SEC Comments and Trends
An analysis of current reporting issues
September 2017
Every year, we closely monitor the Securities and Exchange Commission (SEC) staff's comments on public company filings to provide you with insights on its areas of focus. Understanding the SEC staff’s comments and trends can help you as you head into the year-end reporting season. However, each registrant’s facts and circumstances are different and require judgments about the appropriate accounting treatment and evaluations about materiality. Therefore, while this publication highlights areas where the SEC staff may comment, registrants should carefully consider their disclosures based on whether the information is material to investors.

The SEC continues to encourage registrants to streamline disclosures and make them more meaningful. In light of the Commission’s initiative regarding disclosure effectiveness in recent years, registrants should consider the following points when evaluating the trends in staff comments we highlight in this publication and whether to adjust their disclosures:

- The SEC staff often issues comments to obtain additional information when it believes that a company may not have complied with requirements, omitted information that may be material or provided disclosures that appear misleading to investors. That does not mean the staff has not reached a conclusion that the requested information is material. Registrants should consider the materiality of additional disclosures before including them solely to clear an SEC staff comment.

- Registrants should regularly evaluate whether their disclosures continue to be material to investors as their facts and circumstances change. That is, they may eliminate immaterial disclosures even if they were included in prior filings in response to an SEC staff comment.

- Registrants should improve their disclosures by eliminating repetition and focusing on more meaningful discussion. For example, management’s discussion and analysis (MD&A) disclosure of critical accounting estimates often repeats disclosure from the significant accounting policies footnote without providing additional insight into the judgments and uncertainties underlying management’s estimates.

You can use this publication to identify topics where the SEC staff may challenge the accounting treatment or request enhanced disclosure. In all cases, we encourage companies to include a disclosure only when it is material to users.

The SEC staff continues to focus on many of the same topics that we highlighted last year. The following chart summarizes the top 10 most frequent comment areas in the current and previous years.
To our clients and other friends

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* Based on comment letter topics assigned by research firm Audit Analytics for SEC comment letters issued to registrants related to Forms 10-K from 1 July 2015 through 30 June 2017.

** This category includes comments on MD&A topics, in order of frequency: (1) results of operations (27%), (2) critical accounting policies and estimates (12%), (3) liquidity matters (10%), (4) business overview (8%) and (5) contractual obligations (3%). Many companies received MD&A comments in more than one category.

*** This category includes SEC staff comments on fair value measurements under Accounting Standards Codification (ASC) 820 as well as fair value estimates, such as those related to revenue recognition, stock compensation and goodwill impairment analyses. Individual SEC staff comments may be associated with more than one comment area in this chart.

While over the past 12 months we have seen the SEC staff continue its focus on the use of non-GAAP financial measures, which now ranks as the most frequent comment area, the staff continues to question registrants’ disclosures related to significant judgments and estimates, including those related to segment reporting, goodwill impairment, income taxes and revenue recognition. Registrants are spending significant time addressing SEC staff comments on these topics. The SEC staff requests additional information to support registrants’ conclusions and additional disclosures about the facts and circumstances that support significant judgments.

The main section of this publication discusses recent matters that concern all registrants. Appendices A, B and C highlight emerging trends related to specific industries, companies filing initial public offering (IPO) registration statements and foreign private issuers, respectively. Appendix D provides an overview of the SEC staff’s filing review process and best practices for responding to staff comments.

We hope you find this publication helpful. EY professionals are prepared to discuss any concerns or questions you may have.
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Management's discussion and analysis

Critical accounting estimates

Summary of issues noted
The SEC staff’s comments have frequently targeted repetitive discussions about critical accounting estimates in MD&A. The SEC staff has reminded registrants that MD&A should supplement but not repeat the disclosures in the significant accounting policies note of the financial statements. The SEC staff often asks registrants to focus their MD&A discussion of critical accounting estimates on the quality and variability of management’s most significant judgments and assumptions.

Analysis of current issues
Critical accounting estimates are those that are most important to the financial statement presentation and that require the most difficult, subjective and complex judgments. SEC Financial Release No. 72, *Commission Guidance Regarding Management’s Discussion and Analysis of Financial Condition and Results of Operations* (FRR-72), reminds registrants that MD&A rules require disclosure of critical accounting estimates and assumptions when both of the following conditions are met:

- The nature of the estimates or assumptions is material because of the levels of subjectivity and judgment needed to account for matters that are highly uncertain and susceptible to change.
- The effect of the estimates and assumptions is material to the financial statements.

The SEC staff has noted that registrants’ disclosures about critical accounting estimates often are too general and should provide a more robust analysis what is in the significant accounting policies note to the financial statements. The SEC staff has commented that there are numerous examples of portions of the significant accounting policies note being repeated verbatim in MD&A. While accounting policies in the notes to the financial statements generally describe the method used to apply an accounting principle, the discussion in MD&A should provide more insight into the uncertainties involved in applying the principle at a given time and the variability that is reasonably likely to result from its application.

Example SEC staff comment: Duplicative disclosure about critical accounting estimates

The disclosure of critical accounting policies within MD&A appears to duplicate your accounting policy disclosure in the notes to your financial statements. Please modify the MD&A disclosure to address the specific methods, assumptions and estimates used in your critical accounting measurements. If you prefer to include this disclosure elsewhere in your filing, such as an expanded disclosure in the notes to your financial statements, please consider including a simple cross-reference within your MD&A to avoid repetition.

Registrants can consider including in MD&A a cross-reference to the footnote disclosure about significant accounting policies. However, they should expand the MD&A disclosure to (1) address why the accounting estimate or assumption bears the risk of change and (2) analyze the following, if material:

- How the registrant arrived at the estimate/assumption
- How accurate the estimate/assumption has been in the past
Because critical accounting estimates and assumptions are based on highly uncertain matters, the SEC staff believes that registrants also should consider analyzing their specific sensitivity to change based on reasonably likely outcomes that could have a material effect on the financial statements. In addition to qualitative disclosures, the SEC staff believes that registrants should provide quantitative information when it is reasonably available and material.

**Example SEC staff comment: Expand disclosure of critical accounting estimates**

Please expand your disclosures to discuss how accurate your estimates and assumptions have been in the past, how much they have changed in the past and whether they are likely to change in the future. Further, please include quantitative disclosure of your sensitivity to change based on other outcomes that are reasonably likely to occur and that would have a material effect on the company. For example, with regard to inventories, please tell us whether your estimated inventory losses have been accurate or have required adjustment, and please indicate the effect on net income if there was a 1% change in the amount of markdowns.

**Example SEC staff comment: Impairment of long-lived assets**

Please revise your disclosure of the critical policy for impairment of long-lived assets to better explain the significant judgments management made when it performed impairment tests. Since the grouping of assets to determine the lowest level of identifiable cash flows requires considerable judgment, please disclose the level at which your assets are grouped.

Please also identify the types of events or changes in circumstances that may indicate that the carrying amount of an asset (asset group) may not be recoverable. Please indicate whether there were any events or changes in circumstances that triggered a need to estimate the recoverable amount for any asset or asset group. If there were or if there are reasonably possible scenarios that indicate there may be a material impairment at any of your asset group levels, please expand your disclosures to provide additional information as follows:

- Quantify the carrying value of each asset group tested for impairment or at risk of impairment
- Describe the key assumptions used by the company in calculating the asset group’s future cash flow and how those assumptions were determined
- Discuss the degree of uncertainty associated with the specific key assumptions
- Describe the potential events and/or changes in circumstances that are specific to the asset group and could reasonably be expected to negatively affect the key assumptions

We believe that the adoption of the new revenue recognition standard may result in more disclosures about revenue recognition within critical accounting estimates. Companies should reevaluate the need for and sufficiency of critical accounting estimate disclosures related to revenue recognition.

The SEC staff may request enhancements to the MD&A discussion of particular critical accounting estimates, which we discuss separately in this publication (e.g., realizability of deferred tax assets, goodwill impairment, allowance for loan loss, revenue — sales incentives).

**EY resources**

2016 SEC annual reports — *Form 10-K* (SCORE No. 03265-161US), November 2016
Liquidity and capital resources

Summary of issues noted

The SEC staff may request 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:

- Sources and uses of cash and the availability of cash to fund liquidity needs
- Implications of liquid assets held by foreign subsidiaries when there is an assertion for tax purposes that earnings of those foreign subsidiaries have been indefinitely reinvested
- Transparency in the contractual obligations table and its footnotes about interest payments and other items

Further, the SEC staff may request more comprehensive disclosures about material debt covenants when there is an elevated risk of default or when management has concluded it is reasonably likely that covenants will not be complied with in the future.

Analysis of current issues

General disclosures

Items 303(a)(1) and (2) of Regulation S-K require 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 requests that registrants expand MD&A to include a meaningful analysis and discuss the material components to explain the variability of cash flows. For example, the SEC staff often challenges the discussion about cash flows that recites items that are readily apparent from the statement of cash flows (e.g., changes in working capital) but does not provide analysis about the underlying drivers for material changes.

Further, the SEC staff may ask registrants to expand MD&A to include a discussion of increases or decreases in liquidity and capital resources due to events that have occurred or are reasonably likely to occur. For example, if a registrant expects growth in the business from a recently completed acquisition, the SEC staff may expect a discussion of the likely resulting increase or decrease in liquidity that may be material.

Example SEC staff comment: Changes in operating cash flows

Your discussion of net cash provided by operating activities does not appear to contribute substantively to an understanding of your historical cash flows. When preparing the discussion and analysis of operating cash flows, you should address material changes in the underlying drivers that affect these cash flows. These disclosures should include a discussion of the underlying reasons for changes in working capital accounts that affect operating cash flows.
The SEC staff also has requested that registrants disclose:

- Whether identified trends will continue, and if so, how long they will continue, as well as steps the registrant is taking to address the trends, including plans to remedy any identified material deficiency in short- or long-term liquidity
- An analysis of all internal and external sources of liquidity, beyond cash on hand, as of the balance sheet date
- Amounts outstanding and available at the balance sheet date under each source of liquidity, with a comparison to cash needs over the next 12 months, including any significant planned capital expenditures
- The sufficiency of the amount available under an existing short-term credit arrangement, the anticipated circumstances requiring its use, any uncertainty surrounding the ability to access funds when needed and the implications of not being able to access the arrangement

**Example SEC staff comment: Expected sources and uses of cash over the next twelve months**

Please expand your disclosures to better address how you determined that your current sources of cash will be sufficient to meet your anticipated cash needs for at least the next 12 months in light of the following:

- Your increasing working capital deficit
- Increased restrictions on the uses for your unused borrowing capacity

When there is a heightened risk of debt default, the SEC staff may request enhanced disclosures about the nature of and compliance with debt covenants.

- Specific terms of material debt covenants and performance relative to the covenants
- Actual quantitative ratios or amounts compared with required minimum/maximum values contained in debt covenants, along with explanations of how such ratios or amounts are determined and their relationship to amounts reported under US GAAP
- The nature of waivers or modifications of existing debt covenants obtained to cure or prevent potential violation(s), including how long any waivers apply and a description of the related covenant
- Disclosure of the likelihood of failing financial covenants in the future
Example SEC staff comment: Supplemental disclosures when dealing with elevated risk of debt default

Your disclosures indicate that you have substantial amounts of debt expected to mature in the next five years and plan to increase your current cash dividends in the coming years. During the recently completed fiscal year, your total return of capital to shareholders through cash dividends and common stock repurchases exceeded free cash flow. Additionally, during the last two fiscal years, your interest expense exceeded or approached your operating income.

Given the above considerations, please disclose in greater detail your ability to meet upcoming cash requirements over both the short-term and long-term periods. Please also provide us with the debt covenant calculations pertaining to your revolving credit facility and disclose the impact of these covenants on your ability to undertake additional financing.

Foreign earnings

The SEC staff continues to request that registrants consider the effect on consolidated liquidity when they assert their intention to indefinitely reinvest foreign earnings under ASC 740. The SEC staff requests disclosure of the amount of cash and short-term investments held by foreign subsidiaries that are not available to fund domestic operations unless the funds are repatriated and the potential income tax payments that would be required upon repatriation.

This disclosure can be important for investors to understand the registrant's liquidity. While a registrant may appear to have significant liquid assets, a large portion of those assets may not be generally available for use domestically without material tax implications.

In response to these requests, registrants have provided MD&A disclosures such as the following: “As of December 31, 2016, $2 billion of the $2.5 billion of cash and short-term investments (on the consolidated balance sheet) was held by foreign subsidiaries.” After making this type of disclosure, the registrant may then be asked to discuss the income tax implications of repatriation and the effects of repatriation on liquidity.

Example SEC staff comment: Foreign earnings

You disclosed that substantially all of your cash is held overseas and that you operate in many foreign jurisdictions that may place restrictions on the repatriation of cash to the US.

In future filings, please revise this discussion to disclose the amount of cash and cash equivalents held by foreign subsidiaries at the date of each balance sheet presented and quantify any amounts that would not be available for use in the US without incurring US taxes. Discuss any strategies you employ to make unrepatriated cash available for US operations.

Please also provide a discussion of any known trends, demands or uncertainties relating to your liquidity as a result of your policies of permanently reinvesting earnings outside the US.
Contractual obligations

Item 303 of Regulation S-K requires registrants (other than smaller reporting companies, issuers of asset-backed securities and registered investment companies) to provide tabular presentations of known contractual obligations as of the end of the most recent fiscal year.

The goal of the contractual obligations table is to present a meaningful snapshot of the cash requirements arising from such obligations. The MD&A rules permit flexibility so that the presentation can reflect company-specific information in a way that is suitable to a registrant’s business. Registrants should develop a presentation that is clear and understandable and that appropriately reflects the categories of obligations that are meaningful in light of their capital structure and business.

Uncertainties about what to include in the table and how to allocate amounts to the required periods should be resolved consistent with the purpose of the disclosure. Registrants should consider providing narrative disclosure, in addition to the table and related footnotes, to promote an understanding of the tabular data.

The SEC staff has questioned the completeness of items included in registrants’ contractual obligations tables and has asked those companies to provide the reasons for excluding certain items from the table. Most notably, the SEC staff has asked companies to include amounts for future interest payments in the contractual obligations table or a footnote to the table, if material. When interest rates are variable, registrants should describe the assumptions that were used to estimate future payments. The SEC staff also has asked registrants to disclose their long-term liabilities related to self-insurance reserves.

Example SEC staff comment: Contractual obligations

We note that long-term liabilities related to self-insurance, workers’ compensation and general liability insurance and nonqualified investment plans are not included in the table of contractual obligations. In future filings, please add a footnote to the table that discusses these liabilities.

EY resources

2016 SEC annual reports – Form 10-K (SCORE No. 03265-161US), November 2016
Results of operations

Summary of issues noted

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 the analysis of changes in revenue, the SEC staff has been commenting more often on significant components of expenses and provisions.

The SEC staff also has increased its focus on performance metrics, including whether registrants have disclosed key metrics monitored by management and how those metrics correlate to material changes in the results of operations.

Analysis of current issues

Item 303(a)(3) of Regulation S-K provides general instructions for preparing MD&A disclosures about the results of operations. The SEC staff often asks registrants to provide a more detailed discussion about their results of operations, including requesting that they:

- Describe any unusual or infrequent events or transactions, or any significant economic changes, that materially affect income from continuing operations, as well as the extent to which income was affected (e.g., significant events that have been disclosed in the press but not disclosed in an SEC filing)
- Describe any other significant components of revenue or expense necessary to understand the results of operations (such as components of cost of sales)
- Describe any known trends, events or uncertainties that have had or are expected to have a material effect on sales, revenue or income from continuing operations (such as uncertainties arising from foreign operations in countries subject to political or financial risk)
- Discuss how much of any material increase in net sales or revenue is due to business combinations, increased sales volume, introduction of new products or services, or increased sales prices and quantify, if possible, each factor’s effect
- Discuss segment information needed to understand their results of operations, including the effect that the performance of a particular product line may have had, in addition to discussing the registrant as a whole

The SEC staff typically requests that registrants provide a more granular quantification and discussion about the specific factors (including material offsetting factors) and the underlying business or economic reasons that contributed to material period-to-period changes. For example, when a registrant discloses that two or more factors contributed to a material period-to-period change in a financial statement line item, the SEC staff often requests that the registrant quantify and analyze each factor’s effect.
Example SEC staff comment: Results of operations – quantification of factors

We note that your comparative discussions of revenues and cost and expenses identify multiple key variables as the primary reasons for the year-to-year changes in your operating results. We also note that your discussion does not quantify the effect of each of these variables. Please revise your discussion in future filings to quantify the effect that each material variable or factor referenced in your discussion had on your results of operations, if practicable. Refer to the guidance in SEC Release 34-48960 available on the SEC website at www.sec.gov/rules/interp/33-8350.htm.

Some of the factors that may cause period-to-period changes in revenue and operating costs of a registrant’s reportable segments are foreign currency fluctuations and changes in the macroeconomic environments around the world. The SEC staff expects that any material effect of such factors will be separately quantified for the affected reportable segments.

The SEC staff has also requested that companies provide forward-looking information about known trends and uncertainties. This information is required for uncertainties that have had or are reasonably likely to have a material effect on revenues or income from continuing operations. In evaluating the disclosure requirement, the registrant must determine whether the trend or uncertainty is reasonably likely to occur. If it isn’t, no disclosure is required. If the registrant cannot make that determination, it must assume that the uncertainty will occur and it must disclose that item in MD&A, unless it is not reasonably likely to have a material effect.

When material effects on results of operations are ascribed to an increase (or decrease) in headcount or other internal initiatives (e.g., IT infrastructure), the SEC staff may ask registrants to discuss expectations about ongoing investments in these areas. When registrants disclose exposures to law or regulatory changes, foreign exchange fluctuations or economic conditions (e.g., increasing interest rates), the SEC staff may ask about the effects of these items on revenues and income in future periods.

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

Please describe any known trends or uncertainties that you reasonably expect will have a material favorable or unfavorable effect on your revenue or income from continuing operations. We note your series of Medicare risk factors starting on page XX, as well as the statement in the second paragraph under “Regulatory Change” on page XX regarding “some of the more significant health care regulatory changes that have affected our financial performance.”

If it is known that the events described will cause a material change in the relationship between your costs and revenues, you should disclose the change in the relationship.
Significant components of expense and changes in reserve balances

The SEC staff has asked registrants to expand their discussions about significant components of operating expenses, such as costs of sales. In their segment discussions, registrants often describe only changes in revenue and operating income 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 operating expenses that have affected segment operating income. The SEC staff believes this information helps investors better understand a registrant’s business.

In addition, the SEC staff is increasingly asking for additional information and disclosure about material provisions or reversals affecting reserve accounts (e.g., bad debt allowance, inventory reserves, sales return reserves) as well as their effects on the results of operations.

Example SEC staff comment: Results of operations – changes in reserve accounts

Please expand your disclosures to explain the reasons for the changes in your provision for credit losses on loans receivable recorded for each period presented. See Item 303 of Regulation S-K and SEC Release No. 33-8350.

Key financial and operating metrics

The SEC staff continues to believe that key financial and operating metrics can be useful for investors to assess management’s performance. SEC Chief Accountant Wes Bricker has emphasized the importance of having effective disclosure controls and procedures with respect to these performance metrics. “Similar to non-GAAP financial reporting, key operating metrics and forecasts may also be distorted via bias – for example, painting a potentially misleading picture – error or fraud, all of which undermine the credibility of the reporting. Therefore, it is important that companies proactively and thoughtfully address risks to their reporting,” Mr. Bricker said in a speech in May 2017.

The SEC staff may ask a registrant to disclose key performance indicators in its SEC filings if it provides those metrics outside of its SEC filings (e.g., websites, press releases, analyst presentations). To help investors view the registrant through the eyes of management, FRR-72 suggests that the registrant disclose in MD&A the key performance indicators, financial or nonfinancial, that are used to manage its business. Key performance metrics vary by industry. For example, retail companies use same-store sales and store openings and closings, while social networking and online gaming companies typically use monthly or daily users.

When a registrant uses a key metric to discuss operating results in MD&A, the SEC staff frequently requests that it:

- Define the metric, especially when a registrant’s definition differs from the definition commonly used in its industry
- Discuss how the metric is calculated
Discuss any limits on the usefulness of the metric (e.g., individuals may be counted more than once in an average monthly users metric)

Consider providing information about the metric on a disaggregated basis, such as by segment, geography or revenue stream (e.g., breaking down same-store sales between e-commerce and in-store sales)

Clearly explain how the metric or period-to-period change in the metric links to operating results to reveal a trend (e.g., using the increase in the number of customers to explain revenue growth)

The SEC staff recognizes the value of using an operating metric in MD&A to help explain operating results. However, the staff has asked for clarification when it believes that a registrant’s use of such metrics without the appropriate context is potentially misleading and does not appropriately explain any changes in income statement line items. For example, if a company discloses that it has 10 million total users and expects the number to grow 12%, but doesn’t explain that the majority of them are non-paying, investors may incorrectly expect a direct correlation between total user growth and profitability.

**Example SEC staff comment: Results of operations – key financial metrics**

Please revise to clarify the definition and significance of your member-based performance metric on page XX. For example, it appears from the discussion at the top of page XX that roughly 98% of your users are non-paying members. If the company does not obtain any revenue from these non-paying members, please clarify the significance of including these members to calculate your member-based performance metric.

**EY resources**


2016 SEC annual reports – Form 10-K (SCORE No. 03265-161US), November 2016
Summary of issues noted

Non-GAAP financial measures continued to be a major focus area for the SEC staff. Officials have publicly expressed concerns about registrants’ use of non-GAAP financial measures in filings and in earnings releases, particularly when those measures differ significantly from or are presented more prominently than GAAP metrics. This topic was the most frequent area of SEC staff comment in the year ended 30 June 2017.

Many of the staff comments focused on compliance with the Compliance and Disclosure Interpretations (updated C&DIs) on the use of non-GAAP financial measures, which the staff updated in May 2016 to provide more explicit guidance on when non-GAAP financial measures may violate SEC rules.

The SEC staff has asked registrants to explain how their use of non-GAAP measures complies with the updated C&DIs or to change their presentation of items including:

- Non-GAAP financial measures that tailor GAAP recognition and measurement principles, don’t include the same items in all periods, don’t treat similar gains and losses consistently or exclude cash operating expenses from performance measures
- Non-GAAP financial measures that are presented more prominently than GAAP measures or disclosures that don’t appear to comply with Item 10(e) of Regulation S-K (e.g., presenting a measure that could be misleading, omitting disclosure of the measure’s usefulness to investors or management, removing cash settled charges from liquidity measures, labeling recurring items as nonrecurring)
- Per-share measures that appear to be liquidity measures

Many of the SEC staff comments have focused on the registrants’ use of non-GAAP measures in earnings releases and other information (e.g., websites, investor presentations) in addition to their SEC filings.

Analysis of current issues

The updated C&DIs provide more explicit guidance on uses of non-GAAP financial measures that the SEC staff believes would be misleading. A non-GAAP measure may be considered misleading if it (1) is presented inconsistently in different fiscal periods or if similar gains and losses are treated differently, (2) excludes recurring cash operating expenses from performance measures, or (3) tailors GAAP recognition and measurement principles, such as accelerating deferred revenue. In its comment letters, the SEC staff has focused on all three areas.

Inconsistent presentation

In the updated C&DIs, the SEC staff said that presenting a non-GAAP financial measure that adjusts a particular charge or gain in the current period but doesn’t adjust similar charges or gains in prior periods could violate Regulation G unless the change is disclosed and the reasons for it are explained. The SEC staff has asked registrants how they define specific non-GAAP measures and challenged whether unusual gains have been eliminated consistently with unusual charges or losses.
Example SEC staff comment: Inconsistent presentation

We note that you disclose the non-GAAP measure “Adjusted earnings,” which excludes pension settlement charges, merger and restructuring charges and abandonment and impairment charges. Considering you have not provided any adjustments to exclude net gains on asset sales, please advise us how you have considered Question 100.03 of the updated C&DI's issued on 17 May 2016.

Exclusion of normal, recurring cash operating expenses

In the updated C&DI's, 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 SEC staff has asked registrants whether non-GAAP performance measures exclude recurring charges such as restructuring charges and litigation costs that should be included as normal, cash operating expenses.

Example SEC staff comment: Exclusion of normal, recurring cash operating expenses

We note several items in the reconciliation of EBITDA to adjusted EBITDA remove recurring cash operating expenses, such as professional fees and management fees and expenses. Considering these adjustments include recurring cash operating expenses, tell us how your presentation complies with the May 17, 2016, updated C&DI's on Non-GAAP financial measures.

Tailoring GAAP recognition and measurement principles

In the updated C&DI's, the SEC staff clarified that non-GAAP performance measures that accelerate the recognition of revenue to the time of sale or customer billing but under GAAP would be recognized ratably over the performance period or that use other accounting methods not allowed under GAAP (e.g., proportionate consolidation) may be misleading. While the SEC staff initially focused on revenue when asking about compliance with this interpretation, the SEC staff has broadened its approach and challenged other ways registrants modify GAAP recognition and measurement principles in calculating non-GAAP financial measures.

Example SEC staff comment: Proportionate consolidation of equity investments

We note that your adjusted EBITDA calculation adjusts for your “proportionate share from equity accounted investments.” Your proportionate presentation may be inconsistent with Question 100.04 of the updated C&DI's issued on May 17, 2016. Please review this guidance when preparing future filings.

The SEC staff’s focus on non-GAAP financial measures in comment letters is consistent with the messages SEC officials have been delivering in speeches.
Compliance with Item 10(e) of Regulation S-K

Item 10(e)(1)(i)(A) of Regulation S-K requires a presentation, with equal or greater prominence, of the most directly comparable financial measure or measures calculated and presented in accordance with GAAP. The SEC staff has objected when registrants appear to give undue prominence to non-GAAP financial information either in an SEC filing or earnings release.

The prohibition on presenting non-GAAP financial measures with greater prominence than GAAP measures applies to both the order of presentation and the degree of emphasis. For example, the SEC staff has questioned discussions of non-GAAP financial measures that precede the discussion of the corresponding GAAP measures, use bold or larger font or significantly exceed the length of the discussion of the corresponding GAAP measures.

Example SEC staff comment: Prominence of non-GAAP measures

We note that you present non-GAAP earnings and non-GAAP margin before the most directly comparable GAAP measures. Your presentation appears to give greater prominence to the non-GAAP measures than to the comparable GAAP measures, which is inconsistent with the updated C&DIs issued on May 17, 2016. Please review that guidance when preparing future earnings releases. The SEC staff also has asked registrants to clarify and expand their disclosures to discuss how a particular measure is useful to investors and how management uses it. Often, these disclosures are boilerplate or too general to help readers understand how they should use a particular measure. If a registrant cannot explain how a measure is useful to investors, or if the SEC staff believes the presentation could be misleading, the staff has asked registrants to expand the disclosure or remove the non-GAAP measure. Additionally, the SEC staff has questioned the usefulness of adjustments that do not appear to be consistent with the purpose of the measure described by the registrant.

When disclosing non-GAAP financial measures, registrants also should consider the following areas of frequent SEC staff comment:

- The labeling of a non-GAAP financial measure should clearly describe the nature of any adjustments to a standard measure and should not imply that it is an unadjusted measure. For example, a measure that includes adjustments to the standard definition of EBITDA should not be labeled “EBITDA.”

- Adjustments to non-GAAP measures that are labeled as nonrecurring should only comprise items that are infrequent or unusual in nature, as required by Item 10(e)(1)(ii)(B) of Regulation S-K. If the adjusted item has occurred within the past two years or is likely to recur within two years, it should not be characterized as nonrecurring.
Example SEC staff comment: Usefulness of a non-GAAP measure

We note your disclosure of the non-GAAP measure “adjusted net income” provides a meaningful comparison of financial performance between years and transparency in your operating results. However, your current disclosure is too generic in terms of describing how you use it and why it is useful to investors. Please revise your disclosure to provide more detail regarding how you use it and its usefulness to investors.

