

SEC Reporting Update

Highlights of trends in 2024 SEC staff comment letters

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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 2024 was consistent with last year, when it was sharply higher compared with each of the previous four years.
- ▶ 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, goodwill and intangible assets, and business combinations.
- ▶ With the SEC staff continuing to issue a significant number of comment letters, it is important that registrants understand the process and effectively respond to the staff’s comments.
- ▶ Comment letters can provide insights into the SEC staff’s views and expectations on accounting and disclosures. Over the next year, we expect the SEC staff to focus on new accounting standards (e.g., the FASB’s new segment disclosure requirements) and recently adopted SEC disclosure rules on cybersecurity and clawbacks.

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 2024 was consistent with last year when the volume was sharply higher compared with each of the previous four years.

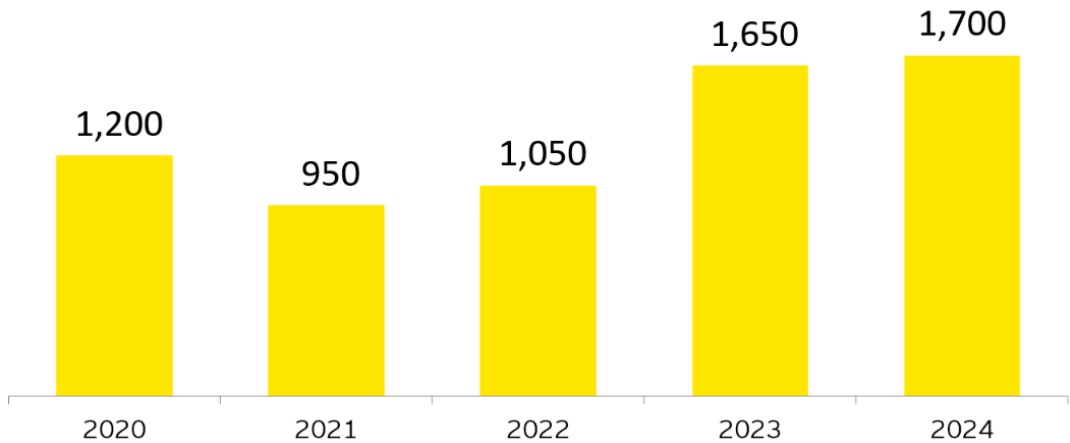
The number of registrants receiving staff comment letters also remained consistent with last year and, once again, management’s discussion and analysis (MD&A) and non-GAAP financial measures took the top two spots on the list of topics the SEC staff addressed most frequently in comment letters.

This publication is intended to provide you with insights on 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 remains elevated

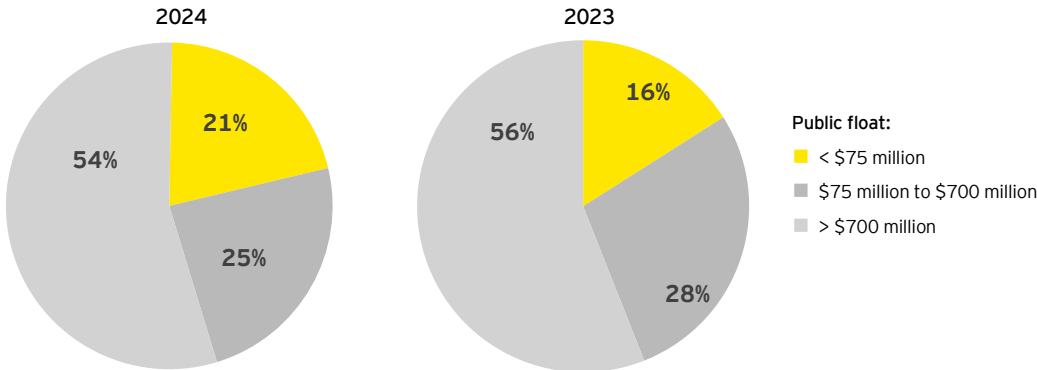
Both the volume of SEC staff comment letters and the number of recipients remained elevated in the year ended 30 June 2024.

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 31 August 2024.

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 2024 and 30 June 2023, 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 results in the SEC staff reviewing the filings of larger registrants more frequently than those of smaller registrants, the SEC staff has increased its focus on smaller registrants (i.e., those with less than \$700 million in market capitalization) over the past three years.

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, as well as business combinations, moved into the SEC staff's top areas of comment. Climate-related disclosures dropped out of the staff's top areas of comment this year, as the SEC staff issued comments on climate-related disclosures only through the first half of fiscal 2024.

The following list of most frequent comment areas includes areas for which a significant number of registrants received a comment on the topic. The frequency with which the topic was included in letters received by registrants is also reflected below.

Comment area	2024		
	Ranking for 12 months ended 30 June ¹	Comment area received as a percentage of registrants receiving comment letters	Average letters per registrant ³
Management's discussion and analysis ²	1	34%	1.2
Non-GAAP financial measures	2	32%	1.3
Segment reporting	3	15%	1.3
Revenue recognition	4	13%	1.2
Goodwill and intangible assets	5	7%	1.2
Business combinations	6	6%	1.1

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 2023 through 30 June 2024, excluding comment letters issued to SPACs and other blank check entities. In some cases, individual SEC staff comments are assigned to multiple topics.

² For the year ended 30 June 2024, this category includes comments on MD&A topics in order of frequency: (1) results of operations (56%), (2) liquidity matters (30%) and (3) various other matters, including key performance indicators and critical accounting estimates (14%). Many registrants received MD&A comments on more than one MD&A topic.

³ This represents the average number of comment letters (or rounds of comments) the SEC staff issued for each topic to resolve its concerns.

The average number of comment letters (or rounds of comments) the SEC staff issued for each topic to resolve its concerns also was consistent with last year but remained elevated compared to historical levels.

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 staff has already concluded that the disclosures must change. Registrants receiving comment letters should generally view the process as an opportunity to educate the 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 generally 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 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, who should be engaged early in the process to make sure the response is complete and accurate
- ▶ 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 did not appear in a filing or if a registrant believes the accounting for an item is immaterial, providing a robust explanation of the quantitative and qualitative factors the registrant considered as part of its materiality analysis
- ▶ 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 a large amount of them are focused on disclosures about results of operations. Many of them 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 (SG&A) 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

The SEC staff routinely requests that registrants identify and quantify the impact of each positive or negative factor that has a material effect on results of 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)

We note that you attribute the increase in product revenue to the growth in the average number of customers and price increases. Please revise future filings to specifically describe the extent to which these changes are attributable to changes in prices or to changes in sales volume. Refer to Item 303(b)(2)(iii) of Regulation S-K. As a related matter, where you describe two or more factors that contributed to a material change in a financial statement line item between periods, please quantify the extent to which each factor contributed to the overall change in that line item. Refer to Item 303(b)(2) of Regulation S-K and SEC Release No. 33-8350 for guidance.

