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**DEVELOPMENTS  
IN THE  
DIVISION OF CORPORATION FINANCE  
National Conference on Current SEC & PCAOB Developments  
December 10, 2013**

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# Disclaimer

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# Polling Question

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**Were you involved in responding to a comment letter from the Division of Corporation Finance in 2013?**

**A. Yes**

**B. No**

**C. N/A or Not Sure**

# Overview

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- I. CF Review Process – Reminders
- II. GAAP-Related Issues
- III. Reporting Issues
- IV. Other Matters
- V. Industry Issues
- VI. Wrap Up

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# **I. CF Review Process - Reminders**

# I. CF Review Process - Reminders

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- ❖ Purpose of CF Reviews
- ❖ Draft Registration Statements
- ❖ Resources
- ❖ CF-OCA Waiver Request Process

# **I. CF Review Process – Reminders Resources**

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## **2013 FRM Updates**

- **Rule 3-14 financial statements**
- **Acquired oil and gas properties**
- **Emerging growth companies (updates to conform to JOBS Act and CF FAQs)**

# I. CF Review Process – Reminders

## CF-OCA Waiver Request Process

- Email waiver requests to [dcaoletters@sec.gov](mailto:dcaoletters@sec.gov)
- Waiver requests should include:
  - Background on registrant and transaction
  - Identify the issue and rules involved
  - State the relief being sought and reasons why needed
  - Analyze why result is anomalous and why the financial statements would not be material
  - Describe proposed alternative disclosures



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## **II. GAAP-Related Issues**

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- ❖ **Deferred Taxes**
- ❖ **Pensions and Other Post-Retirement Employee Benefits (OPEB)**
- ❖ **Business Combinations**
- ❖ **Goodwill**
- ❖ **Segments**
- ❖ **Stock-Based Compensation**

## **II. GAAP-Related Issues - Deferred Taxes**

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- **Tax rate reconciliation**
- **Valuation allowance**
- **Indefinitely reinvested foreign earnings**

# **II. GAAP-Related Issues - Deferred Taxes**

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## **Tax rate reconciliation**

- **Unclear labeling or incomplete disclosure**
- **Inappropriate aggregation**
- **Inconsistencies with other disclosures**
- **Corrections of errors inappropriately characterized as changes in estimates**

## **II. GAAP Related-Issues - Deferred Taxes**

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- **Tax rate reconciliation**
- **Valuation allowance**
- **Indefinitely reinvested foreign earnings**

## **II. GAAP-Related Issues – Pensions and OPEB**

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- **Significant accounting policies**
- **Expected return on plan assets (EROA)**
- **Unusual or unexpected relationships**

# II. GAAP-Related Issues – Pensions and OPEB

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## Significant Accounting Policies

Disclosures should include registrant elections in areas such as (not all inclusive):

- Expected return on plan assets
  - Use fair value or calculated value?
  - How determine calculated value?
- Method of amortization of actuarial gains / losses
  - Period
  - Corridor

# **II. GAAP-Related Issues – Pensions and OPEB**

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## **Expected Return on Plan Assets (EROA)**

Disclose a narrative description of the basis used to determine the overall expected long-term rate-of-return-on-assets assumption, such as:

- the general approach used,
- the extent to which the overall [EROA] was based on historical returns,
- the extent to which adjustments were made to those historical returns in order to reflect expectations of future returns,
- and how those adjustments were determined

(ASC 715-20-50-1d)



# **II. GAAP-Related Issues – Pensions and OPEB**

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## **Expected Return on Plan Assets (EROA)**

- **Sensitivity analysis – i.e., effect of changes in EROA**
- **Reasonable alternatives for assumption**
- **Historical performance (recent individual years and over time) and limitations of this data (e.g., changes in asset allocation)**
- **If change in EROA, why?**

# **II. GAAP-Related Issues – Pensions and OPEB**

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## **MD&A Disclosures on Unusual or Unexpected Relationships**

- **P&L effects: Impact of contributions on expected return**
- **Statement of cash flows: Non-cash contributions**

## **II. GAAP-Related Issues – Business Combinations**

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- **Asset vs. business determinations**
- **Measurement period adjustment vs. correction of error**

## **II. GAAP-Related Issues – Goodwill**

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- **Consideration of impairment indicators**
- **Factors giving rise to goodwill**
- **FRM 9510 disclosures**
- **Disclosures in period of charge**

# **II. GAAP-Related Issues - Goodwill**

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**Consider disclosing for each reporting unit at risk of failing step one of the impairment test:**

