

SEC Reporting Update

Highlights of trends in 2025 SEC staff comment letters

In this issue:

Overview	1
Volume of SEC staff comment letters decreases	2
Responding to a comment letter	3
Management's discussion and analysis	5
Non-GAAP financial measures	11
Segment reporting	19
Revenue recognition	27
Goodwill and intangible assets	30
Other areas of comment	33
Looking ahead	39
Appendix: Resources	40

What you need to know

- ▶ The volume of SEC staff comment letters issued to registrants about their disclosures in periodic SEC filings in the year ended 30 June 2025 fell, reversing the trend of elevated volumes in the prior two years. The volume of comments may continue to decrease if new SEC leadership makes changes to the filing review program.
- ▶ Management's discussion and analysis and non-GAAP financial measures remained in the top two spots on the list of the most frequent topics the SEC staff addressed in comment letters, followed by segment reporting, revenue recognition and goodwill and intangible assets.
- ▶ Comment letters can provide insights into the SEC staff's views and expectations on accounting disclosures and corporate reporting. Over the next year, we expect the SEC staff to focus on disclosures related to segment reporting following the adoption of ASU 2023-07 and risks related to the current macroeconomic environment and emerging technologies (e.g., artificial intelligence).

Overview

The volume of comment letters issued to registrants by staff of the Securities and Exchange Commission (SEC or Commission) about their disclosures in periodic SEC filings in the year ended 30 June 2025 fell compared to the high volume of the previous two years. This reverses the upward trend seen over the past few years, bringing the volume of comment letters closer to that of 2022.



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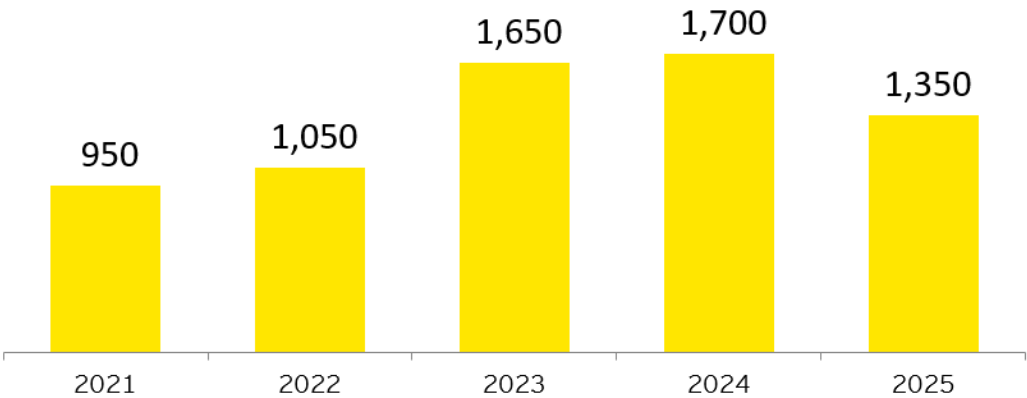
The number of registrants receiving SEC staff comment letters also fell relative to last year. However, the distribution of the total number of SEC staff comment letters across the different sizes of registrants remained relatively consistent with last year. Management's discussion and analysis (MD&A) and non-GAAP financial measures continued to lead our list of topics the SEC staff addressed most frequently in comment letters in the year ended 30 June 2025.

This publication is intended to provide you with insights into the types of issues that the SEC staff has raised questions about throughout the year and to help you prepare for an SEC staff comment letter. It is not intended to drive changes to your accounting or disclosures, unless you determine that changes are necessary to comply with the accounting or disclosure requirements.

Volume of SEC staff comment letters decreases

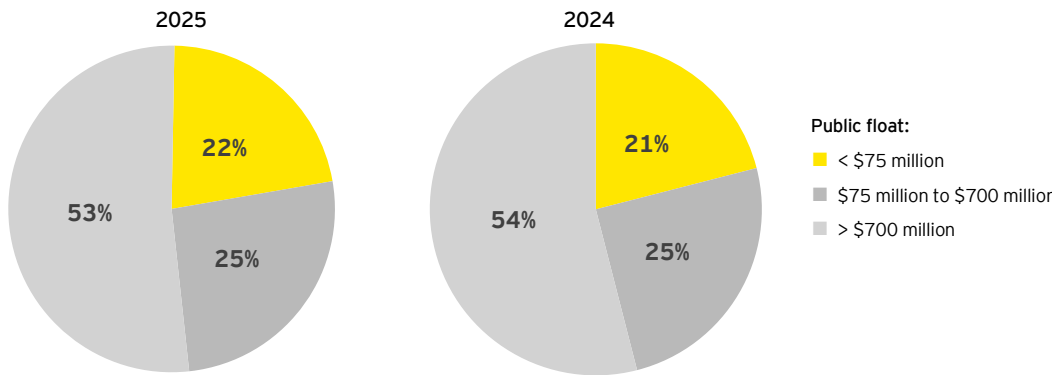
Both the volume of SEC staff comment letters and the number of recipients receiving a comment letter decreased in the year ended 30 June 2025.

Number of SEC comment letters by year (rounded to the nearest 50)



Source: Audit Analytics – SEC UPLOAD comment letters related to Forms 10-K and 10-Q that were issued during the 12-month periods ended on 30 June each year and became publicly available by the date of our analysis, excluding those issued to special purpose acquisition companies (SPACs) and other blank check entities. Since the SEC publicly releases comment letters no earlier than 20 business days after the completion of its reviews, our analysis for the latest year includes letters that were issued by 30 June and were publicly available by 6 August 2025.

Size of registrants receiving comment letters on Forms 10-K and 10-Q filings



Source: Audit Analytics – SEC UPLOAD comment letters issued related to Forms 10-K and 10-Q for the 12-month periods ended 30 June 2025 and 30 June 2024, excluding SPACs and other blank check entities.

The SEC staff must review the filings of registrants at least once every three years, using a risk-based approach to select registrants' periodic filings for review. While this generally results in the SEC staff reviewing the filings of larger registrants more frequently than those of smaller registrants, the SEC staff has issued more comments to smaller registrants (i.e., those with less than \$700 million in market capitalization) over the past three years than it has done historically.

Most frequent comment areas

The SEC staff continued to focus on many of the topics we highlighted last year. MD&A and non-GAAP measures continued to draw the most scrutiny from the SEC staff, followed by segment reporting and revenue recognition. Goodwill and intangible assets also remained in the SEC staff's top areas of comment.

Although we observed a decrease in the total number of registrants receiving SEC staff comment letters this year, the percentage of registrants that received SEC staff comments on MD&A and non-GAAP financial measures each increased by more than 10% compared to last year.

The following list of most frequent comment areas includes areas for which a significant number of registrants received a comment on the topic.

Comment area	2025
	Ranking for 12 months ended 30 June ¹
Management's discussion and analysis	1
Non-GAAP financial measures	2
Segment reporting	3
Revenue recognition	4
Goodwill and intangible assets	5

¹ These rankings are based on topics assigned by research firm Audit Analytics for SEC comment letters issued to registrants with a market capitalization of \$75 million or more on Forms 10-K and 10-Q from 1 July 2024 through 30 June 2025, excluding comment letters issued to SPACs and other blank check entities. In some cases, individual SEC staff comments are assigned to multiple topics.

On average, the SEC staff issued 1.2 comment letters (or rounds of comments) per registrant to resolve its concerns on each of these areas, which was generally consistent with last year.

Responding to a comment letter

General

The SEC staff views the comment process as a dialogue with a registrant about its disclosures, and the initial comments should generally not be interpreted to mean that the SEC staff has already concluded that the disclosures must change. Registrants receiving comment letters should generally view the process as an opportunity to educate the SEC staff about how they arrived at their disclosure or accounting conclusions, rather than an indication that revisions are necessary. In many cases, comments are resolved once the SEC staff has gained a full understanding of a registrant's facts and circumstances and obtained sufficient insight into management's judgments that led to the disclosure or accounting conclusion.

The SEC staff typically requests a written response to its comment letters within 10 business days. However, it is common for registrants to need more time to sufficiently respond to the comments. In those cases, registrants should contact the SEC staff to obtain an extension, which is typically granted. A registrant also may consider contacting the SEC staff if it needs clarification about a comment or to obtain some informal feedback regarding its approach to responding. As a matter of practice, the SEC staff will not clear or resolve outstanding comments in a conference call.

As a reminder, all comment letters, including registrants' responses, become part of the public record as they are posted on the SEC's website once they are resolved. Registrants should file all response letters on EDGAR, redacting any specific information for which they are seeking confidential treatment.

Registrants should also be aware that if the SEC staff doesn't comment on a particular matter, that does not mean the SEC staff concurs with their accounting judgments or disclosures. That is, the SEC staff may comment in the future about an accounting conclusion or disclosure it hasn't questioned in the past.

Leading practices

To facilitate responses to comment letters, registrants should maintain contemporaneous documentation of significant accounting and disclosure decisions. Contemporaneous documentation is more persuasive than a retrospective defense prepared after the receipt of a comment letter and facilitates a more comprehensive and timely response.

Registrants should take the time needed to provide a comprehensive initial response to reduce the number of rounds of comments necessary to reach resolution with the SEC staff. When responding to a comment letter, a registrant may initially assume that the SEC staff has not yet concluded on a matter and merely needs more information, unless the SEC staff clearly indicates in its comment that this is not the case. To resolve any comments in a timely fashion, a registrant should draft a response that:

- ▶ Reflects the input of the appropriate internal personnel, legal counsel and independent auditors
- ▶ Focuses on the question(s) the SEC staff asked and provides a complete response addressing all aspects of the comment, citing authoritative literature and related guidance wherever possible
- ▶ Addresses materiality if the SEC staff asks why a particular disclosure was omitted or if a registrant believes the accounting for an item is immaterial
- ▶ Addresses the registrant's specific facts and circumstances and judgments made in applying the relevant guidance and contemplates the registrant's communications to stakeholders outside of the filing on the accounting and/or disclosures in question
- ▶ Avoids overreliance on other registrants' disclosures or comment letter responses on similar topics because there may be differences in facts that are not readily apparent

Disclosure revisions

Registrants may decide to revise their disclosures in future filings as a result of the comment letter process. Before proposing a revised disclosure, registrants should make sure they are capable of producing the financial or other information necessary to provide the revised disclosure.

In its response to a comment letter, the registrant should indicate where in the filing the disclosure revisions will be made and, if possible, include the proposed language for a revised disclosure. If the registrant includes the proposed revised disclosure language in its response, it should also indicate that the facts and circumstances may change in a way that may require a different disclosure.

If the registrant does not include the proposed revised disclosure language, it should be prepared to provide such proposed language because the SEC staff may not accept a statement that the registrant will revise its disclosure in future filings without seeing the proposed revisions.

Disclosure requirements

The SEC requires that a registrant meeting the definition of an accelerated filer, a large accelerated filer or a well-known seasoned issuer disclose, in its annual reports on Form 10-K or Form 20-F, written comments the SEC staff has made in connection with a review of its Exchange Act reports that:

- Are believed to be material by the registrant
- Were issued more than 180 days before the end of the fiscal year covered by the annual report
- Remain unresolved as of the date of the filing of the Form 10-K or Form 20-F

The disclosure must describe the substance of the unresolved comments. SEC staff comments that have been resolved, including those that the SEC staff and the registrant have agreed will be addressed in future Exchange Act reports, do not need to be disclosed. Registrants can provide other information, including their positions regarding any unresolved comments. This information is not required in the registrant's quarterly reports on Form 10-Q or Form 6-K.

Management's discussion and analysis

The SEC staff's comments address various aspects of MD&A disclosure sections, and many of them are focused on disclosures about results of operations. Many comments relate to a registrant's lack of sufficiently detailed disclosures about the reasons for material period-to-period changes in a registrant's financial statement line items. The SEC staff has also continued to ask registrants about liquidity and capital resources disclosures, including the effects of the macroeconomic environment, and critical accounting estimates.

Results of operations

The SEC staff often requests that registrants explain the results of their operations with greater specificity, including identifying underlying drivers for each material factor that affected their earnings or is reasonably likely to have a material effect on future earnings. In addition to commenting on a registrant's analysis of changes in revenue, the SEC staff has been commenting on other line items or subtotals, such as cost of goods sold, gross profit, research and development (R&D) costs, and selling, general and administrative expenses.