In the updated C&DI, the SEC staff also noted that constant currency measures are considered non-GAAP financial measures and said that registrants should present the historical amounts and describe their process for calculating constant currency amounts in lieu of a numeric reconciliation of the non-GAAP metric. The SEC staff has commented on registrants’ use compliance with its interpretation.

Example SEC staff comment: Constant currency measures

We note your disclosure elsewhere in the filing that your constant currency measures are non-GAAP financial measures. In future filings, please comply with the reconciliation requirements of Regulation G and Item 10(e) by presenting the historical amounts and the amounts in constant currency and describing the process for calculating the constant currency amounts and the basis of presentation.

Registrants must present non-GAAP financial measures with quantitative reconciliations to the most directly comparable US GAAP measures. This requirement also applies to forward-looking non-GAAP measures if the forward-looking US GAAP measure is reasonably available. If a comparable US GAAP measure isn’t available, the SEC staff expects registrants to disclose why the reconciliation is not presented. The SEC staff has objected to registrants presenting a full non-GAAP income statement as a form of reconciliation because it gives undue prominence to the non-GAAP information. The staff has objected to registrants presenting reconciliations that begin with the non-GAAP information.

Example SEC staff comment: Reconciliation to GAAP measure

We note that in your reconciliation of adjusted EBITDA, you begin the reconciliation with the non-GAAP measure rather than the GAAP measure. Please revise to begin the reconciliation with the most directly comparable GAAP measure, net income (loss).

Liquidity versus performance measures

Non-GAAP financial measures may be presented as performance measures, liquidity measures or both. When a registrant uses a non-GAAP measure as both a performance and liquidity measure, the registrant should include separate reconciliations and disclosures for each type of measure. For example, a registrant should reconcile EBITDA to both net income and cash flows from operations if EBITDA is presented as both a performance measure and a liquidity measure.
The SEC staff has asked registrants to revise future disclosures to comply with the Regulation S-K requirements for liquidity measures. Registrants cannot present non-GAAP liquidity measures on a per-share basis, and they cannot adjust liquidity measures to remove charges or liabilities that require or will require cash settlement.

**Example SEC staff comment: Non-GAAP liquidity measures**

We note your presentation of adjusted cash flow from operations. You refer to the measure as a performance measure, yet you reconcile the non-GAAP measure to cash flow from operations. Tell us your consideration of whether this is a performance measure or a liquidity measure, and revise your presentation in accordance with Item 10(e)(1)(i) of Regulation S-K. If you are presenting this measure as a liquidity measure, please tell us how the presentation complies with the guidance in Item 10(e)(1)(ii)(A) of Regulation S-K.

The SEC staff’s updated CD&Is state that it will base its determination of whether a measure is a liquidity measure or a performance measure for purposes of per-share presentation on the substance of the adjustments rather than management’s characterization of the measure. For example, if the majority of adjustments in a non-GAAP measure are noncash adjustments but management reconciles the measure to net income, the staff may consider the non-GAAP measure a liquidity measure. Based on the nature of the adjustments made, the staff has asked registrants to remove certain measures presented on a per-share basis that it considers to be liquidity measures in substance.

**Example SEC staff comment: Non-GAAP liquidity measures per share**

We note that non-GAAP net income per share provides meaningful information regarding your operating performance and cash flows, including your ability to meet future debt service, capital expenditures and working capital requirements. As such, it appears that you are presenting non-GAAP net income per share as a liquidity measure. Non-GAAP liquidity measures should not be presented on a per-share basis. Please tell us your consideration of Question 102.05 in our updated C&DIs regarding non-GAAP financial measures.

**EY resources**

- To the Point, *SEC staff updates guidance on non-GAAP financial measures* (SCORE No. 01108-161US), May 2016
- 2016 SEC annual reports – Form 10-K (SCORE No. 03265-161US), November 2016
Executive compensation disclosures

Summary of issues noted
The SEC staff focuses its reviews on registrants’ compensation discussion and analysis (CD&A) in an effort to promote more direct, specific and clear executive compensation disclosures. The CD&A should explain how and why a registrant’s compensation committee establishes executive compensation policies and reaches specific executive compensation decisions. The staff may perform these reviews separately from or in conjunction with its review of other sections of a company’s filing.

The SEC staff recently has commented on:

- Effects of peer company benchmarks, performance criteria and targets, and shareholder advisory votes on compensation decisions
- Basis for identifying fewer than five named executive officers
- Requirements to update executive compensation disclosures in registration statements

Analysis of current issues
Item 402 of Regulation S-K requires registrants to include disclosures related to director and executive officer compensation in most proxy or information statements, Form 10-K filings and various registration statements.

The SEC staff has asked registrants to consider providing sufficient detail about how they used competitor information in making decisions about compensation for their named executive officers. The SEC staff also has asked registrants to disclose the peer companies they used for benchmarking executive compensation and specify how the peer group was established. When a benchmarking exercise is material to a compensation program, the staff has asked registrants to confirm that all identified peers were used in the benchmarking analyses and explain how the compensation for named executive officers compared with the benchmarks. If actual compensation differs from targeted percentiles in the peer group, the SEC staff expects registrants to explain the reasons.

The SEC staff also has asked registrants to provide details on individual and corporate performance criteria and targets, both quantitative and qualitative, for each named executive. Such details include how the targets were met and how meeting those targets aligns with the overall strategy of the company. Registrants are not required to disclose the targets if doing so would result in competitive harm. A registrant that doesn’t disclose targets must disclose the likelihood or the difficulty of achieving those targets.
Example SEC staff comment: Executive compensation disclosures

We note that the corporate performance measures used to determine bonus awards under your incentive plan were consolidated revenue and adjusted earnings per share (EPS). In future filings, please clearly disclose the minimum, target and maximum for both the performance goals and payout levels for your incentive plan. The grants of plan-based awards tables should include threshold, target and maximum estimated future payouts under equity and non-equity incentive plans. Refer to Item 402(b)(x2)(v) of Regulation S-K. To the extent you believe that disclosure of the targets is not required because it would result in competitive harm such that you may omit this information under Instruction 4 to Item 402(b) of Regulation S-K, please provide a detailed explanation of such conclusion.

Item 402(b) of Regulation S-K requires a registrant to disclose how the results of the most recent shareholder advisory vote on executive compensation were considered in determining compensation policies and decisions. The SEC staff has asked registrants to disclose in future filings the results of the shareholder advisory vote and the effect on executive compensation.

Example SEC staff comment: Shareholder advisory vote

In future filings, please disclose whether and, if so, how the compensation committee has considered the results of your most recent shareholder advisory vote on executive compensation in determining compensation policies and decisions.

The SEC staff also may request that a registrant clarify the factors that its compensation committee considered when it exercised its discretion in granting equity awards.

Identifying named executive officers

A registrant is generally required to provide executive compensation information for its principal executive officer, principal financial officer and three other highest-paid executive officers. However, the registrant may report fewer than five named executive officers if an executive officer’s total compensation is less than $100,000 or the registrant cannot identify the required number of executive officers. The definition of executive officer under Exchange Act Rule 3b-7 includes any vice president in charge of a principal business unit, division or function or any other officer who performs a policy-making function. The SEC staff often requests an explanation when a registrant does not identify or provide compensation information for five named executive officers (or three executive officers for a smaller reporting company or emerging growth company (EGC)).

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1 Smaller reporting companies and emerging growth companies only have to provide information for the principal executive officer and two other highest-paid executive officers. In certain cases, registrants may have to provide information for additional executive officers who were not serving in those roles at fiscal year-end.

2 Executive officers of subsidiaries may be considered executive officers of the registrant if they perform policy-making functions for the registrant.
Updating executive compensation disclosures in registration statements

In certain cases, an SEC registration statement must include executive compensation disclosures for the registrant’s most recently completed fiscal year before the Form 10-K or proxy statement is filed. For example, an initial registration statement (Form S-1 or Form 10) filed or declared effective after the end of the registrant’s fiscal year must include executive compensation disclosures for that fiscal year. In addition, a registrant, other than a well-known seasoned issuer, that files a registration statement on Form S-3 must provide executive compensation disclosures for the same period for which annual financial statements are incorporated by reference in the Form S-3, even if the proxy statement is not yet due.

The SEC staff may request that a registrant amend its registration statement or update its Form 10-K or proxy statement to include executive compensation disclosures for the most recent fiscal year before declaring a registration statement effective.

**Example SEC staff comment: Executive compensation disclosures in registration statements**

We note that your registration statement incorporates by reference your Form 10-K for the fiscal year ended 31 December 2016, which incorporates by reference Part III information from a proxy statement that has not yet been filed. Please amend your Form 10-K to include the Part III information, including executive compensation for the fiscal year ended 31 December 2016, or file your proxy statement including such information. Alternatively, please amend your registration statement to include such information. We refer you to Question 123.01 of the Securities Act Forms Compliance and Disclosure Interpretations and Question 217.11 of the Regulation S-K Compliance and Disclosure Interpretations for more information.

**EY resources**

2017 proxy statements: An overview of the requirements and observations about current practice (SCORE No. 03267-161US), November 2016
Summary of issues noted

With registrants preparing to adopt new standards on revenue recognition, leases and credit impairment, SEC officials have publicly expressed their views about what information registrants should provide in disclosures to comply with Staff Accounting Bulletin (SAB) Topic 11.M (also known as SAB 74). The SEC staff has been closely monitoring registrants’ disclosures about the revenue standard, which is effective 1 January 2018 for calendar-year registrants, and requesting expanded disclosures in some cases.

Analysis of current issues

The SEC staff has said that if a registrant does not know or cannot reasonably estimate the effect that adopting a new standard will have on its financial statements, it should make a statement to that effect and consider providing qualitative disclosures to help the reader assess the potential significance of the effect on the registrant’s financial statements. These qualitative disclosures should include a description of the new standard’s effect on the registrant’s accounting policies and provide a comparison to the registrant’s current accounting policies.

For the new revenue standard, the SEC staff has said that a registrant should consider the full scope of the new standard, including presentation in the financial statements and disclosures in the notes to the financial statements, when evaluating the effect on its financial statements. The SEC staff also expects registrants to include a description of the process they are using to assess the effect of the new standard, where they are in the implementation process, what matters still need to be addressed and what additional steps they plan to take.

The SEC staff expects a registrant’s disclosures to evolve as the effective date of a standard nears and the registrant makes progress in its implementation plan. That is, the SEC staff expects a registrant’s disclosures to be more specific each quarter. It is important for management to consider these expectations when developing their disclosures and discuss them with the audit committee each quarter.

Example SEC staff comment: SAB 74 disclosure

You state that you are in the process of evaluating the impact that the amended revenue recognition guidance in ASC 606 will have on your consolidated financial statements. Please revise to provide a qualitative discussion of the potential impact that this standard will have on your financial statements when adopted. In this regard, include a description of the effects of the standard that you expect to apply and a comparison to your current revenue recognition policies. Describe the status of your process to implement the new standard and the significant implementation matters yet to be addressed. In addition, to the extent that you determine the quantitative impact that adoption of ASC 606 will have on your results, please also disclose such amounts.
Summary of issues noted

The SEC staff has questioned the completeness and adequacy of exhibits, consents, audit reports, management signatures or certifications filed by registrants as required by various rules and regulations. Although deficiencies in these items may seem inconsequential, they may require registrants to amend their filings.

Analysis of current issues

Compliance with Item 601(b)(10) of Regulation S-K

When a registrant has discussed significant transactions or agreements in its disclosures, the SEC staff has asked why the related contracts were not filed as exhibits under Item 601(b)(10) of Regulation S-K. In addition, the SEC staff has asked registrants to file missing schedules, exhibits or appendices of material contracts (e.g., a credit agreement should be filed with all of its schedules, exhibits and appendices). Registrants often can provide the missing information in a subsequent filing rather than by amending the original filing.

Example SEC staff comment: Compliance with Item 601(b)(10)

Please include as exhibits in your future filings your exclusive distribution agreement with [XYZ Company] and the additional distribution agreements you entered into with [ABC Company], or explain to us why they need not be filed under Item 601(b)(10) of Regulation S-K. We note that Exhibit 10.6 appears to be the only agreement with [ABC Company] filed with this Form 10-K, but your disclosure refers to multiple other agreements.

Consents and auditors’ reports

Item 601 of Regulation S-K requires registrants to file the consents of experts (e.g., auditors) and counsel as exhibits to various forms filed with the SEC. Independent registered public accounting firms must consent to the use of their names and related reports in Securities Act registration statements. The SEC staff has issued comments when such required consents (1) are missing from the filing, (2) omit the conformed signature of the accounting firm or the date of the consent, or (3) refer to the incorrect auditor’s report or periods covered by that report.

Registrants should make sure that the “Report of Independent Registered Public Accounting Firm” also includes the conformed signature and location of the accounting firm and appropriately identifies all periods, financial statements and schedules that have been audited.

Section 302 certifications

The management certification required under Section 302 of the Sarbanes-Oxley Act must be filed as Exhibit 31 to the Form 10-K. The specified form of the Section 302 certification must be filed exactly as specified in Item 601(b)(31)(i) or (ii) of Regulation S-K. Separate certifications must be filed by the principal executive officer and principal financial officer.
The SEC staff frequently has asked registrants to correct these certifications by refiling the entire report in an amendment (i.e., not simply filing a revised certification). When preparing officer certifications, registrants should:

- Follow the exact form specified by Item 601(b)(31) of Regulation S-K
- Not include the certifying individual’s title in the first line of the certification
- Include the required language on internal control over financial reporting (ICFR) in the fourth paragraph of the certification when management’s report on ICFR is included in the Form 10-K (this language may be omitted during the transition period allowed for newly public companies to comply with Item 308(a) of Regulation S-K)
- Include a conformed signature of the signing officer, its job title and the date the certification was signed at the bottom of the certification

**Example SEC staff comment: Section 302 certifications**

We note that your certification filed on Exhibit 31.1 does not include the signature of the officer completing the certification, the job title(s) of the officer and the date that the certification was signed. Please file an amended Form 10-K to revise this certification accordingly. Refer to the guidance in Item 601(B)(31) of Regulation S-K.

**Form 10-K signatures**

General instruction D of Form 10-K requires the annual report to be signed by the registrant and on the registrant’s behalf by (1) its principal executive officer(s), (2) its principal financial officer(s), (3) its controller or principal accounting officer and (4) a majority of the board of directors or others acting in a similar function. If an officer signs the filing in multiple capacities (e.g., the chief financial officer is also the principal accounting officer), his or her signature line should indicate all such roles.

The SEC staff requires registrants to include the signature of the person serving as the controller or principal accounting officer or indicate who signed the report in that capacity. It’s also important that the Form 10-K include officers’ signatures on behalf of the registrant, as well as in their individual officer capacities. Officers sometimes incorrectly only sign on behalf of the registrant and not individually, or vice versa.

**Example SEC staff comment: Form 10-K signatures**

Please note that your annual report on Form 10-K must be signed by your controller or principal accounting officer. Any person who occupies more than one of the specified positions should indicate each capacity in which he or she signs the report. Please refer to General Instruction D(2) of Form 10-K and advise.

**EY resources**

2016 SEC annual reports – Form 10-K (SCORE No. 03265-161US), November 2016
Summary of issues noted
ICFR continues to be an area of significant focus of the SEC staff and the SEC's Division of Enforcement. The SEC staff has questioned the following areas related to ICFR and disclosure controls and procedures:

- The nature and timely identification of material weaknesses
- The implications to ICFR when a registrant discloses immaterial error corrections regardless of materiality
- The omission of disclosures about changes in ICFR after significant events that make material changes likely, such as a business combination or a significant accounting change
- The effectiveness of disclosure controls and procedures when management concludes that ICFR is ineffective

Analysis of current issues
Over the past few years, the SEC staff has expressed concerns that material weaknesses are not being identified timely, and control deficiencies are not being evaluated appropriately before a material misstatement occurs. The conclusion about the severity of a control deficiency depends on an evaluation of both the likelihood and magnitude of an error occurring without being prevented or detected by a registrant’s ICFR, not just the occurrence or magnitude of an actual error requiring correction.

The SEC staff said it has seen registrants focus their interim or annual disclosures related to a material weakness on the accounting error itself rather than describing whether a control had an ineffective design or failed to operate effectively. The SEC staff has asked for additional information on the deficiency, including:

- The nature and cause of the material weakness (and financial statement error, if applicable)
- Who identified the material weakness and when it was identified
- Whether the material weakness is more pervasive or affects other accounts or processes
- The planned actions, costs and timeframe to remedy the material weakness
- How the registrant compensates for the material weakness to make sure that the financial statements are free from material misstatement
- The status of any unremediated material weakness previously disclosed
- The effect on disclosure controls and procedures when ICFR is ineffective given that ICFR constitutes a substantial element of disclosure controls and procedures

The SEC staff also has questioned why a registrant’s disclosures under Item 308(c) of Regulation S-K did not identify a material change in ICFR during the most recent quarter if a registrant (1) concludes its ICFR and/or disclosure controls and procedures are ineffective due to a new material weakness or (2) reports the remediation of a previously reported material weakness.

The SEC staff continues to focus on the timely reporting of material weaknesses in SEC filings. When there is a new material weakness disclosed in a registrant’s filing, the SEC staff may request supplemental information from the registrant to determine whether the material weakness should have been reported in prior periods.
Example SEC staff comment: Material weakness

We note that you amended your fiscal year 2015 Form 10-K on August 10, 2016, to identify a material weakness as of September 30, 2015. Please provide us with a comprehensive discussion of the control deficiencies and the nature of the material weakness, including when the material weakness first began and how you discovered the control deficiencies that led to the material weakness. As part of your response, please tell us whether these were identified control deficiencies as of September 30, 2015, or earlier that were not raised to the level of a material weakness until the filing of your amendment to the 2015 Form 10-K.

In addition, if there are indicators of control deficiencies in filings, the SEC staff may ask registrants to explain whether those deficiencies were identified by management and, if so, describe their severity, including whether the deficiencies are material weaknesses.

For example, the SEC staff may challenge the effectiveness of ICFR when a registrant corrects an immaterial out-of-period error during the current period without revising prior-period amounts. The SEC staff may question whether the correction of immaterial errors affects current and previous conclusions related to the effectiveness of ICFR and disclosure controls and procedures.

If a registrant determines that ICFR or its disclosure controls and procedures (or both) were effective despite the immaterial error correction, the SEC staff may challenge the basis of these conclusions. In particular, SEC staff often questions the nature of the deficiency that resulted in the error and the likelihood that such deficiency could result in a material misstatement (notwithstanding the fact that it did not).

Example SEC staff comment: Immaterial error correction and ICFR

Please explain the extent to which you considered the effect of the identified errors on your internal controls and explain how management’s conclusion regarding the effectiveness of disclosure controls and procedures, as well as internal control over financial reporting, is appropriate in light of the errors.

The SEC staff has questioned the absence of disclosures about a material change in internal control under Item 308(c) of Regulation S-K after a registrant acquires an entity in a business combination or is affected by another significant event (e.g., significant accounting change) that is expected to require a consequential change in ICFR.

The SEC rules require a registrant to disclose all material changes to internal controls, if any, and not merely that a change occurred as a result of a business acquisition. If the registrant excludes a recently acquired entity from its internal control assessment, the disclosures related to all material changes resulting from the business combination since the date of the acquisition may be included in the first annual report in which the acquired business is included in the scope of the ICFR assessment. We expect the staff to focus on disclosures related to significant accounting changes as companies adopt recently issued accounting guidance, including the new standards on revenue recognition and leases.
Items 307 and 308 of Regulation S-K require that management's conclusions about effectiveness explicitly state whether disclosure controls and procedures and ICFR are either "effective" or "ineffective." Generally, the SEC staff challenges registrants that inappropriately express management's conclusions, such as statements that disclosure controls and procedures are "adequate," "effective, except for" or "effective, to the best of our knowledge."

Disclosure controls and procedures include components of ICFR that (1) relate to the maintenance of records that fairly reflect an issuer’s transactions, (2) provide reasonable assurance that the transactions are properly recorded to permit the preparation of financial statements in accordance with GAAP and (3) provide reasonable assurance that unauthorized transactions that could have a material effect on the financial statements have been prevented.

The scope of these procedures would generally include ICFR because they apply to all material information to be included in a report, within and outside the financial statements. The SEC staff has challenged registrants when ICFR was concluded to be ineffective, but disclosure controls and procedures were not concluded to be ineffective.

**Example SEC staff comment: Disclosure controls and procedures and ICFR**

Please explain how you concluded that your disclosure controls and procedures were effective as of March 31, 2016 and June 30, 2016, considering that your internal controls over financial reporting were not effective as of these dates.

**Section 308 disclosures**

Item 308 of Regulation S-K requires a report of management on the registrant’s ICFR that, among other items, contains a statement identifying the framework used by management to evaluate the effectiveness of the registrant’s ICFR. To assess ICFR, many organizations use the internal control framework that the Committee of Sponsoring Organizations of the Treadway Commission (COSO) updated in 2013 to assess ICFR. Registrants should make sure that management's assessment of ICFR and the ICFR audit opinion use the same framework.

**Example SEC staff comment: Section 308 disclosures**

The audit report refers to the framework Internal Control – Integrated Framework (2013) issued by COSO. Please confirm that management also used the COSO framework of 2013 in performing its assessment and provide a revised report in an amended Form 10-K to disclose the framework used, as required by Item 308(a)(2) of Regulation S-K.

**EY resources**

2016 SEC annual reports – Form 10-K (SCORE No. 03265-161US), November 2016


Financial reporting developments, Accounting changes and error corrections (SCORE No. BB2752), May 2017
Materiality

Summary of issues noted
The SEC staff requests that registrants identify and discuss the quantitative and qualitative factors considered when they assessed the materiality of error corrections. The SEC staff challenges a registrant’s conclusions that quantitatively large errors are immaterial.

Analysis of current issues
SAB Topic 1.M, which is codified into ASC 250-10-S99-1, includes a list of possible qualitative and quantitative factors that a registrant might consider when assessing how a reasonable investor might consider the materiality of a financial statement item, including a financial statement error. The factors listed in SAB Topic 1.M are not intended to be exhaustive, and therefore each registrant should consider all qualitative and quantitative factors that may be relevant in its circumstances.

Evaluating whether an item is material requires judgment. Quantitative and qualitative factors should be individually considered in the materiality assessment. Registrants must consider qualitative factors even when the error is small and they should consider them when an error is quantitatively large. However, it has been unusual for a registrant to conclude that a quantitatively significant error is not material based on qualitative factors.

The SEC staff frequently requests that registrants identify the factors they considered when assessing materiality with respect to current-period and prior-period financial statements when they correct errors relating to a prior period. Management should avoid using a “check-the-box” approach to its materiality determinations. Instead, it should develop a qualitative and quantitative analysis that is specific to the registrant’s facts and circumstances and considers each period affected by the error, including quarterly and annual periods. The analysis also should consider the effects of errors on key performance indicators that may be important to investors, even if the indicators are non-GAAP measures.

The SEC staff may question management’s judgment when the error results in a large quantitative effect on certain key measures.

Example SEC staff comment: Materiality
We note your disclosure that you made certain adjustments to fiscal 2016 earnings to correct errors attributable to prior years that you believe are both quantitatively and qualitatively immaterial to the current period and previously reported periods, including quarterly periods. However, we note that this adjustment appears to result in a tax benefit in the rate reconciliation over 100% of fiscal 2016 pretax income, or approximately $X million. To help us understand your disclosure, please provide the following additional information:

- The analysis of how you determined these errors were both quantitatively and qualitatively immaterial to the current period and all previously reported periods (please refer to SAB Topics 1.M and 1.N when preparing your response)
- The specific nature of these errors, how and why you believe they occurred, and when and how you discovered them
The SEC staff also challenges materiality assessments for a “Little r restatement.” Such a restatement occurs when an error is immaterial to the prior-year financial statements, but correcting the error in the current period would materially misstate the current-period financial statements. As a result, the prior-year financial statements are restated, even though the revision is immaterial to the prior year(s).

In these situations, registrants generally are not required to file an Item 4.02 Form 8-K, Non-reliance on previously issued financial statements or a Related Audit Report or Completed Interim Review, or amend prior filings. Instead, they may correct the prior-period financial statements, with appropriate disclosure, in the next periodic report that includes the prior-period financial statements, as outlined in SAB Topic 1.N. The SEC staff may request the registrant’s materiality assessment to evaluate whether the method of correcting the error and related reporting are appropriate.

**EY resources**

Financial reporting developments, Accounting changes and error corrections (SCORE No. BB2752), May 2017
Other entity financial statements

Summary of issues noted
SEC regulations require registrants to provide financial information about other entities in certain situations, including when they (1) make a significant acquisition (Rule 3-05 of Regulation S-X (Rule 3-05)), (2) have a significant equity method investee (Rules 3-09 of Regulation S-X (Rule 3-09) and 4-08(g)) or (3) are subject to guarantor reporting requirements (Rule 3-10). The financial statement requirements for each rule are based on whether certain thresholds or criteria are met, and each rule has specific requirements for which financial statements to include in a filing. The SEC frequently questions whether registrants have appropriately applied these rules.

Analysis of current issues

Financial statements of an acquired business (Rule 3-05)
When an acquisition of a significant business has occurred or is probable, Rule 3-05 requires the registrant to file separate, pre-acquisition historical financial statements for the acquired business. The SEC staff frequently requests that the registrant provide its detailed analysis (including the tests of significance) to help the SEC staff determine whether Rule 3-05 was applied appropriately. The SEC staff also questions the completeness of acquiree financial statements included in a filing.

Example SEC staff comment: Significance tests
It appears that you have not filed historical financial statements pursuant to Rule 3-05 of Regulation S-X. Please submit the analysis you performed to determine that this acquisition was not significant under the investment test, asset test and income test based on the guidance in Rule 3-05 of Regulation S-X, and you were therefore not required to file historical and pro forma financial statements on Form 8-K related to this acquisition, if this is your view.

When a registrant has disclosed letters of intent regarding a potential acquisition in the months before filing a new registration statement, the SEC staff may question whether it is probable a highly significant acquisition (i.e., exceeding 50% significance) will occur, and if so, the SEC staff may ask the registrant to disclose pro forma information and historical financial statements for the target acquiree in the registration statement.

Furthermore, for purposes of complying with Rule 3-05 in registration statements, tests of significance should be conducted for each consummated and probable acquisition individually and in the aggregate since the last audited balance sheet appearing in the registration statement.

Example SEC staff comment: Disclosures about probable acquisitions
We note that you have entered into letters of intent regarding potential acquisitions. Please confirm to us that these pending probable acquisitions are not significant and there are no other probable acquisitions that would be significant such that additional historical and pro forma financial statements could be required by Rule 3-05 of Regulation S-X.
Financial statements of equity method investees (Rules 3-09 and 4-08(g))

When there are indications that a registrant may have significant equity method investees in any of the periods presented, the SEC staff has asked the registrant to provide its analysis, including the detailed significance test computations, supporting why it didn't need to provide separate financial statements or summarized financial information of the investees under Rules 3-09 and 4-08(g) of Regulation S-X.

The SEC staff's comments depend on the registrant's facts and circumstances. However, the SEC staff expects strict application of the significance tests and frequently requests a registrant's detailed analysis to determine whether Rule 3-09 was applied appropriately. Registrants that inappropriately apply the requirements or fail to timely file investee financial statements may face consequences, such as the loss of Form S-3 eligibility and a conclusion that disclosure controls and procedures are ineffective.

