 4.2.4 Carve-Out Financial Statements

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

“Carve-out financial statements” is a generic term used to describe separate financial statements that are derived from the financial statements of a larger parent company. A carve-out occurs when a parent company segregates a portion of its operations and prepares a distinct set of financial statements for the segregated portion in preparation for a sale, spin-off, or IPO of the “carve-out entity.” Examples of a carve-out entity may include (1) all or part of a subsidiary of a parent company or (2) a line of business that was previously part of a larger parent company.

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

When financial statements of a carve-out entity are used in an IPO, it is critical that the carve-out financial statements identify the appropriate assets and operations of the registrant. A registrant’s determination of the composition of the carve-out financial statements depends on its specific facts and circumstances and may require significant judgment because the process of identifying appropriate assets and operations of the registrant in an IPO transaction may be complex. At the 2014 AICPA Conference, the SEC staff acknowledged that determining what financial statements to include in a registration statement can be complex and that registrants need to use judgment when doing so, particularly because (1) there may not be SEC guidance directly on point and (2) accounting guidance (e.g., the guidance in ASC 505-60 on determining the accounting spinnor and spinnee) may not be wholly determinative of the SEC’s reporting requirements.

Further, at the 2015 AICPA Conference, the SEC staff reminded conference participants to consider the legal form of the arrangement when identifying a predecessor in a carve-out or spin-off transaction. In determining what to include in the carve-out financial statements, registrants may need to consider issues such as the parent’s existing reporting structure (e.g., segments and reporting units), the nature and size of the operations being carved out as compared with the operations being retained by the parent, and the legal structure of the carve-out. Carve-out financial statements should present

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2 **ASC 505-60-20** defines a spin-off as the “transfer of assets that constitute a business by an entity (the spinnor) into a new legal spun-off entity (the spinnee), followed by a distribution of the shares of the spinnee to its shareholders, without the surrender by the shareholders of any stock of the spinnor.”
information about all aspects of the carve-out business’s historical results and operations (i.e., provide balanced and transparent financial information that reflects all of the carve-out business’s historical successes and failures). As a result, the carve-out financial statements may even include certain assets or operations that are not part of the IPO transaction. The staff noted that the financial statements of the predecessor may include financial statements other than those of the entity in which the investor ultimately invests.

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

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

For additional considerations related to carve-out transactions, see Deloitte’s *A Roadmap to Accounting and Financial Reporting for Carve-Out Transactions*.

### 4.3 Public-Entity Disclosures and Transition Provisions

A nonpublic entity’s previously issued financial statements may not be sufficient for an IPO. Nonpublic entities may need to revise their financial statements to include the public-entity accounting and disclosures required under U.S. GAAP and Regulation S-X. In addition, such entities will need to obtain an auditor’s report on their financial statements that (1) is issued by a PCAOB-registered accounting firm and (2) refers to the PCAOB’s standards.³

#### 4.3.1 U.S. GAAP

Certain provisions of U.S. GAAP differ for public and nonpublic entities. A registrant’s financial statements in an IPO must adhere to accounting principles and disclosures required for public entities for all periods presented. The term “public entity” generally refers to an entity that files its financial statements with the SEC. However, there are different definitions of a public entity under U.S. GAAP. Topics in which certain accounting principles and disclosures apply only to public entities include EPS, segment reporting, certain supplemental disclosures related to business combinations, temporary equity classification of redeemable securities, certain disclosures related to income tax, certain disclosures related to pensions and other postretirement benefits, and disclosures of the date through which subsequent events are evaluated.

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³ In certain circumstances, auditors are required to refer to both auditing standards generally accepted in the United States (i.e., AICPA standards) and the standards of the PCAOB for certain nonissuers, including, but not limited to, (1) entities making confidential submissions of an initial public registration statement under the JOBS Act, (2) entities that voluntarily submit a registration statement to the SEC staff for nonpublic review before the company’s public filing, and (3) entities filing a Form 10 to effect an initial registration of securities. See paragraph 4110.3 of the FRM for additional information.
In addition, the effective date of a new accounting pronouncement may be sooner for certain public entities than for nonpublic entities. Since registrants generally must apply public-entity guidance for all periods presented in the IPO financial statements, a nonpublic entity may be required to retrospectively change its date of adoption of a new standard to that required for a public entity. However, an emerging growth company (EGC) is not required to adopt new or revised accounting pronouncements as of the effective dates for public entities. Instead, an EGC adopts new or revised accounting standards as of the effective dates for nonpublic entities unless it elects to opt out of the extended transition period. When an EGC that has initially elected to use the adoption dates applicable to private entities loses its EGC status, it will be required to conform its adoption dates to those applicable to public entities. See Section 3.8.1.2 for more information about (1) EGCs that elect to use the adoption dates applicable to private entities and (2) EGCs that plan to use those deferred adoption dates but subsequently lose their EGC status.

Registrants should monitor standard-setting developments that change, or would change, effective dates of major new accounting standards to give implementation relief to certain types of entities. Over the past year, the FASB has amended effective dates of such standards by issuing the following ASUs:

- **ASU 2019-09** (issued November 2019), which defers the effective dates of ASU 2018-12 (codified in ASC 944) for all entities.
- **ASU 2019-10** (issued November 2019), which (1) provides a “two-bucket” framework to stagger effective dates of future major accounting standards and (2) changes effective dates of (a) ASU 2017-12, as amended (codified in ASC 815); (b) ASU 2016-13, as amended (codified in ASC 326); and (c) ASU 2017-04 (codified in ASC 350). See Deloitte’s November 19, 2019, Heads Up.

Further, a company that is preparing to go public — or that may consider going public in the future — should be cautious about electing the alternatives developed by the PCC. Once a company is considered a PBE, it would no longer be permitted to apply PCC accounting alternatives. Consequently, any previously elected PCC alternatives would need to be eliminated from the company’s historical financial statements before such statements can be included in its IPO registration statement. For discussion about the unavailability of private-company accounting alternatives to entities that meet the definition of a PBE even though they may not be SEC filers, see Section 3.2.1.

### 4.3.2 SEC Rules and Regulations

<table>
<thead>
<tr>
<th>Examples of SEC Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>- We note . . . that holders of your preferred stock may redeem their shares at any time on or after the fifth anniversary of the original issue date. Revise the balance sheet and all other applicable sections of the filing to present these [shares of] convertible redeemable preferred stock separate from your total stockholders’ equity. See Rule 5-02(27) of Regulation S-X.</td>
</tr>
<tr>
<td>- In view of the risk factor disclosed . . . in regard to your status as a holding company and reliance on distributions from your subsidiary as your source of cash flow, please explain to us your consideration of Rules 4-08(e), 5.04(c) Schedule I and 12-04 of Regulation S-X.</td>
</tr>
</tbody>
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4 See Section 3.2.1 for an explanation of the two-bucket framework.

5 Also in response to the adverse economic effects of the COVID-19 pandemic, Sections 4013 and 4014 of the CARES Act provide certain optional deferrals of the application by certain entities of (1) the troubled debt restructuring accounting and disclosure guidance applicable to lenders under ASC 310-40 and (2) the requirement to adopt ASC 326 beginning in 2020. See Deloitte’s Heads Up, “Highlights of the CARES Act.”
In an IPO, the registrant’s financial statements should also comply with the applicable requirements of Regulation S-X, and SEC staff views in SABs, for each period presented in the financial statements. Because such requirements and views are new to the registrant, its disclosures may not be fully compliant; as a result, the SEC staff frequently requests additional disclosures. Regulation S-X prescribes the types, form, and content of the financial information that registrants must file. Many of these requirements expand on the disclosures directly required by U.S. GAAP. SABs provide staff views on 14 broad topics, including business combinations, revenue recognition, and share-based payment arrangements.

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

- Balance sheet and income statement presentation requirements (Regulation S-X, Rules 5-02 and 5-03 for commercial and industrial registrants).
- Age of financial statement requirements applicable once the financial statements are publicly filed (Regulation S-X, Rule 3-12).
- Summarized financial information of subsidiaries not consolidated and 50 percent or less owned persons (Regulation S-X, Rule 4-08(g)).
- Income tax expense (Regulation S-X, Rule 4-08(h)).
- Related-party disclosures (Regulation S-X, Rule 4-08(k)).
- Audited financial statement schedules (Regulation S-X, Articles 5 and 12).
- Preferred stock and other securities (e.g., common stock) subject to mandatory redemption requirements or whose redemption is outside the issuer’s control (Regulation S-X, Rule 5-02(27); ASR 268; ASC 480-10-S99-3A).

For additional reporting considerations related to these topics, see Sections 2.4, 2.9, 2.12, and 3.2.

### 4.4 Distributions to Owners

<table>
<thead>
<tr>
<th>Example of an SEC Comment</th>
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<tbody>
<tr>
<td>If the distribution to shareholders is not reflected in the latest balance sheet but would be significant to reported equity, please provide a pro forma balance sheet reflecting the distribution accrual (but not giving effect to the offering proceeds) alongside the historical balance sheet. In addition, since a cash distribution to shareholders will be paid out of the proceeds of the offering rather than from the current year’s earnings, please present pro forma per share data (for the latest year and interim period only) giving 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) in addition to historical Earnings Per Share.</td>
</tr>
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</table>

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 if a planned distribution is not reflected in the latest historical balance sheet but would be significant in relation to reported equity, the distribution should be presented in a pro forma balance sheet regardless of whether it has been declared or will be paid from the proceeds of the offering. The pro forma balance sheet should be presented alongside the most recent historical balance sheet in the filing and should reflect the distribution (but not give effect to the offering proceeds).
In addition, SAB Topic 1.B.3 and paragraph 3420.2 of the FRM discuss distributions to be paid to owners out of proceeds of the offering rather than from the current year’s earnings. In the historical income statement, pro forma per-share data (pro forma EPS) should be presented for only the latest fiscal year and interim period. The SEC staff considers dividends declared in the year before the IPO to be in contemplation of the IPO; therefore, it expects such dividends to be paid out of offering proceeds if they exceed earnings during the preceding 12 months. A registrant should calculate pro forma EPS by including an incremental number of shares (not to exceed the number of shares being offered in the IPO) that, on the basis of the offering price, would be needed to pay the portion of the dividend that exceeds earnings for the previous year.

### 4.5 Changes in Capitalization and Other Common IPO Considerations

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 or discontinued operations, are reflected retrospectively in all periods presented in the financial statements. Other changes, which may include, but are not limited to, the automatic conversion of preferred stock to 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.

#### 4.5.1 Pro Forma Information

<table>
<thead>
<tr>
<th>Example of an SEC Comment</th>
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</thead>
<tbody>
<tr>
<td>(W)e note the disclosure . . . that your preferred shares will automatically convert upon completion of this offering. Please address the following:</td>
</tr>
<tr>
<td>• Tell us whether you intend to provide a pro forma balance sheet and statement of operations (including EPS) to give effect to the automatic conversion; . . .</td>
</tr>
<tr>
<td>• Provide us with the relevant authoritative guidance supporting your planned presentation.</td>
</tr>
</tbody>
</table>

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, the filing should include a pro forma balance sheet (presented alongside the historical balance sheet) that takes into account the change in capitalization but not the effects of the offering proceeds.

In addition, paragraph 3430.3 of the FRM indicates that when a conversion of outstanding securities occurs after the latest balance sheet date and will result in a material reduction in EPS exclusive of the effects of the offering, registrants should present pro forma EPS (but should exclude the effects of the offering). Such pro forma EPS should be presented for the latest fiscal year and interim period. A common example of this scenario is the mandatory conversion of preferred stock to common stock in conjunction with an IPO. In this case, pro forma basic EPS would include the preferred stock on an as-converted basis.

If an issuer is organized as a nontaxable entity (e.g., a partnership, limited liability company, or S corporation) and expects to be converted to a taxable entity (e.g., a C corporation) in conjunction with its IPO, pro forma income taxes and EPS should be presented in the historical income statement to reflect the impact of the conversion. This presentation is required for the latest fiscal year and interim period; but if the pro forma adjustments are limited to income taxes, pro forma information for all periods presented is permitted, as discussed in paragraph 3410.1 of the FRM.
4.5.2 Draft Audit Reports

<table>
<thead>
<tr>
<th>Example of an SEC Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td>We note that you intend to affect a reverse split of your common stock prior to the effectiveness of the offering. We remind you that in accordance with SAB Topic 4-C you will need to revise your financial statements and your disclosures throughout the filing to give effect to the expected reverse split. If your auditors believe that only a “draft” report can be presented due to a pending future event such as the reverse stock split, they can include in the filing a signed and dated preface to their “draft” report stating the reason and that they expect to be in a position to issue the report in the form presented prior to effectiveness. A signed, dated, and unrestricted auditor’s report must be included in the filing prior to effectiveness. See Rule 2-02 of Regulation S-X.</td>
</tr>
</tbody>
</table>

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

An entity may enter into a transaction to dispose of a component or group of components that meets the criteria in ASC 205-20 to be classified as a discontinued operation. Although the disposal may occur after the date of the entity’s most recent balance sheet included in the registrant’s financial statements (in which case, presentation as a discontinued operation would typically be precluded), the registrant in certain circumstances may be able to present the transaction retrospectively in the financial statements and include a “to-be-issued” accountant’s report on those financial statements. The highlights of the June 2014 CAQ SEC Regulations Committee joint meeting with the SEC staff indicate that for the registrant to be qualified to do so, “the following must be completed prior to the initial filing: 1) the disposal of the discontinued operation has occurred; 2) the audit of the financial statements, including the retrospective revision; and 3) registrant consultation with the appropriate [review office].”

In addition to the requirements above, a pre-effective amendment to the registration statement must contain (1) updated financial statements for a period that includes the disposal date and (2) an unrestricted accountant’s report.

Other Deloitte Resources

A Roadmap to Initial Public Offerings
4.6 Dilution Disclosure

**Example of an SEC Comment**

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

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 items should be excluded from tangible assets (e.g., deferred costs or goodwill) and (2) cites examples of when the SEC staff has allowed dual calculation of tangible book value (i.e., made with and without certain assets). 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.
Chapter 5 — Foreign Private Issuers

The SEC staff's comments to foreign private issuers (FPIs) using IFRS Standards have addressed a number of financial accounting and disclosure topics. Many of the comments are generally consistent with those issued to domestic filers and raise topics discussed in other sections of this publication (although SEC staff comments to FPIs on such financial statement topics refer to IFRS Standards). Staff comments to FPIs that are uniquely relevant to entities that report under IFRS Standards are primarily related to the presentation of financial statements (under IAS 1).

### 5.1 Presentation of Financial Statements

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

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

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

In addition, paragraph 85 of IAS 1 requires an entity to present additional line items, headings, and subtotals on the face of the statement of comprehensive income “when such presentation is relevant to an understanding of the entity's financial performance.” Further, paragraph 97 of IAS 1 requires that “[w]hen items of income or expense are material, an entity shall disclose their nature and amount separately” (emphasis added). When including such line items and subtotals, an entity should consider providing transparent disclosures that clearly convey the relevance of the items to financial statement users. In such cases, an entity may amend the description of the line items and reorder them to explain the particular element of financial performance.
Chapter 6 — Industry-Specific Topics

6.1 Consumer

6.1.1 Retail, Wholesale, and Distribution

The SEC staff's comments to registrants in the retail, wholesale, and distribution industry have focused on the convergence of digital technology with the traditional “brick-and-mortar” and direct channels. Retailers citing an omnichannel customer experience have received comments on MD&A related to the impact of multiple distribution channels on trends in results of operations and in liquidity and capital resources. In addition, with the recent adoption of ASC 606, questions have been raised about the nature of the timing of revenue recognition, the evaluation of variable consideration, and the appropriateness of information disclosed in accordance with the standard.

Retailers have also been asked to explain their level of aggregation when performing a long-lived asset impairment analysis.

Like registrants in other industries, registrants in the retail, wholesale, and distribution industry continue to receive comments on the presentation of non-GAAP measures. See Section 3.4 for a discussion of non-GAAP comment letter trends.

Over the past year, the SEC staff has not issued to retail, wholesale, and distribution companies a significant number of comments related to the accounting for leasing transactions under ASC 842. Consequently, it is too early to identify any comment letter trends or themes related to such registrants’ application of the new leasing standard. However, during the 2019 AICPA Conference, the SEC staff provided some disclosure reminders for registrants to consider as they prepare their annual financial statements. Specifically, registrants should (1) consider the new leasing standard’s changes to disclosure requirements, (2) avoid boilerplate disclosures that simply restate the requirements of ASC 842, (3) tailor their disclosures to specific lease arrangements, and (4) provide disclosures about the assumptions they used in applying the standard’s guidance to specific lease arrangements.

6.1.1.1 MD&A

Examples of SEC Comments

- We note that you include e-commerce sales in your determination of comparable retail sales and that you attribute increases to your revenues for both [fiscal year 1] and the [first quarter of fiscal year 2] to the growth in this metric. To the extent that e-commerce sales have a measurable effect on your comparable retail sales, please quantify your e-commerce sales or provide transparent disclosure regarding the impacts that e-commerce sales had on your comparable retail sales metric.

- We note your disclosure that company comparable store sales for the third quarter of fiscal [year 2] decreased by [X]%, compared to the same period in fiscal [year 1] and that comparable store sales for the year-to-date period of fiscal [year 2] decreased [Y]%, compared to the same period in fiscal [year 1]. Please revise your discussion to provide more robust insight from management as to the underlying reasons for the decline in your comparable store sales and to clarify whether management expects this trend to continue in the future.
Examples of SEC Comments (continued)

- Please expand your discussions of sales for each year to quantify in dollars the increase in sales from new stores and the increase in comparable store net sales. Please also expand your discussions of gross profit, selling, general and administrative expenses and operating income, to quantify the impact that each material variable or factor had on your results of operations.
- Please tell us the percentage of revenue generated from sales to [X] Members and the percentage of revenue from sales to non-members during each of fiscal [year 1] and the [first quarter of fiscal year 2]. To the extent that you are experiencing different trends in revenue or gross profit from members and non-members, please tell us how you considered discussing and quantifying these trends in MD&A. We remind you that your MD&A disclosure should include a robust discussion of known trends or uncertainties that you reasonably expect have had, or will have, a material impact on your sales.
- Please revise your definition of [gross merchandise value (GMV)] to state whether it includes shipping charges or the merchandise value of items that are returned.