The SEC staff's requests for more details about results of operations include requests that registrants:

- Discuss the effects of each factor that contributed to material period-to-period changes in quantitative and qualitative terms, including the underlying business or economic factors and any material offsetting factors
- Describe and discuss the impact of any unusual or infrequent events or transactions or any significant changes in the economic environment that materially affected income from continuing operations
- Provide insight into significant components of revenue or expense necessary to understand the results of operations (e.g., revenues attributable to significant new customers, impact of changes in pricing and quantity, changes related to acquisitions versus organic growth, components of cost of sales)
- Describe any known trends or uncertainties that have had or are reasonably likely to have a material effect on sales, expenses or income from continuing operations (e.g., the impact of higher interest rates)
- Discuss reportable segment information necessary to understand their results of operations

When a registrant discloses that two or more factors contributed to a material period-to-period change in a financial statement line item or subtotal, the SEC staff often reminds the registrant that Item 303 of Regulation S-K requires disclosure of the reasons for material changes, in quantitative and qualitative terms, for each factor.

Example SEC staff comment: Results of operations – disclosure of quantitative and qualitative factors (revenue)

Please revise to explain in sufficient detail the reasons driving changes in your financial statement line items on a consolidated and segment basis. When you discuss revenue fluctuations, specifically describe the extent to which changes are attributable to changes in prices, changes in the volume or amount of goods or services being sold, or to the introduction of new products or services. Where you describe two or more business reasons that contributed to a material change in a financial statement line item between periods, please quantify, where possible, the extent to which each factor contributed to the overall change in that line item, including any off-setting factors. Also, revise to include a separate discussion of the company's consolidated results based on the line items in your consolidated statements of income. Refer to Item 303(a) and (b) of Regulation S-K and SEC Release No. 33-8350.

Example SEC staff comment: Results of operations – disclosure of quantitative and qualitative factors (cost of goods sold)

Since cost of revenues is material to your results, please consider a separate quantitative and qualitative comparable analysis of it to the extent material in helping investors better understand your operations and results. Refer to Item 303(b). In doing so, consider discussing the impact of each component of cost of revenues that caused cost of revenues to materially vary (or not vary when expected to). Consider performing the analysis at the segment level to the extent meaningful in further understanding your operations and results.

The SEC staff has also requested that registrants provide certain forward-looking information about known trends and uncertainties. Disclosure is required for trends and uncertainties that are “reasonably likely” to have a material effect on revenues or income from continuing operations. In evaluating this requirement, the registrant must determine whether the trend or uncertainty is reasonably likely to come to fruition. If it isn't, no disclosure is required. A registrant that cannot make this determination must assume that the trend or uncertainty is reasonably likely to come to fruition and must provide disclosure in MD&A, unless it is not reasonably likely to have a material effect.

Example SEC staff comment: Results of operations – known trends and uncertainties

You have a history of reported operating and net losses for several interim and annual periods. Please specifically discuss here, under “Business Continuity” on page X or elsewhere as appropriate in your periodic filings to the extent this situation continues to exist whether this is a known trend. In doing so, describe matters that have had a material impact on reported operations, as well as those reasonably likely based on your assessment to have a material impact on future operations. For example, consider discussing the operational reasons for the losses, what you must do to generate positive results and when you expect, if practicable, to generate positive operating results. Refer to Items 303(a) and (b)(2)(ii) of Regulation S-K and trend information within Release No.33-6835 and 33-8350 for guidance.

The SEC staff routinely requests that registrants identify and quantify the impact of each positive or negative factor, including any off-setting factors, that has a material effect on results of operations.

Significant components of financial condition and results of operations

The SEC staff has asked registrants to expand their discussions about significant components of their financial condition and results of operations. In their segment discussions, registrants often describe only changes in revenue and segment profit or loss and do not directly explain the changes in significant operating expenses. The SEC staff frequently asks registrants to quantify and discuss separately the significant components of financial condition and results of operations that have affected segment results. The SEC staff believes this information helps investors better understand a registrant's business, particularly when the profitability of segments varies. Registrants should also assess how the FASB Accounting Standards Update (ASU) 2023-07, *Segment Reporting (Topic 280): Improvements to Reportable Segment Disclosures*, and its required significant segment expense disclosures may affect MD&A. For further discussion, please refer to the segment reporting section of this publication.

Example SEC staff comment: Results of operations – significant components of expense

Please revise to explain the underlying reasons for the decrease in operating expenses for the year ended December 31, 202X. Refer to Item 303(b)(2)(i) of Regulation S-K and Staff Release No. 33-8350.

The SEC staff frequently requests that registrants with significant R&D costs provide additional quantitative and qualitative disclosures that give more transparency about the type of expenses incurred. In addition, the SEC staff has requested registrants to break out R&D costs incurred by specific program or product type. If the registrant does not track R&D costs by program or product type, the SEC staff will often request that the registrant disclose that fact and explain why it does not evaluate R&D costs in such a manner.

Example SEC staff comment: Results of operations – research and development costs

Please disclose the costs incurred during each period presented for each of your key research and development projects or key programs separately. If you do not track your research and development costs by project or program, please disclose that fact and explain why you do not maintain and evaluate research and development costs by project or program. For amounts that are not tracked by project or program, provide other quantitative or qualitative disclosure that provides more transparency as to the type of research and development expenses incurred (i.e., by nature or type of expense), which should reconcile to total research and development expense on the Statements of Operations.

Key financial and operating metrics

To help investors view the registrant from management's perspective, the SEC requires that the registrant disclose in MD&A the key performance indicators (KPIs or metrics), financial or nonfinancial, used to manage its business that would be material to investors and necessary in the evaluation of the company's performance.

When a registrant uses a key metric to discuss operating results in MD&A, the SEC staff expects it to appropriately classify the information (i.e., as a non-GAAP measure or a KPI) and follow the appropriate guidance on presentation and disclosures (e.g., [the Commission's guidance](#) for KPIs and Item 10(e) of Regulation S-K for non-GAAP measures). The SEC staff also said that it would generally expect, based on the facts and circumstances, the following additional disclosures to accompany the metric:

- A clear definition of the metric and how it is calculated
- A statement indicating the reasons why the metric provides useful information to investors

- A statement indicating how management uses the metric in managing or monitoring the performance of the business

If there are estimates or assumptions underlying the metric or its calculation, the registrant should evaluate whether disclosure of this information is necessary for the disclosure of the metric not to be misleading.

A registrant that changes the method it uses to calculate or present a metric from one period to another should consider disclosing, if material, the differences in the calculation or presentation along with the reasons for and effects of the change. Depending on the significance of the change(s) in methodology and results, the registrant should consider whether it is necessary to recast prior metrics to conform to the current presentation and place the current disclosure in an appropriate context. The SEC staff also reminds registrants to consider whether effective controls and procedures are in place related to the disclosure of metrics that are material.

While the SEC staff recognizes the value of using metrics in MD&A to help explain operating results, it has asked for clarification when it believes that a registrant's use of such metrics without the appropriate context may not adequately explain changes in income statement line items. In addition to commenting on the additional disclosures required to accompany a metric disclosed in MD&A, the SEC staff often questions a registrant's use of KPIs in earnings releases or investor presentations if the KPIs are not discussed in MD&A.

Example SEC staff comment: KPIs without appropriate context

We note your disclosure of revenue per customer contract in your earnings release filings and investor presentations on your website which appears to be a metric. We further note references to and discussions of changes in this metric in your 10-Q and 10-K filings. In future filings, please provide the following disclosures for any metrics disclosed (refer to SEC Release No. 33-10751):

- How the metric is calculated, including any estimates or assumptions underlying the metric or its calculation;
- The reasons why the metric provides useful information to investors; and
- How management uses the metric.

Liquidity and capital resources

The SEC staff has asked for enhanced disclosures in the liquidity and capital resources section of MD&A, particularly when there are trends or uncertainties affecting liquidity. Such requests may focus on the sources and uses of cash, including:

- The availability of cash to fund liquidity needs
- Underlying drivers of changes in operating, investing and financing activity cash flows
- Known trends and uncertainties reasonably expected to have material effects on the future sources and uses of cash

Registrants must also describe their material cash requirements, their general purpose and the anticipated source of the funds needed to satisfy them. We have observed the SEC staff comment on cash held in foreign jurisdictions and the impact on a company's liquidity when the company has significant foreign operations.

Item 303 of Regulation S-K also requires that a registrant discuss known material trends, demands, commitments, events or uncertainties that are reasonably likely to affect (either favorably or unfavorably) liquidity or capital resources.

The SEC staff often requests that registrants expand MD&A to include a meaningful analysis of any variability in cash flows and discuss the material components of these cash flows. For example, the SEC staff often challenges discussions about cash flows that recite items that are readily apparent from the statement of cash flows (e.g., changes in working capital) but do not analyze the underlying drivers of material changes.

Example SEC staff comment: Changes in operating cash flows

Your disclosure appears to discuss how reported operating cash flows was derived for each period, as already presented in the statement of cash flows. Rather, your disclosure should be a comparative discussion and analysis of the change from period to period in the amount of reported operating cash flows. Please provide a more informative discussion and analysis of the material factors causing changes in operating cash flows, including changes in working capital components, between periods. Explain the underlying reasons for all factors cited and discuss trends affecting variability in your operating cash flows. Note merely citing changes in results, working capital items, and noncash items reported in the statement of cash flows may not provide a sufficient basis to understand changes in reported operating cash flows between periods. Refer to Item 303(a) of Regulation S-K and the introductory paragraph of section IV.B and all of B.1 of Release No. 33-8350.

Other matters

The SEC staff often requests additional disclosures to enhance an investor's understanding of the impact of current or emerging trends in the macroeconomic environment on the company and the company's response to those trends.

For example, we have observed that the SEC staff has focused on registrants with large loan portfolios and has requested additional qualitative and quantitative information necessary to understand the loan portfolio, such as disaggregation by borrower type (e.g., office, hotel, multifamily) and disclosure of geographic concentrations, loan-to-value ratios and occupancy rates.

Example SEC staff comment: Commercial real estate loan portfolio

We note the tabular disclosure detailing the composition of your gross loan portfolio, which includes commercial real estate ("CRE"). Given the significance of CRE in your total loan portfolio, please revise your disclosures, in future filings, to further disaggregate the composition of your CRE loan portfolio by separately presenting the components of the portfolio by key borrower type (e.g., by office, hotel, multifamily) as well as whether the loans are owner occupied or not. Also, to the extent that there are material characteristics (e.g., current weighted average and/or range of loan-to-value ratios, occupancy rates, etc.) material to an investor's understanding of your CRE loan portfolio, include those details in future filings. Finally, revise to describe the specific details of any risk management policies, procedures or other actions undertaken by management in response to the current environment.

The SEC staff has requested additional details from registrants on how management has evaluated the risks related to higher interest rates and the commercial real estate environment.

The SEC staff requests enhanced disclosures of changes in operating cash flows and the underlying reasons for and implications of material changes.

Example SEC staff comment: Risks related to the commercial real estate environment

We note the discussion in which you disclose plans to prioritize loan growth in response to exceeding internal policy limits for Economic Value of Equity derived from simulation analysis used to manage interest rate risk in up rate scenarios explained in conjunction with your related tabular information. We also note your disclosure on page XX that certain loans including real estate-related credit risks are a significant concern for you. Please revise future filings to describe the specific details of any risk management policies, procedures or other actions undertaken by management to address management's noted plans to expand loan growth despite credit risk concerns, and in response to the current environment. We note Item 305 of Regulation S-K.

Critical accounting estimates

The SEC staff continues to ask registrants to focus their discussion of critical accounting estimates on the quality and variability of management's most significant judgments and assumptions.

Critical accounting estimates, as defined by Item 303(b)(3), are those that involve a significant level of estimation uncertainty and have had, or are reasonably likely to have, a material impact on the registrant's financial condition or results of operations.

The SEC staff has noted that registrants' disclosures about critical accounting estimates often are too general and should provide a more robust analysis than what is in the significant accounting policies note to the financial statements. While that note generally describes the method used to apply an accounting principle, the discussion in MD&A should address the measurement uncertainties involved in applying the principle at a given time.