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

We note that in lieu of providing a comparative discussion of cost of sales, you have provided a discussion of gross margin. In this discussion, you state that within the health care segment, gross profit margins may vary from one period to the next, and that changes in the mix of products sold as well as changes in your customer mix have been the most significant drivers affecting your gross profit margin. It appears that the provision of a comparative discussion of cost of sales in similar format to net sales may be material to an understanding of your results of operations. Please revise accordingly or tell us why such a revision is unnecessary. Refer to Items 303(b)(2) and 303(c)(2) of Regulation S-K.

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 reported several consecutive periods of operating and net losses and negative operating cash flows. Please discuss whether these are known trends. In doing so, include descriptions and amounts of matters that have had a material impact on reported operations, as well as matters that are reasonably likely based on your assessment to have a material impact on future operations.

For example, consider discussing the operational reasons for the losses and negative operating cash flows, what you must do to generate positive results and operating cash flows, and explain how you intend to meet your cash requirements and maintain operations. Refer to Item 303(b)(2)(ii) of Regulation S-K and Release No. 33-6835 and 33-8350 for guidance.

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. For further discussion, please refer to the segment reporting section of this publication.

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

In circumstances where there is more than one business reason for a change between periods, please quantify the incremental impact of each individual business reason discussed on the overall change in the line item. For example, when discussing the period over period reasons for changes in each segment's adjusted operating income and general corporate expenses, you do not appear to provide quantification of the business reasons you note or discuss why SG&A costs and depreciation and amortization at the segment level were higher in the current period. Please provide us your revised disclosures. Refer to Item 303 of Regulation S-K.

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 revise your future filings to disclose your research and development costs incurred for each of your key product candidates/programs for all periods presented. To the extent that you do not track expenses by product candidate/program, disclose that fact and explain why you do not maintain and evaluate research and development costs in this manner. For unallocated research and development expenses, provide a breakdown by type or nature of expense. Please assure that the sum reconciles to the total research and development expense for the period on the Consolidated 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 that in your earnings call you indicated that the company looks at metrics around number of customers, conversion, retention and average revenue per customer across the entire company, as well as by area. Please tell us whether these metrics are key performance indicators used in managing your business and if so, please include a quantified discussion of these metrics for each period presented in your periodic filings. Refer to SEC Release No. 33-10751.

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

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

Please provide an analysis of why the reported amount of operating cash flows materially changed from period to period for annual and interim periods. Refer to Item 303 of Regulation S-K. Your current discussion appears to be a recitation of the items presented in your statement of cash flows of how the amount of operating cash flows was derived for each period. Your discussion also refers to noncash items that do not impact cash. Note references to results and working capital items may not provide a sufficient basis to understand how the amount of operating cash actually was affected between periods. Your analysis should discuss all material factors that actually affected the reported amount of operating cash and reasons for material changes between periods underlying these factors. Refer to the introductory paragraph of section IV.B and B.1 of Release No. 33-8350 for further guidance.

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 the staff issuing comments in response to higher interest rates that have focused on how management evaluates related risks, what management is doing to manage these risks, the board's role in risk oversight and quantitative disclosures on the registrant's exposure, which can include comments on interest rate sensitivity analyses.¹

Example SEC staff comment: Qualitative disclosures on interest rate risk

Please revise future filings to include a materially complete description of how you seek to manage risks due to changes in interest rates and other material impacts on your operational facts and circumstances, including any management or corporate governance controls or procedures for identifying and responding to rapid changes in interest rates due to or as a result of exogenous or unknown factors.

Example SEC staff comment: Quantitative disclosures on interest rate risk

We note the statement on page XX that you use an asset/liability simulation model to monitor interest rate risk, and the model contains a number of assumptions, including those related to the behavior of loan and deposit pricing, prepayment rates on mortgage-based assets, principal amortization and maturities on other financial instruments, as well as effects of standard prepayment options on mortgages and customer withdrawal options for deposits. Your disclosure also states that while the assumptions are inherently uncertain, you believe your assumptions are reasonable. Please tell us and revise future filings to disclose the key assumptions and parameters which are necessary to understand the disclosure made for purposes of your interest rate sensitivity analysis. Additionally, you should provide a discussion of the changes in the outputs in the analysis from period to period and the factors driving the changes. See Item 305(a)(1)(ii)(B) of Regulation S-K.

Additionally, we have observed that the 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 borrower type (e.g., by office, hotel, multifamily), geographic concentrations and other characteristics (e.g., current weighted average and/or range of loan-to-value ratios, occupancy rates) material to an investor's understanding of your CRE loan portfolio. In addition, revise to describe the specific details of any risk management policies, procedures or other actions undertaken by management in response to the current environment.

Critical accounting estimates

The SEC staff continues to ask registrants to focus their MD&A 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: Enhanced disclosure

Please revise the discussion of your critical accounting policies to focus on the assumptions and uncertainties that underlie your critical accounting estimates. Also quantify, where material, and provide an analysis of the impact of critical accounting estimates on your financial position and results of operations for the periods presented, including the effects of changes in critical accounting estimates between periods. In addition, include a qualitative and quantitative analysis of the sensitivity of reported results to changes in your assumptions, judgments, and estimates, including the likelihood of obtaining materially different results if different assumptions were applied. These disclosures should supplement, not duplicate, the accounting policy disclosures included in your financial statement footnotes. Please refer to SEC Release No. 33-8350.

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 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 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.

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

We note that your disclosures begin with reference to a recent acquisition followed by a discussion of your non-GAAP measures. As presented your discussion and analysis appears to place greater emphasis on non-GAAP measures, which would generally be contrary to Item 10(e)(1)(i)(A) of Regulation S-K and the associated guidance in the answer to Question 102.10(a) of our Compliance and Disclosure Interpretations for non-GAAP measures. Please reposition your non-GAAP disclosures to follow a comparable discussion and analysis of your GAAP information

C&DI Question 102.10(a) provides additional examples of instances in which non-GAAP measures are considered by the 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

You present consolidated results of operations in constant currency for the years ended December 31, 2022, and 2021. It appears that you are presenting a partial income statement of non-GAAP measures. Please tell us your consideration of Question 102.10(c) of the Compliance and Disclosure Interpretations on Non-GAAP Financial Measures and Item 10(e)(1)(i)(A) of Regulation S-K.