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, registrants should (1) clearly define same-stores sales, (2) disclose how same-stores sales are calculated, and (3) describe any key assumptions and limitations to the metric. The SEC staff often asks registrants in the retail sector to enhance their disclosures about metrics such as same-store sales and elaborate on any factors that could affect year-to-year comparability.

Online retailers that sell on behalf of third parties will often quote GMV to provide additional disclosure of the value of the merchandise that runs through their systems. In such instances, the SEC staff may ask registrants to clearly define GMV.

Further, the SEC staff has frequently commented on a registrant’s non-GAAP measures, including when adjustments have appeared to be normal recurring cash operating expenses and when a registrant has presented non-GAAP financial measures without providing the required quantitative reconciliation to the most directly comparable GAAP financial measure.

See Sections 3.1 and 3.4 for additional information.

6.1.1.2 Revenue Recognition — Accounting and Disclosure

Examples of SEC Comments

- We note your disclosure that you recognize revenue from the rental of digital textbooks at the time of sale and that once the digital content is delivered to the customer your performance obligation is complete. Please explain how your performance obligation is complete at the time of sale. Also clarify whether you recognize revenue from the rental of digital textbooks gross as a principal or net as an agent and the reasons supporting your accounting treatment. If such revenues are recognized net, please disclose such information in future filings.
- Please tell us how you earn and account for revenues from third party sales as well as your consideration of disclosing your accounting policy for this revenue stream and income statement classification. In your response please also address whether or not third-party sellers maintain ownership of their inventory and what services, if any, you provide in fulfilling third-party sales and returns.
Examples of SEC Comments (continued)

- Please tell us your consideration of the disclosures in ASC 606-10-50-12(b) related to payment terms and whether your contracts with customers have a significant financing component. In this regard we note your disclosures . . . related to financing receivables and payables under your order to cash program. Also, tell us your consideration of the disclosures in ASC 606-10-50-20(c) related to allocating the transaction price to specific parts of customer contracts.

The SEC staff may ask registrants to clarify the key terms and related accounting and disclosure for certain revenue recognition items common among retailers, including matters related to direct sales, customer loyalty programs, gift card breakage, and gross versus net reporting. As third-party marketplaces become more prevalent, it will become increasingly important to understand when a retailer is a principal or an agent in a transaction.

See Section 2.17 for additional information.

6.1.1.3 Store Impairment

Examples of SEC Comments

- In light of the fact that discrete financial information is available at the individual store level through the monthly individual store [profit and loss (P&L)] statements, please explain to us in further detail how you concluded the lowest level of identifiable cash flows that are largely independent of other cash flows are the [X] and [Y] operating segments. As part of your response, please tell us whether items purchased online are ever returned to stores, and if so, whether and how that is reflected in the individual store P&L statements. Also tell us in more detail why you believe your non-store sales could not be allocated to individual stores or groups of stores in a meaningful way to create identifiable cash flows that are largely independent of the cash flows of other assets and liabilities at some level below the operating segment level.

- Based on your disclosure, it does not appear you recorded any store level long-lived asset impairments in fiscal [year 1] or through the third quarter of fiscal [year 2]. Further, you state in your disclosure, “For store level long-lived assets, expected cash flows are determined based on management’s estimate of future sales, merchandise margin rates and expenses over the remaining expected terms of the leases.” In this regard, we note the comments made by management in the third quarter [year 2] earnings call that would imply that certain stores are cash flow negative. Additionally, we note declining sales and gross profit margins for the fiscal year ended [201X], and the 13 and 39 weeks ended December 1, [201X]. With reference to ASC 360-10-35-21, please clarify whether or not you tested any store level long lived assets for recoverability during the 39 weeks ended December 1, [201X]. If not, please provide support for your conclusion that impairment testing was unnecessary. If you tested these assets for impairment, please refer to the guidance in ASC 360-10-35-29 through 33, and provide us with the summary results of your testing, including the underlying material assumptions you relied on in determining the estimates of future cash flows.

As retailers consider their omnichannel strategies (e.g., buy online and pick up at the store, buy online and return to the store), they need to carefully consider whether there are interdependencies of cash flows between channels. Generally, retailers have evaluated impairment at the store level. Any changes to aggregate at a higher level need to be fully supported and documented. The SEC staff may ask for more detailed information about the nature and timing of store impairment considerations, particularly when results are declining.
6.1.1.4 Segments

Examples of SEC Comments

- Explain to us how you evaluated the aggregation criteria in ASC 280-10-50-11 in determining you have only one reportable segment. In doing so, explain in sufficient detail how you determined your operating segments have similar economic characteristics. We note from your most recent Forms 10-K and 10-Q that retail store and e-commerce comparable sales increases were materially different for all periods presented. We further note management’s statements during your fourth quarter . . . earnings call that e-commerce sales have margins below that of your brick and mortar business.

- You disclose you have three operating segments (North America, EMEA and Asia Pacific). You further indicate you have aggregated these operating segments into one reportable segment based upon their shared customer base and similar economic characteristics. Please explain to us in detail how the customer base is shared and how this meets the applicable criteria for aggregation contained in ASC 280-10-50-11. Likewise, demonstrate how the economic characteristics are similar among the three separate geographic operating segments and how you determined the segments can be expected to essentially have the same future prospects. In your response, tell us the measure(s) you consider to be economically similar and why such measure(s) was selected.

Given that registrants in the retail, wholesale, and distribution industry typically have multiple distribution channels (e.g., stores, catalogs, the Internet), geographic locations, and store concepts and brands, the SEC staff frequently asks such registrants about the identification and aggregation of their operating segments, particularly when they disclose only one reportable segment. In addition, when a registrant changes its segments, it should clearly disclose the new operating and reportable segments and any related changes to reporting units. See Section 2.19 for more information about SEC staff comments related to segment reporting.

6.1.2 Transportation, Hospitality, and Services

The SEC staff’s comments to registrants in the transportation, hospitality, and services (THS) industry have focused on (1) revenue recognition and (2) non-GAAP measures and key operating metrics.

6.1.2.1 Revenue Recognition

Examples of SEC Comments

- [W]e note revenue is generated and your customer receives benefit as the freight progresses toward delivery locations. In this regard, please explain why recognition of revenue at a point in time (i.e. upon completion of delivery to the receiver’s location) rather than over time is appropriate. As part of your response, please tell us your consideration of the guidance outlined in ASC 606-10-25-27 and ASC 606-10-55-5 and 6 in determining your accounting treatment.

- We note your disclosure . . . that rental income for leases and subleases to franchisees [is] outside of the scope of the revenue standard and [is] within the scope of lease guidance. We also note from your disclosure . . . that Franchise revenue consists of franchise royalties, initial franchise fees, license fees due from franchisees, IT support services, and rental income for leases and subleases to franchisees. Please revise to disclose the amount of revenue recognized from contracts with customers separately from other sources of revenue, such as revenue from leases. See guidance in ASC 606-10-50-4(a).

- Please disclose the amount of revenue recognized in the reporting period that was included in the contract liability balance at the beginning of the period, pursuant to ASC 606-10-50-8(b).

- We note that you provide some of your customers incentives for meeting or exceeding specified cumulative volumes or shipping to and from specific locations. Please tell us if you consider the volume-based rebates as variable consideration and, if so, which method you used to estimate the amount of variable consideration (projected future shipments) pursuant to . . . ASC 606-10-50-20(a).
The SEC staff often asks THS registrants about their disclosures related to performance obligations in contracts with customers. Topics of focus in staff comments issued to THS registrants on disclosures required under ASC 606-10-50-8 through 50-20 fall primarily within three broad categories: (1) timing of revenue recognition, (2) contract liability and remaining performance obligation disclosures, and (3) variable consideration estimation methods and any related constraints due to expected significant revenue reversals.

Specifically, the SEC staff has asked THS registrants to (1) clarify why recognition of revenue at a point in time rather than over time is appropriate in the transportation industry, (2) include disclosures related to remaining performance obligations for existing contract liabilities, and (3) provide details of the methods used in determining any variable consideration estimates.

See Section 2.17 for more information.

### 6.1.2.2 Non-GAAP Measures and Key Operating Metrics

Registrants in the THS industry continue to receive comments from the SEC staff on the use of non-GAAP measures. The SEC staff often question registrants regarding (1) the undue prominence of their non-GAAP measures, (2) their failure to properly reconcile a non-GAAP measure to the most directly comparable GAAP measure, and (3) their use of adjustments in forming non-GAAP measures that appear to represent recurring operating charges. For additional considerations, see Section 3.4.

### 6.2 Energy, Resources, and Industrials

#### 6.2.1 Oil, Gas, and Chemicals

The SEC staff's comments to registrants in the oil, gas, and chemicals industry continue to focus on (1) oil and gas reserves; (2) disclosures about drilling activities, wells and acreage data, and delivery commitments; (3) income statement classification; and (4) impairment considerations.

#### 6.2.1.1 Oil and Gas Reserves

##### 6.2.1.1.1 Proved Undeveloped Reserves

**Examples of SEC Comments**

- We note your response to prior comment [X] and your disclosure stating that all [proved undeveloped (PUD) reserves] will be drilled within five years of their initial booking date. Please expand on this statement to provide additional detail regarding [Company A's] development program and to describe how it results in the drilling of these [PUD reserves] in a timely manner. Your revised disclosure should address your ability to execute a development plan and estimate the costs to drill and develop these reserves considering that no development activity occurred during the prior two years. Refer to Item 1203(c) of Regulation S-K and Rule 4-10(a)(31) of Regulation S-X.

- Your disclosure indicates the proved undeveloped reserves that have remained undeveloped for five years or more were not material to the Company's total proved reserves. Please expand your disclosure to clarify the extent to which those reserves are material to the Company's total proved undeveloped reserves . . . . As part of your expanded disclosure, clearly explain the reasons for a time period longer than five years to convert these reserves to developed status. Your discussion should relate the anticipated timing of converting these reserves to the associated activities resulting in their conversion to developed status. Refer to Item 1203(d) of Regulation S-K.
Under Regulation S-X, Rule 4-10(a)(22), a registrant should be reasonably certain when estimating proved reserves that the reserves can be recovered in future years under existing economic conditions. In accordance with Rule 4-10(a)(31)(ii), “[u]ndrilled locations can be classified as having undeveloped reserves only if a development plan has been adopted indicating that they are scheduled to be drilled within five years, unless the specific circumstances, justify a longer time.”

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

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).

6.2.1.1.2 Separate Disclosure of Natural Gas Liquids Reserves

**Example of an SEC Comment**

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

Although NGLs are not separately identified as a product type in Regulation S-K, Item 1204(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.

6.2.1.1.3 Significant Changes in Reserves and Standardized Measures

**Examples of SEC Comments**

- To the extent that you continue to disclose dry gas locations as proved undeveloped reserves . . . , please quantify for us and expand your disclosure to provide the total number of locations and net proved reserve amounts pursuant to FASB ASC 932-235-50-10.
- The projected unit development cost from the . . . subsidiaries standardized measure is $[X]/BOE (=$[X] million/[X] MMBOE). Your . . . incurred unit development cost appears to be $[X]/BOE (=$[X] million/[X] MMBOE . . . ). We see similar differences for [the prior two years]. Please explain the reason(s) for these variances between your projected and incurred unit development costs.
The SEC staff has commented on registrants’ disclosures about (1) changes in proved reserves and standardized measures and (2) their compliance with ASC 932-235-50. Accordingly, the SEC staff may ask registrants to:

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

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

6.2.1.1.4 Reserve Reports

<table>
<thead>
<tr>
<th>Example of an SEC Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td>The reserve report does not include certain disclosures required by Item 1202(a)(8) of Regulation S-K. Please obtain and file a revised reserves report to include the following information in order to satisfy your filing obligations.</td>
</tr>
<tr>
<td>- The purpose for which the report was prepared (e.g., for inclusion as an exhibit in a filing made with the U.S. Securities and Exchange Commission (SEC) (Item 1202(a)(8)(i)).</td>
</tr>
<tr>
<td>- The proportion of the Company’s total proved reserves covered by the report (1202(a)(8)(iii)).</td>
</tr>
<tr>
<td>- A statement that the assumptions, data, methods and procedures used in the preparation of the report are appropriate for the purpose served by the report (Item 1202(a)(8)(iv)).</td>
</tr>
<tr>
<td>- A statement that the third party has used all methods and procedures as it considered necessary under the circumstances to prepare the report (Item 1202(a)(8)(viii)).</td>
</tr>
</tbody>
</table>

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

### Examples of SEC Comments

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

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

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

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

(a) For each of the last three fiscal years disclose production, by final product sold, of oil, gas, and other products. Disclosure shall be made by geographical area and for each country and field that contains 15% or more of the registrant's total proved reserves expressed on an oil-equivalent-barrels basis unless prohibited by the country in which the reserves are located.

(b) For each of the last three fiscal years disclose, by geographical area:

1. The average sales price (including transfers) per unit of oil, gas and other products produced; and
2. The average production cost, not including ad valorem and severance taxes, per unit of production.

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

6.2.1.3 Income Statement Classification

Under Regulation S-X, Rule 5-03, if product or service revenue is greater than 10 percent of total revenue, disclosure of such component is required as a separate line item on the face of the income statement, and costs and expenses related to the product or service revenue should be presented in the same manner. Revenue streams vary by sector within the oil, gas, and chemicals industry. For example, in the midstream sector, revenue streams could include transportation and storage of crude
or refined petroleum products, processing of natural gas, and marketing fees generated from the sale of such products. In connection with these services, midstream companies may purchase, take title to, or otherwise have risk of ownership for the related products they are transporting, storing, or processing. If revenues from these product sales exceed 10 percent of total revenues, registrants are required to disclose such revenues and costs and expenses separately in the income statement. For more information, see Section 2.9.2.

### 6.2.1.4 Impairment

**Example of an SEC Comment**

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

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

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

- The “nature of the estimates or assumptions is material due to the levels of subjectivity and judgment necessary to account for highly uncertain matters or the susceptibility of such matters to change.”
- The “impact of the estimates and assumptions on financial condition or operating performance is material.”

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

For additional information, see Section 2.11.

### 6.2.2 Power, Utilities, and Renewables

The focus of recent SEC staff comments to registrants in the power, utilities, and renewables (PU&R) industry is largely consistent with that of staff comments issued in past years. Among the topics of focus are (1) impairments of property, plant, and equipment (PP&E), including considerations related to early retirements, goodwill impairments, and disclosures about critical accounting policies; and (2) revenue recognition, including disclosures about alternative revenue programs.
Comments to registrants in the PU&R industry have also focused on the use of non-GAAP measures, especially the use of gross and net margin as a non-GAAP measure and the inclusion of appropriate disclosures about the use of non-GAAP measures. For additional information on non-GAAP measures, see Section 3.4.

### 6.2.2.1 Impairments of PP&E, Including Considerations Related to Early Retirements and Goodwill Impairments

#### Examples of SEC Comments

- Please tell us your consideration of providing additional critical accounting policy disclosure that allows for an assessment of the probability, magnitude and timing of future material charges associated with early retirement or shutdown of these units, along with a description of the specific events and/or changes in circumstances that could reasonably be expected to result in early retirement or shutdown. Refer to Section V of SEC Release 34-48960 and Item 303(a)(3)(ii), which requires a description of a known uncertainty.

- Please provide information for investors to assess the probability of future goodwill impairment charges. For example, please disclose whether any of your [component] reporting units are at risk of failing step one of the impairment test or that the fair value of each of the reporting units [is] substantially in excess of carrying value and [is] not at risk of failing step one. If a reporting unit is at risk of failing step one, you should disclose:
  - [T]he percentage by which fair value exceeded carrying value at the date of the most recent step one test;
  - [T]he amount of goodwill allocated to the reporting unit;
  - [A] more detailed description of the methods and key assumptions used and how the key assumptions were determined;
  - [A] discussion of the degree of uncertainty associated with the assumptions; and
  - [A] description of potential events and/or changes in circumstances that could reasonably be expected to negatively affect the key assumptions.


In comments to registrants in the PU&R industry, the SEC staff continues to focus on issues related to the impairment of long-lived assets, including (1) whether a registrant has recorded, or is at risk of recording, an impairment charge; (2) the lack of disclosures about specific events or changes in circumstances that could reasonably be expected to result in impairments, including disclosures about a registrant’s assessment of the probability, magnitude, and timing of future material charges; and (3) the basis for a registrant’s conclusion regarding the classification of impairment losses.

In addition, SEC staff comments to registrants in the PU&R industry have increasingly focused on matters related to the probability of goodwill impairment charges. Specifically, such registrants have received comments asking them to disclose whether any of their reporting units are at risk of failing an impairment test and, if so, to provide additional disclosures, including:

- Quantitative information.
- Detailed descriptions of methods and key assumptions used and how they were determined.
- Discussion of the degree of uncertainty associated with the key assumptions.
- A description of any potential events or changes in circumstances that could reasonably be expected to negatively affect the key assumptions used.