The rules clarify that the critical accounting estimates disclosure must supplement, not duplicate, the disclosures in the financial statements. Therefore, registrants can consider including in MD&A a cross-reference to the footnote disclosure about significant accounting policies but should not repeat information that is already included in that note. MD&A disclosures should be expanded as necessary to address the following, if material:

- ▶ Quantitative and qualitative information to help investors understand the impact of estimation uncertainty on a registrant's financial condition or operating results
- ▶ Why the estimate is subject to uncertainty
- ▶ How much the estimate and/or assumption has changed over a relevant period
- ▶ The sensitivity of the reported amounts to the methods, assumptions and estimates underlying the estimate's calculation

Therefore, the SEC staff may ask registrants to provide both quantitative and qualitative information when it is reasonably available and material to investors and also may ask how their discussion of specific critical accounting estimates aligns with the information they provide in the notes to the financial statements, in a press release or elsewhere.

Since critical accounting estimates and assumptions are based on matters that are highly uncertain, the SEC staff believes that registrants should also analyze their specific sensitivity to change based on other outcomes that are reasonably likely to occur and would have a material effect.

Example SEC staff comment: Critical accounting estimates

We note your disclosure of critical accounting estimates appears to relate to estimates in connection with the allowance for credit losses, securities valuation, and income taxes; however, your disclosure appears to only refer to disclosure of information within the financial statement footnotes. Instruction 3 to Item 303(b)(3) of Regulation S-K requires that critical accounting estimates must be provided in a format that facilitates easy understanding and that supplements, and does not duplicate, descriptions of accounting policies and other disclosure already provided in the Form 10-K. Please revise to explain why each critical accounting estimate is subject to uncertainty and, to the extent the information is material and reasonably available, how much each estimate and/or assumption has changed over a relevant period, and the sensitivity of the reported amounts to the material methods, assumptions and estimates underlying its calculation. Refer to Item 303(b)(3) of Regulation S-K.

The SEC staff requested additional details this year related to management's goodwill impairment assessment. The SEC staff has asked registrants to expand their MD&A disclosure to include the potential events and changes in circumstances that could impact key estimates and the registrant's accounting for and impairment testing of goodwill as a critical accounting policy. For further discussion, please refer to the goodwill and intangible assets section of this publication.

How we see it

We believe registrants should continually assess which estimates they identify as critical accounting estimates, given the significant level of judgment involved. That is, registrants should consider the impact of any changes in the level of judgment and estimation uncertainty and the materiality of the estimate's reasonably likely impact on the financial statements.

Non-GAAP financial measures

As defined in Item 10(e) of Regulation S-K, a non-GAAP financial measure is a numerical measure of a registrant's historical or future financial performance, financial position or cash flows that does either of the following:

- Excludes amounts, or is subject to adjustments that have the effect of excluding amounts, that are included in the most directly comparable measure calculated and presented in accordance with US GAAP in the statement of comprehensive income, balance sheet or statement of cash flows (or equivalent statements) of the issuer
- Includes amounts, or is subject to adjustments that have the effect of including amounts, that are excluded from the most directly comparable US GAAP measure so calculated and presented

The SEC staff has long expressed concerns about the improper use of non-GAAP measures and continues to focus on whether they comply with Regulation G, Item 10(e) of Regulation S-K and the SEC staff's Compliance and Disclosure Interpretations (C&DIs) on non-GAAP measures, including whether:

- The most directly comparable GAAP financial measure is presented with equal or greater prominence as a disclosed non-GAAP measure and reconciled to that measure
- Adjustments render a non-GAAP measure misleading
- Non-GAAP measures and related adjustments are clearly labeled and described in sufficient detail so investors can understand all material components and distinguish them from GAAP measures, including the segment profitability measure required to be disclosed by Accounting Standards Codification (ASC) 280, *Segment Reporting*

- Disclosures convey the reasons why a non-GAAP measure provides useful information to investors

Undue prominence of non-GAAP measures

Rule 100(a) of Regulation G provides the overarching disclosure requirements that apply when a registrant presents or releases publicly (in writing or orally) any material information that includes a non-GAAP financial measure. If a non-GAAP financial measure is included in an SEC filing (e.g., Form 10-K), Item 10(e) of Regulation S-K requires additional disclosures and stipulates certain prohibitions. Among other things, Regulation G and Item 10(e) require registrants that present non-GAAP financial measures to present the most directly comparable measure calculated in accordance with GAAP. Item 10(e) requires that GAAP measure to be presented with equal or greater prominence than the non-GAAP measure.

The SEC staff believes that, to comply with the requirement to present the comparable GAAP measure with equal or greater prominence, a registrant needs to present and provide any discussion and analysis of the most directly comparable GAAP measure before that of the related non-GAAP measure. For this reason, GAAP measures must precede the non-GAAP measures in the required reconciliations. Additionally, registrants should avoid presenting non-GAAP measures in a manner that emphasizes them over GAAP measures. Furthermore, any discussion or analysis of a non-GAAP measure must be preceded by a discussion of the comparable GAAP measure.

Example SEC staff comment: Undue prominence of non-GAAP measures

We note your discussion of non-GAAP financial measures at the beginning of your MD&A before any discussion of your results of operations reported in GAAP. Please revise future filings to move the Use of Non-GAAP Financial Measures and the Reconciliations of GAAP to Non-GAAP Financial Measures sections further down in MD&A so you can present and discuss the directly comparable GAAP measures with equal or greater prominence than the non-GAAP measures. Refer to Item 10(e)(1)(i)(A) of Regulation S-K and Question 102.10 of the Compliance and Disclosure Interpretations on Non-GAAP Financial Measures. Your Quarterly Reports on Form 10-Q and Form 8-K earnings releases should be similarly revised.

C&DI Question 102.10(a) provides additional examples of instances in which non-GAAP measures are considered by the SEC staff to be more prominent than the comparable GAAP measures, including presenting an income statement of non-GAAP measures, or a ratio where a non-GAAP financial measure is the numerator and/or denominator without also presenting the ratio calculated using the most directly comparable GAAP measure with equal or greater prominence. Consistent with this guidance, the SEC staff has objected to registrants presenting a full non-GAAP income statement as a form of reconciliation because this gives the non-GAAP information undue prominence.

Example SEC staff comment: Presentation of a non-GAAP income statement

We note your non-GAAP reconciliations appear to include a full non-GAAP income statement. The presentation of a full non-GAAP income statement, or a presentation that gives the appearance of one, may place undue prominence on the non-GAAP information and give the impression that the non-GAAP income statement represents a comprehensive basis of accounting. Please remove this presentation in your future filings. To the extent you wish to present any of the non-GAAP measures, you should present a separate reconciliation for each non-GAAP measure and provide all the disclosures required by Item 10(e)(1)(i) of Regulation S-K including quantification and description of each adjustment individually. Refer to Question 102.10(a) and (c) of the C&DIs for Non-GAAP Financial Measures.

Reconciliation to the most directly comparable GAAP measure

Rule 100(a) of Regulation G and Item 10(e) of Regulation S-K require registrants to provide a reconciliation of the differences between a non-GAAP measure and its most directly comparable GAAP measure. When earnings before interest and taxes (EBIT) and earnings before interest, taxes, depreciation and amortization (EBITDA) have been presented as performance measures, the SEC staff has challenged when a registrant reconciles those measures to a measure other than GAAP net income as noted in C&DI 103.02.

Example SEC staff comment: Reconciliation of adjusted EBITDA to operating income

We note your reconciliation of the non-GAAP financial measure, adjusted EBITDA, uses operating income as the starting point for reconciling the adjusted EBITDA. Please refer to Question 103.02 of the Staff's Compliance and Disclosure Interpretation on Non-GAAP Financial Measures ("Non-GAAP C&DIs") and modify your reconciliations in future filings accordingly. The comment also applies to your earnings releases and other public disclosures, such as investor presentations.

The SEC staff has also challenged the reconciliation of non-GAAP margin measures to something other than GAAP gross margin even when GAAP gross margin is not presented on the face of the registrant's income statement. A company is expected to derive a GAAP gross margin (i.e., fully loaded gross margin) for purposes of the reconciliation requirements of Item 10(e) of Regulation S-K.

Example SEC staff comment: Reconciliation of a non-GAAP margin measure

Please reconcile the non-GAAP measure "adjusted gross profit" to the most directly comparable GAAP measure which is a fully-loaded GAAP gross profit that must be presented even if one is not depicted on your statements of operations. In addition, as you are presenting your adjusted gross margin on a percentage basis, please revise your disclosure to include your fully-loaded GAAP gross margin. Refer to Item 10(e)(1)(i)(A) of Regulation S-K. This comment also applies to your Forms 10-Q and Item 2.02 Forms 8-K which present a similar measure.

C&DI 102.10(b) notes that when presenting a forward-looking non-GAAP measure, registrants may exclude the quantitative reconciliation if they rely on the exception provided by Item 10(e)(1)(i)(B), but must disclose that fact, along with the specific information that is not available and its significance. This disclosure should be made with the same or greater prominence as that of the forward-looking non-GAAP measure.

Example SEC staff comment: Reconciliation of forward-looking non-GAAP measures

We note you have provided several forward-looking non-GAAP measures, but have not provided quantitative reconciliations to the most directly comparable GAAP financial measures. Please revise your presentation in future filings to provide the required reconciliations, or, if relying on the exception provided by Item 10(e)(1)(i)(B) of Regulation S-K, provide the reason such reconciliation has not been provided, the information that is not available, and the significance of that information. Refer to Question 102.10(b) of the non-GAAP C&DIs.

The SEC staff has objected to non-GAAP adjustments when it views certain expenses as normal, recurring cash operating expenses.

Misleading adjustments

Rule 100(b) of Regulation G states that a non-GAAP financial measure, taken together with accompanying information, may not misstate or omit a material fact necessary to make the presentation not misleading in light of the circumstances in which the presentation is made. Further, the SEC staff's C&DIs on non-GAAP measures state that whether an adjustment results in a misleading non-GAAP measure depends on the registrant's facts and circumstances. The C&DIs include several examples of actions that could cause an adjustment to be misleading and/or presentation and disclosure to be inappropriate, as discussed below.

Exclusion of normal, recurring cash operating expenses

In C&DI Question 100.01, the SEC staff said that non-GAAP performance measures could be considered misleading if they exclude normal, recurring cash operating expenses necessary to operate the registrant's business. The C&DI describes how the SEC staff considers whether operating expenses are "normal" and "recurring." The C&DI notes that, in making the determination of whether an operating expense is normal, the SEC staff considers how the nature and effect of non-GAAP adjustments relate to the company's operations, revenue-generating activities, business strategy and regulatory environment. Further, it states the SEC staff's view that an operating expense that occurs repeatedly or occasionally, including at irregular intervals, is recurring.

The SEC staff has asked registrants whether cash operating expenses are normal or recurring and, therefore, whether their exclusion from a non-GAAP financial measure could be misleading based on C&DI Question 100.01. While C&DI Question 100.01 refers to the exclusion of "normal, recurring, cash operating expenses," the SEC staff has said an adjustment may be misleading even if the expense excluded from the non-GAAP measure does not have all three of those attributes (i.e., normal, recurring, and cash) simultaneously. As such, an adjustment for a non-cash expense could be considered misleading under C&DI Question 100.01.

Historically, the SEC staff has objected to a variety of adjustments, including:

- Inventory-related valuation, reserves and impairment charges
- Certain legal and regulatory expenses
- Location (e.g., store, restaurant) pre-opening (including geography entry costs) and closing costs, and rent expense
- Cash-based compensation costs (e.g., certain retention and sign-on bonuses)
- Up-front and contingent milestone payments in connection with collaborative and licensing arrangements, or R&D arrangements
- Acquired in-process research and development (IPR&D) assets charged to R&D costs in an asset acquisition (e.g., in the pharmaceutical industry)
- Costs to be a public company (e.g., liability insurance for public company directors and officers, investor relation costs, listing fees)

Example SEC staff comment: Exclusion of IPR&D charges in an asset acquisition**Round 1 comment:**

Please explain to us why you believe that the adjustment to exclude acquired in-process research and development from net income in your reconciliation to non-GAAP Net Income is consistent with Item 10(e) of Regulation S-K or Regulation G, as well as the guidance in Question 100.01 of the Non-GAAP Financial Measures Compliance and Disclosure Interpretations.

Round 2 comment:

We have reviewed your response to prior comment 1. We believe adjustments to exclude acquired in-process research and development expense are inconsistent with the guidance in Question 100.01 of the Non-GAAP Financial Measures Compliance and Disclosure Interpretations. Please confirm to us that you will no longer include these adjustments in any non-GAAP financial measure presented in accordance with Item 10(e) of Regulation S-K or Regulation G as well as the guidance in Question 100.01 of the Non-GAAP Financial Measures Compliance and Disclosure Interpretations.