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. The SEC staff has asked registrants to revise their presentation when a non-GAAP reconciliation does not start with the applicable GAAP measure as noted in C&DI Question 102.10(b) because that presentation would give undue prominence to a non-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 staff has challenged when a registrant reconciles those measures to a measure other than GAAP net income.

Example SEC staff comment: Reconciliation beginning with a non-GAAP measure

We note your non-GAAP reconciliations of adjusted EBITDA begin with Net Income on a non-GAAP basis rather than with the most directly comparable GAAP measure, Net Income. For each non-GAAP reconciliation you present, please revise future filings to begin the reconciliation with the appropriate and most directly comparable GAAP measure as required by Item 10(e)(1)(i)(B) of Regulation S-K and Questions 102.10(b) and 103.02 of the Division of Corporation Finance's Compliance & Disclosure Interpretations on Non-GAAP Financial Measures.

The 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

We note your presentations of third-party gross profit, adjusted gross profit and adjusted gross profit margin, which are all non-GAAP measures. Please disclose in equal or greater prominence the most directly comparable US GAAP measure and provide reconciliations from that measure. In this regard, total net sales would not qualify as the most comparable US GAAP measure, since it does not include any costs that are being adjusted out. Also note that gross profit and gross profit margin presented in accordance with US GAAP must be calculated with a fully burdened cost of products sold.

Registrants must also reconcile a forward-looking non-GAAP measure to the comparable GAAP measure if the latter is available without unreasonable efforts. If a forward-looking non-GAAP measure cannot be reconciled to a comparable GAAP measure without unreasonable effort, registrants 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.

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 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 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 staff’s view that an operating expense that occurs repeatedly or occasionally, including at irregular intervals, is recurring.

The 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. Although C&DI Question 100.01 only refers to cash operating expenses, the staff also has asked registrants about noncash operating expenses in this context.

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 pharmaceutical 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 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 inventory impairment charge

Round 1 comment:
We note that impairment, restructuring and other charges are excluded from your non-GAAP measure adjusted income (loss) from operations for all periods presented. With reference to the inventory impairment charges included in this line item, please tell us your consideration of the guidance in Question 100.01 of the Compliance and Disclosure Interpretations for Non-GAAP Financial Measures. Also, see ASC 420-10-S99-3.

Round 2 comment:

We note your response to prior comment 1. Notwithstanding their scope and magnitude, the inventory impairment charges recognized following the decision to discontinue and exit the market for the majority of your X brands and product lines do not appear to be outside the normal course of your operations. With reference to Question 100.01 of the Compliance and Disclosure Interpretations for Non-GAAP Financial Measures and ASC 420-10-S99-3, please confirm that you will no longer exclude these inventory impairments from your non-GAAP measure.

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. 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 staff also has asked registrants to explain and quantify the components of these adjustments.

Example SEC staff comment: Exclusion of restructuring costs

We refer to the adjustments related to inventory costs, consulting fees, professional fees, and CEO severance, retention and relocation costs. Please describe to us the specific nature of the costs reflected in each of these adjustments and explain to us how you determined that these adjustments are appropriate based on the guidance in Question 100.01 of the Division's Compliance & Disclosure Interpretations on Non-GAAP Financial Measures.

The staff has also challenged adjustments for implementation costs related to long-term strategic investments in technology (e.g., replacement of an enterprise resource planning system over several years).

Individually tailored accounting principles

The 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.

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.

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
- Normalize effective tax rates or eliminate a tax valuation allowance
- Eliminate the amortization of only a portion of acquired intangibles
- Accelerate the recognition of deferred revenue or add back lost revenue
- Change an item from accrual to cash basis or from gross to net
- Deconsolidate one or more consolidated subsidiaries
- Combine consolidated and unconsolidated results or balance sheet amounts

We have also seen the SEC staff comment on non-GAAP adjustments related to the results of operations of businesses exited or to be exited that do not meet the criteria to be presented as discontinued operations in accordance with ASC 205-20, *Presentation of Financial Statements – Discontinued Operations*.

Example SEC staff comment: Adjustment related to the results of operations of businesses exited or to be exited

We note that your non-GAAP gross profit, non-GAAP net income, and adjusted EBITDA measures include an adjustment for the results of operations of businesses exited/to be exited. Please explain to us the nature of this adjustment, including the identity of the businesses and whether or not they have been presented as discontinued operations. Please note that if amounts relate to businesses that do not meet the criteria for being presented as discontinued operations pursuant to ASC 205-20, they would represent individually tailored accounting measures in light of the guidance in Question 100.04 of the Non-GAAP Compliance and Disclosure Interpretations. Please advise or revise accordingly.

How we see it

Registrants should consider the 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.

Omission or inappropriate presentation of applicable tax effects

C&DI Question 102.11 clarifies that a registrant should appropriately reflect the income tax effects of adjustments made in calculating its non-GAAP measures. This includes potentially reflecting the appropriate tax rate that would apply to adjustments made to calculate a non-GAAP performance measure, considering both the applicable current tax expense and deferred tax expense, which could differ from the registrant's GAAP effective tax rate.

The SEC staff has asked registrants to explain the appropriateness of their calculation of non-GAAP income tax effects (e.g., the reasonableness of the tax rate used to calculate the effects, the basis for including or excluding certain effects) and to explain more clearly in future filings how the effects are calculated.

Example SEC staff comment: Calculation of non-GAAP tax effects**Round 1 comment:**

We note that you include adjustments to income tax expense to arrive at adjusted net income attributable to common stockholders and adjusted earnings per share to arrive at an adjusted effective tax rate of 20%. Considering the US statutory rate is 21% and that 75% of your business is outside of the US that results in a net increase to your effective tax rate, it is unclear how an adjusted effective tax rate of 20% for non-GAAP purposes is appropriate and reflective of the tax environment in which your business operates. Please advise with reference to Question 102.11 of the Compliance and Disclosure Interpretations for Non-GAAP Financial Measures.