For additional considerations related to impairments of goodwill, see Section 2.11.
6.2.2.2 Revenue Recognition

Examples of SEC Comments

- We note that total consideration for customer agreements including price escalators and guarantees is estimated and recognized over the term of the customer agreement and that this results in creating an unbilled receivable balance for the first half of the customer agreement which is then reduced during the second half. In order to better understand the Company’s accounting determination, please describe to us the following:
  - The nature of the goods and services that you have promised to transfer. See ASC 606-10-50-12.
  - The performance obligation(s) you have determined from your contracts with customers. For each performance obligation, highlight whether the Company has bundled any goods or services that are not considered distinct and whether a series of distinct goods or services that are substantially the same and have the same pattern of transfer to the customer have been identified pursuant to ASC 606-10-25-14.
  - How you applied the allocation guidance in ASC 606-10-32-28 through ASC 606-10-32-41. In that regard, highlight how you considered the variable consideration allocation exception guidance in ASC 606-10-32-39 and ASC 606-10-32-40 when evaluating the impact of the price escalators and performance guarantees in your customer arrangements.
- Please disclose the amount of revenue arising from alternative revenue programs. Refer to ASC 980-605-45-1. Please also disclose whether you meet all three of the recognition criteria within [ASC] 980-605-25-4 and disclose the methodology used to calculate revenues from alternative revenue programs.

In various comments issued to registrants in the PU&R industry, the SEC staff has focused on ensuring that disclosures related to a company’s conclusions that reported amounts are within the scope of ASC 606 provide details on the company’s accounting determination. Specifically, the staff has asked such registrants to (1) support their conclusions that revenue should be recognized under ASC 606 and (2) provide detailed disclosures about how the revenue recognition criteria in ASC 606 were met.

In addition, registrants in the PU&R industry have received SEC staff comments indicating that in accordance with Regulation S-K, Item 303(a)(3)(ii), they are required to provide disclosures about (1) any known trends or uncertainties that they reasonably expect will have a material impact on revenues or income from continuing operations and (2) any known events that will cause a material change in the relationship between costs and revenues.

In other recent comments to registrants in the PU&R industry, the SEC staff has focused on the sufficiency of disclosures about a registrant’s alternative revenue programs, including disclosures of (1) the amount of revenue attributable to these programs, (2) whether the criteria in ASC 980-605-25-4 for recognizing revenue from these programs have been met, and (3) the method used to calculate revenue from these programs. For revenue from an alternative revenue program to be recognized, all of the following criteria in ASC 980-605-25-4 must be satisfied:
  - “The program is established by an order from the utility’s regulatory commission that allows for automatic adjustment of future rates.”
  - “The amount of additional revenues for the period is objectively determinable and is probable of recovery.”
  - “The additional revenues will be collected within 24 months following the end of the annual period in which they are recognized.”
6.3 Financial Services

6.3.1 Banking and Capital Markets

The number of SEC staff comments issued to registrants in the banking and capital markets industry has significantly declined in the past couple of years. However, revenue recognition is a key topic of interest in comment letters recently issued to registrants in this industry as well as in other industries. In addition, because of the regulatory and legal environment in the banking and capital markets industry, the SEC staff has focused on the disclosures of reasonably possible losses on contingencies.

Further, ASU 2016-13 (the “credit losses standard”) has had a significant impact on the banking and capital markets industry in 2020. However, at the time of this publication, only three quarters have passed since adoption, which has not allowed sufficient time for the SEC staff to issue substantial comments. The SEC staff has been providing registrants that have not yet adopted the credit losses standard with reminders about best practices to apply in the periods leading up to the adoption. The staff’s reminders reiterate themes it has addressed over the years leading up to the adoption that have focused on disclosures related to implementation activities. For expanded discussion about SAB Topic 11.M disclosures, see Section 2.18.

Changing Lanes

On September 11, 2020, the SEC issued a final rule that amends and codifies the disclosure requirements of the SEC Division of Corporation Finance Industry Guide 3. The final rule’s scope includes bank holding companies, banks, savings and loan holding companies, and savings and loan associations. The SEC indicated that there is not a large population of registrants that are providing Guide 3 disclosures that will be outside the scope of this final rule. The final rule codifies the amended disclosure requirements in a new subpart of Regulation S-K, which replaces Industry Guide 3. For additional discussion about the codification and removal of certain existing requirements, as well as additional required disclosures in the final rule, see Deloitte’s October 8, 2020, Heads Up.

6.3.1.1 Revenue Recognition

Example of an SEC Comment

Please tell us which streams of the Company’s revenue are within the scope of the new revenue standard and how you addressed the requirement in ASC 606-10-50-4 to disclose revenue recognized from contracts with customers separately from other sources of revenue.

Although many revenue streams in the banking and capital markets industry are outside the scope of the new revenue standard (ASC 606), some comment letters to registrants in the industry have focused on revenue recognition, including adequate disclosure of which revenue streams are within the scope of ASC 606 and which are not. Other revenue-related matters discussed in comment letters to registrants in this industry include the following:

- **Principal-versus-agent analysis** — The SEC staff requested additional information about the nature of the services performed by an agent and emphasized that the disclosure should include an indication of how the revenue recognition criteria are met when a third party is providing services to the customer and the related revenue is reported on a gross basis.

- **Performance obligations** — The SEC staff questioned whether promised goods or services in a contract with a customer should be accounted for as a single performance obligation, requesting additional information on each promised good or service.
• Disclosure of significant payment terms — The SEC staff questioned how a company determined that it did not need to disclose significant payment terms related to its performance obligations.

For additional discussion on revenue, see Section 2.17.

6.3.1.2 Loss Contingencies

Example of an SEC Comment

Please expand your disclosure to specify your estimate of reasonably possible loss or the range of reasonably possible loss pertaining to this matter. If you have not prepared an estimate and are unable to estimate such amount or range, you must include a statement that such an estimate cannot be made to comply with FASB ASC 450-20-50-3 and 4. If this is the case, disclose the amount of damages that are being sought and which have been quantified, and identify any aspects of the litigation for which the amount of damages claimed remain unspecified.

Some comment letters to registrants in the banking and capital markets industry have focused on adequate disclosures of legal matters, such as estimates of reasonably possible losses related to ongoing litigation. For example, the SEC staff has commented that in accordance with ASC 450-20-50-3 and 50-4, such disclosures should include (1) an estimate of the reasonably possible loss or range of loss related to the matter or (2) a statement that such an estimate cannot be made. The SEC staff has also sought additional disclosures that quantify the damages being sought and identify instances in which damages have not yet been specified by the plaintiff.

For additional discussion on contingencies, see Section 2.3 and Deloitte's A Roadmap to Accounting for Contingencies, Loss Recoveries, and Guarantees.

6.3.2 Investment Management

The SEC staff's recent comments to registrants in the investment management industry have focused on topics such as (1) variable interest entities (VIEs), (2) investments in and advances to affiliates, (3) repurchase agreements, and (4) schedules of investments.

6.3.2.1 VIE Disclosure

Example of an SEC Comment

We note that substantially all of your consolidated affiliates are considered variable interest entities; however, we do not see where you have provided the disclosures required by ASC 810-10-45-25 and ASC 810-10-50-3. Please advise, or tell us why this information is not required.

In accordance with ASC 810-10-50-3, registrants are required to disclose additional information related to the consolidated assets and liabilities of a VIE except when (1) the VIE meets the definition of a business, (2) the VIE issues voting equity interests and the primary beneficiary holds a majority voting interest, and (3) the VIE’s assets can be used for purposes other than the settlement of the VIE’s obligations. The required disclosures include the ability to use the VIE’s assets to settle obligations outside of the VIE structure. If the VIE is a business and its assets can be used to settle obligations outside of the VIE, it is important for the registrant to properly disclose these facts about the VIE in such a way that a reader would understand that the registrant falls within the exception to the requirement to provide further disclosure.
6.3.2.2 Investments in and Advances to Affiliates

**Example of an SEC Comment**

Please expand your disclosure in future filings to provide a more detailed description of the types of investments held by your affiliate.

Investments in and advances to affiliates are subject to both FASB and SEC disclosure requirements. Although there are specific requirements that apply to these related-party transactions, the SEC staff has asked registrants engaged in such transactions to expand certain qualitative information presented. Registrants should be reminded that their disclosures regarding related parties should meet the requirements outlined in ASC 850 and Regulation S-K, Item 404, which include open-ended statements (e.g., the provision in Item 404(a)(6) that requires a registrant to disclose “[a]ny other information regarding the transaction or the related person in the context of the transaction that is material to investors in light of the circumstances of the particular transaction”).

6.3.2.3 Repurchase Agreements

**Example of an SEC Comment**

Please expand your [MD&A] disclosure in future filings to quantify the average quarterly balance of your repurchase agreements for each of the past three years, the period end balance for each of those quarters and the maximum balance at any month-end. Please also provide a discussion explaining the causes and business reasons for significant variances among these amounts.

Registrants may use repurchase agreements to provide access to financing. In accordance with ASC 860-10-55-51, when a repurchase agreement does not meet all of the conditions in ASC 860-10-40-5, it should be accounted for as a secured borrowing. Regulation S-K, Item 303, outlines the disclosures related to liquidity and capital resources that registrants are required to provide in MD&A.

6.3.2.4 Schedule of Investments

**Example of an SEC Comment**

We refer to the schedule of investments included in the [201X] Form 10-K and note that the Company has not fully complied with the requirements contained in footnote 8 to Rule 12-12 of Regulation S-X with respect thereto.

Investment companies are required to present their investment holdings within a schedule of investments (SOI) and must include all information detailed in Regulation S-X, Rule 12-12. As specified in the comment above, footnote 8 to Rule 12-12 requires a company to include additional disclosure of restricted securities. Restricted securities are those that are obtained in an unregistered private sale from the issuing company or from an affiliate of the issuer. A symbol must be attached in the SOI to each issue of a restricted security, and additional information must be presented in a footnote to the SOI. The additional required information includes the (1) acquisition date, (2) carrying value per unit of investment as of the balance sheet date, (3) cost of the security, and (4) aggregate value of all restricted securities and the percentage which the aggregate value bears to net assets. If the security was acquired during the preceding year, the registrant must also disclose the date on which the purchase price was agreed to, as well as the date on which an enforceable right to acquire the security was obtained.
Fundamental to making these disclosures is the determination of whether an investment position is “restricted.” Registrants may need to consult with trading professionals and legal advisers in making such a determination.

6.3.3 Real Estate

The SEC staff’s recent comments to registrants in the real estate industry continue to focus on non-GAAP financial measures. While such registrants have seen a decline in the number of comments issued on other topics, they should be aware of comments related to matters such as (1) whether, for U.S. GAAP purposes, real estate acquisitions represent business combinations or asset acquisitions and whether, for SEC reporting purposes, a registrant has acquired a business or real estate operations; (2) capitalization of real estate development, construction, and leasing costs; (3) liquidity considerations associated with distributions; (4) consolidation; and (5) early-warning disclosures related to impairments and leasing activities, especially in light of the macroeconomic impacts of the COVID-19 pandemic. The SEC expects registrants to clearly disclose material risks and uncertainties from the impact of COVID-19 in various sections of their SEC filings, including the risk factors section, MD&A, the business section, legal proceedings, disclosure controls and procedures, internal control over financial reporting, and financial statements.

6.3.3.1 Non-GAAP Financial Measures

<table>
<thead>
<tr>
<th>Examples of SEC Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Please tell us how your definition of FFO is consistent with the NAREIT definition of FFO. Specifically, tell us how you have determined it was appropriate to exclude financing expense in connection with [Company A] from your definition of FFO.</td>
</tr>
<tr>
<td>• We note the reconciliation of NOI and SSNOI on page [X]. Please tell us how you determined it was appropriate to present a measure that includes 100% of NOI related to your unconsolidated joint ventures. We refer you to Question 100.04 of the Division’s Compliance and Disclosure Interpretations for Non-GAAP Financial Measures.</td>
</tr>
<tr>
<td>• We note that your calculation of EBITDA contains an adjustment for items other than interest, taxes, depreciation and amortization. Please revise future filings to ensure that measures calculated differently from EBITDA are not characterized as EBITDA. Reference is made to Question 103.01 of the Division’s Compliance and Disclosure Interpretations for Non-GAAP Financial Measures.</td>
</tr>
<tr>
<td>• We note that you focus on non-GAAP financial measures such as “Company Same Store NOI” and “Company EBITDA” in your highlights section. Such a presentation causes your non-GAAP measure to be more prominent than the most directly comparable GAAP measure. Please revise accordingly in future filings. Reference is made to Question 102.10 of the updated Compliance and Disclosure Interpretations issued on May 17, 2016.</td>
</tr>
<tr>
<td>• We note that you adjust your non-GAAP pro rata balance sheet and income statement for your proportionate economic ownership of each asset in your portfolio that [is] not wholly-owned which substitutes an individually tailored accounting principle for the one in GAAP. Please describe the changes you expect to make to your presentation in light of the new guidance in Question 100.04 of the updated Non-GAAP Compliance and Disclosure Interpretations issued on May 17, 2016.</td>
</tr>
<tr>
<td>• In arriving at [funds from operations (FFO)], you start with net income attributable to [Company A] and make adjustments for redeemable non-controlling interests and preferred stock dividends. As a result, it appears FFO, and ultimately Company FFO, are attributable to common shareholders and redeemable non-controlling interest holders. Please clarify and/or revise the labeling of your non-GAAP financial measures in future filings to adequately reflect what is being presented.</td>
</tr>
<tr>
<td>• We note your presentation of FFO per share and AFFO per share for the [periods]. In future earnings releases, please reconcile these non-GAAP per share measures to GAAP earnings per share. Please refer to Question 102.05 of the updated Compliance and Disclosure Interpretations issued on May 17, 2016.</td>
</tr>
</tbody>
</table>
As noted above, the SEC staff has continued to focus on non-GAAP financial measures in its recent comments to registrants in the real estate industry. Issues addressed in such comments have included (1) the presentation of non-GAAP financial measures more prominently than GAAP measures, (2) pro rata consolidation adjustments, (3) clearer labeling, (4) the reconciliation of non-GAAP per-share measures to the most directly comparable GAAP metrics, and (5) the use of misleading adjustments and application of tailored accounting principles. See Section 3.4 for additional information.

Registrants in the real estate industry should also be aware of Questions 102.01 and 102.02 of the C&DIs on non-GAAP financial measures, which indicate that FFO as defined by NAREIT as of May 17, 2016, as well as FFO per share, will continue to be accepted as a performance measure. The presentation of any FFO measure in a manner that departs from NAREIT’s definition (e.g., adjusted FFO, core FFO), or as a per-share amount based on such a modified measure, is subject to the prohibitions in Regulation S-K, Item 10(e), and should be treated as a performance measure or a liquidity measure. If modified FFO is considered a performance measure, it may be presented on a per-share basis; if a modified FFO per share is, in substance, a liquidity measure, presentation on a per-share basis is prohibited. Acceptability of FFO per-share measures, or modified FFO per share, does not override the prohibition against the presentation of cash flow per-share data and other per-share measures of liquidity.

FFO may be reported gross or net of noncontrolling interest adjustments. When the FFO calculation takes into account noncontrolling interest adjustments, the registrant should clearly label the measure to reflect “FFO attributable to common stockholders” or “FFO attributable to the company.”

### 6.3.3.2 Real Estate Acquisitions

**Examples of SEC Comments**

- Given the acquisition of the industrial property in [Location A on Date X], please tell us why you did not provide financial statements in compliance with Rule 3-14 of Regulation S-X for this property or pro forma financial statements showing the effects this transaction will have on the registrant.

- [We] note your disclosure relating to your acquisition of complete ownership of [Portfolio A]. Please tell us how you considered the requirements of Items 2.01 and 9.01(a)–(b) of Form 8-K with respect to this acquisition.

- We note that your acquisition of [Property A] was recorded as an asset acquisition. We further [note] your disclosure . . . that acquisitions of properties with in-place leases are accounted for as a business combination. Please tell us how recording the [Property A] acquisition as an asset acquisition complies with your policy.

- Please provide us with your significance test for the [Facility A in Location B] acquired on [Date X]. As part of your response, tell us how you considered the need to present audited historical financial statements and unaudited pro forma information for this acquisition in accordance with Rule 3-14 of Regulation S-X.

- Please explain to us how you arrived at the conclusion that your acquisition of [Property A] should be accounted for as an asset acquisition.

- We note . . . that [Acquiree A] terminated its employees immediately preceding the acquisition and you did not acquire an assembled workforce. . . . To the extent employees of [Acquiree A] were hired by your external manager at the time of acquisition, please address the following:
  - Tell us if [your external manager] hired the employees responsible for leasing, tenant management, and managing and supervising your operational processes.
  - Tell us if the employees are considered critical to the creation of outputs.

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1 In December 2018, NAREIT issued an updated definition of FFO that did not alter the fundamental definition of FFO. Although the SEC has not updated its C&DIs to include the restated definition of FFO, registrants may continue to use NAREIT’s definition of FFO that is in effect at the time of the filing of the financial statements as long as the adjustments are consistent with the updates made by NAREIT.
Under SEC reporting rules, an acquisition by a registrant is treated as either an asset or a business for SEC reporting purposes. If an acquiree meets the definition of a business under Regulation S-X, Rule 11-01(d), the acquiree would be within the scope of Regulation S-X, Rule 3-05 or Rule 3-14. Rule 3-05 requires a registrant to provide full financial statements (and pro forma financial information) for significant acquired or to be acquired businesses. However, Rule 3-14 requires a registrant to file only abbreviated income statements (and pro forma financial information) for significant acquired or to be acquired real estate operations that meet certain requirements. Because the requirements of Rules 3-05 and 3-14 are different, it is important for a registrant to determine whether it acquired a real estate operation (which is subject to Rule 3-14). As a result, from an SEC reporting standpoint, the SEC staff may ask a registrant to provide an analysis supporting its conclusion that its acquisitions are real estate operations under Rule 3-14. When a registrant has not provided financial statements for an acquired or to be acquired real estate operation under Rule 3-14, the staff may ask the registrant to provide an analysis in support of its conclusion that the acquisition or potential acquisition did not trigger the rule's requirement to file related financial statements.