We have also seen the SEC staff comment on non-GAAP adjustments related to frequent restructuring and acquisition-related costs. Although the SEC staff has said that restructuring costs have not typically been found to be normal in their assessed fact patterns, it has emphasized that registrants should consider how restructuring relates to the factors noted in C&DI Question 100.01 (i.e., operations, revenue-generating activities, business strategy, industry and regulatory environment) to make that determination. Additionally, based on the restrictions in Item 10(e) and C&DI Question 102.03, it would not be appropriate to adjust for a charge or gain identified as non-recurring, infrequent or unusual when the nature of the charge or gain is such that it is reasonably likely to recur within two years or there was a similar charge or gain within the prior two years.

When a registrant has frequent business acquisitions and restructuring costs over successive quarters or years, the SEC staff has asked about the facts and circumstances supporting an adjustment for what could be a recurring cost. The SEC staff also has asked registrants to explain and quantify the components of these adjustments.

Example SEC staff comment: Exclusion of restructuring costs

We note that your non-GAAP measures include adjustments for “restructuring and cost reduction,” “Electronic Materials inventory adjustment,” “business transformation costs,” and “additional start up resources and scrap.” Please explain to us in sufficient detail the nature of all items included in each adjustment. Explain how you concluded each cost is not a normal, recurring, cash operating expense of your business and why eliminating it within your non-GAAP financial measures is meaningful and appropriate. Refer to Question 100.01 of the Non-GAAP C&DIs.

How we see it

We believe adjustments to exclude restructuring costs and acquisition-related costs from non-GAAP measures will generally continue to be allowed. However, registrants will need to exercise judgment, based on their facts and circumstances, to determine whether such adjustments are appropriate.

Individually tailored accounting principles

The SEC staff has asked registrants about non-GAAP adjustments to both revenue and expenses that could have the effect of changing the recognition and measurement principles required by GAAP, thereby rendering them “individually tailored” and potentially resulting in a misleading measure based on C&DI Question 100.04 and violating Rule 100(b) of Regulation G.

C&DI Question 100.04 provides guidance on non-GAAP measures that the SEC staff believes could be misleading and includes a non-exhaustive list of examples of non-GAAP adjustments to both revenue and expenses that could have the effect of changing the recognition and measurement principles required by GAAP and, therefore, could be misleading. For example, it would be misleading to present a non-GAAP measure of revenue that deducts transaction costs as if the company acted as an agent in the transaction, when gross presentation as a principal is required by US GAAP.

Significant judgment is required to determine whether a measure of a registrant’s historical or future financial performance, financial position or cash flows may apply tailored accounting principles. While the SEC staff historically focused on adjustments to revenue, its current approach is broader and includes challenging other ways registrants modify GAAP recognition and measurement principles to calculate non-GAAP measures as described in C&DI 100.04.

Recent examples of measures that the SEC staff has objected to include those that:

- Adjust the fair value of assets purchased and/or liabilities assumed in purchase accounting
- Eliminate the amortization of only a portion of acquired intangibles
- Change the pattern of recognition (e.g. accelerate the recognition of deferred revenue)
- Change an item from accrual to cash basis or from gross to net
- Combine the results of continuing and discontinued operations

Example SEC staff comment: Adjustment related to Non-GAAP Net Revenue: Gross-to-Net

We note your presentation of the non-GAAP performance measure titled “Non-GAAP Net Revenue” in your earnings presentations on your website. Considering this measure adjusts your ... GAAP revenue from a gross basis to a net basis, please explain to us why you believe this measure does not substitute individually tailored revenue recognition and measurement methods for those of GAAP. Refer to Rule 100(b) of Regulation G.

How we see it

Registrants should consider the SEC staff’s objections to non-GAAP measures to determine whether they should make any adjustments to their own measures.

Registrants should be prepared to revise their future filings, earnings releases, earnings guidance and other documents containing the measures, including revising any comparative data. When the SEC staff concludes that a non-GAAP measure is misleading, it expects the registrant to discontinue using the measure or the portion of the measure that is misleading for all periods presented.

Inappropriate and/or unclear labeling and descriptions

The SEC staff often requests additional information and explanation from a registrant when a measure may meet the definition of a non-GAAP measure in Item 10(e) but is not identified as a non-GAAP measure.

For instance, C&DI Question 104.04 notes that the total segment profit or loss presented in the reconciliation required by ASC 280 would be a non-GAAP financial measure if it is presented outside the context of the segment reporting footnote in the consolidated financial statements. The SEC staff has asked registrants to comply with the relevant SEC rules and regulations on the use of non-GAAP measures when such a total is presented outside the consolidated financial statements.

Further, the SEC staff has continued to issue comment letters on registrants' segment reporting disclosures. For further discussion, please refer to the segment reporting section of this publication.

Item 10(e) of Regulation S-K prohibits registrants from using titles or descriptions of non-GAAP financial measures that are the same as, or confusingly similar to, titles or descriptions used for GAAP financial measures. Further, C&DI Question 100.05 notes that a non-GAAP financial measure (or an adjustment made to a GAAP financial measure) can be misleading if it is not appropriately labeled and clearly described and includes examples of inappropriate labeling practices, such as the failure to identify and describe a measure as non-GAAP and the presentation of a non-GAAP measure with a label that does not reflect its nature.

The SEC staff often asks registrants to clearly label and describe non-GAAP measures and related adjustments in sufficient detail so investors can understand all material components and distinguish them from GAAP measures.

Example SEC staff comment: Description of non-GAAP adjustments

This measure is calculated using adjusted return after taxes. Accordingly, please revise the description of this measure to present what it represents as it is confusingly similar to a measure calculated with GAAP amounts. Refer to Item 10(e)(1)(ii)(e) of Regulation S-K and Question 100.05 of our Compliance and Disclosure Interpretations on Non-GAAP Financial Measures. Additionally, it appears the comparable measure to this non-GAAP measure is return on invested capital using GAAP amounts rather than return on assets as currently presented. Please revise your presentation as appropriate.

In C&DI Question 102.07, the SEC staff has emphasized the need for clear definitions and descriptions of measures that do not have a uniform definition and whose title does not describe how they are calculated (e.g., free cash flow). The C&DI refers to "free cash flow" as cash flows from operating activities (as presented in the statement of cash flows under GAAP) less capital expenditures. The SEC staff continues to issue comments and ask registrants to change the title of a non-GAAP measure when its calculation appears different from the typical calculation of the measure.

Example SEC staff comment: Definition and labeling of free cash flow

Refer to your presentation of “Free Cash Flow” throughout the filing. Since free cash flow is typically calculated as cash flows from operating activities as presented in the statement of cash flows under GAAP, less capital expenditures, and your calculation includes an additional adjustment, please revise your computation accordingly or revise the title of this measure to be “adjusted free cash flow”. Refer to Question 102.07 of the Non-GAAP Financial Measures Compliance & Disclosure Interpretations. Please also apply this comment to your earnings release presentation on future Form 8-K.

In C&DI Question 103.01, the SEC staff has emphasized that registrants should not label as EBIT or EBITDA non-GAAP measures that are calculated differently from those described in the **2003 rulemaking release**, whereby Regulation G and Item 10(e) of Regulation S-K were adopted. The 2003 release defines EBIT as earnings before interest and taxes and EBITDA as earnings before interest, taxes, depreciation and amortization. The SEC staff has objected to the labeling of non-GAAP measures as EBIT or EBITDA when they do not meet the definitions in the 2003 release.

Example SEC staff comment: Definition and labeling of EBITDA

We note your description of EBITDA on page X and the reconciliation from Net Income Attributable to the Company on page XX, which include reconciling items other than interest, taxes, depreciation, and amortization. To the extent this measure is presented in future filings, please characterize the measure as something other than EBITDA, such as “Adjusted EBITDA.” Refer to question 103.01 of the C&DIs for Non-GAAP Financial Measures. This comment is applicable to all instances where this non-GAAP measure is disclosed.

Usefulness and purpose of the disclosure

Although C&DI Question 102.04 notes that there is no prohibition against disclosing a non-GAAP financial measure that is not used by management in managing the business, Item 10(e) of Regulation S-K requires registrants to disclose the reasons why management believes that a non-GAAP measure provides useful information to investors and, to the extent material, any additional purposes for which the registrant’s management uses the non-GAAP measure. The SEC staff has asked registrants to clarify and expand their disclosures to discuss why a particular measure is useful to investors and any additional purposes for which management uses it. Often, the disclosures that the SEC staff asks about are boilerplate or too general to help readers understand how they should use a particular measure. If a registrant cannot adequately explain why a measure is useful, the SEC staff may consider that as an indication that the measure may be misleading.

Example SEC staff comment: Usefulness of non-GAAP measures

We note your disclosure that you believe the non-GAAP measures to be important supplemental measures of performance that are commonly used by securities analysts, investors and other interested parties in the evaluation of companies in your industry and that you use this information internally for forecasting and budgeting. In that regard, please tell us in further detail and expand your disclosure to address each of the non-GAAP measures presented as to how and why each individual measure is useful to investors regarding your financial condition and results of operations. We note you present non-GAAP measures for every single income statement line item. Refer to Item 10(e)(i)(C) and (D) of Regulation S-K.

Segment reporting

The SEC staff continues to focus on how registrants apply the guidance in ASC 280, including:

- How registrants identify operating segments
- How registrants aggregate operating segments into reportable segments
- Whether registrants provide appropriate disclosures for each of their reportable segments (e.g., information about segment profit or loss, significant segment expenses), entity-wide disclosures, and the related reconciliations required by ASC 280

When reviewing segment reporting, the SEC staff considers information in the registrant's public filings, as well as information available from a registrant's earnings calls, website, and industry or analyst presentations. The SEC staff has asked registrants to explain any inconsistencies between how the business is described in public information and how it is described in their segment footnotes.

For example, the SEC staff has challenged a registrant's basis for identifying its operating segments (e.g., by geographic area) when it publicly discloses information elsewhere (e.g., its website) that suggests the chief operating decision-maker (CODM) uses a different basis (e.g., by products or service lines) to make decisions and allocate resources.

The term “chief operating decision-maker” defines a function rather than an individual with a specific title.

Identification of operating segments

The segment reporting guidance is based on a “management approach” (ASC 280-10-05-3 through 05-4). That is, segment disclosures should reflect a registrant's internal reporting structure to enable investors to view the company in a similar way as management does.

Identifying operating segments (ASC 280-10-50-1 through 50-9) is the first step in preparing segment disclosures. A critical element of this analysis is identifying the CODM. To evaluate a registrant's identification of operating segments, the SEC staff often requests a description of the registrant's organizational structure and detailed information about employees who report directly to the CODM, including their roles and responsibilities and interactions with the CODM, in addition to information about how operating decisions are made (e.g., allocation of resources).

The SEC staff also considers the basis on which budgets and forecasts are prepared and how performance objectives are evaluated, including how executive compensation is determined (e.g., performance criteria underlying compensation plans). This information helps the SEC staff understand how the CODM assesses performance and allocates resources, and whether that is consistent with the operating segments identified.

To qualify as an operating segment, a component of a registrant must have discrete financial information that the CODM regularly reviews to assess performance and make resource allocation decisions. The SEC staff frequently has requested that registrants describe the financial information provided to the CODM so it can understand the information used by the CODM to assess performance and allocate resources.

When a registrant identifies only one operating segment, the SEC staff is more likely to challenge how decisions can be made about performance and resources for the company as a whole without evaluating discrete financial information on a more disaggregated basis.

Example SEC staff comment: Identification of operating segments

Although we note your disclosures that you manage the business on a global basis and that you believe your company represents a single consolidated operating segment, we note that the executive management team on your website includes regional presidents for America, Asia, China, and Europe. We further note that you discuss regional results and trends within your results of operations and during the most recent quarterly earnings call. Please tell us in sufficient detail how you determined that you have only one reportable and operating reportable segment. In doing so, provide us with the following information:

- Tell us the title and role of each individual that reports to your Chief Operating Decision Maker (CODM);
- Identify and describe the role of each segment manager;
- Tell us how often the CODM meets with his/her direct reports, the financial information the CODM reviews to prepare for those meetings, the financial information discussed in those meetings, and who else attends those meetings;
- Describe the information regularly provided to both the CODM and the Board of Directors, and how frequently it is prepared;
- Explain how budgets are prepared, who approves the budget at each step of the process, the level of detail discussed at each step, and the level at which the CODM makes changes to the budget.
- Describe the level of detail communicated to the CODM when actual results differ from budgets and who is involved in meetings with the CODM to discuss budget-to-actual variances; and
- Describe the basis for determining the compensation for each of the individuals that report to the CODM.