Financial statements of guarantors (Rule 3-10)

The SEC staff often asks registrants about their compliance with the criteria that permit financial reporting relief under Rule 3-10 of Regulation S-X. The staff asks registrants to (1) confirm and disclose that the subsidiary issuers and guarantors are 100% owned rather than “wholly owned,” (2) clarify that guarantees are full and unconditional and (3) confirm and disclose that the guarantees are joint and several.

The SEC staff may also focus on the form and content of condensed consolidating financial information disclosed in the parent company's consolidated financial statements in lieu of separate financial statements for each subsidiary issuer and guarantor of registered debt securities, including whether the individual columns in the consolidating financial information comply with Regulation S-X and are prepared in accordance with US GAAP.

EY resources

2016 SEC annual reports – Form 10-K (SCORE No. 03265-161US), November 2016


Financial reporting developments, Equity method investments and joint ventures (SCORE No. 02230-161US), July 2016

Tips for complying with the SEC reporting requirements for equity method investees (SCORE No. 00370-171US), January 2017
Summary of issues noted
The SEC staff has asked registrants about pro forma financial information disclosed in filings, including registration statements, proxy statements and Forms 8-K. The SEC staff has asked registrants to explain how they have met the requirements of Article 11 of Regulation S-X. The SEC staff also has asked for more transparent disclosure about the calculation of pro forma adjustments.

Analysis of current issues
The objective of pro forma financial information is to help investors understand the effect of a significant transaction, such as an acquisition or disposition, that has either occurred or is probable after the date of the historical financial statements (or is not fully reflected in the historical financial statements) by showing the effect on the registrant's historical financial statements “as if” the transaction had occurred at an earlier time. Article 11 of Regulation S-X describes the circumstances when pro forma information should be presented in SEC filings and the form and content for the presentation.

Pro forma adjustments included in pro forma financial information to provide this “as if” perspective of a transaction must be (1) directly attributable to each specific transaction, (2) factually supportable and (3) expected to have a continuing impact (for the pro forma income statement only). The SEC staff’s questions about pro forma adjustments often cite specific Article 11 criteria and ask how pro forma adjustments comply with them.

Directly attributable
Pro forma adjustments should be directly attributable to the transaction reflected in the pro forma financial information. Pro forma financial information should exclude adjustments that reflect how the acquirer might have changed the acquiree’s management practices and operating decisions had the acquirer had control over the acquiree during the period of the pro forma presentation.

The SEC staff has questioned adjustments that do not appear to be directly attributable to the transaction reflected in the pro forma financial information. For example, in pro forma information giving effect to a significant acquisition, a restructuring charge recognized in the target's historical financial statements would generally not be considered directly related to the business combination and should not be eliminated from the pro forma financial information. Furthermore, any integration restructuring activities and anticipated cost savings that the acquirer intends to implement subsequent to the acquisition would also generally not be considered directly related to the business combination and their effects should not be included in the pro forma financial information.

Example SEC staff comment: Pro forma adjustments
We note that you have included a pro forma adjustment to eliminate compensation to the company's chief executive officer because he or she will perform limited duties under a consulting agreement subsequent to this offering and acquisition. Since we assume that the compensation historically paid was commensurate with the duties he or she performed, please revise to eliminate this adjustment.
**Factually supportable**

Pro forma adjustments should be factually supportable. The SEC staff has indicated that an adjustment generally would be considered factually supportable if there is reliable documented evidence, such as an executed contract or completed transaction. For example, the SEC staff has challenged registrants when they include in their adjustments the effects of a new compensation arrangement that they expect to implement following a business combination if an agreement for such compensation was not executed in conjunction with the business acquisition negotiations. The SEC staff also has indicated that the effects of some events and transactions are too uncertain to be considered factually supportable. For example, a company should not eliminate compensation expense on a pro forma basis for employees terminated following a business combination because the effects on revenues and operations from having fewer employees would be too uncertain.

**Continuing impact**

Pro forma income statement adjustments must have a continuing impact on the registrant or remove from the historical financial statements transaction-related costs or other items that are not expected to have a continuing impact. The SEC staff has asked registrants to explain how an adjustment has a continuing impact. The SEC staff has historically used a 12-month rule of thumb to evaluate the continuing impact criterion. However, certain items that affect the pro forma income statement for a period of less than 12 months may still be considered to have a continuing impact. The evaluation will depend on the registrant’s facts and circumstances. For example, an adjustment for interest expense on a bridge loan that may be incurred for a period of less than 12 months might be considered to have a continuing impact since such loans are typically replaced with permanent financing shortly after an acquisition closes.

**Registrants should clearly disclose the nature of pro forma adjustments and how they are calculated.**

**Example SEC staff comment: Pro forma adjustments**

We note your disclosure that you have included an adjustment to the pro forma statement of operations to recognize a $5 million 3% call premium for the repayment of debt. Please tell us how you determined that this expense is a recurring item and revise your disclosures accordingly. Please refer to Articles 11-02(b)(5) and 11-02(b)(6) of Regulation S-X for guidance.

**Transparency of pro forma adjustments**

In addition to meeting the criteria in Article 11 of Regulation S-X, pro forma adjustments should be clearly presented. The following disclosures should be included in the notes to the pro forma financial information:

- The nature of pro forma adjustments
- How pro forma adjustments are calculated
- The assumptions used to determine such amounts
For example, if two partially offsetting pro forma adjustments are presented in the aggregate to adjust deferred tax liabilities in the pro forma balance sheet, the notes to the pro forma financial information should explain the two gross adjustments within the net adjustment presented on the face of the pro forma financial information. The SEC staff often asks for clarification or additional disclosure when it’s unclear how pro forma adjustments were calculated or when the amount of the total or net adjustment does not agree with the underlying gross pro forma adjustments explained in the notes.

**Example SEC staff comment: Pro forma adjustments**

Please expand your disclosure to provide a more detailed description of all of the pro forma adjustments reflected. Your revised disclosure should include a discussion of the methodologies used by the company to determine fair value as well as a listing of any material assets or liabilities currently shown net in the footnote (i.e., above-market lease intangibles and lease origination costs reflected as “lease intangible assets”).

**EY resources**

**Pro forma financial information: A guide for applying Article 11 of Regulation S-X**

(SCORE No. 04126-161US), December 2016
Summary of issues noted

The SEC staff has asked registrants about third-party restrictions that appear to limit their ability to (1) pay dividends to shareholders or (2) transfer net assets from subsidiaries. If such restrictions exist, the SEC staff asks registrants to disclose them as required by Rule 4-08(e) of Regulation S-X. The SEC staff has also asked registrants about how they considered the requirements under Rule 5-04 of Regulation S-X to present condensed financial information on an unconsolidated basis (i.e., parent company financial statements).

Analysis of current issues

The SEC staff often issues comments about Rule 4-08(e) disclosures to registrants in the insurance and midstream oil and gas industries because of their legal structures, but the disclosure requirement applies to all registrants.

The SEC staff may use a registrant’s footnote disclosures about debt and debt agreements filed as exhibits as the basis for inquiring about compliance with the requirements of Rule 4-08(e). For example, the footnote may describe certain restrictions imposed by financial covenants on the registrant or its subsidiaries (e.g., quantitative working capital requirements, restricted amounts of net assets).

The SEC staff also has asked registrants about their compliance with Rule 5-04(c) and Rule 12-04 of Regulation S-X. Rule 5-04(c) requires registrants to include parent-only condensed financial information on Schedule I, *Condensed financial information of registrant*, using the form and including the content required by Rule 12-04 when restricted net assets of only the registrant’s consolidated subsidiaries exceed 25% of the registrant’s consolidated net assets. This schedule shows investors the amount of net assets, operations and cash flows at the parent level on a standalone basis with all subsidiaries reflected on an unconsolidated basis (i.e., under the equity method).

Example SEC staff comment: Rule 4-08(e) disclosures and parent-only financial information

You disclose that the restricted payments covenant in the indenture governing your subsidiaries’ notes as well as restrictions in your credit facility generally limit your ability to pay dividends. Please discuss any restrictions on your ability to declare dividends and the impact on your liquidity, financial condition and results of operations based on these restrictions. Please provide, if necessary, the disclosures required by Rule 4-08(e) of Regulation S-X. Please also tell us what consideration you gave to the need for parent-only financial statements under Rules 5-04 and 12-04 of Regulation S-X.

EY resources

2016 SEC annual reports – Form 10-K (SCORE No. 03265-161US), November 2016
Other SEC reporting issues

Summary of issues noted
The SEC staff has questioned how a registrant complies with the various disclosure requirements of Regulation S-K or other SEC rules and has requested additional disclosures, if material.

Analysis of current issues
The following is a brief overview of SEC disclosure areas where the staff continues to issue comments requesting compliance.

Business disclosures
Item 101 of Regulation S-K requires disclosure about the registrant’s business, including a description of its products or services, segments and geographic areas. Although the nature of SEC staff comments vary significantly in this area, depending on the registrant’s facts and circumstances, the SEC staff typically has commented on the required disclosures about backlog, customer concentration, material supply/collaboration agreements and patents. The SEC staff has searched a registrant’s publicly available information (quarterly earnings calls or presentations) to challenge the completeness and accuracy of the disclosures provided.

Selected quarterly financial data
When disclosing quarterly financial data required by Item 302 of Regulation S-K, the registrant must explain any unusual or infrequently occurring items recognized in each quarter (e.g., the effects of a disposal, acquisition or restructuring plan) and the aggregate effect and nature of year-end or other adjustments that are material to the results of the fourth quarter. The SEC staff issues comments when such items are not transparently disclosed as a note to the table of selected quarterly financial data even if they are addressed elsewhere in the filing (e.g., MD&A).

Example SEC staff comment: Selected quarterly financial data
We note from your disclosure of selected quarterly financial data that the net loss recorded in the third quarter of 2017 was significantly different from the net incomes recorded in the other 2017 quarterly periods. Please revise to include disclosure of any significant, unusual or infrequently occurring items, such as restructuring, acquisition costs, legal settlements or impairment charges that affected the results of operations in your quarterly periods for 2017. See guidance in Item 302(a)(3) of Regulation S-K.

Risk Factors — General
Item 503(c) of Regulation S-K requires a registrant to disclose the significant risks it faces and how it is affected by each of them. Risk factors should be specific to the registrant’s facts and circumstances and should not be general risks that could apply to any registrant. The SEC staff has questioned risk factor disclosures that could apply to any public company and limitations that some registrants include in their risk factor disclosures that do not comply with item 503(c) of Regulation S-K. The SEC staff also has questioned the completeness of a registrant’s risk factor disclosures based on information included elsewhere in the document or in other public information (i.e., an earnings call).
With the increase in the frequency and severity of cyber attacks and data breaches, cybersecurity continues to be an area of focus. CF Disclosure Guidance: Topic No. 2, *Cybersecurity* (issued by the staff of the Division of Corporation Finance (DCF)) provides a framework for registrants to consider when evaluating whether to disclose information about risks and incidents involving cybersecurity. The SEC staff guidance notes that material cybersecurity risks or cyber incidents must be disclosed to avoid potential incomplete or misleading disclosures. Chairman Jay Clayton has said that he expects companies to take seriously their obligation to disclose material information about cyber risks and cyber events.

**Related-party transactions**

The SEC staff may request that registrants clarify or expand their disclosures about related-party transactions as required by Item 404(a) of Regulation S-K. Item 404(a) requires a registrant to describe related-party transactions (both actual and proposed) exceeding $120,000 since the beginning of its last fiscal year and in which any related party had or will have a direct or indirect material interest. The SEC staff expects the description of a particular transaction to summarize the nature of the transaction in quantitative and qualitative terms and include any material additional information. The SEC staff often questions inconsistencies and the completeness of disclosures provided under Item 404(a) by reviewing the notes to registrants’ annual and interim financial statements, disclosures within the business and risk factors sections and any new agreements filed as exhibits. Preparing complete related-party disclosures is often challenging because registrants and their advisers have to consider whether information regarding a related-party transaction or the related person in the context of the transaction is material to investors in light of the circumstances of the particular transaction. For example, the SEC staff recently has questioned registrants that fail to disclose indemnification provisions included in agreements with their executive officers.

**State sponsors of terrorism**

The SEC staff may comment on disclosures about liquidity, risk factors and results of operations for registrants with foreign operations in countries that have been identified by the US Department of State as state sponsors of terrorism, including Syria, Iran and Sudan. The SEC staff will search a registrant’s publicly available information (e.g., websites) for connections to the restricted countries, including comments related to unaffiliated retail locations where a registrant’s branded product is sold. For further discussion, please refer to *Appendix C: Foreign Private Issuers*.

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**EY resources**

- **2016 SEC annual reports – Form 10-K** (SCORE No. 03265-161US), November 2016
- **Pro forma financial information – A guide for applying Article 11 of Regulation S-X** (SCORE No. 04126-161US), December 2016
- **New SEC chairman Jay Clayton outlines views in policy speech**, (SCORE no. 04401-171US), July 2017
Summary of issues noted
The SEC staff continues to ask registrants to provide information supporting their conclusions on the appropriate presentation of revenue and cost of sales in the income statement. Specifically, the SEC staff focuses on the income statement presentation guidance in Rules 5-03(b)(1) and (2) of Regulation S-X.

Analysis of current issues
Many registrants derive revenues from the sale of different product categories or the sale of both products and services. In such cases, presentation of revenues by category may provide meaningful information to the users of the financial statements, particularly if the gross margins of the various categories of sales transactions are disparate. Rule 5-03(b)(1) of Regulation S-X requires the following items to be separately stated on the face of the income statement, unless the amount is less than 10% of total revenue:

- Net sales of tangible products (gross sales less discounts, returns and allowances)
- Operating revenue of public utilities or others
- Rental income
- Revenue from services
- Other revenues

Rule 5-03(b)(2) of Regulation S-X requires that costs and expenses applicable to sales and revenues be presented on the face of the income statement in the same categories as the corresponding revenue.

When other disclosures in a registrant’s filings (e.g., MD&A discussion) or public materials (e.g., an earnings release) refer to revenue being derived from various sources, the SEC staff asks registrants to provide their analyses and other information (including quantitative data by revenue source) that was used to conclude on the income statement presentation of revenue and cost of sales. Registrants should continuously monitor the relative proportion of revenue earned from each source to make sure they are properly presenting revenue and cost of sales attributable to each significant category.

Example SEC staff comment: Rule 5-03(b)

We note from your disclosure that you generate revenue from service-related contracts. Please tell us what consideration you gave to separately disclosing revenue and costs of revenue for service-related contracts. Please refer to Rules 5-03(b)(1) and (2) of Regulation S-X.

Furthermore, upon implementation of ASC 606, registrants will be required to provide a note disaggregating revenue recognized from contracts with customers into categories that depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors. This disaggregation should be performed using the criteria outlined in ASC 606-10-50-89 through 91 and is in addition to the disaggregated revenue presentation on the face of the income statement required by Rule 5-03(b) of Regulation S-X.
Statement of cash flows classification and presentation

Summary of issues noted
The SEC staff continues to focus on the classification of cash flows as operating, investing and financing activities in the statement of cash flows.

That’s because the guidance in ASC 230 doesn’t prescribe how companies should classify cash flows from certain transactions and particularly those that may have aspects of more than one classification. As a result, registrants must apply judgment in determining the proper classification. In some cases, this has resulted in diversity in how registrants classify cash flows from similar transactions and questions from the SEC staff about the appropriateness of cash flow classification.

The Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-15 to address eight cash flow classification issues, including several on which the SEC staff frequently comments. The FASB also issued ASU 2016-18 to clarify how entities should present restricted cash and restricted cash equivalents in the statement of cash flows. Both updates, which were based on Emerging Issues Task Force (EITF) consensuses, are effective for public business entities for fiscal years beginning after 15 December 2017 and interim periods within those years. Early adoption, subject to certain conditions, is permitted. The SEC staff has frequently commented on the issues addressed by these ASUs.

Analysis of current issues
To determine how to appropriately classify cash flows when the guidance in ASC 230 is not explicit, a registrant must analyze the nature of the activity and the predominant source of the related cash flows and do the following:

▪ Retain documentation of its rationale for classification
▪ Provide transparent disclosure of classification either on the face of the statement of cash flows or in the notes to the financial statements

When the SEC staff asks a registrant to explain its basis for classifying items in the statement of cash flows, the registrant should explain the judgment it applied to determine the classification. However, even registrants that make transparent disclosures may receive comments from the SEC staff about their cash flow conclusions. Retaining sufficient documentation about these conclusions will help registrants respond to SEC staff questions.

The SEC staff also has asked registrants to expand their significant accounting policy footnote disclosures to address how certain items are classified in the statement of cash flows and the basis for their accounting policy.

Example SEC staff comment: Statement of cash flows presentation
Regarding the consolidated statements of cash flows, please explain how you reflect the costs to acquire long-lived assets to be sold and how you differentiate between costs to acquire assets to be sold versus leased. Refer to the accounting literature in supporting the basis for classification.
**EY resources**


To the Point, *FASB clarifies the classification of certain cash receipts and cash payments* (SCORE No. 02677-161US), September 2016

To the Point, *FASB addresses the presentation of restricted cash in the statement of cash flows* (SCORE No. 03938-161US), November 2016
Summary of issues noted

The SEC staff asks registrants to provide, in both the financial statements and MD&A, a robust description of the accounting policies and methods used to estimate the allowance for doubtful accounts. The staff also has asked registrants to explain significant or unusual fluctuations in the allowance accounts relative to other financial statement accounts as compared to the prior period. Further, the SEC staff has asked registrants to provide additional information related to the credit quality of accounts receivable; in some cases the staff has asked specific questions about portfolio segments or customers that may be material to registrants' operations.

Analysis of current issues

ASC 310 provides the disclosure requirements for accounts receivable under US GAAP. Registrants with sales that result in accounts receivable should have accounting policies and methods to estimate an allowance for doubtful accounts. They also should have policies for tracking delinquencies, determining when receivables become impaired and writing off uncollectible receivables. The SEC staff has requested disclosure about how registrants determine their allowance for doubtful accounts, including the significant assumptions used.

When conditions cause significant or unusual changes in accounts receivable or in the allowance for doubtful accounts, the SEC staff has requested that registrants disclose the factors that led to the changes. The staff requested that registrants disclose whether any specific customers or portfolio segments disproportionately drove the changes. The staff also questions whether the changes indicate trends that may have a material effect on the entity’s financial condition and/or results of operations, which would require disclosure in MD&A.

Example SEC staff comment: Allowance for doubtful accounts

We note that you recognized a $5 million increase to the allowance for doubtful accounts, which is a significant increase over the prior-year period. We also note a similar increase in the amount of discounts taken during 2016 and your disclosures indicate that overall net sales were impacted by markdowns, price reductions and chargeback sales discounts.

Please expand your disclosures to further discuss the reasons your allowance increased significantly during 2016, the reasons why customer returns were higher in 2016, the segments impacted and whether you anticipate this to be an ongoing trend.

The staff has also asked registrants to provide additional information related to the credit quality of accounts receivable, including:

- The entity's process for monitoring credit quality indicators
- The effect of market conditions (e.g., decline in commodity prices) on the collectability of accounts receivable
- Specific information on customer credit profiles (e.g., percentage of customers with credit ratings below investment grade and/or customers currently in bankruptcy)
Summary of issues noted

The SEC staff has asked registrants to enhance or explain their disclosures about business combinations by:

- Presenting all of the detailed disclosures required by ASC 805, including the pro forma information required by ASC 805-10-50-2(h)
- Providing the SEC staff with information and expanding disclosures about contingent consideration arrangements
- Providing the SEC staff with information about how they identified and determined the fair value of acquired intangible assets, especially when goodwill is a substantial portion of the consideration transferred
- Explaining how they evaluated whether the acquired set of assets and activities constituted a business or an asset

Analysis of current issues

General disclosures

The disclosures in ASC 805 are intended to help financial statement users evaluate:

- The nature and financial effect of business combinations that occur during the current reporting period or after the balance sheet date but before the financial statements are issued
- The financial effects of adjustments recognized in the current reporting period that relate to a business combination that occurred in the current or previous reporting periods

The SEC staff questions whether registrants’ disclosures about business combinations are sufficient and requests that registrants expand their disclosures to provide all material information required by ASC 805. The SEC staff also has asked registrants to explain why they believe their disclosures comply with ASC 805-10-50-3, which requires certain disclosures for individually immaterial combinations if they are material in the aggregate.

Example SEC staff comment: General disclosures

Please address the following:

- Provide a schedule in the footnotes showing the components of the consideration transferred. Refer to ASC 805-30-30-7 through 30-8.
- Provide a table in the footnotes for the fair value of the major classes of assets acquired and liabilities assumed. As part of this presentation, please separately present each major class of property, plant and equipment and identifiable intangible assets acquired. Refer to ASC 805-20-50-1.
- Please tell us where you disclosed the primary reasons for the acquisition as required by ASC 805-10-50-2(e). If this disclosure was not provided, please provide it in your upcoming filing.
When goodwill resulting from a business combination represents a significant portion of the consideration transferred, the SEC staff has asked the registrant to revise its disclosures to be more specific in its qualitative description of factors that make up the amount of goodwill recognized, such as the specific synergies expected from the business combination, as required by ASC 805-30-50-1.

**Example SEC staff comment: Disclosures relating to goodwill recognized**

Given the significant amount of purchase consideration allocated to goodwill, please describe the qualitative factors that make up goodwill, such as expected synergies from the combining operations, intangible assets that do not qualify for separate recognition or other factors. Refer to the guidance outlined in ASC 805-30-50-1.

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 it is impracticable for the registrant to prepare the disclosures or to provide a supplemental calculation to support the registrant’s assertion that the acquisition is not material. It is important to note that the evaluation of materiality for this purpose is separate and distinct from the significance test performed for the purposes of presenting Article 11 pro forma financial information.

**Example SEC staff comment: Pro forma disclosures**

Please tell us your consideration of disclosing the following information to enable users of your financial statements to evaluate the nature and financial effect of the acquisition in accordance with ASC 805-10-50-2(h):

1. The amounts of revenue and earnings of the acquiree since the acquisition date included in the consolidated income statement for the reporting period
2. The revenue and earnings of the combined entity for the current reporting period as though the acquisition date for the business combination that occurred during the year had been as of the beginning of the annual reporting period
3. The revenue and earnings of the combined entity as though the acquisition that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period

**Contingent consideration arrangements**

The SEC staff asks registrants to provide more robust descriptions of any contingent consideration arrangement and the basis for estimating the amount of the future payments. The SEC staff asks registrants to explain how they account for and determine the fair value of contingent payments to former owners both as of the acquisition date and in subsequent periods, including whether payments represent compensation or consideration. The SEC staff may request that registrants enhance their disclosures based on its review.
Identification and valuation of acquired intangible assets

The SEC staff has challenged whether additional intangible assets should have been recognized in a business combination and whether the valuation of an acquired intangible asset is appropriate. This is often the case when registrants have allocated a significant portion of the purchase price to goodwill. For further discussion, please refer to the Intangible assets section of this publication.

Determination of business or asset acquisition

When disclosure about the acquired assets and activities is unclear, the SEC staff has asked registrants to explain how they evaluated whether the acquired set constitutes a business or an asset. The SEC staff has stated that it may question a registrant’s conclusion when the difference in accounting could be material, such as in transactions involving significant premiums, transaction costs or contingent consideration.

EY resources

Financial reporting developments, Business combinations (SCORE No. BB1616), 06 June 2016
Variable interest entity consolidation, noncontrolling interests and deconsolidation

Summary of issues noted
The SEC staff has asked registrants to:

- Explain how they determined whether an entity is a variable interest entity (VIE), including details of the arrangement and the registrants’ involvement with the entity
- Explain how they determined whether they were or were not the primary beneficiary of a VIE
- Provide additional details related to their noncontrolling interests, including computation of ownership interest and net gain or loss attributable to their noncontrolling interests
- Provide a robust explanation of their decision to deconsolidate, including an explanation of how control was lost and the gain or loss calculation
- Provide enhanced consolidation accounting policy disclosures, as well as consolidation conclusions regarding the determination whether registrants have controlling financial interests

Analysis of current issues

VIE determination
The SEC staff has asked registrants to provide their VIE analyses, including as much detail as possible. The SEC staff continues to remind registrants that ASC 810-10-50 requires disclosure of qualitative and quantitative information about involvement with a VIE, including, but not limited to, the nature, purpose, size and activities of the VIE. Also ASC 810-10-45-25 requires certain assets and liabilities of a consolidated VIE to be presented separately on the face of the registrants' balance sheets. Further, ASC 810-10-50-2AA requires registrants to disclose how their involvement with a VIE affects their financial position, financial performance and cash flows.

Example SEC staff comment: VIE determination
We note your disclosure that states that despite lacking an equity interest in VIE A, you believed you were the primary beneficiary of this VIE. Please provide us with your analysis supporting your conclusion that you were the primary beneficiary of VIE A during the periods you consolidated the entity. Include in your analysis: a description of the purpose and design of VIE A, the significant activities of VIE A, the parties that made the decisions about the significant activities, any related-party or de facto agent/principal relationships, and how the equity interest holders of VIE A did not have standalone power and economics in the entity. Refer to ASC 810-10 for guidance.

The SEC staff expects registrants to avoid making boilerplate disclosures of the facts and circumstances they evaluated to determine the primary beneficiary and reach their consolidation conclusions. For example, the SEC staff has cautioned registrants that merely listing the contractual arrangements between a registrant and the VIE does not provide sufficient insight into the judgments the registrant made in evaluating whether to consolidate the VIE.
Consolidation when the registrant holds greater than 50% ownership

The SEC staff also has challenged registrants that did not consolidate entities for which they held greater than 50% ownership and requested additional disclosure of the registrant’s rationale for not consolidating.

Gains and losses attributable to a noncontrolling interest

The SEC staff has asked registrants to explain how they calculated gains and losses attributable to a noncontrolling interest, including their valuation methodology. In certain cases, the SEC staff has recommended providing example calculations to assist in the explanation.

EY resources

Financial reporting developments, Consolidation – Determination of a controlling financial interest and accounting for changes in ownership interests (SCORE No. 02856-161US), September 2016
Contingencies

Accounting for and disclosure of loss contingencies

Summary of issues noted
Over the past couple of years, we have seen loss contingencies reemerge as a frequent area of comment. In its comments on registrants’ compliance with loss contingency disclosure requirements, the SEC staff focuses on disclosures about reasonably possible losses and the clarity and timeliness of loss contingency disclosures.

Analysis of current issues
The SEC staff questions a registrant’s failure to make required footnote disclosures when losses are considered reasonably possible or to disclose the range of reasonably possible losses, including when there is a reasonable possibility of a loss in excess of the amount accrued. The SEC staff seeks to verify that a registrant has considered and disclosed an estimate of the amount or range of reasonably possible losses or, if applicable, made a specific disclosure that the amount of loss cannot be estimated.

The SEC staff generally has not objected when registrants make either of the following disclosures, as applicable, about reasonably possible losses to comply with ASC 450:

- The amount or range of reasonably possible losses on an aggregate basis
- The amount or range of reasonably possible losses in certain cases and a statement that the registrant cannot estimate an amount for other cases

The SEC staff has questioned how a registrant has determined that an estimate of a reasonably possible loss or range of loss cannot be made in a reporting period. If a registrant cannot make an estimate, the SEC staff expects the registrant to undertake sufficient procedures to support its conclusion and may request additional information about the process.

If a registrant says an estimate cannot be made, the SEC staff looks for information (such as the registrant’s history with similar legal matters and the age of the litigation) that may indicate otherwise. The staff challenges disclosures that imply a need for precision in estimating the loss or range of loss because US GAAP does not require a level of “certainty” or “confidence” for such an estimate.

The staff also has challenged the use of limited time periods to develop a loss estimate when losses are reasonably expected to continue beyond the timeframe used to develop the estimate. An example would be a contingency measured using expected payments over a five-year period if losses are expected to continue beyond that period.