In addition, from an accounting standpoint, the SEC staff has asked registrants with material acquisitions to elaborate on their process and policies for determining whether the acquired assets, including acquired real estate that is subject to a lease, qualify as a business or an asset acquisition under U.S. GAAP (ASC 805). This determination is important because the accounting for an asset acquisition differs from the accounting for a business combination and can require management to use judgment, especially when assessing the screen under ASC 805, to determine whether substantially all of the fair value of the acquired assets is concentrated in a single asset or asset group. 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.

See Deloitte’s June 2, 2020, Heads Up for information about the SEC’s final rule, which updates Rules 3-05 and 3-14, and becomes effective on January 1, 2021, for calendar-year-end registrants.

### 6.3.3.3 Capitalization of Real Estate Development, Construction, and Leasing Costs

**Example of an SEC Comment**

We note that you capitalize indirect costs clearly related to the construction and improvements of investment properties and that for the fiscal year . . . invested approximately $[X] million in development properties as well as approximately $[X] million in capital expenditures and tenant improvements. Please disaggregate the amounts between development, redevelopment and leasing of real estate and tell us the amount of indirect costs capitalized by segment for each year presented, or tell us why you believe such disclosure is not beneficial for investors.

The SEC staff may ask 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 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).

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2 On May 20, 2020, the SEC issued a final rule that amends financial statement requirements for acquisitions and dispositions of businesses, including real estate operations, and related pro forma financial information under Rules 3-05 and 3-14. See Section 3.2.2 for additional information about the final rule.

3 See Deloitte’s A Roadmap to Accounting for Business Combinations for further guidance.
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 disclose expenditures related to new properties (e.g., acquisitions, new development) separately from expenditures related to existing properties (e.g., redevelopment, improvements, construction-in-progress).

6.3.3.4 Liquidity and Capital Resources — Distributions

<table>
<thead>
<tr>
<th>Example of an SEC Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td>We note your disclosure . . . that you paid $[X] million, comprised of $[X] million of cash dividends and $[X] million reinvested by stockholders, in cash. We further note your [Form 10-Q disclosure] where you indicate that cash distributions exceeded net income for the reporting period. In future Exchange Act reports, please revise your disclosure to provide the relationship between distributions paid and cash flow from operations, and disclose the source of any shortfall.</td>
</tr>
</tbody>
</table>

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 staff may inquire about the cash resources used to cover the shortfall, such as borrowings or offering proceeds. Registrants should adequately disclose the risks associated with paying distributions in excess of GAAP cash flow from operations. In addition, the staff may request disclosures that compare earnings (or FFO) with paid distributions, including amounts reinvested through a distribution reinvestment plan. The staff sometimes asks registrants to disclose these items on a cumulative basis so that financial statement users can better understand the relationship between earnings (or FFO) and distributions.

6.3.3.5 Consolidation

<table>
<thead>
<tr>
<th>Examples of SEC Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>• We note that you have [an X percent] interest in [Entity A]. Please provide to us an analysis discussing your basis in accounting for the joint venture investment using the equity method, and cite the accounting literature [relied] upon. In your response, elaborate how [Entity A Investee]'s ability to participate in major decisions equates to shared decision making ability, detailing the characteristics of [its] participation rights and how such rights are substantive. Further, clarify what happens in situations where the parties do not agree and whether contractually one party has the ability to break any deadlock.</td>
</tr>
<tr>
<td>• We note that you have consolidated JVs for which you are the primary beneficiary. Please tell us how you have met the disclosure requirements of ASC 810-10-50-5A or revise accordingly in future filings.</td>
</tr>
</tbody>
</table>

The SEC staff has commonly focused on registrants’ involvements with VIEs and joint ventures and has inquired about consolidation assessments.

The SEC staff may also ask for additional information and disclosures about non-VIE joint ventures, particularly when (1) a registrant uses the equity method of accounting and either has a majority ownership interest or is the general partner or managing member or (2) the qualitative disclosures about such arrangements are not robust. Disclosures about these arrangements should include a discussion of the ownership structure as well as the governance provisions that led the registrant to conclude that it does not have a controlling financial interest in the joint venture. In addition, the staff routinely asks for clearer qualitative disclosures when there are amendments to management agreements or changes in ownership structure or percentages that do not result in a change to a registrant’s consolidation conclusion.

For additional discussion on consolidation, see Section 2.2.
6.3.3.6 Early-Warning Disclosures — Impairments and Leasing Activities

Examples of SEC Comments

- For each impaired property in [years 2, 3, and 4], tell us the holding period assumed for the property in your impairment analysis performed in [year 1] and the rationale behind that holding period given your repositioning strategy.
- Please address the following with respect to tenant bankruptcies and other store closings. Please provide the information requested separately for tenant bankruptcies and other store closings:
  - Please tell us the gross number of tenant bankruptcies and store closings during [year 1], [year 2] and year to date [year 3] and the gross number of stores affected.
  - Please tell us the gross leasable area of stores affected by tenant bankruptcy and store closings.
  - Please provide us with an analysis of the gross amount of lost rent as a result of tenant bankruptcies and store closings from the date of lease termination or bankruptcy through the original lease termination date for each future annual period impacted.
- We note that you recognized $[X million] and $[Y million] in lease termination income in [year 2] and [year 1] respectively. We further note your disclosure . . . that a number of your tenants have declared bankruptcy in recent years. Please tell us what consideration you have given to discussing recent tenant bankruptcies and the impact of those bankruptcies on current and future operations in your MD&A.
- We note your agreement established on [date X, year 1] and amended in [month Y, year 2] to sell [A properties] for an aggregate sales price of $[X] million. . . . We further note you recorded an impairment charge of $[Y] million related to the [A properties] during the quarterly period ended March 31, [year 2]. Please tell us how you determined it was unnecessary to record an impairment charge for the [A properties] during the year ended December 31, [year 1].

The SEC staff has frequently asked registrants in the real estate industry to enhance their disclosures about the inputs used in their asset recoverability tests and the valuation techniques used to develop nonrecurring measurements of fair value. SEC comments on this topic are consistent with those discussed in Section 2.11.

Also, over the past few years, as circumstances in the retail industry have deteriorated and as retail trends evolve, the SEC staff has asked registrants in the real estate industry that lease property to entities in the retail industry to enhance their disclosures related to rental performance, leasing activities, and the impact of tenants’ financial difficulties on the registrants’ current and future operations. This trend has also affected all sectors of the real estate industry given the effects of the COVID-19 pandemic. The staff continues to request early-warning disclosures about tenant difficulties that alert investors to the underlying conditions and risks that a registrant faces before a material charge or decline in performance is reported. In addition, the staff may use hindsight, after an impairment or charge is reported, to inquire why the registrant did not include any early-warning disclosures in prior periods leading up to the period in which the impairment was recorded.

Given the uncertainty associated with COVID-19, there is a substantial increase in the level of judgment registrants need to apply in estimating future results and the potential range of reasonably likely outcomes. Registrants are therefore expected to expand their disclosures about (1) the key assumptions used in their most significant estimates and (2) the sensitivity of such estimates to changes that could reasonably occur as events associated with COVID-19 continue to develop. Consequently, registrants should consider updating the critical accounting estimates previously disclosed to the extent that there have been material changes to key assumptions and estimates.

See Section 3.1 for additional information on early-warning disclosures.
6.4 Life Sciences

The SEC staff’s comments to registrants in the life sciences industry have focused on a number of topics, including (1) revenue recognition, (2) research and development (R&D), (3) business combinations, (4) non-GAAP measures, and (5) disclosures regarding state sponsors of terrorism.

6.4.1 Revenue Recognition

6.4.1.1 Gross-to-Net Adjustments (ASC 606)

<table>
<thead>
<tr>
<th>Examples of SEC Comments</th>
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<tbody>
<tr>
<td>• To the extent that re-estimates of prior year gross-to-net variable consideration is significant in future periods, please represent to us that you will disclose herein the impact on your product sales and operating results and include in your financial statements the disclosure required by ASC 606-10-50-12A.</td>
</tr>
<tr>
<td>• Please explain to us why adjustments to prior year estimates of gross-to-net variable consideration in the aggregate of up to [X]% of total revenues are not material to your financial statements taken as a whole. In this regard, [X]% of your total revenues for the first half of [year 2] equating to approximately $[X] million appears that it could at least be quantitatively material to operating loss and pre-tax loss for the first half of [year 2] and to your customer allowances liability at December 31, [year 1]. In addition, prior period adjustments of that magnitude could significantly impact trends and explanation thereof could be meaningful disclosure for investors.</td>
</tr>
<tr>
<td>• You identify product revenue recognition as a critical accounting estimate. Given the magnitude of your net product sales and your gross-to-net adjustments as previously conveyed in your quarterly earnings conference calls, please address the following:</td>
</tr>
<tr>
<td>o Provide us a roll forward of the accrual of each gross-to-net adjustment type (whether reflected as an allowance against accounts receivable or a liability) that depicts the following for each annual period from [Date 1] to [Date 2] and for the six-month period from [Date 3] to [Date 4]:</td>
</tr>
<tr>
<td>▪ Beginning balance;</td>
</tr>
<tr>
<td>▪ Current provision related to sales made in current period;</td>
</tr>
<tr>
<td>▪ Current provision related to sales made in prior periods;</td>
</tr>
<tr>
<td>▪ Actual returns or credits in current period related to sales made in current period;</td>
</tr>
<tr>
<td>▪ Actual returns or credits in current period related to sales made in prior periods; and</td>
</tr>
<tr>
<td>▪ Ending balance.</td>
</tr>
<tr>
<td>o Tell us the amount of and reason for significant fluctuations in the provision from period to period for each type of gross-to-net adjustment, and the amount and reason that changes in your estimates of these items had on your revenues and operations.</td>
</tr>
</tbody>
</table>

The recognition of revenue in the life sciences industry relies heavily on estimates and assumptions related to returns, chargebacks, rebates, discounts, promotions, shelf stock adjustments, and other adjustments to transaction prices that affect revenue. ASC 606-10-50-12A requires an entity to “disclose revenue recognized in the reporting period from performance obligations satisfied (or partially satisfied) in previous periods (for example, changes in transaction price).” The SEC staff has commented on registrants’ disclosures of these types of changes in estimates in variable consideration, including the magnitude and nature of any current-period adjustments to estimates made in prior periods. The staff has also requested that registrants provide a rollforward of the accruals for each gross-to-net adjustment in MD&A, including similar disclosures of current-period adjustments related to sales made in prior periods.
### 6.4.1.2 Multiple-Element Arrangements (ASC 606)

#### Examples of SEC Comments

- You state that the development and manufacturing services for the [X] agreements are viewed as a single performance obligation and therefore the upfront payments, future research and development reimbursement payments and any potential additional development milestone payments under each agreement will be deferred until the commencement of commercial manufacturing. Please address the following:
  - Identify for us each of the promised goods or services in these agreements including the transfers of licenses and explain how you determined that you only had a single performance obligation under the guidance in ASC 606-10-25-14.
  - With reference to ASC 606-10-25-23 to 25-26, explain to us why revenue is deferred until commencement of commercial manufacturing and how you considered that you have already transferred the licenses and begun providing development services.
  - Explain to us whether you intend to recognize revenue over time or at a point in time, and why with reference to ASC 606-10-25-30 or 25-31, as applicable.

- Please address the following as it relates to your determination that the performance obligations represented a single performance obligation since the license, clinical development and manufacturing and supply obligations were not distinct:
  - How your statement . . . that [Customer X] was not granted any other rights to, or benefits from, the intellectual property is consistent with . . . the agreements. The agreements appear to give [X] the right to use [Product A] as necessary to . . . seek and obtain Regulatory Approval for the Licensed Product in the Field in the Territory.
  - Why the license and research and development services, either alone or combined, are not capable of being distinct from the manufacturing services pursuant to ASC 606-10-25-19a. In this respect, the subcontracting and sublicensing rights . . . and step-in rights in . . . the agreements appear to indicate there may be available resources outside of the company that could provide the research and development services and supplies. Refer also to Example 56, Case B in ASC 606-10-55-371 through 55-372. In this regard, we note in Case A that an approved drug is provided in the contract with manufacturing services, for which no other promised goods or services are included in the contract, which appears to be contrary to the company's facts and circumstances.
  - Why the license and research and development services, either alone or combined, are not separately identifiable from the supply obligation and thus do not meet the criteria in ASC 606-10-25-19b. In this regard, it appears due to the subcontracting and sublicensing rights, the license and research and development services are not inter-related with the manufacturing services pursuant to ASC 606-10-25-21c. Refer also to Example 56, Case B, ASC 606-10-55-372A.
Examples of SEC Comments (continued)

- As it relates to your determination that revenue from the combined performance obligation should be recognized at a point in time upon the supply of the drug, please address the following:
  - Your response states that you intend to recognize revenue at the point in time in which [Customer X] achieves control over batches supplied. However, you also state that you will recognize revenue as product is delivered to [X] based on the quantity supplied compared to the forecasted quantity of the drug to be supplied over the term of the agreements, which would appear to be an over time measurement. Please clarify this apparent inconsistency. Please also explain how you intend to estimate the forecasted quantity of the drug to be supplied over the term of the agreements and how this estimate would be deemed to be a reasonable measure of progress considering the guidance in ASC 606-10-25-36.
  - Your response [to the initial comment letter] states that [the company] will “start satisfying its performance obligation only upon supply of the drug after issuance of regulatory marketing approvals.” Explain how you considered the contract duration guidance in ASC 606-10-25-3 which states that the guidance in this Topic should be applied to the duration of the contract (that is, the contractual period) in which the parties to the contract have present enforceable rights and obligations. In this regard, it would appear that the enforceable rights and obligations under these contracts began at their effective dates . . . . Accordingly, it is unclear to us why an over time measurement of your performance obligation would not be recognized over the entire contractual period.
  - Explain how you considered the guidance in ASC 606-10-25-27(c) in determining whether your performance obligation is being satisfied over time. In this regard, address the following:
    - Clarify whether your performance under the contracts [creates] an asset with alternative future use. In this regard, explain whether you are contractually restricted from developing [Compound A] for your or any other entity's benefit as long as the [X] agreements are in effect.
    - Explain whether you have an enforceable right to payment for performance completed to date under the contracts. In this regard, it would appear that you would have the full right to the non-refundable upfront payments (at a minimum) even in the event that the drug does not receive regulatory approval and enter the commercialization phase.
- We acknowledge your . . . determination that the performance obligations represented a single performance obligation since they were not distinct. Please tell us the following information so we may further evaluate your response:
  - Why you did not identify the research and development services, which appear to be required under the contract to get [Product A] through regulatory approval, as a separate performance obligation . . . .
  - Why the license and research and development services, either alone or combined, are not capable of being distinct from the manufacturing services pursuant to ASC 606-10-25-19a. In this respect, the subcontracting rights under . . . the agreement appear to indicate that there may be available resources outside the company that could provide the research and development services and supplies. Refer also to Example 56, Case B in ASC 606-10-55-371 through 55-372.
  - Why the license and research services, either alone or combined, are not separately identifiable from the manufacturing obligation and thus do not meet the criteria in ASC 606-10-25-19b. In this regard, it appears due to the subcontracting rights, the license and research services are not inter-related with the manufacturing services pursuant to ASC 606-10-25-21c. Refer also to Example 56, Case B, ASC 606-10-55-372A.
  - If you will be compensated separately for any research and development services, such as the technical development activities discussed in . . . the agreement, how you intend to account for those payments.
  - If you will be compensated separately for the supply of goods under the Supply agreement beyond the upfront fee and milestone payments received, and if so, whether or not the compensation includes a normal profit margin.
Examples of SEC Comments (continued)

- Why control has transferred upon manufacturing the vials for [Customer A] pursuant to ASC 606-10-25-23.
- How you intend to estimate the expected vials to be produced during the contract term of the supply agreement and how the estimate would be deemed to be a reasonable measure of progress pursuant to ASC 606-10-25-36.

Regarding the [agreement], for which you determined the total transaction price to be $[X] million, please provide us your analysis of the accounting for the agreement which explains why you did not recognize any portion of the consideration for the license upon transfer of the license at inception of the agreement. Address:
- If you concluded the license was distinct from the other obligations and why or why not,
- If you concluded the license was a right to use license or a right to access license and why,
- The standalone selling prices determined for each performance obligation and how you determined such,
- Why you did not recognize the guaranteed minimum royalty payments as fixed consideration upon transfer of the license at inception of the agreement, and
- Why you combined the license with the services to arrange for supplies.

- You disclose that if you are unable to reasonably estimate royalty revenue or if you do not have access to the information, you record royalty revenue when the information needed for a reliable estimate becomes available. Please tell us how this policy complies with the requirement in ASC 606-10-55-65 to reflect royalties upon the later of subsequent sale or the satisfaction of the performance obligation to which the royalty has been allocated. In your response, tell us when the information needed for a reliable estimate becomes available in comparison to the period of actual sale.

- We note you have identified certain complementary products as separate performance obligations that are satisfied over the [X-] year warranty period. Please address the following:
  - Explain in more detail the nature of the complementary products and how you evaluated these arrangements under ASC 606-10-25-19 to 25-22.
  - Tell us the time period over which these performance obligations are recognized. In this regard we note your disclosure the performance obligations are satisfied over the [X-] year warranty period. However we note that all of your deferred revenue is classified as a current liability on your balance sheet.