Aggregation of operating segments

ASC 280 allows, but does not require, a registrant to aggregate operating segments for reporting purposes. To aggregate operating segments, a registrant must determine that all of the following criteria in ASC 280-10-50-11 are met:

- The aggregation must be consistent with the objective and basic principles of ASC 280
- The operating segments must be economically similar
- The following five qualitative characteristics of the operating segments must be similar: (1) the nature of the products and services, (2) the nature of the production processes, (3) the type or class of customer for their products and services, (4) the methods used to distribute their products or provide their services and (5) the nature of the regulatory environment, if applicable

The SEC staff often reviews the registrant's website, analyst presentations and information in public filings, and it raises questions if any of that information is inconsistent with the registrant's conclusion that aggregating operating segments is appropriate. For example, a discussion of diverging trends or differing results at two business lines could indicate that these business lines, if they qualify as operating segments, may not be economically similar.

The SEC staff has requested historical and projected operating margins, gross margins, revenue and other measures of operating performance when challenging a registrant's aggregation of operating segments.

The SEC staff has frequently asked registrants that have aggregated operating segments into a reportable segment to explain why they believe that the operating segments are economically similar and that the five qualitative characteristics of the operating segments are similar, as required by ASC 280.

The SEC staff has also reminded registrants that the guidance on determining whether two operating segments are similar requires a company to consider the range of its business activities and the economic environment in which it operates. For example, while one registrant with a diversified product portfolio may consider certain products similar, another registrant with a narrower range of activities may not consider those products similar.

The SEC staff has also asked registrants to explain how the aggregation of operating segments into reportable segments complies with ASC 280-10-50-11. The SEC staff has also asked registrants to disclose the factors used to identify their reportable segments, including the basis of organization, in accordance with ASC 280-10-50-21.

Example SEC staff comment: Aggregation of operating segments

Round 1 comment:

We note your disclosure that the AB reportable segment includes the A and the B operating segments, and that the XY reportable segment includes the X and Y operating segments. Please tell us how you considered aggregating or combining these operating segments in determining your reportable segments pursuant to ASC 280-10-50-10 through 50-13. Please compare and contrast aggregated or combined operating segments relative to their economic characteristics and to each of the areas listed in ASC 280-10-50-11(a) to 11(e).

Round 2 comment:

1. We note your response that you considered the economic characteristics of the A and B operating segments to be similar and that the aggregation meets the objective and basic principles of segment reporting under ASC 280. Please address the following points:
 - Please elaborate how the aggregation of these two operating segments helps investors understand your performance and assess prospects for future cash flows. In doing so, please consider providing a balanced assessment of both supporting and contradicting evidence such as your communications with investors, industry reports or other analyses by users of your financial statements. For example, we note from the quarterly investor presentations in 202X published on your website that B's growth ranged from 8% to 12%, while A's growth ranged from 2% to 4%. We also note that in your earnings calls, management and analysts discussed the significant growth in B on various occasions.
 - Please provide us with the actual margins for each of these two operating segments in historical periods presented in your financial statements and further explain how you analyzed the similarity of the long-term average margins.
 - Your response indicates that the historical margins as calculated as pre-tax adjusted income from operations divided by total adjusted revenues ranged from 3% to 5%. Please tell us how you considered the similarity of economic characteristics on both an absolute and relative basis and your basis for expecting the operating segments to exhibit similar long-term financial performance.

ASC 280 requires entities to disclose certain entity-wide information if it is material, even if it is not used by the CODM to manage the entity.

2. We note your response regarding your aggregation of the X and Y operating segments. Please address the following:

- Your response indicates the historical margins (i.e., pre-tax adjusted income from operations divided by total adjusted revenues) for these operating segments have ranged from the high single digits to the low double digits, and X has generally performed at the higher end of that range relative to Y while management expects further margin convergence over the long term. Please provide us with the actual margins for each of these two operating segments in historical periods presented in your financial statements and explain how you analyzed the similarity of the long-term average margins, including when you expect convergence to occur over the long-term. As part of your response, please include your consideration of the implementation guidance in ASC 280-10-55-7A.
- We also note your response indicates that variations in the financial performance of the two operating segments are expected due to factors such as the type of products offered, local regulatory capital requirements, and customer location and demographics. In addition to the economic similarity, please explain how you considered this variation in your analysis of the qualitative factors in ASC 280-10-50-11(a) to 11(e).

Disclosures

ASC 280 requires disclosure of certain financial information for each reportable segment (e.g., revenue, a measure of profit or loss, assets) and additional “entity-wide” disclosures (e.g., revenue for the entire entity, organized by products and services and by geographic area, long-lived assets). ASC 280 also requires certain quantitative reconciliations of combined reportable segment information to the corresponding amounts reported in the consolidated financial statements. Each quantitative reconciliation also should disclose applicable amounts attributable to the “all other”¹ category separately from other significant reconciling items. For example, a reconciliation from the total of the reportable segments’ revenue to the entity’s consolidated revenue should disclose “all other revenue” separately from corporate eliminations of intersegment revenues.

Entity-wide disclosures

The following entity-wide disclosures, if material, are required under ASC 280 regardless of whether that information is provided to or used by the CODM:

- Disaggregated revenue by product and service – revenue derived from transactions with external customers for each product or service, or each group of similar products or services
- Disaggregated revenue and long-lived assets by geography – revenue and long-lived assets information attributed to the registrant’s country of domicile and all foreign countries in total and separately for each foreign country that is material
- Revenue contributed by significant customers – total revenue from each major customer (i.e., one that contributes 10% or more of total revenues) and the segment(s) in which the revenue is reported

The SEC staff has challenged the absence of these disclosures when the registrant’s publicly disclosed information indicates that its reportable segments contain a range of products or services, that there may be material revenue or long-lived assets from foreign locations and/or that there may be a concentration of sales attributable to a specific customer. The SEC staff has also questioned the level of disaggregation provided in entity-wide disclosures (e.g., when a registrant presents revenue disaggregated by geographic region but not by customer or major product category).

The SEC staff has reminded registrants that the entity-wide disclosures required by ASC 280 must be presented in accordance with US GAAP.

Example SEC staff comment: Entity-wide disclosures

We note that you disclose revenue disaggregated by geography within each of your reportable segments, A, B and C. We also note that during the last few years you have made several acquisitions, including X, and during your recent earnings calls and in presentations you discuss sales volume/mix trends for three businesses within the A segment: X; Y; and Z. Please explain to us how you have considered the requirements to present revenue at a lower level by product or service, as required by ASC 280-10-50-40. See also guidance for disaggregated revenue presentation in ASC 606-10-50-5.

Reconciliations

The SEC staff has commented on registrants' omission of one or more of the reconciliations required by ASC 280-10-50-30 or when the reconciliation provided does not reconcile to the corresponding consolidated amount required by ASC 280 (e.g., it reconciles the total of the reportable segments' profit or loss measure to consolidated gross profit rather than to consolidated income before income taxes).

Example SEC staff comment: Combined total of reportable segments' measures of profit or loss is not reconciled to consolidated income before income taxes

We note your reconciliation of total segment earnings from operations excluding corporate overhead, asset impairment charges, net gains (losses) on lease modifications, and gain on sale of assets to total earnings from operations. Please note that ASC 280-10-50-30(b) requires a reconciliation of the total of the reportable segments' measures of profit or loss to the public entity's consolidated income before income taxes. In future filings, please revise your reconciliation to comply with this guidance.

The SEC staff has also questioned the appropriateness of registrants' quantitative reconciliations when they do not begin with a combined total for all reportable segments, as required by ASC 280, and/or that do not separately identify and describe reconciling amounts that are attributable to the "all other" category and other significant reconciling items.

Example SEC staff comment: Reconciliation required by ASC 280 begins with an incorrect measure

ASC 280-10-50-30(b) requires the total of the reportable segments' measures of profit or loss be reconciled to the public entity's consolidated income before income taxes and discontinued operations. Please revise your reconciliations to start with the total of the measures of profit or loss for all of your reportable segments. In this regard, we note your reconciliation does not include all reportable segments and does not include all eliminations, such as intersegment eliminations, that should be presented as reconciling items to arrive at consolidated income before income taxes rather than included in the starting point. See ASC 280-10-50-31 and 280-10-55-49. Please similarly revise other required reconciliations, such as reportable segments' revenues and assets, to start with the total of the reportable segments' amounts. See ASC 280-10-50-30(a), (c), and (d).

Measure of profit or loss for reportable segments

By definition, the segment measure of profit or loss that a company is required to disclose in accordance with ASC 280 for reportable segments (i.e., the measure of segment profit or loss used by the CODM for purposes of making decisions about allocating resources to the segment and assessing its performance) is not a non-GAAP measure and is not subject to the SEC's rules and regulations on the use of non-GAAP financial measures. However, registrants should be aware that a combined total of reportable segments' measures of profit or loss may create a non-GAAP financial measure and would require compliance with Item 10(e) and the C&DIs on non-GAAP measures if it were used anywhere outside the required ASC 280 reconciliation (e.g., if it is disclosed in MD&A).

Example SEC staff comment: Combined total of reportable segments' measures of profit or loss is disclosed outside the segment footnote

Although we note that earnings (loss) from operations at the segment level represents a required ASC 280 measure, please note that the measure on a total combined basis outside of the notes to the financial statements represents a non-GAAP measure. See Question 104.04 of the Compliance and Disclosure Interpretations on Non-GAAP Financial Measures ("Non-GAAP C&DIs"). Accordingly, if you continue to present such measure outside of your consolidated financial statements, please label it as a non-GAAP financial measure and ensure that your presentation and disclosures fully comply with non-GAAP rules, including Item 10(e) of Regulation S-K and the Non-GAAP C&DIs. The comment also applies to such non-GAAP measures disclosed in earnings releases furnished in Forms 8-K.

Registrants should determine the measure of segment profit or loss that is required to be disclosed in accordance with ASC 280-10-50-22. That is, if the CODM uses more than one measure of segment profit or loss to assess performance and allocate resources, the measure required to be disclosed is the one determined in accordance with the measurement principles most consistent with those used in measuring the corresponding amounts in the entity's consolidated financial statements (i.e., the segment measure that is most consistent with US GAAP).

For example, if the CODM uses segment operating income and segment EBITDA to assess performance and allocate resources, the measure of segment profit or loss required to be reported under ASC 280 would be segment operating income, since that measure is most consistent with US GAAP. The SEC staff has questioned the appropriateness of the disclosed measure of segment profit or loss (e.g., when other information suggests the CODM also uses a measure more consistent with US GAAP for purposes of making decisions about allocating resources to the segment and assessing its performance).

Example SEC staff comment: Disclosed measure of segment profit or loss

You state that you use segment revenue less repair payments as a primary measure to allocate resources and measure segment performance. We note you also disclose a "segment gross profit" measure in your reconciliation. Please tell us if the segment gross profit is a measure of a segment's profit or loss regularly provided and used by your CODM in assessing segment performance and deciding how to allocate resources. If your CODM uses both segment revenue less repair payments and segment gross profit as segment profit or loss measures, the reported measure shall be the one determined in accordance with the measurement principles most consistent with those used in the corresponding amounts in your consolidated financial statements. Please revise your disclosure to clarify the segment profit or loss measures required to be disclosed by ASC 280.

Disclosures pursuant to the adoption of ASU 2023-07

In November 2023, the FASB issued ASU 2023-07, *Segment Reporting (Topic 280): Improvements to Reportable Segment disclosures*, which amended ASC 280 to require that all public entities disclose additional information about a reportable segment's expenses, among other items. Under key provisions of the ASU, public entities are required to:

- Disclose the title and position of the individual or the name of the group or committee identified as the CODM
- Disclose significant segment expenses and an amount for "other segment items" for each reportable segment (including a description of the composition of other segment items)
- Explain how the CODM uses the reported measures of segment profit or loss in assessing segment performance and deciding how to allocate resources

The guidance permits entities to disclose more than one measure of a segment's profit or loss if such measures are used by the CODM to allocate resources and assess performance, as long as at least one of the measures reported is the one that is most consistent with US GAAP (i.e., the segment profitability measure required to be reported in accordance with the historical ASC 280 guidance which the ASU did not change). All other segment profitability measures used by the CODM that a public entity chooses to disclose are considered additional measures of segment profit or loss.