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3 While it is acceptable to aggregate the amount or range of all reasonably possible losses, the SEC staff has objected to the aggregation of losses in all categories (i.e., it is not acceptable to disclose one estimate combining probable, reasonably possible and remote loss contingencies).
Example SEC staff comment: Accounting for and disclosure of loss contingencies

To the extent an unfavorable outcome related to your outstanding contingencies is reasonably possible, please disclose an estimate of the possible loss or range of loss, or include a statement that such an estimate cannot be made. If you conclude that you cannot estimate the reasonably possible loss or range of loss, please: (1) explain to us the procedures you undertake on a quarterly basis to attempt to develop a range of reasonably possible loss for disclosure and (2) tell us what specific factors are causing the inability to estimate and when you expect those factors to be alleviated.

The SEC staff requests that a registrant’s disclosures use terms that are consistent with the language in ASC 450 when discussing the likelihood of occurrence (i.e., probable, reasonably possible or remote) and the estimated reasonably possible loss (i.e., additional loss, range of loss, an estimate cannot be made or the estimated additional loss or range of loss is not material).

The SEC staff also expects management to evaluate its loss contingency disclosures (or lack thereof) in each reporting period. The staff expects those disclosures to evolve to include more quantitative information as the loss contingency progresses. The staff sometimes issues comments on the same matter in subsequent annual and quarterly periods.

Further, the SEC staff may challenge the adequacy of historical disclosures when loss contingencies have been settled. In particular, the staff reviews prior-period disclosures and inquires whether disclosures or accruals were sufficient in the prior periods based upon the development of the matter.

Presentation of insurance recoveries

The SEC staff has questioned the presentation of any insurance recoveries on the balance sheet (i.e., whether they are presented as assets versus as a reduction of the related loss contingencies) as well as their disclosure. ASC 210-20, Balance Sheet — Offsetting, provides guidance on how to determine whether assets and liabilities can be offset and presented on a net basis. We believe it would be rare for all of the criteria in ASC 210-20 to be met for insurance recoveries related to loss contingencies.
Earnings per share

Participating securities and the two-class method

Summary of issues noted
The SEC staff has asked registrants for additional information about the rights of holders of securities that share in dividends with common stockholders and whether these securities are participating securities that require the two-class method to be applied to compute earnings per share.

Analysis of current issues
Companies sometimes issue securities that participate in distributions with common shares based on a predetermined formula. These securities are referred to as participating securities. ASC 260 requires entities that issue participating securities or that have multiple classes of common stock to apply the two-class method to compute basic and diluted EPS.

A common example of a participating security is preferred stock that receives dividends based on dividends paid on common stock. Under the two-class method, EPS is calculated for each class of common stock and participating security considering both dividends declared (or accumulated) and participation rights in undistributed earnings as if all such earnings had been distributed during the period. The contractual rights and obligations of the participating securities determine whether losses are attributed to them. However, it is unusual for securities other than common stock to have terms that require a company’s losses to be allocated to those securities. The SEC staff has asked registrants to clarify and provide additional disclosure about the rights of other classes of securities to distributions (such as dividends), specifying whether such securities are participating and require the use of the two-class method.

Example SEC staff comment: Unvested share-based payment and application of the two-class method
You disclose that the holders of your preferred stock are entitled to receive non-cumulative dividends in an amount equal to or greater than those declared to holders of common stock out of funds legally available if and only when declared by the Board of Directors. Disclose how you considered the two-class method under ASC 260-10 in calculating your loss per share. Further, tell us how you considered whether to present the preferred stock in the table of potentially dilutive securities that were not included in the calculation of diluted net loss per share.

EY resources
Financial reporting developments, Earnings per share (SCORE No. BB1971), July 2016
Financial reporting developments, Share-based payment (SCORE No. BB1172), October 2016
Contracts that may be settled in stock or cash

Summary of issues noted
The SEC staff has challenged registrants’ assertions that they have the intent and the ability to settle a contract in cash and asked why they believe they have overcome the presumption of common stock settlement for purposes of the diluted EPS calculation.

Analysis of current issues
ASC 260 requires entities to assume, for the purpose of calculating EPS, that contracts they can choose to settle in common stock or cash will be settled in stock. However, this presumption can be overcome if an entity’s past experience or a stated policy provides a reasonable basis for the entity to believe that the contract will be settled in cash. For contracts that give the counterparty the choice between settlements in common stock or in cash, the entity’s stated policy or past experience for settling similar contracts is not determinative. Therefore, the more dilutive method of settlement, cash or shares, should be assumed.

Companies often issue convertible debt instruments that provide the issuer with an option to satisfy all or part of the obligation in cash upon conversion. If the entire obligation is assumed to be settled in common stock, the instrument generally would be included in diluted EPS using the if-converted method. If the presumption that the contract will be settled in common stock is overcome and the registrant has the intention and a stated policy to settle the entire obligation in cash, the instrument would not affect diluted EPS.

The SEC staff has said that a registrant’s stated policy must have substance to be relied upon as the basis for excluding obligations that can be settled in shares from a registrant’s diluted EPS calculation. The SEC staff has asked registrants for more information about how they overcame the presumption that a contract will be settled in common stock.

Example SEC staff comment: Contract that can be settled in cash or shares
You disclose that you have the intent and ability to settle the principal amount of the 2015 notes in cash, and therefore the potential issuance of shares related to the principal amount of the 2015 notes did not affect diluted shares. Your disclosures indicate that currently the holder has the option to convert such holder’s notes into shares of common stock under certain conditions. Beginning in 2017, it appears that the holder at any time will have the option to convert such holder's notes into shares of your common stock. In this regard, please help us better understand how you were able to overcome the presumption that the debt will be settled in common stock pursuant to ASC 260-10-45-45 through 47 and ASC 260-10-55-32 through 36A.

EY resources
Financial reporting developments, Earnings per share (SCORE No. BB1971), July 2016
Financial reporting developments, Share-based payment (SCORE No. BB1172), October 2016
**Summary of issues noted**

Fair value measurement continues to be a frequent area of comment. In its comments on registrants’ compliance with fair value measurement disclosure requirements, the SEC staff focuses on disclosures about valuation techniques and inputs used in fair value measurements. While we observed comments from the staff related to a variety of recurring and nonrecurring fair value measurements, many of the comments were focused on goodwill impairment analyses.

**Analysis of current issues**

The SEC staff asks registrants to provide more robust disclosures about the valuation techniques and inputs they use in determining fair value, including valuation techniques and inputs used by third parties. The staff’s questions continue to be granular, frequently focusing on specific inputs to a fair value measurement. For example, the staff may inquire about the basis for the valuation methodology applied and the basis for inputs used in the valuation, such as discount rates, selected valuation multiples, cash flow forecasts and discounts/premiums applied. Further, the staff may inquire about the “weighting” assigned to multiple value indications when registrants use more than one valuation technique (e.g., internal model valuations and pricing indications from independent sources).

<table>
<thead>
<tr>
<th>Example SEC staff comment: Third-party pricing information</th>
</tr>
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<tbody>
<tr>
<td>We note your disclosure indicates that the fair values of your agency MBS, non-agency MBS and derivative instruments are based upon pricing service quotations or broker quotations. In future filings, please revise your disclosure to describe the valuation techniques used by third parties to determine the fair value of each of these instruments categorized within Level 2.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Example SEC staff comment: Valuation inputs and use of multiple techniques</th>
</tr>
</thead>
<tbody>
<tr>
<td>Please describe the significant assumptions used to determine the fair value in connection with goodwill impairment. Please provide us with quantified information describing the historical results, as well as how projections were developed that were used as a basis for your income approach. Please quantify other significant assumptions, such as growth rates, terminal values and discount rates. Please tell us how you weighted the income and market approaches and the basis for such allocation. Also, please reconcile the fair values determined under the income approach to that of the market approach.</td>
</tr>
</tbody>
</table>
Example SEC staff comment: Valuation techniques and inputs – Multiple valuation techniques

It remains unclear to us why the company is relying solely on the market approach. In this regard we note that ASC 820-10-35-24B indicates that, in some cases, multiple valuation techniques will be appropriate (for example, this might be the case when valuing a reporting unit). Please explain to us, in greater detail, how you concluded that it was appropriate to determine the fair value of the reporting units solely based on the market approach. As part of your response, please tell us whether you have forecasts for each of the reporting units and if such forecasts exist why you did not perform a discounted cash flow analysis.

The SEC staff also comments on disclosures about fair value measurements categorized in Level 3 of the fair value hierarchy. These comments generally focus on a registrant’s failure to provide required disclosures about valuation techniques and inputs and quantitative information about the significant unobservable inputs used in the fair value measurement. For example, the staff may ask why a registrant does not disclose the sensitivity of the Level 3 measurement to changes in significant unobservable inputs or may request that the registrant provide the range of unobservable inputs used to value Level 3 measurements.

Example SEC staff comment: Level 3 disclosures

Please provide us with (and revise future filings to include) quantitative information about the significant unobservable inputs used in the fair value measurement for fair value measurements categorized within Level 3 of the fair value hierarchy for impaired loans and other real estate owned. Also, provide a description of the sensitivity of the fair value measurement to changes in unobservable inputs if a change in those inputs to a different amount might result in a significantly higher or lower fair value measurement. Please refer to ASC 820-10-50-2(bbb) and (g).

EY resources

Financial reporting developments, Fair value measurement (SCORE No. BB1462), September 2016
Financial instruments

Summary of issues noted
The SEC staff has asked registrants how they account for redeemable equity instruments and redeemable noncontrolling interests (NCI).

Analysis of current issues
Redeemable equity instruments (e.g., preferred shares) may be classified as liabilities under ASC 480 if the registrant is unconditionally obligated to redeem them. Otherwise, they often are classified in temporary equity or the “mezzanine” section of the balance sheet and measured at, or accreted to, their redemption values. The accounting for these instruments is complex and based partly on the nature of the redemption feature.

Holders (or issuers) of NCI may have many reasons to contractually agree to sell (or buy) the NCI at some point in the future through a contractual redemption feature. The accounting in this area by the parent is complex because registrants need to consider the form of the redemption feature (i.e., whether it is embedded or freestanding), the nature of the redemption feature (i.e., option-like or forward-like) and the pricing of the redemption feature (i.e., fixed, variable or fair value), along with the guidance that applies to each of the variables.

The primary guidance to be considered for classification of and accounting for these instruments is in ASC 480, ASC 815 and the SEC’s guidance in ASC 480-10-S99-1, ASC 480-10-S99-2 and ASC 480-10-S99-3A.

The SEC staff has asked registrants general questions about how redemption provisions affect the classification of preferred stock and NCI as a liability, permanent equity or temporary equity. Additionally, the SEC staff has asked registrants how they applied specific elements of the guidance or how a specific redemption provision was analyzed under the relevant guidance. For example, the SEC staff has asked what consideration was given to ASC 480-10-S99-3A when a preferred stock is exchangeable to common stock on a one-for-one basis but the number of shares of common stock required to satisfy the exchange exceeds the number of authorized common shares.

Example SEC staff comment: Redeemable noncontrolling interests
Please clarify for us and disclose how you accounted for the NCI and the related call and put options. In doing so, please also tell us whether the exercise price for the call and put options are fixed and similar or not significantly different. Refer to ASC 480-10-55-59 through 55-62.

EY resources
Financial reporting developments, Derivatives and hedging (SCORE No. BB0977), September 2016
Financial reporting developments, Issuer’s accounting for debt and equity financings (SCORE No. BB2438), September 2016
Financial reporting developments, Consolidation: Determination of a controlling financial interest and accounting for changes in ownership interests (SCORE No. 02856-161US), September 2016
Summary of issues noted
The SEC staff has asked registrants about the classification and measurement of equity derivatives and convertible instruments that may be settled in the registrant’s own stock.

Analysis of current issues
A registrant’s analysis of an equity derivative or convertible instrument requires it to consider guidance in ASC 470-20, ASC 480 and ASC 815-40. The SEC staff has continued asking broad, open-ended questions about how such guidance was considered whenever convertible instruments or equity derivatives were issued. In recent years, the SEC staff has asked focused questions about how a registrant applied specific elements of the accounting guidance or how a specific feature or provision of a financial instrument was analyzed under the relevant guidance.

For example, the SEC staff has asked registrants how they accounted for the issuance of convertible debt where the conversion price is denominated in a foreign currency other than the registrant’s functional currency and how the registrant concluded whether such a conversion option should be considered indexed to the registrant’s own stock pursuant to ASC 815-40.

For convertible instruments that do not require bifurcation of the conversion feature, the SEC staff may also ask about the consideration of the other accounting models that could require separate accounting for the conversion feature, including the guidance in ASC 470-20 on cash conversion and beneficial conversion features.

Example SEC staff comment: Issuance of convertible debt and warrants
Please tell us in sufficient detail how you account for the convertible debt you issued. In doing so, tell us how you analyzed the embedded conversion option and the warrants issued concurrently for derivatives and/or beneficial conversion features, how you account for the conversion option associated with dividends paid-in-kind, and where you classify the warrants on your balance sheet. Tell us the specific provisions of the conversion option and warrants, including the conversion price(s), whether the warrants are legally detachable and separately exercisable, and how the exercise price of the warrants is determined.

Generally, the staff asks about the classification and measurement of equity derivatives and convertible instruments upon issuance. However, the SEC staff may issue comments at any time during an instrument’s life, including when its terms are modified or upon settlement. The SEC staff has asked registrants:

- How they account for an accelerated share repurchase arrangement at inception and at settlement
- The basis for reclassifying freestanding equity-linked instruments (e.g., warrants, forward sales on common stock) after issuance
- How they accounted for the issuance or settlement of financial instruments for consideration above or below fair value and the treatment of the difference
- How they accounted for the modification, settlement or cancellation of existing warrants

Warrants, embedded conversion features and other equity derivatives
The SEC staff has asked registrants how they applied the relevant accounting guidance to a specific feature or provision of a financial instrument.
EY resources

Financial reporting developments, *Derivatives and hedging* (SCORE No. BB0977), September 2016

Disclosure of the effects of foreign currency adjustments

Summary of issues noted
The SEC staff has asked registrants to expand their disclosures to more comprehensively discuss and analyze the effects that foreign currency translation and remeasurement adjustments have on their financial statements. The SEC staff frequently requests registrants to quantify and describe how changes in foreign currency rates and transactions, including those with offsetting effects, affected their results of operations.

Analysis of current issues
The recent comments are consistent with the SEC staff’s published views, which state that registrants with material foreign operations and transactions should consider:

- Disclosing the nature and extent of the currency risks to which the company is exposed and the effects of changes in exchange rates on its financial statements
- Describing in MD&A any material effects of changes in currency exchange rates on reported revenues, costs and business practices and plans
- Quantifying the extent to which material trends in amounts are attributable to changes in the value of the reporting currency relative to the functional currency of the underlying operations and analyzing any materially different trends in operations or liquidity that would be apparent if reported in the functional currency
- Identifying the currencies of the environments in which material business operations are conducted where exposures are material
- Identifying material unhedged monetary assets, liabilities or commitments denominated in currencies other than the operation's functional currency, and describing strategies for managing currency risk

In recent comments, the staff has requested registrants to revise their disclosure format related to foreign currency and other market risks to comply with one of the three acceptable disclosure approaches described in item 305(a) of Regulation S-K: tabular presentation, value at risk and sensitivity analysis to hypothetical changes in market rates.

Example SEC staff comment: Quantitative disclosure about foreign currency exchange rate risk
In future periodic filings, please revise your foreign currency exchange rate risk disclosures to include quantitative information in one of the formats outlined in Item 305(a)(i) through (iii) of Regulation S-K.

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4 Division of Corporation Finance: Frequently Requested Accounting and Financial Reporting Interpretations and Guidance, Section II.J.
Summary of issues noted
The SEC staff has requested additional information about goodwill, including:

- Disclosures about reporting units that may be at risk of goodwill impairment and the timing of impairment losses
- Information about the registrant’s impairment testing policies
- Disclosure of goodwill impairment testing policies
- Information on how reporting units were identified and components aggregated, particularly when only a single reporting unit is identified

Analysis of current issues
Reporting units “at risk” of impairment
The SEC staff has frequently asked registrants to discuss in MD&A the possibility of future impairment of goodwill for any reporting unit with an estimated fair value that does not substantially exceed its carrying value (i.e., the reporting unit is at risk of failing a future Step 1 impairment test under ASC 350). This request is particularly common when the registrant’s operating results (or that of the relevant segment) have declined significantly.

Example SEC staff comment: Reporting units at risk of impairment
To the extent that any of your reporting units have estimated fair values that are not substantially in excess of the carrying value and to the extent that goodwill for these reporting units, in the aggregate or individually, if impaired, could materially impact your operating results, please provide the following disclosures for each of these reporting units:

- Identity of the reporting unit
- The percentage by which fair value exceeds the carrying value as of the most recent step-one test
- The amount of goodwill
- A description of the methods and key assumptions used and how the key assumptions were determined
- A discussion of the degree of uncertainty associated with the key assumptions
- A discussion of any potential events and/or circumstances that could have a negative effect on the estimated fair value

While no bright-lines exist to determine whether the fair value was not substantially in excess of the carrying amount, and thus a reporting unit’s goodwill is considered “at risk,” the SEC staff has stated that it expects a registrant to apply judgment when making those disclosures. 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 Step 1 goodwill impairment test, the SEC staff expects the registrant to disclose that fact in MD&A.

The SEC staff has highlighted the importance of disclosing the percentage by which the fair value exceeded the carrying value of reporting units that are at risk of impairment as of the most recent Step 1 goodwill impairment test.
The SEC staff also has challenged the timing of a goodwill impairment charge, particularly when the conditions that resulted in the charge also existed in prior periods. The SEC staff also 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.”

**Information on impairment analysis**

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

- 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 reporting units
- Sensitivity analyses regarding material assumptions used in testing goodwill for impairment, including qualitative and quantitative factors, and how changes in those assumptions might affect the outcome of the goodwill impairment test
- The reconciliation of the aggregate fair values of the reporting units to the registrant’s market capitalization and justification of the implied control premium, including relevant transactions reviewed to support the control premium
- Details of the registrant’s analysis of events that have occurred since the latest annual goodwill impairment assessment and whether those events are indicators of impairment that require an interim goodwill impairment assessment
- The reasons for and the result of any goodwill impairment test, even if no impairment was recognized
- The type of events that could lead to a future goodwill impairment

The SEC staff also has asked registrants whether they performed interim impairment tests when publicly available information indicated that such a test was necessary (e.g., the company’s market capitalization declined, the company reduced prices, the company faced more competition). If the registrant didn’t perform a test, the SEC staff has requested an explanation. The staff has also challenged the results of interim impairment testing.

The SEC staff has asked registrants to disclose additional information about their impairment analyses in critical accounting estimates within MD&A after reviewing the information provided.

**Disclosure of accounting estimates**

The SEC staff has asked registrants to provide robust disclosures in their critical accounting estimates section in MD&A about assessing goodwill for impairment and frequently requested additional information about the factors and circumstances leading to any recognized goodwill impairment. These requests often focus on:

- The accounting policies related to the goodwill impairment tests, including when the two-step impairment test is performed, whether the optional qualitative assessment was performed for any reporting units, how reporting units are identified and aggregated, and how goodwill is assigned to reporting units
• The facts and circumstances leading to an impairment or that could lead to a future impairment
• How the fair value of each reporting unit was estimated, including the significant assumptions and estimates used
• Reporting units with material amounts of goodwill that are at risk

Example SEC staff comment: Factors that could lead to a future impairment
Please expand your disclosures to discuss any material uncertainties, such as operational, economic and competitive factors specific to the key assumptions underlying the fair value estimate used in your impairment testing that have a reasonable possibility of changing and could lead to additional material goodwill impairment charges in the future.

Identification of reporting units and aggregation of components
A reporting unit is either an operating segment, as defined in ASC 280, or a component, which is one level below an operating segment, depending on whether certain criteria are met.

An operating segment is the highest level that can be a reporting unit (i.e., the operating segment level is the ceiling), and the component level is the lowest level that can be a reporting unit (i.e., the component level is the floor). For further discussion on segment reporting, please refer to the Segment reporting section of this publication.

The SEC staff has asked registrants to clarify the number and type of reporting units (i.e., operating segments or components) identified for impairment testing and include the reasons for any changes in the number of reporting units. In particular, if a registrant has completed an acquisition or reorganization, the SEC staff has requested information on the reason for a change (or lack of change) in the number of reporting units and the effect on goodwill impairment testing.

Example SEC staff comment: Identification of reporting units
Please tell us the level at which you evaluate goodwill for impairment. We interpret your disclosures to indicate that you have only one operating segment. If our interpretation is incorrect, please clarify. If you evaluated goodwill at a component level, please explain how you determined each reporting unit and provide us a summary of the reporting units evaluated along with the related goodwill associated with each unit. If you evaluated goodwill on a single operating segment basis, please explain in detail your basis for this designation given your history of discrete business acquisitions.
Example SEC staff comment: Change in reporting units

Based on disclosures in your current- and prior-year Forms 10-K, it appears to us that there was a reduction in your reporting units from three to two. Please explain to us the reason for this change and address the effect, if any, it had on your annual goodwill impairment testing. Also, please ensure future filings adequately address any changes in reporting units.

A component of an operating segment is a reporting unit if it constitutes a business for which discrete financial information is available, and segment management regularly reviews its operating results. Segment management consists of one or more segment managers.\(^5\) Two or more components within the same operating segment should be aggregated and deemed a single reporting unit if the components have similar economic characteristics.\(^6\)

The SEC staff has asked registrants to clarify whether a single reporting unit exists or whether multiple components were aggregated into a single reporting unit. In the latter case, the SEC staff has asked the registrant to explain the specific facts and circumstances (e.g., analysis of similar economic characteristics) that support this conclusion.

When reviewing the aggregation of components into a single reporting unit, the SEC staff considers public information available from a registrant’s earnings calls and website, as well as industry and analyst presentations. The SEC staff has asked registrants to explain any perceived inconsistencies in how the businesses (i.e., components) are described in public information and how components are evaluated for aggregation into a single reporting unit.

Example SEC staff comment: Aggregation of components into a single reporting unit

In your most recent conference call held by management, there appears to be diversity in operating results for the various regions comprising the two operating segments. As such, please provide us with a more comprehensive understanding as to how you determined that the components have similar economic characteristics in light of the statements noted suggesting otherwise. Please advise and address whether additional disclosure should be provided in your footnote disclosure and/or critical accounting policies section of MD&A for the identification of your reporting units and level at which goodwill is being tested.

EY resources

Financial reporting developments, Intangibles – Goodwill and other (SCORE No. BB1499), June 2017

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\(^5\) For purposes of ASC 350, the term “segment manager” has the same meaning as in ASC 280.

\(^6\) ASC 350-20 states that ASC 280-10-50-11 must be considered when determining whether the components of an operating segment have similar economic characteristics.
Disclosures related to deferred tax assets and their realizability

Summary of issues noted
The SEC staff continues to focus on registrants’ accounting for the realizability of deferred tax assets and the related disclosures both in the financial statements and in MD&A. In particular, the SEC staff may question the realizability of deferred tax assets recorded by registrants that have recognized consecutive annual losses or a significant loss in the current year. The staff also may inquire when the reasons are not readily apparent why a valuation allowance was recognized initially, reversed or significantly changed. Also, the SEC staff often comments if a registrant omits disclosures or provides inadequate disclosures related to deferred tax assets.

Analysis of current issues
A valuation allowance is required if, based on the weight of available evidence (both positive and negative), it is more likely than not (i.e., likelihood of more than 50%) that some portion or all of a deferred tax asset will not be realized.

There are four sources of taxable income to be considered when determining whether a valuation allowance is required (ASC 740-10-30-18). Ultimately, the realizability of deferred tax assets depends on the existence of sufficient taxable income of the appropriate character in either the carryback or carryforward period available under the tax law.

The SEC staff frequently asks registrants to provide more information about their:

- Consideration of the four sources of taxable income, including the prominence of each source and the material uncertainties, assumptions or limitations associated with each source
- Foreign tax credits and net operating loss carryforwards, including the period over which credits and carryforwards are expected to be realized or expire unused
- Assessment of all available positive and negative evidence used to determine the realizability of deferred tax assets, how the evidence was weighted and the extent to which the evidence was objectively verifiable
- Use of similar assumptions and projections of future income to assess the realizability of deferred tax assets and assess other assets (e.g., long-lived assets, indefinite-lived intangible assets, goodwill) for impairment
- Deferred tax asset valuation allowance, particularly when negative evidence suggests it might be necessary or positive evidence suggests it is unnecessary
- Reversal of a previously recorded valuation allowance or increase in a valuation allowance when the evidence that led to this decision is not readily apparent

Overall, the questions that the SEC staff typically raises stem from what it perceives to be inadequate or overly general (e.g., boilerplate) disclosures in the financial statements and MD&A regarding how a registrant evaluated the realizability of deferred tax assets.
As noted above, the SEC staff has asked registrants about the positive and negative evidence they considered when a valuation allowance was initially recognized, reversed or significantly changed if the reason for that change is not readily apparent. When determining the weight to place on each piece of evidence, registrants should consider how objectively verifiable the evidence is. By its very nature, future taxable income (exclusive of the reversal of existing temporary differences and carryforwards) requires estimates and judgments about future events.

Registrants should carefully assess the realizability of their deferred tax assets and make transparent and complete disclosures in their financial statements and MD&A about their deferred tax assets’ recoverability.

**Example SEC staff comment: Realizability of deferred tax assets**

We note from your disclosure that cumulative profitable quarters and projected future pretax income are sources of positive evidence that led you to conclude that it is more likely than not you will realize your deferred tax asset. However, we note you recorded pretax operating losses in fiscal 2015, 2013 and during the nine months ended September 30, 2016. As it appears that pretax cumulative operating losses in recent years exist, please explain to us why you believe it was appropriate to reverse your entire valuation allowance in fiscal 2015. As part of your response, please provide us with your analysis of the positive and negative evidence considered in determining the likelihood that your deferred tax assets will be realized, including the weight given to each positive and/or negative factor and the extent to which each factor is objectively verifiable. Additionally, please include the significant assumptions used in your future pretax income projections and why you believe they are reasonable and appropriate.

The SEC staff has asked registrants to provide additional detail in their financial statement disclosures related to deferred tax assets, particularly related to operating loss and tax credit carryforwards. ASC 740-10-50-3 requires registrants to disclose amounts and expiration dates of operating loss and tax credit carryforwards for income tax purposes. Those carryforwards are the amounts determined under the applicable tax law that are available to reduce taxes payable in future-year tax returns.

**Example SEC staff comment: Disclosures related to deferred tax assets**

We note that you have federal, state and foreign operating loss carryforwards. Please revise your future filings to disclose the expiration date(s) of your operating loss carryforwards. Refer to ASC 740-10-50-3(a).

**EY resources**

- Financial reporting developments, Income taxes (SCORE No. BB1150), October 2016
Indefinite reinvestment assertions and related disclosures

Summary of issues noted
The SEC staff has challenged registrants’ assertions that foreign earnings will be indefinitely reinvested and requested evidence supporting that assertion. This line of inquiry is often accompanied by a request to reconcile the registrant’s assertion with its discussion of liquidity in MD&A.

Further, the SEC staff may ask registrants whether they have appropriately considered and included all of the disclosures required by ASC 740 when deferred taxes have not been provided on undistributed foreign earnings.

Analysis of current issues
The SEC staff has requested details of specific plans when a registrant asserts that it is indefinitely reinvesting earnings of foreign subsidiaries. ASC 740-30-25-3 includes a presumption that all undistributed earnings of a subsidiary will be remitted to the parent entity. As a result, the default is to assume that the registrant will repatriate all earnings and has recognized a related provision for income taxes attributable to those earnings. For undistributed earnings of foreign subsidiaries, registrants may overcome this presumption if sufficient evidence shows that the subsidiary has invested or will invest the undistributed earnings indefinitely or that the earnings will be remitted in a tax-free liquidation.