Round 2 comment:

Please provide us with a more comprehensive explanation as to how you concluded that a tax rate of 20% is reflective of your global business from a non-GAAP perspective. In this regard, we note your statement, "... the tax environment in which the Company operates is primarily driven by historical US tax losses, which the Company has carried forward and reported in its financial statements as deferred tax assets, and not the concentration of the Company's business outside of the US." This statement is focusing on your US GAAP results and tax position in which there was a history of losses generating the deferred tax assets. However, the tax rate used to calculate your non-GAAP adjusted net income should focus on your non-GAAP results. To the extent from a non-GAAP perspective, you have consistently and cumulatively reported adjusted net income, this would suggest that from a non-GAAP perspective, loss carryforwards may not be available and therefore, should not be considered in determining your non-GAAP income tax adjustment. It further suggests that on a non-GAAP basis, you may have recorded significant taxes. As such, an adjustment for income tax expense should be commensurate with your non-GAAP measure of profitability. Finally, your disclosures regarding your income tax expense should clearly explain to investor how you estimated the total amount of income tax expense on a non-GAAP basis. Refer to Question 102.11 of the Compliance and Disclosure Interpretations for Non-GAAP Financial Measures.

C&DI Question 102.11 also says that adjustments to arrive at a non-GAAP measure should not be presented net of tax in the reconciliation to the most comparable GAAP measure. The effect of income taxes on the non-GAAP reconciliation should be shown as a separate adjustment and clearly explained. The SEC staff has objected to registrants presenting reconciliation adjustments net of tax.

Example SEC staff comment: Omission of non-GAAP tax effects

We note you present a non-GAAP financial measure you identify as non-GAAP Net Income (Loss); however, the measure does not appear to include any income tax effects. Please revise your measure in future filings to separately present and include related income tax effects or explain how you determined your current measure complies with Question 102.11 of the SEC's Division of Corporation Finance C&DIs related to non-GAAP Financial Measures which requires that non-GAAP financial measures include current and deferred income tax expense commensurate with the non-GAAP measure of profitability. Please be advised, although we note you recorded GAAP net losses during the periods presented, it would not be appropriate to consider potential tax benefits from GAAP losses in determining the income tax effects related to non-GAAP Net Income since that would not result in current and deferred income tax expense commensurate with the non-GAAP measure of profitability.

Inappropriate adjustments and presentation of certain liquidity measures

Item 10(e) of Regulation S-K prohibits registrants from excluding charges or liabilities that required or will require cash settlement, or would have required cash settlement absent an ability to settle in another manner, from a non-GAAP liquidity measure other than EBIT or EBITDA included in an SEC filing (e.g., Form 10-K).² The SEC staff has questioned the exclusion of cash-settled charges and liabilities from such non-GAAP liquidity measures (e.g., when adjusted free cash flow excludes a cash-settled payment for litigation).

Example SEC staff comment: Non-GAAP liquidity measure adjustment

We note that your measure of free cash flows excludes legal fees, interest on convertible senior notes, capital advisory fees, and sales and marketing event cancellation fees. Tell us how you considered Item 10(e)(ii)(A) of Regulation S-K, which prohibits the exclusion of charges or liabilities that require, or may require, cash settlement from a liquidity measure. Please explain or revise to remove such adjustments.

In C&DI Question 102.09, the SEC staff notes that a registrant may be required to disclose measures associated with debt covenants if management believes that the credit agreement is a material agreement, that the covenant is a material term of the credit agreement and that information about the covenant is material to an investor's understanding of the company's financial condition and/or liquidity. These measures would not meet the definition of a non-GAAP measure if they are required to be disclosed under Item 303 of Regulation S-K. The staff has asked registrants that present such measures to limit their presentation to the liquidity section discussion in MD&A.

Example SEC staff comment: Debt covenant measure presentation

We note you include adjustments for the change in deferred revenue and the change in deferred costs of revenue in your non-GAAP measure of adjusted EBITDA, which you disclose is used in certain covenant calculations for the 2030 Notes. Please tell us why you believe the related covenants, and therefore this measure, is material to an investor's understanding of your financial condition and/or liquidity, such that disclosure of this measure is required. To the extent you continue to believe this measure is necessary, revise to limit such measure to your liquidity section discussion. Also, clarify that this measure is a liquidity measure based on your reference to using such measure for purposes of analyzing the Indenture covenants and make sure you include disclosures as referenced in the guidance in Question 102.09 of the Non-GAAP CD&Is. To the extent you refer to adjusted EBITDA elsewhere outside of your liquidity discussion, revise to remove the adjustments for change in deferred revenue and change in deferred cost of revenue as these adjustments result in a measure that reflects individually tailored recognition methods.

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.

Example SEC staff comment: Non-GAAP segment profitability measures

You refer to "segment profit" of \$X million for the third quarter of 2023, which appears to be the sum of the measure of profit for your three reportable segments less the shared services and corporate costs. This segment profit measure is a non-GAAP measure that should be reconciled to the most directly comparable GAAP measure, and other related non-GAAP disclosures should be included. Please revise to address the following:

- ▶ Identify this as a non-GAAP measure and disclose the reasons why you believe the measure provides useful information to investors.
- ▶ Reconcile it to the most directly comparable GAAP measure, operating income, and present GAAP operating income with equal or greater prominence.
- ▶ Change the title of the measure, as "segment profit" appears to imply it is the operating results of the segments; however, the measure includes costs that are not allocated to segments.

Alternatively, consider removing the measure, as it does not appear to be significant to your discussions. Refer to Item 10(e)(1)(i) of Regulation S-K and Questions 100.05 and 104.04 of the Non-GAAP C&DIs.

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 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

Your disclosure that you exclude amortization or impairment of acquisition-related intangibles from non-GAAP measures because they arise from your prior acquisitions "and have no direct correlation to the ongoing operating results" of your business is confusing, as the acquired intangible assets that are not yet fully amortized would be used to generate revenues in future periods. Please revise your description of this adjustment in future filings to eliminate this confusing language, or advise us.

The SEC staff has continued to emphasize the importance of revenue determined in accordance with US GAAP to investors and said more registrants are inappropriately presenting non-GAAP measures with the word "revenue" in the title. For example, presenting a measure entitled "gross revenue" before discounts or other incentives that reduce revenue under US GAAP would not be appropriate. However, the staff said a registrant could present such a measure and call it "billings" if it is consistent with amounts invoiced to customers. In that case, the non-GAAP rules would not apply because the metric would be considered a KPI.

The staff also said some registrants have presented as “net revenue” a measure calculated by adding back a portion of the cost of revenue. A registrant that presents such a measure should make it clear that it is a non-GAAP margin calculation, and it should not use the term “revenue” in the title.

Example SEC staff comment: Definition and labeling of non-GAAP “net revenue” measure

We note your disclosure that net revenue is calculated excluding pass through revenue of your X and Y segments. Please tell us how you determined it was appropriate to use a title for your non-GAAP financial measure that appears to be the same as, or confusingly similar to, a title used for a GAAP financial measure. Refer to Non-GAAP Financial Measures C&DI 100.05. Clarify within your response if the adjustment to exclude pass through revenue includes a mark-up of passthrough costs.