Additionally, the guidance clarifies that entities with a single reportable segment are also required to provide the new disclosures and all the disclosures historically required under ASC 280.

The guidance was effective for all public entities for fiscal years beginning after 15 December 2023. This means that calendar year-end public companies provided the segment expense and other disclosures required by ASU 2023-07 for the first time in their 2024 annual financial statements. This section discusses emerging themes in the SEC comment letters addressing registrants' new disclosures under the guidance that were available at the time of this publication.

How the CODM uses the reported measure(s) of segment profit or loss

The SEC staff has frequently commented on registrants' omission of this disclosure, including when a registrant's disclosure merely states that the CODM uses the reported measure(s) without further describing how the CODM uses the measure.

Example SEC staff comment: How the CODM uses the measure(s) of segment profit or loss

You state that the CODM assesses performance and decides how to allocate resources based on net loss as reported in the consolidated statements of operations. Please tell us how you considered the guidance in ASC 280-10-50-29(f) and the example at 280-10-55-54(c) to discuss how the CODM uses this measure in assessing performance and deciding how to allocate resources or consider revising.

Additional measures of segment profit or loss

The SEC staff has said that additional measures of segment profit or loss a public entity chooses to disclose that are not determined in accordance with US GAAP would be considered non-GAAP financial measures because ASC 280 does not (1) require disclosure of additional measures of segment profit or loss or (2) expressly permit their disclosure by prescribing or otherwise specifying the additional measures that may be disclosed.

Although Item 10(e) of Regulation S-K prohibits the inclusion of non-GAAP measures on the face of the financial statements and accompanying footnotes, the SEC staff has said it will not object to the disclosure of additional segment profitability measures that are not determined in accordance with US GAAP in the footnotes to the financial statements, provided that these measures otherwise comply with all other aspects of Item 10(e) of Regulation S-K, Regulation G and the related SEC staff's C&DIs, including that the presentation of the non-GAAP measure not be misleading.

Example SEC staff comment: Disclosure of non-GAAP measures of segment profit or loss

1. You disclose that the primary measure used by the chief operating decision maker ("CODM") is segment income or loss from operations; however, we note that you also present segment gross profit. Please tell us whether the CODM receives segment gross profit for each reportable segment and how it is used. If the CODM uses more than one measure of segment profit or loss, such as segment gross profit and segment operating income, to assess segment performance and to decide how to allocate resources, tell us which of the reported segment profit or loss measures is required to be disclosed in accordance with ASC 280-10-50-28A. In this regard, the measure required to be disclosed is that which management believes is determined in accordance with the measurement principles most consistent with those used in measuring the corresponding amounts in the consolidated financial statements. Additional measures may be disclosed pursuant to ASC 280-10-50-28A through 50-28C.
2. In connection with your response to the preceding comment, if both segment gross profit and segment operating income are used by the CODM and will be disclosed:
 - Please tell us how you considered the disclosures required by ASC 280-10-50-29(f) for segment gross profit; and
 - Please tell us what consideration was given to identifying the additional measure of segment profit or loss as non-GAAP and providing the disclosures required by Item 10(e)(1)(i) of Regulation S-K in the filing.

The SEC staff also said that when additional non-GAAP segment profitability measures are disclosed, the related disclosures required under Item 10(e) and the C&DIs on non-GAAP financial measures may be included in the segment footnote or elsewhere in the entity's public filing, such as MD&A. If these disclosures are presented outside of the financial statements (e.g., in MD&A), the SEC staff does not expect a cross reference from the segment footnote to other sections of the filing where the non-GAAP disclosures are located, because doing so is prohibited under SEC regulations.

How we see it

We encourage entities to carefully consider this SEC staff guidance and to engage with their legal counsel and independent auditors when considering disclosure of additional non-GAAP segment measures of profit or loss in the financial statements.

Significant segment expenses and other segment items

ASC 280 requires a public entity to disclose, for each reportable segment, the significant expense categories and amounts that are regularly provided to the CODM and included in each reported measure of a segment's profit or loss (referred to as the significant expense principle). The guidance also requires a public entity to disclose, for each reportable segment, a category and amount for "other segment items" representing the difference between reported segment revenue, the significant segment expenses disclosed under the principle and the reported measure of segment profit or loss.

When no significant expense categories and amounts are disclosed for a reportable segment, a public entity should report an amount and a description of the composition of “other segment items” and describe the expense information that the CODM uses to manage the operations of that segment (e.g., whether the CODM uses budgeted or forecasted expense information or consolidated expense information).

The SEC staff has commented on registrants’ omission of the disclosure of significant segment expenses and other segment items. The SEC staff has also commented when a registrant’s disclosure does not clearly distinguish significant segment expenses from other segment items.

Example SEC staff comment: Omission of significant segment expense and other segment items disclosures

We note your disclosure of other segment items and that you do not disclose significant segment expenses. Please tell us how you considered ASC 280-10-50-26C and ASC 280-10-55-15G which requires that if an entity does not disclose significant expense categories and amounts it shall explain the nature of the expense information the chief operating decision maker uses to manage operations.

Example SEC staff comment: Distinction between significant segment expenses and other segment items

Please refer to the reconciliation of net sales to segment operating income. Please tell us whether operating expenses represents a significant segment expense determined in accordance with ASC 280-10-50-26A or if it represents “other segment items” in accordance with ASC 280-10-50-26B. If the amount represents other segment items, please tell us how you complied with the guidance in ASC 280-10-50-26B, including disclosure of a qualitative description of the composition of other segment items.

Revenue recognition

Disaggregated revenue disclosures

Disaggregated revenue disclosures continue to be one of the areas most frequently commented on by the SEC staff. Under ASC 606-10-50-5, entities are required to disclose disaggregated revenue information to illustrate how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors. While ASC 606, *Revenue from Contracts with Customers*, does not specify how revenue should be disaggregated, the implementation guidance in ASC 606-10-55-89 through 55-91 suggests categories for entities to consider.

This guidance states that when an entity selects categories, it should consider how the information about its revenue has been presented for other purposes, including outside the financial statements and in information regularly reviewed by the CODM.

The SEC staff has requested additional details about how registrants have considered the implementation guidance when selecting categories of revenue.

The SEC staff continues to review all publicly available information (including MD&A, investor presentations and earnings calls transcripts) to evaluate whether the objectives of this disclosure requirement have been met. The SEC staff has requested explanations when registrants have not disaggregated revenue in a manner similar to how they disclosed information in other communications, particularly when revenue is disaggregated into fewer categories than would be expected based on how registrants’ products and services are described in other communications.

Example SEC staff comment: Disaggregated revenue disclosures

We note that you recognize revenues from several research collaboration and license agreements, and that such revenues are recognized on either a straight-line basis over the estimated performance period under the arrangement or over the estimated performance period based on your best estimate of costs to be incurred. We also note that your revenues could represent amounts from up-front fees, option fees, research funding fees, milestone payments, or royalties. Please explain to us your consideration of providing disaggregated revenue disclosures into categories that enable the users of your financial statements to better understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from your contracts with customers. Please refer to the guidance in ASC 606-10-50-5 and ASC 606-10-55-89 through 91 in your response.

We believe that registrants should analyze the characteristics and risk factors for each of their revenue streams to determine the proper level of revenue disaggregation that will be beneficial to users of financial statements. If certain characteristics or risk factors could lead to changes in the timing of revenue recognition, they should be evaluated as potential categories for this disclosure.

In addition, ASC 606-10-50-6 requires an entity to explain the relationship between the disclosure of disaggregated revenue and revenue information that is disclosed for each reportable segment. Registrants should review their disclosures to verify that they meet this disclosure requirement. For further discussion on segment disclosures, including entity-wide revenue disclosures, refer to the segment reporting section of this publication.

Identifying and satisfying performance obligations***Identification of performance obligations***

To apply ASC 606, an entity must first identify the promised goods and services in a contract with a customer and then determine which of those goods and services are separate performance obligations. Promised goods and services represent separate performance obligations if the goods or services are distinct (by themselves or as part of a bundle of goods and services) or if the goods and services are part of a series of distinct goods and services that are substantially the same and have the same pattern of transfer to the customer.

A promised good or service is distinct if both of the following criteria are met: (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 (i.e., 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 (i.e., the promise to transfer the good or service is distinct in the context of the contract).

Over the past year, the SEC staff continued to seek more details about how registrants identified performance obligations in contracts with customers.

Registrants should carefully identify the promises in a contract and evaluate the criteria for determining whether the promises for those goods and services are separately identifiable from other promises in the contract. Registrants also should provide detailed disclosures about their performance obligations in contracts with customers, including a description of the nature of the goods or services that they have promised to transfer.

Satisfaction of performance obligations

In accordance with ASC 606-10-25-23, revenue is recognized when (or as) the entity satisfies a performance obligation by transferring a promised good or service to the customer. ASC 606 states that an entity must determine at contract inception whether it will transfer control of a promised good or service over time. If an entity does not satisfy a performance obligation over time, the performance obligation is satisfied at a point in time. The guidance requires entities to disclose when they typically satisfy their performance obligations (e.g., upon shipment, as services are delivered). Entities must also disclose significant judgments made in determining the timing of satisfaction of performance obligations.

Further, when an entity has determined that a performance obligation is satisfied over time, ASC 606 requires it to select a single revenue recognition method (i.e., measure of progress) that depicts the entity's performance in transferring control of the goods or services and disclose the method selected, including why the method selected provides a faithful depiction of the transfer of goods or services.

The SEC staff continues to ask registrants to provide more details about the timing of when control of a good or service transfers as well as their methods of recognizing revenue.

Example SEC staff comment: Identification and satisfaction of performance obligations

We request that you provide comprehensive disclosures for revenues related to the various services you provide including (a) identification of the performance obligations (i.e., when typically satisfied, significant payment terms, nature of goods and services, obligations for returns, refunds, and other similar obligations, and types of warranties and related obligations) with reference to ASC 606-10-50-12 through 50-12A and 606-10-50-17, (b) significant judgments for the method used to recognize revenue over time and why the method faithfully depicts the transfer of the services with reference to ASC 606-10-50-18, (c) significant judgments made in evaluating when a customer obtains control of a service that is recognized at a point in time with reference to ASC 606-10-50-19 and (d) variable consideration and any other obligations with reference to ASC 606-10-50-20.

Disclosure of remaining performance obligations

The SEC staff has requested that registrants describe when they expect to recognize revenue for remaining performance obligations. For performance obligations that are unsatisfied (or partially unsatisfied) as of the end of the reporting period, ASC 606-10-50-13 requires entities to disclose:

- The aggregate amount of the transaction price allocated to the remaining performance obligations
- An explanation (either on a quantitative or a qualitative basis) of when the entity expects to recognize the transaction price allocated to the remaining performance obligations as revenue

Example SEC staff comment: Disclosure of remaining performance obligations

You disclose that contracted not recognized revenue was approximately \$X billion, of which you expect to recognize approximately X% over the next 12 months and the remaining thereafter. Please revise to further explain when the remaining Y% will be recognized as revenue, on a quantitative basis using time bands that would be most appropriate or by using qualitative information. Please include proposed draft disclosure in your response. Refer to ASC 606-10-50-13b.

Separate presentation of revenue

Over the past year, the SEC staff has reminded registrants to consider the guidance in Rule 5-03(b) of Regulation S-X to determine which line items must be separately stated on the face of the income statement. If product or service revenue is greater than 10% of total revenue, a registrant must disclose each component as a separate line item on the income statement (for both revenues and the related costs).

Example SEC staff comment: Separate presentation of revenues

We note subscription revenue, which includes revenue from SaaS and managed services and term-based license subscriptions, was approximately X% of total revenue for the year ended September 30, 202X. Accordingly, and if material, revise to separately present revenue from services, such as SaaS and managed services, from product revenue on the face of your income statement. Relatedly, revise to also separately present cost of revenue related to these sources. Refer to Rule 5-03(b)(1) and (2) of Regulation S-X. As part of your response, please quantify the revenues from SaaS and managed services separately for each period presented.