The SEC staff has asked registrants to explain how they have overcome the presumption and to provide evidence of specific plans for reinvestment of foreign earnings (e.g., past experience, working capital forecasts, long-term liquidity plans, capital improvement programs, merger and acquisition plans, investment plans).

The SEC staff also requests similar evidence when registrants assert that they intend to indefinitely reinvest only a portion of undistributed foreign earnings or when undistributed foreign earnings are considered to be indefinitely reinvested, but there is a recent history of repatriation. In addition, when there is a change in assertion, registrants should disclose the facts and circumstances that led to it during the reporting period.

Refer to the Management’s discussion and analysis – Liquidity and capital resources section for further insight into SEC staff comments about liquidity when registrants assert that they are indefinitely reinvesting earnings of foreign subsidiaries.

Example SEC staff comment: Indefinite reinvestment assertion
During the quarter ended September 30, 2016, you determined that a portion of your foreign earnings were not permanently reinvested within the meaning of ASC 740-30-25-17. You estimated that a portion of your foreign earnings would be repatriated to the US in the fourth quarter of 2016. Please help us better understand the facts and circumstances which led to your determination that these funds should be repatriated and correspondingly the amount to repatriate. Upon your planned repatriation, please tell us how you were able to conclude that the remainder of your undistributed earnings of foreign subsidiaries should continue to be considered indefinitely reinvested pursuant to ASC 740-30-25-17. Please address your specific plans for reinvestment for these undistributed earnings that demonstrate remittance of the earnings would be postponed indefinitely.
When registrants assert that foreign earnings are indefinitely reinvested and don’t recognize deferred tax liabilities on outside basis differences, the SEC staff focuses on the specific disclosures required by ASC 740. ASC 740-30-50-2(b) requires registrants to disclose the amount of temporary differences that relate to investments in foreign subsidiaries and foreign corporate joint ventures for which they don’t recognize deferred tax liabilities.

In addition, registrants are required to disclose the amount of the related unrecognized deferred tax liability if the determination of that liability is practicable. If it is not practicable, a statement to that effect is required. Notably, there is no practicability exception for disclosing the temporary difference required by ASC 740-30-50-2(b).

Registrants also should disclose the types of events or circumstances that would cause such unrecognized deferred tax liabilities to become taxable (e.g., repatriation of foreign earnings).

**EY resources**

Summary of issues noted

The SEC staff continues to express concern about the clarity of registrants’ income tax rate reconciliations and the transparency of the effect of foreign earnings on their effective tax rates. More specifically, for material rate reconciliation items associated with foreign jurisdictions, the SEC staff asks registrants to disclose the identities of specific jurisdictions that materially affect the effective tax rate, their tax rates and information about the effects of such foreign jurisdictions (e.g., magnitude, mix) on the effective tax rate.

Further, the SEC staff has expressed concerns about the quality of registrants’ MD&A disclosures related to income taxes. The SEC staff has indicated that the income tax disclosures in MD&A often aren’t cohesive and don’t tell a complete story about the company’s tax positions and related trends and uncertainties. The SEC staff often asks registrants for additional information regarding:

- Reasons for historical changes in the effective tax rate
- Discussion about changes in reconciling items between the effective and statutory tax rates
- Whether and why past income tax rates are indicative of future tax rates
- Trends and uncertainties related to changes in unrecognized tax benefits
- Differences between trends in income tax expenses and cash taxes paid

Analysis of current issues

The SEC staff reminds registrants to clearly label items in the income tax rate reconciliation. Registrants are required to provide a reconciliation between the amount of reported total income tax expense (benefit) and the amount computed by multiplying the income (loss) before tax by the applicable statutory federal income tax rate, showing the estimated dollar value of each of the underlying causes for the difference (ASC 740-10-50-12). Reconciling items that are individually less than 5% of the computed amount may be combined in the reconciliation (Article 4-08(h) of Regulation S-X).

Example SEC staff comment: Income tax rate reconciliation

In your reconciliation of your effective income tax rate, your reconciling item labeled “Other, net” represented a 20% increase to the income tax benefit at US federal statutory rates. Please tell us the nature of amounts included in this line item for the fiscal years presented. To the extent any individual reconciling items within this caption are greater than 5%, please revise to disclose them pursuant to Rule 4-08(h)(2) of Regulation S-X.

The SEC staff also questions whether large “provision to return” or “true-up” adjustments included in the income tax rate reconciliation reflect the correction of prior-year errors rather than changes in estimates. In addition, the staff questions registrants when information in the income tax rate reconciliation is inconsistent with the disclosures elsewhere in the filing (e.g., MD&A or valuation allowance disclosures in the notes to the financial statements).
Further, reconciling items affected by multiple factors should be clarified and disaggregated so that users can understand factors driving the reconciling items. For example, reconciling items labeled “foreign rate differential” should be limited to statutory tax rate differences.

*Foreign earnings*

A registrant may report a relatively low effective tax rate if it derives substantial income from low-tax-rate jurisdictions and indefinitely reinvests such earnings. In these circumstances, the registrant’s income tax reconciliation may include a large reconciling item related to these low-tax-rate jurisdictions.

The SEC staff often asks registrants that label a reconciling item as the difference between the foreign tax rate and the domestic tax rate whether they actually include more than just the rate differential in that line item (e.g., permanent differences such as tax amortization of foreign entity goodwill). When applicable, registrants should consider whether this reconciling item should be further disaggregated so that the effect of the low tax rate is presented separately from other items.

Further, if a disproportionate amount of a registrant’s profit is attributable to countries with a low tax rate, such as Ireland, the SEC staff has requested quantified disclosure of such amounts (e.g., $1 billion of our foreign profits were earned in Ireland, which has an effective tax rate of 10%).

**Example SEC staff comment: Foreign earnings**

You disclose that your global effective tax rate differs from the statutory rates, in part as a result of the mix of foreign income. Please provide expanded disclosures of the impact that changes in the mix of foreign income have had on your effective tax rate and specifically explain the relationship between the foreign and domestic effective tax rates in greater detail. In this regard, it appears that separately discussing the foreign effective income tax rates may be important information necessary to understanding your results of operations. To the extent that certain countries have had a more significant impact on your effective tax rate, disclose this information and include a discussion regarding how potential changes in such countries’ operations may impact your results of operations. Refer to Item 303(a)(3)(i) of Regulation S-K and Section III.B of SEC Release No. 33-8350.

The SEC staff also has stated that an investor should be able to easily determine the effective tax rate attributable to a registrant’s domestic and foreign operations. To this end, the SEC staff notes that, in addition to the US GAAP disclosure requirements related to income taxes, Article 4-08(h) of Regulation S-X requires disclosure of the amount of pretax income or loss and income tax expense or benefit generated from domestic and foreign sources.
**Example SEC staff comment: Domestic and foreign components of pretax income**

Please revise to disclose the components of income (loss) before income tax expense (benefit) separately as either domestic or foreign. Refer to Rule 4-08(h) of Regulation S-X.

**EY resources**


Summary of issues noted

The SEC staff has requested that registrants provide the following details about their intangible-asset disclosures:

- Information about intangible assets recognized as part of a business combination
- An explanation of how the useful lives were determined, and for finite-lived intangible assets the factors leading to the amortization method selected
- Supplemental information on how intangible assets were assessed for impairment

After reviewing this information, the SEC staff has asked registrants to enhance or revise their intangible asset disclosures.

Analysis of current issues

Intangible assets recognized in a business combination

ASC 805 requires a registrant to determine the fair value of identifiable assets acquired and liabilities assumed (with certain limited exceptions), including intangible assets that (1) arise from contractual or other legal rights or (2) are separable.

The SEC staff’s comments have focused on the values assigned to specific identifiable intangible assets, as well as the significant estimates and assumptions used in calculating fair value measurements and the subsequent accounting for such recognized intangibles. Specifically, the SEC staff has requested that registrants discuss in MD&A the valuation method and principal assumptions they used to determine the fair value of each major class of intangible assets acquired.

Useful life determination – indefinite-lived intangible assets

When determining the useful life of an intangible asset, a registrant should consider the period over which the asset is expected to contribute directly or indirectly to its future cash flows. Registrants should consider all of the factors listed in ASC 350 and all other relevant information when determining the useful lives of intangible assets. The SEC staff has asked how a registrant has considered its own historical experience in renewing or extending similar arrangements (consistent with the intended use of the asset by the registrant). A registrant should consider its own historical experience even if similar arrangements did not have explicit renewal or extension provisions. A registrant should consider the useful life of an intangible asset to be indefinite only after considering all relevant facts and determining that there are no legal, regulatory, contractual, competitive, economic or other factors that limit the useful life of the intangible asset. The SEC staff also has challenged a registrant’s assertions that intangible assets have an indefinite life and has asked registrants to explain what factors were considered when making this determination.
The SEC staff has challenged whether impairments of indefinite-lived intangibles should be recognized if a registrant’s market capitalization or operating results (or the operating results of the relevant segment) have declined significantly.

**Example SEC staff comment: Useful life determination – indefinite-lived intangible assets**

Tell us how you determined that the acquired intangible assets from your acquisition of ABC Company were deemed to have indefinite useful life. In your response, please tell us why you believe that no legal, regulatory, contractual, competitive, economic, expected use or other factors could limit the useful life of these intangible assets. We refer you to ASC 350-30-35-1 through 4.

**Useful life determination and amortization method – finite-lived intangible assets**

The SEC staff focuses on the useful life and amortization method of acquired finite-lived intangible assets (e.g., trade names, customer lists, customer contracts, customer relationships). The SEC staff has asked registrants to disclose how they determined the useful life of these assets and challenged such useful lives when the underlying assumptions do not appear consistent with information disclosed in other areas of the filing. The SEC staff also has inquired about the amortization method chosen for these assets (e.g., straight-line versus accelerated) and requested that registrants explain their key assumptions about the expected future cash flows from an acquired intangible asset to support their chosen amortization method.

**Example SEC staff comment: Amortization method – finite-lived intangible assets**

We note that you amortize other intangible assets, including customer relationships, on a straight-line basis over their estimated useful lives of 20 years. Customer relationships generally dissipate at a more rapid rate in the earlier periods following a company’s succession to these relationships, with the rate of attrition declining over time. Under this pattern, a significant amount of cash flows derived from the acquired customer base may be recognized in earlier periods and then fall to a materially reduced level in later years. Please tell us why you believe that the straight-line method of amortization rather than an accelerated method reflects the pattern in which the economic benefits are consumed or explain why you cannot reliably determine the pattern in accordance with ASC 350-30-35-6.

**Supplemental information on impairment analysis**

An indefinite-lived intangible asset should be tested for impairment annually or more frequently (in accordance with ASC 350) if events or changes in circumstances indicate that the asset might be impaired. The SEC staff has requested that registrants explain how indefinite-lived intangible assets are tested for impairment, including the valuation method 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 indefinite-lived intangibles should be recognized when the market capitalization or operating results of the registrant (or of the relevant segment) have declined significantly.
When a goodwill or long-lived asset impairment charge has occurred, the SEC staff has requested an explanation of how the registrant considered the factors that led to impairment in evaluating the need for an impairment test of other finite-lived intangible assets in the period. Additionally, if a registrant doesn't record an impairment charge when other companies in the same industry or market are experiencing an economic downturn and recognizing impairment charges, the SEC staff has requested an explanation.

**EY resources**

- Financial reporting developments, *Intangibles – Goodwill and other* (SCORE No. BB1499), June 2017
Critical accounting estimates and significant assumptions

Summary of issues noted
The SEC staff continues to question registrants’ disclosures in MD&A and the notes to the financial statements related to critical accounting estimates and significant assumptions.

Analysis of current issues
Questions the SEC staff frequently asks about accounting policy elections include:

- Whether the expected return on plan assets is determined using fair value or a calculated value, and if a calculated value is used, how that value is determined
- Whether the actuarial gains and losses are recognized in other comprehensive income (i.e., the “corridor” approach) or as periodic benefit cost in the income statement
- Which methodology was used to amortize actuarial gains and losses when a corridor approach was used

The SEC staff has also requested that registrants enhance disclosures about significant changes in the defined benefit cost and obligation and explain why they changed key assumptions (e.g., discount rates, expected long-term rate of return on plan assets, mortality, salary scale) used to calculate those amounts. The SEC staff expects registrants to disclose both qualitative and quantitative information about changes in assumptions that materially affected or are expected to materially affect their financial statements. Generally, if any significant assumption has changed or is expected to change in the future, and the effect in future periods will be material, the SEC staff expects registrants to provide robust discussion and analysis in MD&A of the reasons for the change and its expected effects.

Example SEC staff comment: Critical accounting estimates and significant assumptions

Please expand your financial statement note disclosures related to accounting policy elections to quantify the service period of your employees over which you amortize actuarial gains and losses and clarify if you employ a corridor.

Please expand your disclosures here or within MD&A to provide investors with a description of the material assumptions, including quantification, that contributed to the significant decline in the net periodic benefit cost with gains recognized for fiscal year 2016 and the six months ended June 30, 2017.
Discount rates used to measure defined benefit plan costs

Summary of issues noted

The SEC staff continues to focus on disclosures provided by registrants that changed to a spot rate approach from a weighted-average discount rate to calculate interest and service cost components of the net periodic benefit cost.

Analysis of current issues

At the 2015 AICPA National Conference on Current SEC and PCAOB Developments, the SEC staff discussed an alternative approach (the spot rate approach) for determining the discount rate used in the interest cost calculation. Under this approach, which is a more disaggregated approach than the weighted-average discount rate approach, a company that determines its discount rate from a yield curve would use the individual spot rates along the yield curve that correspond with the timing of each future cash outflow for benefit payments to calculate interest cost.

The SEC staff said that it would not object if a registrant that uses the yield curve changes from a weighted-average discount rate approach to a spot rate approach to measure interest cost and accounts for the change as a change in estimate or a change in estimate inseparable from a change in accounting principle.

The SEC staff also reiterated that the processes used to calculate the defined benefit obligation and the interest and services costs should be integrated. That is, a company’s decision to select, or change the selection of, a particular methodology for determining the discount rate should align with the requirement to select the best rate(s) at which the obligation could be effectively settled. Registrants should change the method they use to determine the discount rate only if alternative market information (i.e., source data) results in better information being used to measure the defined benefit obligation.

The SEC staff noted that the selection of a discount rate is generally not made considering materiality and that any change in the method used to calculate the discount rate only should be made when a change in the facts and circumstances warrants the use of a different method.

While we have not observed an increase in SEC comment letters that address this matter, the SEC staff expects registrants that change their method to provide robust and transparent disclosures, including the required disclosures under ASC 250, Accounting Changes and Error Corrections, the discount rates used and the effects of the change on the financial statements. MD&A also should discuss any material cost and earnings trend implications of discount rate and methodology changes for both US GAAP and any non-GAAP measures.

EY resources

Compendium of significant accounting and reporting issues, 2015 AICPA National Conference on Current SEC and PCAOB Developments (SCORE No. CC0433), December 2015

To the Point, Potential alternative to develop discount rates used to measure defined benefit plan costs (SCORE No. BB3053), September 2015
Gross versus net presentation

Summary of issues noted
The SEC staff continues to question how registrants determine whether to present revenue on a gross or net basis. Notably, the SEC staff often asks for more information about specific revenue arrangements and is interested in understanding the analysis performed by registrants to support their conclusion that gross or net revenue reporting is appropriate.

Analysis of current issues
In many revenue arrangements, a registrant may be involved with another party to deliver goods or services to a customer (e.g., it may ship goods to and bill the customer on behalf of a supplier). In these circumstances, the registrant must determine whether (1) it is acting as a principal that holds substantially all of the risks and benefits related to the sale of the goods or services and therefore should present revenue on a gross basis (i.e., the total amount billed to the customer for the goods or services) or (2) it is acting as an agent on behalf of another party (e.g., the supplier) and therefore should present revenue on a net basis for its commission or agency fee (i.e., the amount billed to a customer less the amount paid to the supplier).

The guidance on principal and agent considerations in ASC 605-45 applies to revenue transactions in all industries, unless specific guidance is provided in other authoritative literature. The guidance does not provide any bright lines to determine whether gross or net presentation is appropriate. Rather, it provides indicators suggesting gross or net reporting that often require registrants to apply considerable judgment based on their specific facts and circumstances. While certain indicators are weighted (i.e., strong or weak), no single indicator is presumptive or determinative, and all of the indicators should be analyzed in their totality to determine whether the preponderance of evidence supports gross or net revenue reporting.

Example SEC staff comment: Gross versus net presentation
We note your presentation of revenues on a gross basis with commission expense presented as an operating expense. Please tell us how you considered reporting revenues net as an agent versus gross as a principal. In doing so, please provide us with a detailed gross versus net analysis pursuant to ASC 605-45-45 to support your current presentation.

Your response should discuss all indicators of gross and net reporting, weight placed on each indicator and the facts and circumstances relied upon in placing more weight upon one indicator versus another.

Current guidance was largely written in the context of tangible goods, making its application to service transactions and virtual goods transactions more challenging and subject to greater judgment. Consequently, registrants in service and technology industries that do not carry inventory may be more likely to receive questions from the SEC staff about gross versus net determinations.
The SEC staff often requests that registrants provide further information about certain revenue arrangements and their analyses of each of the indicators identified in ASC 605-45 to support their conclusions on gross or net revenue reporting. Many of these analyses require significant judgment based on the facts and circumstances of a registrant’s arrangement with its customer(s). It is important that the facts and circumstances considered are complete and consistent with other information that is relevant to the analysis, including the content of contracts with customers, marketing materials and information on the registrant’s website. The analyses should be kept up to date.

It also is important for registrants to maintain thorough and contemporaneous documentation to support the conclusions they make in analyzing the indicators and performing an analysis for each type of revenue arrangement. The SEC staff frequently asks for this documentation from registrants that operate in industries where entities present revenue from similar arrangements differently. It is not uncommon for a registrant to act as a principal and appropriately present gross revenue in one arrangement but act as an agent and appropriately report net revenue in another arrangement.
Summary of issues noted

While the number of comments in this area has declined in recent years, the SEC staff continues to ask registrants whether they have appropriately considered and included in their accounting policies all of the disclosures required by the multiple-element arrangements guidance. The SEC staff also asks registrants to discuss whether the multiple-element arrangements guidance is applicable to their transactions.

Analysis of current issues

Many registrants provide multiple products or services (deliverables) to their customers as part of a single arrangement. These arrangements may range from relatively simple ones for the delivery of multiple products on a single date (e.g., when a retailer sells a personal computer and printer to a customer and delivers them together) to more complex ones with multiple elements delivered over different periods (e.g., a vendor provides and installs customized equipment and agrees to operate it for the customer on an outsourced basis for an extended period).

The SEC staff often comments on the following areas:

- Identifying multiple-element arrangements
- Determining separate units of accounting for revenue recognition
- Accounting policy disclosures

Identifying multiple-element arrangements

The SEC staff has requested an analysis of how a registrant determined that deliverables should be accounted for separately.

Example SEC staff comment: Identifying multiple-element arrangements

We note various disclosures indicating that the company provides several types of services. Considering this, tell us whether your arrangements include multiple deliverables and, if so, please describe your accounting for such arrangements. We refer you to ASC 605-25-25 and 605-25-30.

Registrants should monitor whether products and services accounted for historically as single-element arrangements have become arrangements that include multiple deliverables subject to the guidance in ASC 605-25.

Determining units of accounting

The multiple-element guidance requires deliverables within an arrangement to be accounted for as separate units of accounting if they meet the separation criteria in ASC 605-25-25-5. One of the criteria is that the deliverable must have standalone value to the customer.
The SEC staff has requested that registrants provide an analysis supporting their determination that each deliverable accounted for separately has standalone value. However, the SEC staff has not limited its inquiry to registrants that have concluded that standalone value exists. The SEC staff also has requested explanations about whether combined elements should be separated because one or more of the deliverables has value to the customer on a standalone basis.

Example SEC staff comment: Separation criteria

We note that you have standalone value for implementation services for some arrangements but not all. Please explain the difference between Type A and Type B implementation services and tell us how you determined that standalone value exists for arrangements with Type A implementation services but not those with Type B services. Refer to ASC 605-25-25-5.

Registrants should carefully evaluate the criteria for demonstrating standalone value (i.e., the item(s) or services are sold separately by any vendor or the customer could resell the delivered item(s) on a standalone basis), which could require considerable judgment and information about industry sales practices. Thorough and contemporaneous documentation of that analysis is critical in order to appropriately apply the separation guidance in ASC 605-25.

Accounting policy disclosures

The overall disclosure objective is to provide qualitative and quantitative information about the significant judgments and changes to those judgments affecting the timing or amount of revenue recognition in a multiple-element arrangement. The SEC staff has requested that registrants expand their disclosures to provide a detailed explanation of how the estimated selling prices for all deliverables within an arrangement are determined, including a discussion of any factors, trends, inputs, techniques or assumptions used in the registrant’s analysis. Registrants also must disclose how consideration is allocated to the separate units of accounting within multiple-element arrangements.

Example SEC staff comment: Overall disclosures

Provide a proposed revised disclosure to be included in future periodic reports that describes your accounting for the agreement in accordance with ASC 605-25. Disclose the significant deliverables within the arrangement, the timing of delivery, the performance provisions, and whether and how separate units of accounting were identified as stipulated in ASC 605-25-50-2. Also include a discussion of the significant factors, inputs, assumptions and methods used to determine selling price for the separate deliverables, including whether the determination was based on vendor-specific objective evidence, third-party evidence or best estimate of selling price.

Registrants should review their disclosures to verify that they not only meet the specific requirements of ASC 605-25-50-2 but also meet the overall objective discussed above.

EY resources

Financial reporting developments, Revenue recognition: Multiple element arrangements — Accounting Standards Codification 605-25 (SCORE No. BB1843), September 2016
Sales incentives

Summary of issues noted
The SEC staff has asked registrants about how they account for incentive programs, especially when they record a portion of the incentives in expense rather than as a reduction to revenue. In addition, the SEC staff has asked registrants to disclose the amount of discounts or allowances and the corresponding effect that these incentives have on the results of operations, regardless of whether they are classified as expenses or reductions of revenue.

Analysis of current issues
Many registrants offer sales incentives, including discounts, rebates, price protection and promotional products to customers. Under ASC 605-50, consideration given to a customer is presumed to be a reduction to revenue, unless the vendor receives an identifiable benefit and can reasonably estimate the fair value of that benefit.

Example SEC staff comment: Sales incentives
In light of the promotional activities that began in the first quarter of 2016, such as coupons issued for free products, please revise your revenue recognition policy to describe your accounting for such promotions and sales incentives. Also, to the extent that amounts recognized for such incentives are material, please disclose the amount in accordance with ASC 605-50-50-1. Your discussion in MD&A should also be revised to discuss the extent of the contribution of these incentives/promotions to the change in revenue and operating income.

Registrants should clearly disclose their accounting policies related to material sales incentives and allowances provided to customers. When there are new incentive programs or changes in program structure or participation rates, MD&A should include a discussion of the changes and their expected effect on future operations and cash flows, if material.
Expected comment letter trends

While comment letters issued to early adopters of ASC 606 are not public yet, we believe the SEC staff will focus on all aspects of ASC 606 and ASC 340-40, Other Assets and Deferred Costs – Contracts With Customers, in the coming year. We understand that the staff’s comments to this point have been focused on understanding companies’ various estimates and judgments (e.g., identifying performance obligations, determining the transaction price, timing of satisfaction of performance obligations), as well as compliance with the disclosure requirements of the new standard. Given the significant effect of the standard to many registrants and the SEC staff’s stated focus on consistency, we expect this trend to continue for early adopters this year and into the next fiscal year when most public companies will adopt the new revenue standard.
Summary of issues noted
The SEC staff has continued to focus on segment reporting and how registrants apply ASC 280. The areas that the staff is focusing on include:

- How registrants identify operating segments
- How registrants aggregate operating segments into reportable segments
- Whether registrants provide appropriate disclosures, including general information disclosures, reconciliations and entity-wide disclosures related to products and services, revenues attributable to individual foreign countries and revenues from major customers
- Whether registrants have inappropriately included non-GAAP measures in their segment disclosures

Analysis of current issues
The SEC staff has continued to focus on segment disclosures and the application of ASC 280. At the 2016 AICPA National Conference on Current SEC and PCAOB Developments, the SEC staff discussed its emphasis on the objectives and principles outlined in the segment reporting guidance.

The SEC staff has emphasized the importance of internal control over financial reporting, including whether the design and operation of internal controls over the segment reporting judgments are appropriate. The SEC staff has said that the guidance on segment reporting requires the application of reasonable judgment. Therefore, input from, and interaction with, the chief operating decision maker (CODM) may be an important element in the design of effective internal controls over financial reporting, specifically how the CODM allocates resources and assesses performance.

The SEC staff also has reminded registrants that documenting the design and effective operation of management’s controls over these judgments is an integral part of management’s support for the effectiveness of its internal control over financial reporting and is essential to the auditor’s ability to evaluate these controls.

When reviewing segment reporting, the SEC staff considers public 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 footnote.

The SEC staff also has requested an explanation when there are inconsistencies between the description of the business in other sections of a registrant’s public filings and its segment footnote. For example, the staff has challenged registrants when they say the basis for identifying operating segments is something other than product or service lines (e.g., geography) but publicly disclosed information suggests that management uses financial information by product or service lines to make decisions and allocate resources.

The SEC staff expects registrants to continually monitor business developments. The staff has inquired about changes in the business that could affect the identification or aggregation of operating segments.
While the SEC staff has historically commented on segment reporting, we continue to see a high level of focus in this area, even when the staff has previously commented on a registrant’s segment reporting. Questions on segment reporting have often resulted in multiple rounds of comments, particularly when the registrant’s initial response was not comprehensive. The review process also has led to requests for a teleconference with the SEC staff, including representatives of the SEC’s Office of the Chief Accountant.

Identification of operating segments

The segment reporting guidance is based on a “management approach” (ASC 280-10-5). That is, segment disclosures should be consistent with a registrant’s internal management reporting structure to enable investors to view the registrant similarly to the way management does. Registrants should challenge any conclusions they reach on operating segments that are not consistent with the basic organizational structure of their operations. To support the management approach concept, the SEC staff has requested that registrants include a discussion of their internal structure or an organizational chart and the processes used to make operating decisions in their comment letter response.

Identifying operating segments (ASC 280-10-50-1 through 50-9) is the first step in preparing segment disclosures. A critical element of this analysis is identifying the CODM. Under ASC 280, the CODM is a function, not necessarily a manager with a specific title. The SEC staff has said that a registrant should focus on who makes the key operating decisions in the organization and not default to who makes the strategic decisions or has the ultimate decision-making authority. That is, the registrant should not default to the chief executive officer when determining the CODM.

To evaluate a registrant’s identification of operating segments, the SEC staff often requests a description of the registrant’s organizational structure and detailed information about employees who report directly to the CODM, including their roles and responsibilities and interactions with the CODM. 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 allows the SEC staff to challenge whether the identified operating segments are consistent with how the CODM assesses performance and allocates resources.

To qualify as an operating segment, a component must have discrete financial information available that the CODM uses to assess performance and make resource allocation decisions. This financial information must be sufficiently detailed to allow the CODM to make decisions. When determining whether discrete financial information is available, the SEC staff has cautioned that a registrant shouldn’t conclude that discrete financial information is not available simply because certain costs are shared and not allocated specifically to each component. Gross profit information or other operating measures provided to the CODM and used to assess performance and make resource allocation decisions could be considered discrete financial information.
The SEC staff frequently has requested that registrants describe the financial information provided to the CODM so the staff can understand the information used by the CODM to assess performance and allocate resources. However, the staff has clarified that the fact that information is included in a reporting package is not the only factor it considers in its assessment of identified operating segments.