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 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

You state that free cash flow is a non-GAAP performance measure used by management and the Board of Directors to evaluate the performance of your business. As free cash flow is a liquidity measure, which is typically calculated as cash flows from operating activities less capital expenditures, it is unclear what this measure represents or what it is attempting to convey. Please explain and revise your disclosures accordingly. If this is a performance measure, revise to remove the cash-based adjustments and change the title so as not to imply this is a liquidity measure. Alternatively, if this is a liquidity measure, revise to reconcile to cash provided by operating activities, and to the extent it includes cash-based adjustments other than capital expenditures, change the title to adjusted free cash flow. Please provide us with the proposed revised disclosures you intend to include in future filings. Refer to Item 10(e)(1)(i) of Regulation S-K, Questions 100.05 and 102.07.

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 you have included an adjustment for charges associated with Convertible Notes in your calculation of EBITDA. To the extent you are making adjustments to net income (loss) for anything other than interest, taxes, depreciation or amortization, the non-GAAP measure should not be characterized as EBITDA, and its title should be distinguished from EBITDA. Refer to Question 103.01 of the Non-GAAP Financial Measures C&DI.

Based on the restrictions in Item 10(e) and C&DI Question 102.03, it would not be appropriate to state that a charge or gain is 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. The SEC staff has asked registrants about their characterization of certain non-GAAP adjustments as “nonrecurring,” “infrequent” or “unusual” when they have been presented in multiple periods.

Usefulness and purpose of the disclosure

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, as well as 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, to the extent material, 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 a non-GAAP measure

We note your disclosure that management uses non-GAAP results to assist in comparing business trends from period to period on a consistent basis in communications with the board of directors, stockholders, analysts and investors concerning our financial performance. You believe that these non-GAAP measures are useful to investors and other users of your condensed consolidated financial statements as an additional tool for evaluating operating performance and trends. However, this reason appears to be a general statement that applies to all non-GAAP financial measures disclosed. Please revise future filings to provide for each non-GAAP measure, the specific reason(s) why management believes the presentation of such non-GAAP financial measure provides useful information to investors regarding your financial condition and results of operations. Management’s reason should be specific to the individual non-GAAP financial measure and avoid the use of overly generic boilerplate language. See guidance in Item 10(e)(1)(i)(C) 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 have inappropriately included non-GAAP measures in their segment disclosures
- ▶ Whether registrants provide appropriate disclosures, including information about profit or loss for reportable segments, entity-wide disclosures and 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.

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

For example, the SEC staff has challenged registrants that say in an SEC filing the basis for identifying operating segments is something other than product or service lines (e.g., geography) but publicly disclose information elsewhere that suggests management uses financial information by product or service lines to make decisions and allocate resources.

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 chief operating decision-maker (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

Round 1 comment:

You state that you operate and report financial information in one segment and your CODM reviews total company operating results to assess overall performance and allocate resources. Please tell us in detail how you concluded you have a single operating and reportable segment and it is your total company. In doing so, please also discuss:

- ▶ How the CODM goes about allocating resources, assessing operating performance and making key operating decisions using only total company operating results (and not lower level results)
- ▶ Your management structure from the top down to the X team level, including each person’s roles and responsibilities
- ▶ How budgets are prepared, who reviews and approves them, at what lower levels (e.g., X team) they are prepared and the frequency
- ▶ Whether lower level financial information is reviewed by the CODM and/or Board and, if so, describe what it is and how often it is reviewed, and

- Whether any managers are compensated based upon the performance of lower levels of the company and, if so, tell us who and explain how it works

Refer to ASC 280-10-05-3 and paragraphs 50-1 and 50-6 through 50-9 of ASC 280-10-50.

Round 2 comments:

1. Please describe the key operating decisions within your business and who makes these decisions. Additionally, describe how performance is assessed and how resources are allocated within your business. Provide examples supporting your descriptions, and specifically describe the nature of decisions made by the CODM as they relate to the components.
2. Please expand on the discussion of your organizational structure and describe the roles and responsibilities of direct reports to the CODM in more detail. Also, tell us the level of the CODM's involvement in team operations, such as whether the CODM approves player contracts (e.g., contracts over a certain dollar amount or other attribute).
3. Please expand on the discussion of the budgeting process and address the following:
 - Describe in detail how budgets are prepared
 - Who approves the budget at each step of the process, including who prepares and approves each of the business operations and teams' operations budgets before being presented to the CODM
 - What is included in the detailed component-level income statements used by the CODM as part of the budgeting process, such as the level of detail, and how they are used by the CODM
 - Whether component-level or other disaggregated income statements are provided to the board of directors as part of the budgeting process
4. Please describe in detail the component-level financial information provided to the CODM and board of directors and the frequency with which it is provided (even if not regularly). Also, as the CODM uses detailed component-level income statements as part of the budgeting process, tell us whether performance against budget is assessed at the component-level during the year, and if so, the frequency of that review. If the CODM does not review performance against budget at the level during the year, tell us why not.

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 disclose whether the operating segments have been aggregated into reportable segments in accordance with ASC 280-10-50-11 and 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 the disclosure that your ABC and XYZ reportable segments both consist of six aggregated operating segments. Please identify for us your operating segments and tell us in sufficient detail how you determined your operating segments meet all aggregation criteria described in ASC 280-10-50-11. In particular, explain how you determined all operating segments have similar economic characteristics. We note from your first quarter 2023 earnings call that management primarily discusses results and trends of your various "markets," with minimal discussion of your overall reportable segments. We further note from your disaggregated revenue disclosures on Form 10-K and Form 10-Q that certain end markets appeared to have disparate revenue trends for the annual and interim periods presented.

Round 2 comment:

We note your response and have the following comments:

- ▶ Please expand on how the aggregation of your operating segments is consistent with the objective and basic principles of ASC 280-10-10-1. In doing so, explain in greater detail how the aggregated operating segments are so similar that presenting the information separately would not significantly benefit an investor's understanding of your performance and future prospects. As part of your response, specifically address the aggregation within your ABC reportable segment.
- ▶ You indicate that the operating segments in your ABC and XYZ reportable segments have long-term 5-year average gross margins within a range of approximately +/- 5% and +/-10%, respectively. You further indicate that the ABC operating segments "have similar trends in sales growth" for the five-year period from 2017 to 2022. Please provide us with the five-year average gross margins and 5-year sales growth figures for each operating segment, as well as gross margins and sales by year within such periods.