Goodwill and intangible assets

The SEC staff has continued to request additional disclosure and information about goodwill and other intangible assets, including:

- Information about the registrant's goodwill and other intangible assets impairment testing, such as:
 - Disclosure of the methodologies, estimates and underlying assumptions used in the registrant's impairment analyses for both goodwill and other intangible assets
 - Disclosures about reporting units that may be at risk of goodwill impairment
- Details about the timing of impairment charges
- Information about assessing goodwill and other intangible assets for impairment that should be included in the critical accounting estimates section of MD&A
- An explanation of how finite-lived intangible assets' useful lives were determined

Goodwill

Impairment analysis

The SEC staff has asked for information about a registrant's goodwill impairment analysis, including:

- The details of the goodwill impairment analysis for each reporting unit, including how reporting units are identified and how assets, liabilities and goodwill are assigned to them
- The sensitivity of the material assumptions used in testing goodwill for impairment, including quantitative and qualitative factors, and how changes in those assumptions might affect the outcome of the test
- The percentage or amount by which each reporting unit's estimated fair value exceeds its carrying value
- Consideration of triggering events that have occurred since the last goodwill impairment test, whether those events are indicators of impairment that require an interim test

- ▶ The reasons for and the result of any goodwill impairment test, even if no impairment was recognized
- ▶ A description of the facts and circumstances, including the qualitative factors, that lead to goodwill impairment charges
- ▶ The types of events that could lead to a future goodwill impairment

In addition to periodic reports, the SEC staff reviews publicly available information (e.g., news reports, press releases, investor presentations) to identify potential indicators of impairment. Common reasons the SEC staff has cited for issuing comments on a registrant's impairment analysis include significant declines in results and/or market capitalization (particularly when book value exceeds market capitalization), increased costs and reduced margins, changes to the competitive landscape and impairments recorded by a registrant's peers. The SEC staff may request a reconciliation of the aggregate fair values of the reporting units to the registrant's market capitalization and support for the implied control premium.

The SEC staff may also comment on a registrant's disclosure that it tested goodwill and intangible assets for impairment and concluded that they were not impaired. In those cases, the SEC staff has asked for a summary analysis of how the registrant determined goodwill was not impaired. When the SEC staff has observed potential indicators of impairment, it has often asked whether registrants considered the qualitative factors in ASC 350-20-35-3C in determining that goodwill was not impaired.

Example SEC staff comment: Goodwill impairment analysis

We note that during the quarter ended September 30, 202X, Management determined that a triggering event had occurred because of a decrease in the Company's stock price and a revision in the earnings outlook in comparison to budget, and as a result performed an interim goodwill impairment assessment as of August 31, 202X, and concluded that goodwill was not impaired. We also note that the Company performed its annual impairment test as of October 31, 202X, which similarly did not result in impairment being recorded for the year ended December 31, 202X. We further note that the Company's stock price remains below its book value and your disclosure that you have one reportable operating segment. Please provide us a summary analysis of how you determined that goodwill was not impaired as of both your interim and annual testing dates, including as part of your response the percentage or amount by which your estimated fair value exceeded carrying value.

We have also observed the SEC staff request information about why an impairment review was not triggered for certain reporting units when a registrant has tested other assets or reporting units for impairment, and the conditions that triggered the impairment review appear to apply to the reporting units not tested.

At-risk and impaired reporting units

The SEC staff has asked registrants to provide more robust disclosures about their accounting estimates related to goodwill impairment testing, if those estimates are considered critical, as well as the details of any recognized goodwill impairments. Although detailed information, such as the fair value or the carrying amount of reporting units, is not required by US GAAP, the SEC believes that meaningful information about the potential for future goodwill impairment should be included in MD&A. The SEC staff frequently asks that registrants provide in MD&A information that allows for an assessment of the probability of a future material impairment charge for any reporting unit that may have a material amount of goodwill "at risk" of failing a future impairment test under ASC 350 (i.e., a reporting unit whose estimated fair value does not substantially exceed its carrying value).

The SEC staff has requested robust disclosure for reporting units that have estimated fair values that do not substantially exceed their carrying values.

The SEC staff has said that it expects a registrant to apply judgment when determining whether the fair value is not substantially more than the carrying amount, and thus, a reporting unit's goodwill is considered to be at risk. The disclosures in Financial Reporting Manual (FRM) Section 9510.3 should be provided if a registrant identifies estimates related to goodwill impairment as critical and any reporting units are at risk. If the registrant identifies estimates related to goodwill impairment as critical but does not have any reporting units that are at risk of failing the goodwill impairment test, the SEC staff expects the registrant to disclose that fact in MD&A.

Example SEC staff comment: Reporting units at risk of impairment

Please provide information for investors to assess the probability of future goodwill impairment charges. For example, please disclose whether any of your reporting units are at risk of failing the quantitative impairment test or that the fair value of each of your reporting units are substantially in excess of carrying value and are not at risk of failing. If a reporting unit is at risk of failing, you should disclose:

- The percentage by which fair value exceeded carrying value at the date of the most recent 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.

Please refer to Item 303(b)(3) of Regulation S-K.

The SEC staff has historically challenged the timing of a goodwill impairment charge, particularly when the conditions that resulted in the charge appeared to have existed in prior periods. In addition, the SEC staff has questioned whether adequate disclosure was made in previous filings when a goodwill impairment charge was recorded for a reporting unit that was not previously disclosed as being at risk.

When the SEC staff obtains more information from a registrant about its impairment analyses, it has often also asked the registrant to add disclosures about assessing goodwill and other intangible assets for impairment to its critical accounting estimates section in MD&A (e.g., how the fair value of each reporting unit was estimated, including the significant assumptions and estimates used). For further discussion, including disclosures about critical accounting estimates, refer to the MD&A section of this publication.

Other intangible assets
Impairment analysis

Under ASC 350, *Intangibles – Goodwill and Other*, an indefinite-lived intangible asset should be tested for impairment annually or more frequently if events or changes in circumstances indicate that it is more likely than not that the asset is impaired. Under ASC 360, *Property, Plant, and Equipment*, long-lived assets to be held and used (including finite-lived intangible assets) are tested for impairment when factors exist that indicate that the carrying amount of a long-lived asset or asset group may not be recoverable.

Historically, the SEC staff has requested disclosures similar to those described in FRM Section 9510.3 with respect to other intangible assets when it believes a risk of impairment exists. The SEC staff has also asked registrants to disclose how other intangible assets are tested for impairment, including the valuation methods and significant assumptions used to determine the estimated fair values of the assets. As it has done with goodwill impairment, the SEC staff has challenged whether impairments of other intangible assets should have been recognized when the SEC staff observes potential indicators of impairment.

When goodwill impairment occurs, the SEC staff often asks the registrant to explain how it considered the factors that led to that impairment in evaluating the need for impairment testing of other intangible assets.

Useful life determination

The SEC staff has asked registrants to disclose how they determined the useful life of acquired finite-lived intangible assets (e.g., trade names, customer relationships) and challenged such useful lives when the underlying assumptions do not appear consistent with information disclosed elsewhere.

Historically, the SEC staff has also challenged a registrant's assertions that intangible assets have an indefinite life and has asked them to explain the factors they considered when making this determination.

Other areas of comment

In addition to the most frequent comment areas discussed above, the SEC staff has also issued comments on the following topics that could be applicable to a broad range of registrants:

- Business combinations
- Contingencies
- Accounting error corrections, internal control over financial reporting, and disclosure controls and procedures
- New and emerging risks

Business combinations

Definition of a business under ASC 805 and reverse acquisitions

Registrants that engage in acquisition transactions must determine whether the transaction represents a business combination (i.e., the acquired activities and assets constitute a business) or an asset acquisition in accordance with ASC 805, *Business Combinations*. This determination, which may require significant judgment, is critical because the accounting for a business combination differs significantly from that of an asset acquisition. The SEC staff has historically asked registrants to support their conclusions that their acquisitions did or did not meet the definition of a business under the criteria in ASC 805-10-55-3A through 55-9.

Determining whether a business combination has occurred also requires identification of the acquiring entity for accounting purposes (i.e., the accounting acquirer), which is the entity that obtains control of the acquiree.² A transaction in which the legal acquiree obtains control of the legal acquirer that meets the definition of a business results in a reverse acquisition that is accounted for as a business combination. The SEC staff has asked registrants to support their conclusion that an acquisition should not be accounted for as a reverse acquisition when the legal acquiree appears to have obtained control of the registrant.

**ASC 805
requires pro forma
disclosures for
material business
combinations.**

When a reverse acquisition occurs, the financial statements of the combined entity are issued under the name of the legal acquirer (accounting acquirer) but are prepared and presented as a continuation of the financial statements of the legal acquiree (accounting acquiree) pursuant to the guidance in ASC 805-40-45. Recently, the SEC staff has questioned registrants' application of that guidance when retroactively adjusting the consolidated financial statements and earnings per share information in the periods before a reverse acquisition to appropriately reflect the legal capital of the legal acquirer (accounting acquirer).

Pro forma financial information required by ASC 805

ASC 805 requires registrants to provide various disclosures for individually material business combinations. Certain disclosures are also required for individually immaterial business combinations that are material in the aggregate. These disclosures help users of financial statements evaluate the nature and financial effect of business combinations. The SEC staff has requested that registrants expand their disclosures about business combinations to provide the information required by ASC 805. For example, the SEC staff has asked registrants to include the pro forma information required by ASC 805-10-50-2(h) and expand their disclosures to include additional information about each acquisition (e.g., acquisition date, amount and form of consideration, percentage acquired, acquisition-related costs).

ASC 805-10-50-2(h) requires pro forma disclosures assuming the acquisition occurred as of the beginning of the comparable prior annual reporting period. When pro forma disclosures are not provided, the SEC staff has asked the registrant to explain why they weren't provided. It is important to note that the evaluation of materiality for purposes of complying with the pro forma disclosure requirements in ASC 805 is separate and distinct from the significance test performed for the purposes of presenting pro forma financial information in accordance with Article 11 of Regulation S-X (i.e., registrants may need to make pro forma disclosures under ASC 805, even when Article 11 pro formas are not required).

Example SEC staff comment: Pro forma footnote disclosures

Please clarify how your presentation of unaudited pro forma financial information complies with ASC 805-10-50-2(h)(3). The pro forma table on page X appears to present only the revenue of the acquired company and not the revenue and earnings of the combined companies. In addition, tell us your consideration of providing the disclosures in ASC 805-10-50-2(h) for acquisitions that occurred during 202X. Please advise and revise in future filings.

Application of Rule 3-05, Rule 3-14, and Article 11 of Regulation S-X

A registrant that determines it has acquired a business (based on the SEC's definition in Rule 11-01(d)) must provide financial statements in accordance with Rule 3-05 (for acquired businesses) or Rule 3-14 (for acquired real estate operations) and pro forma financial information in accordance with Article 11 if the business is significant to the registrant. Significance is measured using the asset test, the investment test and the income test described in Rule 1-02(w).

The SEC staff has requested more details about how registrants concluded that separate financial statements and pro forma financial information were not required under Rule 3-05 or Rule 3-14 and Article 11, respectively. The SEC staff may also review publicly available information, other than SEC filings, to identify any acquisitions completed by the registrant. When the SEC staff has identified an acquisition that the registrant completed, and the registrant did not file separate financial statements or pro forma information for that business, it has often requested that the registrant provide the relevant significance test calculations and an explanation of its analysis of the requirements of Rule 3-05 or Rule 3-14 and Article 11.

The SEC staff continues to emphasize the importance of transparent, timely and complete disclosures related to loss contingencies.

Registrants should maintain contemporaneous documentation of significance tests performed and their analysis of Rule 3-05 or Rule 3-14 and Article 11 requirements, particularly when they conclude that an acquisition is not significant.

Example SEC staff comment: Application of Article 11 of Regulation S-X

Your Form 8-K filed August 6, 202X includes audited financial statements of Company A and interim financial statements as of March 31, 202X. Please tell us your consideration given to also providing the pro forma financial information required by Article 11 of Regulation S-X.

The SEC staff has also commented on registrants' disclosure of non-GAAP financial measures that exclude acquisition-related costs. For further discussion of frequent SEC staff comments on non-GAAP measures, please refer to the non-GAAP financial measures section above.

Contingencies

Accounting for and disclosure of loss contingencies

The SEC staff has issued comments on loss contingencies and registrants' compliance with the disclosure requirements in ASC 450, *Contingencies*. The comments typically focus on whether reasonably possible losses have been disclosed and the overall clarity and timeliness of the disclosures.