Further, when a registrant identifies only one operating segment, the SEC staff has challenged 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. The SEC staff has said that if the application of the guidance in ASC 280 results in the identification of a single operating segment, a registrant should disclose that it allocates resources and assesses financial performance on a consolidated basis and explain the basis for that management approach.

**Example SEC staff comment: Identification of operating segments**

Please tell us who your CODM is and provide us with your analysis in determining the CODM. As part of your response, please provide us with an organizational chart that includes the titles and roles of the individuals who report directly to the CODM. In doing so, specifically explain to us the responsibilities of these individuals and the manner in which they typically interact with the CODM. In addition, please respond to the following:

- Tell us the nature of the resource allocation and performance assessment decisions the CODM makes, including examples to illustrate the description.
- Describe the information regularly provided to the CODM and how frequently it is prepared.
- Describe the information regularly provided to the Board of Directors and how frequently it is prepared.
- Explain how budgets are prepared, who approves the budget at each step of the process, the level of detail discussed at each step and the level at which the CODM makes changes to the budget. Also describe the level of detail communicated to the CODM when actual results differ from budgets and who is involved in the meetings with the CODM to discuss budget-to-actual variances.
- Describe the basis for determining the compensation of the individuals that report to the CODM.

Identifying operating segments also affects goodwill impairment testing. As discussed in the Goodwill section of this publication, the SEC staff has requested information about the registrant’s determination of its reporting units. Incorrectly identifying operating segments could result in the incorrect identification of reporting units that are used in goodwill impairment testing.

For further discussion on goodwill impairment testing, please refer to the Goodwill section of this publication.
Aggregation of operating segments

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

- 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.

To be consistent with the objective and basic principles of ASC 280, the aggregation should help users make better-informed judgments about the registrant by improving their understanding of the registrant’s performance and assessment of the prospects for future net cash flows. That is, operating segments may be aggregated only if reporting them separately will not add significantly to the investor’s understanding of the entity because their characteristics are so similar that they can be expected to have essentially the same future prospects.

It’s important to understand that while the identification of operating segments follows a management approach, the aggregation of operating segments should be viewed from the investor’s perspective. The SEC staff has stated that it is important for registrants to consider information such as industry reports and other analyses by users of the financial statements that may provide evidence of how a reasonable investor would analyze the company.

ASC 280 requires that aggregated operating segments have “similar economic characteristics,” such that they would be expected to have similar long-term financial performance. The similarity of the economic characteristics should be evaluated based on both current performance and future projections (ASC 280-10-55-7A). However, the SEC staff has said that the expectation that operating segments will have similar economic characteristics (e.g., long-term average gross margins) in the future does not overcome a lack of similarity in their current and past performance.

The SEC staff often reviews the registrant’s website, analyst presentations and information in public filings and 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 two 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, revenues and other measures of operating performance when challenging the aggregation of operating segments.

When a registrant has aggregated operating segments into a reportable segment, the staff has frequently asked for an explanation of why the registrants believes the five qualitative characteristics of the operating segments are similar, as required by ASC 280.
The SEC staff recently reminded registrants that the guidance on determining whether two operating segments are similar requires the evaluation to consider the range of the company’s business activities and the economic environment in which it operates. For example, while a registrant with a diversified product portfolio may consider certain products similar, a registrant with a more narrow range of activities may not consider those same products similar.

In addition, the SEC staff has inquired about the reasons for the company’s organizational structure that resulted in the identification of separate operating segments and whether those reasons provide evidence that the operating segments are not similar.

**Example SEC staff comment: Aggregation of operating segments**

We note that your five operating segments are aggregated into one reportable segment. Please address the following:

- Compare and contrast your operating segments relative to the areas listed in ASC 280-10-50-11(a) through (e). With respect to any differences among your operating segments, tell us why you determined that disaggregation was not warranted.
- Provide us with each operating segment’s historical and projected revenues, gross margin, operating margin and measure of segment profitability.
- Tell us the basis of organization (i.e., why the company is organized in the manner that it is).

**Ongoing assessment of reportable segments**

The SEC staff has challenged registrants’ identification and aggregation of operating segments when there have been changes to the business. We believe this is linked to the SEC staff’s emphasis on registrants having processes in place to continuously reassess their conclusions because circumstances may change over time. For example, the SEC staff has inquired about how a change in a registrant’s internal reporting due to a significant acquisition, a restructuring or changes in performance among operating segments affected segment reporting conclusions.

**Example SEC staff comment: Identification and aggregation of operating segments including a recent acquisition**

We note your disclosure that you have determined it appropriate to aggregate your operating segments into one reportable segment. Please tell us the consideration given by management in determining your reportable segment in light of the acquisition of XYZ Company (XYZ), which operates in a different region of the country. We note from XYZ’s website that it appears to continue to operate as a separate entity under the XYZ name. In this regard, please tell us how you considered these characteristics of XYZ’s operations in determining that it is appropriate to present one reportable segment. Your response should address how you identified the operating segments under ASC 280-10-50-1 and 280-10-50-3 through 50 and further, how you evaluated each of the aggregation criteria in ASC 280-10-50-11.
Disclosures

General disclosures
ASC 280-10-50-21 requires registrants to disclose the factors used to identify their reportable segments, including whether operating segments have been aggregated. If a registrant has not included this information in the segment footnote, the SEC staff has asked the registrant whether it has aggregated operating segments when determining reportable segments and has asked it to expand its disclosure in future filings. ASC 280-10-50-21 also requires disclosure of the types of products and services from which each reportable segment derives its revenues. The SEC staff has asked registrants to expand their disclosures when the information is not provided or does not include enough detail.

Reconciliations
ASC 280-10-50-30 requires registrants to provide reconciliations of the reportable segments’ total revenues, measure of profit or loss, assets and other significant items, if disclosed, to the corresponding consolidated amounts. The SEC staff has asked registrants to revise their disclosures if they have not disclosed the reconciliations in the consolidated financial statements. The SEC staff also has asked registrants about amounts included in an “other” reconciling item, since ASC 280-10-50-31 requires significant reconciling items to be separately identified and described.

Non-GAAP measures
By definition, a segment measure of profit or loss that a company is required to disclose in accordance with ASC 280 (i.e., the measure that is reported to 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 rules and regulations on the use of non-GAAP financial measures.

The SEC staff’s C&DIs on the use of non-GAAP financial measures address this point. The C&DIs say “because [ASC 280] requires or expressly permits the footnotes to the company’s consolidated financial statements to include specific additional financial information for each segment, that information also would be excluded from the definition of non-GAAP financial measures.”

However, the SEC staff may challenge whether a registrant has inappropriately included a non-GAAP measure in its segment disclosures. For example, registrants should be aware that a consolidated measure of segment profit may create a non-GAAP financial measure.
Example SEC staff comment: Non-GAAP measures in the segment footnote

While we note that your CODM uses segment operating income (loss) and segment operating margin percentage to evaluate segment performance, the format and labeling of your presentation include non-GAAP measures that are not measures of segment performance and you are not allowed to present them in your financial statements pursuant to Item 10(e)(1)(ii)(C) of Regulation S-K. The amounts you present in the consolidated column for operating income (loss) and operating margin percentage are not amounts presented on your statement of income or which can be directly calculated therefrom. While you may present the total of profit or loss of individual segments as part of the reconciliation required by ASC 280-10-50-30(b), such presentations must be correctly labeled and the reconciliations should be to the consolidated amounts presented in your financial statements. Please revise the format and labeling of your presentation to eliminate the non-GAAP measures consolidated operating income (loss) and consolidated operating profit margin percentage. See also Question 104.04 of the Compliance & Disclosure Interpretations for Non-GAAP Financial Measures.

The SEC staff also has said that registrants should not attempt to circumvent the non-GAAP rules by disclosing multiple measures of a segment’s profit or loss in their financial statements. Similarly, the SEC staff may challenge a registrant that discloses a measure of segment profit or loss when it discloses only one reportable segment. For further discussion, please refer to the Non-GAAP financial measures section of this publication.

Entity-wide disclosures

Disaggregated revenue by product and service
As part of the entity-wide disclosures, ASC 280 requires a registrant to disclose the amount of revenues derived from transactions with external customers for each product or service or each group of similar products or services, if not already provided as part of the segment information required by ASC 280. Entities that have only one reportable segment also are required to disclose such products and services revenues. For example, a registrant with one reportable segment that sells consumer products and provides services would be required to disclose the revenues from each significant product line or service, or groups of similar products or services, in its segment disclosure.

The SEC staff often has asked registrants that have not disclosed disaggregated revenue information to either do so or explain why such disclosure was not necessary. The SEC staff has challenged the absence of such a disclosure when the registrant’s publicly disclosed information indicates that its reportable segments contain a range of products or services. The SEC staff also has questioned when a registrant asserted that providing the disclosure was impracticable when the information was provided elsewhere (e.g., MD&A, earnings calls).
Example SEC staff comment: Disaggregated revenue by product

Please revise to disclose revenues from external customers for each product and service or each group of similar products and services. As part of your response, please describe the similarities and differences between the products and services presented as a group. Please refer to ASC 280-10-50-40.

Disaggregated revenue by geography

ASC 280 requires disclosure of certain revenue information attributed to the registrant’s country of domicile and foreign countries. A registrant also is required to provide this revenue information for each foreign country (ASC 280-10-50-41(a)) if it is material. The SEC staff has asked registrants to disclose revenues attributed to specific countries in light of their other disclosures about foreign locations.

Revenue contributed by significant customers

ASC 280-10-50-42 requires registrants to disclose the total amount of revenues 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 requested registrants to disclose such information when other disclosures indicate that there may be a concentration of sales to a particular customer.

EY resources


Financial reporting developments, Segment reporting – Accounting Standards Codification 280 (SCORE No. BB0698), May 2017
Subjective valuation assumptions

Summary of issues noted
The SEC staff comments on the quality of disclosures about subjective assumptions used to determine the grant-date fair value of share-based payments. In particular, the SEC staff focuses on disclosure of the expected term, expected volatility and expected dividend assumptions applied in an option-pricing model.

Analysis of current issues
Disclosure of assumptions
ASC 718-10-55-21 requires that valuation techniques or models used to estimate the fair value of an employee stock option or similar instrument take into account, at a minimum, six inputs. While several of those inputs can be objectively determined (e.g., exercise price, grant-date share price), others (e.g., expected term, expected volatility, expected dividends) require judgment. ASC 718-10-50-2(f)(2) requires that registrants provide a description of each significant assumption used during the year to estimate the fair value of share-based awards. These disclosures should include the methods for determining expected term, expected volatility and expected dividends, as well as the reasons for any significant changes in assumptions between periods.

Expected term
The expected term of an employee stock option or similar instrument is the period of time the instrument is expected to be outstanding (that is, the period of time from the service inception date to the date of expected exercise or other expected settlement), and it has a significant effect on the option’s fair value. The longer the term, the more time the option holder has to allow the share price to increase, making the option more valuable. Empirical data shows that employees, for a variety of reasons, typically do not wait until the end of the contractual term of a nontransferable option to exercise the option. Accordingly, ASC 718 requires companies to use the expected term of the option, rather than the contractual term, as an input in an option-pricing model.

Registrants (especially new registrants) may not have sufficient historical employee exercise data available to estimate the expected term of employee share options. In these situations, registrants that have “plain vanilla” options, as defined in SAB Topic 14.D.2, may estimate the expected term assumption using a “simplified” method. Under the simplified method, the expected term is calculated as the midpoint between the vesting date and the end of the contractual term of the option. The SEC staff does not expect the simplified method to be used when sufficient information about exercise behavior, such as historical exercise data or exercise information from external sources, becomes available. Further, the simplified method cannot be used for options that are not plain vanilla, such as awards granted with an exercise price that does not equal the fair value of the underlying stock on the date of grant or awards subject to performance or market conditions. The SEC staff questions the use of the simplified method when historical data may appear to be available or the characteristics of the awards are not plain vanilla (e.g., a modified option’s exercise price may be more or less than the share price on the modification date).

Example SEC staff comment: Expected term

Please more fully explain to us why you believe it is appropriate to use the simplified method to estimate the expected life of your stock options and address the impact that your current approach has had on your financial statements. Please also tell us when you expect sufficient historical information to be available to you to determine expected life assumptions. Refer to SAB Topic 14.D.2.

Registrants that use the simplified method to estimate the expected term of plain vanilla options should clearly disclose in the notes to the financial statements the following:

- Use of the method
- Reason why the method was used
- If the method was not used for all stock option grants, the types of stock option grants for which the method was used
- If the method was not used in all periods, the periods for which the method was used

Expected volatility

Much of the value of a stock option is derived from its potential for appreciation. The more volatile the stock price, the more valuable the option because of the greater possibility of significant positive changes in share price. ASC 718-10-55-37 identifies certain factors to consider when estimating expected volatility, including historical volatility and implied volatility (derived from a traded option in the registrant’s shares).

The SEC staff asks registrants to provide additional disclosures about the assumptions used to estimate expected volatility.

SAB Topic 14.D.1 provides guidance about the expected volatility assumptions used to estimate the grant-date fair value of share-based awards. The SEC staff has indicated that registrants should disclose in their critical accounting estimates and significant accounting policies, if material, the basis for their decisions to use historical volatility, implied volatility or a combination of both. Registrants also should explain the reasons for any change in the method used to estimate expected volatility from the prior reporting period and the reasons why the volatility assumptions have remained constant from period to period (if applicable).

Example SEC staff comment: Expected volatility

We note from your disclosure that the company’s expected volatility at the valuation date was estimated based on the historical volatility of comparable companies. Please tell us what consideration was given to disclosing the reason for the continued reliance on the historical volatility of comparable companies in arriving at this assumption. We refer you to ASC 718-10-55-37 and SAB Topic 14.D.1.
**Expected dividends**

Employees may receive grants of nonvested shares on which they do not receive dividends until the shares vest. Because the value of a share includes the value of expected dividends, the value of a share that does not pay dividends during the vesting period is less than that of a share that pays dividends.

The SEC staff asks registrants to provide additional disclosures about the valuation of nonvested stock that does not entitle the employee to dividends before the shares vest. ASC 718-10-55-44 provides guidance on the effects of dividend entitlements on the valuation of share-based payments. Registrants should explain which awards entitle the employee to receive dividends and the effect on the fair value of the awards.

<table>
<thead>
<tr>
<th>Example SEC staff comment: Expected dividends</th>
</tr>
</thead>
<tbody>
<tr>
<td>We note that for awards for which employees are not entitled to dividends declared on the underlying shares, the grant-date fair value of the award would be measured using the grant-date fair value of your common shares reduced by the present value of the dividends expected to be paid on the underlying shares during the requisite service period. Conversely, for awards where dividends are either paid or accumulated prior to vesting, such dividends are accounted for under the guidance in ASC 718-10-55-44 through 55-45. Please explain your disclosure and your accounting for dividends on your non-vested restricted stock awards.</td>
</tr>
</tbody>
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<tr>
<th>EY resources</th>
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<tbody>
<tr>
<td>Financial reporting developments, Share-based payment (SCORE No. BB1172), October 2016</td>
</tr>
</tbody>
</table>
Presentation and disclosure

Summary of issues noted
The SEC staff comments when disclosures required by ASC 718 (e.g., general terms of an award, method used for measuring compensation cost from an award) have been omitted without explanation. The SEC staff also comments when total share-based payment expense is presented in any form on the face of the income statement.

Analysis of current issues

Required disclosures
ASC 718-10-50-1 requires a registrant with one or more share-based payment arrangements to disclose information that enables users of the financial statements to understand: (1) the nature and terms of such arrangements that existed during the period and the potential effects of those arrangements on shareholders; (2) the effect of compensation cost arising from share-based payment arrangements on the income statement; (3) the method of estimating the fair value of the goods or services received, or the fair value of the equity instruments granted (or offered to grant), during the period; and (4) the cash flow effects resulting from share-based payment arrangements. Although ASC 718 appears to take a principles-based approach to disclosure requirements, the implementation guidance in ASC 718-10-50-2 provides several pages of detailed disclosure requirements described as the “minimum information” required to achieve these disclosure objectives.

The SEC staff often comments when any of the minimum disclosures identified by ASC 718-10-50-2 have been omitted. If any of the required disclosures have not been provided, the SEC staff expects registrants to disclose why they have elected not to provide the information.

Example SEC staff comment: Required disclosures
Please tell us why you have not provided the disclosures required by ASC 718-10-50-2 for your stock-based compensation plans.

Presentation on the income statement
Share-based payment expense may relate to multiple lines in the statement of operations (e.g., cost of sales; selling, general and administrative expense). The SEC staff continues to object to the disclosure of total share-based payment expense as a separate line item on the face of the income statement. The SEC staff frequently comments that this type of disclosure may give the impression that the nature of the expense related to share-based compensation is different from cash compensation paid to the same employees.

SAB Topic 14.F addresses the SEC staff’s views regarding classification of compensation expense associated with share-based payment arrangements. The SEC staff believes a registrant should present the expense related to share-based payment arrangements in the same line or lines as cash compensation paid to the same employees. Registrants instead could consider disclosing the amount of expense related to share-based payment arrangements in a parenthetical note to the appropriate income statement line items in the reconciliation of net income to net cash flows from operating activities under the indirect method or in MD&A.
**Example SEC staff comment: Presentation on the income statement**

We note you present stock compensation expense as a separate line item in your statement of operations. Please revise future filings to present the expense related to share-based payment arrangements in the same line or lines as cash compensation paid to the same employees. Refer to SAB Topic 14.F.

**EY resources**

Financial reporting developments, *Share-based payment* (SCORE No. BB1172), October 2016
In this supplement, we analyze trends in SEC staff comment letters related to the banking industry. The following table summarizes the topics the SEC staff focused on most often in comment letters sent to registrants in the banking industry. Many of these topics are frequent areas of comment in letters received by registrants in other industries and are covered in the rest of this publication.

<table>
<thead>
<tr>
<th>Comment area</th>
<th>Comment rank for the 12 months ended 30 June*</th>
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<tbody>
<tr>
<td>Loans receivable – valuation and allowance</td>
<td>1</td>
</tr>
<tr>
<td>Fair value measurements**</td>
<td>2</td>
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<tr>
<td>Acquisitions, mergers and business combinations</td>
<td>3</td>
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<tr>
<td>Management discussion and analysis</td>
<td>4</td>
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<td>Executive compensation disclosures</td>
<td>5</td>
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<td>2017</td>
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* Based on comment letter topics assigned by research firm Audit Analytics for SEC comment letters issued to registrants related to Forms 10-K from 1 July 2015 through 30 June 2017.

** This topic was not in the top five comment areas in 2016.

*** This category includes SEC staff comments on fair value measurements under ASC 820 as well as fair value estimates, such as those related to revenue recognition, stock compensation and goodwill impairment analyses. The SEC staff may have commented on more than one topic in a letter.

The following industry supplement focuses on comment areas that are unique to registrants in the banking industry. The supplement should be read in conjunction with the topics in the main section that also may contain relevant information to registrants in the banking industry.

In its comments, the SEC staff may request additional information about a topic and compliance with SEC rules or accounting literature. However, the SEC staff comments are based on the registrant’s facts and circumstances, including judgments about materiality. This supplement can help companies identify the SEC staff's areas of focus, but registrants should also consider significance to investors when including disclosures in their filings.

The SEC staff continues to focus on the appropriateness of non-GAAP measures, including those in the MD&A and in the notes to the financial statements. Examples include non-GAAP measures of loans receivable such as allowance coverage ratios and amounts such as earnings per share that have been adjusted to exclude acquisition expenses. For further discussion, refer to the Non-GAAP financial measures discussion in the main section of this publication as the comments relating to the banking industry are not significantly different.
Summary of issues noted
The SEC staff has asked registrants to provide more information about their lending activities and their allowances for credit losses. The SEC staff also focuses on disclosures of credit quality indicators and registrants’ accounting for and disclosures of acquired loans, among other things.

Analysis of current issues

Credit quality indicators
The SEC staff continues to comment on whether a registrant’s disclosures about credit quality indicators in both the notes to the financial statements and MD&A are sufficient. The staff often comments when changes in allowance levels appear inconsistent with changes in key credit quality indicators and changes in loan portfolios (e.g., loan portfolio mix, concentration, amounts). The staff may request, among other things:

- Additional discussion of the changes in key credit quality indicators, including movement of loans between current and past due categories, coverage ratio, allowance to charge-off ratio and allowance to total loans
- More detail about changes in the underlying credit risk of loans collectively evaluated and the effect of qualitative factors
- More detail about the types of loans included in the impaired loan category, including any individually material impaired loans
- Discussion of the effect or lack of an effect from changes in underwriting and lending policies

Example SEC staff comment: Qualitative disclosures
Describe directionally the trends in your qualitative factors and how these trends affected the overall level of the qualitative component of your general allowance for each period presented. For example, describe what factors resulted in increases or decreases in the qualitative components during each of the periods presented. Additionally, describe whether certain product classes result in higher or lower qualitative adjustments and the factors driving those trends. Lastly, please provide an indication of the level of the qualitative component of the general allowance relative to the component based on historical loss rates.

Accounting and disclosures related to acquired loans
The SEC staff continues to focus on whether the initial and ongoing credit quality disclosures for purchased loans, which registrants may acquire as a separate portfolio or in a business combination, are sufficient.

The SEC staff has asked registrants to provide, in the notes to the financial statements and in MD&A, additional disclosures related to acquired loans, such as:

- Discussion of how the acquired loan portfolios affect credit ratios and trends, including comparability to prior periods
- Separate disclosure of credit quality indicators and allowances for acquired loans and originated loans
• More detailed disclosures for each significant acquisition of loans, including whether the loans are purchased credit impaired (PCI) or non-PCI

• Discussion of the policy for removing loans from pools at the time of sale or foreclosure in accordance with ASC 310-30-40-1

• Clarification of whether recognition of interest income on nonaccrual acquired loans has ceased in accordance with ASC 310-30

Example SEC staff comment: Acquired loans

Please revise future filings to present all credit quality metrics (including impaired loans, credit risk profile and allowance for loan loss activity) by originated loans, acquired loans using ASC 310-20 accounting and acquired credit impaired loans using ASC 310-30 accounting to provide a consistent presentation of your credit quality metrics. Please also ensure that you provide a similarly consistent discussion and analysis of the loan portfolio in your MD&A.

Example SEC staff comment: Acquired loans

Please clarify whether you have ceased recognizing interest income on nonaccrual acquired loans in accordance with ASC 310-30. If so, please explain your basis for being unable to reasonably estimate the cash flows for these loans. Please refer to ASC 310-30-35-3 for guidance.

Please tell us whether you have any loan pools under ASC 310-30 that continue to have loan balances but no longer have any remaining accretable difference. If so, please quantify those pools and explain the factors driving zero accretable difference for these pools.
Fair value measurements

Summary of issues noted
The SEC staff continues to focus on whether a registrant’s fair value measurement disclosures are sufficient. The SEC staff has focused on the fair value measurements of impaired loans and foreclosed assets included in the notes to the financial statements. For further discussion, refer to the Fair value measurements section of this publication.

Fair value measurement of impaired loans and foreclosed assets
The SEC staff has asked registrants for additional disclosures in the notes to the financial statements and may request, among other things:

- Discussion of how the unobservable inputs are used in Level 3 fair value measurements as required by ASC 820-10-50-2(bbb)
- Discussion of how often appraisals are obtained, adjustments to appraised value are made and how the potential for outdated appraisal values is considered

Example SEC staff comment: Fair value measurement of other real estate and impaired loans
We note that you have other real estate owned and impaired loans that are based on Level 3 fair value measurements on a nonrecurring basis for all periods presented. In future filings please include quantitative information about the significant unobservable inputs used in the fair value measurement in accordance with ASC 820-10-50-2(bbb).
In this supplement, we analyze trends in SEC staff comment letters to registrants in the real estate industry. The following table summarizes the topics the SEC staff focused on most often. Many of these topics are frequent areas of comment in letters received by registrants in other industries and are covered elsewhere in this publication.

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* Based on comment letter topics assigned by research firm Audit Analytics for SEC comment letters issued to registrants related to Forms 10-K from 1 July 2015 through 30 June 2017.

** This topic was not in the top five comment areas in 2016.

*** This category includes SEC staff comments on fair value measurements under ASC 820 as well as fair value estimates, such as those related to revenue recognition, stock compensation and goodwill impairment analyses. The SEC staff may have commented on more than one topic in a letter.

This supplement focuses on comment areas that are unique to real estate registrants. It should be read in conjunction with the topics in the main section that also may contain relevant information to registrants in the real estate industry.

In its comments, the SEC staff may request additional information about a topic and compliance with SEC rules or accounting literature. However, the SEC staff comments are based on the registrant’s facts and circumstances, including judgments about materiality. This supplement can help companies identify the SEC staff’s areas of focus, but registrants should also consider significance to investors when including disclosure in their filings.
Summary of issues noted

The SEC staff issues comments about real estate registrants’ use of funds from operations (FFO) and other non-GAAP financial measures. The staff often asks registrants to reconcile FFO and other non-GAAP measures to the most directly comparable GAAP financial measure and comments on adjustments to non-GAAP measures that in substance appear to portray a liquidity measure. The staff also frequently asks registrants to modify line item captions within the calculation of FFO or a non-GAAP financial measure to improve their transparency (e.g., more clearly identify the class of equity holders to which a non-GAAP measure is attributable) and to explain why management considers FFO and other non-GAAP financial measures useful to investors. The staff has also objected to non-GAAP measures that use individually tailored accounting principles (e.g., proportionate consolidation).

Analysis of current issues

Many real estate investment trusts (REITs) disclose FFO, a non-GAAP measure of financial performance that is defined by the National Association of Real Estate Investment Trusts (NAREIT). The SEC staff accepts NAREIT’s definition of FFO as a performance measure and will not object to the presentation of FFO per share. The market closely follows REITs’ FFO expectations, and investors and analysts view FFO as a key industry performance indicator.

However, some real estate companies provide modified calculations of FFO, such as “adjusted” FFO (AFFO), “modified” FFO and “core” FFO, and they may use different methods to calculate these measures. In some cases, registrants have used entity-specific adjustments that management says are important to investors.

The SEC staff asks management to clarify modifications and adjustments to FFO disclosures. For example, SEC staff comments have sought additional clarity about the nature of certain adjustments labeled as “nonrecurring” or “unusual.” In some cases, registrants are asked to revise or remove adjustments or provide additional information to clarify the purpose of an adjustment. The SEC staff also continues to comment on lack of disclosures explaining the usefulness of FFO and other non-GAAP measures to investors.

Example SEC staff comment: Funds from operations – usefulness

We note you have disclosed a performance measure referred to as “adjusted funds from operations.” Please provide us with a detailed analysis of why this measure is useful to investors. Where appropriate, please address the usefulness of each significant adjustment. In addition, please revise your reconciliation to reconcile AFFO to the most directly comparable GAAP financial measure.

Real estate registrants should evaluate any adjustments they make to FFO to make sure that, when they report adjusted FFO per share, they don’t violate Item 10(e) of Regulation S-K that prohibits presenting liquidity measures on a per-share basis. The SEC staff focuses on the substance of a non-GAAP per-share measure rather than management’s characterization of the measure as a performance measure.
Appendix A: Industry supplements

Example SEC staff comment: Liquidity measure

We note that you present Core FFO and Adjusted FFO on a per-share basis. It appears that the adjustments are noncash and both measures approximate operating cash flows and could be used as liquidity measures. Please explain to us why you believe it is appropriate to present these measures on a per-share basis.