Disclosures

ASC 280 requires disclosure of certain financial information for each reportable segment (e.g., revenue by segment, a measure of profit or loss, assets by segment) and additional “entity-wide” disclosures (e.g., revenues for the entire entity, organized by products and services and by geographic area, long-lived assets). ASC 280 also requires quantitative reconciliations of differences between combined reportable segment revenues, profit or loss, and assets, respectively, and their corresponding consolidated totals. Each quantitative reconciliation also should disclose applicable amounts attributable to the “all other”³ category (e.g., all other profit or loss) separately from other significant reconciling items (e.g., corporate eliminations).

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 consolidated measure of segment 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: Non-GAAP measures in the segment footnote

We note that your segment measure of profitability used by the CODM and disclosed is adjusted earnings before interest, taxes, depreciation and amortization (EBITDA). We also note that in addition to providing the segment measure of profitability for the ABC segment and XYZ segment in accordance with ASC 280-10-50-22, you present a corporate and other adjusted EBITDA and a consolidated adjusted EBITDA amount. Please note that ASC 280 requires disclosure of the profitability measure for each segment only, and disclosure of a consolidated adjusted EBITDA amount is therefore considered a non-GAAP financial measure and as such should not be disclosed in the notes to the financial statements under the guidance in Item 10(e)(1)(ii) of Regulation S-K. Please revise to remove the consolidated adjusted EBITDA amounts.

Registrants should determine the measure of 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 profit or loss to assess performance and allocate resources, the measure required to be disclosed is the one most consistent with the measure used to calculate the corresponding amounts in the entity’s consolidated financial statements.

For example, if the CODM uses operating income and EBITDA to assess performance and allocate resources, the measure of segment profit or loss required to be reported under ASC 280 would be 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

We note you disclose your CODM uses segment adjusted EBITDA as “a primary profitability measure” to evaluate performance and allocate resources and you disclose segment adjusted EBITDA for each reportable segment pursuant to ASC 280. However, we also note the following:

- ▶ You more prominently present and discuss operating income for each reportable segment in MD&A.
- ▶ You reconcile operating income for each reportable segment to adjusted EBITDA for each reportable segment in MD&A.
- ▶ Operating income for each reportable segment is determined in accordance with measurement principles that appear to be more consistent with those used in measuring the corresponding amounts in your consolidated financial statements relative to adjusted EBITDA for each reportable segment.

Based on the above, please more fully explain to us how and why you determined adjusted EBITDA for each reportable segment is your primary segment profitability measure based on the requirements of ASC 280-10-50-28.

In November 2023, the FASB issued Accounting Standards Update (ASU) 2023-07, *Segment Reporting (Topic 280): Improvements to Reportable Segment disclosures*, to, among other things, permit 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 those measures is determined in a way that is most consistent with the measurement principles used to measure the corresponding amounts in the consolidated financial statements.

The SEC staff said in response to the FASB's issuance of the guidance that additional segment profitability measures 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.

Based on discussions with the SEC staff in August 2024, we understand that, 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 staff 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.

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 staff guidance, and 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.

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.

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 – revenues 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 revenues are 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 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

Please disclose revenues from external customers attributed to your country of domicile and attributed to all foreign countries in total from which you derive revenues in future filings. In addition, disclose long-lived assets located in your country of domicile and located in all foreign countries in total in which you hold assets. Also disclose the amount of revenues from external customers attributed to and the amount of long-lived assets in an individual foreign country, if material.

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 appropriate measure(s) 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: Reconciliation to an incorrect measure

We note that in your disclosure of segment profitability you disclose adjusted EBITDA by segment, and then reconcile that amount to income (loss) loss from operations including equity method investment earnings, by segment. Please tell us which measure is the measure of profitability used by the CODM to measure performance and allocate resources to the segment. Please note that if the segment measure is adjusted EBITDA, the total of the reportable segments' adjusted EBITDA should be reconciled to consolidated income before taxes, and each amount of segment adjusted EBITDA should not be reconciled to another segment profitability measure. See guidance in ASC 280-10-50-27 through 28, and 280-10-50-30.

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 begins with an incorrect measure

We note that in your reconciliation of the reportable segment measure of profit or loss (adjusted EBITDA), you begin the reconciliation with an adjusted EBITDA measure that includes amounts for "Corporate, eliminations and other." Please note that the reconciliation should begin with a total of the adjusted EBITDA for reportable segments only and then include the applicable adjustments. Please revise all reconciliations accordingly, including total of reportable segments' revenue to consolidated revenue and total of the reportable segments' assets to consolidated assets. All significant reconciling items should be separately identified and described. See guidance in ASC 280-10-50-30 and 50-31.

Revenue recognition

Disaggregated revenue disclosures

Most of the SEC staff's comments on revenue recognition over the past year addressed registrants' disaggregated revenue disclosures. Under ASC 606-10-50-5, registrants 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 continues to seek more 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 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

Pursuant to ASC 606-10-50-5 and ASC 606-10-55-89 through 55-91, please provide disaggregated revenue disclosures that depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors. Also tell us the specific revenue categories included in the information regularly reviewed by your chief operating decision-maker.

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 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

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). Registrants 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: Satisfaction of performance obligations

For each method with a material amount of revenue, please provide us an accounting analysis that explains how each method is consistent with the guidance in ASC 606-10-25-23 that states that revenue should be recognized as you satisfy a performance obligation. Specifically, tell us in detail and revise future filings to disclose how each method faithfully depicts the transfer of your services. Refer to ASC 606-10-50-18 for guidance.

Disclosure of remaining performance obligations

The SEC staff 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 the company expects to recognize as revenue over the next 12 months approximately X% of the unsatisfied or partially satisfied performance obligations with the remainder being recognized thereafter. Please revise to disclose when the remaining X% will be recognized on a quantitative basis using time bands that would be most appropriate for the duration of the remaining performance obligations or by providing qualitative information. Refer to ASC 606-10-50-13.

Determining the transaction price

Over the past year, the SEC staff has asked about registrants' disclosure of the significant judgments used in applying ASC 606, specifically in the determination of the transaction price and any variable consideration. Under ASC 606-10-50-20(a), an entity is required to disclose information about the methods, inputs and assumptions used in determining the transaction price, which includes, but is not limited to, estimating variable consideration, adjusting the consideration for the effects of the time value of money, and measuring noncash consideration.