It is common in the life sciences industry for an entity to transfer a license of intellectual property along with other services (e.g., R&D or manufacturing services). In the evaluation of how to account for a licensing transaction under the new revenue standard, it is important for an entity to consider each of the five steps of the standard’s revenue recognition model (see Chapter 1 of Deloitte’s A Roadmap to Applying the New Revenue Recognition Standard for additional information about these five steps). Some of the key judgments that a life sciences entity will need to make are likely to be in connection with step 2 (identify the performance obligations) and step 5 (recognize revenue) of the model. Further, for licensing transactions in which consideration is tied to the subsequent sale or usage of intellectual property, judgments may also involve the determination of whether it is appropriate to apply the guidance in ASC 606-10-55-65 on the standard’s sales- or usage-based royalty exception, under which “an entity should recognize revenue for a sales-based or usage-based royalty promised in exchange for a license of intellectual property only when (or as) the later of the following events occurs:

a. The subsequent sale or usage occurs.

b. The performance obligation to which some or all of the sales-based or usage-based royalty has been allocated has been satisfied (or partially satisfied).
Application of the new revenue standard’s accounting and disclosure requirements to licensing arrangements has been a topic of focus for the SEC staff. Registrants in the life sciences industry have received staff comments asking them about how they determined (1) the number of performance obligations in a licensing arrangement and (2) the period(s) in which consideration allocated to each performance obligation should be recognized. In addition, the staff has inquired about the significant judgments made in the determination of whether a registrant provided a customer with a right-to-use or a right-to-access license, as well as about a registrant’s considerations related to the application of the sales- or usage-based royalty exception (e.g., in arrangements involving guaranteed or minimum royalty payments).

6.4.1.3 Collaborative Arrangements (ASC 606 and ASC 808)

**Examples of SEC Comments**

- [Y]ou entered into the [collaboration agreement with Entity X] to jointly develop and commercialize [Product A]. You state that you identified two performance obligations, consisting of the delivery of the licenses and your participation on joint steering and other collaboration committees. Your accounting policy . . . states that for collaboration arrangements with multiple performance obligations, such as granting a license and performing research and development activities, you allocate the upfront and milestone payments under a relative standalone selling price method. It is not clear why amounts for research and development in the [collaboration agreement with X] are not considered a performance obligation nor why . . . you record cost reimbursement payments to you from [X] as a reduction of research and development expense rather than as revenue. It appears to us that your separation, measurement, allocation and classification of amounts related to the [collaboration agreement with X] is inconsistent with your accounting policy . . . and with your accounting for your agreement with [Entity Y]. Please provide us an analysis with reference to authoritative literature supporting your accounting for the [collaboration agreement with X]. Also, provide us proposed revised accounting policy disclosure to be included in future filings addressing this inconsistency or tell us why revised disclosure is not necessary.

- Please provide us the following terms governing the [X] collaboration, as well as your consideration of providing additional disclosure pursuant to ASC 606-10-50:
  - Quantify the amount allocated to each performance obligation.
  - Describe and quantify the methods and assumptions used to determine standalone selling price for each collaboration.
  - Provide a range of milestone and other payment obligations to be received by stage (e.g. development, regulatory and commercialization).

- With regard to the $[X] million non-refundable, upfront license fee received in the [collaboration agreement with Entity A] and the estimates made in accounting for the agreement, please tell us:
  - [M]ore specifically what you mean by “Therefore, there was significant judgment applied in determining a reasonable, rational method of recognizing revenue under the [collaboration agreement with A], with the Company considering the guidance in ASC 606 Revenue from Contracts with Customers,” and whether and, if so, to what extent you analogized to ASC 606 or other literature and, if not, the basis in the accounting literature for the accounting you applied to separate, allocate, measure and recognize amounts within the collaborative arrangement,
  - [T]he amount allocated to each of [Compound B] and [Compound C] and your consideration of disclosing the amount allocated to each of [Compound B] and [Compound C] separately,
  - [H]ow you determined the five years over which you will complete development activities for [Compound B] when we note the FDA accepted a New Drug Application . . . ,
  - [Y]our basis in the accounting literature for recognizing milestone payments when achieved addressing regulatory milestones separately from sales milestones,
Examples of SEC Comments (continued)

- Why you record reimbursement for [X]% of your development activity expenses incurred as a reduction to research and development costs rather than as part of the transaction price for purposes of recording revenue given your accounting for research and development activities as a performance obligation that you recognize using the proportional performance method,
- The basis in the accounting literature for presenting in [201X] the co-promote loss as negative revenue rather than as an expense, and
- The breakout showing the amount and type of regulatory versus sales milestone related to the $[X] million in milestone payments upon [Compound B] regulatory approvals and first commercial sale events in certain major markets and an additional $[X] million in milestone payments upon [Compound C] regulatory approvals and first commercial sale events in certain major markets.

Collaborative arrangements are common among biotech and pharmaceutical companies. In the past, the SEC staff has asked registrants about the nature of, and accounting for, their collaborative arrangements and has probed to better understand the basis for such accounting under U.S. GAAP. Inquiries to registrants have focused on matters such as:

- The registrant’s conclusion about whether certain transactions with the collaboration partner represent true vendor-customer activities.
- The registrant’s accounting policies regarding separation (i.e., unit of accounting) and allocation (i.e., when multiple units exist) for collaborative arrangements.
- Supplemental explanation of the registrant’s determination and disclosure of (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 has also requested enhanced disclosure, when material, about registrants’ collaborative arrangements, including the overall effect of collaborative arrangements on the financial statements.

As part of registrants’ application of the new revenue recognition standard and the guidance in ASU 2018-18 on clarifying the interaction between ASC 808 and ASC 606, registrants need to evaluate whether transactions between partners in a collaborative arrangement are within the scope of the new revenue standard. Registrants should be mindful that the SEC staff may continue to ask registrants about their accounting policies for collaborative arrangements after the adoption of ASC 606 and ASU 2018-18.
6.4.2 Research and Development

**Examples of SEC Comments**

- Please tell us whether you track any component of your research and development expenses by drug candidate. . . . If so represent to us that you will revise your disclosure in future filings to disaggregate research and development expenses by drug candidate for each period presented. If not, tell us whether you can provide more granular information, perhaps by nature, such as manufacturing expenses, clinical trial costs, preclinical study expenses, etc. in order to provide more insight into your research and development activities. Otherwise tell us why you cannot provide such additional detail or why its disclosure is not warranted.

- You make several assertions regarding the safety and efficacy of certain of your product candidates. For example, in your discussion . . . regarding an ongoing Phase I/II study of [Candidate], you disclose that “the data demonstrated that [Candidate] continues to be safe and well-tolerated, with no new serious adverse events and no development of inhibitors.” In addition, in your discussion . . . of your preclinical [X] program, you disclose that these preclinical studies “demonstrate that [Candidate] appears to be safe due to a lack of off-target activity.” Safety and efficacy determinations are solely within the authority of the FDA (or applicable foreign regulator). Please revise your future filings to remove statements/inferences that your product candidates are safe and/or effective. You may provide the objective results of the clinical trial in relation to the stated end points and indicate whether the candidates were well tolerated.

- Please provide us an analysis of research and development expenses incurred for each year presented by product candidate. Consider providing us proposed disclosure to be included in future periodic reports to improve your disclosure.

- Please provide us a breakdown of your research and development (“R&D”) expenses incurred for each year presented by product candidate or project. To the extent that you do not track costs by project, please explain how your R&D costs are managed and how they are reported within the organization. To the extent that you can distinguish your R&D costs by discovery, preclinical and clinical development categories and/or therapeutic class or by the type of cost, please provide us with this information. Please also tell us your consideration of disclosing this information given that you consider research and development to be essential to your business.

- [Y]ou indicate that your external research and development costs include legal fees. Please tell us:
  - The nature of these legal fees;
  - The amount of legal fees included in research and development expenses in each of the last three fiscal years and the [first through third quarters of 201X]; and
  - How these legal fees meet the definition of either research or development in ASC 730-10-20 and your consideration of the guidance in ASC 730-10-55-2i.

- You disclose that inventory costs incurred prior to receipt of regulatory approval are charged to research and development costs when incurred. You also disclose . . . that inventories on your period end balance sheets are comprised primarily of raw materials purchased subsequent to FDA approval of [Product A]. Please tell us the following:
  - The dollar value of pre-approval inventory costs charged to research and development costs and the calendar years in which those costs were expensed.
  - An estimate of what cost of sales as a percentage of product revenue, net would have been for each quarter from the third quarter of [fiscal year 1] through the third quarter of [fiscal year 2] if you had not charged pre-approval inventory costs to research and development expenses.
  - The estimated amount of future product revenue, net from sales of the zero-cost/low-cost inventory (i.e. inventory that excludes costs charged to expense prior to regulatory approval) on hand at September 30, [201X] and the expected period of time over which it will be sold.

R&D costs are pivotal to life sciences entities as they fuel the future pipeline. Entities can spend billions of dollars on R&D costs in hopes of developing and gaining approval for their next blockbuster drug. These costs are generally classified separately in the income statement and are often a focus of financial statement users since they may provide insight into the entity’s future revenues. Given this focus, the SEC staff often asks registrants in the life sciences industry to disclose in MD&A additional details...
related to their R&D programs, including R&D expenses by drug candidate for each period presented and the nature of R&D costs incurred (e.g., manufacturing expenses, clinical trial costs, preclinical study expenses) to provide more insight into R&D activities and their outcomes. Registrants should also be mindful regarding disclosures of safety and efficacy of their treatments or devices before obtaining the requisite regulatory approval.

In addition, the SEC staff often asks registrants with significant R&D costs to support the classification of the costs comprising the amounts disclosed and explain how the classification is in accordance with ASC 730-10-20. Registrants should be prepared to support their R&D classification by demonstrating careful evaluation of costs under ASC 730.

It is also important for life sciences companies to provide robust disclosures about capitalizing prelaunch inventory since the SEC staff has historically focused on the capitalization of prelaunch inventory that has not been approved by the FDA. Specifically, the staff has asked registrants to quantify the total amount of capitalized unapproved inventory and clarify their accounting policy for the capitalization of unapproved products. In addition, the staff may ask a registrant to provide disclosures that help a reader understand the comparability of cost of sales in periods before and after prelaunch inventory began to be capitalized.

### 6.4.3 Business Combinations

<table>
<thead>
<tr>
<th>Examples of SEC Comments</th>
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</thead>
<tbody>
<tr>
<td>• You recorded the . . . acquisitions as asset acquisitions. Please tell us, for each acquisition, why you believe the acquisitions are not required to be recorded as an acquisition of a business pursuant to ASU 2017-01. In this [regard], please specifically address the following:</td>
</tr>
<tr>
<td>◦ As it appears you acquired both tangible and intangible assets in the [first] acquisitions and the [subsequent] acquisition appears to relate to assets with significantly different risks, please confirm our understanding that the acquisitions did not meet the “practical screen” in ASC 805-10-55-5A through 55-5C as the term is used in ASC 805-10-55-5. Refer also to the example in ASC 805-10-55-68.</td>
</tr>
<tr>
<td>◦ Please address each of the criteria in ASC 805-10-55-5E in determining whether or not a substantive process was acquired, that together with the input acquired, significantly contribute to the ability to create outputs.</td>
</tr>
<tr>
<td>• With respect to the [p]roduct [r]ights [a]cquired from [Company A], your response does not consider risks, other than marketing and promotional risks. At a minimum, please address the following potential risks:</td>
</tr>
<tr>
<td>◦ The drugs are intended to treat significantly different conditions which bear the risk of potentially different long-term side effects. Branded drugs are subject to litigation which may not occur for years after being marketed;</td>
</tr>
<tr>
<td>◦ Each drug has a significantly different potential customer base with different regulatory risks;</td>
</tr>
<tr>
<td>◦ Each drug has different risks with respect to being on drug formulary lists; and</td>
</tr>
<tr>
<td>◦ Although the products have been marketed for more than [X] years, the competition differs for each of the different drugs, despite the lack of promotional activity for the drugs.</td>
</tr>
</tbody>
</table>

In light of the risks, other than marketing and promotional risk, please tell us why you believe the product rights acquired from [A] do not have significantly different risk characteristics and thus meet the “practical screen” test in ASC 805-10-55-5A through 55-5C. If the acquisitions do not meet the “practical screen test” please address each of the criteria in ASC 805-10-55-5E in determining whether or not a substantive process was acquired, that together with the input acquired, significantly contribute to the ability to create outputs.
In recent years, the life sciences industry has seen an increase in mergers and acquisitions activity. While many entities in the industry have sought ways to expand their pipeline of products in development or acquire additional commercial products, others have explored how to generate additional returns on assets that are no longer a strategic focus.

Accounting for a transaction as a business combination differs significantly from accounting for a transaction as an asset acquisition. Accordingly, the SEC staff has often issued comments to life sciences companies related to whether the acquired set meets the definition of a business and has further inquired about the basis for the registrants’ conclusions.

In January 2017, the FASB issued **ASU 2017-01**, which clarifies the definition of a business in ASC 805 and provides a framework that an entity can use to determine whether a set of activities and assets constitutes a business. The ASU includes several examples that illustrate how a life sciences entity would apply the guidance in the standard. The amendments in the ASU became effective for PBEs for annual periods beginning after December 15, 2017, including interim periods therein. Although the SEC staff has issued fewer comments related to whether the acquired set meets the definition of a business since the effective date of the new guidance, the staff has asked registrants to explain how they applied the new definition of a business, including the ASU’s “practical screen” for determining when a set is not a business. See Section 2.1.1 for additional information.

**6.4.4 Non-GAAP Measures**

<table>
<thead>
<tr>
<th>Examples of SEC Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>• We note that you present the forward-looking non-GAAP measure adjusted diluted earnings per share without providing the reconciliation to the most directly comparable GAAP financial measure or the statement that providing such reconciliation requires unreasonable efforts. Refer to Item 10(e)(1)(i)(B) of Regulation S-K and the guidance in Question 102.10 of the Compliance and Disclosure Interpretations on Non-GAAP Financial Measures and revise your future filings to provide the required information.</td>
</tr>
<tr>
<td>• It appears that you are presenting non-GAAP adjusted net loss and net loss per share as liquidity measures based on your statement that these measures remove the impact of stock-based compensation due to your emphasis on cash burn and, more specifically, cash used in operations. As such, please revise to provide a reconciliation of adjusted net loss to the most directly comparable GAAP measure for a liquidity measure (i.e., cash flows from operations). In addition, please note that non-GAAP liquidity measures that measure cash generated must not be presented on a per share basis. Whether per share data is prohibited depends on whether the non-GAAP measure can be used as a liquidity measure, even if management presents it solely as a performance measure. Refer to Question 102.05 of the updated Non-GAAP Compliance and Disclosure Interpretation.</td>
</tr>
<tr>
<td>• Describe the nature and purpose of the following non-GAAP adjustments and explain the factors that you considered in excluding them from the non-GAAP financial measures: re-measurement of royalties for medicines acquired through business combinations, drug substance harmonization costs, upfront and milestone payments related to license agreements, accretion of royalty liabilities and royalties for medicines acquired through business combinations.</td>
</tr>
<tr>
<td>• Please disclose your purpose for including the adjustments for “milestones received from new or existing partners” and “upfront consideration and milestones paid to new or existing partners” in calculating the non-GAAP net income and non-GAAP net income per share measures. Also, tell us how you determined these adjustments do not substitute individually-tailored income or expense recognition methods for those of GAAP. Refer to Question 100.04 of the Division's Non-GAAP Financial Measures Compliance and Disclosure Interpretations.</td>
</tr>
</tbody>
</table>
In the life sciences industry, there have been noted improvements in the form of registrants’ non-GAAP disclosures, as indicated by a decline from past years in the number of comment letters issued.

The SEC staff has continued to evaluate the form of preparers’ non-GAAP disclosures in the context of the C&DIs. Recently, the staff has focused more acutely on the appropriateness and usefulness of the metrics presented and the nature and description of the adjustments included therein. For example, some companies in the life sciences community make adjustments for up-front, milestone, and royalty payments made to or received from other parties to business development transactions. The SEC staff has commented on the nature and purpose of these adjustments.

Companies should continue to evaluate the form of their non-GAAP information in filings and press releases and should consider the details about the facts and circumstances supporting the metrics presented, the adjustments included therein, and the usefulness of those items to external stakeholders and the investing community.

For additional discussion of non-GAAP comment letter trends, see Section 3.4.

6.4.5 Disclosures Regarding State Sponsors of Terrorism

Example of an SEC Comment

You disclose sales in the Middle East and Africa, regions that include Syria and Sudan. Your disclosure does not discuss contacts with those countries. As you know, Syria and Sudan are designated by the State Department as state sponsors of terrorism and are subject to U.S. sanctions and/or export controls. Please describe to us the nature and extent of any past, current, and anticipated contacts with Syria and Sudan . . . , including with their governments, whether through subsidiaries, distributors, resellers, affiliates, or other direct or indirect arrangements. Please also discuss the materiality of any contacts, in quantitative terms and in terms of qualitative factors that a reasonable investor would deem important in making an investment decision. Tell us the approximate dollar amounts of any revenues, assets and liabilities associated with Syria and Sudan for the last three fiscal years and the subsequent interim period. . . . Finally, tell us whether any contacts involve dual use products and, if so, the nature of the dual uses.

Life sciences companies operate in multiple countries and regions around the world. The SEC staff has recently commented on registrants’ disclosures about the nature and extent of their activities related to countries identified by the U.S. State Department as state sponsors of terrorism that are subject to U.S. sanctions, export controls, or both. For example, the staff has asked registrants to quantitatively and qualitatively discuss the level of their past, current, and planned future contacts with such countries and to describe their process for monitoring and complying with any applicable sanctions or export controls. For additional discussion of comment letter trends related to state sponsors of terrorism, see Section 3.9.5.