The SEC staff also has focused on improving the transparency of line item captions REITs use when presenting calculations of FFO. Registrants that have noncontrolling interest holders or multiple classes of equity holders have frequently been asked to modify the caption of the FFO measure to more clearly identify the class of equity holders to which it relates (e.g., FFO attributable to Company Z, FFO attributable to common shareholders, FFO attributable to unitholders).

Example SEC staff comment: Funds from operations — terminology

We note that you reconcile FFO to net income attributable to common stockholders, and it appears FFO represents FFO attributable to common stockholders. In future filings, please revise the label of this non-GAAP measure to indicate that it is FFO attributable to common shareholders or tell us why this is not necessary.

Registrants that present other non-GAAP financial measures (e.g., adjusted EBITDA, same-store operating income) are also frequently asked to describe the usefulness of the measure to investors and reconcile the amount to the most directly comparable GAAP financial measure.

The SEC staff has also focused on non-GAAP measures that use individually tailored accounting principles. While the SEC’s staff interpretation addresses altering revenue recognition, we have seen the SEC staff take exception to the use of measures that utilize proportionate consolidation for partially owned subsidiaries. To resolve these concerns, the SEC staff has allowed companies to separately present their pro rata share, or the non-controlling interests’ share, of financial statement line items, which could allow a user to compute a measure that effectively reflects proportionate consolidation.

Example SEC staff comment: Non-GAAP measures — alteration of GAAP principles

Please note that you continue to adjust your non-GAAP measures to include your proportionate interest from unconsolidated ventures. This presentation appears to inappropriately alter the consolidation principles required by GAAP and could be misleading. Please revise accordingly.

Further discussion about SEC comments related to non-GAAP financial measures can be found in the SEC reporting issues section of this publication.

The SEC staff has frequently commented on the prominence of FFO in the earnings release.
Summary of issues noted

Over the past year, we have seen the SEC staff focus on compliance with the disclosure requirements for the Schedule of Real Estate and Accumulated Depreciation.

Analysis of current issues

As required by Rule 12-28 of Regulation S-X, registrants in the business of acquiring and holding real estate must file Schedule III listing the cost of real estate and the related accumulated depreciation. Footnote 6 of Rule 12-28 requires registrants to disclose the aggregate cost of their real estate assets for federal income tax purposes.

The SEC staff frequently issues comments when real estate registrants do not disclose the aggregate cost of their real estate assets for federal income tax purposes in Schedule III.

Example SEC staff comment: Rule 12-28 disclosures

Please tell us how you complied with footnote 6 to Rule 12-28 of Regulation S-X, or tell us how you determined it was not necessary to disclose the aggregate cost for federal income tax purposes of your real estate assets.

The SEC staff generally closes the above comment upon a company’s acknowledgement that it will add the required disclosures prospectively in their future filings.

Resources

- Technical Line, A closer look at the SEC staff’s scrutiny of non-GAAP financial measures (SCORE No. 03290-161US), October 2016
- To the Point, SEC staff updates guidance on non-GAAP financial measures (SCORE No. 01108-161US), May 2016
- Technical Line, Spotlight on non-GAAP financial measures (SCORE No. 00785-161US), April 2016
- 2016 SEC annual reports – Form 10-K (SCORE No. 03265-161US), November 2016
Oil and gas supplement

In this supplement, we analyze trends in SEC staff comment letters related to the oil and gas industry. The following table summarizes the topics the SEC staff focused on most often in comment letters sent to registrants in the oil and gas industry. Many of these topics are frequent areas of comment in letters received by registrants in other industries and are covered in the rest of this publication.

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<tr>
<td>Management’s discussion and analysis</td>
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<tr>
<td>Oil and gas reserves</td>
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<tr>
<td>Fair value measurements***</td>
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</tr>
<tr>
<td>Long-lived assets, goodwill and related impairments</td>
<td>5</td>
</tr>
</tbody>
</table>

* Based on comment letter topics assigned by research firm Audit Analytics for SEC comment letters issued to registrants related to Forms 10-K from 1 July 2015 through 30 June 2017.

** This topic was not in the top five comment areas in 2016.

*** This category includes SEC staff comments on fair value measurements under ASC 820 as well as fair value estimates, such as those related to revenue recognition, stock compensation and goodwill impairment analyses. The SEC staff may have commented on more than one topic in a letter.

This supplement focuses on comment areas that are unique to oil and gas registrants. It should be read in conjunction with the topics in the main section that also may contain relevant information to registrants in the oil and gas industry.

In its comments, the SEC staff may request additional information about a topic and compliance with SEC rules or accounting literature. However, the SEC staff comments are based on the registrant’s facts and circumstances, including judgments about materiality. This supplement can help companies identify the SEC staff’s areas of focus, but registrants should also consider significance to investors when including disclosure in their filings.
Summary of issues noted
Registrants are required to disclose significant information about their oil and gas reserves under ASC 932-235 and Regulations S-X and S-K. In addition to the areas discussed below, the SEC staff continues to monitor consistency between a registrant’s reserve disclosures in the supplemental information accompanying its financial statements and:

- Information in MD&A
- Prior filings (e.g., the prior-year annual report)
- Other publicly available information (e.g., website, earnings calls)
- Market data (e.g., market prices)

The SEC staff has also requested additional information to support reserve amounts, including well information, income forecasts, engineering reports, maps and other documentation. The SEC staff inquires about how a registrant considers current and expected information about market prices, development costs and other estimates that may be relevant to recognition of oil and gas reserves.

Analysis of current issues
Recognition of proved undeveloped reserves (PUDs)
To recognize PUDs, a registrant must have made a final investment decision to develop an oil and gas property within five years of initial recognition, with limited exceptions. To meet this criterion, the registrant must be able to demonstrate, with reasonable certainty, that it will execute the development plan within the five-year period. The SEC staff expects development plans to include management’s expectations about capital expenditures and related financing. If the registrant subsequently changes its development plan, the SEC staff may question whether the registrant had reached a final investment decision.

The SEC staff may request historical information, such as rollforwards of PUD properties, to evaluate how closely the registrant’s drilling activities on specific properties align with its plans for those properties. A registrant that cites a significant change in prices to explain a change in its development plan may receive questions from the SEC staff about whether it has identified the appropriate period to recognize PUDs. If planned drilling has not occurred, the staff may challenge whether PUD recognition is appropriate, either retrospectively or prospectively.

Example SEC staff comment: Final investment decision
Please provide us with your development schedule, indicating for each future period the net quantities of proved reserves and estimated capital expenditures necessary to convert all of the proved undeveloped reserves disclosed as of December 31, 2016, to developed. Please refer to Rule 4-10(a)(31)(ii) of Regulation S-X and Question 131.04 in the C&Dis, issued October 26, 2009 and updated May 16, 2013, and either confirm or tell us the extent to which all of the proved undeveloped locations are part of a development plan that has been adopted by your management, including approval by your Board of Directors, if such approval is required, and is current as of December 31, 2016.
Conversion of PUDs

The SEC staff requests that registrants with a large percentage of proved reserves classified as PUDs provide additional information about the amount and percentage of PUDs that were converted to developed reserves over the past several years. When the historical conversion rates are less than 20%, the SEC staff may challenge whether the registrant will be able to execute plans to develop PUDs within the five-year guideline.

Example SEC staff comment: PUD conversion

We note that during 2015, you converted about 10% of the PUD reserves available at year-end 2014 to developed status. In the years ended 2012-2015 (9%, 19%, 17% and 10%, respectively), it appears that your four-year cumulative conversion is about 55%. In part, the Glossary of FASB ASC Section 932-235-20 defines “proved undeveloped oil and gas reserves” with “undrilled locations can be classified as having undeveloped reserves only if a development plan has been adopted indicating that they are scheduled to be drilled within five years, unless the specific circumstances justify a longer time.” We would expect a five-year development plan to result in annual conversions averaging about 20%. Please explain the reasons for these low conversions.

The SEC staff has asked registrants to expand disclosures about the cost to develop PUDs. Additionally, the SEC staff has inquired about the effects of expected reductions in capital spending on PUD development plans and challenged expected development cost assumptions in the standardized measure of discounted future net cash flows when these assumptions deviate significantly from historical results.

Example SEC staff comments: PUD conversion costs

We note your disclosure indicating that in preparing your 2017 capital expenditure budget of approximately $50 million, you had assumed there would be an improvement in commodity prices by the summer of 2017, although you also indicate that if commodity prices stayed at current levels or declined further, your capital expenditure budget could be reduced to approximately $20 million. You also disclose that substantially all of the $20 million would be spent on completing previously drilled wells in the XYZ Field in the ABC region and that these wells were classified as proved developed non-producing as of December 31, 2016. Please tell us and expand your disclosure to explain how your development plan schedules comply with the timeframe stipulated in Rule 4-10(a)(31)(ii) of Regulation S-X, regarding the proved undeveloped reserves that you have disclosed as of December 31, 2016.
**Expiring acreage**

Item 1208(b) of Regulation S-K requires disclosures under appropriate captions in SEC filings about undeveloped acreage, both leases and concessions, including, if material, the minimum remaining terms of leases and concessions. When a registrant has a significant number of lease expirations in the near term, the SEC staff frequently asks whether there are significant PUD reserves associated with those properties and whether they will be developed prior to lease expiration.

<table>
<thead>
<tr>
<th>Example SEC staff comment: PUDs and expiring acreage</th>
</tr>
</thead>
<tbody>
<tr>
<td>You disclose that leases for 25% of your undeveloped acreage will expire in 2017. Please tell us the extent to which your proved undeveloped reserves are attributed to acreage having expiration dates that precede the scheduled date for initial development, and explain how you expect to forestall the expiry of such acreage.</td>
</tr>
</tbody>
</table>
In this supplement, we analyze trends in SEC staff comment letters related to the life sciences industry. The following table summarizes the topics the SEC staff focused on most often in comment letters sent to life sciences registrants. Many of these topics are frequent areas of comment in letters received by registrants in other industries and are covered in the rest of this publication.

<table>
<thead>
<tr>
<th>Comment area</th>
<th>Comment rank for the 12 months ended 30 June*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Management’s discussion and analysis</td>
<td>1</td>
</tr>
<tr>
<td>Non-GAAP financial measures</td>
<td>2</td>
</tr>
<tr>
<td>Revenue recognition</td>
<td>3</td>
</tr>
<tr>
<td>Segment reporting</td>
<td>4</td>
</tr>
<tr>
<td>Fair value measurements***</td>
<td>5</td>
</tr>
</tbody>
</table>

* Based on comment letter topics assigned by research firm Audit Analytics for SEC comment letters issued to registrants related to Forms 10-K from 1 July 2015 through 30 June 2017.

** This topic was not in the top five comment areas in 2016.

*** This category includes SEC staff comments on fair value measurements under ASC 820 as well as fair value estimates, such as those related to revenue recognition, stock compensation and goodwill impairment analyses. The SEC staff may have commented on more than one topic in a letter.

This supplement focuses on comment areas that are unique to life sciences registrants. It should be read in conjunction with the topics in the main section that also may contain relevant information to registrants in the life sciences industry.

In its comments, the SEC staff may request additional information about a topic and compliance with SEC rules or accounting literature. However, the SEC staff comments are based on the registrant’s facts and circumstances, including judgments about materiality. This supplement can help companies identify the SEC staff's areas of focus, but registrants should also consider significance to investors when including disclosures in their filings.
Milestone method of revenue recognition

**Summary of issues noted**
The SEC staff continues to ask life sciences registrants to expand disclosures about each research and development (R&D) arrangement for which they recognize revenue from one or more milestone payments in accordance withASC 605-28.

**Analysis of current issues**
Life sciences registrants often enter into arrangements to provide research or development deliverables in which one or more payments are contingent on the achievement of uncertain future events or conditions called milestones. Life sciences registrants may elect to recognize a milestone payment in its entirety in the period in which the milestone is achieved if the milestone meets all criteria to be considered substantive inASC 605-28-25-2. The SEC staff may request that life sciences registrants provide further analysis about how they have accounted for milestone arrangements.

ASC 605-28-50-2(b) requires disclosures at the individual milestone level. As a result, the SEC staff may question the adequacy of disclosures about each arrangement and each milestone. Many life sciences registrants, especially those with multiple arrangements and numerous milestones within each arrangement, may prefer to include disclosures on an aggregated basis in an effort to improve their usefulness. While SEC staff comments and responses indicate that the staff believes disclosure of each milestone is required, it has not objected to aggregated disclosures in certain cases. In these cases, life sciences registrants have asserted that individual milestones are not material, and information on an aggregated basis is more useful to users of the financial statements.

**Example SEC staff comment: Milestone method of revenue recognition**
For each of your collaboration agreements under which you are eligible to receive future milestone payments, please provide us the amount of each milestone payment and a description of its triggering event. Please also explain how you considered the disclosure guidance inASC 605-28-50 for those arrangements that include milestone consideration.

**EY resources**
Technical Line, *Aggregating milestone method disclosures may sometimes be appropriate* (SCORE No. BB2264), January 2012
Other industries

The following tables summarize the topics the SEC staff focused on most often in comment letters sent to registrants in several other industries. Many of these topics are frequent areas of comment in letters received by registrants that are covered in the rest of this publication.

**Aerospace and defense industry**

<table>
<thead>
<tr>
<th>Comment area</th>
<th>2017</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Management’s discussion and analysis</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>Segment reporting</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>State sponsors of terrorism</td>
<td>3</td>
<td>**</td>
</tr>
<tr>
<td>Inventory, vendor and/or cost of sales</td>
<td>4</td>
<td>**</td>
</tr>
<tr>
<td>Executive compensation plan disclosure</td>
<td>5</td>
<td>**</td>
</tr>
</tbody>
</table>

**Automotive industry**

<table>
<thead>
<tr>
<th>Comment area</th>
<th>2017</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-GAAP financial measures</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>Management’s discussion and analysis</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>Income taxes</td>
<td>3</td>
<td>**</td>
</tr>
<tr>
<td>Liabilities, payables and accrual estimates</td>
<td>4</td>
<td>**</td>
</tr>
<tr>
<td>Foreign (affiliate or subsidiary) matters</td>
<td>5</td>
<td>**</td>
</tr>
</tbody>
</table>

**Airlines industry**

<table>
<thead>
<tr>
<th>Comment area</th>
<th>2017</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-GAAP financial measures</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>State sponsors of terrorism</td>
<td>2</td>
<td>5</td>
</tr>
<tr>
<td>Signatures, exhibits and agreements</td>
<td>3</td>
<td>**</td>
</tr>
</tbody>
</table>

**Health industry**

<table>
<thead>
<tr>
<th>Comment area</th>
<th>2017</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-GAAP financial measures</td>
<td>1</td>
<td>**</td>
</tr>
<tr>
<td>Management’s discussion and analysis</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>Segment reporting</td>
<td>3</td>
<td>**</td>
</tr>
<tr>
<td>Revenue recognition</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>Income taxes</td>
<td>5</td>
<td>**</td>
</tr>
</tbody>
</table>
# Retail and consumer products industry

<table>
<thead>
<tr>
<th>Comment area</th>
<th>Comment rank for the 12 months ended 30 June*</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2017</td>
</tr>
<tr>
<td>Management’s discussion and analysis</td>
<td>1</td>
</tr>
<tr>
<td>Non-GAAP financial measures</td>
<td>2</td>
</tr>
<tr>
<td>Segment reporting</td>
<td>3</td>
</tr>
<tr>
<td>Revenue recognition</td>
<td>4</td>
</tr>
<tr>
<td>Fair value measurements*</td>
<td>5</td>
</tr>
</tbody>
</table>

# Media and entertainment industry

<table>
<thead>
<tr>
<th>Comment area</th>
<th>Comment rank for the 12 months ended 30 June*</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2017</td>
</tr>
<tr>
<td>Non-GAAP financial measures</td>
<td>1</td>
</tr>
<tr>
<td>Management’s discussion and analysis</td>
<td>2</td>
</tr>
<tr>
<td>Segment reporting</td>
<td>3</td>
</tr>
<tr>
<td>Acquisitions, mergers and business combinations</td>
<td>4</td>
</tr>
<tr>
<td>Income taxes</td>
<td>5</td>
</tr>
</tbody>
</table>

# Mining and metals industry

<table>
<thead>
<tr>
<th>Comment area</th>
<th>Comment rank for the 12 months ended 30 June*</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2017</td>
</tr>
<tr>
<td>Mining reserves</td>
<td>1</td>
</tr>
<tr>
<td>Non-GAAP financial measures</td>
<td>2</td>
</tr>
<tr>
<td>Asset sales, disposals, divestures and reorganization issues</td>
<td>3</td>
</tr>
<tr>
<td>Management’s discussion and analysis</td>
<td>4</td>
</tr>
<tr>
<td>Property, plant and equipment</td>
<td>5</td>
</tr>
</tbody>
</table>

# Power and utilities industry

<table>
<thead>
<tr>
<th>Comment area</th>
<th>Comment rank for the 12 months ended 30 June*</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2017</td>
</tr>
<tr>
<td>Non-GAAP financial measures</td>
<td>1</td>
</tr>
<tr>
<td>Fair value measurements*</td>
<td>2</td>
</tr>
<tr>
<td>Intangible assets and goodwill</td>
<td>3</td>
</tr>
<tr>
<td>Management’s discussion and analysis</td>
<td>4</td>
</tr>
<tr>
<td>Executive compensation</td>
<td>5</td>
</tr>
</tbody>
</table>
### Technology industry

<table>
<thead>
<tr>
<th>Comment area</th>
<th>Comment rank for the 12 months ended 30 June*</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2017</td>
</tr>
<tr>
<td>Non-GAAP financial measures</td>
<td>1</td>
</tr>
<tr>
<td>Management's discussion and analysis</td>
<td>2</td>
</tr>
<tr>
<td>State sponsors of terrorism</td>
<td>3</td>
</tr>
<tr>
<td>Income taxes</td>
<td>4</td>
</tr>
<tr>
<td>Revenue recognition</td>
<td>5</td>
</tr>
</tbody>
</table>

* This category includes SEC staff comments on fair value measurements under ASC 820 as well as fair value estimates, such as those related to revenue recognition, stock compensation and goodwill impairment analyses. The SEC staff may have commented on more than one topic in a letter.

** This topic wasn’t in the top five comment areas in 2016.

### Telecommunications industry

<table>
<thead>
<tr>
<th>Comment area</th>
<th>Comment rank for the 12 months ended 30 June*</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2017</td>
</tr>
<tr>
<td>Non-GAAP financial measures</td>
<td>1</td>
</tr>
<tr>
<td>Management's discussion and analysis</td>
<td>2</td>
</tr>
<tr>
<td>State sponsors of terrorism</td>
<td>3</td>
</tr>
<tr>
<td>Segment reporting</td>
<td>4</td>
</tr>
<tr>
<td>Depreciation, depletion and amortization reporting issues</td>
<td>5</td>
</tr>
</tbody>
</table>

* This category includes SEC staff comments on fair value measurements under ASC 820 as well as fair value estimates, such as those related to revenue recognition, stock compensation and goodwill impairment analyses. The SEC staff may have commented on more than one topic in a letter.

** This topic wasn’t in the top five comment areas in 2016.
This supplement should be read in conjunction with the topics in the main section and other appendices that may be relevant to a company's IPO registration statement filing.

The following chart summarizes the top 10 most frequent comment areas related to registration statements on Form S-1 in the current and previous years:

<table>
<thead>
<tr>
<th>Comment area</th>
<th>Comment rank for the 12 months ended 30 June</th>
<th>Comments as % of total registrants that received comment letters*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Management's discussion and analysis</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Risk factors</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Signatures, exhibits and agreements</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>Terms of the Offering</td>
<td>4</td>
<td>**</td>
</tr>
<tr>
<td>Use of proceeds and dilution disclosures</td>
<td>5</td>
<td>5</td>
</tr>
<tr>
<td>Pro forma financial information</td>
<td>6</td>
<td>9</td>
</tr>
<tr>
<td>Debt, warrants and equity security issues</td>
<td>7</td>
<td>10</td>
</tr>
<tr>
<td>Fair value measurements**</td>
<td>8</td>
<td>**</td>
</tr>
<tr>
<td>Executive compensation</td>
<td>9</td>
<td>7</td>
</tr>
<tr>
<td>Non-GAAP financial measures</td>
<td>10</td>
<td>**</td>
</tr>
</tbody>
</table>

* Based on comment letter topic taxonomy, excluding topics related to the terms of the offering or general updating of prospectus information, according to research firm Audit Analytics for SEC comment letters issued to companies on their Form S-1 registration statements from 1 July 2015 through 30 June 2017.

** This topic wasn't in the top five comment areas in 2016.

*** This category includes SEC staff comments on fair value measurements under ASC 820 as well as fair value estimates, such as those related to revenue recognition, stock compensation and goodwill impairment analyses. The SEC staff may have commented on more than one topic in a letter.

This supplement excludes SEC staff comments or trends related to several of these comment areas that are discussed elsewhere in this publication. It discusses specific matters and topics that the SEC staff has raised in comments related to IPO registration statements, including matters related to stock compensation, pro forma financial information and disclosure and filing requirements of emerging growth companies.

In its comments, the SEC staff has requested additional information about the related topic and compliance with SEC rules or accounting literature. However, the SEC staff comments vary based on facts and circumstances, including judgments about materiality. This supplement can help companies identify the SEC staff's areas of focus, but companies should also consider significance to investors when including disclosure in their filings.
Summary of issues noted
The SEC staff has continued to ask registrants for information to support their valuations underlying share-based payment awards, especially when the fair value of the company’s pre-IPO common stock is significantly less than the expected IPO price.

Analysis of current issues
One of the key accounting issues in many IPO transactions is the valuation of equity securities (including stock options) issued as compensation while a company is privately held. In many cases, the estimated fair value of equity securities granted in the months before the IPO is significantly less than the IPO price. As a result, the SEC staff may question pre-IPO fair value estimates and adequacy of the related disclosures in the financial statements and MD&A.

Example SEC staff comment: Valuation of pre-IPO equity securities
Please reconcile and explain any difference between the fair value of the underlying units recently granted by your Board of Directors and the midpoint of your estimated IPO offering range. This reconciliation should describe significant intervening events within the company and changes in assumptions as well as weighting and selection of valuation methodologies employed that explain the changes in the fair value of your common unit up to the filing of the registration statement.

The SEC’s Financial Reporting Manual (FRM) states that companies should disclose all of the following information on share-based compensation in the financial statements included in an IPO filing:

- The methods used to determine the fair value of the company’s shares and the material assumptions used in determining the fair value
- The extent to which such estimates are considered highly complex and subjective
- That such estimates will not be necessary for new awards once the shares begin trading

Companies should discuss the material assumptions used and describe the methodology and judgments used, highlighting that they may be complex and subjective.

However, the FRM states that, while the SEC staff may issue comments to help it understand unusual valuations, the staff will not expect expanded disclosure in MD&A about the underlying events and business developments that affected such valuations.

The SEC staff expects registrants to support judgments and estimates about the fair value of their securities anytime they grant significant share-based payments. The AICPA’s Accounting and Valuation Guide, Valuation of Privately-Held-Company Equity Securities Issued as Compensation (the Guide), provides a framework and best practices for valuing private company securities. The SEC staff expects privately held companies contemplating IPOs to apply the Guide’s valuation guidance when granting share-based payments.
The Guide recommends that private companies obtain contemporaneous valuations from independent valuation specialists to determine the fair value of securities issued as compensation. The SEC staff frequently has asked about estimates of the fair value of share-based payments issued before the IPO, even if a contemporaneous independent valuation has been obtained. Accordingly, a well-documented timeline of significant intervening events, along with contemporaneous valuations supporting grants throughout the 12-month period before an IPO, can help a registrant support its judgments and assumptions.

The SEC staff expects private companies to consider other relevant data points when valuing equity securities. For example, private companies may sell equity securities to third parties, or employees and other stockholders may sell shares in secondary markets. The SEC staff expects registrants to provide an analysis of the weightings assigned to any stock sale transactions on or before the valuation date.

**EY resources**

Financial reporting developments, Share-based payment (SCORE No. BB1172), October 2016

Best practices when going through the IPO registration process (SCORE No. 02281-161US), August 2016
Pro forma financial information in IPO registration statements

Summary of issues noted
Certain circumstances related to IPOs may warrant the presentation of pro forma financial information on the face of the financial statements included in the IPO registration statement. In these situations, the SEC staff has asked registrants about how they have considered the need to present pro forma information in light of the SEC staff’s guidance.

Analysis of current issues
When IPO proceeds are used to pay dividends to the issuer’s prior owners, promoters and/or parents, SAB Topic 1.B.3 requires registrants to evaluate whether they are required to present pro forma EPS or a pro forma balance sheet on the face of the financial statements included in the IPO filing. Registrants should provide a pro forma balance sheet alongside the historical financial statements to reflect an accrual, with an offsetting amount to retained earnings if the dividends are not reflected in the latest balance sheet. In addition, the SAB Topic requires pro forma EPS if dividends paid at or before the closing of an IPO are greater than the earnings for the most recent year.

The SEC staff has also commented on the application of the SAB Topic when the registrant has paid dividends during the 12 months before the offering or disclosed its intent to pay dividends using IPO proceeds.

Example SEC staff comment: SAB Topic 1.B.3
We note that as part of your use of the net proceeds from this offering you intend to make a distribution to shareholders. Please explain to us what consideration you gave to providing a pro forma balance sheet alongside your latest historical balance sheet reflecting the distribution accrual (but not giving effect to the full offering proceeds) and providing pro forma earnings per share information giving effect to the number of shares whose proceeds would be necessary to pay the distribution. Reference is made to SAB Topic 1.B.3.

Registrants also may be required to present pro forma EPS or a pro forma balance sheet in connection with an IPO when there are material changes in capital structure or tax status or when IPO proceeds will be used to extinguish debt.

EY resources
Financial reporting developments, Earnings per share (SCORE No. BB1971), July 2016
Pro forma financial information – A guide for applying Article 11 of Regulation S-X (SCORE No. 04126-161US), December 2016
Best practices when going through the IPO registration process (SCORE No. 02281-161US), August 2016
Summary of issues noted
Since the enactment of the Jumpstart Our Business Startups Act (JOBS Act) in 2012, which created a new category of issuer called an emerging growth company, EGCs have taken advantage of the scaled disclosures in their IPO registration statements. The SEC staff has asked EGCs about their disclosures and filing requirements, including:

- Discussion of EGC status and elections made under the EGC provisions of the JOBS Act
- Submission of “test-the-waters” communications

Analysis of current issues
The SEC staff continues to ask EGCs to include additional disclosures about elections made under the EGC provisions and related risk factors. For example, if applicable, an EGC should disclose its election to opt out of any extended transition period to comply with new or revised accounting standards as if it were a privately held company (i.e., elect to follow public company effective dates) and that such election is irrevocable. Conversely, if the registrant elects to retain the option to use the extended transition period to comply with new or revised accounting standards, the SEC staff expects the registrant to include a risk factor stating that in the future its financial statements may not be comparable to companies complying with public company effective dates.

Example SEC staff comment: Emerging growth companies
Since you appear to qualify as an “emerging growth company,” as defined in the Jumpstart Our Business Startups Act, please revise your prospectus to provide the following additional disclosures:

- Describe how and when a company may lose emerging growth company status;
- a brief description of the various exemptions that are available to you, such as exemptions from Section 404(b) of the Sarbanes-Oxley Act of 2002 and Section 14A(a) and (b) of the Securities Exchange Act of 1934; and your election under Section 107(b) of the Act:
  - If you have elected to opt out of the extended transition period for complying with new or revised accounting standards pursuant to Section 107(b) of the JOBS Act, include a statement that the election is irrevocable; or
  - If you have elected to use the extended transition period for complying with new or revised accounting standards under Section 102(b)(2)(B) of the JOBS Act, provide a risk factor explaining that this election allows you to delay the adoption of new or revised accounting standards that have different effective dates for public and private companies until those standards apply to private companies. Please state in your risk factor that, as a result of this election, your financial statements may not be comparable to companies that comply with public company effective dates. Include a similar statement in your critical accounting policy disclosures in MD&A.
In addition, the JOBS Act permits an EGC to “test the waters” by communicating with certain institutional buyers and accredited investors before or after it files its registration statement. The SEC staff often requests EGCs to provide copies of all written testing-the-waters communications to evaluate whether the information is materially consistent with the information disclosed in the registration statement. Such materials can be submitted in hard copy rather than electronically via EDGAR, and registrants should consult with their legal counsel about how to request confidential treatment under Rule 83 for any materials submitted.