Example SEC staff comment: Determining the transaction price

We note you estimate the variable consideration related to your sales incentive programs based on the sales terms with customers and historical experience. Please provide in future filings the qualitative and quantitative information about the significant judgments and changes in judgments that significantly affect the determination of your transaction price, as set forth in ASC 606-10-50-1(b), 50-17(b), and 50-20(a). Provide us any intended revisions and the calculations used to determine variable consideration.

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 intangible assets impairment testing, including:
 - ▶ Disclosure of the methodologies, estimates and underlying assumptions used in the registrant's impairment analyses for both goodwill and 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 the intangible assets' useful lives were determined

Goodwill impairment analysis

The SEC staff has asked for information about a registrant's 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
- A reconciliation of the aggregate fair values of the reporting units to the registrant's market capitalization and support for the implied control premium
- Consideration of triggering events that have occurred since the last goodwill impairment test, and 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 staff has cited for issuing comments on a registrant's impairment analysis include significant declines in results and/or market capitalization, increased costs and reduced margins, changes to the competitive landscape, and impairments recorded by a registrant's peers.

Example SEC staff comment: Interim goodwill impairment test

We note that there has been a significant decline in your market capitalization since the October 31, 202X goodwill impairment test was performed and since your December 31, 202X year end. It appears that this may be a triggering event that would require you to reassess your goodwill for impairment. Please tell us what consideration you have given to reassessing the recoverability of your goodwill in the first quarter of fiscal 202X. If you did not perform impairment tests during the first quarter, please explain why. To the extent that an impairment test was performed, tell us whether or not an impairment of goodwill existed. Refer to ASC 350-20-35-30.

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. 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.

We have also observed the SEC staff request information about why an impairment review was not triggered for certain assets or 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 assets not tested.

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

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.

Reporting units at risk of impairment

The SEC staff has frequently asked registrants to provide additional disclosure when the future impairment of goodwill represents a known uncertainty required to be disclosed in MD&A. The SEC staff often makes this request when potential indicators of impairment are observed.

To assist registrants in meeting this disclosure obligation, the SEC staff refers to the list of disclosures in Financial Reporting Manual (FRM) Section 9510.3 that registrants should provide when any reporting unit's estimated fair value does not substantially exceed its carrying value (i.e., the reporting unit is at risk of failing a future impairment test under ASC 350).

Example SEC staff comment: Goodwill impairment analysis

In future filings, revise to provide information for investors to assess the probability of future goodwill impairment charges. For example, for each reporting unit at risk of failing an impairment test, disclose the following:

- ▶ The percentage by which fair value exceeded carrying value at the date of the most recent test
- ▶ A 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
- ▶ A description of potential events and/or changes in circumstances that could reasonably be expected to negatively affect the key assumptions

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

The SEC staff has stated 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 FRM Section 9510.3 should be provided if any reporting units are at risk. If goodwill impairment is identified as a critical accounting estimate, but the registrant 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.

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.

Other intangible asset 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.

ASC 805 requires
pro forma
disclosures for
material business
combinations.

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 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 in other areas of the filing.

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.

Business combinations

ASC 805, Business Combinations

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. 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 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.

<p>Example SEC staff comment: Application of the definition of a business</p> <p>We note that your acquisition was accounted for as a purchase of assets. Tell us why this transaction did not constitute the acquisition of a business. Your response should clearly explain why the acquired entity did not represent a business in accordance with the guidance outlined in ASC 805-10-55-4 through 55-6 and ASC 805-10-55-8 through 55-9.</p>
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Additionally, 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 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

We note you completed the acquisition of Company A in July 202X. Please tell us how you considered the disclosure requirements of ASC 805-10-50-2(h) and revise your future periodic filings to include all the required disclosures as applicable, including, for instance, the supplemental pro forma information.

The SEC staff comments related to business combinations also have included inquiries focused on the values assigned to specific identifiable intangible assets, including the significant estimates and assumptions used in calculating fair value measurements. When goodwill resulting from a business combination represents a significant portion of the consideration transferred, the SEC staff has asked registrants to revise their disclosures to provide more detailed qualitative descriptions of the factors that make up the amount of goodwill recognized (e.g., the specific synergies expected from the business combination) as required by ASC 805-30-50-1.

Example SEC staff comment: Goodwill and intangible asset valuation

As a result of the acquisition of Company A, we see that you recorded goodwill of \$XX and an intangible asset of \$X. Please address the following:

- ▶ Identify the intangible asset acquired and its amortization period.
- ▶ Tell us why no other intangible assets were recognized in accordance with ASC 805-20-25-10 and the examples in ASC 805-20-55-11 through 55-45.
- ▶ Describe to us the qualitative factors that make up the goodwill recognized, such as expected synergies from the combined operations, intangibles assets that did not qualify for separate recognition or any other factors in consideration of ASC 805-30-50-1a.

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 continues to request 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.

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 Rule 3-05 and Article 11 of Regulation S-X

We note that you acquired 100% of the outstanding shares of Company A. Please tell us how you considered the impact of this acquisition in considering whether you are required to provide financial statements of the acquiree and pro forma financial information under Rule 3-05 and Article 11 of S-X. Your response should include your assessment of each significance test in accordance with Rule 1-02(w) of Regulation S-X in assessing compliance with Rule 3-05 of Regulation S-X.

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:

- Risk factors
- Contingencies
- Climate-related disclosures
- Accounting error corrections, internal control over financial reporting and disclosure controls and procedures

Risk factors

The SEC staff continues to issue comment letters to registrants regarding the sufficiency of their risk disclosures in light of current macroeconomic and geopolitical factors, including the impact of inflation, interest rates, supply chain issues and changes in the commercial real estate market. The SEC staff has challenged registrants' risk factor disclosures as being too general (e.g., boilerplate disclosures) and asked registrants to more clearly describe how the macroeconomic factors may impact their operations, such as identifying and disclosing the types of inflationary pressures and how their business operations may have been materially impacted. In addition, the SEC staff has provided comments in cases where risk factor disclosures may need to be updated for evolving facts and circumstances.

We have also observed that the SEC staff has continued to issue comments requesting enhanced risk disclosures for registrants with a corporate structure based in or with the majority of its operations in China. In addition, the SEC staff often comments on the need for expanded disclosures from companies with crypto assets, including material risks from pending or enacted legislation or regulations.