The SEC staff often questions whether a registrant omitted the required disclosure in the notes to the financial statements regarding reasonably possible losses, including reasonably possible losses in excess of the amount accrued. Registrants must disclose an estimate of the possible loss or range of loss. If a registrant cannot estimate the amount or range of reasonably possible loss, it should include a statement to that effect. However, the SEC staff has questioned how a registrant determined that an estimate of a reasonably possible loss or range of loss cannot be made and has requested additional disclosure of the specific barriers to making an estimate and when the registrant expects those factors to be alleviated.

While the SEC staff acknowledges there are many uncertainties and potential outcomes associated with loss contingencies, registrants should undertake sufficient procedures to support their conclusions, including determining which of the potential outcomes are reasonably possible and what the range of losses would be for those outcomes.

Example SEC staff comment: Disclosure about reasonably possible losses

We note your disclosures that you are or may be involved in various legal proceedings, your disclosure of the putative securities class action suit filed against you, and that "no reserve has been established for any potential liability related to this suit." To the extent it is reasonably possible that you will incur losses in excess of recorded accruals related to your contingencies, please provide in future filings the applicable disclosures required by ASC 450-20-50-3 through 50-4, including the amount or range of reasonably possible losses in excess of recorded amounts. If an estimate of reasonably possible additional losses can be made and that amount is not material to your consolidated financial position, results of operations or cash flows, we will not object to a statement to that effect. Alternatively, if no amount of loss in excess of recorded accruals is believed to be reasonably possible, please state this in your disclosure. Although we recognize that there are a number of uncertainties and potential outcomes associated with loss contingencies, please note that ASC 450 does not require estimation of a reasonably possible range of loss with precision or certainty.

The SEC staff expects disclosures about loss contingencies to evolve and include more quantitative information as a matter progresses. The SEC staff also sometimes tracks this evolution in periodic filings and may challenge the timing of recorded losses or the adequacy of earlier disclosures when a loss contingency appears to have been resolved unexpectedly.

In addition to complying with the ASC 450 disclosure requirements, registrants must also provide the separate legal proceeding disclosures required by Item 103 of Regulation S-K.

Accounting error corrections, restatements, internal control over financial reporting, and disclosure controls and procedures

Materiality assessment

The SEC staff has requested additional information about a registrant's materiality assessment when it discloses the correction of an immaterial error in previously issued financial statements (e.g., "little r" restatements).

For example, the SEC staff has questioned the basis of the registrant's assessment, including whether all qualitative and quantitative factors have been considered, when a registrant concluded the error is not material to previously issued financial statements, in accordance with the guidance in Staff Accounting Bulletin (SAB) 99, *Materiality*, and ASC 250, *Accounting Changes and Error Corrections*.

Example SEC staff comment: Error correction materiality assessment

We note you had an error for the three and nine months ended September 30, 202X which you believe is immaterial. It is not clear to us why a non-GAAP measure is noted as a basis to determine materiality. Please provide us with your materiality analysis. Refer to the guidance in SAB 99.

When the SEC staff disagrees with the conclusion that the correction of an error in previously issued financial statements is immaterial, registrants are asked to comply with the SEC reporting requirements associated with "Big R" restatements (e.g., amending previously filed Forms 10-K and/or 10-Q as applicable, filing disclosures required by Item 4.02 of Form 8-K) and to provide information about how they will comply with those requirements.

Disclosures related to clawbacks of incentive-based compensation

Registrants are required to check boxes on the cover page of their Form 10-K to indicate whether (1) the financial statements included in the filing reflect the correction of an error to previously issued financial statements and (2) any of those restatements required a recovery analysis of incentive-based compensation received by any of the registrant's executive officers during the relevant recovery period. When registrants have checked the first box or both boxes, the SEC staff has questioned their consideration of providing the disclosures required by Item 402(w) of Regulation S-K.

Example SEC staff comment: Disclosures related to no recovery of incentive-based compensation

Your response states that the restatement did not impact your executive compensation payments and, thus, no recovery was required. This was because the performance-based portion of your executive compensation payments was calculated and finalized based on financial results provided in your year-end financial statements, which already took into account the adjustments to the first three quarters of 202X that resulted from the restatement, and the time-based RSUs were not granted on the basis of your performance or financial results. You also indicate you determined that no disclosure was required by Item 402(w) of Regulation S-K as there was no erroneously awarded compensation. However, Item 402(w)(2) of Regulation S-K requires disclosure of a brief explanation as to why application of your recovery policy resulted in no recovery of erroneously awarded compensation when you conclude that recovery is not required pursuant to your recovery policy. Please provide this disclosure in future filings.

Internal control over financial reporting and disclosure controls and procedures

The SEC continues to issue comments to registrants that have omitted disclosure of management's conclusions on the effectiveness of the registrant's disclosure controls and procedures (DCPs), required by Item 307 of Regulation S-K, and/or the effectiveness of the registrant's internal control over financial reporting (ICFR), required by Item 308(a) of Regulation S-K, as of the end of the registrant's most recent fiscal year.

The SEC staff has also challenged management's conclusions on the effectiveness of ICFR and DCPs when a registrant corrects a prior-period error, including corrections of immaterial out-of-period errors during the current period. The SEC staff may request additional information, such as:

- ▶ A detailed description of the error, including who identified the error, when and how it was identified, and whether it was the result of a control deficiency
- ▶ A description of any control deficiency identified, including the registrant's evaluation of the severity of the deficiency and any remediation plans or the rationale for the registrant's conclusion that there was not a material weakness

The SEC staff reminds registrants that management's assessment must consider the magnitude of the potential misstatement that could result from a control deficiency, and the actual error is only the starting point for determining the potential impact and severity of a deficiency. The SEC staff has also questioned management's judgment when it attributes a material error to a control deficiency but does not conclude that the deficiency is a material weakness.

The SEC staff has also challenged registrants that say they concluded that ICFR was ineffective (e.g., when a material weakness was identified), but DCPs were effective.

Example SEC staff comment: ICFR and DCP effectiveness conclusion

We note that you have removed the disclosures related to material weaknesses and revised your conclusion regarding the effectiveness of internal control over financial reporting (ICFR) stating that it was effective as of December 31, 202X. Considering that you have restated your financial statements for the fiscal year ended December 31, 202X to correct errors identified by your auditor, it is unclear how you concluded that your disclosure controls and procedures (DCP) and ICFR were effective. Further, your Form 10-Q disclosures stated that you have concluded that your DCP was not effective as of March 31, 202Y and June 30, 202Y, while indicating that there were no material changes in your ICFR since December 31, 202X. If management has determined that material weaknesses existed in relation to the errors identified and therefore, ICFR and DCP are ineffective, please amend your filing to disclose this information.

The SEC staff has also issued comments requiring registrants to revise their filings when certifications by the principal officers, as required by Rule 13a-14(a) and 15d-14(a) under the Securities Exchange Act of 1934, do not include all of the language regarding ICFR as prescribed by Item 601(b)(31) of Regulation S-K. Registrants, particularly those that are required to provide management's assessment of ICFR for the first time (i.e., starting with the registrant's second annual report), should pay attention to the specific language required in management's certifications (e.g., paragraphs 4 and 4(b)).

New and emerging risks

The SEC staff has issued comment letters to registrants requesting expanded disclosure for new and emerging risks, including:

- ▶ **Cybersecurity:** The SEC staff has requested additional information regarding registrants' disclosures about their cybersecurity risk management systems, particularly the relevant expertise of senior management responsible for overseeing the company's cybersecurity risk management in accordance with Item 106(c)(2)(i) of Regulation S-K.
- ▶ **Crypto assets:** The SEC staff has issued comments requesting registrants enhance their risk factors disclosure to include the material effects that specific regulations and material pending regulations may have on the business and business plans. The SEC staff has also asked registrants to disclose crypto asset custody obligations to their customers, including when the company may be fully liable for the theft or other loss of crypto assets.

Example SEC staff comment: Cybersecurity risk management

We note your Chief Information Security Officer (CISO) is responsible for assessing and managing risks from cybersecurity threats, and we note the Information Security Committee (ISC) assists executive management and the Board of Directors in their oversight of responsibilities related to information security. You also state that the ISC reviews and recommends security-related policies and standards, among other activities related to cyber risks. We also note that you describe the relevant expertise of your CISO but not of the other members of the ISC. Please revise future filings to discuss the relevant expertise of such members of senior management as required by Item 106(c)(2)(i) of Regulation S-K.

Example SEC staff comment: Risks related to crypto assets

Please add separate risk factors that describe the risks to your business from the regulations and regulatory developments related to crypto assets, the crypto asset markets and artificial intelligence products in the jurisdictions in which you operate and intend to operate, identify the specific regulations and material pending regulations, and describe the material effects each such regulation and pending regulation may have on your business and business plans. In addition, please revise your "Blockchain Technology carries with it certain risks and compliance issues" risk factor on page X to expand your description of the "risks associated with blockchain[s] due to cyber criminals and fraud throughout the world" by providing specific examples of such risks.

The SEC staff has also commented on the sufficiency of registrants' risk disclosures in light of current macroeconomic and geopolitical factors and challenged disclosures considered too general (i.e., boilerplate disclosures). We have also observed the SEC staff continue to issue comments requesting enhanced risk disclosures for registrants with a corporate structure based in or with the majority of its operations in China.

Looking ahead

We expect the SEC staff to continue to focus over the upcoming year on the topics discussed above, including disclosures pursuant to the adoption of ASU 2023-07 on segments. The SEC staff may also expand its comments to other financial reporting topics, including disclosures made in response to other newly effective or early adopted financial accounting standards (e.g., ASU 2023-09, *Income Taxes (Topic 470): Improvements to Income Tax Disclosures*) and the effects of the current economic environment (e.g., tax legislation) on registrants' accounting, financial reporting and results. The SEC staff may also focus on disclosures related to artificial intelligence or required by any new or amended SEC rules that may be adopted in the upcoming year.

Even with new topics, comment volume could continue to decline next year if new SEC leadership decides that changes to the filing review program, alongside rulemaking, can further reduce compliance burdens on issuers and support capital formation.

Endnotes:

- ¹ "All other" includes immaterial operating segments, and other business activities that are not identified as operating segments.
- ² Determining whether control has been obtained begins with determining whether control should be evaluated based on variable interests or voting interests. See section 3.2 of our Financial reporting developments (FRD), *Business combinations*, for comprehensive guidance on identifying the accounting acquirer.

Appendix: Resources

This appendix lists other EY resources on the topics addressed in this publication.

MD&A

- [2024 SEC annual reports – Form 10-K](#)
- [2024 AICPA & CIMA Conference on Current SEC and PCAOB Developments](#)
- To the Point, [SEC issues guidance on disclosures about key performance indicators and other metrics in MD&A](#)

Non-GAAP measures

- Technical Line, [Navigating the requirements for non-GAAP financial measures](#)
- [2024 SEC annual reports – Form 10-K](#)

Segment reporting

- Financial reporting developments, [Segment reporting](#)
- Technical Line, [A closer look at the FASB's new segment disclosure requirements](#)

Revenue recognition

- Financial reporting developments, [Revenue from contracts with customers \(ASC 606\)](#)

Goodwill and intangible assets

- Financial reporting developments, [Intangibles – goodwill and other](#)

Business combinations

- Financial reporting developments, [Business combinations](#)
- [Pro forma financial information – A guide for applying Article 11 of Regulation S-X](#)
- Technical Line, [Applying the SEC's requirements for significant acquired businesses](#)
- Technical Line, [How to apply the amended S-X Rule 3-14 to real estate acquisitions](#)

Accounting error corrections, internal control over financial reporting, and disclosure controls and procedures

- [2024 SEC annual reports – Form 10-K](#)
- Financial reporting developments, [Accounting changes and error corrections](#)
- To the Point, [SEC adopts rules to require 'clawback' policies and disclosures](#)

New and emerging risks

- [2024 SEC annual reports – Form 10-K](#)
- Technical Line, [A closer look at the SEC's new rules on cybersecurity disclosures](#)
- Technical Line, [Accounting for digital assets, including crypto assets](#)
- To the Point, [SEC staff rescinds guidance on obligations to safeguard crypto assets under SAB 121](#)

Looking ahead

- Technical Line, [A closer look at the FASB's new segment disclosure requirements](#)
- [2024 AICPA & CIMA Conference on Current SEC and PCAOB Developments](#)
- Technical Line, [A closer look at the SEC's new rules on cybersecurity disclosures](#)
- To the Point, [Companies should consider the effects of the current economic environment and tariffs on their accounting and financial reporting](#)