**EY resources**


Update on emerging growth companies and the JOBS Act (SCORE No. 03814-161US), November 2016

Best practices when going through the IPO registration process (SCORE No. 02281-161US), August 2016
Appendix C: Foreign private issuers

The SEC staff’s comments to foreign private issuers (FPIs) often are similar to its comments to domestic registrants.

Many of the topics in the main and industry supplement sections of this publication are relevant for FPIs and are not discussed at length here. They include:

- Non-GAAP financial measures
- MD&A matters, including critical accounting estimates, results of operations and liquidity
- Consolidation, including variable interest entities
- Fair value measurements
- Income taxes, including deferred tax assets and foreign earnings
- Operating items, including revenue recognition, hedging and impairment
- Segment reporting

The following chart summarizes the 10 most frequent comment areas in 2017 on annual reports on Form 20-F compared with the 2016 results:

<table>
<thead>
<tr>
<th>Comment area</th>
<th>Comment rank for the 12 months ended 30 June</th>
<th>Comments as % of total registrants that received comment letters*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Management’s discussion and analysis</td>
<td>1</td>
<td>1</td>
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<tr>
<td>Non-GAAP financial measures</td>
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<td></td>
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<tr>
<td>Fair value measurements***</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>State sponsors of terrorism</td>
<td>4</td>
<td>4</td>
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<tr>
<td>Fixed assets</td>
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<td>Segment reporting</td>
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<tr>
<td>Oil and gas and mining reserves</td>
<td>7</td>
<td>8</td>
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<tr>
<td>Intangible assets and goodwill</td>
<td>8</td>
<td>10</td>
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<tr>
<td>Consolidation</td>
<td>9</td>
<td>5</td>
</tr>
<tr>
<td>Revenue recognition</td>
<td>10</td>
<td></td>
</tr>
</tbody>
</table>

* Based on comment letter topics assigned by research firm Audit Analytics for SEC comment letters issued to registrants related to their annual reports on Form 20-F from 1 July 2015 through 30 June 2017.

** This topic was not in the top 10 comment areas in 2016.

*** This category includes SEC staff comments on fair value measurements under ASC 820 and IFRS 13, *Fair Value Measurement*, as well as fair value estimates, such as those related to revenue recognition, stock compensation and goodwill impairment analyses. An SEC staff comment may address multiple comment areas in this chart.

Below are matters that the SEC staff has raised in comments to FPIs, some of which, such as non-GAAP financial measures and activities with countries designated as state sponsors of terrorism, are not unique to FPIs.
Non-GAAP financial measures

Summary of issues noted

Non-GAAP financial measures continue to be an area of significant focus of the SEC staff, and it is now the second most frequent comment area in this year’s top 10 list for FPIs. Since the SEC staff updated its Compliance and Disclosure Interpretations on the use of non-GAAP financial measures in May 2016, the staff has challenged FPIs on their compliance with these interpretations, particularly on matters relating to their recognition and measurement methods.

In addition, the SEC staff has questioned whether FPIs that apply IFRS have disclosed financial measures in their filings that are required or expressly permitted by their other local accounting and disclosure standards. If they are, the non-GAAP (i.e., non-IFRS for FPIs reporting under IFRS) measures may be presented under a Regulation G and S-K Item 10(e) exemption without significant additional disclosure. Otherwise, the SEC staff has challenged the usefulness and prominence of those non-GAAP financial measures, reminding FPIs that non-GAAP measures must not be shown with greater prominence than the comparable GAAP measures.

Analysis of current issues

When an FPI presents non-GAAP financial measures and it is unclear whether they qualify for the Regulation G and Item 10(e) exemption, the SEC staff asks the registrant to address the following:

- Whether the measure is required or permitted by local accounting and disclosure standards
- The literature that the FPI relied on to conclude that its local accounting and disclosure standards either require or permit disclosing the measure
- When permitted, the economic substance behind management’s decision to disclose the measure

We expect the SEC staff to question the compliance with IAS 1 of additional measures presented on the face of IFRS financial statements that would otherwise be considered non-GAAP measures under Regulation G and Item 10(e) of Regulation S-K.

When a non-GAAP financial measure does not qualify for the exemptions under Regulation G and S-K Item 10(e), the SEC staff has asked FPIs about whether the measure provides useful information to investors about the entity’s financial condition and results. The SEC staff has also questioned FPIs about the appropriateness of the reconciliation to the most directly comparable measure under the accounting framework (i.e., US GAAP or IFRS) the FPI is using.

The SEC staff also evaluates all non-GAAP items, including those expressed as percentages or per-share amounts and questions their labeling if it is inconsistent with the nature of the adjustments to GAAP measures.
Example SEC staff comment: Reconciliation of non-GAAP measure

We note you present the measure “Income on transportation before loss from revaluation of vessels” here and elsewhere in your filing. This appears to be a non-IFRS measure, and therefore is subject to the presentation and disclosure requirements of Item 10(e) of Regulation S-K. Specifically, in future filings, please present the most directly comparable IFRS measure with equal or greater prominence, a reconciliation to the most directly comparable IFRS measure, and a discussion of the measure’s usefulness to investors.

For further discussion, refer to the Non-GAAP financial measures discussion in the SEC reporting issues section of this publication.

EY resources

Technical Line, Spotlight on non-GAAP financial measures (SCORE No. 00785-161US), April 2016

To the Point, SEC staff updates guidance on non-GAAP financial measures (SCORE No. 01108-161US), May 2016

2016 SEC annual reports - Form 10-K (SCORE No. 03265-161US), November 2016

Technical Line, A closer look at the SEC’s staff scrutiny of non-GAAP financial disclosures (SCORE No. 03290-161US), October 2016

2016 SEC annual reports – Form 10-K (SCORE No. 03265-161US), November 2016
Appendix C: Foreign private issuers

Summary of issues noted
The United Kingdom (UK) is negotiating the terms of its exit from the European Union (EU) following a 2016 referendum in which the British people voted to leave the EU. The UK now has until 29 March 2019 to leave the EU, unless the negotiations are extended by unanimous consent of the European Council.

The UK’s exit from the EU, known as Brexit, may have long-term implications for registrants that have operations in the UK and/or investments in UK entities. Entities with significant UK or EU exposure need to consider whether they need to make additional disclosures in their financial statements or in other parts of their SEC reports to address the current and future implications of Brexit. In addition, because market volatility stemming from Brexit has extended beyond the UK and EU, even entities without exposure to the UK or EU may need to consider the accounting and financial reporting implications.

Given the significance of this event, we believe the SEC staff might look for additional disclosures from registrants in their filings.

Analysis of current issues
SEC reporting considerations
We expect the SEC staff to consider the adequacy of FPIs’ disclosures related to Brexit in MD&A and other sections of their SEC filings, especially for companies in industries such as banking and financial services, food and hospitality, manufacturing, airlines and the automotive industry. Companies may need to make additional disclosures to describe changes in foreign operations materially affected by these developments, including the following:

- Disclosures of risk factors should be updated for new or materially changed exposures, including direct and indirect effects of Brexit.
- Market risk disclosures required under Item 305 of Regulation S-K may need to be updated to help users of the financial statements understand material changes to the quantitative and qualitative information presented.
- Known trends or uncertainties related to the effects of declines in market prices or foreign currency exchange rates should be clearly disclosed in MD&A.
- Disclosures about critical accounting estimates may need to be supplemented with additional quantitative and qualitative information describing the uncertainty associated with fair value estimates.

Updated disclosures should be tailored to the registrant’s facts and circumstances. That is, they should discuss the affected foreign operations and the effects on the registrant’s operations, liquidity and financial position. For example, unless the registrant determines that a material trend or uncertainty is reasonably likely to occur, it must assume that the uncertainty will occur and disclose that item in MD&A unless it would not be reasonably likely to have a material effect.
Material changes in the sensitivity of reasonably likely outcomes related to goodwill, intangible assets and property, plant and equipment impairment assumptions for at-risk reporting units could warrant additional disclosure. Cash flow forecasts used in value-in-use calculations should be based on the most recent budgets and forecasts, taking into account Brexit-related uncertainties. For finite-lived assets, these uncertainties could trigger impairment reviews of assets that are not regularly tested for impairment. Using appropriate assumptions is also important for assessing the net realizable value of inventories and determining whether loans and receivables and other investments, including those in investees and joint ventures, are impaired.

**Foreign currency matters**

Given the uncertainties related to changes in British pound exchange rates, the SEC staff may challenge FPIs’ disclosures of the currency risk exposure in the financial statements and in the business, risk factors and MD&A sections of SEC filings.

**Income taxes**

Brexit may have numerous implications for income tax accounting due to possible changes in operating and legal structures and changes in tax treaties and tax laws. It gives rise to uncertain tax positions as it raises significant uncertainty about how the existing tax laws will apply after Brexit.

Brexit has also raised uncertainty about the future tax status of entities, which may lead to changes in their accounting treatment. Tax legislation in EU member states and other countries contains tax exemptions and tax reliefs (e.g., withholding tax and merger relief) that depend on whether the entities involved are EU domiciled. Once the UK leaves the EU, these exemptions and reliefs may no longer apply to transactions between UK entities and entities that remain in the EU. Hence, additional tax liabilities may crystallize. It is uncertain which of these exemptions and reliefs will be renegotiated as part of Brexit.

**EY resources**


Financial reporting developments, Foreign currency matters (SCORE No. BB2103), June 2017

Financial reporting developments, Income taxes (SCORE No. BB1150), October 2016

The impact of Brexit on corporate reporting, Considerations for preparers and audit committees (SCORE No. EY-000034506-01), July 2017
Summary of issues noted
The SEC staff frequently asks FPIs to provide additional information about business activities in or with countries identified by the US State Department as state sponsors of terrorism, which currently are Iran, Sudan and Syria. The SEC staff reviews different sources, including past filings and correspondence, news articles, company websites and press releases (checking information such as company location and contact listings) to identify registrants with operations in these countries. If an FPI has been identified as having any business operations in or with one of those countries, the SEC staff periodically (e.g., every year or two) asks for updates on those activities.

Analysis of current issues
US securities laws do not impose a specific disclosure requirement that addresses business activities in or with a country based on its designation as a state sponsor of terrorism. However, Rule 408 of Regulation C and Exchange Act Rule 12b-20 require a registrant to disclose additional information if it is material and necessary to make sure its filings are not misleading, given the registrant’s facts and circumstances. Because of these rules, the SEC staff frequently asks registrants to provide and, based on materiality, to disclose the following:

- The nature and extent of past, current and any anticipated operations in or with a country designated as a state sponsor of terrorism, whether through subsidiaries, partners, customers, affiliates, joint ventures, distributors, resellers or other direct or indirect arrangements
- Any services, products, information or technology provided to and agreements, commercial arrangements or other contracts entered with governments or entities controlled by the governments designated as state sponsors of terrorism
- Whether any of the technologies or materials provided or intended to be provided to a country designated as a state sponsor of terrorism are controlled items included in the US Department of Commerce’s Commerce Control List
- Whether operations in or with state sponsors of terrorism constitute a material risk in quantitative terms by discussing revenues, assets and liabilities associated with such operations and qualitative factors that a reasonable investor would deem important in making an investment decision, including any potential adverse effect on company reputation and share value

In addition to these requests for information, the Iran Threat Reduction and Syria Human Rights Act of 2012 amended the Securities Exchange Act of 1934 to require all issuers, both domestic filers and FPIs, to disclose in their annual and quarterly reports filed with the SEC whether they or their affiliates knowingly engaged in various prohibited activities involving Iran.
### Example SEC staff comment: Activities with countries designated as state sponsors of terrorism

Your Forms 6-K provide disclosure that you had revenues from Syria and Sudan. As you are aware, Syria and Sudan are designated by the US Department of State as state sponsors of terrorism and are subject to US economic sanctions and export controls. Please describe to us the nature and extent of your past, current and anticipated contacts with Syria and Sudan, whether through subsidiaries, distributors, resellers, affiliates or other direct or indirect arrangements. You should describe any products or services you have provided to Syria and Sudan, directly or indirectly, and any agreements, commercial arrangements or other contacts with the governments of those countries or entities they control.
Summary of issues noted

The SEC staff has questioned registrants’ disclosures of risks and uncertainties related to foreign operations, such as uncertainty regarding the status of Argentina as a highly inflationary economy or the effect of global economic sanctions against certain countries.

Analysis of current issues

Argentina

According to the International Monetary Fund’s April 2017 World Economic Outlook report, Argentina’s 2017 inflation rate is projected to be 22% and the cumulative three-year inflation rate is projected to be 103% at the end of 2017.

At the May 2017 International Practices Task Force meeting, the SEC staff noted that it has not observed objectively verifiable data that would indicate Argentina’s economy was highly inflationary at 31 December 2016. However, the SEC staff asked registrants to closely monitor the level of inflation in 2017, in combination with other pertinent factors and data points, in determining whether Argentina should be considered a highly inflationary economy.

Companies with significant operations in Argentina should include relevant disclosures in the risk factors and MD&A sections of their SEC filings, as appropriate.

Example SEC staff comment: Argentina

We note your disclosure regarding the monetary and nonmonetary assets located in Argentina. Please expand your disclosures as follows:

1. Clarify the nature of your operations in Argentina (e.g., manufacturing, importing, marketing) and the nature of the activities conducted between those operations and your non-Argentine operations.

2. Quantify the amount of monetary and nonmonetary assets in Argentina by significant asset grouping (e.g., cash, inventories, PP&E, intercompany accounts).

3. Clarify how the economic situation in Argentina impacts your liquidity, including the extent of intercompany receivables due from your Argentine subsidiaries, to the extent material.

4. Quantify the amount of foreign currency translation losses attributed to your Argentine operations that are included in other comprehensive income as of the latest balance sheet date.

Other foreign countries with uncertainties

Registrants with significant operations in foreign countries facing political or economic uncertainties should consider appropriate disclosures about the effects of these uncertainties on their operating results and risk factors, as required by Items 303 and 503(c) of Regulation S-K.

Sanctions against Russia and some other countries are examples of uncertainties that should be closely monitored. Although we have not yet seen many SEC staff comment letters related to registrants’ operations in those countries, we believe this may become a future area of focus. Registrants with significant operations in those countries should evaluate their facts and circumstances to determine whether additional disclosures are necessary.
The DCF of the SEC selectively reviews filings made under the Securities Act of 1933 and the Securities Exchange Act of 1934 to monitor and enhance compliance with disclosure and accounting requirements. In its filing reviews, DCF accountants concentrate on disclosures and accounting methods that may conflict with US GAAP or SEC rules or that may need clarification. Other DCF staff may review other aspects of SEC filings for compliance with the federal securities laws and regulations.

DCF performs its primary review responsibilities through 11 offices that each have specialized industry, accounting and disclosure expertise. DCF assigns public companies in a particular industry to one of these 11 Assistant Director Offices as shown below based upon their Standard Industrial Classification (SIC) code. Each company’s office assignment is listed in EDGAR within the basic company information that precedes the company’s filing history.

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<thead>
<tr>
<th>Office</th>
<th>Primary industries</th>
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</thead>
<tbody>
<tr>
<td>1</td>
<td>Healthcare and insurance</td>
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<tr>
<td>2</td>
<td>Consumer products</td>
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<tr>
<td>3</td>
<td>Information technologies and services</td>
</tr>
<tr>
<td>4</td>
<td>Natural resources</td>
</tr>
<tr>
<td>5</td>
<td>Transportation and leisure</td>
</tr>
<tr>
<td>6</td>
<td>Manufacturing and construction</td>
</tr>
<tr>
<td>7</td>
<td>Financial services</td>
</tr>
<tr>
<td>8</td>
<td>Real estate and commodities</td>
</tr>
<tr>
<td>9</td>
<td>Beverages, apparel and mining</td>
</tr>
<tr>
<td>10</td>
<td>Electronics and machinery</td>
</tr>
<tr>
<td>11</td>
<td>Telecommunications</td>
</tr>
</tbody>
</table>

The SEC’s Office of Disclosure Standards focuses on the effectiveness of DCF’s review program and the quality and consistency of comment letters.

**Required and selective review**

As required by the Sarbanes-Oxley Act of 2002, DCF staff reviews, at some level, every registrant at least once every three years, but it reviews many registrants more frequently. In addition, DCF staff generally reviews all IPOs and Form 8-K Items 4.01 and 4.02 and selectively reviews other transactional filings, such as those made in connection with business combination transactions, proxy statements or other public offerings. DCF staff publicly sends “no-review” letters when it has not selected an issuer’s registration statement for review.

In many cases, DCF staff conducts a preliminary review before determining what level of further review to conduct, as discussed below. Prior to issuing comments, DCF staff considers all public information such as company websites, press releases and analyst calls in addition to the content of the filing.
The SEC staff has reviewed over 50% of registrants each year since 2013. The following graph summarizes the percentage of registrants reviewed in each of the last five years:

![Percent of issuers reviewed graph](attachment:image)

*Source: SEC 2016 Annual Performance Report*

In addition, the SEC staff has sent the majority of its comment letters to larger public companies, as illustrated below:

![Size of registrants receiving comment letters on Form 10-K filings](attachment:image)

*Source: Audit Analytics – Comment letters issued related to Forms 10-K for the 12-month period ended 30 June 2017*

**Levels of review**

If DCF staff selects a filing for review, the extent of that review will depend on many factors. The level of review may be:

- A full cover-to-cover review in which DCF staff examines the entire filing for compliance with the applicable requirements of the federal securities laws and regulations
- A financial statement review in which DCF staff examines the financial statements and related disclosures, such as MD&A, for compliance with the applicable accounting standards and SEC disclosure requirements

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8 This graph shows the size (based on public float) of companies that received comment letters on Form 10-K filings during the 12 months ended 30 June 2017. However, the SEC staff may not send a comment letter to every registrant that it reviews.
A targeted issue review in which DCF staff examines one or more specific items of disclosure in the filing for compliance with the applicable accounting standards or the disclosure requirements of the federal securities laws and regulations. DCF staff may not always inform registrants of the type of review performed (such as a target review or a full review), but it will focus on what it considers necessary in the company’s circumstances. When DCF staff believes that a registrant can enhance its disclosure or improve its compliance with the applicable disclosure requirements, it makes comments in a letter to the registrant. The range of possible comments is broad and depends on the issues that arise in a particular filing review. DCF staff completes many filing reviews without issuing any comments. In those cases, the registrant will not be notified that its SEC filing was reviewed.

In addition to an initial reviewer, at least one other more senior DCF staff member typically reviews a filing and proposed comments. This second-level review is intended to enhance quality and consistency across filing reviews.

**DCF staff comments**

DCF staff views the comment process as a dialogue with a registrant about its disclosures. DCF staff’s comments are in response to a registrant’s disclosures and other public information and are based on DCF staff’s understanding of that registrant’s facts and circumstances. At the time of the initial comment letter, DCF staff may be seeking additional information and may not have concluded that there is a deficiency or that additional disclosure is necessary.

In its comments, DCF staff may request that a registrant (1) provide additional supplemental information in a response letter so it can better evaluate the registrant’s disclosure, (2) amend its SEC filing to revise or supplement its disclosures or (3) provide additional or different disclosures in a future filing with the SEC.

**Best practices for registrant responses to comments**

A registrant generally responds to the SEC comment letter by sending a letter back to DCF staff. When responding to DCF staff comment letters, registrants should consider the following:

- Responses to each comment should focus on the question(s) asked by the SEC staff, and those responses should cite authoritative literature wherever possible.
- Responses should address the registrant’s unique facts and circumstances. While it may be helpful to consider response letters from other registrants as a resource, registrants should not just copy responses made by other registrants to similar comments.
- Registrants should file all response letters on EDGAR redacting any specific information for which they are seeking confidential treatment.
- If revisions are being made to a filing as a result of a comment from DCF staff, responses should indicate specifically where these revisions are being made. If additional disclosure will be included in a future filing, it may be helpful for the registrant to provide the proposed language in their response letter to avoid an additional comment once the disclosure is filed.
Companies should seek the input of all appropriate internal personnel and professional advisers (such as legal counsel and independent auditors) so that they fully respond to the comment letter in a complete and accurate manner. Waiting for a later round of comments to involve the necessary resources may delay or hinder a successful resolution.

A registrant should not assume that because DCF staff has issued a comment that it disagrees with the registrant’s disclosures or accounting treatment. Providing a thorough explanation or analysis of an issue to DCF staff beyond the existing disclosure may help DCF staff better understand the accounting and disclosure, and it often will resolve the comment. To facilitate such responses, registrants should maintain contemporaneous documentation of significant accounting and disclosure decisions. Judgment applied and documented contemporaneously is more persuasive than a retrospective defense following receipt of a DCF staff comment.

Depending on the nature of the issue, DCF staff’s concerns and the registrant’s response, DCF staff may issue more comments following its review of the registrant’s response. This comment and response process continues until the DCF staff and the registrant resolve all comments.

The following graph shows the number of comment letters (or rounds) that were issued by the SEC staff for reviews completed during the 12 months ended 30 June 2017:

![Number of comment letters issued to complete review](image)

The majority of reviews are closed after one or two comment letters, which shows that a well-organized process for responding to SEC staff comments can minimize the amount of back and forth with the SEC staff.

Comment letters from DCF staff on certain filings often request a written response within 10 business days. If a registrant needs more time to respond, it should contact the DCF staff, which is generally accommodating in granting extensions that will enhance the quality of the response letter. A registrant also may consider contacting the DCF staff if it needs additional clarification about a comment.

Proactive communication with DCF staff may expedite the comment letter process.
**Closing a filing review**

When a registrant has satisfactorily resolved all DCF staff’s comments on a filing, DCF staff provides the registrant with a “completion of review letter” to confirm that the SEC staff’s review is complete. To increase the transparency of the review process, after the DCF staff completes a filing review, it publicly releases its comment letters and registrant responses to those letters on the SEC’s EDGAR system no earlier than 20 business days after the review’s completion.

**Reconsideration process**

DCF staff and the registrant may ultimately disagree about an accounting or disclosure matter. A registrant should, in any instance it wishes, seek reconsideration of a comment by other SEC staff, including those within DCF’s Office of the Chief Accountant (DCF-OCA).

DCF staff members, at all levels, are available to discuss disclosure and financial statement presentation matters with a registrant and its legal, accounting and other advisers. A registrant may request that DCF staff reconsider a comment or reconsider a DCF staff member’s view of the registrant’s response at any point in the filing review process. DCF does not have a formal protocol for registrants to follow when seeking reconsideration; a request for reconsideration may be oral or written.

Registrants also may ask the SEC’s Office of the Chief Accountant (OCA), which is distinct from the DCF’s Office of the Chief Accountant (DCF-OCA), to reconsider an accounting conclusion of the DCF staff at any stage in the process. Generally, the SEC’s Office of the Chief Accountant addresses questions about the application of US GAAP while DCF resolves matters concerning the age, form and content of financial statements required to be included in a filing. Even before a registrant requests reconsideration, DCF staff may have consulted internally about the issue with DCF-OCA and then with OCA.

A registrant should initiate a reconsideration with OCA by informing the staff in DCF of its intention to request such reconsideration. In these circumstances, a registrant does not need to make a submission directly to OCA if all of the relevant information is contained in comment letter responses from the registrant to DCF, although a separate submission to OCA may serve to expedite the process.

**Disclosure requirements**

The SEC requires that all entities defined as an accelerated filer, a large accelerated filer or a well-known seasoned issuer disclose, in their annual reports on Form 10-K or Form 20-F, written comments DCF staff has made in connection with a review of Exchange Act reports that:

- The registrant believes are material
- 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 identify the substance of the unresolved comments. DCF staff comments that have been resolved, including those that DCF 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 such unresolved comments. This information is not required in the registrant’s quarterly reports on Form 10-Q.

**Requests for waivers, pre-clearance and interpretive guidance**

DCF staff has reminded registrants that it is better to “seek permission than ask for forgiveness” as it relates to SEC reporting. To help reduce the risk of being questioned in the comment process on a complicated reporting matter, registrants may “pre-clear” their questions regarding financial reporting and disclosure information with DCF staff by submitting a formal pre-clearance request in writing on a named basis. DCF staff generally responds in writing to formal requests made in writing on a named basis within 10 business days.

In thinking about facilitating capital formation, SEC Chairman Jay Clayton recently encouraged registrants to seek waivers from the DCF staff under Rule 3-13 of Regulation S-X. This may indicate expanded flexibility in how this rule is applied prospectively.

Under this rule when certain required financial statements are burdensome to generate but are not material in the total mix of information available to investors, registrants may request DCF staff permission to omit this information or submit alternative information that might be of comparable benefit to investors at a reduced cost in cases. DCF staff can waive certain periods required by rule 3-05, certain financial statements required by rule 3-09 financial statements or permit registrants to substitute full financial statements required under these rules with abbreviated financial statements. This rule does not allow DCF staff to waive US GAAP (or IFRS) requirements or other disclosure requirements.

Registrants also may request informal interpretive guidance from DCF staff on a named or no-named basis in a telephone call to DCF staff or in a request form for interpretive guidance and other assistance on the SEC’s website. Requests made by telephone or an online request form\(^9\) are informal and may remain anonymous; however, responses to such requests cannot be relied upon as formal positions of DCF staff.

In addition, companies may pre-clear conclusions on the application of US GAAP (or IFRS) with the Commission’s Office of the Chief Accountant. OCA staff encourages companies to consult on a pre-filing basis when the company is uncertain about accounting issues. Further discussion of the procedures for consulting with OCA is on the SEC’s website at [http://www.sec.gov/info/accountants/ocasubguidance.htm](http://www.sec.gov/info/accountants/ocasubguidance.htm).

\(^9\) The online request form is available at: [https://tts.sec.gov/cgi-bin/corp_fin_interpretive](https://tts.sec.gov/cgi-bin/corp_fin_interpretive).
## Appendix E: Abbreviations

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<th>Abbreviation</th>
<th>FASB Accounting Standards Codification</th>
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<td>ASC 210</td>
<td>FASB ASC Topic 210, Balance Sheet</td>
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<td>FASB ASC Topic 230, Statement of Cash Flows</td>
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<td>ASC 250</td>
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<td>FASB ASC Topic 320, Investments – Debt and Equity Securities</td>
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<td>FASB ASC Topic 350, Intangibles – Goodwill and Other</td>
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<td>FASB ASC Topic 350-20, Intangibles – Goodwill and Other – Goodwill</td>
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<td>FASB ASC Topic 606, Revenue Recognition – Revenue from Contracts with Customers</td>
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<td>ASC 932-235</td>
<td>FASB ASC Topic 932-235, Extractive Activities – Oil and Gas – Notes to Financial Statements</td>
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<tr>
<td>SAB Topic 14.D.1</td>
<td>SEC Staff Accounting Bulletin Topic 14.D.1, Share-Based Payment, Certain Assumptions Used in Valuation Methods, Expected Volatility</td>
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<tr>
<td>SAB Topic 14.F</td>
<td>SEC Staff Accounting Bulletin Topic 14.F, Share-Based Payment, Classification of Compensation Expense Associated with Share-Based Payment Arrangements</td>
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