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 has failed to make 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 amount or range of such losses. 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 that no material loss contingencies have been accrued for other legal matters in the ordinary course of business, but you indicate that litigation can have a material adverse impact. To the extent it is reasonably possible you will incur losses in excess of recorded accruals related to your contingencies, please provide the applicable disclosures required by ASC 450-20-50-3 through -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, both for each individual matter and in the aggregate, is not material to your consolidated financial position, results of operations or cash flows, we will not object to a statement to that effect. Alternatively, if no amount of loss in excess of recorded accruals is believed to be reasonably possible, please state this in your disclosure.

The SEC staff often comments on whether reasonably possible losses have been properly disclosed and the sufficiency of such disclosures.

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.

Climate-related disclosures

The SEC staff continued to issue comments on climate-related disclosures through the first half of fiscal 2024. The SEC staff's comments aligned with the [sample comment letter](#) that the SEC's Division of Corporation Finance posted on the SEC website in September 2021 to illustrate the types of comments it had begun issuing to registrants about their compliance with the [Commission's 2010 guidance regarding disclosure related to climate change](#). That guidance says registrants may need to make disclosures about climate-related matters in the description of the business (Item 101), discussion of legal proceedings (Item 103), risk factor disclosures (Item 105) and/or MD&A (Item 303) in response to the requirements of Regulation S-K. Securities Act Rule 408 and Exchange Act Rule 12b-20 also require a company to disclose any other material information necessary to make the required disclosures not misleading.

The staff's comments continued to focus on registrants' disclosures of:

- ▶ The impact of climate legislation, regulation, international accords and litigation
- ▶ Indirect consequences of climate-related regulation or business trends
- ▶ The physical effects of climate change
- ▶ Material expenditures for climate-related projects and compliance costs

The SEC staff also continued to ask registrants why climate-related information they provide voluntarily in corporate social responsibility (CSR) reports was not also provided in annual reports. The staff had indicated in the sample letter that it also would ask these types of questions.

The SEC staff often issued multiple rounds of letters on climate-related disclosures or reissued the same comments, particularly when the registrant's initial response did not address each of the items in the initial comment letter.

Additionally, when registrants asserted that the effects or costs of climate-related matters were not material, the SEC staff asked them to quantify the effects or costs and explain their analysis of materiality. As a result, the average number of rounds of climate-related comments was higher than the average number of rounds of comments on any other topic.

The SEC adopted in March 2024 final amendments to Regulation S-X and Regulation S-K to require registrants to provide climate-related disclosures in annual reports and registration statements. The SEC said in its adopting release that even after adoption of the rules, registrants should continue to consider the Commission's 2010 guidance because it addresses how various existing rules may require disclosure about climate-related matters.

How we see it

The SEC voluntarily stayed its climate-related disclosure rules on 4 April 2024, pending judicial review by the US Court of Appeals for the Eight Circuit of the consolidated challenges to the rules. Companies should continue to consider the Commission's 2010 guidance and the September 2021 sample comment regardless of the status of the new rules and whether they are adopted.

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

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 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

Please provide an analysis to support your assertion that the adjustments you recorded during the quarterly period ended December 31, 202X were not material to any prior period financial statements. In doing so, also describe the nature and amounts of each error being corrected and consider the impact of the errors individually and in the aggregate on each prior period. Refer to SAB Topics 1.M and 1.N.

Historically, the SEC staff has challenged the effectiveness of internal control over financial reporting (ICFR) and disclosure controls and procedures (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.

How we see it

We expect the SEC staff to continue asking questions about management's materiality assessment of accounting errors and challenging management's conclusions about the effectiveness of ICFR and DCPs.

The SEC also 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 (Item 307 of Regulation S-K) and/or the effectiveness of the registrant's ICFR as of the end of the registrant's most recent fiscal year (Item 308(a) of Regulation S-K).

Additionally, the SEC staff has 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., paragraph 4 and 4(b)).

Looking ahead

We expect the SEC staff to continue to focus on the topics discussed above in the upcoming year. The SEC staff may also expand its comments to other financial reporting topics, including disclosures made in response to recently issued SEC rules and financial accounting standards and areas of emerging risk, such as artificial intelligence and crypto assets.

Disclosures related to recently finalized rulemaking or standard setting

We expect the SEC staff's comments on the cybersecurity risk management, strategy and governance disclosures required under the **new rules** to evolve over the coming year, with an initial focus on compliance with the new rules. The SEC staff clarified guidance on both **voluntary disclosure** and **selective disclosure** of cybersecurity incidents, and **published** new C&DIs related to the disclosure of material cybersecurity incidents involving ransomware payments.

The SEC staff has said that it will continue to focus on clawback disclosures, including confirming a registrant has filed a clawback policy and assessing disclosures when a recovery analysis is triggered, in accordance with the final rules **adopted** by the SEC in October 2022.

The SEC staff may review and issue comments on registrants' compliance with the new segment reporting disclosure requirements in ASC 280, which are effective for fiscal years beginning after 15 December 2023.

The SEC staff may also comment on registrants' disclosures for supplier finance programs as required by the amendments to ASC 405-50, *Liabilities - Supplier Finance Programs*, which are effective for fiscal years beginning after 15 December 2022, except for the amendment on rollforward information, which is effective for fiscal years beginning after 15 December 2023.

Endnotes:

- ¹ The SEC staff has stated that it is usually most appropriate to provide the required quantitative and qualitative disclosures about market risk under Item 305 of Regulation S-K in a single location outside the financial statements. A separate section in Form 10-K for market risk disclosures is common, but not necessary. The SEC staff has indicated that management instead may elect to integrate the market risk disclosures with MD&A and the description of business sections.
- ² Earnings releases furnished on Item 2.02 of Form 8-K and other communications (e.g., investor presentations, earnings calls) are not subject to this prohibition.
- ³ “All other” includes immaterial operating segments, and other business activities that are not identified as operating segments.

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This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax or other professional advice. Please refer to your advisors for specific advice.

Appendix: Resources

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

MD&A

- ▶ [2023 SEC annual reports – Form 10-K](#)
- ▶ [2023 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](#)
- ▶ [2023 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](#)
- ▶ 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](#)

Risk factors

- ▶ [2023 SEC annual reports – Form 10-K](#)

Climate-related disclosures

- ▶ Technical Line, [Revisiting the SEC's guidance on climate change disclosures in today's environment](#)
- ▶ Technical Line, [A closer look at the SEC's climate-related disclosure requirements](#)

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

- ▶ [2023 SEC annual reports – Form 10-K](#)
- ▶ Financial reporting developments, [Accounting changes and error corrections](#)

Looking ahead

- ▶ Technical Line, [A closer look at the FASB's new segment disclosure requirements](#)
- ▶ [2023 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, [SEC adopts rules to require 'clawback' policies and disclosures](#)