- a. Percentage by which fair value exceeded carrying value as of the date of most recent test;**
- b. Amount of goodwill allocated to the reporting unit;**
- c. Description of methods/key assumptions used and how the assumptions were determined;**
- d. Discussion of degree of uncertainty associated with key assumptions; and**
- e. Description of potential events that could affect key assumptions.**

**(FRM 9510.3)**

## **II. GAAP-Related Issues - Goodwill**

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**Examples of poor disclosure:**

**“Fair value exceeds book value by \$12 million.”**

**“The excess for each of our reporting units ranged from \$5 million to \$200 million.”**

**“We did not record an impairment of goodwill in the past year, and the amount of our excess for each of our reporting units increased from last year.”**

**(Example created by staff based on themes in multiple registrant filings)**

# **II. GAAP-Related Issues - Goodwill**

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**Consider disclosing for each reporting unit at risk of failing step one of the impairment test:**

- a. Percentage by which fair value exceeded carrying value as of the date of most recent test;**
- b. Amount of goodwill allocated to the reporting unit;**
- c. Description of methods/key assumptions used and how the assumptions were determined;**
- d. Discussion of degree of uncertainty associated with key assumptions; and**
- e. Description of potential events that could affect key assumptions.**

**(FRM 9510.3)**

## **II. GAAP-Related Issues – Goodwill**

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- **Consideration of impairment indicators**
- **Factors giving rise to goodwill**
- **FRM 9510 disclosures**
- **Disclosures in period of charge**



## **II. GAAP-Related Issues - Segments**

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- **Aggregation of operating segments**
- **Enforcement matter**

## **II. GAAP-Related Issues – Stock-Based Compensation**

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### **Critical Accounting Estimate Disclosures In IPOs (FRM 9520.2):**

- a. Description of methods and assumptions;**
- b. Table disclosing number of instruments granted, exercise price, fair value of underlying stock, and fair value of instruments granted for the twelve month period preceding the most recent balance sheet date;**
- c. Narrative disclosures that describe factors contributing to significant changes in fair values of underlying stock during period referred to in (b) above; and**
- d. If considered material to investors, the disclosures outlined in paragraphs (a) and (b) should also include analysis before and/or after the period indicated.**

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# III. Reporting Issues

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- ❖ **Non-GAAP Financial Measures**
- ❖ **Metrics**
- ❖ **Regulation S-X Rule 3-10**
- ❖ **Internal Control over Financial Reporting**
- ❖ **Standard Setting**

# **III. Reporting Issues – Non-GAAP Financial Measures**

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- **Clear labeling / description**
- **Terminology**
- **Context**

# **III. Reporting Issues – Non-GAAP Financial Measures**

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## **Pension-Related Non-GAAP Adjustments**

- **Clear disclosure and labeling as to what the adjustment represents**
- **Non-cash pension expense?**
- **Adjustments related to actuarial gains/losses**
- **Usefulness of measure**

# III. Reporting Issues – Non-GAAP Financial Measures

## Non-GAAP Measures

Example - Adjustments related to actuarial gains/losses:

Operating income	\$100	(3)% return
Q4 actuarial loss on pension plan	<u>20</u>	
Adjusted operating income	<u>\$120</u>	8% return

- Item 10(e) disclosures
- Statement that GAAP measure reflects actual return of (3)% or \$YY
- Statement that non-GAAP measure reflects expected return of 8% or \$XX
- Amount of pension expense reflected in non-GAAP measure is \$ZZ

# **III. Reporting Issues – Non-GAAP Financial Measures**

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## **Non-GAAP Measures**

- **Clear disclosure and labeling as to what the adjustment represents**
- **Non-cash pension expense?**
- **Adjustments related to actuarial gains/losses**
- **Usefulness of measure**



# III. Reporting Issues – Metrics

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## Examples

### High-Tech Industry

- Number of registered users to a company's website
- Number of active users,
- Daily average users (DAUs),
- Monthly average users (MAUs),
- Number of paying players for gaming companies, and
- Average revenue per user (ARPU)

### Retail Industry

- Comparable store sales
- Store openings
- Store closings

# III. Reporting Issues – Metrics

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## Disclosures

- Clear definition and description of calculation
- Limitations
- Balance
- Complete

# III. Reporting Issues

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- ❖ **Non-GAAP Financial Measures**
- ❖ **Metrics**
- ❖ **Regulation S-X Rule 3-10**
- ❖ **Internal Control over Financial Reporting**
- ❖ **Standard Setting**

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## **IV. Other Matters**

# **IV. Other Matters – China-Based Issuers**

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**Risk factor disclosure of the following:**