6.4.6 Other Disclosure Considerations

Example of an SEC Comment

We note that you rely very heavily on defined terms throughout the filing and, especially so, in the Analysis of Results of Operations. When preparing your future filings, consider using defined terms sparingly in your discussions and disclosures so that investors can more easily read and comprehend the information. Refer to Staff Legal Bulletin 7. See also the guidance provided in the SEC’s Plain English Handbook found at www.sec.gov/pdf/handbook.pdf.
Life sciences companies invest millions of dollars to develop and commercialize proprietary devices, treatments, compounds, or therapies that are key drivers of the financial performance of their companies and, therefore, a key factor used by investors. The SEC staff has recently commented on registrants’ disclosures about the use of defined or proprietary language when discussing financial results and the impact that has on the investor’s ability to understand those disclosures. Registrants should continue to carefully evaluate the terms and definitions used to disclose their operating results to ensure those investors can easily understand the trends and drivers of their financial results being disclosed within MD&A.

Other Deloitte Resources

- A Roadmap to Accounting for Business Combinations
- A Roadmap to SEC Reporting Considerations for Business Combinations
- Life Sciences Industry Accounting Guide
- A Roadmap to Non-GAAP Financial Measures and Metrics

6.5 Technology, Media, and Telecommunications

6.5.1 Technology

6.5.1.1 Capitalized Software Development Costs

Example of an SEC Comment

We note your policy disclosure regarding internally developed software costs and that no internally developed software costs were capitalized during the periods presented. Please describe for us the development process related to your internal-use software, highlighting recently developed offerings and added functionality, and explain why there [were] no development costs capitalized during the periods presented. Also, describe for us how you apply the guidance in ASC 350-40-25 and what consideration was given to disclosing your policies for internal-use software development costs particularly since your software is provided in a software-as-a-service platform.

ASC 985-20 provides guidance on accounting for costs incurred to purchase or internally develop software that will be sold, leased, or marketed. Under this guidance, costs incurred to establish technological feasibility of the software are expensed as incurred, whereas subsequent production costs (e.g., those for testing or producing master copies) are capitalized.

ASC 350-40 details how to (1) determine whether purchased or internally developed software is for internal use and (2) account for costs incurred for developing or obtaining internal-use software. Under this guidance, costs incurred during the preliminary project and postimplementation stages are generally expensed as incurred, while certain costs incurred during the application development stage are capitalized. Internal-use software is described as being “acquired, internally developed, or modified solely to meet the entity’s internal needs” and as being developed with no substantive plan to “market the software externally.” Therefore, if the software is used to produce a product or is used in a process to provide a service to the customer, but the customer is not given the right to obtain or use the software, the related costs would be accounted for in accordance with ASC 350-40.

The accounting for software development costs can be complex and challenging, and the costs that are eligible for capitalization may depend on whether the costs are accounted for in accordance with ASC 985-20 or ASC 350-40.
6.5.1.2 Costs Related to Contracts With Customers

Examples of SEC Comments

- You state that there are no new costs to obtain or fulfill incurred upon renewal unless the client signs on for additional applications, at which time costs to fulfill are minimized. Please tell us whether additional commissions are paid when clients purchase additional applications. If so, tell us whether such costs are commensurate with the initial commissions and the period of time over which you amortize commission costs related to additional purchases. Refer to ASC 340-40-35-1.

- Please tell us, and revise to clarify, whether sales commissions paid upon contract renewal are commensurate with the initial commissions and disclose how commissions paid for renewals are considered in the three to seven year period of benefit for the initial commission. You also disclose that renewals are amortized over the “remaining period of benefit.” Please tell us whether the period of benefit for these commissions exceeds the term of the respective customer contract and if so, explain what the remaining period of benefit represents and how your policy complies with ASC 340-40-35-1. Also refer to ASC 340-40-50-2(b).

- You disclose that you apply a practical expedient to expense sales commissions as incurred when the amortization period would have been one year or less. Please tell us whether sales commissions are earned on contract renewals and if so, how you considered those in determining the amortization period.

- You disclose that certain sales commissions associated with multi-year contracts are subject to an employee service requirement and are expensed as incurred as they are not considered incremental costs to obtain a contract. Please tell us the nature of the service requirement and how it impacted your consideration in accounting for these sales commissions. Also, tell us whether sales commissions are earned on multi-year contracts that are not subject to an employee service requirement and, if so, how you account for such commissions.

- Please tell us, and revise to clarify, whether sales commissions paid upon contract renewals are commensurate with the initial commissions and disclose how commissions paid for renewals are considered in the 8 year period for the initial commission. You also disclose that renewals are amortized over 18 months. Please tell us whether this exceeds the term of the respective customer contract and if so, explain how your policy complies with ASC 340-40-35-1. Lastly, please tell us how you determined the 4 year amortization period for add-ons. Refer to ASC 340-40-50-2(b).

ASC 340-40 provides guidance on accounting for costs related to an entity’s contract with a customer, including (1) incremental costs of obtaining a contract within the scope of ASC 606 and (2) costs of fulfilling a contract with a customer that are not within the scope of another standard. Under ASC 340-40-25-1 and 340-40-25-3, costs incurred to obtain a contract with a customer that the entity would not have incurred had the contract not been obtained are capitalized and recognized as an asset, while costs of obtaining a contract that would have been incurred regardless of whether the contract was obtained are “recognized as an expense when incurred, unless those costs are explicitly chargeable to the customer regardless of whether the contract is obtained.”

ASC 340-40 details how to determine (1) whether particular costs are incurred to obtain a contract with a customer and (2) the amortization period for such costs. Under this guidance, an entity should consider whether such costs would have been incurred had the customer decided that it would not enter into the contract just before the contract was ready to be signed; if so, the costs would not be incremental to obtaining the contract. An example of incremental costs incurred to obtain a contract would be commission payments to employees. The accounting for commission payments requires significant judgment when the entity has a tiered commission structure that includes payments the entity makes upon obtaining new contracts as well as payments the entity makes upon contract renewals. The entity should consider whether the commission paid upon a contract renewal is commensurate with the initial commission. This determination will also affect the determination of the amortization period under ASC 340-40-35-1.
6.5.1.3 Recognition of Revenue From Contracts With Customers

In the technology industry, contracts with customers typically have multiple performance obligations. Consequently, when the SEC staff reviews the filings of registrants in the technology industry, 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 promised goods or services in an arrangement, how they determined the stand-alone selling prices of those promised goods or services, and the timing of each element’s delivery or performance.

6.5.1.3.1 Identification of Performance Obligations

<table>
<thead>
<tr>
<th>Examples of SEC Comments</th>
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<tbody>
<tr>
<td>• You state in your . . . Form 10-K that you offer specified upgrades and new license products. Please tell us how you have considered these obligations under ASC 606 and clarify if they represent separate performance obligations.</td>
</tr>
<tr>
<td>• You disclose that certain software licenses and related post-contract support are combined into a single performance obligation when ongoing services provide frequent and critical updates to maintain the continued functionality of the software. Please describe the software licenses and services you combine into a single performance obligation. Explain how you considered the guidance in ASC 606-10-25-21.</td>
</tr>
<tr>
<td>• You state that you combine intelligence dependent appliances and software licenses with the related intelligence subscription and support as a single performance obligation. Please explain further the nature of your support services and how you determined that such services are not separately identifiable from the appliance and related software. Refer to ASC 606-10-25-19 and 25-21.</td>
</tr>
<tr>
<td>• You disclose that your SaaS-based and PaaS-based arrangements represent a single promise to provide continuous access, a stand-ready performance obligation, to your software solutions and [the software’s] processing capabilities. You also indicate that fixed consideration under these arrangements may relate to a material right. Please tell us, and revise your disclosures to clarify, whether the material right is a separate performance obligation and if and how you have allocated consideration to this promise. Reference ASC 606-10-55-41.</td>
</tr>
<tr>
<td>• You disclose . . . that customer licensing arrangements include the term license, implementation services, and annual support inclusive of unspecified upgrades and enhancements, and that these promises represent one combined performance obligation because they are not distinct in the context of the contract. Please tell us how you made this determination and considered the guidance in ASC 606-10-25-21.</td>
</tr>
</tbody>
</table>

When a contract is identified and determined to be within the scope of ASC 606, all promised goods and services should be identified. ASC 606-10-25-18 provides examples of certain items that could constitute promised goods or services in an entity’s contract with a customer, and the entity should evaluate whether such promised goods or services are distinct (i.e., capable of being distinct and distinct within the context of the contract). Such promises could be implied on the basis of business practice or explicitly stated in the contractual agreement; however, the entity is not required to identify immaterial promises.

ASC 606-10-25-19 states that a promised good or service is distinct if (1) the “customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (that is, the good or service is capable of being distinct)” and (2) the “entity’s promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (that is, the promise to transfer the good or service is distinct within the context of the contract).” If both of these criteria are met, the entity should consider the guidance in ASC 606-10-25-14 to determine whether the promised good or service is part of a series of goods or services that (1) are substantially the same and (2) have the same pattern of transfer to the customer as defined in ASC 606-10-25-15. If the criteria in ASC 606-10-25-14 are not met, the unit of accounting is the individual
distinct good or service; alternatively, if these criteria are met, the unit of accounting is the series of distinct goods or services. In accordance with ASC 606-10-25-22, if the promised good or service is not distinct, the entity should “combine that good or service with other promised goods or services until it identifies a bundle of goods or services that is distinct.”

Technology companies need to use significant judgment when identifying performance obligations in a contractual agreement. For example, multiyear license agreements typically contain the software license as well as postcontract customer support (PCS). Under legacy revenue guidance, an entity may not have had vendor-specific objective evidence of fair value for the software license or PCS in the arrangement because the software license and the PCS were frequently bundled. Under ASC 606, an entity is required to assess whether the software license and the PCS are each distinct; this determination could affect the identification of performance obligations, the allocation of the arrangement’s contract value to each performance obligation, and the timing of revenue recognition. When combining promised goods and services into one performance obligation, the entity should evaluate the guidance in ASC 606-10-25-20 and 25-21.

### 6.5.1.3.2 Estimation of the Stand-Alone Selling Price

<table>
<thead>
<tr>
<th>Examples of SEC Comments</th>
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</thead>
<tbody>
<tr>
<td>• You indicate that you use the residual approach to estimate the standalone selling price for your software licenses since the same products are sold to different customers at a broad range of prices, which are highly variable. Please provide a comprehensive, quantitative discussion of such variability to support your conclusion.</td>
</tr>
<tr>
<td>• Please tell us the methods, inputs, and assumptions used to determine the transaction price and allocation of the transaction price for each of your performance obligations. Clarify how your existing disclosures comply with ASC 606-10-50-20.</td>
</tr>
<tr>
<td>• We note from your response . . . that you sometimes use the residual approach to estimate the standalone selling price for sales of new products, services and [X] software suite offerings. Please tell us how you met one of the criteria in ASC 606-10-32-34(c), and to the extent material please provide a comprehensive discussion to support use of the residual approach for new products, services and [X] software suite offerings.</td>
</tr>
</tbody>
</table>

Under ASC 606-10-32-28, an entity should allocate the transaction price of a contract with a customer to the promised goods or services “in an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services to the customer.” In arrangements with multiple performance obligations, the transaction price must be allocated to the promised goods or services on a relative stand-alone selling price basis. To determine the stand-alone selling price of each promised good or service, an entity considers the price at which it would separately sell a promised good or service to a customer. The best evidence of this separate price is the price associated with a stand-alone sale of the promised good or service in similar arrangements. However, in the absence of observable evidence, an entity could use alternative approaches, including (1) the adjusted market assessment approach, (2) the expected cost plus a margin approach, and (3) the residual approach.

The residual approach should be used only when the stand-alone selling price of a good or service is not directly observable and is either highly variable or uncertain. In such cases, it may be appropriate for an entity to use the residual approach if, for example, the entity (1) sells the same good or service to different customers at a broad range of prices or (2) has not yet established a price for the good or service.
The SEC staff focuses on how registrants in the technology industry allocate consideration to promised goods or services in arrangements with customers that involve multiple performance obligations, and the staff may request additional information about the factors, inputs, and assumptions used to determine the stand-alone selling price of each promised good or service. The application of these factors, inputs, and assumptions requires judgment, particularly in the evaluation of promised goods or services that are not sold on a stand-alone basis.

For example, suppose that an entity does not sell software licenses on a stand-alone basis but instead sells term-based licenses in bundles that include both a right-to-use software license and PCS. To establish the stand-alone selling prices of the software license and the PCS, the entity must first determine whether the software license and the PCS are each capable of being distinct and distinct within the context of the contract. If the entity determines that the software license and the PCS meet both of these criteria, it should then consider observable data points if they exist. In addition, when the entity is establishing the stand-alone selling prices of the software license and PCS, it may be appropriate for the entity to consider (1) the value relationship between the PCS and the software license if PCS is typically priced as a percentage of the license fee, (2) the economic life of the entity's software, and (3) the renewal rates of the entity's customers.

### 6.5.1.3.3 Timing of Revenue Recognition

<table>
<thead>
<tr>
<th>Examples of SEC Comments</th>
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</thead>
<tbody>
<tr>
<td>• You state that on-premise revenue is recognized upon delivery and transfer of control of the underlying license to the customer. Please clarify whether your reference to &quot;the customer&quot; means a channel partner such as reseller, distributor or system integrator, or end-user customer. Also, tell us how you determine when the customer has obtained control. Refer to ASC 606-10-25-30 and 606-10-50-19.</td>
</tr>
<tr>
<td>• Please help us better understand the nature of services associated with setup fees, including whether they are recurring or one-time. If material, please revise your future filings to describe the timing of revenue recognition associated with these fees. Please refer to ASC 606-10-50-18 and 50-19.</td>
</tr>
<tr>
<td>• Please tell us what consideration was given in disclosing the measure of progress of each type of service revenue and how each method depicted your performance in transferring control of goods or services promised to a customer. We refer you to ASC 606-10-25-31 and 25-33.</td>
</tr>
<tr>
<td>• We note that a majority of your SaaS subscription revenues are satisfied over time with certain SaaS performance obligations satisfied at a point in time. Please clarify the nature of the services that are satisfied at a point in time and what consideration was given to disaggregating revenue from contracts with customers into categories that depict how the nature and timing of revenue and cash flows are affected by economic factors. We refer you to ASC 606-10-50-5 and 55-91(f).</td>
</tr>
</tbody>
</table>

ASC 606-10-25-23 requires an entity to “recognize revenue when (or as) the entity satisfies a performance obligation by transferring a promised good or service (that is, an asset) to a customer.” The satisfaction of a performance obligation is determined by the transfer of control of an asset to a customer. ASC 606-10-25-25 states, in part, that “[c]ontrol of an asset refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. Control includes the ability to prevent other entities from directing the use of, and obtaining the benefits from, an asset.” If control is transferred over time, revenue will be recognized over time in a manner that depicts the entity’s performance in transferring control of the promised good or service. If control is transferred at a point in time, revenue will be recognized at that point.
For an entity to recognize revenue over time, one of the following criteria in ASC 606-10-25-27 must be met:

- “The customer simultaneously receives and consumes the benefits provided by the entity’s performance as the entity performs.”
- “The entity's performance creates or enhances an asset (for example, work in process) that the customer controls as the asset is created or enhanced.”
- “The entity's performance does not create an asset with an alternative use to the entity . . . , and the entity has an enforceable right to payment for performance completed to date.”

If any one of these criteria is met, an entity should recognize revenue over time by using a method that depicts the pattern of transfer of control to the customer. ASC 606-10-25-33 indicates that input or output methods are appropriate methods of measuring progress when revenue is recognized over time.

However, ASC 606-10-25-30 indicates that when a performance obligation is not satisfied over time, revenue related to the performance obligation should be recognized at the point in time at which the performance obligation is satisfied. This is typically the case when an entity sells perpetual and term-based software licenses.

### 6.5.1.4 Disclosures About Non-GAAP Measures and Key Metrics in MD&A

#### Examples of SEC Comments

- In the highlight section, you present non-GAAP organic revenue growth, adjusted EBIT margin growth and adjusted EPS growth without also presenting the change in the comparable GAAP measures. Your presentation appears to give greater prominence to the non-GAAP measures, which is inconsistent with the Question 102.10 of the Compliance and Disclosure Interpretations on Non-GAAP Financial Measures. Please revise your future earnings releases to comply with that guidance.

- Your revised disclosure . . . indicates that the Daily Active User growth was relatively flat in the latter part of the quarter . . . . Expand your disclosure to explain the factors that impacted your user growth rate during this period. . . . You state . . . that in the past you relied on third-party analytics to calculate your metrics and that your metrics may not be comparable to prior periods. To understand comparability among periods, revise to disclose when you shifted to using internally generated analytics, particularly Daily Active Users.

- We note that you adjust the income tax provision to reflect the expected cash taxes to be paid in your calculation of Non-GAAP adjusted net income. Your income tax adjustment is inconsistent with Question 102.11 of the updated Non-GAAP Compliance and Disclosure Interpretations issued on May 17, 2016. Please revise the tax adjustment in future filings to reflect the current and deferred tax expense commensurate with the non-GAAP measure of profitability.

- We note that you present forward looking non-GAAP measures for various financial line-items without providing the reconciliation to the most directly comparable GAAP financial measure or the statement that providing such reconciliation requires unreasonable efforts. Refer to Item 10(e)(1)(i)(B) of Regulation S-K and the guidance in Question 102.10 of the Compliance and Disclosure Interpretations on Non-GAAP Financial Measures and revise your future filings to provide the required information.

Within MD&A, registrants in the technology industry often use non-GAAP measures and key metrics to convey additional relevant information to investors.
The metrics used may differ significantly among such registrants given the different service offerings provided. Metrics commonly used in the 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 in the industry when (1) certain metrics are not explained in MD&A, (2) changes are not appropriately quantified, and (3) 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 Interpretive Release No. 33-8350 (34-48960) and Regulation S-K, Item 303(a)(3)(iii).

Because of the vast volume of the metrics used, the SEC staff has been concerned that (1) metrics may not be presented with appropriate context and (2) the link between registrants’ key metrics and their income and future profitability may not be clear. Registrants should review their metrics to ensure that the metrics are clearly defined, portray a balanced discussion, and remain relevant. For additional considerations related to non-GAAP measures and certain financial or operating metrics, see Section 3.4.

6.5.2 Telecommunications

The SEC staff's comments to registrants in the telecommunications industry have recently focused on the adoption of the new revenue recognition standard, ASC 606.

6.5.2.1 Revenue Recognition

<table>
<thead>
<tr>
<th>Examples of SEC Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Please tell us the nature of the specific goods and services that you consider separate performance obligations, particularly as it relates to video entertainment, legacy voice and data as well as strategic services. Please refer to ASC 606-10-50-12.</td>
</tr>
<tr>
<td>• Please clarify the nature of the equipment and services for which you recognize revenue on a gross basis and those for which you recognize revenue on a net basis. In addition, provide us with a comprehensive analysis regarding how you concluded you were the principal or agent in the related arrangements. Please refer to ASC 606-10-50-12(c) and ASC 606-10-55-36 through 55-40.</td>
</tr>
<tr>
<td>• For contracts that require the use of certain equipment in order to receive service, please tell us the significant judgements used in determining if equipment should be considered a separate performance obligation. Please refer to ASC 606-10-25-19 through 25-22.</td>
</tr>
<tr>
<td>• Please identify the specific products and/or services transferred to your customers within your distribution and affiliate agreements. Tell us if you have combined any products and/or services for purposes of determining your performance obligations. . . . Please also describe the judgements used in determining both the timing of satisfaction and amounts allocated to each performance obligation. Refer to ASC 606-10-50-12 and 606-10-50-17.</td>
</tr>
</tbody>
</table>

The SEC staff has asked registrants in the telecommunications industry to expand or clarify their disclosures related to revenue recognition under ASC 606. For example, the staff has asked registrants in the industry to provide details about their compliance with the new revenue standard's expanded disclosure requirements. The staff has indicated that such registrants must provide more comprehensive information related to the significant judgments that affect the amount of revenue recognized and the timing of revenue recognition.
As the telecommunications industry continues to evolve and new products are introduced, registrants in the industry must consider updating their disclosures about the significant judgments that may affect revenue recognition, including judgments related to performance obligations, transaction prices, and costs of obtaining a contract with a customer. For example, various service and equipment offerings that wireless operators make available to subscribers through multiple distribution channels can affect factors such as the allocation of transaction prices, the timing of satisfaction of performance obligations, and the determination of whether the reporting entity is acting as a principal or as an agent. The conclusions reached may be matters of judgment that can have significant implications for revenue recognition and disclosures under the new standard. Changes in judgments made in the application of the standard may require registrants to provide additional disclosures that clarify comparability for investors. As registrants' businesses and offerings evolve, their new business practices are likely to draw further SEC staff scrutiny if their relevant revenue recognition policies and considerations are not clearly disclosed.

For information about other revenue-related considerations, see Section 2.17.
Appendix A — SEC Staff Review Process

The SEC’s Division of Corporation Finance (the “Division”) conducts selective and required reviews of filings made under the Securities Act and the Exchange Act. Since September 29, 2019, the Division’s disclosure program has operated under a revised organizational structure consisting of the following four groups:

- **Disclosure Review Program** — Performs most of the selective and required reviews. Reviews are conducted by the following seven review offices:
  - Energy & Transportation.
  - Finance.
  - Life Sciences.
  - Manufacturing.
  - Real Estate & Construction.
  - Technology.
  - Trade & Services.

Registrants are assigned to a specific review office on the basis of their industry, and each office is staffed by professionals with specialized industry, accounting, and disclosure review expertise. Before the organizational change, each registrant subject to a disclosure review was assigned to one of 11 assistant director offices.

- **Specialized Policy and Disclosure** — Handles matters related to international corporate finance, mergers and acquisitions, structured finance, and corporate governance.

- **Office of Risk and Strategy** — Provides guidance to Division staff on emerging risks and related disclosures.

- **Office of Assessment and Continuous Improvement** — Evaluates the effectiveness of the Disclosure Review Program.

For more information on the revised organizational structure, including the name of the chief and the senior adviser of each review office, see the Division’s announcement.

The SEC’s Web site includes an overview that explains the Division’s filing review and comment letter process. The overview aims to increase transparency in the review process and expresses the staff’s willingness to discuss issues with registrants. The overview indicates that the Division focuses “on critical disclosures that appear to conflict with Commission rules or applicable accounting standards and on disclosure that appears to be materially deficient in explanation or clarity.” In addition, the overview notes that the “Division completes many filing reviews without issuing comments.”
The overview encourages registrants to view the comment letter process as a dialogue and states that “[i]f a company does not understand a comment or the staff’s purpose in issuing it,” the company may “seek clarification [first] from the examiner” and then from “the staff member who approved the comment.” In addition, registrants may request “[a]t any time during the filing review process . . . that the staff reconsider either a previously-issued comment or its view of the company's response to a comment.” Although the Division does not require registrants to follow a formal protocol for seeking reconsideration, such a request should be directed to the chief of the office conducting the review. Further, registrants “should feel free to involve the Disclosure Program Director, the Division’s Deputy Director or Director at any stage in the filing review process.”

Registrants may also 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 or proactively communicate with the SEC staff regarding expected timing. 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 and company responses to those letters are made public, via the SEC’s Web site, at least 20 business days after the Division has completed its review of a periodic or current report or declared a registration statement effective. See Appendix C for tips for searching the SEC’s comment letter database.

In certain instances, the SEC staff may conclude that a registration statement or offering document is so deficient that the staff will defer review until such filing is amended to address the deficiencies. Historically, the staff has communicated this to registrants on a confidential basis. Since 2018, however, in a manner consistent with the SEC’s effort to improve transparency, letters requiring registrants to amend their filings to resolve the deficiencies before the staff commences its review have been made public via the SEC’s Web site within 10 days of issuance. Thus far, the issuance of such letters has been limited.

1 Contact information is provided in the concluding paragraph of a comment letter.
Appendix B — Best Practices for Working With the SEC Staff

B.1 Managing Unresolved SEC Comment Letters

The best practices below are intended to help registrants resolve any staff comment letters in a timely manner. Unresolved comments may affect a registrant’s ability to issue financial statements and an auditor’s ability to issue the current-year audit report. In addition, when responding to staff comment letters, registrants should be mindful of their responses because all responses to staff comment letters are made publicly available and become part of a registrant’s “total mix of information” and disclosure records (i.e., investors may read such responses similarly to how they interpret a registrant’s other filings and publicly available information).\(^1\) A registrant should therefore do the following:

- Review the comment letter immediately and respond to the SEC staff reviewer (named in the letter) within the time indicated in the comment letter (usually 10 business days). If possible, the registrant should not request an extension, since this may delay resolution of the comment letter. However, in certain circumstances, the registrant should consider requesting an extension to provide a more thorough and complete response that addresses all of the staff’s comments.
- If the registrant does not fully understand any specific comment, it should contact its SEC staff reviewer quickly for clarification so that it can provide an appropriate response.
- Consider the impact the comment letter may have on its ability to issue the financial statements.
- Consult with its SEC legal counsel about the impact the comment letter may have on the certifications contained in its Form 10-K or Form 10-Q.
- Consult with its auditors to discuss the impact the comment letter may have on their ability to issue the current-year audit report.
- Include in the response a discussion of supporting authoritative accounting literature and references to the specific paragraph(s) from the standard(s).
- Because some comments may request disclosure in future filings, the registrant should consider including such disclosure in the response letter to potentially eliminate additional requests from its SEC staff reviewer.
- If an immaterial disclosure is requested, the registrant should consider explaining why the disclosure is immaterial instead of including the immaterial disclosure in future filings.
- Maintain contact with its SEC staff reviewer and make the reviewer aware of the registrant’s required timing (on the basis of its current-year filing deadlines).

\(^1\) The SEC staff discussed this topic at the 2012 AICPA Conference. Refer to Deloitte’s December 11, 2012, *Heads Up* for more information.
• If the registrant 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.

Further, at recent AICPA Conferences, the SEC provided the following additional recommendations and reminders for registrants to consider when communicating with the SEC staff during the comment letter process:

• Just because the staff asks a question does not mean that it has reached a conclusion or that a change is required.

• A registrant should not agree to include a disclosure in future filings solely to expedite the completion of a review.

• If a registrant believes that a comment concerns an immaterial matter, the registrant should communicate that belief to the staff early in the review process.

• A registrant should use caution when analogizing to other registrants’ fact patterns since a small difference in facts could make a meaningful difference in the response.

• A registrant should ensure that the SEC staff is provided enough time to appropriately evaluate substantive new information during the review process.

• Provide the staff with contact information for the responding company and its outside counsel.

• Clearly and directly address the issues raised in the comments.

• When calling the staff with an interpretive or procedural question, do not assume that the staff has all the facts. Responding registrants should do the appropriate research, provide sufficient background information, and present an analysis that points to relevant authoritative literature.

• The scope of the staff’s review encompasses information beyond the review of specific filings to include other information, such as press releases, information on a registrant’s Web site, analyst calls, and investor presentations.

• Given the significant impact of registrants’ adoption of new accounting standards, the staff will be focusing on registrants’ accounting and disclosures upon adoption of such guidance. The staff indicated that it will accept reasonable judgments and will work with the SEC’s Office of the Chief Accountant (OCA) to resolve material issues that arise.

B.1.1 Oral Comments

In certain circumstances, the SEC staff may provide oral comments to a registrant instead of a written comment letter. At the 2018 AICPA Conference, Cicely LaMothe, associate director of the SEC’s Division of Corporation Finance (the “Division”), offered insight into the staff’s practice of providing oral comments. She noted that as the staff completes its review, it may reach out to registrants by phone to (1) facilitate the timely closure of an ongoing staff review, (2) address time-sensitive matters, or (3) discuss minor points of clarification.

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.

Separately, the SEC staff may also contact a registrant to discuss publicly reported significant events, such as a cyber breach affecting the registrant, before commencing a review or issuing any written comments.

B.1.2 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.

B.2 Rule 3-13 Waivers and Other Requests

As stated in the FRM, the Division’s Office of the Chief Accountant (CF-OCA) performs the following functions that may result in communications with companies and their advisers:

- “Acts on behalf of the Commission to grant relief under Rule 3-13 of Regulation S-X. The staff has authority, where consistent with investor protection, to permit registrants to omit, or substitute for, required financial statements.”
- “Answers interpretive request letters and provides informal interpretive advice about the form and content of financial statements and other financial information required to be included in Commission filings.”
- “Helps identify and explain the applicable rules, regulations, forms, and guidance that affect the form and content of financial statements and other financial information required to be included in Commission filings.”

B.2.1 Rule 3-13 Waivers

In remarks and congressional testimony that have been consistent with the Commission’s focus on capital formation, SEC Chairman Jay Clayton has encouraged registrants to seek modifications to their financial reporting requirements under Regulation S-X, Rule 3-13, particularly when the requirements are burdensome but may not be material to the total mix of information available to investors. Rule 3-13 has historically given the staff the authority to permit the omission or substitution of certain financial statements otherwise required under Regulation S-X “where consistent with the protection of investors,” and Chairman Clayton’s remarks and congressional testimony indicate that the SEC staff is placing a high priority on such requests.

The SEC staff has recommended that when a registrant prepares a prefiling letter to request a waiver from the CF-OCA, the registrant should consider the following to facilitate a prompt response:

- Be concise and focus on relevant facts and circumstances.
- Propose solutions and adequate support for the proposals.
- Include support related to why the waiver request is consistent with the protection of investors.
- Show the letter to the registrant’s auditors and have them weigh in before sending it.

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2 Page 2 of the FRM provides contact information for each of the respective CF-OCA functions listed.
Appendix B — Best Practices for Working With the SEC Staff

The SEC staff has also indicated that it is available to discuss potential waiver fact patterns by phone in advance of a registrant's submission of a written request.

Examples of waiver requests under Rule 3-13 include:

- Omission of one or more years of historical financial statements for a recently acquired business that is subject to Regulation S-X, Rule 3-05.\(^5\)
- Omission of certain financial statements of an equity method investment that is subject to Regulation S-X, Rule 3-09.

While many of the SEC's recent rulemaking activities (e.g., those that improve disclosures for business acquisitions) are intended to modernize the requirements and expected to reduce the number of waivers, registrants may still seek modifications to their reporting requirements under Rule 3-13 as the SEC staff continues to entertain those requests.

Separately, registrants may also be faced with complex accounting matters. Registrants are encouraged to submit a prefiling letter to the OCA on the proposed application of U.S. GAAP to resolve these complex issues before filing. For best practices related to consulting with the OCA, see the guidance on the SEC's Web site.

B.2.2 Requests for Informal Interpretive Guidance

Registrants may reach out to the CF-OCA to seek informal interpretive guidance on a named or unnamed basis by e-mail, phone, or online form. Given the nature of the informal discussions, statements made by the staff are intended to be helpful but cannot be relied upon since they are not binding.

B.2.3 Requests for Omission of Selected Financial Data

In certain circumstances (e.g., certain filings that include the financial statements of a recently carved-out business), a domestic registrant that is not an emerging growth company (EGC) or smaller reporting company (SRC)\(^6\) may wish to request omission of the earliest two years of the five years of selected financial data required by Regulation S-K, Item 301. The SEC staff has advised registrants seeking to omit selected financial data to contact either CF-OCA or the relevant review office to discuss whether such information may be omitted without comment or objection from the staff.

B.2.4 Requests to Expedite the Processing of Draft or Filed Registration Statements

The Division staff will consider reasonable requests to expedite the processing of both confidentially submitted (“draft”) and publicly filed (“filed”) registration statements. Companies and their advisers are encouraged to review the timing of the related offering with the staff members assigned for review. Requests to expedite the processing of both draft and filed registration statements should be directed to the relevant review office in the Division that is responsible for performing the review.

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5 Although a registrant may be granted relief from providing financial statements and related pro forma requirements in accordance with Rule 3-05 before consummating an acquisition, the registrant would still be required to file an Item 2.01 Form 8-K to disclose the completion of the acquisition. The waiver under Rule 3-13 applies only to the historical and pro forma financial statement requirements and does not provide relief from filing the Item 2.01 Form 8-K.

6 An EGC is not required to present selected financial data in accordance with Regulation S-K, Item 301, for any period before the earliest audited period presented. An SRC is not required to present selected financial data in accordance with Regulation S-K, Item 301, for any period.
Appendix C — Tips for Searching the SEC’s Database for Comment Letters

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

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

C.1 Full-Text Searching

To perform a full-text search, first go to the SEC’s home page (www.sec.gov) and click on the “EDGAR” link on the left side of the ribbon:
Appendix C — Tips for Searching the SEC's Database for Comment Letters

Then, click the “EDGAR Full Text Search” link in the left sidebar on the “EDGAR — Search and Access” page:

On the EDGAR full-text search page, select “more search options”.

This brings up the following form:
In the form, limit the search results to SEC comment letters by clicking “Browse filing types” and choosing “UPLOAD” (or select “CORRESP” to include registrant responses as well) or by selecting “Filing review correspondence” from the filing category (“View all”) drop-down menu:

![Screenshot of filing types selection]

Then, enter search terms in the “Document word or phrase” 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.”

C.1.1  Enhancing Search Results

“EDGAR Full Text Search” uses an implied AND Boolean operator between query terms, so there is no need to enter AND in the query. To narrow your search by telling the search system that all terms must be contained anywhere in a document and in any order in the document (but not necessarily in the same sentence or paragraph), enter the terms in the search field (e.g., software hardware). All resulting documents will contain software and hardware anywhere in the document content.

To further refine searches, terms can be excluded from the results documents by using a - (hyphen or dash) immediately preceding a query term (e.g., software -hardware). All resulting documents will contain software, but not hardware, anywhere in the document content.

Note that wildcard searches and natural language search capabilities are not currently supported.

C.1.2  Sorting by Dates and Other Specific Criteria

On the full-text search form, selections (individually or in combination) can also be made to limit results to a specified:

- Company name.
- Ticker.
- Central index key (CIK) number: ¹
- Individual’s name.

¹ According to the SEC’s Web site, a “CIK is the unique number that the SEC’s computer system assigns to individuals and corporations [that] file disclosure documents with the SEC. All new electronic and paper filers, foreign and domestic, receive a CIK number.”
• Date range.
• State, province, country, or territory in which a company's principal executive offices are located or in which a company is incorporated (i.e., the primary location associated with a filing).

Any of these can be combined in a single search.

C.1.3 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 10,000 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, and (3) providing a date range spanning the last two years, the number of results would be more relevant and manageable.