- 1. Substantially all operations are concentrated in China**
- 2. Holding company relies on contractual agreements with VIE**
- 3. Uncertain legality**
- 4. Potential for conflict of interest**
- 5. Limited legal protections available to registrant**
- 6. Limited legal protections available to investors**
- 7. Cash transfer and exchange restrictions**

# **IV. Other Matters – China-Based Issuers**

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## **VIE Footnote Disclosure – Nature of Involvement:**

- **Quantitative – financial position, performance, and cash flow**
- **Qualitative – asset light or asset heavy?**

# **IV. Other Matters – China-Based Issuers**

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## **Disclosures on Cash Restrictions:**

- **MD&A disclosure of cash inside and outside China (inside and outside VIE, if applicable)**
- **Use of proceeds uncertainties and applications**

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# V. Industry Issues



# V. Industry Issues

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- ❖ Information Technologies and Services
- ❖ Real Estate
- ❖ Utilities
- ❖ Retail
- ❖ Oil and Gas

# **V. Industry Issues – Info Technologies & Services**

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## **Virtual Goods – Polling Question**

**Have you ever purchased a virtual good while playing an on-line or mobile game?**

**A. Yes**

**B. No**

# V. Industry Issues

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- ❖ Information Technologies and Services
- ❖ Real Estate
- ❖ Utilities
- ❖ Retail
- ❖ Oil and Gas

# V. Industry Issues – Real Estate

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- **Scope of Rule 3-14**
  - **Definition of “real estate operations”**
- **Use of pro formas when calculating significance**
- **Significant in the aggregate test**
- **Blind pools – significance test in the distribution period**
- **Net lease position clarifications**

# V. Industry Issues

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- ❖ Information Technologies and Services
- ❖ Real Estate
- ❖ Utilities
- ❖ Retail
- ❖ Oil and Gas

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# VI. Wrap Up

# VI. Wrap Up – Take-Aways

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- ❖ Careful consideration of disclosure
- ❖ Policy disclosure where there is optionality
- ❖ Known trends and uncertainties
- ❖ Inter-relatedness of issues / disclosures
- ❖ Context and balance
- ❖ Emphasis of material matters
- ❖ Precise and defined language from GAAP

# VI. Wrap Up – Take-Aways

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## Polling Question

**Do you believe your filings include immaterial or ineffective disclosures?**

**A. Yes**

**B. No**

**C. Don't know**



# VI. Wrap Up – Take-Aways

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## Polling Question

**Are you planning to reconsider any immaterial or ineffective disclosures for your next annual report?**

**A. Yes**

**B. No**

**C. Don't know**

**D. N/A – we don't have unnecessary or ineffective disclosures**

# VI. Wrap Up – Take-Aways

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## Polling Question

**What is primary reason you are not planning to reconsider any immaterial or ineffective disclosures?**

- A. No time**
- B. Not sure how**
- C. Worried about CF comment**
- D. Advisors insist we keep disclosures**
- E. Other**
- F. N/A – we don't have unnecessary or ineffective disclosures**

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# VI. Wrap Up

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# Appendix

# Resources – General

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❖ **Corporation Finance Home Page:**

[www.sec.gov/divisions/corpfm.shtml](http://www.sec.gov/divisions/corpfm.shtml)

❖ **Information for Accountants:**

[www.sec.gov/divisions/corpfm/cfreportingguidance.shtml](http://www.sec.gov/divisions/corpfm/cfreportingguidance.shtml)

❖ **Financial Reporting Manual:**

<http://sec.gov/divisions/corpfm/cffinancialreportingmanual.shtml>

❖ **CF Disclosure Guidance Topics:**

<http://www.sec.gov/divisions/corpfm/cfdisclosure.shtml#cfguidancetopics>

❖ **Compliance and Disclosure Interpretations:**

<http://www.sec.gov/divisions/corpfm/cfguidance.shtml>

# Resources - Contacts

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- ❖ **Comment process – Disclosure Operations  
Staff listed in comment letter**
- ❖ **Staff interpretation or informal question –**
  - **Financial Reporting – CF Office of Chief Accountant at (202) 551-3400**
  - **Submit request through online form at:**  
**[https://tts.sec.gov/cgi-bin/corp\\_fin\\_interpretive](https://tts.sec.gov/cgi-bin/corp_fin_interpretive)**

# Resources - Contacts

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- ❖ Formal requests related to financial reporting:

[dcaoletters@sec.gov](mailto:dcaoletters@sec.gov)

- ❖ Formal consultations on the application of GAAP:

[OCA@sec.gov](mailto:OCA@sec.gov)