C.1.4 Additional Information

For more information about full-text searching, click on the FAQ link in the search form:
Appendix D — Titles of Standards and Other Literature

**SEC Literature**

**ASR**
No. 268, *Presentation in Financial Statements of “Redeemable Preferred Stocks”* (Rule 5-02.28 of SEC Regulation S-X)

**CF Disclosure Guidance**
Topic 2, “Cybersecurity”
Topic 9, “Coronavirus (COVID-19)”

**Concept Release**
No. 33-8860, *Mechanisms to Access Disclosures Relating to Business Activities in or With Countries Designated as State Sponsors of Terrorism*

**EDGAR Filer Manual**
Volume II, *EDGAR Filing*
  - Section 6.14, “Syntax of Calculation Linkbases”
  - Section 6.15, “Content of Calculation Linkbases”

**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 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”
Appendix D — Titles of Standards and Other Literature

Final Rules
No. 33-8176, Conditions for Use of Non-GAAP Financial Measures
No. 33-9877, Pay Ratio Disclosure
No. 33-10513, Smaller Reporting Company Definition
No. 33-10514, Inline XBRL Filing of Tagged Data
No. 33-10618, FAST Act Modernization and Simplification of Regulation S-K
No. 33-10762, Financial Disclosures About Guarantors and Issuers of Guaranteed Securities and Affiliates Whose Securities Collateralize a Registrant's Securities
No. 34-88365, Accelerated Filer and Large Accelerated Filer Definitions
No. 33-10786, Amendments to Financial Disclosures About Acquired and Disposed Businesses
No. 33-10825, Modernization of Regulation S-K Items 101, 103, and 105
No. 33-10835, Update of Statistical Disclosures for Bank and Savings and Loan Registrants

Industry Guide
No. 3, “Statistical Disclosures by Bank Holding Companies”

Interpretive Releases
No. 33-8350 (34-48960), Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations
No. 33-10415, Commission Guidance on Pay Ratio Disclosure
No. 33-10459, Commission Statement and Guidance on Public Company Cybersecurity Disclosures
No. 33-10751, Commission Guidance on Management's Discussion and Analysis of Financial Condition and Results of Operations

Proposed Rule
No. 33-10750, Management's Discussion and Analysis, Selected Financial Data, and Supplementary Financial Information

Regulation G
Rule 100, “General Rules Regarding Disclosure of Non-GAAP Financial Measures”

Regulation S-K
Item 10, “General”
Item 101, “Description of Business”
Item 103, “Legal Proceedings”
Item 105, “Risk Factors”
Item 301, “Selected Financial Data”
Item 302, “Supplementary Financial Information”
Item 303, “Management’s Discussion and Analysis of Financial Condition and Results of Operations”
Item 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 506, “Dilution”
Item 601, “Exhibits”
Item 1202, “Disclosure of Reserves”
Item 1203, “Proved Undeveloped Reserves”
Item 1204, “Oil and Gas Production, Production Prices and Production Costs”
Item 1205, “Drilling and Other Exploratory and Development Activities”
Item 1206, “Present Activities”
Item 1207, “Delivery Commitments”
Item 1208, “Oil and Gas Properties, Wells, Operations, and Acreage”

**Regulation S-T**

Rule 302, “Signatures”

Rule 405, “Interactive Data File Submissions and Postings”

**Regulation S-X**

Rule 1-02, “Definitions of Terms Used in Regulation S-X (17 CFR Part 210)”

Rule 2-02, “Accountants’ Reports and Attestation Reports”

Rule 3-01, “Consolidated Balance Sheets”

Rule 3-02, “Consolidated Statements of Comprehensive Income and Cash Flows”

Rule 3-03, “Instructions to Statement of Comprehensive Income Requirements”

Rule 3-04, “Changes in Stockholders’ Equity and Noncontrolling Interests”

Rule 3-05, “Financial Statements of Businesses Acquired or to Be Acquired”

Rule 3-09, “Separate Financial Statements of Subsidiaries Not Consolidated and 50 Percent or Less Owned Persons”

Rule 3-10, “Financial Statements of Guarantors and Issuers of Guaranteed Securities Registered or Being Registered”

Rule 3-12, “Age of Financial Statements at Effective Date of Registration Statement or at Mailing Date of Proxy Statement”
Rule 3-13, “Filing of Other Financial Statements in Certain Cases”
Rule 3-14, “Special Instructions for Real Estate Operations to Be Acquired”
Rule 3-16, “Financial Statements of Affiliates Whose Securities Collateralize an Issue Registered or Being Registered”
Rule 4-08, “General Notes to Financial Statements”
Article 5, “Commercial and Industrial Companies”
Rule 5-02, “Balance Sheets”
Rule 5-03, “Statements of Comprehensive Income”
Rule 5-04, “What Schedules Are to Be Filed”
Article 8, “Financial Statements of Smaller Reporting Companies”
Rule 8-02, “Annual Financial Statements”
Article 10, “Interim Financial Statements”
Article 11, “Pro Forma Financial Information”
Rule 11-01, “Pro Forma Financial Information; Presentation Requirements”
Rule 11-02, “Preparation Requirements”
Article 12, “Form and Content of Schedules”
Rule 12-04, “Condensed Financial Information of Registrant”
Rule 12-12, “Investments in Securities of Unaffiliated Issuers”
Rule 13-01, “Guarantors and Issuers of Guaranteed Securities Registered or Being Registered”
Rule 13-02, “Affiliates Whose Securities Collateralize Securities Registered or Being Registered”

SAB Topics
No. 1.M, “Materiality” (SAB 99)
No. 1.N, “Considering the Effects of Prior Year Misstatements When Quantifying Misstatements in Current Year Financial Statements” (SAB 108)
No. 4.C, “Change in Capital Structure”
No. 5.P, “Restructuring Charges”
No. 5.Y, “Accounting and Disclosures Relating to Loss Contingencies”
No. 11.B, “Depreciation and Depletion Excluded From Cost of Sales”
No. 11.C, “Tax Holidays”
No. 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)


No. 14.F, “Classification of Compensation Expense Associated with Share-Based Payment Arrangements”

**Securities Act of 1933**

Rule 405, “Definitions of Terms”

Rule 436, “Consents Required in Special Cases”

**Securities Exchange Act of 1934**

Rule 13a-15, “Controls and Procedures”

Rule 15d-15, “Controls and Procedures”

**AICPA Literature**

**Accounting and Valuation Guide**

*Valuation of Privately-Held-Company Equity Securities Issued as Compensation* [“Cheap Stock Guide”]

**FASB Literature**

**ASC Topics**

ASC 205, *Presentation of Financial Statements*

ASC 220, *Income Statement — Reporting Comprehensive Income*

ASC 230, *Statement of Cash Flows*

ASC 250, *Accounting Changes and Error Corrections*

ASC 260, *Earnings per Share*

ASC 280, *Segment Reporting*

ASC 310, *Receivables*

ASC 326, *Financial Instruments — Credit Losses*

ASC 340, *Other Assets and Deferred Costs*

ASC 350, *Intangibles — Goodwill and Other*

ASC 360, *Property, Plant, and Equipment*

ASC 410, *Asset Retirement and Environmental Obligations*

ASC 420, *Exit or Disposal Cost Obligations*

ASC 450, *Contingencies*

ASC 480, *Distinguishing Liabilities From Equity*

ASC 505, *Equity*

ASC 606, *Revenue From Contracts With Customers*
Appendix D — Titles of Standards and Other Literature

ASC 710, Compensation — General
ASC 715, Compensation — Retirement Benefits
ASC 718, Compensation — Stock Compensation
ASC 730, Research and Development
ASC 740, Income Taxes
ASC 805, Business Combinations
ASC 808, Collaborative Arrangements
ASC 810, Consolidation
ASC 815, Derivatives and Hedging
ASC 820, Fair Value Measurement
ASC 830, Foreign Currency Matters
ASC 835, Interest
ASC 840, Leases
ASC 842, Leases
ASC 850, Related Party Disclosures
ASC 860, Transfers and Servicing
ASC 932, Extractive Activities — Oil and Gas
ASC 944, Financial Services — Insurance
ASC 970, Real Estate — General
ASC 980, Regulated Operations
ASC 985, Software

ASUs

ASU 2013-12, Definition of a Public Business Entity — An Addition to the Master Glossary
ASU 2016-02, Leases (Topic 842)
ASU 2016-09, Compensation — Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting
ASU 2016-13, Financial Instruments — Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments
ASU 2017-01, Business Combinations (Topic 805): Clarifying the Definition of a Business
ASU 2017-04, Intangibles — Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment
ASU 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities
ASU 2018-12, Financial Services — Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts
ASU 2018-18, Collaborative Arrangements (Topic 808): Clarifying the Interaction Between Topic 808 and Topic 606
ASU 2019-09, Financial Services — Insurance (Topic 944): Effective Date
ASU 2019-10, Financial Instruments — Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842): Effective Dates
ASU 2020-04, Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting
ASU 2020-05, Revenue From Contracts With Customers (Topic 606) and Leases (Topic 842): Effective Dates for Certain Entities

**Concepts Statements**

No. 2, Elements of Financial Statements of Business Enterprises (superseded)

No. 8, Conceptual Framework for Financial Reporting: Chapter 1, The Objective of General Purpose Financial Reporting, and Chapter 3, Qualitative Characteristics of Useful Financial Information — a replacement of FASB Concepts Statements No. 1 and No. 2

**IFRS Literature**

IAS 1 (Revised 2007), Presentation of Financial Statements
## Appendix E — Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>AFFO</td>
<td>adjusted funds from operations</td>
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<tr>
<td>AICPA</td>
<td>American Institute of Certified Public Accountants</td>
</tr>
<tr>
<td>AICPA Conference</td>
<td>AICPA Conference on Current SEC and PCAOB Developments</td>
</tr>
<tr>
<td>ARO</td>
<td>asset retirement obligation</td>
</tr>
<tr>
<td>ARR</td>
<td>alternative reference rate</td>
</tr>
<tr>
<td>ARRC</td>
<td>Alternative Reference Rates Committee</td>
</tr>
<tr>
<td>ASC</td>
<td>FASB Accounting Standards Codification</td>
</tr>
<tr>
<td>ASR</td>
<td>SEC Accounting Series Release</td>
</tr>
<tr>
<td>ASU</td>
<td>FASB Accounting Standards Update</td>
</tr>
<tr>
<td>BC</td>
<td>Basis for Conclusions</td>
</tr>
<tr>
<td>BOE</td>
<td>barrels of oil equivalent</td>
</tr>
<tr>
<td>C&amp;DI</td>
<td>SEC Compliance and Disclosure Interpretation</td>
</tr>
<tr>
<td>CAQ</td>
<td>Center for Audit Quality</td>
</tr>
<tr>
<td>CD&amp;A</td>
<td>Compensation Discussion and Analysis</td>
</tr>
<tr>
<td>CECL</td>
<td>current expected credit loss (referring to the FASB's new credit losses standard (ASC 326))</td>
</tr>
<tr>
<td>CEO</td>
<td>chief executive officer</td>
</tr>
<tr>
<td>CF-OCA</td>
<td>SEC's Division of Corporation Finance, Office of the Chief Accountant</td>
</tr>
<tr>
<td>CFDG</td>
<td>Corporation Finance Disclosure Guidance</td>
</tr>
<tr>
<td>CFO</td>
<td>chief financial officer</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>CIK</td>
<td>central index key</td>
</tr>
<tr>
<td>CODM</td>
<td>chief operating decision maker</td>
</tr>
<tr>
<td>COSO</td>
<td>Committee of Sponsoring Organizations of the Treadway Commission</td>
</tr>
<tr>
<td>COVID-19</td>
<td>coronavirus disease 2019</td>
</tr>
<tr>
<td>DC&amp;P</td>
<td>disclosure controls and procedures</td>
</tr>
<tr>
<td>DTA</td>
<td>deferred tax asset</td>
</tr>
<tr>
<td>EBIT</td>
<td>earnings before interest and taxes</td>
</tr>
<tr>
<td>EBITDA</td>
<td>earnings before interest, taxes, depreciation, and amortization</td>
</tr>
<tr>
<td>EBITDAR</td>
<td>earnings before interest, taxes, depreciation, amortization, and restructuring or rent costs</td>
</tr>
<tr>
<td>EDGAR</td>
<td>SEC's Electronic Data Gathering, Analysis, and Retrieval system</td>
</tr>
<tr>
<td>EGC</td>
<td>emerging growth company</td>
</tr>
<tr>
<td>EITF</td>
<td>FASB Emerging Issues Task Force</td>
</tr>
<tr>
<td>EMEA</td>
<td>Europe, Middle East, and Africa</td>
</tr>
<tr>
<td>EPS</td>
<td>earnings per share</td>
</tr>
<tr>
<td>ERP</td>
<td>enterprise resource planning system</td>
</tr>
<tr>
<td>FASB</td>
<td>Financial Accounting Standards Board</td>
</tr>
<tr>
<td>FAQ</td>
<td>frequently asked question</td>
</tr>
<tr>
<td>FDA</td>
<td>U.S. Food and Drug Administration</td>
</tr>
<tr>
<td>FFO</td>
<td>funds from operations</td>
</tr>
<tr>
<td>FPI</td>
<td>foreign private issuer</td>
</tr>
<tr>
<td>FRM</td>
<td>SEC Division of Corporation Finance's Financial Reporting Manual</td>
</tr>
<tr>
<td>Abbreviation</td>
<td>Description</td>
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<tr>
<td>--------------</td>
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</tr>
<tr>
<td>GAAP</td>
<td>generally accepted accounting principles</td>
</tr>
<tr>
<td>GMV</td>
<td>gross merchandise value</td>
</tr>
<tr>
<td>IAS</td>
<td>International Accounting Standard</td>
</tr>
<tr>
<td>ICFR</td>
<td>internal control over financial reporting</td>
</tr>
<tr>
<td>IFRS</td>
<td>International Financial Reporting Standard</td>
</tr>
<tr>
<td>IP</td>
<td>intellectual property</td>
</tr>
<tr>
<td>IPO</td>
<td>initial public offering</td>
</tr>
<tr>
<td>IT</td>
<td>information technology</td>
</tr>
<tr>
<td>iXBRL</td>
<td>Inline XBRL</td>
</tr>
<tr>
<td>KPI</td>
<td>key performance indicator</td>
</tr>
<tr>
<td>LIBOR</td>
<td>London Interbank Offered Rate</td>
</tr>
<tr>
<td>MBS</td>
<td>mortgage-backed securities</td>
</tr>
<tr>
<td>MD&amp;A</td>
<td>Management's Discussion and Analysis</td>
</tr>
<tr>
<td>MMBOE</td>
<td>million barrels of oil equivalent</td>
</tr>
<tr>
<td>NAREIT</td>
<td>National Association of Real Estate Investment Trusts</td>
</tr>
<tr>
<td>NEO</td>
<td>named executive officer</td>
</tr>
<tr>
<td>NFP</td>
<td>not-for-profit</td>
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<tr>
<td>NGL</td>
<td>natural gas liquid</td>
</tr>
<tr>
<td>NOI</td>
<td>net operating income</td>
</tr>
<tr>
<td>OCA</td>
<td>SEC Office of the Chief Accountant</td>
</tr>
<tr>
<td>OCI</td>
<td>other comprehensive income</td>
</tr>
<tr>
<td>OIBDA</td>
<td>operating income before depreciation and amortization</td>
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</table>

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>PaaS</td>
<td>platform as a service</td>
</tr>
<tr>
<td>P&amp;L</td>
<td>profit and loss</td>
</tr>
<tr>
<td>PBE</td>
<td>public business entity</td>
</tr>
<tr>
<td>PCAOB</td>
<td>Public Company Accounting Oversight Board</td>
</tr>
<tr>
<td>PCC</td>
<td>Private Company Council</td>
</tr>
<tr>
<td>PCS</td>
<td>postcontract customer support</td>
</tr>
<tr>
<td>PP&amp;E</td>
<td>property, plant, and equipment</td>
</tr>
<tr>
<td>PU&amp;R</td>
<td>power, utilities, and renewables</td>
</tr>
<tr>
<td>PUD</td>
<td>proved undeveloped</td>
</tr>
<tr>
<td>R&amp;D</td>
<td>research and development</td>
</tr>
<tr>
<td>ROU</td>
<td>right-of-use</td>
</tr>
<tr>
<td>SaaS</td>
<td>software as a service</td>
</tr>
<tr>
<td>SAB</td>
<td>SEC Staff Accounting Bulletin</td>
</tr>
<tr>
<td>SEC</td>
<td>Securities and Exchange Commission</td>
</tr>
<tr>
<td>SG&amp;A</td>
<td>selling, general, and administrative expense</td>
</tr>
<tr>
<td>SIC</td>
<td>standard industrial classification</td>
</tr>
<tr>
<td>SOFR</td>
<td>Secured Overnight Financing Rate</td>
</tr>
<tr>
<td>SRC</td>
<td>smaller reporting company</td>
</tr>
<tr>
<td>SSNOI</td>
<td>same store net operating income</td>
</tr>
<tr>
<td>THS</td>
<td>travel, hospitality, and services</td>
</tr>
<tr>
<td>UTB</td>
<td>unrecognized tax benefit</td>
</tr>
<tr>
<td>VIE</td>
<td>variable interest entity</td>
</tr>
<tr>
<td>XBRL</td>
<td>eXtensible Business Reporting Language</td>
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</table>
The following is a list of short references for the Acts mentioned in this publication:

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Act</th>
</tr>
</thead>
<tbody>
<tr>
<td>CARES Act</td>
<td>Coronavirus Aid, Relief, and Economic Security Act</td>
</tr>
<tr>
<td>Dodd-Frank Act</td>
<td>Dodd-Frank Wall Street Reform and Consumer Protection Act</td>
</tr>
<tr>
<td>FAST Act</td>
<td>Fixing America's Surface Transportation Act</td>
</tr>
<tr>
<td>JOBS Act</td>
<td>Jumpstart Our Business Startups Act</td>
</tr>
<tr>
<td>Sarbanes-Oxley Act</td>
<td>Sarbanes-Oxley Act of 2002</td>
</tr>
<tr>
<td>Securities Act</td>
<td>Securities Act of 1933</td>
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</table>
Appendix F — Changes Made in the 2020 Edition of This Publication

The nature of this Roadmap is such that we annually perform a comprehensive review of each topic discussed to ensure that the material accurately reflects current-year comment letter trends and themes. We also provide updates, when relevant, of new U.S. GAAP or SEC literature that could affect the types of comments issued by the SEC staff.

A number of revisions made in the 2020 edition are primarily editorial (e.g., to clarify or update existing text). Some sections have been renumbered since the publication of last year’s edition. More significant updates include (1) the addition of preliminary trends associated with SEC staff comments related to the COVID-19 pandemic (see Section 1.3), (2) enhanced discussion of SEC staff comments related to lease accounting under ASC 842 (see Section 2.13), and (3) the addition of trends associated with SEC staff comments on inventory accounting (see Section 2.12A).